

# New Zealand Fixed Income Monthly October 2022

New Zealand consumers have proved resilient, but that may be tested by inflation and interest rates

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## New Zealand inflation looking increasingly entrenched

As in the rest of the world, consumers in New Zealand are facing significant headwinds as the cost of living rises. New Zealand's consumers price index (CPI) showed an annual increase of 7.2% in the September 2022 quarter after jumping 7.3% in the June 2022 quarter, demonstrating levels of inflation not seen in the country since the early 1990s. CPI is now further than ever from the Reserve Bank of New Zealand (RBNZ)'s policy target band, which is currently between 1% and 3%. Furthermore, the figure for the September 2022 quarter was far stronger than had previously been forecasted. The consensus was for inflation to decline rapidly after peaking, and market observers had been expecting the CPI to be at the mid-6% level in the quarter. However, the data now show that New Zealand's inflation is becoming significantly entrenched, broad based, and domestically driven.

## Consumers showing resilience despite cost-of-living headwinds

Although the impact of inflation on necessities and mortgage rates would normally depress consumer spending, data from Stats NZ, New Zealand's statistics agency, showed that the total value of seasonally adjusted retail sales in the June 2022 quarter was broadly unchanged from the previous quarter at NZD 29 billion. One of the factors supporting consumption appears to be strong wage rises amid tightness in the labour market. As most mortgages in New Zealand are fixed for either one or two years, many consumers may feel that they are keeping up with inflation after seeing their pay increase before higher rates feed through to their home loan payments. In addition, New Zealand's households have built up approximately NZD 30 billion in savings, mainly as a result of constraints on spending during COVID-19 lockdowns as well as large, pandemic-related support payments from the government. The Official Cash Rate (OCR), however, currently stands at 3.5% after several consecutive 50-basis-point hikes by the RBNZ, and consumers are now set to feel the full impact of this rapid upward movement in interest rates. There are also signs that consumers are already beginning to tighten their belts. In the above-mentioned Stats NZ data, for example, the figure for the total volume of seasonally adjusted retail sales (rather than the total value) was down 2.3% in the June 2022 quarter.

## OCR above 5% would stretch consumer spending

In view of the above, it may be useful to consider the kind of interest rate level that could depress consumption in New Zealand. We think that household budgets will start to come under pressure if the OCR moves towards 5%, and that consumer spending will be increasingly stretched if the rate moves beyond that level. Although weaker consumption could help to slow down price increases, we feel that inflation is likely to remain above 3% in 2023 given how strongly domestic inflation has taken hold.

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