

PLANNING FORECAST

DECEMBER 2024



NZ Economy: Holding pattern

Executive summary

The New Zealand (NZ) economy is about to enter a new year with improved levels of business confidence, though positive sentiment has not yet been translated into meaningful improvements in economic performance. Despite expectations of further interest rate declines, NZ continues to face significant challenges both domestically and internationally.

The global outlook is less optimistic than in recent decades, with ongoing geopolitical risks and wars leading to a more insular trading environment. This poses risks for NZ, a country heavily reliant on international trade. Additionally, potential trade tensions, such as US President-elect Donald Trump's proposed tariffs on China, Canada, and Mexico, could have far-reaching implications. The newly unified Republican control of the White House, Congress, and Senate could facilitate the implementation of more policies that diverge from orthodox economic approaches, such as potentially interfering with the Federal Reserve's independence in respect to monetary policy.

The US economy may see short-term boosts under President Trump, which could result in a weaker NZ dollar relative to its major trading partners. This could benefit exporters but also lead to higher import prices, reigniting concerns surrounding inflation.

Domestically, NZ continues to grapple with productivity issues and the need for robust policy solutions on aging population funding, particularly regarding superannuation and health services.

However, it's not all bad news. Commodity prices - particularly dairy have recently increased, providing positive news for NZ's regional economies.

Inflation has fallen back within the Reserve Bank's target range with expectations of further significant reductions in interest rates next year, which will be welcomed by long suffering businesses and households alike.

The NZ share market has also rebounded in 2024, with the NZX 50 index gaining around 12%.

In terms of regulation, the Government is making strides by addressing unnecessary barriers to economic growth, notably through the proposed Regulatory Standards Bill. This initiative aligns with BusinessNZ's policy agenda and could significantly improve the regulatory environment over time.

Meanwhile work is well underway to implement the Coalition commitment to replace the Resource Management Act 1991 with new resource management laws premised on the enjoyment of property rights as a guiding principle. Both businesses and households should look forward to a more streamlined and permissive resource management regime in the future.

HIGHLIGHTS

The NZ economy is currently in a holding pattern with only modest improvements in economic growth forecast.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 8 for the December 2024 quarter, an improvement of 6 on the previous quarter, and an improvement of 8 on a year ago. An ECI reading above 0 indicates that economic conditions are generally improving overall; below 0 that economic conditions are generally declining. Improvements in business and consumer sentiment, and declines in inflation and interest rates, have been offset somewhat by weaker labour market conditions.

Both the BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI) continue to perform below par.

Other sectors provide for mixed results. Construction activity remains subdued with housing consent numbers down, while retailing and hospitality continue to struggle as a result of cautious household spending. Tourism, while improving, is still performing at sub pre-covid levels.

The agricultural sector is perhaps the one bright light with commodity prices continuing to improve, particularly dairy, while input prices have receded to much lower levels than in the recent past.

Government moves to introduce more accountability in respect to regulatory initiatives, to supplement fiscal and monetary policy accountability mechanisms will be applauded by the business community. For too long regulatory policy has tended to be ad hoc and inconsistent.

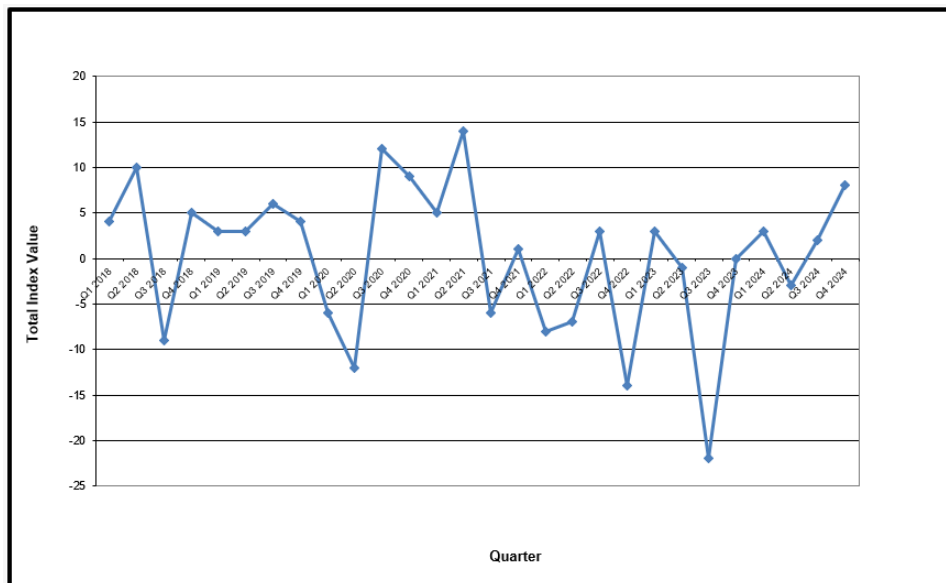
Internationally, geopolitical tensions are still a significant issue while greater moves towards protectionism are creating barriers to trade.

PART 1: THE NZ ECONOMY – WHERE ARE WE NOW?

The BusinessNZ Economic Conditions Index (ECI) is a measure of NZ’s major economic indicators. It sits at 8 for the December 2024 quarter, up 6 on the previous quarter, and up 8 on a year ago. An ECI reading above 0 indicates that economic conditions are generally improving overall; below 0 means economic conditions are generally declining. Improvements in the ECI is principally a result of stronger business and consumer sentiment, and continued declines in inflationary expectations and interest rates. On the other hand, improvements have been offset somewhat by weaker labour market conditions.

The ECI tracks over 30 indicators on a quarterly basis. The overall index value for any one quarter represents the net balance of the indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance. Note: The results for the December quarter 2024 are estimates based on available information to date.

Overall Economic Conditions Index (ECI)



Data in the ECI is broken into four key sub-groups:

- Economic growth/performance indicators
- Monetary policy/pricing indicators
- Business/consumer confidence indicators
- Labour market indicators

Economic growth/performance indicators sit at 6 for the December 2024 quarter, up 3 on the previous quarter and up 9 on a year ago. Commodity prices have generally increased of late, which is positive for the agricultural sector, and dairy in particular, with the projected milk payout for the current season continuing to improve.

Monetary policy/pricing indicators sit at 6 for the December 2024 quarter, up 2 on the previous quarter, and up 3 on a year ago. Inflation is now back within the Reserve Bank’s target range of 1-3 percent, with further significant interest rate reductions expected next year which will be of relief to both businesses and households.

Business/consumer confidence indicators sit at 3 for the December 2024 quarter, up 1 on the previous quarter and up 2 on a year ago. Improving sentiment is being driven by expectations of further declines in the cost of capital, commodity prices showing general improvement and consumers much more positive in light of mortgage interest rates continuing to decline which will add to household’s disposable income.

Labour market indicators sit at -7 for the December 2024 quarter, the same as the previous quarter and a deterioration of 6 on a year ago. The labour market is showing continued signs of easing, but in an orderly way. Declining employment opportunities and rising unemployment are now evident while net migration, is falling rapidly from the dizzy heights of the past couple of years.

PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING?

1.1 Economic growth (GDP) – downside risks remain

While the NZ economy is showing some tentative signs of recovery and rising business confidence about investment intentions next year are positive, the outlook for growth is relatively benign over the forecast period out to December 2026.

Improved business confidence is based on expectations of higher growth over the next year rather than improved performance in the here and now. In this respect there is a significant decoupling of confidence based on current activity compared to future expected activity.

As a trading nation, NZ faces the potential fall-out of greater moves towards international trade protectionism. On the home front, policy makers face a number of hard and complex issues both in the short term and longer term, in respect to trying to get the economic boat to go faster. Currently we are stuck in a rut.

We'll start below with to the international outlook first, before assessing the domestic outlook.

Global outlook

Things looks a lot less positive than recent decades with ongoing geopolitical risks and numerous wars on a number of fronts creating a much more insular trading environment - which is impacting on NZ as a country heavily dependent on international trade to support our standard of living.

According to the International Monetary Fund (IMF) World Economic Outlook Update (October 2024), global economic growth is projected to remain stable yet underwhelming with growth at a respectable 3.2 percent in 2024 and the same in 2025. Advanced (or developed) countries continue to show mediocre growth while emerging and developing countries show a more positive outlook as can be seen from the graph below.



The **International Monetary Fund (IMF)** considers the balance of risks to be tilted to the downside for the global economy. Several factors contribute to this result:

Geopolitical tensions: The potential for geopolitical conflicts to escalate could increase global instability, adding uncertainty to international trade and investment.

Financial market volatility: Sudden disruptions in financial markets could tighten financial conditions, making it harder for businesses and governments to access credit and capital, which in turn could hurt economic activity.

China's property sector: Ongoing problems in China's property market could create spillover effects, potentially affecting global trade. China is a major player in the global economy, and instability in its property sector could reduce demand for goods and services worldwide.

Protectionism and economic fragmentation: The rise in protectionist policies and the continued fragmentation of the global economy (e.g. through trade barriers or sanctions) may reduce international trade flows, affecting growth prospects for trade-dependent economies like New Zealand.

Disinflation process: Disruptions to the ongoing disinflation process (the gradual decline of inflation) could prevent central banks from easing monetary policies further, which would make it harder to stimulate economic growth. This, in turn, would create challenges for fiscal policy and financial stability.

Despite these risks, the IMF emphasised the importance of advancing structural reforms to boost long-term growth. Such reforms could include investments in infrastructure, education, technology, and the reduction of trade barriers, all of which could enhance productivity and competitiveness in the long run.

Meanwhile globally, manufacturing activity is showing continuing weakness with most countries showing sub-growth with a figure above 50.0 showing expansion while a figure below 50.0 indicates contraction.



It is not all bad news internationally though. 2024 has been quite a successful year for international investors with world share markets up around 20% on a year earlier. This is well over twice the rate of returns compared to the average return of 7.4% per annum over the last 20 years.

Inflation rates continue to moderate in most countries and are approaching central bank targets, although there is an air of caution in the future direction of international inflation given a number of policy approaches across countries towards greater protectionism.

Potential impact of US tariff policies

The incoming President-elect Donald Trump has made headlines with his statements regarding the imposition of significant tariffs on China, Canada, and Mexico. These measures could have wide-ranging effects, both domestically in the US and internationally.

1. **Impact on US consumers:** The tariffs will likely drive up the cost of household goods, putting pressure on American families. This could also result in higher interest rates as the Federal Reserve may be less able to stimulate the economy through monetary policy.
2. **Retaliatory action:** Other countries might take retaliatory measures, further disrupting global trade. This would set back trade reform efforts, especially in the context of ongoing global challenges.

3. **Impact on inflation:** The tariffs will likely push inflation higher, leading to increased costs for businesses and consumers. For New Zealand, which is heavily reliant on foreign capital, this could mean higher borrowing costs and strain on the nation's increasing debt burden.
4. **Impact on NZ exports:** While the impact on New Zealand exports is still uncertain, any restrictions on the country's access to the US market would negatively affect exporters. The US is a significant trading partner for NZ, so any disruptions could dampen export performance.
5. **NZ exporters operating in China and Mexico:** Many large NZ exporters have operations in China and Mexico, both of which are directly impacted by US tariffs. These companies are likely to face higher costs or may need to adjust their operations.
6. **Multinational decisions:** Multinational companies may reconsider their global supply chains, specifically where they establish manufacturing plants, to avoid the effects of US tariffs. This could lead to greater costs overall for businesses, impacting global trade dynamics.

With the Republicans controlling the White House, Congress, and the Senate, President Trump has greater freedom to implement policies, which may include more radical measures. While Trump's economic strategy of lower taxes, less regulation, and increased tariffs could offer a short-term boost to the US economy, it is likely to come at a cost:

- **Higher capital costs:** As tariffs increase and the debt burden continues to rise, capital costs for businesses, including in New Zealand, could rise. This could lead to financial risks, particularly as US debt levels continue to grow. Eventually, this could lead to a reckoning when the US needs to confront its debt challenges.
- **Pressure on the Federal Reserve:** There are concerns that Trump might intervene more actively in the workings of the Federal Reserve. His policies could create inflationary pressures, leading to potential tensions with the Fed. There may be pressure for the Fed to avoid raising interest rates for fear of stifling economic activity, complicating monetary policy decisions.

Potential for a shift in US foreign policy

An intriguing potential development is the possibility that Trump's approach to international relations could lead to a quicker resolution of the Ukraine conflict. Some analysts believe that Trump and Russian President Vladimir Putin could strike a deal, potentially forcing Ukraine to concede territory to Russia in exchange for ending the current hostilities.

This would represent a significant shift in US foreign policy, especially since Trump has signaled no strong commitment to continue providing Ukraine with military aid. If such a deal were to happen, it would likely reduce tensions in Europe, but it would also signal a major shift in the geopolitical landscape.

The NZ Outlook

New Zealand's domestic economy faces both challenges and opportunities as it looks towards the future. While some economic indicators show sluggishness, there are also positive signs that suggest potential for recovery and growth in the coming years.

Positive developments:

1. **Business confidence:** Business sentiment is currently elevated, with many companies optimistic about future prospects. This is driven by interest rate cuts, which have reduced borrowing costs and improved the investment climate. Despite recent sluggishness, businesses are hopeful for better times ahead.
 2. **Stock market performance:** The NZX50 Index has shown resilience, gaining around 12% in 2024, well above the 20-year average. This marks a significant recovery from the previous three years when the market had struggled.
 3. **Inflation control and falling interest rates:** Inflation is now under control, which is a relief for both consumers and businesses. The decline in interest rates is a key factor in alleviating financial pressures that have built up over the past few years, benefitting households and businesses alike.
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4. **Commodity prices and dairy:** Commodity prices have remained relatively stable, with dairy prices in particular performing well. This is particularly beneficial for NZ's regional economies, which rely heavily on agricultural exports.
5. **Weaker NZ dollar:** The NZ dollar's decline against major trading partners is providing an additional boost to exporters. The weaker currency increases the value of export returns when converted back into NZ dollars, benefiting the broader economy.

Challenges and risks:

1. **Higher input costs for exporters:** While a weaker NZ dollar is beneficial for exporters, many New Zealand businesses rely on imported products as key inputs into the production process. A lower currency will result in higher input costs, which could potentially drive inflation. This will create a complex balancing act for businesses as they navigate the trade-off between higher export returns and increased operational costs.
2. **Interest rates and economic growth:** The falling interest rates are positive in the short term, but they may not return to the historically low levels seen in the past. This suggests that businesses and households may need to adjust to a new normal where interest rates are relatively higher compared to previous decades. This could affect the broader economic landscape, particularly in terms of investment and consumption.

Structural and Long-term Challenges:

New Zealand faces significant long-term challenges that need to be addressed to maintain and improve its standard of living. The country is grappling with several critical issues that could hinder its long-term economic growth:

1. **Productivity growth:** New Zealand has been struggling with poor productivity growth, which limits its ability to increase output and improve living standards. Addressing this will require significant investment in innovation, skills development, and improving business efficiency.
2. **Rising debt and borrowing costs:** The country's increasing debt levels and the associated costs of borrowing are a growing concern. Expenditure blowouts in recent years have led to a ballooning public debt, which could limit the Government's ability to invest in infrastructure, healthcare, and other essential services.
3. **Ageing population:** The ageing population poses a significant challenge, particularly in terms of funding for superannuation and healthcare. As the population grows older, the demand for social services will increase, requiring careful management of fiscal policy and long-term planning to ensure sustainability.
4. **Infrastructure deficits:** Many areas of New Zealand's infrastructure remain substandard or inadequate to meet future needs. This includes issues such as housing shortages, aging transport networks, and gaps in digital infrastructure. Investment in these areas will be crucial to support economic growth and improve quality of life.
5. **Brain drain to Australia:** New Zealand has been experiencing a brain drain, with a record number of young and skilled individuals leaving for Australia. This outflow of human capital, particularly the loss of the country's most productive and talented individuals, could hinder innovation and economic progress.

Navigating Fiscal Challenges

New Zealand's fiscal position is under increasing scrutiny, with growing concerns about the structural deficit and the future sustainability of government spending. A recent Treasury paper highlighted that the Government's return to surplus will likely be delayed further, as new numbers are expected in the upcoming Half-year Economic and Fiscal Update. The Government faces challenging decisions as it grapples with deficits forecast for the coming years and attempts to stabilise its finances, particularly in light of higher debt levels and significantly increased cost of servicing debt.

Key fiscal challenges:

1. **Increased debt and rising interest costs:** Over the past three years, New Zealand has seen a substantial increase in debt due to emergency spending in response to COVID-19. While debt levels remain relatively low compared to other countries, the cost of servicing that debt is rising rapidly. The bill is expected to hit \$10 billion in 2025, which further strains the Government's budget.
2. **The impact of COVID-19 spending:** The Government's fiscal response to COVID-19, including the Response and Recovery Fund and various subsidies, was critical to maintaining economic stability during the pandemic. However, this spending is proving difficult to unwind, as businesses, households, and individuals have become reliant on taxpayer-funded assistance to a greater extent. As the economy recovers, it will be challenging to reduce these support mechanisms without significant social and political resistance.
3. **Structural deficit:** The Government faces a structural deficit, where ongoing spending exceeds revenue, exacerbated by unfunded policies from previous governments that have come to light. These policies are contributing to increased expenditure in areas like health, education, and social security, making it difficult for the Government to return to surplus anytime soon.

Addressing the expenditure side:

One area that will require significant reform is New Zealand's social security and welfare spending, particularly NZ Superannuation. This program accounts for more than 50% of the country's total welfare spending, and as the population ages, the cost of superannuation is expected to rise significantly.

Several options could be considered to reduce the cost of superannuation:

- **Raising the age of eligibility:** In line with rising life expectancy, the Government could gradually raise the eligibility age for superannuation, similar to what other countries like Australia, Britain, and the US have done.
- **Tiered superannuation payments:** A more targeted approach could involve offering higher benefits for those who delay receiving superannuation, or providing greater benefits to older recipients based on their needs and life stage.
- **Freezing or reducing benefits:** The Government could freeze superannuation payments or index them to the Consumer Price Index (CPI) rather than wages, which would reduce the rate of increase in superannuation costs over time.
- **Means testing:** This approach would involve assessing individuals' assets and income to determine whether they should receive full or partial superannuation, addressing concerns about fairness.
- **Phasing out NZ superannuation:** Another option is to phase out superannuation for younger generations, such as those under 30, who would not be eligible for state-funded retirement benefits in the future.

All the above options come with trade-offs. For example, means testing could create administrative burdens, and freezing benefits could significantly impact those who rely on superannuation as their primary source of income.

Revenue side: The debate on taxes

As the Government works to manage its expenditure, it also needs to address revenue to ensure fiscal sustainability. There has been increasing discussion about raising new taxes, particularly through the introduction of a Capital Gains Tax (CGT). While New Zealand already has some form of CGT (e.g. Bright Line Test on investment property), there is no comprehensive CGT system in place.

However, introducing a comprehensive CGT brings several challenges and potential distortions:

1. **Capital gains and lock-in effect:**

- In a well-functioning market, capital gains are typically offset by capital losses, making a CGT less effective at raising significant revenue. Moreover, because CGT would only likely be levied on realised gains, it may discourage people from selling assets, even if their circumstances change, leading to inefficient investment decisions and a lock-in effect.

2. Exclusions and distortions:

- Many countries exempt the family home from CGT or offer rollover relief, which allows taxes to be deferred. A CGT applied only to investment properties but not to owner-occupied homes could create distortions in the market, as individuals may choose to invest in assets not subject to CGT.

3. Double taxation:

- CGT could be seen as double taxation, particularly for businesses. Profits are already subject to income tax, and imposing a CGT on any subsequent gains could be viewed as an unfair tax burden.

4. Volatility in tax revenue:

- CGT revenues tend to fluctuate with the performance of asset markets and the broader economy. This means CGT revenue would likely peak during economic booms but could drop significantly during downturns, making it a volatile and unreliable source of revenue for long-term fiscal planning.

As New Zealand navigates its fiscal challenges, the Government must carefully balance its spending and revenue policies to ensure long-term fiscal sustainability. While there is no easy solution to the country's structural deficit, reforming key areas like superannuation and exploring tax policy changes, such as capital gains tax, will be essential in ensuring that the country can continue to provide essential public services while maintaining a competitive economy. Careful consideration of the long-term economic impacts of these policies will be necessary to avoid unintended distortions that could hinder growth and innovation.

Forecasts: Real GDP percent Growth

	Years Ending		
	Dec 24	Dec 25	Dec 26
Highest	0.2	1.7	3.1
Average	0.0	1.5	2.9
Lowest	-0.2	1.3	2.8

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary policy – easing

As anticipated by financial markets, the Reserve Bank of New Zealand (RBNZ) reduced the Official Cash Rate (OCR) by another 50 basis points in November. They have signaled that further cuts are likely in 2025, with a further 50-basis point reduction expected in February 2025. This would bring the OCR down to 3.75%, still above the "neutral" level, where the OCR is not actively seeking to expand or contract economic activity.

Inflation – inside the cage

Inflationary pressures in New Zealand have continued to ease, with inflation now at 2.2%, well within the Reserve Bank's target range of 1-3%. Forecasts suggest inflation will remain well within this range until at least December 2026. However, there are still potential risks ahead.

While tradeable inflation (inflation driven by international goods and services) has been under control for some time, non-tradeable inflation (domestic inflation) has remained relatively high. This is primarily driven by factors such as increased insurance costs and local government rates, which are expected to gradually ease.

Tradeables inflation has stabilised in line with the stabilisation of international energy prices. However, supply chain disruptions, geopolitical pressures on shipping routes, and the potential for increased protectionism (e.g. tariffs) may continue to cause price increases globally, which could affect New Zealand's inflation levels.

On the domestic front, demand constraints in New Zealand have continued to ease. Households remain cautious with their spending, as evidenced by a range of indicators, including electronic sales data. This reduced demand has contributed to a stabilisation in housing prices. Broadly, decreased demand for goods and services has resulted in excess capacity, with businesses adjusting pricing and, in some cases, reducing staff or shutting down altogether.

Net migration, while still high, is slowing down rapidly, which will ease pressure on housing and other goods and services. As a result, housing prices and rents are expected to stabilise or even decrease in some regions, depending on the economic strength of each area.

Despite these demand constraints, some forecasters, including the Reserve Bank, predict that housing demand will pick up in 2025, largely as a result of lower interest rates which may attract more people back into the housing market.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Dec 24	Dec 25	Dec 26
Highest	2.3	2.3	2.3
Average	2.2	2.0	2.2
Lowest	1.9	1.6	2.1

Source: ASB, BNZ, Kiwibank and Westpac

Interest rates – on the way to bottoming out?

The Reserve Bank of New Zealand's (RBNZ) latest monetary policy statement indicates a clear trajectory for further interest rate reductions. The key questions now are how quickly and how far the RBNZ will reduce the Official Cash Rate (OCR) to more neutral levels.

Banks are already anticipating significant cuts in the OCR over the next year or so, which has led to front-loaded mortgage rate reductions for households and businesses in New Zealand. While these rate cuts will provide welcome relief for mortgage holders, it's unlikely that interest rates will return to the ultra-low levels seen before the Covid-19 pandemic.

RBNZ projections suggest that the OCR will continue to decline, potentially settling at around 3% by early 2027. Historically, many economists considered the "neutral" level of the OCR to be just above 2%, which aligns with the Reserve Bank's target inflation range of 1-3%. This was the case for many years, except during the Covid period and its aftermath.

In the decade leading up to the pandemic, the OCR fluctuated between 1% and 3.5%, with an average slightly above 2%. However, the RBNZ now views the long-term neutral level of the OCR as being around 3%, up significantly from 2.3% just a year ago and well above historical estimates of around 2%.

This shift is not unique to New Zealand. Many central banks, including the US Federal Reserve, have also revised their neutral rate estimates upwards in response to global economic factors.

Several factors are driving this adjustment in the neutral OCR rate:

1. **Geopolitical tensions and protectionism:** Rising global tensions, particularly protectionist trade policies, are threatening globalisation and free trade, which adds risk to inflation remaining higher than it otherwise might be.
2. **Higher government debt:** Increased levels of government debt around the world are raising borrowing risks, leading to higher risk premiums on loans and consequently higher interest rates.
3. **Climate change:** Economic adjustments needed to address climate change are adding uncertainty and potential costs, influencing central banks to reconsider long-term rate projections.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Dec 24	Dec 25	Dec 26
Highest	4.4	3.6	3.9
Average	4.3	3.3	3.5
Lowest	4.2	2.9	3.2

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – forecast to improve after recent deterioration

The New Zealand dollar has generally been drifting lower over recent times, largely as a result of New Zealand's approach to monetary policy and also as a result of offshore developments. The RBNZ took aggressive action during the previous tightening cycle, raising interest rates more quickly and significantly compared to many other countries. As a result, NZ is now in a position where it must ease rates faster than others, which is contributing to the weakening of the NZ dollar.

In contrast, the US Federal Reserve is expected to take a more gradual approach to interest rate reductions, influenced by the broader economic situation, including the potential impacts of the new US administration under President Trump. This slower approach may support the US dollar relative to the NZ dollar in the short-to-medium term.

The NZ dollar's performance has also been historically tied to international commodity prices. Recently, there has been some upward movement in commodity prices, which could provide support for the currency. New Zealand's key exports, such as dairy, are crucial in this regard, and any improvement in commodity prices can offer a boost to the NZ dollar.

Additionally, the business-friendly policies of the current coalition Government - particularly those related to property rights and foreign investment-might be helping to increase international interest in investing in New Zealand. This could also have a positive effect on the currency over time.

However, New Zealand's current account deficit remains a concern, even though it is expected to improve from a low base. The deficit indicates that New Zealand is still importing more than it exports, which means the country is not entirely "paying its way" on the global stage. This structural imbalance could weigh on the NZ dollar in the longer term.

While the future direction of the NZ dollar is difficult to predict, it may remain under pressure for some time, given these conflicting forces-interest rate cuts in NZ, global commodity price trends, and concerns around the current account deficit.

Forecasts: Exchange Rates

AUD (cents)				USD (cents)			
	Dec 24	Dec 25	Dec 26		Dec 24	Dec 25	Dec 26
Highest	0.91	0.94	0.95	Highest	0.62	0.66	0.69
Average	0.9	0.9	0.91	Average	0.60	0.62	0.66
Lowest	0.89	0.85	0.85	Lowest	0.59	0.59	0.61

TWI			
	Dec 24	Dec 25	Dec 26
Highest	70.8	73.8	74.7
Average	69.7	70.7	72.3
Lowest	69.0	66.7	67.6

Source: ASB, BNZ, Kiwibank and Westpac

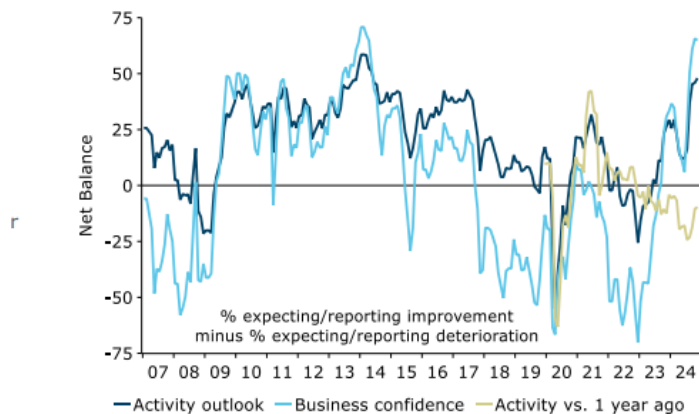
1.3 Business activity and consumer confidence – improved sentiment for 2025

A number of recent business and consumer opinion surveys show sentiment in the future economic outlook is generally improving.

While expectations of further declines in interest rates have excited both businesses and households alike, NZ is still subject to considerable head winds both domestically and internationally. Current activity is largely de-coupled from future expectations of activity.

According to the ANZ Business Outlook for November 2024, business confidence eased 1 point to +65. While 'expected own activity' rose 2 points to +48, 'own experienced activity' rose just 1 point to -10, still very weak. This emphasises the expectations of better times ahead are yet to be translated into actual growth in the here and now.

ANZ NZ Business Outlook



Source: Macrobond, ANZ Research

While it is likely that at least some of the upswing in confidence will be as a result of further significant cuts in the OCR expected next year, a real positive in the latest survey was that inflationary expectations have continued to drop significantly from 2.8% to 2.5%. Inflationary expectations are important from the perspective that they often influence future price setting behaviour and also input costs so it looks increasingly positive that businesses are confident that inflation is beaten. This will also give added comfort to the Reserve Bank when making future decisions, at least on the margins, about further cuts to the OCR and by how much.

Unfortunately, as stated above, further expectations do not necessarily represent where we are now with (quantifiable) data generally showing little improvement in most sectors to date.

A monthly credit indicator report from credit specialists *Centrix* showed liquidations in the country rose 27% in the year to October 31.

On an annual basis, no region or sector *Centrix* measures experienced a reduction. However, month-on-month, liquidations fell to 223 from a record high of 306 in September.

With respective 68% and 42% annual rises, the report showed the transport and hospitality sectors experienced the sharpest year-on-year rises in liquidations. Residential building construction, property operators and cafes and takeaway food companies have been the most likely to be placed in liquidation during the last year, the report found.

The wholesale trade sector, representing nearly 3% of all registered companies in NZ, was particularly impacted, with liquidations up 82% compared with last year.

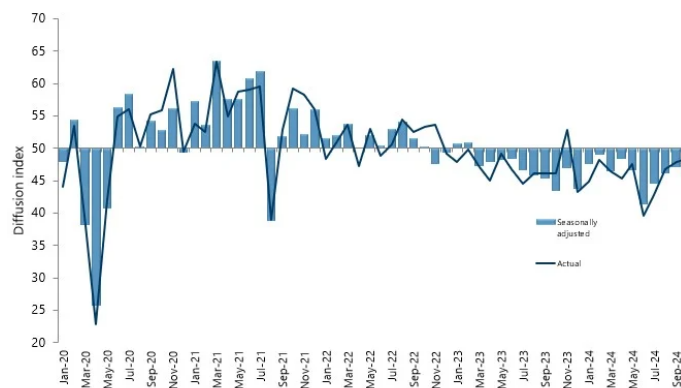
Manufacturing

The latest BNZ-BusinessNZ Performance of Manufacturing Index (PMI) shows manufacturing still performing at sub-par levels. Despite lower interest rates, the manufacturing sector continues to face significant headwinds.

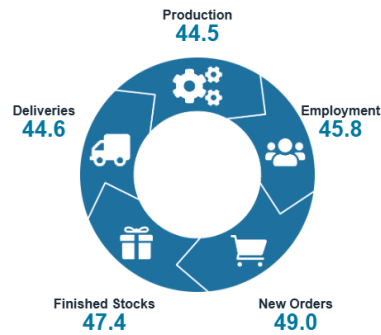
The seasonally-adjusted PMI for October was 45.8 (a PMI reading above 50 indicates that manufacturing is generally expanding; below 50 that it is declining). This was down from 47.0 in September, and the lowest level of activity since July 2024. The sector has now been in contraction for a record 20 consecutive months.

BNZ – BusinessNZ PMI Time Series

January 2020 – October 2024



The key sub-index results for production (44.5) fell 3.4 points from September, while both employment (45.8) and deliveries (44.6) dropped one point. In contrast, finished stocks (47.4) lifted 0.7 points, while new orders (49.0) rose 1.1 points - its highest level since May 2023. This is perhaps one of the few encouraging signs of potentially an uplift in the PMI as we head into the new year.



Also encouraging news was that the proportion of negative comments from respondents stood at 53.5% in October. This was down from 63.5% in September, 64.2% in August, 71.1% in July and 76.3% in June. Negative comments typically focused on the general economic downturn.

Services

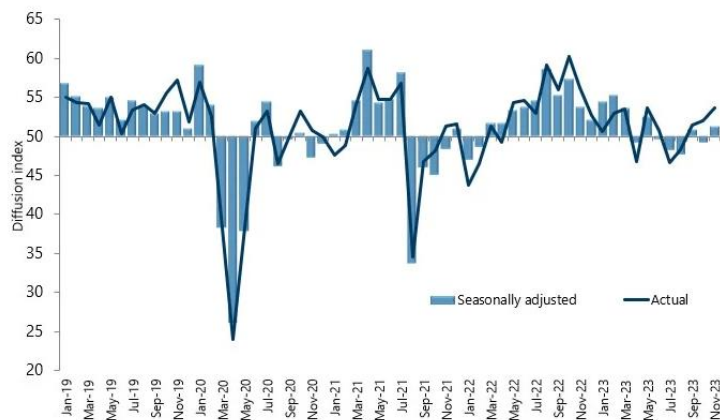
The BNZ–BusinessNZ Performance of Services Index (PSI) is also performing at sub-par levels.

Activity in the services sector inched higher during October, although still remaining in contraction.

The PSI for October was 46.0 (a PSI reading above 50.0 indicates that the services sector is generally expanding; below 50.0 that it is declining). This was up 0.3 points from September, but activity has varied by only 0.7 points over the last four months, which has kept the sector within a tight band of contradictory results. The October result is also still well below the average of 53.1 over the history of the survey.

BNZ – BusinessNZ PSI Time Series

January 2019 – October 2024



The October result showed mixed results when broken down by sub-index values. While the new orders/business index (48.1) was at its highest levels since February 2024, the activity/sales index (44.3) lost some momentum during October. The employment index (46.4) recovered some of its fall after a sizeable drop in September.

The proportion of negative comments for October stood at 59.1%, which was up from September at 58.5%, but down on 60.8% in August and 67.0% in both June and July. The cost of living and the general economic climate

continued to dominate comments from respondents.

On a positive note, the activity outlook for the sector has improved in recent business surveys, but the here and now remains extremely challenging.

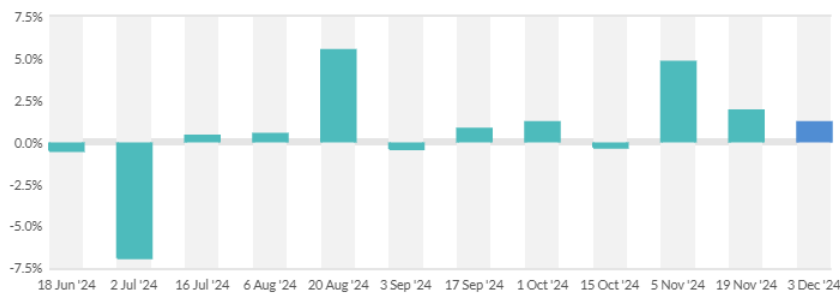


Agriculture

The agricultural sector is showing resilience, with generally improving commodity prices, particularly dairy.

The Global Dairy Trade (GDT) has generally continued to improve over the second half of 2024. GDT prices are now up over 20% this year. Fonterra has increased its milk price forecast for the 2024/25 season from a midpoint of \$9.50 to a midpoint of \$10 which would be the highest of all time. The previous record of \$9.30 was in the 2021/22 season. Fonterra noted that the improved outlook had largely been driven by strong demand out of China as well as Africa, the Middle East and Southeast Asia.

Change in GDT Price Index



Sheep meat prices have also generally improved after a tough few years, although there is likely to be lower volumes of sheep meat available given lower lambing percentages as a result of fewer capital stock numbers, and severe weather affecting the lower South Island during the recent lambing season. In this respect exports of sheep meat are likely to be down on earlier years.

Inputs costs to farmers have generally declined significantly after reaching significant highs over the past year while a lower NZ dollar has helped export returns when converted back into NZ dollars.

Construction and Housing

The construction sector remains subdued as building consent numbers stagnate, and businesses and households await further movements in interest rates before committing to new projects.

There were 2,850 new homes consented in New Zealand in the month of October 2024, down 6.9 percent compared with October 2023, according to figures released by StatsNZ.

In October 2024, 1,487 multi-unit homes were consented, down 18 percent compared with October 2023. Multi-unit homes include townhouses, apartments, retirement village units, and flats.

There were 1,363 stand-alone houses consented, up 8.6 per cent compared with October 2023.

While activity is subdued currently, there are expectations for significant large-scale projects as we enter 2025. The pipeline Snapshot by the *Infrastructure Commission* (September 2024) reported a total of around \$143.6 billion in the pipeline, with a projected annual spend of \$13.7 billion in 2025. This pipeline includes 17 'meg-projects' each cost more than \$1 billion, with transport likely to dominate over the next 10 years.

Also of note, is that the Government has accepted 149 projects to go through its Fast Track Approvals Bill framework, which should provide for greater certainty that such projects will see the light of day. In this respect, the pipeline of work looks more certain, although the big question will remain as to how all these projects will be funded.

House prices remain subdued for a range of reasons outlined below, although confidence is improving as we head into 2025.

First, high interest rates have until very recently kept many people out of the housing market.

Second, concerns over future employment prospects have created a degree of nervousness about households buying new or existing houses.

Third, constraints on banks' lending through the provision of Debt-to-Income Ratios (DTIs) and generally more concerns about risks have resulted in lending levels showing little growth.

Fourth, while net migration levels have remained high, they are falling away quite rapidly as the economy faces headwinds, with many New Zealanders now leaving the country in search of more opportunities overseas, particularly to Australia.

Demand for housing over coming months and years is likely to also be subdued as a result of lower population growth, probably leading to fewer people in the housing market. In this respect, it is noted that rental accommodation prices have generally stabilised and have declined in some cases.

On the other hand, changing tax rules to allow for interest rate deductibility on rental properties and reining in the bright line test may not be enough to entice developers back into the market, although declines in interest rates should spark more interest from first home buyers than in the recent past.

A number of economic forecasting agencies consider that there is scope for rises in house prices next year, partially as interest rates retreat thus making debt servicing cost more realistic.

Notwithstanding the above, a number of surveys are showing that New Zealanders are feeling more positive about the housing market but are not expecting a swift recovery.

The ASB's latest Housing Confidence Survey shows that 24% of respondents expect gains compared to 13% in the previous quarter and a net 20% of respondents believe it is now a good time to buy, a significant jump from 8% in the last quarter. This is not surprising given the substantial reductions in interest rates – with more to come.

While the above increased confidence is welcome, restrictions on land supply is also a continuing factor in the cost of housing.

A recent paper released by the Housing Technical Working Group (HTWG) provides an assessment of how restricted land supply is in Auckland and how this has changed.

Analysis of availability of land supply in Auckland finds evidence of restrictions on the supply of urban land. Among the papers findings is that these restrictions are estimated to have added \$378.4 per square metre to the price of urban land immediately inside the rural urban boundary in Auckland in 2021.

Retail

The retail sector is still struggling as households remain vigilant against unnecessary expenditure in the face of rising unemployment. Electronic sales are also stagnant as reflected in *StatsNZ* data.

The face of retail is also changing with much more online shopping both from domestic suppliers but also from international platforms. This continued move will likely see further changes in shopping patterns over future years as the sector adjusts to new forms of buying.

The latest quarterly *RetailNZ* Report – Retail Radar – shows that as the busy Christmas sales season approaches, retailers say sales continue to be challenging. Yet they say they are responding to green shoots in the economy – recent falls in both the OCR and annual inflation – with a surprising rise in confidence.

The survey of members shows a noteworthy uplift in confidence, with 65% confident or very confident that their retail business will survive the next 12 months, compared to just 58% in mid-2024 and 57% a year ago.

Meanwhile, according to a *Buy NZ Made* survey of its small business members, 59% are still dealing with rising costs and 42% are concerned about cashflow. Just over half (51%) are optimistic about the Christmas trading period and a third say "staying afloat" will be their priority in 2025.

Buy NZ Made executive director Dane Ambler says many businesses are hoping for a change in fortunes this Christmas.

"2024 has been the most difficult year for business since the pandemic. However, the recovery has begun - falling inflation and increasing consumer confidence is expected to boost domestic demand in 2025."

Tourism

The tourism sector continues to bounce back but overall visitor numbers are still below pre-COVID levels.

The international visitor survey results for the year ending September 2024 show a promising increase of 30 per cent in visitor spend while visitor numbers increased by 17 per cent. Also, the survey shows a continued shift towards higher spending visitors, with the median daily spend per visitor up 10 per cent.

For the year ending September 2024, international visitors spent \$11.7 billion in New Zealand, including \$1.9 billion in the September 2024 quarter alone.

Despite these positive results, the Government's recent decision to increase the visitor levy from \$35 to \$100 for most people entering NZ has not gone down well with the sector, with some operators saying it will have a detrimental impact on tourism numbers. While this can be debated, it is important that any money taken as part of the visitor levy is targeted at upgrading the services required by overseas tourists, where direct user-pays is not feasible. There is nervousness that with the Government's coffers very constrained, there could be moves to siphon off levy revenue obtained from tourists to fund departmental activities (which arguably should be funded out of general taxation), rather than funding tourism needs.

There is also a broader concern within the business community that Government may be imposing levies on sectors as a de facto means of supporting government activities, potentially diverting the flow of funds between levy payers and the levy purpose.

A number of examples can be cited, such as the Government decision to increase levies on waste going to landfill (beyond normal landfill charges), while using such funds to benefit the wider community. In this respect there is a clear disconnect between the levy payers and the use of the levy funds.

With respect to the funding of Fire and Emergency NZ (FENZ), the Government is reducing further its already small minuscule contribution to the funding of the public good aspects of the FENZ. This was announced in the Budget Estimates that accompanied the Budget in May 2024.

With respect to immigration, there appears to be a number of ad hoc costs imposed on those seeking visas and border entry into NZ, with concerns that these do not necessarily reflect the costs of the system itself, but are simply easy ways of boosting departmental budgets to carry out 'public good' aspects of migration policy.

In all these cases, it is fundamentally important that various levies do not become a de facto way of funding public good expenditure which should clearly come from the public (taxpayer) purse.

It is important that where Government imposes cost on third party users of services, those costs are related to the services in question, and not simply imposed on households and businesses to help offset general government Budgetary constraints. This may be a good area for the Ministry for Regulation to tackle, given the Government's

objective of removing unnecessary barriers, red tape and costs facing the business community.

While businesses appreciate that the Government's budget is constrained, this is no reason to use regulatory policy to achieve the Government's objectives of trying to balance their finances through what some might consider, inappropriate revenue raising techniques.

1.4 Labour market – easing as expected

The Household Labour Force Survey (HLFS) for the September quarter 2024 shows labour market pressures continuing to ease. The unemployment rate rose to a 3-year high of 4.8%, although, perhaps somewhat surprisingly, the labour force participation rate is still holding up well. The underutilisation rate, a better measure of labour market conditions, actually reduced from 11.8% to 11.6%.

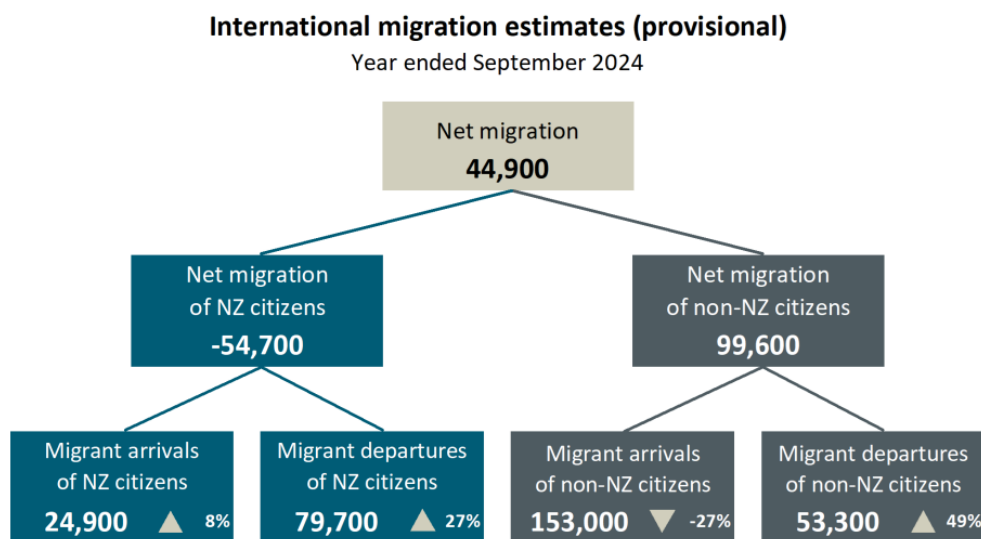
Expectations are for further rises in unemployment as the second round of jobs cuts hit the public sector, while a number of high-profile private sector businesses have announced that they are shutting up shop, for a range of reasons.

A number of business association have reported that they are receiving more calls from members requesting information on restructuring and potential advice on redundancies. This has continued to increase over the past year and would suggest that further rises in unemployment are likely as we enter 2025.

Overall aggregate demand remains soft, and firms are continuing to lay off staff which will drive an increase in the unemployment rate going forward. Also, given that the labour market tends to lag behind general economic activity, there will still be further rises in unemployment next year – likely peaking late 2025.

Notwithstanding that further rises in unemployment are forecast and that the labour market continues to ease, there is likely to be some resistance of employers to let staff given that there may be difficulty in trying to recruit new staff as economic conditions improve.

There are increased signs that net migration is slowing rapidly, as the number of people moving to NZ declines and the number of New Zealanders leaving the country increases.



Notes: Estimates are provisional as of 13 November 2024.

Percentage changes are indicative of the September 2024 year compared with the September 2023 year.

Figures may not sum to totals due to rounding.

Source: Stats NZ

While net migration for the year ended September 2024 was around 45,000 (still well above the long-run average), a major concern is the number of NZ citizens leaving the country. For the year ended September 2024, there were 25,000 returning New Zealanders, but close to 80,000 NZ citizens departed.

This potential brain drain is concerning as more New Zealanders leave the country in pursuit of better opportunities offshore. The record number of Kiwis leaving for Australia, particularly our youngest and brightest, means that NZ is losing some of its most productive human capital for the future.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Dec 24	Dec 25	Dec 26
Highest	5.2	5.4	5.0
Average	5.1	5.2	4.7
Lowest	5.1	5.1	4.6

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – wage growth slowing

While forecasts show further easing in wage/salary pressures are likely over the forecast period, over recent times there has been divergence between wage rises in the private sector compared to the public sector, driven largely by pay equity claims in the public sector.

The Labour Cost Index (LCI) rose by 0.6% for all sectors in the September quarter, while on an annual basis, all wage rates (including overtime) increased 3.8%. This compares with 4.3 percent in the year to the June 2024 quarter.

Average ordinary time hourly earnings the Quarterly Employment Survey (QES) rose 3.9 percent in the year to the September 2024 quarter, compared with 5.0 percent in the year to the June 2024 quarter.

The difference in outcomes for the two measures can be explained by the fact that the LCI measures wages/salaries for a particular job whereas the QES measures what is happening to the wages and salaries of individuals, so includes wage/salary increases as a result of job hopping to higher paid positions.

Forecasts: Labour cost index percentage change (wages and salaries)

	Years Ending		
	Dec 24	Dec 25	Dec 26
Highest	3.5	2.5	2.5
Average	3.2	2.4	2.3
Lowest	2.9	2.0	1.8

Source: ASB, BNZ, Kiwibank and Westpac