BUSINESS NZ

PLANNING FORECAST

DECEMBER 2019

BusinessNZ

NZ Economy: Mixed outlook

Executive Summary

As we near the end of 2019, the NZ economy's overall results card is showing a mixed outcome.

On the one hand, international commodity prices are at very healthy levels with NZ's terms of trade close to historic highs. Inflation remains under firm control, interest rates are at historic lows, unemployment is at, or near, what is considered sustainable full employment and income levels are starting to rise. Business and consumer confidence are also belatedly showing some improvement, albeit off a very low base.

On the other hand, there are still significant risks both at the international and the domestic level.

Ongoing trade tensions continue to play out between the major international powers, with rifts between the US and China very active despite Trump statements to the effect that a "phase 1" trade deal has been reached. Recent tweets by the President of the United States suggest he is in no rush to end the current stand-off and that maybe it would be prudent to delay significant progress towards an outcome until after the US elections next year. Whether this is just another negotiating tactic is unclear at this stage. As a country dependent on international trade, NZ is not immune from the fallouts associated with such trade spats.

Domestically, high levels of household debt leave New Zealanders exposed if asset prices take a dip. A high level of agricultural debt, particularly in respect to dairy, could prove problematic given factors that will impact on land prices, including greater regulatory controls on environmental externalities and uncertainties about the future allocation of freshwater.

Markets dislike risk and uncertainty and will build in a risk premium in respect to future investments if property rights are seriously under threat.

While it is considered New Zealand's fiscal and monetary policy and frameworks incorporate some of the world's best practice, there is still considerable scope for improving regulatory processes to ensure regulation is well thought through and does not simply add to the cost of doing business, ultimately impacting on the country's ability to remain internationally competitive.

On the monetary policy front, it came as no surprise that the Reserve Bank increased requirements on NZ banks in respect to capital adequacy requirements, although it softened the blow somewhat by offering a degree of flexibility both in relation to raising capital and timeframes for change. While such measures might reduce the risk of bank failure, this comes at the expense of higher credit costs and/or restrictions on who can obtain credit. The risk is for greater exposure to the housing market, while other sectors, including agriculture, will also face the pinch. Offsetting this move to some degree are continuing high commodity price levels, which will cushion the burden over the short term.

Low interest rates have potential downsides, particularly if, potentially, they place further pressure on asset prices (this risk is outlined in the Reserve Bank's recent Financial Stability Report). Moreover, low interest rates can have other unintended consequences such as impacting on discount rates with significant implications for some insurance-based products such as NZ's Accident Compensation Corporation (ACC) scheme. This could see significant rises in ACC premiums ahead.

HIGHLIGHTS

The NZ economy is forecast to grow at around 2.5 percent per annum on average, out to December 2021 – not spectacular but still solid relative to our major trading partners.

The BusinessNZ Economic Conditions Index, a measure of NZ's major economic indicators, sits at 10 for the December 2019 quarter, up 9 on the previous quarter, largely on the back of improvements in both the business and consumer confidence indicators.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) has bounced back somewhat after taking a dive into negative territory for the September quarter (the first time since 2012). Meanwhile, its sister survey, the Performance of Services Index (PSI), has remained firmly in positive territory.

International commodity prices are holding up well, particularly in respect to beef, lamb and dairy, underpinning returns to agricultural producers. Notwithstanding, the sector faces significant headwinds, including greater regulatory costs and uncertainties associated with water quality and water allocation and a likely tightening in credit availability on the back of the Reserve Bank's recent move to boost the capital requirements on banks.

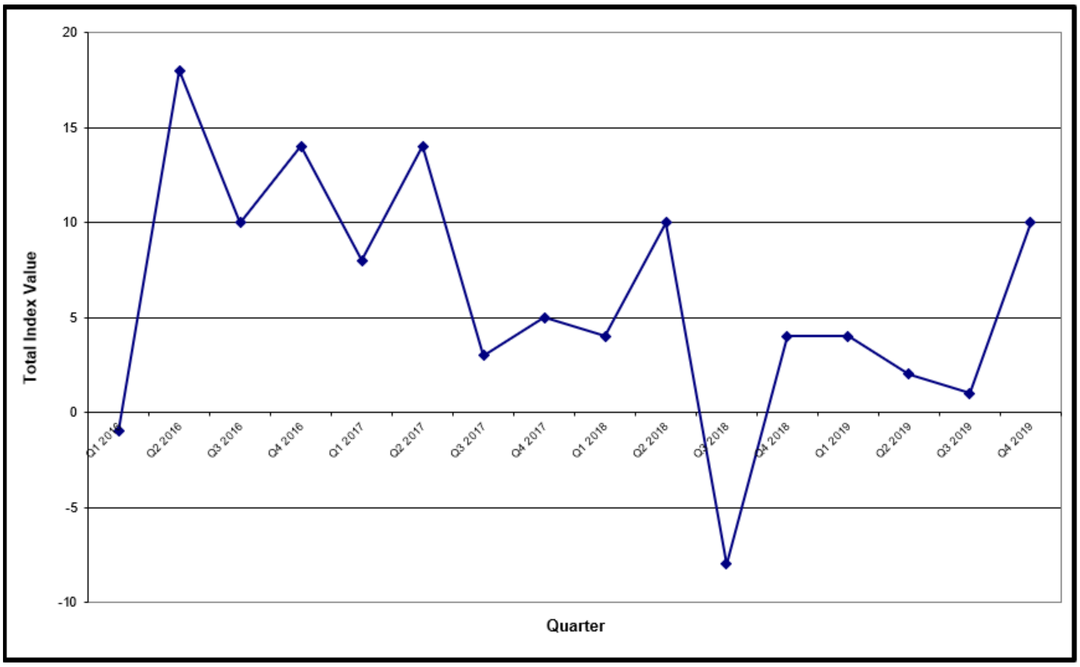
The government accounts remain in a reasonably healthy state as shown by the recent Half-Year Economic and Fiscal Update. Significant increases in expenditure are forecast for infrastructure, although which specific projects will be funded is still up in the air.

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

BusinessNZ Economic Conditions Index (ECI)

The overall BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 10 for the December 2019 quarter, up nine on the previous quarter, largely driven by improvements in both business and consumer confidence indicators.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

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 3 for the December 2019 quarter, up 2 on the previous quarter and up 1 on a year ago. NZ's terms of trade (a measure of the purchasing power of its exports relative to imports) are close to an all-time high, underpinned by relatively high sheep, beef and dairy prices.

Monetary policy/pricing indicators sit at 3 for the December 2019 quarter, up 3 on the previous quarter and up 5 on a year ago. Interest rates are now at historic lows, although there are potential risks with very low interest rates encouraging growth in demand for some assets, thereby further driving up house prices.

Business/consumer confidence indicators sit at 4 for the December 2019 quarter, up 5 on the previous quarter and the same as a year ago. Business confidence has rebounded of late, albeit off a very low base. Meanwhile consumer confidence remains solid but not spectacular.

Labour market indicators sit at 0 for the December 2019 quarter, down 1 on the previous quarter and the same as a year ago. Unemployment remains around 4 percent, largely considered maximum sustainable employment as measured by the Reserve Bank in respect to monetary policy settings.

[1] The ECI tracks over 30 indicators on a quarterly basis. The overall index value for any particular 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 2019 are estimates based on available information to date.

PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING

1.1 Economic growth (GDP) – bottoming out

Forecasts out to December 2021 show that, on average, economic growth in NZ is forecast to be around 2.5 percent per annum, with some uplift in the out years.

While GDP has continued to soften of late, NZ's economic growth is still forecast to grow at a faster rate than economic growth in Australia, US and Europe out to 2021, as outlined in the table below.

Real GDP growth (% per annum)

Country	**2019**	**2020**	**2021**
China	6.2	5.7	5.5
World	2.9	2.9	3.0
NZ	2.7	2.5	2.4
Australia	1.7	2.3	2.3
United States	2.3	2.0	2.0
OECD	1.7	1.6	1.7
Euro area	1.2	1.1	1.2
United Kingdom	1.2	1.0	1.2

Source: OECD

Global and domestic factors are weighing both positively and negatively on NZ's growth potential.

Dealing with the international scene first.

Global economic growth has continued to drift lower over recent months with the ongoing saga of trade tensions between the US and China front of mind.

There is a general lack of clarity as to how trade talks are progressing given President Trump's tendency to throw out tweets every so often, giving the impression he treats trade issues in a somewhat random way. Recent tweets suggest he is in no rush to progress to concluding a comprehensive trade agreement with China, stating he may wait until after the US elections late next year before engaging seriously on the issue. Cynics might suggest such presidential talk is just a negotiating ploy, although financial markets have certainly reacted by offloading equities which, coincidently, have recently recorded historic highs.

Recently also, the US Senate has passed a law supporting Hong Kong's protestors and imposing sanctions on those Chinese and Hong Kong government officials "responsible for eroding Hong Kong's autonomy and human rights violations". China has, in the past, promised retaliation for any such reaction, a promise which could further complicate moves to finalise trade talks quickly.

The International Monetary Fund's World Economic Outlook (October 2019) Executive Summary stated that:

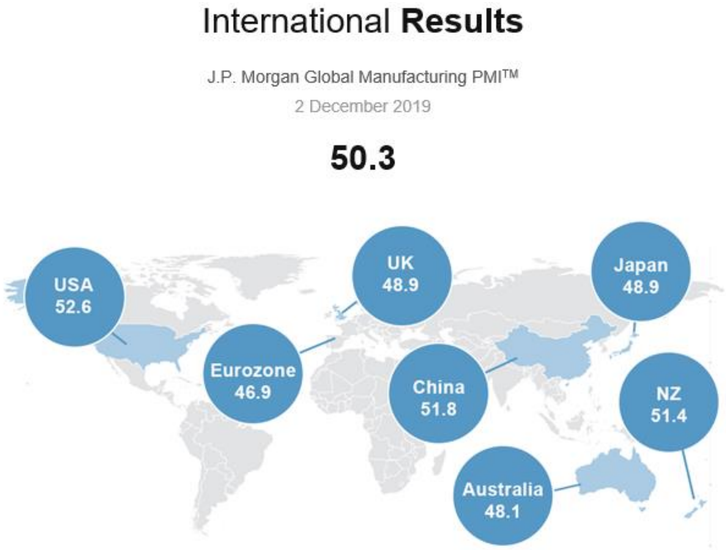
"Rising trade and geopolitical tensions have increased uncertainty about the future of the global trading system and international cooperation more generally, taking a toll on business confidence, investment decisions, and global trade"

As a result, global growth is forecast to be 3.0 percent for 2019 (its lowest level since 2008-09), with growth only picking up marginally (to 3.4 percent) for 2020 and moderating in both the US and China.

From a global output point of view, it is really a game of two halves.

The services sector (which by and large is the significant part of most developed economies) is still performing well. Households and consumers continue to spend up large and the services sector has been rewarded with relatively strong growth.

On the other side of the coin, the J.P Morgan Performance of Manufacturing Index has continued to show mediocre growth across a range of countries, as outlined below. Latest results indicate a slight level of expansion on average (50.3) with NZ continuing to be one of the better performers.



Internationally, the cost of capital remains low with negative interest rates still prevalent in a number of countries.

With returns from fixed term deposits so low, many households are turning to other forms of investment. Equities are still regarded positively across a range of countries.

NZ too has been part of this international phenomenon with growth in the NZX50 achieving remarkable gains of around 20 percent per annum, on average, over the last 5 years.

Reasonable dividend returns and significant capital gains in share prices have provided households with favourable returns to date. The big questions are how much further can prices increase given many companies have very high price to earnings ratios and will current dividend payments continue to be achieved if future expansion needs require some companies to retain their earnings? Some correction seems self-evident.

On the domestic scene, several factors point to positive growth prospects for NZ, despite other factors weighing heavily on the country's growth prospects.

On the positive side of the ledger, key positive factors include:

- Continuing low interest rates
- The service sector still performing well (given it accounts of the bulk of economic growth)
- Commodity prices remaining good (and elevating to even higher levels of late)
- The NZ dollar generally weakening slightly over the past year, elevating returns to NZ producers when converted into $NZs, although there has been some increase of late
- The Government further opening its fiscal purse, providing increased dollops of money for infrastructure projects (yet to be clearly defined)
- Net migration levels remain high, supporting growth
- Unemployment remaining close to its lowest practicable level (i.e. the economy is at its maximum sustainable employment level in Reserve Bank speak)
- Business and consumer confidence indicators improving (albeit off a very low base)
- Equity returns still very attractive (to date)

On the other side of the coin, there are reasons to be nervous:

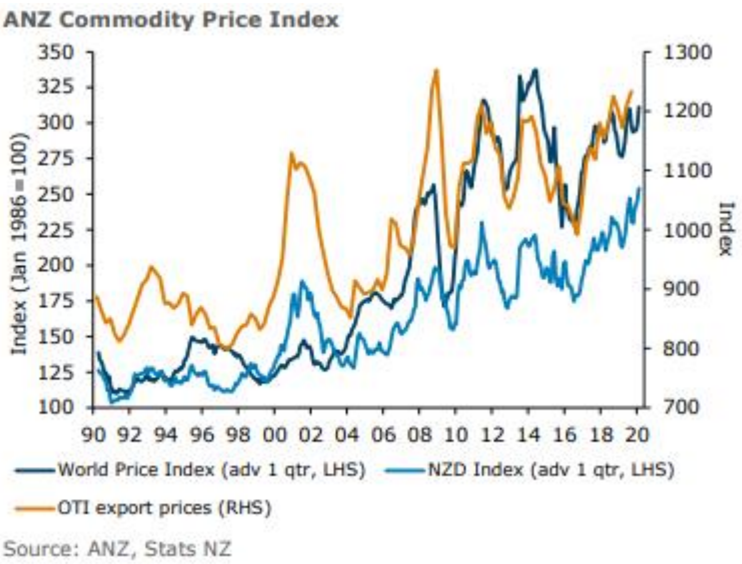
- Economic growth has continued to slow across most regions
- Regulatory uncertainty continues to weigh on business confidence over a range of sectors and issues
- The Reserve Bank has little left in the tank (i.e. in terms of potential interest rate reductions) if the economy tanks

- Debt levels are a problem for the household sector and the concentration of agricultural debt (e.g. dairy) is a cause for concern
- Geopolitical tensions internationally remain elevated with little likelihood of reducing any time soon
- Greater moves towards trade wars and national trade policies are becoming the order of the day, something NZ is not immune from
- The agricultural sector is lacking confidence with a range of factors impacting adversely on sentiment in the sector, despite a further lift in commodity prices of late

Commodity prices, internationally, are currently providing a solid return for farmers, particularly in respect to lamb, beef and dairy. This is at least partially underpinned by China taking more NZ products, a consequence of its ongoing swine flu issue which has seen a significant number of its pigs slaughtered, requiring China to find alternative sources of protein.

The latest ANZ Commodity Price Index (for the month of November) shows the World Commodity Price Index lifting 4.3 percent with beef leading the charge. The overall index is currently 12.4 percent higher than a year ago.

When converted into $NZ, the index lifted 3.5 percent for the month and up a very healthy 18.8 percent annually. The higher annual growth rate when converted to $NZs largely reflects the "lower" NZ dollar over the past year compared with our major trading partners.



Fonterra has also recently boosted its forecast Farmgate Milk Price with the mid-point of its forecast price now $7.30 (the range being $7.00 - $7.60 per kgMS).

While higher forecast dairy payouts will be welcomed by rural communities, given the flow-on effects of increased expenditure within the regions, there are potential clouds on the horizon for agricultural producers which must be factored into decision-making long-term.

First, irrespective of some views of the value of protein from meat, there is a growing voice for the greater use of plant alternatives, for a range of reasons. While the merits of these demands can be debated back and forth, ultimately it is not necessarily scientific and factual arguments that determine what individuals purchase but individual perceptions. Therefore, for NZ agricultural producers, showing a clean, green and environmentally friendly regime will likely be crucial to keeping our more valuable customers on board.

Second, given relatively high levels of agricultural debt (and more specifically dairy debt which tends to be concentrated), the potential exists for banks to take a more cautious approach to lending to this sector. There has already been a significant tightening in lending, perhaps in light of the sector's debt levels but also, in respect to the impending introduction of higher capital adequacy requirements on banks, which will mean they must focus more on reducing what could be termed "risky" debt. As mentioned earlier in this report, the potential exists for banks to move increasingly to fund what are considered less risky asset classes, such as housing, putting the squeeze on credit to the broader agricultural sector – despite currently very favourable commodity prices.

Third, a raft of regulatory measures is either being implemented or in the policy development phase and could impact significantly on the ability of farmers to manage land use as they have done traditionally. This could affect asset prices over time.

Potentially restricting land-use changes, as outlined in the recent Ministry for the Environment *Action for Healthy Waterways* Consultation Document, could have a significant effect in some areas and also put significant cost imposts on farmers in meeting what some have suggested are unrealistic environmental standards.

While it is important to realise that such changes are still at the consultation stage and nothing has been cast in stone, the general direction of movement is towards more and stricter controls.

The costs of production should be largely internalised to the extent possible but there is a need to make appropriate trade-offs to ensure New Zealanders can effectively meet the "4 well-beings" of economic, environmental, social and cultural progress.

Maybe it's time to dust off the concept of enacting a Regulatory Responsibility Act to improve the quality of regulatory interventions across the board – just a thought.

Forecasts: Real GDP percent Growth

	Years Ending		
	Dec 19	Dec 20	Dec 21
Highest	2.3	2.9	3.3
Average	2.1	2.6	2.7
Lowest	1.9	2.3	2.0

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary Policy – changes in the air

The Reserve Bank released its Financial Stability Report late last month. The report underpinned the view that New Zealand's financial system is resilient to a range of economic risks.

Risks identified include:

- Continuing world trade uncertainty slowing global growth
- Global interest rates expected to remain at low levels (which could prompt some borrowers to take on too much debt)
- Some households with high debt levels potentially at risk should their incomes fall, or interest rates increase.

The Reserve Bank also signalled in its Financial Stability Report that a greater bank capital adequacy requirement would be necessary to prevent the risk of bank failure.

It was therefore of little surprise that the Reserve Bank largely went through with its earlier proposals to increase bank capital requirements to deal with what it considers are 1 in every 200-year events.

The pros and cons of increasing capital adequacy have been well canvassed and so are not repeated here. Suffice to state that reducing risk does not come without cost.

One response from banks will likely be to impose further restrictions on lending to what are perhaps considered financially vulnerable sectors (e.g. agricultural debt and more particularly dairy debt) and/or to increase the cost of available credit.

To be fair to the Reserve Bank, it softened the blow of its increased capital requirements in two important ways. First, it extended the time frame for banks to meet the new capital requirements from 5 years in the original consultation document to 7 years (with the clock ticking from July 2020).

Second, the Reserve Bank has allowed for greater flexibility in respect to capital raising options from the initial consultation paper.

It is pleasing the Reserve Bank has taken on board some business community concerns about the timing of the proposed changes and has also, belatedly, provided a cost/benefit analysis of the changes that accompanied its final announcements on 5th December.

However, it is disappointing that interested parties have had no opportunity to comment on the cost/benefit analysis as the bank's final decisions have already been made.

Given the significance for consumers, households, businesses, and the rural sector, all of whom will ultimately bear the increased costs and/or restrictions on capital, of the Reserve Bank's decisions, a further round of consultation would have been appreciated.

Perhaps even more importantly, when the Reserve Bank is assessing risk in respect to financial stability, the question needs to be asked as to how far can (or should) the bank go in trying to protect individuals and businesses from themselves. The danger is that increased bank capital requirements and the Government's "in principle" decision to implement compulsory depositor insurance (up to around $50,000) will set a precedent: that government (read taxpayer) will act to protect investors and households against other risks as well. For example, will "Kiwisaver" investments be next and how far will the Reserve Bank go down this paternalistic path? Ultimately consumers and households (read taxpayers) will carry the risk.

Interest Rates – low for longer but risks attached

The 90-day bill rate is forecast to remain low out to December 2021.

With the Reserve Bank's recent stance on the Official Cash Rate (OCR), further interest rate cuts are not beyond the realms of possibility, although there are risks, such as the potential for encouraging individuals to get further into debt, something which may come back to haunt them if income levels fall and/or interest rates rise substantially.

There are several reasons why lowering the OCR to 1 percent (with some commentators saying there is more to come) was not necessarily a smart move.

First, there is a misguided assumption that lowering interest rates further will stimulate productive investment; businesses just need that extra reduction to make things happen and restore business confidence. However, business confidence to invest has little to do with interest rates (already at historic lows) but more to do with regulatory and international uncertainty as to future demand.

Second, if lower interest rates lead to the further expansion of housing demand, this will simply drive up house prices while increasing household debt levels, already at historic highs. Moreover, given the recent increase in their capital adequacy requirements, banks could push to move out of more "risky" lending (e.g. rural lending) and increase their lending in other areas such as housing, simply exacerbating current house prices.

Not surprisingly, very low interest rates mean debt servicing costs, currently, are relatively low. However, should borrowing costs increase and/or restrictions be placed on lending to some sectors, the ability to service loans could come under significant pressure.

Third, there is certainly a concern that if the economy turns to custard there will be little left in the tank. NZ is just a small step away from potentially negative interest rates.

Fourth, very low interest rates are encouraging households and individuals to look increasingly to equity markets which to date are providing much higher returns. Pump priming equity markets may result in a much harder landing if households and investors start looking seriously behind recent share price gains, particularly at the increasing margin between share prices and earnings.

Fifth, when interest rates rise – which at some stage they will – that will likely bite hard on households' continuing debt servicing capacity. Down the track, the impact on asset prices could be significant.

Finally, there are also, potentially, several unintended consequences for taxpayers by way of significant and prolonged interest rate reductions. For example, low interest rates can significantly change discount rates, affecting assets required to pay for future costs such as the cost of the Accident Compensation Corporation (ACC) scheme. Reduced discount rates as a direct result of lower risk-free interest rates have resulted in the ACC scheme going from a situation where it was more than fully-funded to one where current assets are considered to fall well short of what is needed to deliver on future liabilities. This will likely mean both employers (in respect to work accidents), earners (in respect to non-work accidents) and motorists (in respect to Motor Vehicle Accidents) will face either a significant increase in levies or a change in ACC's funding policy. Watch this space.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Dec 19	Dec 20	Dec 21
Highest	1.2	1.2	1.3
Average	1.2	1.0	1.1
Lowest	1.1	0.9	0.9

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – bottomed out?

One silver lining for NZ producers and international investors over the last year is that a decline in the NZ dollar has boosted returns for both. The NZ dollar has generally tended to drift lower compared with that of most of its major trading partners, although it has generally risen of late.

Given the potential for an even lower OCR next year, it is likely some pressure will continue to keep the exchange rate in the zone. On the other hand, relatively strong growth in commodity prices has put some upward pressure on the NZ dollar of late. NZ's terms of trade are currently close to an all-time high with several business and consumer confidence indicators tending to increase of late giving further impetus to the rising dollar scenario.

Notwithstanding the above, forecasts below, show that, on balance, the NZ dollar is expected to remain relatively stable against both the Australian and the US dollars out to December 2021, although some upward pressure is possible.

Despite current forecasts, the risk of wild swings in exchange rates cannot be ruled out. Particular attention will be focused on international economic developments and on any substantial interest rate changes.

Uncertainty over trade deals and uncertainty in general will affect the currencies of countries such as NZ, largely dependent on commodity-based exports.

Forecasts: Exchange Rates

AUD (cents)			
	Dec 19	Dec 20	Dec 21
Highest	0.96	0.94	0.95
Average	0.95	0.94	0.94
Lowest	0.94	0.94	0.92

USD (cents)			
	Dec 19	Dec 20	Dec 21
Highest	0.67	0.67	0.70
Average	0.64	0.65	0.68
Lowest	0.63	0.63	0.65

TWI			
	Dec 19	Dec 20	Dec 21
Highest	73.0	72.6	73.5
Average	71.2	71.0	72.6
Lowest	69.1	69.3	71.0

Source: ASB, BNZ, Kiwibank and Westpac

Inflation – in the zone

Inflation as measured by the Consumers' Price Index is likely to remain well within the Reserve Bank's target band of 1-3 percent out to December 2021.

While non-tradeable (domestic) inflation is still running at 2.8 percent per annum, tradeables' inflation remains subdued, although with rising commodity prices in the air, some rise in tradeables inflation is likely.

It is also likely non-tradeables' inflation will show further upward pressure over time for a range of reasons, including the difficulty of achieving new capacity and some upward pressure finally starting to come through from higher wage rates.

In this respect, we consider the Reserve Bank should be extremely cautious about deciding on any further cuts to the OCR, quite apart from the issues outlined under "interest rates" above.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Dec 19	Dec 20	Dec 21
Highest	1.8	1.9	1.9
Average	1.7	1.8	1.8
Lowest	1.6	1.7	1.6

Source: ASB, BNZ, Kiwibank and Westpac

1.3 Business activity and confidence – rising from low base

Business confidence is rising, albeit from an extremely low base.

While business confidence has basically remained in the cellar since the general election over 2 years ago, there has been some uplift of late.

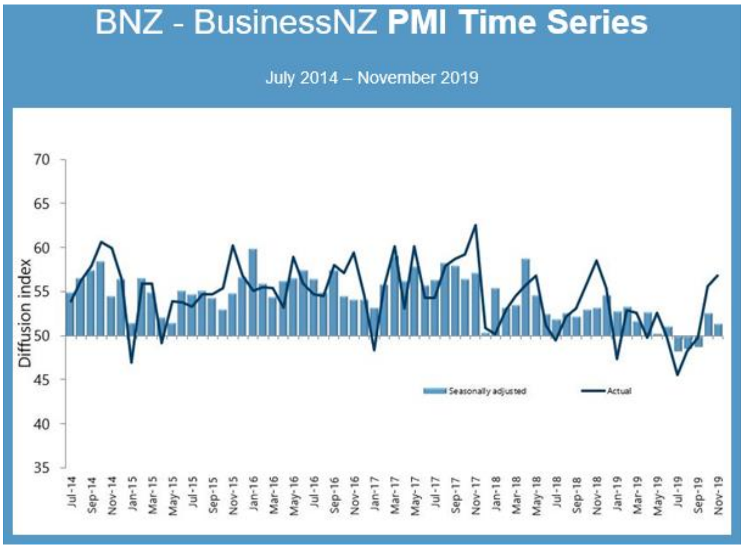
A key indicator for growth is how firms' expectations of their own activity over the coming year are tracking and after being in negative territory for much of the third quarter of 2019, there is some positive progress as NZ heads into 2020.

Some of the key factors impacting on growth are now more positive, including some uplift in firms' employment intentions, investment and capacity utilisation.

Rising business confidence is increasingly reflected in the quantitative data coming out of both the BNZ-NZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI).

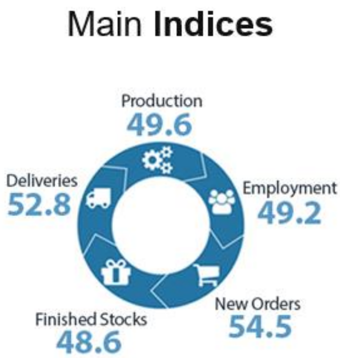
After dipping into negative territory for July, August, and September 2019 (for the first time since 2012), the PMI has made something of a comeback over the last two months.

The seasonally adjusted PMI for November was 51.4 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining), the second consecutive month in expansion but 1.2 points lower than October's value.



The November result could be considered somewhat of a mixed bag.

The sub-index of new orders (54.5) continued to lead the charge in terms of displaying the highest level of expansion. However, production (49.6) fell back into slight contraction, as did employment (49.2). Finished stocks (48.6) remained in a fairly tight band of contraction for October, while deliveries of raw materials (52.8) continued to improve from the previous month.

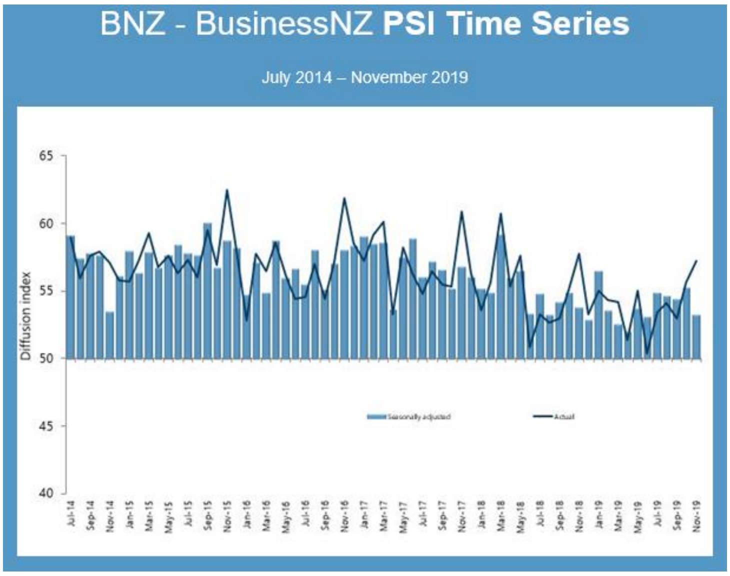


The fact that new orders remained relatively healthy should provide further impetus for the sector in the coming months. However, a sustained level of activity above the long-term average for new orders would help get the sector as a whole back on track.

Despite the dip in expansion, the proportion of positive comments for November (65.3%) was higher than October (57.6%) and September (48.8%). Seasonal factors, such as Christmas, were a common theme in comments, together with more offshore demand.

Meanwhile, activity in New Zealand's services sector continues to expand according to the BNZ-BusinessNZ Performance of Services Index (PSI), albeit at a lower level.

The PSI for November was 53.3, 2 points down from October (a PSI reading above 50.0 indicates the services sector is generally expanding; below 50.0 that it is declining). Despite a reasonable level of expansion, the November result was below the long-term average of 54.4 for the survey.



Looking at the key sub-index values, a major concern is the drop in expansion for new orders/business (53.9), at its lowest level since September 2012. The other key sub-index of activity/sales (54.1) also fell to its lowest point since April 2019. These results tend to suggest it may be a while longer before we see a sustained level of healthy expansion in the sector.

Looking at respondents' comments, it was good to see a further lift in the proportion of positive comments from 50.7% in October to 60.9% in November.

Consumer confidence continues to hold up reasonably well, driven in part by a continuing tight labour market which has put some upward pressure on wages. Other factors affecting consumer spending are also reasonably favourable, (e.g. historically low interest rates making servicing debt easier) while inflation remains subdued.

Reasonably solid building consent growth will help support residential investment and there is the "feel good" factor of a renewed upward movement in house prices which tends to support continued consumer spending.

Retail and electronic sales are at healthy levels after showing some weakening earlier in year.

The kicker though is that increased debt has to be serviced and with household and businesses now used to very low interest rates, any upward interest rate movement, or weakening in the economy, will potentially see a decline in asset prices leaving many people with little ability to service debt.

Furthermore, the Reserve Bank's recent changes to bank capital adequacy requirements (as mentioned earlier) could encourage the banks to consider carefully who they will lend credit to, on what terms, and for how long. The days of easy credit may well be gone for the foreseeable future.

1.4 Labour market – at full capacity?

The unemployment rate is forecast to remain broadly stable at around 4 percent out to December 2021.

Current levels of labour market activity suggest that by Reserve Bank standards, the labour market is currently in line with maximum sustainable employment over the medium term.

At present, the labour market remains at a relatively healthy level despite some increase in the official unemployment rate, as measured by Statistics NZ's Household Labour Force Survey (HLFS) for the September quarter 2019.

Notwithstanding, there is evidence that the labour market has peaked (e.g. in respect to job adds) and while some softening could continue in the short-term, by historic standards, activity is still solid.

Employment, though still growing, has slowed over the last 1-2 years. Annual employment growth for the year to September 2019 was around 1.0, the lowest level of employment growth in 6 years.

A stronger labour market has encouraged more people to enter the market which has had something of a two-pronged effect, creating both greater opportunities for first-time entry, and for entry by the long-term unemployed.

Long-term unemployment is still an issue with the potential for a minority of people to be left behind, becoming reliant on welfare benefits while the rest of society moves ahead. The importance of getting a foot on the employment ladder is crucial if individuals are to build their skill levels and hence their employability and earnings potential over time.

Net inward migration remains at an elevated level with net migration of over 50,000 per annum, although down on the mid-60,000 achieved in 2016. Relatively high levels of net migration reflect several factors, including, but not limited to, the fact that the NZ economy is still performing at satisfactory levels and is relatively stable compared with many of our trading partners. Consequently, NZ not only continues to be an attractive destination for many migrants but is also encouraging more New Zealanders than in the past to stay put.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Dec 19	Dec 20	Dec 21
Highest	4.3	4.4	4.3
Average	4.2	4.3	4.1
Lowest	4.1	4.2	3.9

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – steady movement

Forecasts below show labour cost increases forecast to remain around 2.3 percent out to December 2021 (see below).

Notwithstanding modest increases in wage rates to date, significant increases in the minimum wage over the next couple of years, plus potential pay equity settlements, will likely have flow-on effects to other employment areas as relativity arguments are raised. The Government's proposed regulatory regime for the labour market is also likely to ratchet up labour costs, more so than in the past, given a generalised move towards more centralised bargaining.

Other more recent increases in labour costs also reflect significant (and continuing) rises in the minimum wage, while settlements in the public sector (health, education and police) are more likely a reflection of regulatory outcomes rather than of a cyclical labour market upturn per se.

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

	Years Ending		
	Dec 19	Dec 20	Dec 21
Highest	2.6	2.4	2.5
Average	2.4	2.3	2.3
Lowest	2.2	2.2	1.9

Source: ASB, BNZ, Kiwibank and Westpac