BUSINESS NZ

PLANNING FORECAST

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BusinessNZ

NZ Economy: Constraints to Growth

Executive Summary

While many key economic indicators point to the NZ economy bouncing back reasonably well in 2021, with the recent March quarter GDP growth coming in well above forecast at 1.6 percent for the quarter, there are still significant and increasing constraints to growth.

It is positive news NZ will get more supplies of the Pfizer vaccine in July, allowing for the start of a wider roll-out to the broader population, but it will be hard if not impossible to expect that enough people will have been vaccinated by the end of the year to reach a state of herd immunity. Every month the rolling out of the vaccine is delayed, the longer the NZ border will be effectively closed, postponing the upswing in activity to be expected when people are more freely able to enter NZ for business, employment, and recreation purposes.

Obtaining much needed skilled staff is still front and centre for many companies, with inflationary pressures building and supply constraints affecting numerous sectors across the board. Closed borders and ongoing supply chain issues are compounding these pressures.

In relation to infrastructure, the NZ Infrastructure Commission's recent Consultation Document *Infrastructure for a better Future* outlines several issues concerning the infrastructure deficit NZ currently faces and the challenge of ensuring its infrastructure is fit for purpose. Given the country depends on international trade for its economic lifeblood, it is important to have infrastructure that ensures NZ can retain and enhance its international competitiveness.

Housing remains a major concern for many New Zealanders, with prices continuing to rise despite a range of measures taken by the Government and the Reserve Bank to try to dampen demand.

Treasury, in its recent Budget Forecasts, along with some other private forecasters, is predicting that several factors will see housing price growth constrained over coming years. These include: 1. the Government's implementation of tax changes to make investment in housing less attractive, 2. the potential for lower population growth (given uncertainty over the time of the border re-opening and the Government's potential policy on "resetting-immigration" levels once the border has reopened) 3. the fact that return on investment (rental returns) is likely to be maxed out, given the ability of people to pay increased rent is being sorely tested. 4. moves by the Reserve Bank to constrain credit through the reintroduction of LVRs and proposals to introduce Debt-to-Income Ratios. The latter, together with an inevitable rise in interest rates in response to growing inflationary pressures, will act to constrain credit growth.

The Government's regulatory policy in more than one area raises concerns as to the overall cost impact on the competitiveness of NZ businesses. Cost increases and increased regulation are coming, including environmental and labour market legislation. Sound cost/benefit analysis is needed to ensure appropriate use of taxpayer funds with least-cost solutions taken wherever possible to meet specific objectives.

HIGHLIGHTS

The BusinessNZ Economic Conditions Index, a measure of NZ's major economic indicators, sits at 12 for the June 2021 quarter, up 6 on the previous quarter and up 26 on a year ago (not surprising given the impact of COVID-19 on the economy in the first half of last year).

Growth will be constrained by continued border restrictions, likely to remain in place until well into next year despite Treasury's recent Budget projection that the border would be effectively open from the start of 2022. As a result, NZ will face the continued prospect of a two-speed economy with some sectors and regions going from strength to strength while others continue to lag.

The building and construction sector is reporting record levels of consenting for residential housing and the value of work undertaken is rising. However, supply chain constraints are causing delays and forcing up prices, as seen in the Government's review of costings associated with recent infrastructure projects. Recent business opinion surveys also point to expectations of increased input and output prices.

The agricultural sector is still the unsung hero, with commodity prices at historically high levels, boding well for profitability in that sector, notwithstanding potential regulatory constraints on land use which will confront the sector over coming years.

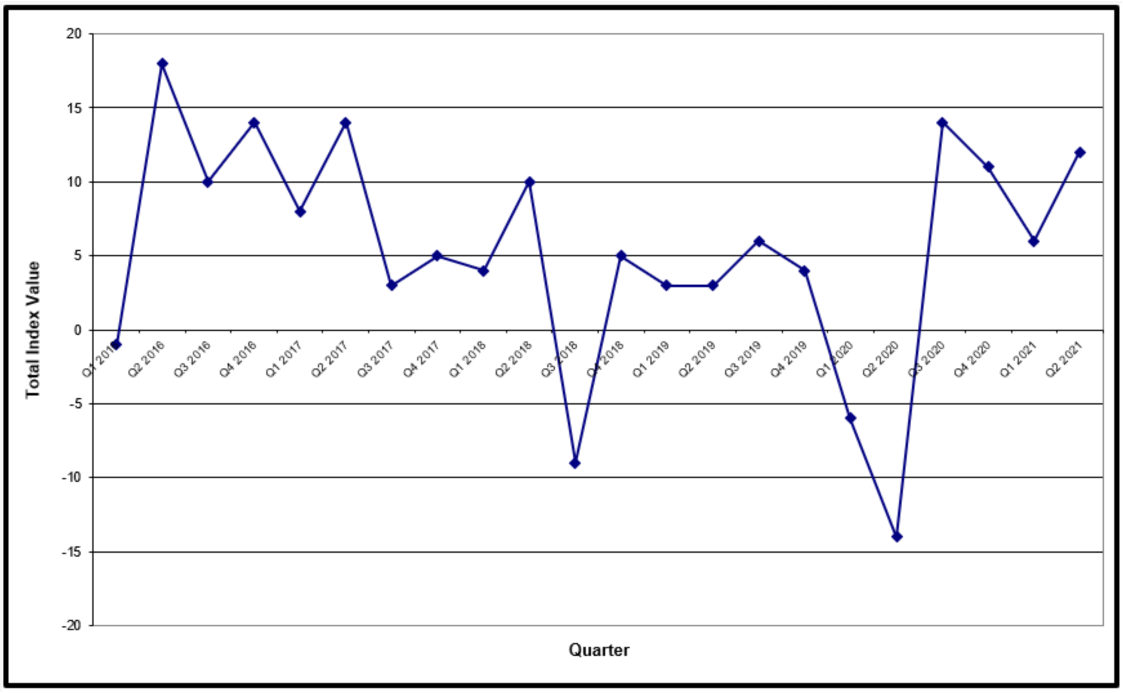
Meanwhile, sectors dependent on overseas visitors, particularly hospitality and tourism, continue to struggle, despite some upward movement in internal travel by New Zealanders.

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 12 for the June 2021 quarter, up 6 on the previous quarter and up 26 on a year ago. This significant improvement since mid-2020 needs to be read in the context of a massive drop in economic growth over the first half of 2020 as a direct result of COVID-19 related restrictions. Since then, the economy has bounced back despite facing continuing challenges as outlined below.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

Data in the ECI is broken up 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 5 for the June 2021 quarter, up 4 on the previous quarter and up 10 on a year ago. NZ's Terms of Trade are now at historically high levels on the back of commodity price rises in particular. Nevertheless, shipping capacity is still stretched, leading to delays and potential cost increases for many sectors.

Monetary policy/pricing indicators sit at -1 for the June 2021 quarter, down 1 on the previous quarter and down 2 on a year ago. Longer term interest rates are starting to increase consequent upon increased pricing intentions and continuing supply chain issues with building inflationary pressures now increasingly apparent across many sectors.

Business/consumer confidence indicators sit at 5 for the June 2021 quarter, up 4 on the previous quarter and up 10 on a year ago. Business and consumer confidence indicators have shown significant improvement of late. However, uncertainty is still playing on the minds of many businesses and there are regulatory challenges in the pipeline which will add to the costs facing many businesses and households.

Labour market indicators sit at 3 for the June 2021 quarter, down 1 on the previous quarter and up 8 on a year ago. Unemployment at below 5 percent is far below what many had forecast at this time last year. Notwithstanding, there are still significant pockets of underutilisation while at the same time businesses are having extreme difficulty in securing skilled migrant labour with an essentially closed border impacting on a range of sector outputs.

[1] 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 June quarter 2021 are estimates based on available information to date.

Note: Given a very fluid international and to some extent domestic situation at present, the forecasts below, including with respect to economic growth, interest rates, exchange rates, inflation, and unemployment, should be seen for what they are – the best available information to date. Some banks are currently updating their forecasts while other forecasts will likely be subject to significant change as both the global and the domestic scenes continue to evolve over coming months.

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

1.1 Economic growth (GDP) – Constrained

Forecasts out to June 2023 show economic growth to be reasonably solid but risks remain, both domestically and internationally. In the near term, several factors are likely to constrain growth although there are positives as well that need to be considered.

On the positive side of the coin, several outcomes are encouraging. In no order of priority these include:

- NZ has avoided any significant community outbreaks of COVID-19 for some months now, allowing the return of mass crowds and concerts, sporting events etc., while our border security appears to have improved over recent times, although arguably off quite a low base.

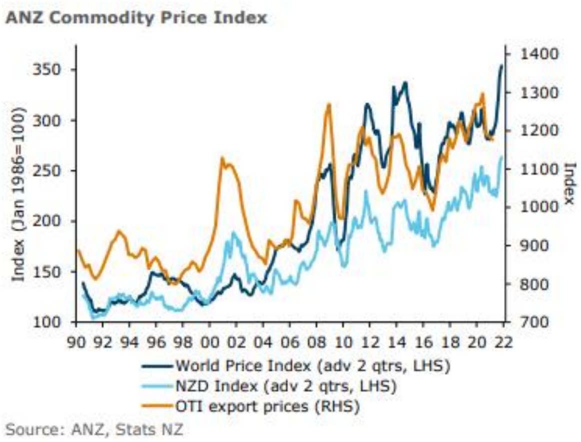
- NZ has largely come through COVID-19 in reasonable shape from an aggregate employment perspective, with unemployment levels remaining under 5 percent – a good result by international standards.

- GDP growth for the March 2021 quarter, at 1.6 percent, came in much higher than many public and private economic agencies had forecast. Perhaps more importantly, growth was more broadly focused than previously, with construction and household consumption driving significant growth for the quarter. Nevertheless, growth for the March quarter needs to take account of the fact that many sectors faced significant drops in activity last year as a result of COVID-19, so the on the surface rosy result for the March 2021 quarter has to be put in context.

- The ANZ NZ Truckometer (which measures both the movement of goods and people) generally is improving, although there is some continuing volatility in monthly numbers given global and international transport disruptions weakening the signal from the data. Notwithstanding, both the Heavy Traffic Index and Light Traffic Index generally closely mirror GDP growth so that over recent months, the general improvement in data overall is good news for future economic growth prospects.

- International commodity prices remain at elevated levels as the world economy begins to recover post-COVID, with demand for agricultural commodities holding up well - good news in respect to both dairy and meat prices for NZ producers. NZ's Terms of Trade (a measure of the value of exports required for a given number of imports) are at historically high levels on the back of a continued improvement in commodity prices.

The ANZ World Commodity Prices Index lifted 1.3 percent in May 2021, its eighth consecutive lift. Prices for all major categories of commodities lifted, pushing the index to a record level (see below).



In local currency terms, the index gained 1.0 percent in May as stronger commodity prices were partially offset by a firming in the Trade Weighted Index (up 0.6 percent).

- The world economic outlook has continued to improve in light of the generally rapid roll-out of COVID-19 vaccines over a range of countries, boding well for a return to more normalised trading conditions. Our key trading partner, China, is showing a return to very solid growth projections which will be good for New Zealand's export trade with that country, despite some simmering tensions below the surface in respect to foreign policy issues.

- The International Monetary Fund (IMF) in its World Economic Outlook (WEO - April 2021) shows the global economy projected to grow by a strong 6.0 percent this year and by the slightly more modest rate of 4.4 percent in 2022. China is expected to grow by 8.4 percent this year and 5.6 percent in 2022.

The IMF stated that: *"The projections for 2021 and 2022 are stronger than in the October 2020 WEO. The upward revision reflects additional fiscal support in a few large economies, the anticipated vaccine-powered recovery in the second half of 2021, and continued adaptation of economic activity to subdued mobility. High uncertainty surrounds this outlook, related to the path of the pandemic, the effectiveness of policy support to provide a bridge to vaccine-powered normalization, and the evolution of financial conditions"*

- Globally, manufacturing activity continues to expand at a robust pace, culminating in an 11-year high for May. However, this has put upward pressure on input prices across most countries, including New Zealand, with comments from respondents indicating the increased cost of raw materials as a key issue.

- Significant stimulus packages, particularly in the United States, are expected to have a considerable impact on US GDP growth this year and welcome demand spillovers for other trading partners. While longer-term interest rates are starting to increase, the increase is off a low base though still adding fuel to the equities fire. The US is expected to grow by over 6 percent this year and by a still healthy 3.5 percent in 2022.

Latest World Economic Outlook Growth Projections

(real GDP, annual percent change)	2020	PROJECTIONS 2021	2022
World Output	-3.3	6.0	4.4
Advanced Economies	-4.7	5.1	3.6
United States	-3.5	6.4	3.5
Euro Area	-6.6	4.4	3.8
Germany	-4.9	3.6	3.4
France	-8.2	5.8	4.2
Italy	-8.9	4.2	3.6
Spain	-11.0	6.4	4.7
Japan	-4.8	3.3	2.5
United Kingdom	-9.9	5.3	5.1
Canada	-5.4	5.0	4.7
Other Advanced Economies	-2.1	4.4	3.4

Source: IMF

- Despite significant increases in net Core Crown Debt, from around 19 percent of GDP in early 2020 to a projected 48 percent by 2023, NZ's overall debt levels (at their projected peak) are still well below those of many of the countries we normally compare ourselves to.

On the negative side of the equation, there are worrying issues which will likely adversely affect NZ's growth potential. Again, in no order of priority:

- Closed borders (apart from the Australasian bubble) are continuing to have significant effects including on:

  1. Certain regions where many businesses have been particularly affected by a lack of foreign tourists and are hanging on by a thread
  2. The agricultural and horticultural sectors unable to undertake important seasonal work due to a lack of foreign expertise and skilled and unskilled migrant labour, adversely affecting returns and infrastructure projects.
  3. Revenue in the higher (tertiary) education sector due to a lack of foreign students.

- The continuing slow roll-out of the Pfizer vaccine in NZ compared with many other countries is concerning given the Government's earlier intention of reaching herd immunity by this year's end and having the border opening at the start of next year, according to the Treasury's budget forecasts. These assumptions now appear rather heroic to say the least.

- Supply chain issues are still a significant problem adding to cost pressures and delays in obtaining materials that are essential if businesses are to progress at pace. Combined with very strict controls on sourcing foreign expertise for key projects, supply chain issues have delayed some projects while others have simply been put on hold or canned completely.

- On the question of infrastructure, the recent Consultation Document from the NZ Infrastructure Commission, *"Infrastructure for a better Future",* outlines several issues arising from the infrastructure deficit NZ currently faces and the challenge of ensuring the country's infrastructure is fit for purpose. Given NZ depends on international trade for its economic lifeblood, it is important to have infrastructure that retains and enhances its international competitiveness.

- Housing remains a major concern for many New Zealanders, with prices continuing to rise despite a range of measures taken by the Government to try and dampen demand. The real difficulty is still the supply side, although there is some evidence the issue of a greater number of building consents is feeding through into the greater value of the work being done.

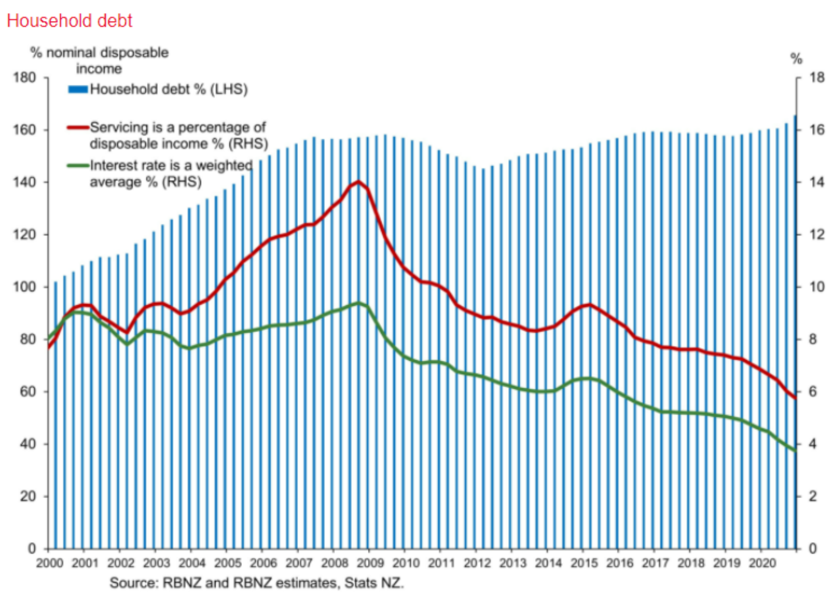
- On climate change, there are difficult decisions to be made about how hard and how fast NZ can (or should) go in reducing gross carbon emissions to reach a net zero emissions target by 2050 and the part carbon sinks (such as forestry) or longer term, international trade, should play in gaining (or selling) carbon credits. Certainly, NZ should in general apply the principle of least cost solutions, despite some push, particularly from the Climate Change Commission, to move away from this concept.

- Inflationary pressure is starting to rear its head through more than one channel, with shipping capacity constraints, material supplies and labour shortages in key sectors, such as construction, raising costs and restricting overall growth in the NZ economy. Inflationary pressure is not only a NZ phenomenon but is increasingly being felt around the world as the impact of expansionary monetary and fiscal policies encourages increased demand for goods and services fueled by historically low interest rates.

A recent survey by BusinessNZ on Energy and Transport Prices (June 2021) found both energy and transport costs have increased substantially for many businesses. 40.7 percent of respondents experienced electricity price increases in the last 12 months and of those facing increases, 75.7 percent was the average increase. Close to two-thirds of respondents expect their electricity price to increase in the next 12 months.

In respect to transport costs, the survey found the average increase in costs for imports was 124.2 percent, for exports, 77.76 percent and for storage and inventory, the average was 23.5 percent.

- The Reserve Bank's continued very loose monetary policy stance (the "no-regrets policy") is having a significant impact on asset prices (particularly housing) that will extend the gap between the haves and have nots and has encouraged the continued buildup of household debt. NZ household debt now sits at an historic high with much of it tied into the housing market. Ironically, at the same time, debt servicing costs are at their lowest level for well over two decades. This will be a concern when interest rates rise - now likely to be sooner rather than later.



- While the Government's core Crown net debt has increased significantly in response to various COVID-19 support measures (and will continue to do so for the next couple of years), overall debt levels are still relatively manageable, as outlined earlier. However, there is no free lunch here and debt will need to be repaid back at some stage, reducing the choices NZers can make, and potentially raising the risk profile (interest rates) required for investment in NZ.

- The Government's regulatory policy over several areas raises concern as to the overall cost impact on the competitiveness of NZ businesses, while broader issues relating to tax neutrality are also fundamental in this context. Further cost increases and increased regulation are coming down the track, including, but not limited to, environmental and labour market legislation. A sound cost/benefit analysis is both necessary and desirable to ensure best use of taxpayer funds and that the rationale for regulation is clearly understood.

Forecasts: Real GDP percent Growth

	Years Ending		
	Jun 21	Jun 22	Jun 23
Highest	4.0	3.3	4.4
Average	3.9	3.0	3.4
Lowest	3.6	2.0	2.6

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary Policy – what's next?

There have been significant changes to how the Reserve Bank operates and its mandate has expanded radically since targeting inflation was largely the bank's sole focus.

There are things the Reserve Bank can do well (particularly targeting inflation through interest rates) but matters such as having multiple, and potentially conflicting, objectives provide little certainty for businesses. The trade-off between so-called full employment on the one hand and stable prices on the other is difficult enough to navigate let alone throwing into the mix matters such as asset prices (specifically housing) and climate change, which border on the extreme. Determining what takes preference and under what circumstances will be a difficult ask.

While the Reserve Bank proposes looking to use new tools such as Debt-to-Income (DTI) Ratios with the Government in principle giving the green light to try and stem housing demand by restricting capital availability, such tools are very crude and do not take account of the financial situation of people wishing to borrow or their unique circumstances. Furthermore, trying to constrain housing prices while minimising any impact on first home buyers seems somewhat difficult, to be frank. Good luck with that.

Interest Rates – higher?

The New Zealand Institute of Economic Research's (NZIER) Shadow Board considers that while current momentary policy settings are appropriate for the short-term, attention is now turning towards a tightening in monetary policy over the coming year.

In the near term, members of the Shadow Board generally point to the uncertainty over how sustainable the recovery will be given continued border restrictions – hence the rather cautious approach to making any changes short-term.

The Reserve Bank in its statements appears to be of the view that until inflationary pressure is very apparent, it will maintain a very loose monetary policy stance (a "no regrets policy"). While many will support this approach, it does raise concerns if inflationary pressure proves more lasting when the need to up interest rates more significantly could be problematic, particularly given high levels of household debt, driven in most part by the significant ramping up of house prices over recent years. It is a difficult time for the Reserve Bank given its increased mandate to be essentially all things to all people. Deciding when to pull the trigger on interest rates will not be easy in view of the many balls in the air the bank is supposed to be juggling.

Notwithstanding the above, the timing of interest rate rises is not only something that will be front of mind for the Reserve Bank over coming months, but it is also an issue which central banks are facing around the world. It is not a case of if interest rates rise – but simply when and by how much. The very loose monetary policies around the world over the past year or so may yet come home to roost

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Jun 21	Jun 22	Jun 23
Highest	0.4	0.7	1.8
Average	0.4	0.6	1.4
Lowest	0.4	0.5	1.2

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – mixed

The speed at which interest rates rise around the world will have an impact on the future direction of currency movements. Central banks around the world are currently reviewing their stance on monetary policy settings and it is likely interest rate rises will occur sooner than was originally intended over a range of countries.

With the roll-out of vaccines well underway and the gradual re-opening of the global economy, investors are likely to take on more risk. And with global commodity prices increasing significantly on the back of renewed demand, it is likely the NZ dollar will remain firm for the forecast period as can be seen below, although some concern about interest rate hikes in the US being brought forward could see the NZ dollar come under some pressure in the short-term.

The NZ dollar is expected to remain relatively stable against the Australian dollar out to June 2023 but some appreciation against the US dollar is expected. However, forecasting the future direction of the NZ dollar is fraught with difficulty and a potentially wide range of outcomes is possible as can be seen below.

While exchange rates have not necessarily been front of mind for most exporters recently, with supply chain constraints of perhaps more concern, if the NZ dollar remains firm, it may make it easier for the Reserve Bank to keep inflation within the broader target band of 1-3 percent annum. But this will obviously lower returns to NZ producers when converted back into NZ dollars.

Forecasts: Exchange Rates

	AUD (cents)		
	Jun 21	Jun 22	Jun 23
Highest	0.93	0.95	0.95
Average	0.93	0.93	0.93
Lowest	0.91	0.92	0.91

	USD (cents)		
	Jun 21	Jun 22	Jun 23
Highest	73.0	78.0	79.0
Average	72.0	76.0	75.0
Lowest	70.0	74.0	72.0

	TWI		
	Jun 21	Jun 22	Jun 23
Highest	75.2	77.7	75.7
Average	74.5	75.7	74.7
Lowest	73.8	74.2	73.8

Source: ASB, BNZ, Kiwibank and Westpac

Inflation – building pressures?

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 June 2023 as can be seen from the forecast below.

Notwithstanding the above, business opinion surveys are now consistently showing stronger inflationary expectations with around two-thirds of respondents reporting an intention to raise prices over the next year – an elevated result compared with historical survey results. At the same time even more respondents are expecting input costs to rise as well.

There are also questions over supply chain cost increases which will ultimately feed through into consumer costs with the New Zealand Institute of Economic Research's (NZIER) latest Consensus CPI forecast showing the CPI expected to spike at about 2.6 percent in September 2021 before moderating in 2022. However, the wide range of forecasts suggests there is a larger than usual degree of uncertainty over the inflation outlook. Capacity pressures are re-emerging, and Covid-19-related supply chain disruptions are also contributing to higher cost pressures.

Further down the track, the impact of progressively opening the border as vaccinations are rolled out may also affect inflation pressure, depending on how open NZ is to immigration and how fast immigration proceeds. Signals suggest the Government may be much more restrictive when it comes to allowing migrants to come to NZ and this could dampen medium term inflationary pressure, particularly the pressure on housing.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Jun 21	Jun 22	Jun 23
Highest	2.8	2.8	2.4
Average	2.6	2.1	2.1
Lowest	2.5	1.5	1.8

Source: ASB, BNZ, Kiwibank and Westpac

1.3 Business activity and confidence – moving on up

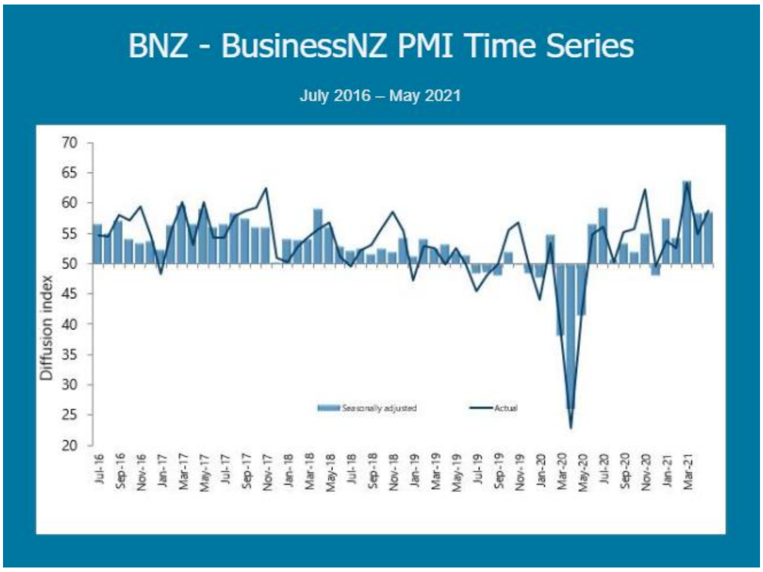
Recent surveys of business activity and confidence show significant improvement from the doom and gloom experienced last year. However, while business confidence has improved, there are evaluated risks – particularly over future pricing expectations.

Tight constraints on both labour supply and goods are putting upward pressure on prices while at the same time affecting NZ's ability to grow. Nevertheless, most surveys point to improved labour market outcomes and unemployment rates lower than expected.

Many sectors are now experiencing strong growth, particularly in manufacturing and construction alongside agriculture but other sectors remain in the doldrums consequent upon the ongoing partial closer of the border, particularly in respect to tourism and hospitality.

The manufacturing sector is trucking on in a positive manner, as shown in the latest BNZ – BusinessNZ Performance of Manufacturing Index (PMI) - for May 2021.

The seasonally adjusted PMI for May was 58.6 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was 0.3 points higher than April.



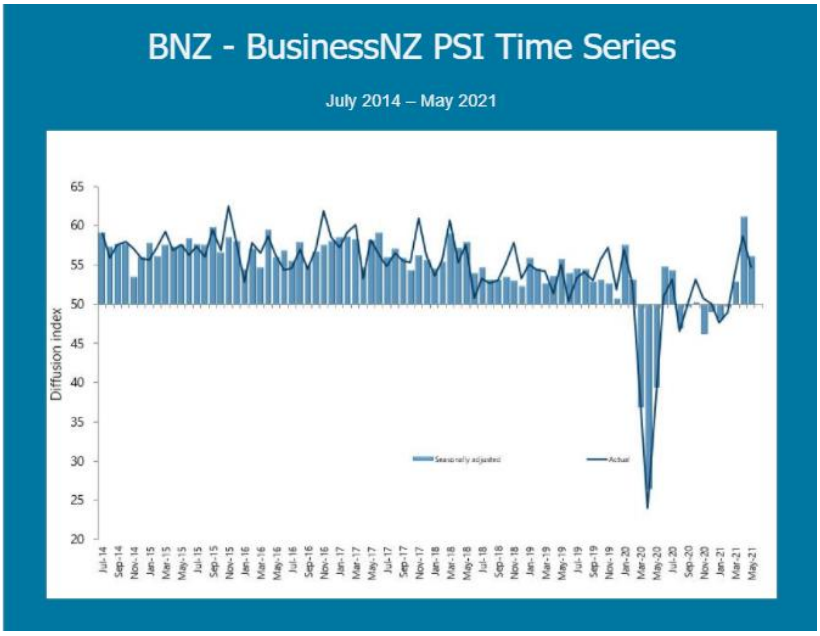
The two major sub-index values of Production (65.3) and New Orders (63.7) remain the cornerstones of ongoing expansion in the manufacturing sector. By contrast, Employment (51.5) continues to slip into lower expansion, while Finished Stocks (52.4) and deliveries of Raw Materials (53.5) remain above the 50-point mark.

The context of generally higher PMI results over recent months needs to be put in the context of the general recovery internationally. Globally, manufacturing activity continues to expand at a robust pace, culminating in an 11-year high for May, as mentioned earlier in this report.

After being in negative territory for most of last year and early this year, the BNZ – BusinessNZ Performance of Services Index (PSI) has moved back into positive territory for the second consecutive month.

The PSI for May was 56.1. (A PSI reading above 50.0 indicates that the service sector is generally expanding; below 50.0 that it is declining). Although this was down 5.1 points from its highest ever result in April, it was still above its long-term average of 53.9.

The drop in the level of expansion for May was not unexpected, given the significant level of activity seen in April and that also needs to be viewed in the context of the significant negative results for long periods over 2020.

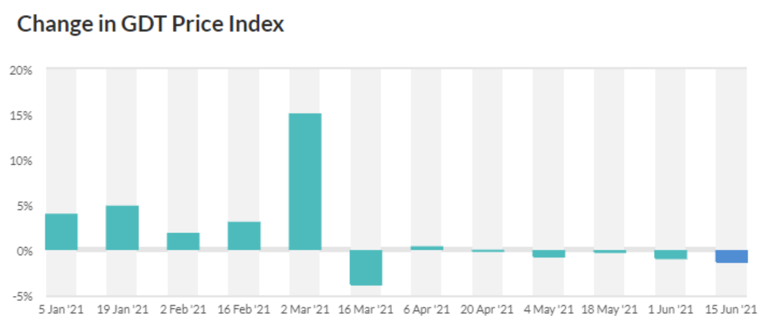


New Zealand continues to follow global trends with strong New Orders/Business (62.1) and Activity/Sales (58.7). However, Supplier Deliveries (45.1) remains solidly in contraction.

While the current strength in the PSI (and PMI) says goods things for economic growth over coming quarters, the obvious supply side stresses suggest significant upward pressure is building on inflation.

Meanwhile, agricultural sentiment has improved significantly from last year, likely driven by significant rises in commodity prices, with dairy at the front of the pack.

The Global Dairy Trade (GDT) has remained at very high levels despite some slight decline in prices over more recent months after a number of significant rises earlier this year (see below).



Source: Global Dairy Trade (GDT)

But improved agricultural sentiment notwithstanding, there is significant concern in the agricultural community and the mineral extraction sector over the potential impact of some aspects of freshwater reform which will adversely affect the ability to use land in an optimal manner. How climate change policy proposals will affect the agricultural sector in terms of required emission reductions will also be exercising the minds of the sector's leaders.

The construction sector is showing real strength as stated earlier, with a record number of building consents and a particular focus on the Government's massive infrastructure spend down the track. The outlook for construction looks positive both in respect to residential building and the Government's recently announced large infrastructure investments.

While construction growth increased by 6.6 percent over the March quarter 2021, this should not be seen as the sector not facing constraints in terms of both labour and the supply of raw materials. Numerous blockages prevent building work from coming to fruition and current supply chain issues are greatly affecting the ability to build at pace and on time.

Despite solid improvements in all the above sectors, some are still doing it tough, and will do so until the border is largely reopened – at best early next year.

The impact of the lack of international inbound tourists on tourist-dependent towns is still being felt. While domestic tourists have been out and about, they are no substitute for inbound tourists' deep pockets.

Tourism jobs took a pounding over the last year as for all intents and purposes international tourism slowed to a trickle despite some upswing with the Australian bubble providing some relief.

The retail sector remains a mixed bag with some upswing over the March quarter 2021, after the drop-off experienced last year.

Quite a few retail shops have closed and/or moved increasingly online resulting in increased retail space becoming available, particularly in CBDs. Alongside this, there has also been an increase in available office space as companies have restructured and employees have continued to work from home to some degree.

1.4 Labour market – better than expected

Perhaps surprisingly, the labour market has performed much better than previously anticipated.

Unemployment fell to 4.7 percent in the March quarter 2021 according to the Household Labour Force Survey (HLFS) while business opinion surveys show a growing number of businesses indicating they intend to take on staff in the near future. Where they will get such staff remains a moot question, but signs are that businesses are starting to ramp up activity again, including greater investment in plant and equipment. In this respect, it appears unemployment peaked to 5.2 percent last September and forecasts are for the rate to drop further out to June 2023 as can be seen below.

While NZ's current aggregate unemployment rate is something to celebrate, the headline rate does tend to mask the impact Covid-19 has had on specific sectors. Furthermore, the number of people considered as underutilised, as indicated by the Household Labour Force Survey (HLFS), is still concerning.

And significant concerns remain about employers' inability to source skilled labour from overseas allowing projects to proceed and providing labour to ensure seasonal activities, particularly in the agricultural and horticultural sectors, can be undertaken.

Accordingly, a greatly reduced ability to source labour from overseas is affecting productivity as there are fewer skilled people in NZ able to do not only specialist, but other necessary tasks. Net migration has effectively reduced to a trickle, limiting the ability of many seasonal operations dependent on foreign-sourced labour to operate as effectively and efficiently as in the past.

It is important for policy makers to understand the contribution migrant employees make to the NZ economy and to individual sectors. These skills cannot, in many, if not most, cases, simply be replaced by employing NZ citizens made redundant from their current employment or from long-term unemployed.

In an interesting move, it is noted that the Government in its May Budget, outlined a proposal to develop a social insurance scheme to assist those made redundant with some suggesting it could be modelled on the ACC scheme (which relates to work, non-work and motor vehicle injuries). While the details of the proposed scheme are still in their infancy, there will be many important issues to be worked through, including funding mechanisms, before such a scheme can get up and running. However, the Minister of Finance seemed reasonably positive that a scheme of this kind will be in place sooner rather when questioned on the matter by commentators at the Budget lock-up last month.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Jun 21	Jun 22	Jun 23
Highest	4.9	4.5	4.2
Average	4.7	4.2	4.0
Lowest	4.6	3.8	3.9

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – drifting up

Forecasts below show labour cost increases will likely be subdued over the forecast period although some increases are expected.

Nevertheless, a relatively modest growth in forecast wage rates in aggregate over the forecast period tends to mask significant gains for specific sectors and individuals within sectors. The inability to source skilled immigrants from overseas may see some job hopping as businesses compete to obtain required expertise from a diminished pool.

The impact of impending regulatory cost increases also needs to be thrown into the mix of factors driving changes in labour costs. While overall, the proposed reforms may result in increased wage rates for some, they will, on the other hand, result in reduced job opportunities for others, if not actual job loss. The Government needs to recognize the need for flexible labour market practices that allow individuals and companies to agree arrangements best suited to their individual circumstances. Moves back towards more centralised wage bargaining do not take account of the unique pressures facing particular companies in particular markets.

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

	Years Ending		
	Jun 21	Jun 22	Jun 23
Highest	2.1	2.6	2.4
Average	2.0	2.3	2.3
Lowest	1.9	1.9	2.2

Source: ASB, BNZ, Kiwibank and Westpac