BUSINESS NZ

PLANNING FORECAST

MARCH 2024

BusinessNZ

NZ Economy: Filling in the potholes

Executive Summary

While the economy is starting to get back on the road, there are still a number of potholes which remain for unwary travellers (Government, businesses, and households).

While there has been a strong and continued renewal of business confidence, and a government seemingly committed to cut through the regulatory and fiscal burdens New Zealanders currently face, it will be long journey before economic growth rates start to move upward significantly.

On the positive side of the ledger, the Government has got out of the blocks in a rush to remove some of the regulatory burden stopping businesses getting on with business, while attempts to fast-track much needed infrastructure will be a shot in the arm and welcome move by both businesses and households alike.

The (almost) forgone conclusion that the Reserve Bank has reached the peak of its OCR hikes and moves by some banks to ease longer term mortgage rates will be of some comfort to those stretched householders who have been or will be under the pump as fixed term mortgage rates come up for renewal. Notwithstanding, non-tradeables (domestically generated) inflation remains a concern with a number of significant hikes in train, such as local government rates and insurance premiums to account of greater natural disaster risk.

World commodity prices have generally improved over the last few months with higher prices for agricultural commodities a welcome boast for the agricultural sector who have been facing dual pressures of lower commodity prices and significant rises in regulatory burdens over the past year.

Significant rises in net migration over the past year has provided some relief for many stretched businesses, although sourcing appropriate labour is still an issue for some businesses. On the one hand, higher net migration levels are having a positive impact on the supply of labour and labour market outcomes. But on the other, it will boost demand for many goods and services (and housing), putting further pressure on NZ's already stretched infrastructure and potentially adding to non-tradeables inflation.

Despite the generally positive signs mentioned above, there are many sectors still doing it hard.

Construction activity remains subdued with building consents continuing to trend down. Greater certainty is required with a future pipeline of work if the construction sector is to have confidence to expand.

Both the manufacturing and the services sectors remain in the doldrums, while the retail sector continues to face pressures as seasonally-adjusted retail sales volumes have continued to retreat over the last eight quarters.

Tourism and hospitality remain mixed with the return of international tourists towards more normal (pre-Covid) levels being very positive, while on the other hand, the NZ domestic population has tended to put their wallets away as the cost-of-living crisis continues to squeeze budgets.

At the international level, the picture is mixed and increasingly complex with a number of global challenges continue to restrict overall global growth, including: (1) ongoing inflationary pressure and geopolitical tensions which are also impacting on trade routes and supply chains, adding to shipping delays, (2) lower growth rates in China, and (3) the move by key international powers are making towards greater nationalism. All these issues directly or indirectly affect NZ given this country's heavy economic dependence on trade.

HIGHLIGHTS

Higher levels of business confidence over recent months has yet to be reflected in higher output with economic growth rates subdued over the forecast period.

The companies reporting season has basically ended with mixed results but generally showing lower profitability for many large companies, with around two-thirds of listed companies reporting less profitability compared to the previous six months.

Meanwhile, world growth is expected to be modest over the next few years with concern about ongoing inflationary pressure, higher cost of capital, geopolitical tensions and greater moves towards nationalism stunting growth.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) is up marginally for the March 2024 quarter and sits at 4, up 2 on the previous quarter, and up 1 on a year ago.

Both the BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI) have generally struggled over the past year. The latest PMI result for February is still in negative territory while the PSI has returned to positive territory for the first two months of 2024.

International commodity prices have generally improved of late. However, producers are still burdened by high input costs which are eating away at profitability, although the agricultural sector will likely be heartened by announced moves by current Government to take an axe to unnecessary regulations.

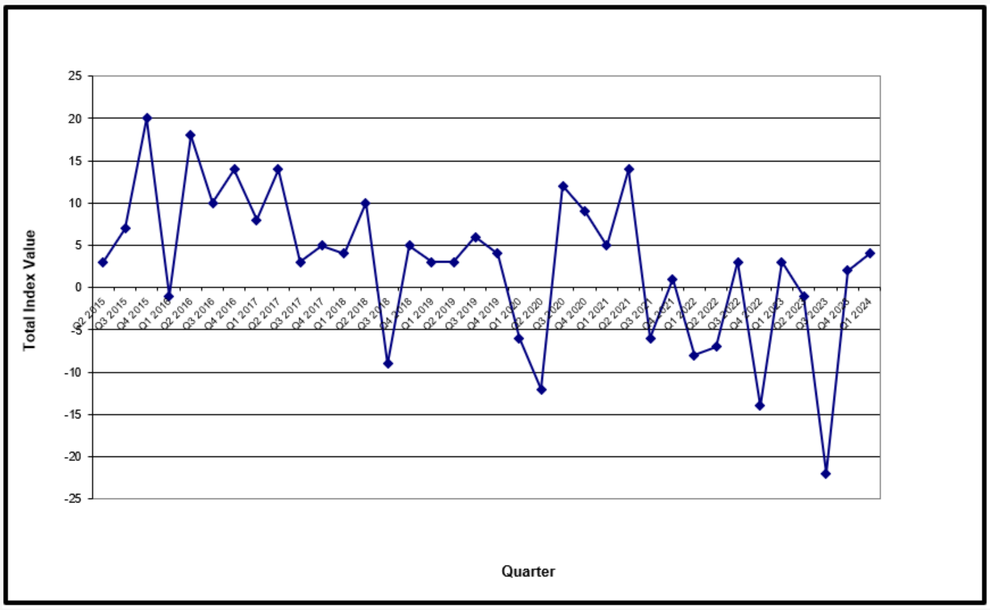
Other activity indicators, such as retail sales, building consent numbers and freight movements, point to a continuing sluggishness while consumer confidence remains downbeat on the back of continued inflation and the likelihood that interest rates will remain at elevated levels for longer.

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

BusinessNZ Economic Conditions Index (ECI)

The overall BusinessNZ Economic Conditions Index[1] (a measure of NZ's major economic indicators) sits at 4 for the March 2024 quarter, an improvement of 2 on the previous quarter and an improvement of 1 on a year ago.

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 5 for the March 2024 quarter, an improvement of 6 on the previous quarter and an improvement of 2 on a year ago. Higher international commodity prices and an improvement in international tourist numbers are providing a more positive story for NZ's terms of trade.

Monetary policy/pricing indicators sit at 1 for the March 2023 quarter, a deterioration of 2 on the previous quarter but an improvement of 4 on a year ago. While inflationary expectations continue to decline, non-tradeables (domestically generated) inflation continues to cause concern while geopolitical risks are impacting of global shipping costs.

Business/consumer confidence indicators sit at 3 for the March 2024 quarter, an improvement of 2 on the previous quarter and an improvement of 2 on a year ago. While business confidence has increased significantly since the third quarter of last year, consumer confidence remains stuck at low levels with rising interest rates and inflationary pressures impacting on consumer spending.

Labour market indicators sit at-5 for the March 2024 quarter, a deterioration of 4 on the previous quarter and a deterioration of 7 on a year ago. While high levels of net migration have taken some of the pressure off the labour market, tough trading conditions will continue to result in reduced employment growth and associated rises in unemployment.

[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 March quarter 2024 are estimates based on available information to date.

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

1.1 Economic growth (GDP) – slow grind

Economic growth is forecast to remain mediocre over the forecast period out to March 2026 (see forecasts below) although there is some light at the end of the tunnel.

Business confidence remains at relatively high levels after being firmly in negative territory over the 2020-2023 period. The improved confidence shown by the business community is likely to be driven at least partly by a new Government intent on trying to ease the regulatory burden facing businesses and allowing them to get on with the job of growing the economy.

There are some other indicators that will also be driving improved business confidence, including but not limited to: (1) inflation having peaked, with some recent marginal declines in bank borrowing costs, (2) net migration numbers at an all-time high taking some of the pressure off the labour market while adding to consumption. This is a two edged sword given increased pressures in inflation, particularly in respect to rental accommodation and housing more generally, (3) higher commodity prices which is certainly a boost for the agricultural sector and regional NZ, (4) the Government's pursuit of removing unnecessary regulatory barriers across the economy as a whole, and (5) the introduction of resource management fast tracking (Fast-Track Approvals Bill) which is intended to reduce the delay in getting new and necessary infrastructure consented.

Despite improving business confidence there are still some key risks and challenges facing the NZ economy when it comes to improving growth prospects over the next few years. As a small island nation, NZ is heavily dependent on world trade with the international economy playing an important role in terms of NZ's overall economic well-being.

NZ faces some ongoing head winds in respect to growth prospects with geopolitical risk in the international environment and governmental constraint domestically. The Government still needs to get Crown expenditure under control and peel back the raft of unnecessary and damaging regulation, while at the same time funding necessary infrastructure and allowing households to keep more of their hard-earned wages through the provision of personal income tax cuts (which are likely to be finalised in the upcoming May Budget).

At the international level there are numerous risks which directly or indirectly on NZ's standard of living and growth. Heightened geopolitical risks are likely number one on the agenda with both the ongoing Russian invasion of Ukraine and the Gaza war having the potential to spill over into wider conflicts. Putting aside for a moment the tragic loss of human life in both conflicts and the infrastructure damage caused, the impact on NZ is being immediately felt in respect to concern about shipping routes and associated costs which ultimately flow back to producers in the form of lower returns (despite rises in international commodity prices). Global shipping prices are generally trending higher as problems traversing the Suez Canal as a result of attacks on shipping (and the Panama Canal as a result of drought conditions) are making journeys longer and more expensive.

Second, and partially linked to the above conflict is the move internationally towards more isolationist policies and nationalism than has been the case for at least three decades - if not more. Greater protectionism in general means higher input costs for the many goods and services NZ needs which is ultimately reflected in cost pressures facing the final consumer.

Thirdly, given NZ's reliance on China as our major trading partner we are heavily dependent on that economy's growth in order to maximise returns to NZ producers. In this respect, China's relatively subdued economic growth prospects post-covid (by China's standard) does not bode well for NZ over the medium term. China's inbound foreign direct investment is down significantly from previous years and some reports suggest it is at its lowest level since 1990.

According to the International Monetary Fund (IMF) World Economic Outlook Update (January 2024), global economic growth is projected at 3.1 percent in 2024 and 3.2 percent in 2025, with the 2024 forecast 0.2 percentage points higher than in the October 2023 World Economic Outlook.

The main drivers for the slightly improved outlook take account of greater than expected resilience in the United States, and several large emerging markets and developing economies, as well as fiscal support in China.

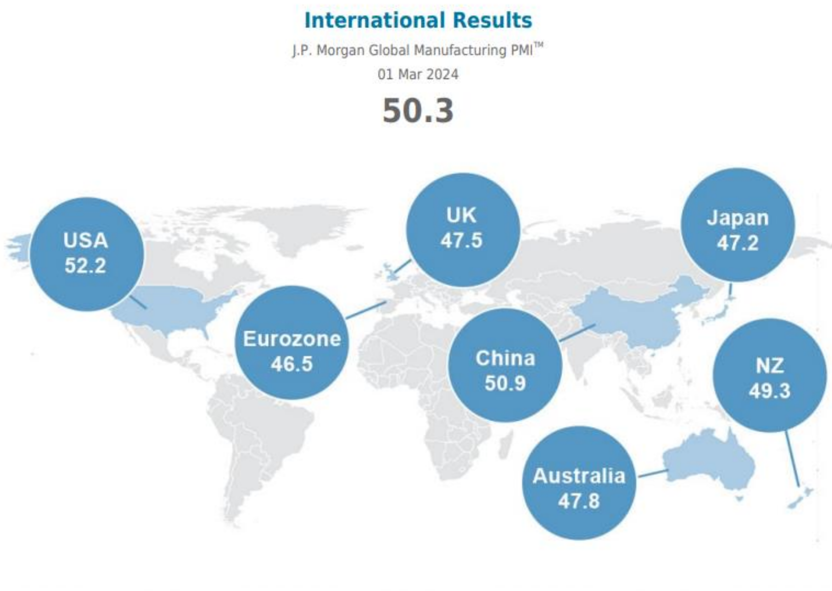
The forecast growth rates are still significantly below the historical long-term average on account of higher interest rates as central banks continue to fight inflationary pressures, and a withdrawal of fiscal support given high levels of debt in many countries which is weighing down economic activity.

Source: IMF World Economic Outlook Update (January 2024)

Meanwhile globally, manufacturing activity is starting to improve.

The JP Morgan Global Manufacturing PMI was back in the black for February (50.3) the first time since August 2022 (with the January 2024 result being neutral).

Although the rate of expansion is only mildly positive, it has been trending towards an improvement which is the main thing.



On the domestic scene, the Government faces tough decisions in respect to getting its books back in the black with deficits forecast for the next several years. The Government books are arguably in a more serious position than earlier thought after the uncovering of numerous unfunded policies from the previous Government became increasingly apparent although compared to many other countries, NZ's debt levels remain relatively low. Notwithstanding, increased debt levels over the past three years and higher interest rates are adding significantly to the cost of servicing Government debt, with the bill expected to increase to around $10 billion in 2025. There is no free lunch here.

The difficulty is getting back to surplus after the blow-outs in expenditure largely as a result of the large fiscal expansion as a direct result of Covid. Often getting back to 'normal' (small budget surpluses) is increasingly difficult as businesses and households become dependent on various forms of subsidies and handouts.

Given weaker growth, it is possible that the Government may not be able to achieve National's pre-election promise to get the Government's books back into surplus by the 2026/27 fiscal year. Weighing on the Government's mind will be the potential for less tax collected given the relatively sluggish growth experienced over the past year or so, along with forecasts of relatively slow growth going forward. Moreover, there are multiple demands on the Government's purse as much needed infrastructure needs to be funded, while the Government is more-or-less committed to providing long overdue personal income tax cuts to hard-working New Zealanders. There already appears to be a shortfall in the ability of the Government to fund its roads of national significance, with the Government looking at new ways to plug the gaps.

While the Government's commitment to reduce public expenditure is a very worthy objective it will, at least in the short-term, have implications in respect to demand for those regions with high levels of taxpayer funded employees – such as Wellington.

Meanwhile, ongoing inflationary pressures has resulted in real incomes being eroded as individuals have tended to move into higher income tax brackets without any indexation of tax bands (commonly called fiscal drag by economists).

Households are also slowing consumption expenditure in light of the cost-of-living crisis which will reduce demand for general good and services with new spending statistics from StatsNZ showing the effects of the cost—of-living crisis on households' budgets.

The latest household expenditure data shows that housing costs and household utilities were the biggest single expense, at 24.9% of the average household's spending. Food costs took up 18.7% of the average household's expenditure and transport 15.7%. Significantly, food spending was up 28.1% from four years earlier.

As a result of increased expenditure on core essentials, discretionary expenditure has tended to decline in relative terms such as cutbacks in motor vehicles, international travel, domestic holidays and non-essential household appliances and furnishings. Such reductions in discretionary spending are being reflected in retail sales volumes with successive seasonally adjusted declines evident over the past eight quarters to December 2023.

Forecasts: Real GDP percent Growth

	Years Ending		
	Mar 24	Mar 25	Mar 26
Highest	0.8	1.8	3.0
Average	0.4	0.7	2.1
Lowest	0.1	-0.3	0.8

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary Policy – renewed focus on inflation

The Government wasted no time in introducing and passing legislation to narrow the Reserve Bank's mandate to price stability.

The focus on price stability is sound, given the potential for a dual mandate (price stability and maximum sustainable employment) to be potentially in conflict at various points in time.

The sole focus on price stability is one which BusinessNZ has promoted consistently over the years and is the best contribution that the Reserve Bank can make to monetary policy and the wider economy.

Hopefully, going back to a single mandate will remove any element of doubt that the Reverse Bank should be totally focused on inflation over time which is also reflected in its new remit in respect to the actions of the Monetary Policy Committee (MPC) when setting the Official Cash Rate (OCR).

Inflation – expectations continuing to decline (slowly)

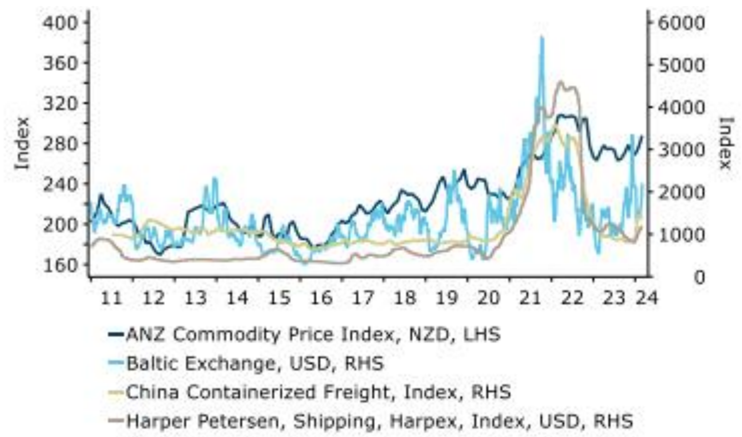
There was little surprise by most commentators when the Reserve Bank decided to retain the OCR at 5.5 percent at its latest review. While a few analysts considered that there was a chance of a further rise (or even two) in the OCR, the Reserve Bank in the nicest possible way has implied that there will be no further rises unless extraordinary circumstances unfold.

While inflation has peaked, there is still a significant risk of it remaining elevated. As the inflationary expectations of both businesses and consumers remain at worrying levels with the Reserve Bank stating that inflation is unlikely to be within its target (1-3%) band until later this year. Even then, this would seem to be a stretch given the number of factors, both domestically and internationally, that are still impacting on inflation.

The CPI results for the December 2023 tended to give a little bit of false hope on the inflation front with tradeables inflation coming in quite low which does not necessarily reflect what has gone on since those results were released. Commodity prices have tended to increase since that time, while international shipping costs have increased significantly in light of both the conflict in Gaza and attacks on shipping in the Suez Canal alongside drought conditions which is impacting on the operations of the Panama Canal. Both these disruptions are seeing journeys longer and more expensive.

The latest ANZ Commodity Price Index (see below), shows that the Baltic Dry Index shot up in February although it still remains well below the levels attained during the Covid pandemic when global shipping was severely disrupted. The ANZ also noted that New Zealand's smaller exporters are more exposed to the recent changes in shipping costs as they rely on gaining space on container ships, as opposed to having long-term contracts directly with the shipping providers or having the scale to utilise charter ships.

ANZ Commodity Price Index and shipping costs



Source: Baltic Exchange, Harper Petersen & Co., Shanghai Shipping Exchange, Macrobond, ANZ Research

While there is little if anything that NZ can do to materially influence tradeables inflation, non-tradeables inflationary pressures (domestically generated) are arguably more problematic and to some extent can be controlled by good policy.

A number of factors are continuing to affect non-tradeables inflation which are briefly outlined below.

First, NZ's move to reduce carbon emissions to meet its international obligation of net zero by 2050 will necessarily involve increasing costs to some sectors, at least initially, as dearer alternatives to fossil fuels are developed over time, likely adding to inflationary pressure during the decarbonisation process.

Second and more immediately, we have seen a significant surge in net inward migration levels (around 125,000) over the last year. While positive in terms of taking some of the pressure off the labour market, this is a large number of people and will both affect housing demand and add to the demand for goods and services more generally.

Third, insurance costs will likely continue rising rapidly as a result of increased risk with a number of insurers likely to increase premiums on housing and cars by between 20% and 30% on an annual basis.

Fourth, households face significant local government rate rises (some up at around 25%) as Councils try and balance their books in the face of increased infrastructure investment costs e.g. water infrastructure.

Fifth, the massive infrastructure deficit will take both significant resources and money to get back into some sort of shape where NZ can feel like a first world country again. This will eventually put upward pressure on prices unless a clear pathway of activity is understood in a timely and systematic fashion, taking account of the various pressures at play.

On the other hand, there are continuing downward pressures on inflation with high levels of net migration taking some of the heat out of the labour market, while households shut their wallets and change consumption activity in light of the cost-of -living crisis.

Overall, the conclusion is that while inflationary pressures are starting to get under control, they are a long way from being dead and buried. Both tradeables and non-tradeables inflationary pressures still lurk below the surface, but inflationary pressures are now much more balanced than they were a few short months ago.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Mar 24	Mar 25	Mar 26
Highest	4.3	2.8	2.4
Average	4.1	2.5	2.1
Lowest	4.0	2.2	2.0

Source: ASB, BNZ, Kiwibank and Westpac

Interest Rates – on hold for now

There is much talk, but differing views, on when the Reserve Bank will start cutting interest rates. Some suggest that there will be several cuts later this year, while others predict that it will be well into next year before any material drop is noticed by businesses and households.

There are strong rational arguments that can be made for keeping interest rates at existing levels for a significant period of time, just as there are similarly credible arguments for reducing them soon.

Given both international uncertainty and domestic pressures, it is likely that the Reserve Bank will take a very cautious approach to lowering the OCR until they are well and truly certain that the inflation genie is back in the bottle. They have been burnt before, so will not want to fuel expectations of any easing which could exacerbate moves by banks to cut rates prematurely.

In this respect it is noted that some banks have already slightly adjusted mortgage rates down, although this is very much marginal stuff at this stage. Holding rates is generally the name of the game currently.

Many households are also yet to feel the full effects of rising interest rates, given a general propensity to have 2-3 year fixed mortgages with the real impact of the Reserve Bank's hikes in the OCR over 2022 and the first half of 2023 yet to flow through.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Mar 24	Mar 25	Mar 26
Highest	5.7	5.3	4.3
Average	5.6	5.0	3.6
Lowest	5.6	4.8	3.2

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – interest rates underpinning NZ dollar

Most international central banks are keeping their monetary policy rates on hold but there is a possibility that other countries may reduce interest rates faster than NZ. So the likelihood is that at least over the short-term, there will be some slight upward pressure on the dollar.

Commodity prices for NZ's traditional exports are also improving. With NZ dollar fortunes heavily tied to commodity prices, that might also act to keep the NZ at current level – if not slightly higher.

Furthermore, what is generally considered by many to be a more 'business-friendly' government in NZ, may have some impact on the direction of the NZ dollar.

On the other hand, the Government's current account deficit remains a cause for concern (although projected to continue to improve). The balance of payments (or current account, which measures inflows and outflows of payments associated with imports, exports, investment and debt servicing) essentially tracks whether NZ is paying its way in the world.

Finally, given the geopolitical risks in many international markets, there could to a tendency for investment to drift towards what many consider to be safer investment options such as the $US.

Overall, forecasting exchange rates is fraught at the best of times. International uncertainty just makes it so much harder.

Forecasts: Exchange Rates

	AUD (cents)		
	Mar 24	Mar 25	Mar 26
Highest	0.94	0.93	0.94
Average	0.93	0.91	0.91
Lowest	0.91	0.89	0.89

	USD (cents)		
	Mar 24	Mar 25	Mar 26
Highest	0.62	0.70	0.72
Average	0.61	0.65	0.68
Lowest	0.60	0.59	0.63

	TWI		
	Mar 24	Mar 25	Mar 26
Highest	72.2	75.4	77.4
Average	70.9	72.6	73.2
Lowest	69.9	71.1	69.9

Source: ASB, BNZ, Kiwibank and Westpac

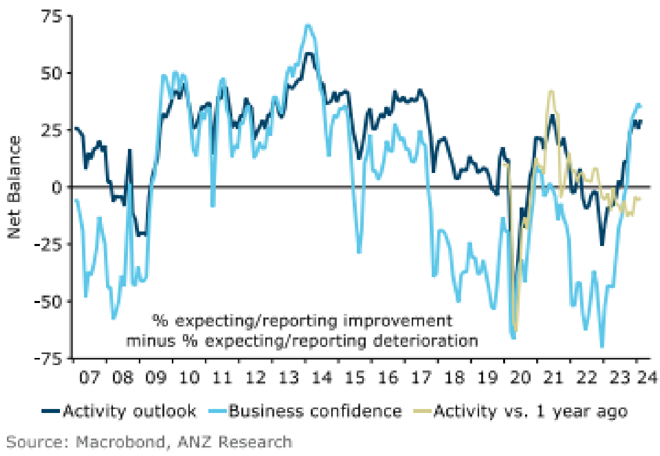
1.3 Business activity and confidence – Businesses more confident but not reflected in activity.

Business confidence is close to its highest level in a decade according to the ANZ Business Outlook, although high levels of confidence are not necessarily being reflected in many activity indicators – yet.

According to the ANZ Business Outlook for February 2024, business confidence eased 2 points to +35 from the previous month but businesses own measure of activity rose 4 points in February. Nevertheless, there appears to be some decoupling between expectations of future activity compared to actual current activity.

This might be reflected in the fact that many activity indicators across many sectors are still relatively subdued compared to business expectations of the future.

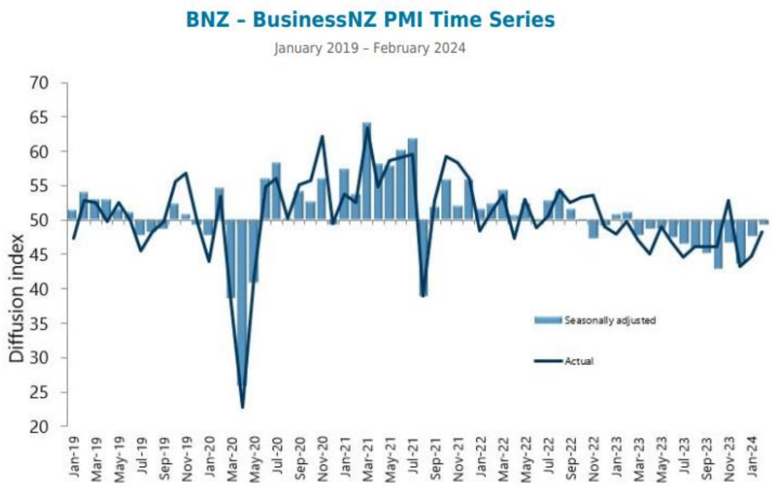
ANZ NZ Business Outlook



Across many sectors, the reality is that businesses are still doing it tough with a range of factors impacting on investment, profitability and sales.

The New Zealand's manufacturing sector remains in negative territory according to the latest BNZ – BusinessNZ Performance of Manufacturing Index (PMI) but is showing signs of improvement of late.

The seasonally-adjusted PMI for February was 49.3 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was up from 47.5 in January and the highest level of activity since February 2023. However, the sector has now been in contraction for 12 consecutive months.

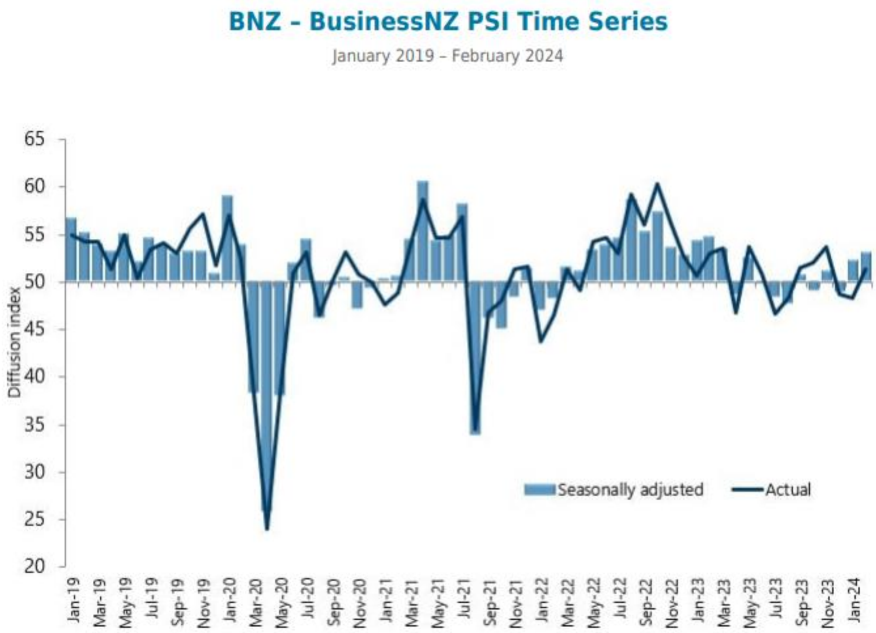


The key sub-index of production (49.1) was at its highest level since January 2023, while Deliveries (51.4) was at its highest point since March 2023. However, New Orders (47.8) has now remained in contraction for nine consecutive months and likely needs to get much closer to the 50-point mark to edge the sector back into expansion.

The proportion of negative comments in February stood at 62%, which was down from 63.2% in January but up from 61% in December. A lack of orders (both domestic and offshore) was mentioned by many respondents, as well as the general slowdown in the economy.

In contrast, the PMI's sister survey, the BNZ – BusinessNZ Performance of Services Index (PSI), continued its path of expansion in February.

The PSI for February was 53.0 (A PSI reading above 50.0 indicates that the service sector is generally expanding; below 50.0 that it is declining). This was up 0.8 points from January and the highest level of activity since March 2023. However, it was still just below the long-term average of 53.4 for the survey.



Three of the last four months has seen the sector in expansion, with the key sub-index results for both Activity/Sales (53.1) and New Orders/Business (56.0) remaining in positive territory for the current month. In fact, the latter was at its highest level of expansion since December 2022. Employment (49.1) remained in slight contraction, although the rate of contraction continues to decline.

The proportion of negative comments from businesses stood at 57.3% in February, compared with 53.0% in January and 58.7% for December. Respondents still saw the cost of living as the key determining factor on business activity, followed by difficult overall economic conditions.

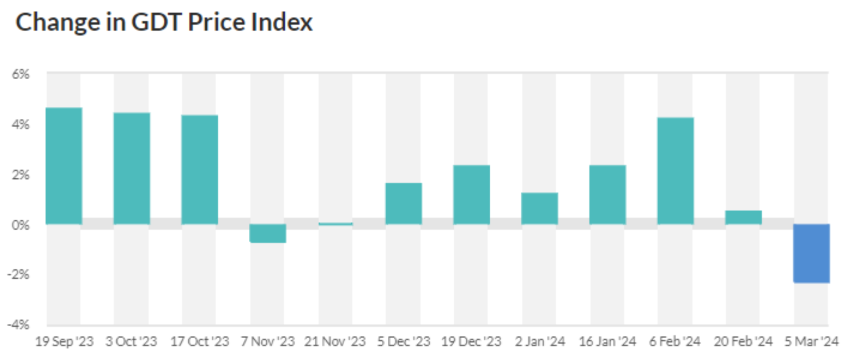
Meanwhile, other sectors remain mixed although confidence in the agricultural sector has lifted over the last six months, up from the historic lows in August 2023.

While farm confidence has recovered from last year's record lows, high interest rates and regulatory costs are still weighing heavily on farmers.

There are likely to be a range of factors that have improved farmer confidence of late, admittedly, still off a very low base.

Firstly, input costs, while still at elevated levels, have come off their highs.

Secondly, commodity prices for key agricultural products, including dairy (as reflected in both the Global Dairy Trade (GDT) have generally risen substantially over the last six months or so on the back of higher international demand. This has resulted in Fonterra recently upgrading their forecast payout to its suppliers.



The headline global dairy trade (GDT) index fell 2.3% at the most recent auction, the first drop since November last year after a run of seven consecutive gains which saw prices rise 12.8%. The headline GDT is now 27.8% above the low in August 2023.

Thirdly, many farmers will be breathing a sigh of relief as the Government moves towards addressing some of the more draconian regulations which would have impacted on the ability of farmers to operate efficiently.

BusinessNZ is pleased that the Government is actively reviewing the National Policy Statement (NPS) on Freshwater making it much more workable for farmers and others to operate in an efficient manner while ensuring that environmental issues are adequately covered within such regulations.

In respect to the NPS on Freshwater, BusinessNZ has a number of concerns with the current structure, including, but not limited to:

- The overwhelming objective of protecting the environment, with human drinking water second in the queue and economic development a distant third.
- The inability to make trade-offs between competing environmental and economic objectives with environmental bottom lines trumping important economic development, irrespective of the cost or benefit.
- Uncertainty surrounding freshwater allocation regimes and consenting/reconsenting paths with limited respect for upholding property rights to water and lack of any compensation where consents can be altered without any form of compensation.
- The difficulty in being freely able to transfer and trade water consents so they flow to their highest valued use is also severely constrained under current arrangements.

The government's decision to introduce the Fast-track Approvals Bill to Parliament, the purpose of which is to fast-track consents for regional and nationally significant infrastructure projects may well be a shot in the arm for the agricultural sector, particularly in respect to the potential development of large water storage for irrigation.

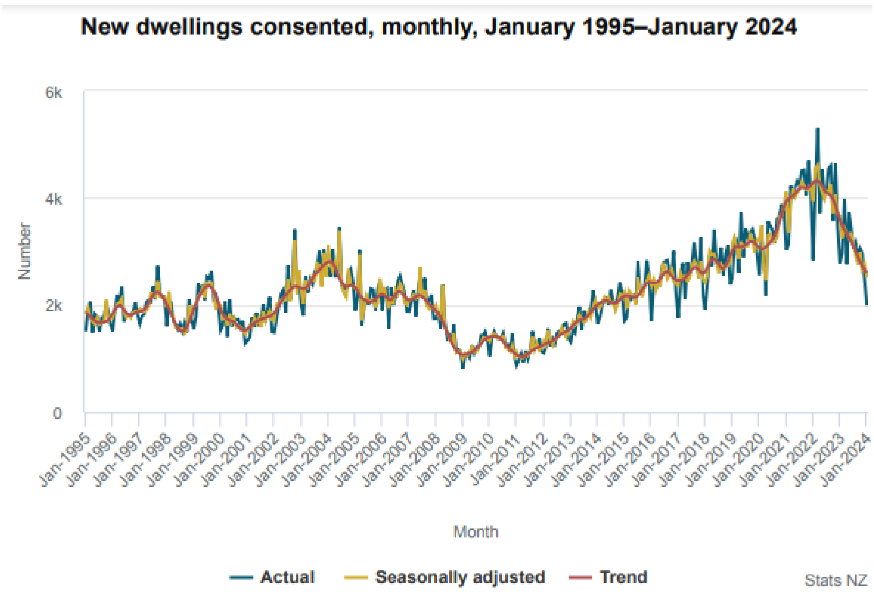
The construction sector continues to face head winds with building consents continuing to fall.

There were 1,991 new homes consented in January 2024, down 28 percent compared with last January. On an annualised basis, the number of homes consented was down 26 percent.

More positive for the construction sector, was the seasonally-adjusted volume of non-residential building work in the December 2023 quarter which was $3.1 billion, up 4.6 percent compared with the September 2023 quarter. The seasonally adjusted volume of residential building work was $5.6 billion, down 2.4 percent over the same period.

The rise in non-residential building work effectively offset the decrease in residential work which led to total building activity being flat for the December 2023 quarter.

The decline in residential building activity and also the continuing ongoing drop in consent does not bode well towards addressing the significant shortage of houses in NZ, with the influx of around 120,000 migrants over the last year needing accommodation which is both forcing up rental accommodation prices – and potentially housing prices more generally.



House sales and prices have tended to pick up somewhat of late although there are significant factors impacting on house prices including higher mortgage interest rates which is constraining the ability of many to even purchase housing with many households becoming under increased strain of mortgage defaults.

The Reserve Bank (RB) is also concerned about the potential financial risks of highly levels of housing debt and recently released a Consultation Paper proposing a package of changes to the Reserve Bank's macroprudential policies, including the activation and calibration of Debt-to-Income (DTI) restrictions on residential mortgage lending.

BusinessNZ, in its submission to the RB does not believe there is a strong case for introducing DTI limits given banks already have significant commercial incentives to stress test loans and ensure that defaults on loans are minimised. DTI also disregards the many factors which a bank will consider when assessing the capacity of a borrower's creditworthiness. Stress tests of banks conducted by the RBNZ have repeatedly shown that banks are resilient to even severe house price shocks and sharp increases in the rate of unemployment.

The tourism sector is showing reasonably strong signs of growth with international tourists coming to NZ getting back to somewhere around pre-Covid levels which is resulting in an improvement in New Zealand's service trade deficit with the services trade deficit narrowing to around $700 million in the December 2023 quarter compared with $2.1 billion in the December 20022 quarter.

The main contributor to the narrowing of the deficit was an increase in travel exports, which increased 44 percent compared with the December 2022 quarter to $3.7 billion. (Travel exports represent the amount spent by visitors in NZ during the period).

Travel exports continue to rise as international travel patterns slowly return to normal and although there were a lot more visitors arriving by plane and cruise ships, we are still some way from seeing pre—Covid levels of visitation.

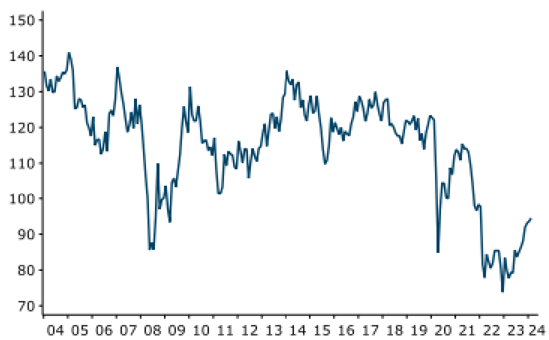
While this is good news for tourism operators, NZ resident tourists are proving to be a different prospect, with people increasingly restricted to local activities and events given the financial pressure households are currently under. Consumer spending habits are also under scrutiny with greater expenditure on essential items such as food as opposed to what are considered more discretionary activities, such as tourism.

The retail and hospitality sectors are still impacted by low levels of consumer confidence, with households under serious financial pressure as a result of the cost-of-living crisis and a slow but steady rise in unemployment levels. The general level of prices across the board is continuing to constrain net disposable incomes, while significant interest rate rises over the last 18 months are now starting to affect the incomes of households with high levels of debt. Debt servicing as a percentage of household incomes is really ratcheting upwards after a long period of relatively low servicing costs.

It is not surprising in light of the above constraints on consumers that the ANZ-Roy Morgan NZ Consumer Confidence survey shows, as do most other consumer confidence surveys, that consumer confidence remains subdued, despite some slight improvement of late.

ANZ-Roy Morgan consumer confidence rose 1 point in February to 94.5, but this is still a very subdued result compared with the long-term average. The latest increase was driven by perceptions of future conditions.

The ANZ-Roy Morgan NZ Consumer Confidence Survey



1.4 Labour market – mixed signals

Strong net migration inflows have taken much of the pressure off the labour market, while the Government has played its part by getting rid of some unnecessary regulatory barriers to businesses such as the so-called Fair Pay Agreement (FPAs) and reinstating the 90-day trial period for all businesses. Both measures by Government have been strongly supported by businesses, ensuring a more flexible and responsive labour market that more closely meets the needs of both employers and employees at the individual enterprise level.

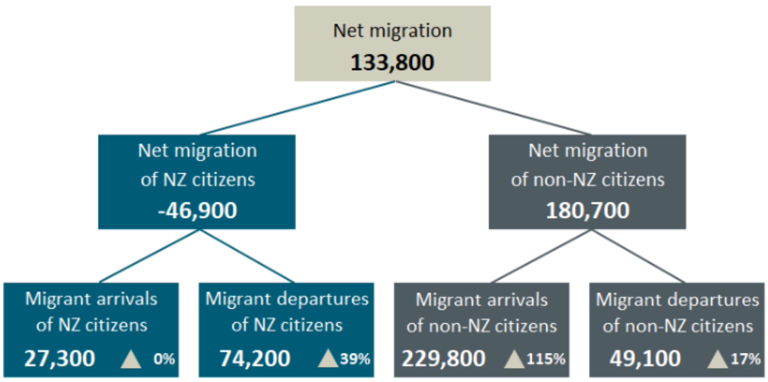
There is still more to be done in the labour market space at it is pleasing that the Minister for Workplace Relations has signalled that she wishes to clarify the boundary between contractors and employees while simplifying the Holidays Act will be welcomed by businesses both large and small.

One of the slightly hidden issues associated with the focus on high levels of net migration is the fact that the number of NZers going overseas continues to hemorrhage. The provisional net migration gain of 133,800 in the January 2024 year was made up of a net gain of 180,700 non-New Zealand citizens, which more than offset a net migration loss of 46,900 New Zealand citizens.

While part of this net migration loss of New Zealanders might well be the result of pent-up movements post-Covid – more concerningly is if it represents the loss of the youngest, best educated and brightest of the population, as this represents a significant loss of future human capital and, ultimately, has ongoing implications for New Zealand standard of living.

International migration estimates (provisional)

Year ended January 2024



Notes: Estimates are provisional as of 14 March 2024.
Percentage changes are indicative of the January 2024 year compared with the January 2023 year.

Source: Stats NZ

The latest Household Labour Force Survey (HLFS) for the December 2023 quarter came in somewhat stronger than many economists were predicted with a marginal rise in unemployment up to 4 percent, although expectations are for further rises in unemployment as the Government makes cuts to the public sector head count, which has grown strongly in many respects over the past six years.

A number of private sector business associations are reporting that private sector employers are also going through restructures which will likely result in job losses as businesses try and keep their head above water in an increasingly difficult operating environment.

This is reflected in reduced growth, sales and profits from many of NZ's largest listed companies.

The recent listed companies reporting season has basically ended with results mixed but generally lower profitability for many large companies with around two-thirds of listed companies reporting less profitability compared to the previous six months.

A worrying aspect is that more than half of the 189,000 New Zealanders on the Jobseeker benefit have received it for at least a year, data from the Ministry of Social Development (MSD) shows.

The latest MSD data from 2023 shows that there are around 380,000 people in NZ receiving a "main benefit" (an emergency, Jobseeker, sole parent, youth or supported living payment). Of these around 50% were on the Jobseeker benefit. It is acknowledged that the Jobseeker payment has two sub-categories: "work ready" – people who are looking or preparing for work; and those with a current medical condition or disability affecting their ability to work.

Given very low levels of unemployment over the last few years, it is important that there is targeted assistance to ensure that those ready and able to work can be reintegrated back into the workforce asap as the alternative – a life of benefit dependency is both going to place a strain on the Government's already strapped finances, while trapping people into long-term poverty, not a desirable outcome.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Mar 24	Mar 25	Mar 26
Highest	4.5	5.7	5.3
Average	4.4	5.3	5.0
Lowest	4.3	5.2	4.7

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – expectations need to moderate

Expectations are for labour costs to moderate over the medium term for a number of reasons.

Firstly, high levels of net inward migration has taken some of the white-hot heat out of the labour market.

Second, surveys have generally shown a marked easing in labour shortages, particularly in respect to unskilled labour. This easing in labour shortages should continue, both as a result of increased net migration and also because of a slowing economy in general acting to reduce further wage pressure on businesses, in turn, hopefully flowing through into reduced generalised inflationary pressure on the wider economy.

It is perhaps concerning in this regard that the latest ANZ-Roy Morgan Consumer Confidence Survey that consumer expectations of inflation have actually increased, which is somewhat surprising.

Thirdly, rising unemployment as the economy slows and restructuring takes place, will lower demand of some labour which ultimately will be reflected in more constrained wage/salary outcomes.

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

	Years Ending		
	Mar 24	Mar 25	Mar 26
Highest	4.2	3.4	3.2
Average	3.9	3.1	2.7
Lowest	3.6	2.6	2.4

Source: ASB, BNZ, Kiwibank and Westpac