BUSINESS NZ

PLANNING FORECAST

JUNE 2024

NZ Economy: Slow grind

Executive Summary

Economic growth is likely to remain mediocre over the forecast period (and negative initially on a per capita basis) as NZ still faces a number of headwinds both in respect to domestic activity but also international factors, which are largely outside of our control.

Slaying the inflation beast is proving harder than initially thought despite inflation, particularly tradeables inflation, having come back into line. Non-tradeables is still a different issue with inflationary expectations, while lowering significantly, still well outside the Reserve Bank's comfort zone of signaling any relief for long suffering mortgage holders - yet. Issues surrounding housing costs, rates, and insurance are still cost drivers that will keep non-tradeables inflation at the high end of the Reserve Bank's target band for some time yet.

Given the Reserve Bank's very questionable control of inflation over the past few years and expansionary monetary policy, they will be loath to ease the Official Cash Rate (OCR) without being very confident that inflation is well and truly back in the bottle.

On the bright side, there are a number of factors which will impact positively on the NZ economy over time. Business lending is up (despite an increase in the number of companies going into liquidation), world commodities are generally improving with the outlook for dairy generally improving of late, while input prices, including oil, are tending to trend lower of late. This is all good news for businesses and households who have faced unrelenting cost increases over the last 3-4 years. Nevertheless, international supply routes remain subject to continued disruption which is still holding up shipping costs for many international traders.

The recently released Budget by the Coalition Government reinforced the financial pressures that NZ is currently under. By and large it represented a balanced approach towards providing belated, and much needed, tax relief after years of real incomes being eroded by fiscal drag, while moves to boast regulatory reform initiatives will be welcome by the business community.

While there was also an understandable emphasis on delivering some of the Coalition Government promises, it was pleasing that it tended to be a "back to basics" budget without the fanfare and splashing of taxpayers' money around which has tended to be the case over recent years to appease various interest groups.

Businesses and individuals need to be unshackled from the burden of unnecessary regulations if we are to collectively grow the economic pie so that society can fund the necessary infrastructure, health, education and employment growth opportunities, that many New Zealanders desire.

The Minister for Regulation's announcement that regulation surrounding early childhood centres will be first cab off the rank for review should be welcomed by many New Zealanders – but this review should only be the start of many to come. Regulation comes with costs and benefits, and it is important that sound cost/benefit analysis underpins any regulation with an understanding that necessary trade-offs will be required in order for the NZ economy to grow to its potential.

In this respect, BusinessNZ is strongly supportive of recent moves by the Government to free up the use of resources and infrastructure development to help grow the economy, provided, of course, that there are appropriate constraints and balances in decision-making. A more welcoming approach to foreign direct Investment (FDI) is also required along with a better understanding of the need for balance between economic development and environmental protection based on sound cost-benefit analysis. Economic development will not always be compatible with environmental protection, so a balanced approach is required.

HIGHLIGHTS

The outlook for economic growth remains subdued over the forecast period.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) is at 3 for the June 2024 quarter, the same as the previous quarter, but up 4 on a year ago.

Both the BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI), remain sub-par.

International tensions, while still at elevated levels, have tended to stabilise somewhat, while commodity prices (dairy prices in particular) have generally improved of late. On the other side of the coin, oil prices have tended to decline of late which is good news in respect to input prices for producers. Both the European Central Bank (ECB) and the Bank of Canda (BoC) have started to ease interest rates with more central banks set to follow as inflationary pressures ease.

The agricultural sector, after being hammered by high input costs, will be pleased that on-farm inflation is coming down. According to Beef and Lamb NZ, annual inflation for the sector is around 2.8%, having previously been well into double digits on an annualised basis. Also, the Government's attempts to remove some of the more onerous regulatory obligations in the sector are welcome news. Notwithstanding these positives, the agricultural sector is still doing it tough with a return to profitability still some way off.

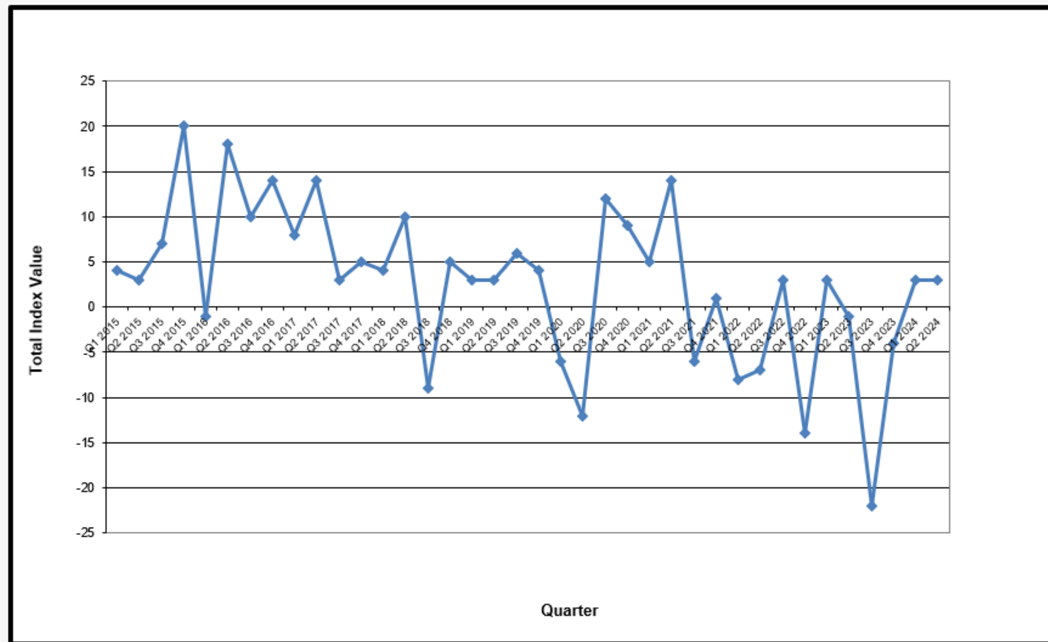
Other activity indicators, such as electronic card transactions, building consent numbers, and freight movements, point to continuing sluggishness while consumer confidence remains downbeat on the likelihood that interest rates will remain at elevated levels for longer. Combined with rising unemployment, households are baulking at committing to big ticket expenditures.

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 3 for the June 2024 quarter, the same as the previous quarter and an improvement of 4 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 7 for the June 2024 quarter, an improvement of 4 on the previous quarter and an improvement of 6 on a year ago. Generally higher international commodity prices (particularly dairy) and an improvement in international tourist numbers is providing some improvement to NZ's terms of trade.

Monetary policy/pricing indicators sit at 2 for the June 2024 quarter, the same as the previous quarter but an improvement of 4 on a year ago. While inflationary expectations continue to decline (particularly in respect to tradeables inflation), non-tradeables (domestically generated) inflation is expected to remain elevated for some time. Any interest rate relief is a while off yet despite slow economic growth.

Business/consumer confidence indicators sit at 1 for the June 2024 quarter, a decline of 2 on the previous quarter and an improvement of 2 on a year ago. Business and consumer confidence have both deteriorated after showing some signs of life late last year. However, on the positive side, business lending is up (despite an increased number of business liquidations). Consumer confidence indicators remain at low levels with rising interest rates and inflationary pressures impacting on consumer spending while rising unemployment is providing a damper on big ticket items.

Labour market indicators sit at-7 for the June 2024 quarter, a deterioration of 2 on the previous quarter and a deterioration of 8 on a year ago. NZ's productivity still remains a major concern for concern while tough trading conditions on the back of weak demand will continue to result in reduced employment growth and associated rises in unemployment over the near term.

[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 2024 are estimates based on available information to date.

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

1.1 Economic growth (GDP) – mediocre

Economic growth is forecast to be mediocre as can be seen from the forecasts below. When converted into growth on a per capita basis, NZ is facing negative growth.

While the global economic environment is showing some signs of improvement, although significant risks remain, the domestic environment is still facing considerable constraints to prolonged growth.

Dealing with the international outlook first:

On the positive side of the ledger, inflationary pressures are easing, which has resulted in a number of central banks starting to move to lower interest rates.

Central Bank	Current Interest Rate	Previous
Federal Reserve	5.50%	5.50%
European Central Bank	4.25%	4.50%
Bank of England	5.25%	5.25%
Reserve Bank of Australia	4.35%	4.35%
Reserve Bank of NZ	5.50%	5.50%
Bank of Japan	0.00%	0.00%
Swiss National Bank	1.50%	1.75%
Bank of Canada	4.75%	5.00%

Given that the NZ Reserve Bank appears to be some way off actively contemplating cuts in interest rates (and at the same time NZ's OCR is at the top end of countries that we generally compare ourselves to) the likelihood is that least over the short term there will be some slight upward pressure on the NZ dollar. While this is likely to be good news in respect to suppressing tradeables inflation, it will likely impact on exporters given that a higher dollar generally makes them less competitive internationally.

World oil prices have eased somewhat which is positive for NZ producers, particularly for agricultural-related production and sectors heavily dependent on transport.

World commodity prices for key NZ export products such as dairy have improved of late with expectations of further improvements over the forecast period. Nevertheless, risks remain, not least of all continuation of major conflicts (Ukraine and Gaza) while geopolitical tensions remain high in a number of other areas as well.

Unfortunately, with increased conflicts and tensions around the world, there has been a tendency for some major powers to reintroduce trade-protectionist policies alongside greater displays of nationalism.

This is not only the case in Europe but also elsewhere, including the US, with both President Biden and Republican contender Donald Trump advocating for increased tariff protectionism and tit-for-tat policies on trade.

According to the International Monetary Fund (IMF) World Economic Outlook Update (April 2024), global economic growth is projected at 3.2% in 2024 and the same in 2025. A slight acceleration for advanced economies where growth is expected to rise from 1.6% in 2023 to 1.7% in 2024 and 1.8% in 2025 – will be offset by a modest slowdown in emerging market and developing economies from 4.3% in 2023 to 4.2% in both 2024 and 2025.

The forecast for global growth five years from now – at 3.1% – is the lowest in decades.

On the positive side of the ledger, global inflation is forecast to decline steadily, from 6.8% in 2023 to 5.9% in 2024 and 4.5% in 2025, with advanced economies returning to their inflation targets sooner than emerging markets and developing economies.

Source: IMF World Economic Outlook Update (April 2024)

The IMF also stated that the global economy has been surprisingly resilient, in light of significant central bank interest rate hikes over the last couple of years to restore price stability.

The IMF considers that the risks to the global outlook are now broadly balanced. On the downside, new price spikes stemming from geopolitical tensions, including those from the war in Ukraine and the conflict in Gaza, could, along with persistent core inflation where labour markets are still tight, result in a rise in interest rate expectations and reduce asset prices.

In China, without a comprehensive response to the troubled property sector, growth could falter, hurting trading partners. High levels of debt in many countries could result in a disruptive return to tax hikes, and spending cuts could undermine confidence. Given China is NZ's largest trading partner (with around 30% of our dairy produce), a slowdown in China would be detrimental to NZ producers.

On the upside, expansionary fiscal policies with looser fiscal policy than necessary could support short-term growth, although there are consequences with more costly policy adjustments required over time.

The Organisation for Economic Cooperation and Development (OECD) is also forecasting similar growth for the global economy according to its latest Economic Outlook (May 2024).

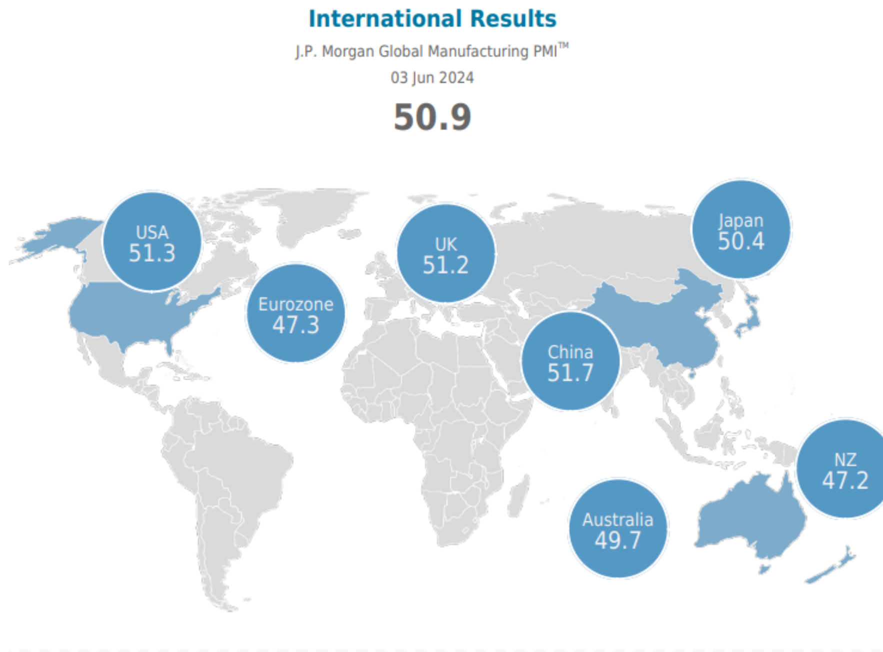
The OECD lays out a series of policy recommendations in its outlook, highlighting the need to ensure a durable reduction in inflation, establish a budgetary path that will address rising fiscal pressures and undertake reforms that improve prospects for medium term growth.

The OECD said that stronger policy action is required to boost investment and enhance skills development and intensify innovation, to drive technological progress and productivity growth and boost employment.

Meanwhile, globally, manufacturing activity is starting to improve.

The JP Morgan Global Manufacturing PMI gathered pace in May (50.9) with the rates of expansion in output and new orders both strengthening. The index has now remained above the neutral 50.0 mark for the fourth successive month. Signs of recovery were broad-based by nation, with output growth accelerating in the US, China and the UK, while rates of contraction eased in Japan and the euro area.

The latest expansion of worldwide manufacturing output was underpinned by rising intakes of new businesses, completion of backlogs of work and improved international trade flows.



As can be seen from the results above, New Zealand is currently lagging the pack.

The NZ Outlook

Key NZ economic indicators do not look pretty at present. Negligible economic growth (significantly negative when measured on a per capita basis), dismal productivity growth, rapidly rising debt and associated borrowing costs as a result of expenditure blow-outs over the last few years, and interest rates which will remain higher for longer as inflation levels, particularly non-tradeables (domestic inflation – e.g. rents, insurance and rates) continue to remain sticky and defy the Reserve Bank's efforts to get the inflation genie back in the bottle. Throw into the mix the record number of Kiwis exiting New Zealand (particularly our youngest and brightest) to Australia, meaning NZ is losing some of its most productive human capital.

These sobering economic indicators are being reflected in numerous business and consumer opinion polls where pessimism persists, with many New Zealanders facing a cost-of-living crisis while businesses are constrained in their ability to grow the economy through the development of infrastructure and use of natural resources, because of regulatory barriers which have grown unabated over recent years.

Budget 24

Budget 2024, which was declared by the Government to be a *Fiscally Responsible Budget*, (although it can be argued that was hardly fiscally responsible given the increased borrowing required over the forecast period) was delivered against a backdrop of overall economic conditions NZ has not experienced for a long time – possibly since the Global Financial Crisis.

A key aspect of Budget 2024 was about delivering on election promises, while at the same time credibly setting the books on a path towards surpluses and a shrinking debt ratio. The mantra around doing more with less, along with reprioritisation, will likely be increasingly commonplace within the halls of Government.

As widely expected, personal income tax reductions (in essence a readjustment of the personal income tax thresholds) was a key element of the 2024 Budget, after years of disposable incomes being eroded by fiscal drag as people moved into higher tax brackets over time.

BusinessNZ has long signalled the need for a tax policy setting that regularly adjusts personal tax rate thresholds against inflation.

There was some talk before the Budget by a number of commentators, including some economists, as to whether NZ could "afford" tax cuts given that there are questions around whether NZ currently has a structural deficit that may not necessarily be fixed as the economy improves.

NZ does not have a problem with the amount of tax raised (which has increased rapidly over the last decade). On the other hand, it does have an expenditure problem that has not been reined in post-Covid. Hard working New Zealanders have been paying more and more tax over time as a result of entering into higher tax brackets as their nominal incomes rise.

The Minister of Finance has pointed out that in 2011, the median-income earner was paying 15.5% of their salary in tax, and today, that figure is around 20.6%.

Regulatory policy, namely the quality of it, has become a key priority for the Coalition Government. The primary change has been the development of the Ministry for Regulation, which aims to strengthen the regulatory management system to improve regulatory quality. Its purpose is to lift quality across all regulatory systems and ensure agencies with regulatory responsibilities follow best practice. Given the adverse structural position NZ finds itself in, particularly around a lack of productivity growth, addressing the quality of regulation is a key way in which to boost living standards over the long term.

Budget 2024 outlines a very challenging few years ahead as the Government focuses on getting the books in order. However, this could also set the tone where fiscal policy is set to be better aligned with monetary policy than it has been over the last few years.

The Economic and Fiscal Outlook out to 2028 provides, generally, an improving economic outlook over the range of key economic and fiscal economic indicators.

- **Economic activity (GDP)** is expected to increase from -0.2% in the current year to 1.7% next year, and 3.2% in 2026 before growing at a slightly lower pace out to 2028.
- **Inflationary pressures** are expected to continue to moderate from 3.4% in the current year, to 2.2% next year before levelling out at 2.0% per annum out to 2028.
- **Unemployment** is expected to increase from 4.9% in the current year to peak at 5.2% in 2025 before declining in the outyears to reach 4.4% in 2028.
- **The current budget deficit** is expected to increase from $11.1 billion (2.7% of GDP) to $13.4 billion next year (3.1% of GDP) before recovering in the outyears. A small surplus is forecast in 2028 of $1.5 billion (0.3% of GDP).
- **Core Crown tax revenue** will increase from $119 billion in the current year (28.8% of GDP) to $148.2 billion (29.5% of GDP). It should be noted that tax revenue is down currently, due mainly to minuscule GDP growth (negative on a per capita basis).
- **Core Crown expenses** will increase from $138.3 (33.5% of GDP) to $156.4 billion (31.1% of GDP) by 2028.
- **Net Core Crown debt** will increase from $178.1 billion to $209.9 billion (41.8 % of GDP).

Overall, these figures represent a long-term improvement in outcomes. Notwithstanding, it should be noted that the operating allowances for Budgets 2025 to 2027 are very tight. Managing within future allowances will be particularly challenging unless significant future expenditure savings are made in the outyears.

The Government will need to be rigorous in its pursuit of keeping expenditure down if it hopes to return to a surplus by 2028.

While the Budget has now come and gone, there are a number of significant pressure points on the NZ economy improving its growth outlook over the medium term. Some of these are outlined below although it is accepted that there are many others also.

Funding superannuation costs for an ageing population

Sticking with the theme of budgetary constraints, political parties, with one or two exceptions, have continued to kick the can down the road in terms of how superannuation payments will be funded in future and what criteria should be in place. The politics of addressing an ageing population might be difficult but that does not make the problem go away.

Superannuation makes up over 50% of NZ's total social security and welfare spending and this number is projected to increase over time. Spending is almost as great as the total cost of spending on health and education combined.

Total spending on superannuation is driven largely by the number of people entitled to receive it, i.e. essentially any NZ citizen or permanent resident aged 65 and over.

A fundamental issue is how to ensure people of retirement age have the resources and income adequate to ensure a reasonable standard of living in their later years.

There are a number of possible options for reducing the cost of superannuation over the medium term:

- Extending the age of eligibility (either in line with increases in life expectancy or on an ad hoc basis to keep costs manageable)
- Having (possibly) a tiered approach to superannuation depending on when a person opts to take it e.g., the later someone 'opts in' the higher the level of payment for the rest of their life
- Stepping up the level of benefit depending on age e.g., 50% of average income at 65 years of age, 70 percent of average income at 75 years of age
- Reducing the amount paid (currently two-thirds of the average wage) over time either through freezing benefits or indexing them to the Consumers' Price Index (CPI) rather than wages
- Means testing benefits either through asset(s) and/or income testing
- Discontinuing NZ Superannuation payments by simply phasing them out over time e.g., those currently below the age of say 30 will not be entitled to any state provision

With individuals generally living longer on average and with medical advances living with improved quality of life, it is reasonable to expect the age of entitlement will increase, as many other countries are increasing their age of pension coverage e.g., Australia, Britain and the US.

However, many of the approaches mentioned above have significant drawbacks e.g., in the case of freezing benefits, the impact this would have on those dependent on NZ Superannuation as a sole source of retirement income. Different levels of benefit depending on age can raise issues of ethnicity (given differing life expectancies), while the pitfalls of income and asset testing are generally well known.

Irrespective of these concerns, eligibility for superannuation is something that will need to be addressed one way or another.

Regulatory risk and investment

It is a fundamental pillar of a market economy that property rights should be relatively clear, unambiguous, and able to be upheld in a court of law. Where property rights are removed or reduced by way of regulatory takings, compensation should generally be paid.

Regulatory takings should not be legislatively condoned. As a general principle, property rights should not be diminished without compensation. BusinessNZ considers the presumption of compensation to be a vital economic system check and balance.

Without reasonable security from confiscation by the state or others, the incentive on individuals and businesses to invest and build up productive assets is severely weakened.

One of the unfortunate, but totally predicable, outcomes of the previous Government's decisions in a range of areas, was to reduce business certainty, with fears about whether the rules of engagement would be changed at the drop of a hat, making businesses reluctant to expose themselves to potentially significant investment losses if the Government changed the rules mid-stream.

Now we have the situation where the current Government is intending to remove the ban on offshore oil and gas exploration, but businesses are looking over their shoulder at the potential for a future Government to reimpose a ban.

This has now raised the stakes, potentially with taxpayers' money having to be used to compensate businesses for such risks, or the Government having to enter into long-term contracts with companies to try and mitigate the risks.

While BusinessNZ can understand the predicament of the current Government, it yet again raises the issue of why the ban (without consultation) was introduced in the first place.

It is not only in respect to the oil and gas ban where decision-making is affected but also in respect to NZ's approach to Foreign Direct Investment (FDI).

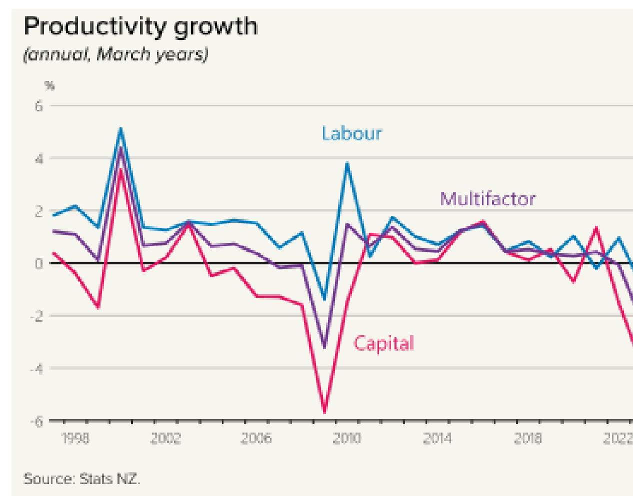
The current Government is moving in a positive direction in respect to being more welcoming to FDI as evidenced by the new policy approach from the Government's Associate Finance Minister David Seymour with his new instructions for implementing the Overseas Investment Act enabling lower risk investors to invest more readily, reducing compliance costs on applicants and not duplicating regulation from other areas. These are positive moves, however the OIA is still very restrictive and requires a complete overhaul.

The Productivity challenge

A recent NZ Treasury Paper (*The productivity slowdown: implications for the Treasury forecasts and projection)* explored recent trends in productivity and the potential drivers of the slowdown.

The paper shows that both labour and multi-factor productivity (MFP) growth have been slowing since the turn of the century in advanced economies, and since the Global Financial Crisis (GFC) in emerging market and developing economies. For example, average labour productivity growth across the Organisation for Economic Co-operation and Development (OECD) countries was still close to 2% p.a. in the 1990s, before falling sharply to around 0.8% p.a. from the 2000s.

Like other countries, NZ's productivity performance has been slowing. Productivity for the whole economy averaged 1.4% p.a. between 1993 and 2013 but averaged only 0.2% p.a. over the last ten years.



In the international context, productivity growth is fundamental to retaining our international competitiveness. In short, if resources can be better utilised offshore and used more efficiently, then they will be. This obviously has impacts on output in New Zealand and ultimately our overall standard of living.

Both capital and labour are highly mobile internationally which means that both businesses and government must be constantly on their toes to ensure that productivity improvements are continually made. In this respect the role of competition is vital in spurring businesses to achieve productivity gains, while government must always to mindful of ensuring that both regulatory and tax burdens fit within international best practice.

It is important to be clear that there is no one silver bullet towards achieving significant productivity improvements. It is not solely the role of government, business or labour organisations to improve New Zealand's productivity record. Some issues are best addressed by business, some by government and some issues must be pursued by individual employees (or collectively in some cases where this makes economic sense).

The following issues are fundamental towards improving productivity although this not an exhaustive list:

- Secure and transparent property rights
- Regulatory policy
- Tax and expenditure policy
- Infrastructure and product market competition
- Flexible and responsive labour markets
- Human capital (skills/education) and managerial capability
- Global connectedness through trade and immigration

- Innovation
- Research and Development (R&D)

NZ is making progress on all these issues. However, as mentioned above, there is still a long way to go particularly in terms of improving regulatory settings if productivity is to be improved significantly.

Climate change and managed retreat

Issues relating to the impact of climate change and possibly managed retreat have been given more airtime since cyclone Gabrielle last year, but this is not an easy topic to navigate given the complexity and cost, with the biggest question being who pays.

Some, such as the drafters of the report into the Future of Local Government Review (October 2023), consider that an intergenerational fund for climate change could be a possibility.

BusinessNZ would suggest any moves towards adopting an intergenerational fund for climate change should be approached with a considerable degree of caution for a range of reasons, including the potential for unintended consequences and gaming. Principally, such a move could provide added incentives for individuals and councils to try and offload risk to third parties, in this case, general taxpayers.

This is not to say there will not be issues which will need to be dealt with on a national basis, but by and large, management of risk is best left to those closest to the actual situation, so they are aware of the costs and benefits of taking or not taking a specific action.

Notwithstanding the above, BusinessNZ acknowledges the current and future effects of more frequent extreme weather on NZ and its infrastructure. More long-term thinking is needed to make sure our responses and infrastructure are future-proofed to deal with any additional stress caused by climate change.

BusinessNZ considers that as a general guiding principle, costs and benefits should be internalised and passed on to individuals to the greatest extent possible. In other words, individuals should manage their own risk whether through insurance or through normal market mechanisms (higher risk generally means lower cost property).

There should be a very high threshold for central and local government intervention. Intervention should be restricted to cases where there is significant risk to the wider community, or public health issues affecting third parties that cannot be mitigated through bonds etc. from property owners.

There are many possibilities in terms of solutions for local problems and the following might be particularly worth investigating further: where the costs of continually providing infrastructure are increasing prohibitively due to climate change, it might be possible for local and/or central government to gift assets to local communities to manage as they see fit (provided standards of hygiene for sewage disposal etc. are met). Alternatively, assets could be sold to communities for heavily discounted values accompanied (or not) by compensation. Contract details would need to be carefully worked through to ensure each party was clear as to what liabilities would arise from such agreements.

There are other examples of funding arrangements, such as the Lake Taupo clean-up, where contributions to reducing nutrient emissions going into the lake have been shared between several parties. This has been necessary because of the difficulty in clearly determining who precisely has caused nutrient leaching where leaching has taken place over many years and cannot entirely be pinned on current landowners.

A complicating factor for businesses and industries making decisions on climate change mitigation policies is that several industries (in, for example, the energy sector) are regulated by the Commerce Commission and/or other agencies of government in terms of their Rate of Return (ROR) and supply/service agreements. This limits their ability to take account of potential climate risks/hazards without the danger of falling foul of government agency requirements. Therefore, some cost-sharing arrangements between government and industry might be needed in dealing with current and/or future risks associated with investment in climate change mitigation measures.

Forecasts: Real GDP percent Growth

	Years Ending		
	Jun 24	Jun 25	Jun 26
Highest	0.1	2.2	3.0
Average	-0.3	1.1	2.8
Lowest	-0.5	-0.2	2.6

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary Policy – changes continue

The Government and the Reserve Bank continue to make changes in the monetary policy space – some good and sensible, others not so good.

On the positive side of the coin, the Government moved quickly to introduce and pass legislation to narrow the Reserve Bank's mandate solely to price stability – away from the dual mandate of price stability and maximum sustainable employment.

The sole focus on price stability is sound, given the potential for a dual mandate to be 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.

On the other side of the coin there are some questionable actions being taken which may well increase the cost of credit and impact particularly on first home buyers and small businesses – decisions by the Reserve Bank to review Loan to Value Ratios (LVRs) and introduce Debt to Income (DTI) ratios from July.

The Reserve Bank (RB) is concerned about the potential financial risks of high levels of housing debt and earlier this year 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's submission to the RB stated that it 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.

It needs to be remembered that there is an optimal amount of activity in reducing risk. Risk generally cannot be completely eliminated at least without great cost and regulators need to be mindful of the fact that regulation can also have significant unintended consequences.

It has also been announced that there will be a review of banking and rural lending which will be undertaken by the Finance and Expenditure Committee along with input from the Primary Production Committee.

Hopefully, it will look at whether current sector constraints on borrowing are fit for purpose and delve a little deeper into whether current lending constraints are justified.

There are some worrying signs from overseas institutions about making decisions to fund or not fund particular activities or sectors which have a distinct feel of George Orwell's Animal Farm - some lending to some sectors is "good" while some lending to some sectors is "bad," irrespective of the financial risks associated with such investments.

It is noted that according to some sources the European Central Bank (ECB) is set to take the unprecedented step of imposing fines on several lenders for their protracted failure to address the impact of climate change.

European regulations require banks to assess whether they are – or will be – exposed to material risks, and that they reflect that in their capital reserves. The ECB has said lenders typically need to understand all the relevant drivers of climate and environmental-related risk and how these are affected given their exposures.

The rigour with which the ECB is pushing banks to manage their climate risk stands in contrast to the approach taken by the Federal Reserve, with chairman Jerome Powell saying the Fed has "narrow, but important, responsibilities regarding climate-related financial risks."

Inflation – downward track but still risks

While inflation is forecast to continue edging down, it is still outside the Reserve Bank's target range. Perhaps more importantly, while tradeables inflation appears to be well in hand, the same cannot be said for non-tradeables (domestically generated) inflation.

The latest official inflation figures from Stats NZ (for the March quarter 2024), while now perhaps a little dated given both international and domestic factors impacting on prices over the last 3 months, make for sober reading and the headline figure of 0.6% increase for the March quarter (or 4% on an annualised basis), tends to provide a degree of comfort to businesses and consumers that may not be warranted.

While non-tradeables inflation was actually down 0.7% for the March quarter (1.6% on an annual basis), non-tradeables inflation was up 1.6% for the March quarter and remains stubbornly high at around 6% on an annualised basis.

In this respect, it is perhaps not surprising that while the Reserve Bank in its latest Monetary Policy Statement maintained the Official Cash Rate (OCR) at 5.5%, its tracking of the OCR indicates a further rise cannot be totally ruled out (see diagram below).

Official and unofficial data (business and consumer opinion surveys and many economic indicators) show that confidence is down, and economic activity is low, so why shouldn't the Reserve Bank be lowering the OCR now?

On the positive side of the ledger, there are continuing downward pressures on inflation with still 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 demand remains weak.

International commodity prices (while improving for dairy, which is good news for NZ producers) show other input costs such as oil generally continuing to decline - which is good news for input costs facing the agricultural sector in particular.

Food prices in NZ only increased 0.2% in the 12 months to May 2024, the smallest increase since September 2018, according to StatsNZ.

The smaller annual food inflation (compared with the 0.8% annual increase in April 2024) was due to cheaper prices for fruit and vegetables (down 11.4 %), as well as meat, poultry, and fish (down 1.2%) in the 12 months to May 2024.

On the other hand, there are a range of very good reasons why the Reserve Bank will be reluctant to move to reduce the OCR before next year despite a number of indicators pointing to the economy being in a mild recession with mediocre growth likely over the forecast period.

First, 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. Moreover, a Financial Condition Report by the Accident Compensation Corporation (ACC) show that some of the ACC Accounts, particularly the Earners Account (relates to non-work accidents) and the Motor Vehicle Account (motor vehicle injuries), are under substantial stress for a range of reasons which will likely result in significant rises in levies facing some ACC Account levy funders for the years 2026-29.

Second, 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.

Third, 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.

Fourth, 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.

Fifth, more immediately, a significant surge in net inward migration levels (over 100,00 over the last year), while positive in terms of taking some of the pressure off the labour market, is a big number of people and will affect housing demand and add to the demand for goods and services more generally.

Sixth, productivity growth in NZ remains painfully slow which in essence means people may be working harder but are essentially not producing more product or ultimately returns on investment to allow for higher non-inflationary growth in incomes. Only through higher productivity can we expect to achieve high quality products at a lower price.

Small businesses nationwide were over 6% less productive in 2023 than the previous year, according to new data from accounting software firm Xero. The latest Xero small business Insights report showed all sectors and regions in the red. Agriculture led the decline with 12.1% less output followed by hospitality and retail trade at 9.2% and 7.8% respectively.

Seventh, moves internationally towards greater nationalism and anti-trade policies will ultimately result in less rather than more innovation as countries protect inefficient domestic industries to the detriment of more competitive products from overseas sources. We are already seeing elements of this at play in the international scene as the recent results of the European Parliament election show growing support for parties that will likely undermine free trading institutions over time.

It is not only in Europe that this is the case but increasing too in the United States (US) where both major political candidates for the Presidency of the United States, Joe Biden and Donald Trump, have promoted the idea of increasing tariffs on overseas goods coming into the country. This will only harm the most vulnerable in society while doing nothing to improve productivity or keep inflation under control.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Jun 24	Jun 25	Jun 26
Highest	3.9	2.6	2.3
Average	3.7	2.5	2.1
Lowest	3.6	2.3	1.7

Source: ASB, BNZ, Kiwibank and Westpac

Interest Rates – a waiting game

One thing is now clear – it is almost universally accepted that the next move on interest rates will be lower. The $64 million dollar question is when?

There are still differing views on when the Reserve Bank will start cutting interest rates with some suggesting 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.

Unless the Reserve Bank is playing mind games with markets, their general view as expressed in the Monetary Policy Statement is that there will likely be no cuts until mid-next year. The Reserve Bank is forecasting that the OCR will peak at 5.7% in the December quarter, before easing back to 5.6% in the March 2025 quarter. It is then seen at 5.4% in the September quarter 2025 and 5.1% in the December quarter 2025.

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.

One could suggest also that the Reserve Bank is playing hardball and trying to ensure that banks do not move too early to reduce interest rates by its more bullish outlook on the economy (and inflation) than would appear to be justified by a range of data sources which indicate that the economy is likely to be more fragile than initially thought. In this respect it is noted that some banks have already slightly adjusted mortgage rates down, although this is very marginal at this stage.

There are equally strong arguments that can be made for keeping interest rates at existing levels for a significant period of time (as outlined above under our inflationary section) just as there are similarly credible arguments for reducing them soon - given weak demand, low consumer confidence on the back of high interest rates and general cost of living pressures.

Our tentative view is that the Reserve Bank may need to reduce rates faster than initially considered given there remain significant cracks in the outlook for the economy.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Jun 24	Jun 25	Jun 26
Highest	5.7	5.0	4.0
Average	5.6	4.7	3.3
Lowest	5.6	4.5	2.9

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – supported by interest rates

A number of international central banks have moved to reduce interest rates or are actively looking at dropping rates.

Given that the NZ Reserve Bank appears to be some way off actively contemplating cuts in interest rates (and at the same time NZ's OCR is at the top end of countries that we generally compare ourselves too), the likelihood is that least over the short term there will be some slight upward pressure on the dollar.

Forecasts below show a relative strengthening in the NZ dollar against the US and also on a TWI basis. Against the Aussie dollar, the NZ dollar is expected to remain relatively stable.

Commodity prices for NZ's traditional exports are also improving and with NZ dollar fortunes heavily tied to commodity prices, these might also act to keep the NZ dollar at current levels, if not slightly higher.

The Coalition Government's policies, generally considered to be more business-friendly and increasingly welcoming to overseas investment – although there is still a very long way to go – could also spark increased interest in NZ as an investment destination which again may help underpin the NZ dollar.

On the other hand, the Government's current account deficit, while projected to continue to improve, is still a cause for concern.

Finally, given the geopolitical risks in many international markets, there could be a tendency for investment to drift towards more safe haven currencies such as the US dollar.

Forecasts: Exchange Rates

AUD (cents)			
	Jun 24	Jun 25	Jun 26
Highest	0.93	0.93	0.95
Average	0.92	0.91	0.91
Lowest	0.91	0.89	0.89

USD (cents)			
	Jun 24	Jun 25	Jun 26
Highest	0.61	0.65	0.70
Average	0.60	0.63	0.66
Lowest	0.59	0.59	0.65

TWI			
	Jun 24	Jun 25	Jun 26
Highest	72.5	73.3	77.3
Average	70.9	72.2	73.5
Lowest	68.6	71.1	71.1

Source: ASB, BNZ, Kiwibank and Westpac

1.3 Business activity and consumer sentiment – backdown

Business confidence, after making a strong surge around the time of the General Election last year, and remaining elevated for a few months, has now petered out.

According to the ANZ Business Outlook for May 2024, business confidence fell 4 points to +11 from the previous month with business expected own activity falling by 2 points to +12. Past activity lifted 2 points to -18. Most sectors are weaker although some improvements were noted for the manufacturing sector off weak levels.

The one bright light was a welcome easing in inflationary expectations and pricing intentions. Pricing intentions fell 5 points to 42 while inflation expectations continued to ease from 3.8% to 3.6%.

ANZ NZ Business Outlook

Other data across many sectors show many businesses are struggling with a range of factors impacting on investment, profitability and sales.

NZ company insolvencies dropped to 203 in April from the highest-recorded March figure of 276. However, they remain up 30% year-on-year.

A recent report from credit specialists Centrix detailed the extent of NZ's insolvencies, which comprise liquidations, receiverships and voluntary administrations.

The four months to May 2024 had the highest number of insolvencies relative to previous years since the data set began in January 2019. In the month to May 30, insolvencies were 255, up 63% compared with May 2023.

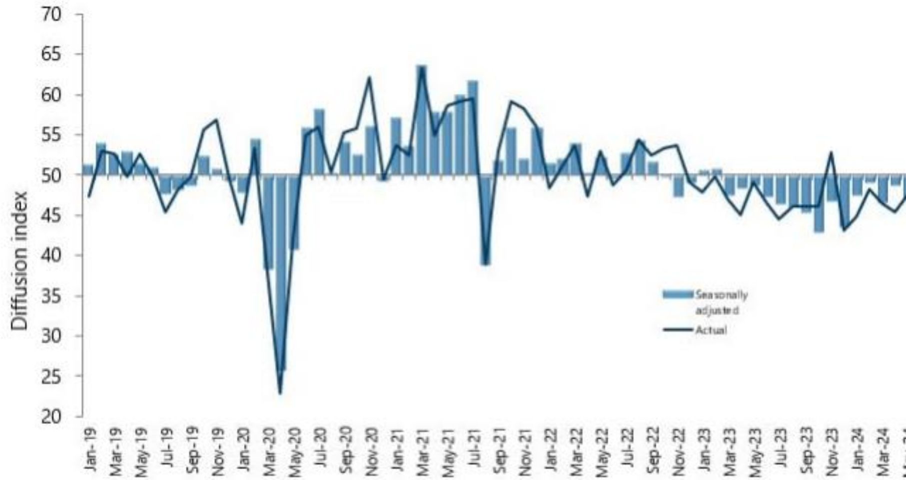
Of all the insolvencies recorded in April, 22% were from the construction sector, followed by 17% from the property industry.

Liquidations of manufacturing businesses (which account for 3.5% of NZ registered companies) increased by 30% year on year with metal product manufacturing businesses experiencing the highest rate of liquidations.

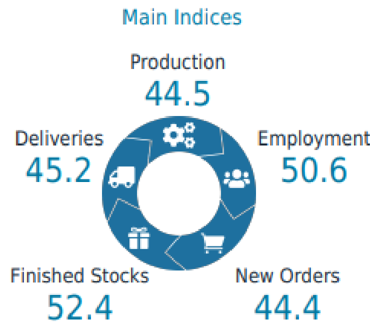
The New Zealand's manufacturing sector remains firmly entrenched in negative territory according to the latest BNZ–BusinessNZ Performance of Manufacturing Index (PMI) and some of the sub-indices raise heightened concerns in respect to weak demand, particularly New Orders.

The seasonally-adjusted PMI for May was 47.2 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was down from 48.8 in April and means the sector has now been in contraction for 15 consecutive months.

There was little in the May result to signal a positive turnaround in the sector is coming soon.



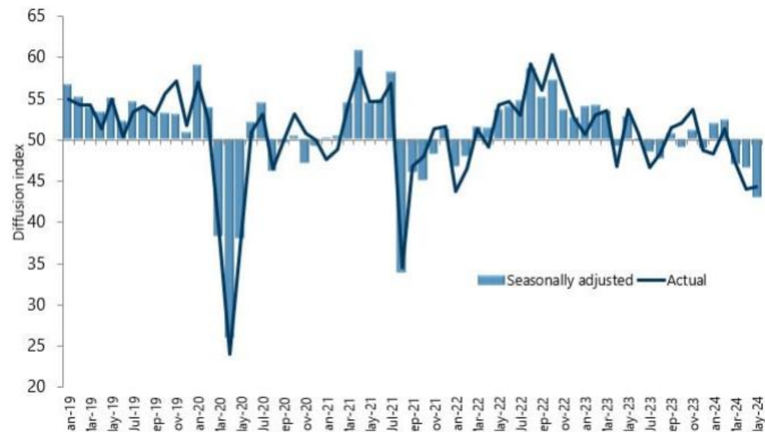
The key sub-index of New Orders (44.4) remains stubbornly in contraction and a clear impediment to overall expansion in the sector. To put this into perspective, during the Global Financial Crisis of 2008/09 New Orders remained in contraction for 14 consecutive months. The current results are now a third more than that with New Orders now in contraction for 21 consecutive months. Production (44.5) reverted back to current trends after a surprise expansion in April, although Employment (50.6) did remain in expansion following the April result.



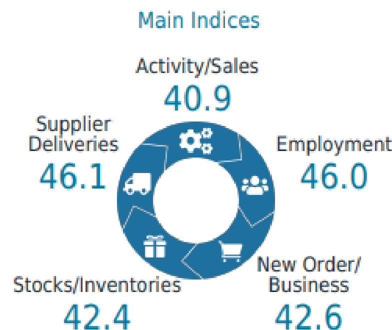
Despite the dip in the May result, the proportion of negative comments stood at 63.5%, which was down from 69% in April and 65% in March. The vast majority of negative comments focused on a general slowdown and the tough recessionary times at present.

The PMI's sister survey, the BNZ–BusinessNZ Performance of Services Index (PSI), also remained in the red for May 2024 and dropped to its lowest level of activity for a non-Covid lockdown month since the survey began.

The PSI for May was 43.0. This was down 3.6 points from April and represents the lowest level of activity for the sector for a non-Covid lockdown month since the survey began in 2007.



The May result is arguably as bad as it can get for the sector, reaching contraction levels greater than during the Global Financial Crisis of 2008/09. While most of the sub-index values did not reach their lowest-ever levels, combined they led the May result well below the long-term average of 53.3. The key index values for Activity/Sales (40.9) and New Orders/Business (42.6) were both in significant contraction, while the Stocks/Inventories (42.4) activity level was the lowest recorded for a non-Covid month.



The proportion of negative comments for May (65.4%) was similar to April (66.3%). Given the overall result, respondents continued to note the typical aspects of the current economic downturn.

The speed of decline is as worrisome as its size over the past three months. There is weak and then there is very weak. Overall, this tells of a services sector in reverse, at pace.

Other key sectors of the economy remain mixed.

The agricultural sector has been under the pump for several years but there are signs of improvement, although this is off a relatively low base.

First, after being hammered by high input costs farmers will be pleased that on-farm inflation is coming down. According to Beef and Lamb NZ, annual inflation for the sector is around 2.8%, having previously been well into double digits on an annualised basis.

Second, the Government's attempts to remove some of the more onerous regulatory obligations in the sector are welcome news. In this respect, the Government's introduction of the Resource Management (Freshwater and Other Matters) Amendment Bill will bring urgent and targeted changes to the resource management system with the objective of reducing the regulatory burden on key sectors, including farming, mining and other primary industries.

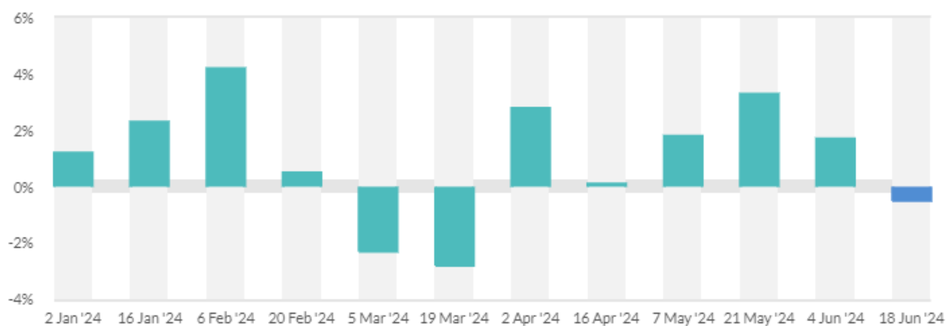
Changes proposed in the Bill will:

- Exclude the hierarchy of obligations contained in the National Policy Statement for Freshwater Management 2020 (the NPSFM 2020) from resource consent application and decision-making processes until the NPSFM 2020 is replaced
- Align the consenting pathway for coal mining with other mineral extraction activities across the NPSFM 2020, National Policy Statement for Indigenous Biodiversity 2023 (the NPSIB 2023) and Resource Management (National Environmental Standards for Freshwater) Regulations 2020 (the NES-F)
- Modify local authority obligations under the NPSIB 2023 to identify and include in district plans new significant natural areas (SNAs) for 3 years
- Amend the Resource Management (Stock Exclusion) Regulations 2020 in relation to sloped land
- Repeal the permitted and restricted discretionary activity regulations and associated conditions for intensive winter grazing from the NES-F
- Make amendments to speed up the process to prepare or amend national direction under the Resource Management Act (RMA).

BusinessNZ notes that the Government is committed to further reforms of the RMA later this Parliamentary term, with new resource management laws based on the guiding principle of the enjoyment of property rights.

Ultimately BusinessNZ supports this approach but accepts that it is necessary to remove unnecessary roadblocks to growth in the meantime, hence our broad support for the Bill.

Third, commodity prices for key agricultural products, including dairy (as reflected in the Global Dairy Trade (GDT)) have generally risen substantially over the last 3 months or so on the back of higher international demand, notwithstanding a slight drop (0.5%) in the latest trade.



Fonterra has announced an opening forecast Farmgate Milk Price for the2024/25 season of $7.25-$8.75 per KgMS, with a midpoint of $8.00 per kgMS. This is an increase to the payout for the 2023/24 season just ended.

Fourth, the Government's earlier decision to introduce the Fast-track Approvals Bill (due to be reported back from the Environment Select Committee in September this year), 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.

Notwithstanding these positives, the agricultural sector is still doing it tough with a return to profitability still some way off.

The construction sector continues to face headwinds with building consents generally declining while building work undertaken has tended to be flat.

House sales and prices, after picking up somewhat late last year and into this year, have now flatlined with a number of factors impacting on house prices.

These include:

First, higher mortgage interest rates, which are constraining the ability of many to purchase housing with many households coming under increased strain of mortgage defaults. The recently announced tax cuts in the Budget will hardly make a difference to most mortgage holders, with many still to feel the full effects of mortgage rate rises as their mortgages come up for renewal.

Second, tighter lending criteria on banks' lending, given the looming changes to Loan to Value Ratios (LVRs) and the introduction of Debt to Income (DTI) ratios, will impact the ability of first homeowners to get on the housing ladder.

Third, while net migration inflows are still high by historical standards, the net outflow of Kiwis is probably taking some of the pressure off housing demand. The likelihood is that net migration inflows may recede quite rapidly, since as the recession continues, the attractiveness of NZ as a destination will take a hit, while at the same time, the Government may well be mindful of the need for a reset of immigration policy given the concern about whether NZ has the appropriate settings to attract high skilled younger individuals that can effectively add to NZ's human capital.

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 NZ's service trade deficit with the services trade deficit narrowing.

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 holidaying or tourism.

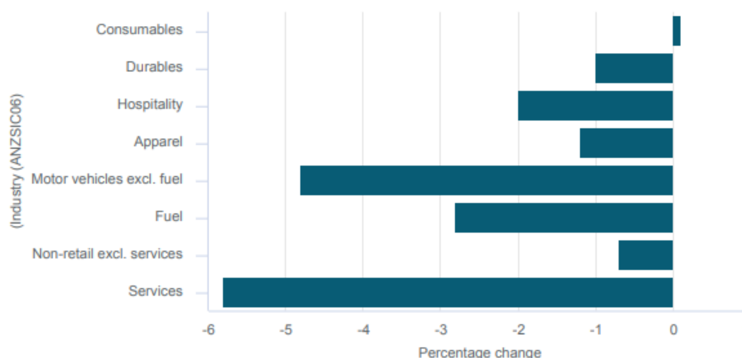
Meanwhile, the retail and hospitality sectors are still impacted by low levels of consumer confidence, with households under serious financial pressure as a result of the cost-of-living crisis and a slow but steady rise in unemployment levels. The general level of prices across the board is continuing 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.

Electronic sales have continued to decline of late with seasonally-adjusted expenditure continuing to decline for May 2024.

By retail spending category, movements were:

- hospitality, down $25 million (2.0%)
- fuel, down $16 million (2.8%)
- durables, down $15 million (1.0%)
- motor vehicles (excluding fuel), down $9.5 million (4.8%)
- apparel, down $3.9 million (1.2%)
- consumables, up $1.3 million (0.1%).

Percentage change in seasonally adjusted card transaction values by industry, April 2024–May 2024



ANZSIC06 – Australian and New Zealand Standard Industrial Classification 2006. Stats NZ

Month on month, the number of NZ consumers behind on credit payments in April improved marginally to 12.52% from 12.7% of the credit active population.

However, consumer arrears are 10.5% higher year on year, tracking closely to 2018 levels after coming off historic lows.

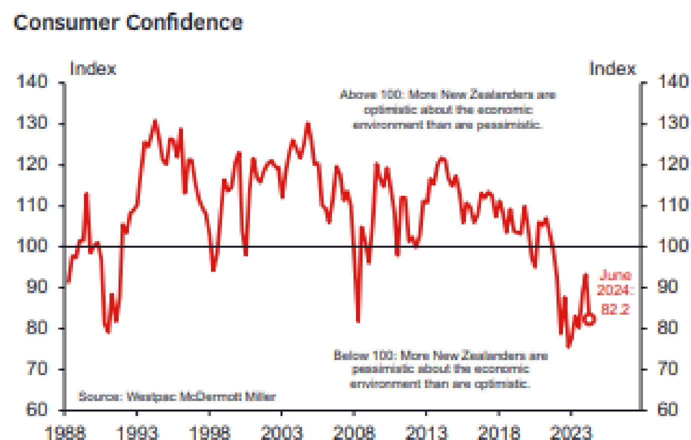
Mortage arrears eased for the second consecutive month but are still up 14% from last year.

According to Centrix, there are now 21,700 home loans reported as past due (down 400 in the past month). This represents 1.45% of all home loans.

Meanwhile the Westpac McDermott Miller Consumer Confidence Index for the June quarter 2024 shows that consumer confidence fell 11 points to 82.2 in June. That fall erased the gains seen over the past six months, leaving consumer confidence at an historically low level.

Household budgets continue to come under pressure from high interest rates and general cost-of-living increases across the board.

Cofnidence is now low right across the country and across all age groups.



While the tax cuts announcedin the recent Budget will be of some marginal relief, they are unlikely to have a material impact on the ability of people to weather the cost of living crisis.

1.4 Labour market – softening

After very low levels of unemployment for a considerable period, unemployment is starting to move up and is expected to reach 5.4% by June next year, before drifting lower in the outyears.

The increasing unemployment rate has yet to be translated into a significant increase in welfare payments. However, should things continue on their current trend reaching over 5% by next year then we can expect that social welfare costs will start to significantly increase.

While unemployment is still relatively low by historical standards, there are some worrying signs in respect to younger people not in employment, education or training (NEETS).

In terms of NEETS, the percentage of 15–24-year-olds was 12.2% in the year to March 2024, up 0.9 percentage points from the previous year.

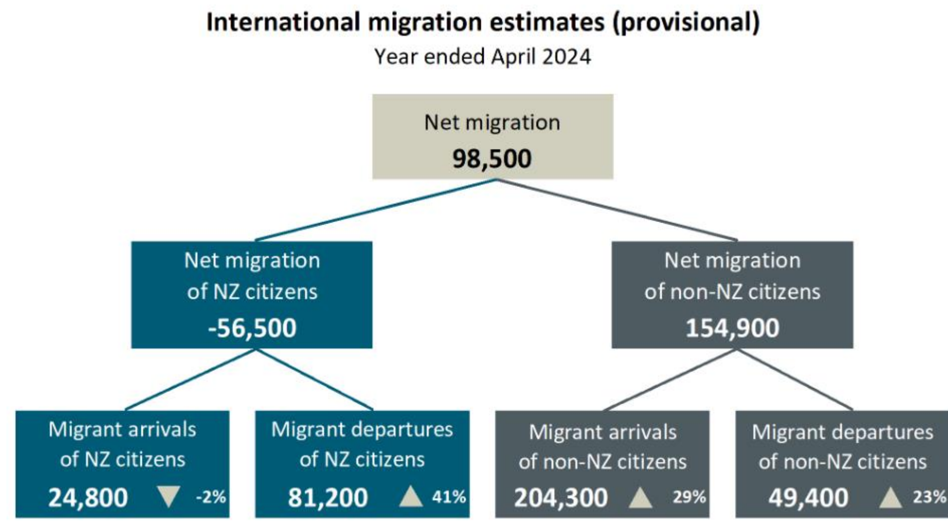
While these latest figures are relatively consistent with previous years, they raise the prospect of younger people becoming increasingly detached from the labour market - and from society - which is problematic. Early

engagement with the labour market is important in gaining much-needed skills in order to improve employment prospects and income levels over time.

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

The April 2024 year provisionally saw two annual records for NZ citizens - first, 81,200 migrant departures, exceeding the previous record (before 2024) of 72,400 in the February 2012 year, and second, a net migration loss of 56,500, exceeding the previous record (before 2023-2024) of 44,400 in the February 2012 year.

It should be noted that the average annual net migration loss of NZ citizens was 26,800 in the April years 2002-2013, and 6,500 in the April years 2014-2019.



Meanwhile the current Coalition government continues apace with its tidy-up of labour market reforms.

A substantial consultation on work health and safety has begun, with roadshows across the regions over the coming months as the first step to deliver on the commitment to reforming health and safety law and regulations, set out in the ACT-National Coalition Agreement.

The Government is seeking feedback on people's experiences with the health and safety system, including views on issues such as:

- Whether health and safety requirements are too strict or too ambiguous to comply with.
- Difficulties caused by the overlap between workplace health and safety legislation and other requirements.
- The actions that businesses undertake, the reasons behind these actions, and their effectiveness.
- Whether the consequences for not complying with health and safety obligations are appropriately balanced and reasonable.
- Whether the threshold at which work-related risks need to be managed is under- or over-cautious.

A revamp of the Holidays Act is also underway, with key changes around annual and sick leave. Annual leave: currently employees are not entitled to annual leave till they've been in a job for a year (though the leave in fact accrues over that time) – this will change from an entitlement to an explicitly accrual basis. Sick leave: currently calculated per 10 days worked, this is hard to calculate for irregular hours - it will change to a pro-rata system where a % of work time counts as sick leave regardless of hours worked.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Jun 24	Jun 25	Jun 26

Highest	4.7	5.5	5.1
Average	4.7	5.4	5.0
Lowest	4.6	5.2	4.7

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – back under control

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

First, high levels of net inward migration have taken a lot of 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 still relatively high levels of 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.

Third, the reduction in general demand for goods and services across the economy will see businesses taking a much more cautious approach to taking on new employees and also numbers of people applying for some jobs will take some of the heat out of wage demands as both employers and employees adjust to the new economic reality of restraint.

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

	Years Ending		
	Jun 24	Jun 25	Jun 26
Highest	4.2	3.2	3.0
Average	3.7	2.9	2.6
Lowest	3.2	2.6	2.2

Source: ASB, BNZ, Kiwibank and Westpac