

PLANNING FORECAST

MARCH 2025 | BY ECONOMIST JOHN PASK



NZ Economy: Wheels turning

Executive summary

The economy is starting to show signs of improvement, albeit off a low base. Nevertheless, significant issues still confront the NZ economy while internationally 'uncertainty' is the name of the game.

A number of indicators suggest improvements in output over the first quarter of this year with further improvement likely later in the year. Forward looking growth indicators such as Massey University's *GDPI* points to a gradual improvement while heavy traffic flows, a good real-time indicator of growth, is generally improving.

Meanwhile, the BNZ – BusinessNZ Performance of Manufacturing Index is back in positive territory for the first two months of this year after being in negative territory for an extended period of time.

Inflationary pressures continue to fall for now, with the Reserve Bank likely to lower the Official Cash Rate (OCR) further over coming months which should see floating interest rates fall further and provide a shot in the arm for new investment while boosting household disposable incomes. However, minimal changes to interest rates are likely for fixed rate mortgages over the 3 – 5-year term.

World commodity prices, particularly for agricultural products, dairy and meat, are solid, providing a much welcome boost to NZ's terms of trade.

A lower NZ dollar is providing better returns to NZ producers when converted back into NZ dollars. A lower dollar, largely on the back of concerns over geopolitical risks is very much a two-edged sword - given that many NZ manufacturers and producers are heavily reliant on international inputs, which will now become progressively more expensive. Despite these positives, NZ continues to face significant challenges both domestically and internationally.

NZ continues to grapple with a broad range of issues from ongoing productivity issues, the need to deal with the structural financial deficit, the potential for inflation to reappear as domestic inflationary pressures such as electricity, local government rates and insurance costs continue to flow through, and perhaps most importantly, dealing with the long raft of regulations holding the economy back.

Internationally, the scene is very much about uncertainty. It has been a long time, perhaps since the cold war, that geopolitical tensions have been as prevalent as they are now, with NZ subject to potential fallout.

NZ's largest trading partners China and the US have had their spats, with the Trump administration rolling out significant tariffs on goods from Mexico, Canada and China with the proposed introduction of reciprocal tariffs more widely. What might or might not be covered in these tariffs changes almost on a daily basis. The potential extension of tariffs to agricultural products will be of concern to NZ. Irrespective of the final outcomes, NZ will get hit by collateral damage. Sharemarkets have generally responded negatively as could be expected with such ad-hoc decision making. World growth will ultimately be lower than it otherwise would have been while it represents another major change away from a global rules-based system towards protectionism.

HIGHLIGHTS

The wheels of the NZ economy are starting to turn but growth expectations over the forecast period remain subdued.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 17 for the March 2025 quarter, an improvement of 7 on the previous quarter, and an improvement of 14 on a year ago. An ECI reading above 0 indicates that economic conditions are generally improving overall; below 0 that economic conditions are generally declining.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) is firmly back in black for the first two months of this year, after previously being in negative territory for close to two years. Meanwhile, its sister survey - the Performance of Services Index (PSI) continues to struggle to keep its head above water.

Other sectors provide for mixed results. Construction activity remains subdued, with building activity down, while retailing and hospitality continue to struggle as a result of cautious household spending on the back of an uncertain employment market. Tourism, while improving, is still performing at sub pre-Covid levels with international numbers up, but domestic numbers subdued.

Higher commodity prices have given the agricultural sector a shot in the arm with dairy prices at elevated levels and meat prices remaining solid. Combined with a significantly lower NZ dollar is increasing returns to producers when converted into NZ dollars which is boosting the rural economy. Input costs have also fallen away.

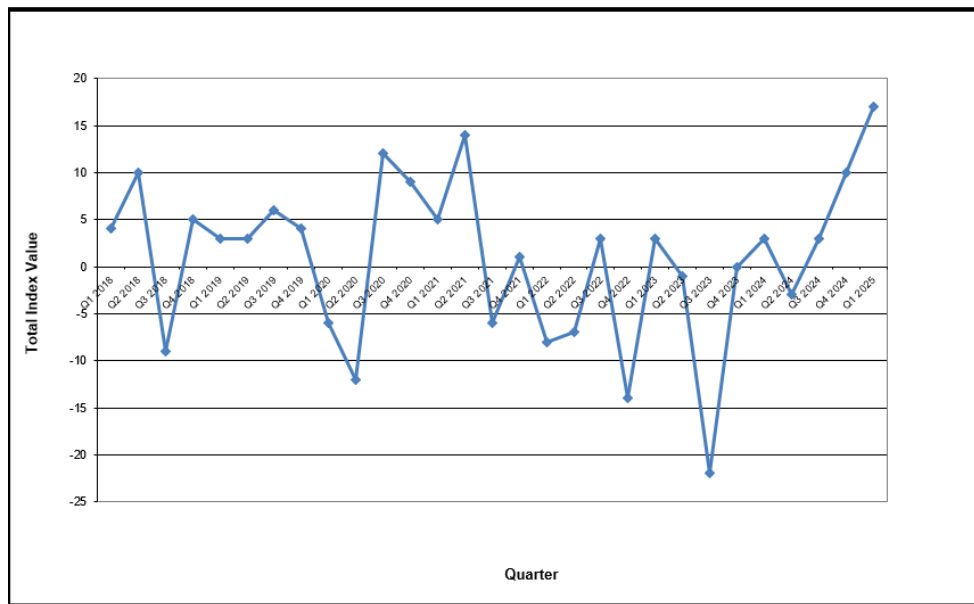
Geopolitical tensions are still a significant issue while greater moves towards protectionism are creating barriers to trade.

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

The BusinessNZ Economic Conditions Index (ECI) is a measure of NZ’s major economic indicators. It sits at 17 for the March 2025 quarter, up 7 on the previous quarter, and up 14 on a year ago. An ECI reading above 0 indicates that economic conditions are generally improving overall; below 0 means economic conditions are generally declining.

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 2025 are estimates based on available information to date.

Overall Economic Conditions Index (ECI)



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

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

Economic growth/performance indicators sit at 5 for the March 2025 quarter, up 4 on the previous quarter and the same as a year ago. Agricultural commodity prices remain relatively high, particularly dairy, which is contributing to NZ’s improving terms of trade of late.

Monetary policy/pricing indicators sit at 8 for the 2025 quarter, the same as the previous quarter, and up 8 on a year ago. Inflation is now back within the Reserve Bank’s target range of 1-3 percent. Further reductions in interest rates are expected over coming months although there is likely to be little further movement in longer-term fixed rates given current global uncertainty.

Business/consumer confidence indicators sit at 9 for the March 2025 quarter, up 4 on the previous quarter and up 6 on a year ago. High levels of business confidence are being reflected in expectations of further declines in the cost of capital, and also expectations of an improving regulatory environment for business domestically as Government attempts to strip away unnecessary regulatory impediments to business growth.

Labour market indicators sit at -5 for the March 2025 quarter, a deterioration of 1 on the previous quarter and the same as a year ago. The labour market is showing continued signs of easing, with associated rises in unemployment. Meanwhile net migration numbers continue to fall from significant highs as NZ residents seek better opportunities offshore.

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

1.1 Economic growth (GDP) – positive signs amid uncertainty

The wheels of the NZ economy are starting to turn again but growth expectations over the forecast period remain subdued.

A number of indicators suggest improvements in output over the first quarter of this year with further improvement likely later in the year. Forward looking growth indicators, such as Heavy traffic flows have generally improved, while Massey University's GDPlive points to a gradual improvement in growth over the current quarter.

Heavy traffic data (mostly trucks) tends to provide a good steer on production GDP in real time (see graph below), as it captures both goods production and freight associated with both wholesale a retail trade. The *ANZ NZ Truckometer* shows that the Heavy Traffic Index fell 0.2% in February, but this was after a sharp rise in January, and it is up 4.9% compared to a year ago (three-month average).

ANZ Heavy Traffic Index and GDP



Meanwhile, the BNZ – BusinessNZ Performance of Manufacturing Index (PMI) is firmly back in positive territory for the first two months of this year after being in negative territory for an extended period of time.

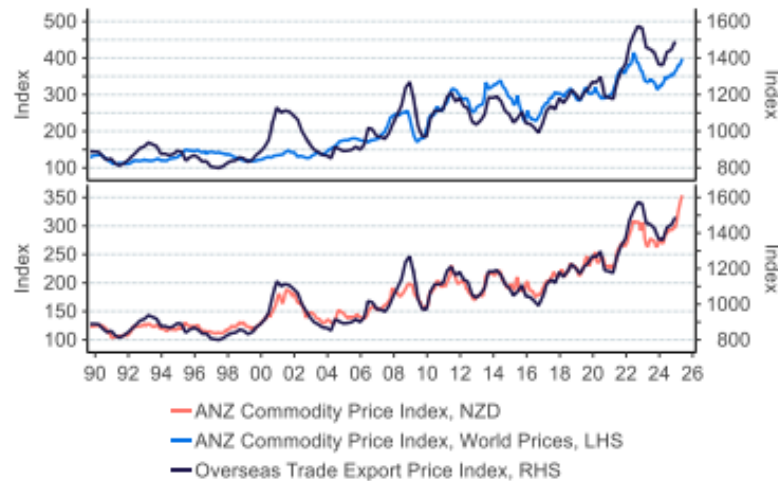
Inflationary pressures continue to fall, for now, with the Reserve Bank likely to lower the Official Cash Rate (OCR) further over coming months which should see floating interest rates fall further and provide a shot in the arm for new investments.

World commodity prices, particularly for agricultural products, dairy and meat, are solid, providing a much welcome boost to NZ's terms of trade.

The ANZ World Commodity Price Index rose 3.0 percent (month on month) in February. When converted into NZ dollars commodity prices rose 2.3 percent (month on month).

Dairy prices lifted 5.1 percent (month on month) in February. Meat and fibre continued to rise (up 1.4 percent, Forestry eked out a 0.4 percent gain while Aluminum prices rose 2.9% (21 percent year on year). However, the US has recently slapped a 25 percent tariff on all aluminum into the US.

ANZ Commodity Price Index



Source: Stats NZ, Macrobond, ANZ Research

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 17 for the March 2025 quarter, an improvement of 7 on the previous quarter, and an improvement of 14 on a year ago. An ECI reading above 0 indicates that economic conditions are generally improving overall; below 0 that economic conditions are generally declining.

Meanwhile, a lower NZ dollar, is providing better returns to NZ producers when converted back into NZ dollars although a lower dollar, largely on the back of concerns over geopolitical risks is very much a two-edged sword, given that many NZ manufacturers and producers are heavily reliant on international inputs which will now become progressively more expensive.

Despite these positives, NZ continues to face significant challenges both domestically and internationally.

Domestically, NZ continues to grapple with a broad range of issues from ongoing productivity issues, the need to deal with the structural financial deficit, the potential for inflation to reappear as domestic inflationary pressures such as electricity, local government rates and insurance costs continue to flow through, and perhaps most importantly, dealing with the long raft of regulations holding the economy back.

There is a need to address the structural deficit which some suggest is in the order of 2.7% of GDP. This will involve taking the pruners to big expenditure items, such as revisiting the age of eligibility for NZ Superannuation and potentially raising extra funds through asset sales. The Government is still a significant owner of many assets for which there is little justification for continued Crown ownership e.g. electricity generation, and in respect to local government, assets such as ports and airports.

The Government has been supportive of business in their endeavors associated with the going for growth strategy. However, the Government needs to focus much more on removing unnecessary regulations and controls to promoting competition and lower prices than hitting large players such as banks, insurers and supermarkets with sticks given many outcomes are a direct result of inappropriate regulations imposed by Government and their various agencies in the first place.

Most proponents of regulations have good intentions, but it is important that their impact, including unintended consequences are well thought through before they are introduced. Often a "do nothing" regulatory approach may be the best approach in many circumstances.

Unfortunately, to date, successive Governments have focused too much on trying to minimise risks which have had unintended consequences such as ultimately raising the cost of capital, increasing the cost of housing or restricting business productivity and profitability through unnecessary bureaucratic imposts. One of the latest bizarre cases to make the headlines is a study by *BECA* for *Electricity Networks Aotearoa*, which shows massive increases in the cost of temporary traffic management on roads from 2019 to 2024. However, to be fair to the Government they have signalled that they will take a more risk-based approach to such issues in the future which is a refreshing thought.

It is important to understand up front that there is an optimal amount of resource which should be utilised in reducing risk just as there is an optimal amount of resource that should be spent on crime prevention, health interventions etc. The crucial and undeniable fact is that resources are limited while risk can often not be completely eliminated or not, at least, without great cost. It might be possible to reduce risk, but beyond a certain point the marginal cost of acting becomes progressively higher, while the potential returns reduce. Therefore, it pays for companies and individuals to invest in risk minimisation strategies only up to the point at which the marginal cost of taking action equals the marginal benefit.

Turning to the international scene – things do not look pleasant. It has been some time, perhaps since the cold war, that geopolitical tensions have been so prevalent than they are now, over the range of countries, with NZ subject to potential fallout.

Geopolitical tensions are still a significant issue with greater moves towards protectionism are creating barriers to trade. China, meanwhile, is flexing its muscles in the Pacific with a recent agreement with the Cook Islands while also undertaking live exercises off the Australian coast.

The Trump administration has proposed the introduction of reciprocal tariffs on many countries, while particularly taking aim at Mexico, China and Canada. While what is to be covered by tariffs changes and rates that will apply almost changes on a daily basis, this will have immediate effects on some NZ companies with production focused offshore in countries covered by such tariffs. For example, *Fisher and Paykel Healthcare* currently manufactures approximately 45% of its volume in Mexico and approximately 55% in NZ, and for the first half of the 2025 financial year approximately 43% of the company's revenue came from the US. Approximately 60% of the US volumes are supplied from the company's Mexico manufacturing facilities.

The potential extension of tariffs to agricultural products will be particularly concerning to NZ. Irrespective of the final tariff outcomes, NZ will get hit by collateral damage. Sharemarkets have generally responded negatively as could be expected although has not universally been the case. Europe and China appear to have largely taken it in their stride, but US markets have taken a hammering and are significantly down over recent weeks. Ultimately consumers and businesses will bear the brunt of such interventions with ultimately higher priced products. This will almost inevitably require central banks to take action to suppress inflation through higher interest rates. Lower world growth will be an inevitable outcome.

While it will take time for the dust to settle surrounding some of Presidents Trump's statements on tariffs and the like, NZ will be affected one way or another (particularly in terms of potentially higher inflation/lower commodity prices and an increased cost of capital), but despite collateral damage, may fare better than some other countries – here are five reasons why;

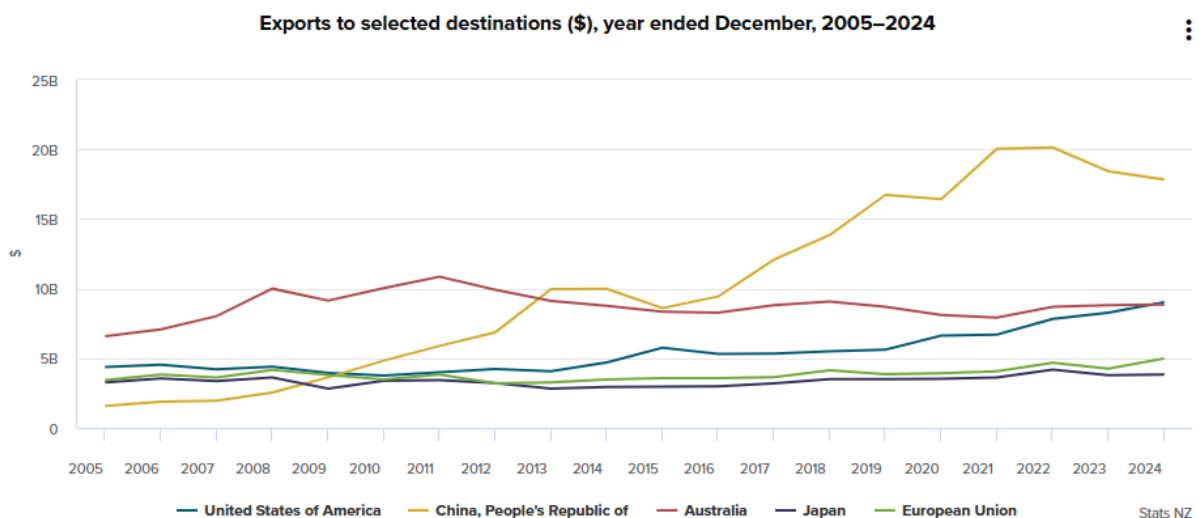
Firstly, NZ has generally had a good relationship with the US over a long period of time and through

various administrations on both sides. Dialogue has generally also been kept open with diplomatic boots on the ground to ensure our voices continue to be heard in Washington.

Second, NZ has few tariffs remaining on imported products which means the potential for reciprocal tariffs imposts are likely to be very minor. However, some products, including textiles, footwear, processed foods, machinery, steel and plastic items, may face tariffs or 5% or 10%.

Third, while President Trump appears to be exercised by an assumption that some countries are taking advantage of the US through vastly different trade balances, NZ's trade balance with the US is not an extreme case although NZ sends around \$1 billion more in goods to the US than we import.

Fourth, although the US is NZ's second largest export destination for NZ goods (with a total value of around \$9.0 billion), NZ ranks outside the top 50 countries from which the US purchases goods so is likely to be well outside the US's immediate line of fire. Nevertheless, over the past decade, the value of NZ exports to the US has nearly doubled from \$4.7 billion in 2014 to \$9.0 billion currently. This has increased NZ exports to the US, as a percentage of our total exports, from 9.4 percent to 12.0 percent over the same period.



Fifth and finally, although the US is a very important trading partners for NZ, currently second behind China (with Australia third), around 75 percent of NZ's trade is with countries covered by negotiated free-trade agreements so there is potential for many of our products to be diverted to other countries should the US take a hard line on tariffs – particularly in respect to agricultural products.

While it is likely that if the US continues with its harsh tariff regime (and extends it) with retaliations from a number of its trading partners already underway, world growth is likely to be affected while the cost of capital will go up as lenders build in a risk premium for uncertainty. Also significantly, inflationary pressures will lead to lower household disposable incomes as central banks around the world fight to maintain price stability.

However, amid the doom and gloom on tariffs, there could be some unintended – but positive – consequences for NZ. It might mean lower prices for some imported goods as other countries find significant trade barriers to the US too costly and seek to offload products onto other markets which could be potentially beneficial in terms of tradeables inflation into NZ.

The latest World Outlook Update by the International Monetary Fund (IMF) is aptly titled - Global Growth: Divergent and Uncertain (January 2025).

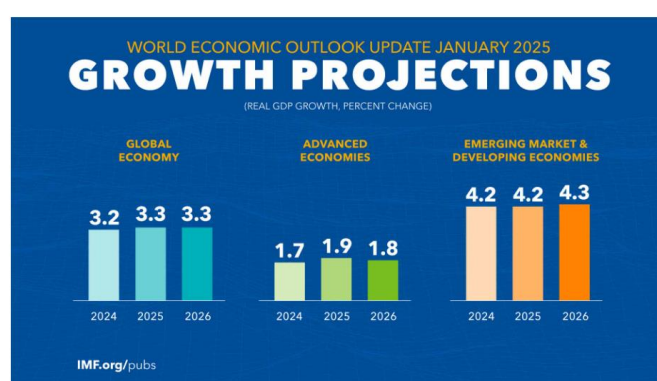
The IMF forecasts that global is projected at 3.3% for both 2025 and 2026 (below the 2000-2019

average of 3.7%).

The IMF considers medium term risks to the baseline are tilted to the downside, while the near-term outlook is characterised by divergent risks.

The IMF considers that while progress is being made in terms of reducing inflation, there are signs that progress is stalling in some countries, and that evaluated inflation is persistent in a few cases. Although core goods price inflation has fallen back or below trend, services price inflation is still running above pre-Covid 19 averages in many economies, most notably the United States and euro area.

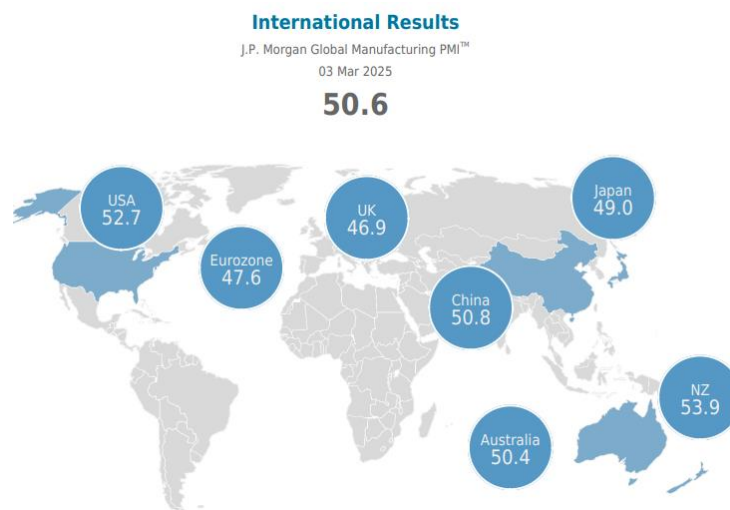
As could be expected, the IMF has pointed out that economic policy uncertainty has increased sharply of late while geopolitical tensions and global trade frictions remain elevated.



In respect to the medium term, the IMF said the balance of risks to the outlook is tilted on the downside:

"An intensification of protectionist policies, for instance in the form of a new wave of tariffs, could exacerbate trade tensions, lower investment, reduce market efficiency, distort trade flows, and again disrupt supply chains. Growth could suffer in both the near and medium term, but at varying degrees across economies." (p.4)

Meanwhile the J.P Morgan Manufacturing PMI has been back in the black for the first two months of this year. February saw the global manufacturing sector move further into expansion territory. Operating conditions improved for the second consecutive month, as rates of growth in output and new orders strengthened. Price pressures continued to rise, with both input costs and selling prices rising at faster rates.



The February result of 50.6, was an eight-month high, up from 50.1 in January. N.B: A level above 50 indicates economic expansion, while a number below 50 indicates a contracting economy.

Three out of the five PMI sub-indices were at levels consistent with improved operating performance, as output and new orders both rose for the second successive months and suppliers' delivery times lengthened. Employment and stocks of purchases both registered further contractions.

Forecasts: Real GDP percent Growth

	Years Ending		
	Mar 25	Mar 26	Mar 27
Highest	0.4	2.7	2.9
Average	-0.8	2.1	2.7
Lowest	-1.3	1.8	2.0

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary policy – reset?

The recent resignation of Adrian Orr as Reserve Bank Governor came as something of a shock to many although it was not entirely unexpected given the rocky relationship he has had with some businesses and indeed a number of politicians, many of whom made their views pretty clear over time.

While a lot has been written about Orr's decisions during his tenure, including losses associated with quantitative easing during Covid, debate surrounding requiring greater capital requirements on banks, and the continued expansion of the head-count at the Reserve Bank, there was also a concern about some of the Reserve Bank's moves to put greater emphasis on issues which are clearly outside its immediate mandate such as dabbling in climate change and other areas like housing and social policy issues.

It may be an opportunity for the Reserve Bank to have a reset and clearly focus solely on price stability again which is the greatest contribution that monetary policy can make to ensuring a stable framework for the private sector to invest.

One of the consequences of focusing too much on trying to minimise risks is that it can have unintended consequences such as ultimately raising the cost of capital and restricting the ability of private sector players to access capital. The Reserve Bank has introduced a number of changes over recent years which have acted in concert to both restrict the cost of capital and reduce its availability to many people. Apart from increasing capital requirements, some other significant changes have been the introduction of Loan-to-Value (LVRs), Debt-to-Income Ratios (DIRs), and the Deposit Insurance Scheme.

On balance, these combined changes are likely to have raised the cost of capital higher than it otherwise would have been.

The Reserve Bank requires banks to hold enough capital to survive a one-in-200-year financial crisis. No other country sets such an extreme standard. Most aim for resilience against a one-in-100-year event.

A submission to the Finance and Expenditure Select Committee Inquiry into Banking by banking experts Andrew Body and Simon Jensen shows, by their analysis, that the Reserve Bank's capital rules add between 0.25 and 0.374 percentage points to mortgage rates compared with Australia. For a

million-dollar mortgage, that means between \$2,500 and \$3,750 in extra annual interest payments.

Furthermore, the Reserve Bank also requires banks to conduct climate-related stress tests and meet complex reporting obligations, even though the higher capital requirements already protect against such risks.

The economic perspective of risk stresses two ideas:

- More resources, including time and money, are needed to reduce risk; and
- People (through their actions) have a desired level of risk well short of zero in view of what the increased cost would require them to give up or for some other specific consideration.

It is not a case of eliminating risk; to do so would effectively be to close down all productive activity.

A more risk-based approach is arguably required not only in respect to monetary policy decisions and prudential supervision, but more broadly across all of government and their various agencies as well.

Inflation – in the cage – for now

Both headline inflation, and inflationary expectations, have tended to trend slightly lower of late – although risks remain to the future outlook given the very fluid international geopolitical situation, while domestically, non-tradeables inflationary pressures still remain.

Dealing with the international situation first. Moves by the Trump administration to introduce significant reciprocal tariffs has the potential to add overall cost pressures while at the same time impacting on world economic growth.

The ongoing war in Ukraine (and the time of writing) and geopolitical tensions elsewhere have to potential to both increase goods inflation internationally, which potentially could impact on NZ.

The potential for supply chains to be disrupted is still real and means added uncertainty and potentially cost pressures.

The NZ dollar has softened significantly over the past 6 months or so, which will be beneficial to NZ exporters when converted back into NZ dollars, but on the other hand, does mean that input costs for NZ producers will increase.

On the domestic front, ongoing cost pressures are dominant in a range of sectors from electricity, through to local government (with double-digit rate rises expected this year as well), alongside ever-increasing insurance costs to take account of NZ's unique risk profile. Insurance costs are not only rising in respect to natural hazard risk (Treasury are already consulting on whether to increase the Natural Hazards Insurance Levy by \$400), but also other forms of insurance including healthcare, which is driven by the shortage of medical staff, alongside other pressure on costs such as pay-equity settlements in the public health sector.

The Government also continues to seek ways to offload costs onto the private sector through various cost-recovery mechanisms, although in some cases these costs are generally of a public good nature and should be arguably funded out of general taxation.

While the Reserve Bank clearly has the ability to see through "one-off" price increases when setting on monetary policy decisions, the fact that non-tradeables pressures remain consistent, is a concern.

On the other side of the equation, inflationary pressures have eased in respect to input costs to some industries e.g. agriculture, while rising unemployment and an easing in labour market conditions has kept wage pressure pressures under firm control.

Meanwhile net migration numbers have continued to decline reasonably rapidly thus reducing pressure on the demand for goods and services in general. This is starting to feed through to housing costs and rental prices more generally, with housing costs expected to be relatively subdued over the coming year with a number of forecasting agencies downgrading their earlier bullish forecasts.

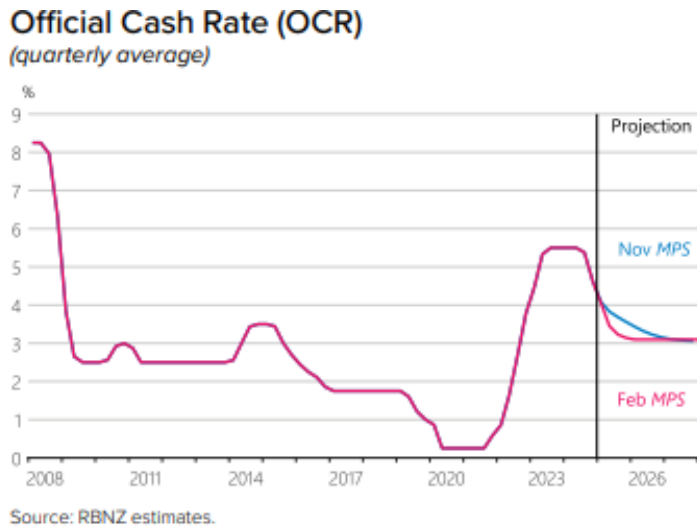
Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Mar 25	Mar 26	Mar 27
Highest	2.5	2.5	2.5
Average	2.3	2.4	2.1
Lowest	2.1	2.3	1.9

Source: ASB, BNZ, Kiwibank and Westpac

Interest rates – further cuts on the cards

Despite recent global upheaval, it is likely that there will be at least another couple of cuts (if not more) to the OCR this year, with the general expectation of an OCR at a neutral level of around 3.0% by the end of the year as outlined in the Reserve Bank’s Monetary Policy Statement – still a much higher “neutral” rate than traditionally has been the case.



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

Geopolitical tensions and protectionism: Rising global tensions, particularly protectionist trade policies, are threatening globalisation and free trade, which adds risk to inflation remaining higher than it otherwise might be.

Higher government debt: Increased levels of government debt around the world are raising borrowing risks, leading to higher risk premiums on loans and consequently higher interest rates.

Climate change: Economic adjustments needed to address climate change are adding uncertainty and potential costs, influencing central banks to reconsider long-term rate projections.

The best short-term fixed rate in NZ (2 years) is currently 4.99% but it is likely that longer-term rates (beyond 3 years) will not move below 5% for a range of reasons.

In addition to the reasons above, banks source their finance from a range of avenues and with long-term interest rates generally holding their own internationally means that the cost of finance will likely remain higher over the longer term.

International risk remains heightened which will add to these pressures as investors seek higher returns to account for geopolitical and policy uncertainty.

On the other hand, the potential exists for interest rates to fall further if indeed investors sit on the sidelines thinking that current uncertainty is not a good time to invest and expand. Already in the US, business and consumer confidence has fallen significantly, with the threat of a recession quite possible. The Trump Administration appears quite comfortable to allow such a recession, given that they believe their relatively radical policy proposals will be of benefit to the US in the long-term. Certainly, the US stock market, and indeed stock markets generally around the world, have not taken kindly to President Trump's economic protectionist prescription.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Mar 25	Mar 26	Mar 27
Highest	3.8	3.5	4.1
Average	3.6	3.2	3.6
Lowest	3.5	2.9	3.2

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – taken a fall but expected to recover

The NZ dollar has generally fallen against most of our major trading partners over recent times.

The NZ dollar has fallen nearly 7% against the US dollar over the past 12 months and 6% on a trade-weighted index basis (TWI).

Both the NZ and Australian dollar have fared worse than almost every major currency, developed or emerging market, over the Trump era.

This is in spite the fact that both countries have so far stayed off the Trump tariff action radar at this stage although just as this was being written, Trump said that there will be no exemptions for Australia on steel or aluminium tariffs.

There are arguably two major reasons for NZ's recent dollar weakness.

Firstly, largely traded and commodity-based currencies such as NZ are under pressure given that swings are part and parcel of outcomes associated with changing investor perceptions.

Second, NZ is heavily exposed to trade with China and given the US's ongoing spat with China (and the introduction of tit for tat tariffs) means that NZ will face some currency fall-out.

Despite current pressures on the NZ dollar, over the longer term some recovery is expected as outlined in the forecasts below – particularly compared to the US.

Notwithstanding, forecasting exchange rate movements even in the short-term is difficult – the long-term, much more so given policy flip flops from key international players.

Forecasts: Exchange Rates

AUD (cents)				USD (cents)			
	Mar 25	Mar 26	Mar 27		Mar 25	Mar 26	Mar 27
Highest	0.91	0.91	0.92	Highest	0.58	0.62	0.67
Average	0.90	0.89	0.89	Average	0.57	0.59	0.63
Lowest	0.89	0.87	0.87	Lowest	0.54	0.55	0.60

TWI			
	Mar 25	Mar 26	Mar 27
Highest	69.0	71.4	73.6
Average	67.6	68.7	71.9
Lowest	65.7	65.1	67.8

Source: ASB, BNZ, Kiwibank and Westpac

1.3 Business activity and consumer confidence – elevated for now

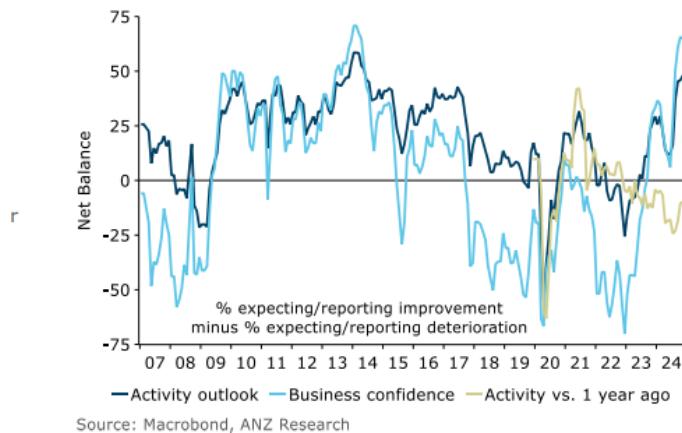
Business confidence remains at high levels, although confidence has not manifested itself in significant changes in investment and output – yet.

The ANZ New Zealand Business Outlook shows that business confidence rose 4 points to +58 in February, while expected own activity eased 1 point to +45. Past own activity (the best GDP indicator) fell 3 points to -3, while past employment was at -7.

Meanwhile one-year ahead inflation expectations continued to drift lower from 2.7% to 2.5%.

Improvements in economy-wide activity were increasingly broad based, with agriculture now firmly in positive mode (more on this later) while other sectors, including construction are still doing it tough.

ANZ NZ Business Outlook



Further out, interest rate reductions are expected to support a gradual recovery in demand although most are not expecting a material lift in activity until the second half of this year.

It should also be noted that despite high levels of business confidence, businesses are not out of the woods yet as reflected in the generally sombre results reflected over the recent business financial reporting season.

Company defaults have continued to rise across all sectors, particularly in construction and transport, with liquidations up by 38% over the past year.

From a consumer/household perspective, things are still pretty dire for many households with consumer confidence stuck at reasonably low levels.

While there are elements of improvement in retail spending, and interest rates continue to trend down, there is still significant uncertainty which is holding back household expenditure.

The latest February Credit Indicator by Centrix shows that while many are predicting further cuts in the OCR later this year, the economic climate remains challenging for many households and businesses.

Mortgage arrears reached an eight-year high with 23,700 home loans past due, a 6% year-on-year increase.

Looking at specific consumer arrear trends, personal loan arrears rose to 9.7% in January and Buy Now Pay Later (BNPL) arrears increased to 8.6%, although both are lower than the previous year.

Furthermore, retail energy payment arrears rose to 5.2%, a 6% year-on-year increase, while teleco arrears rose to 10.7%.

On a more positive note, new mortgage lending increased by 17.7% in January, and new non-mortgage lending also grew.

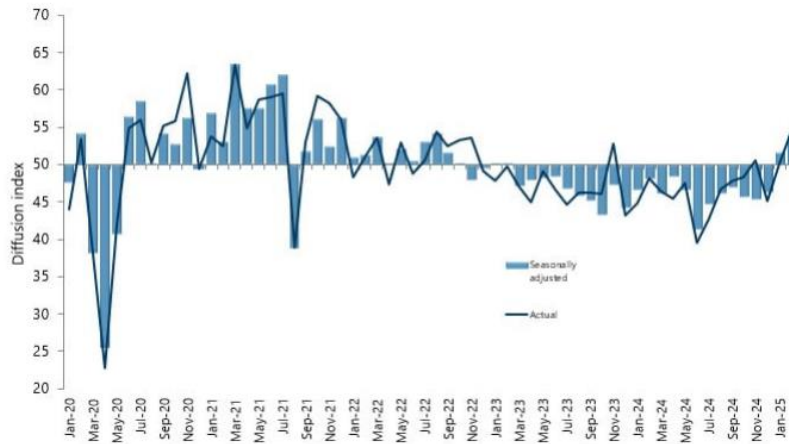
Manufacturing

After close to two years in negative territory (a record since the series began), the manufacturing sector has turned a page with the first two months of 2025 showing positive growth.

NZ's manufacturing sector displayed its highest value for expansion since August 2022, according to the latest BNZ – BusinessNZ Performance of Manufacturing Index (PMI).

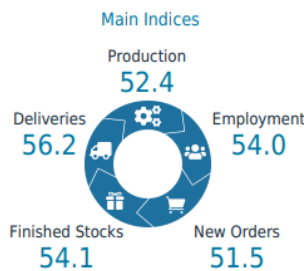
BNZ - BusinessNZ PMI Time Series

January 2020 - February 2025



The seasonally-adjusted PMI for February was 53.9 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This is up from 51.7 in January and the highest level of expansion since August 2022. The February result is also above the long-term average of 52.5 for the survey.

All sub-index values were again in expansion during February. The key sub-index results for both Production (52.4) and New Orders (51.5) were both the highest values recorded since August 2022. Employment (54.0) rose a further 3.2 points from January and at its highest value since September 2021. In addition, both Finished Stocks (54.1) and Deliveries (56.2) experienced notable improvements in expansion, with the latter displaying the strongest level of expansion of the sub-index values in February.



Despite the lift in expansion, the proportion of negative comments from respondents stood at 59.5% in February, compared with 57.7% in January. It was also up from 59% in December and 56% in November. Negative comments during February focused on an ongoing issue around lack of orders for some manufacturers, as well as sluggish sales.

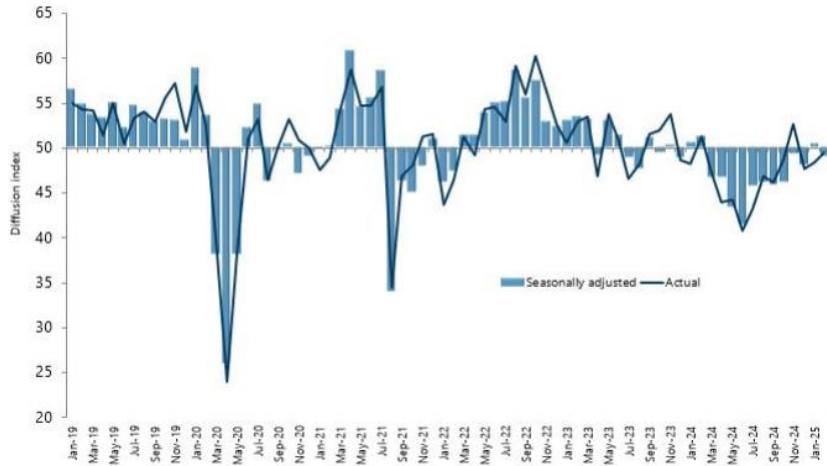
Services

The BNZ – BusinessNZ Performance of Services Index (PSI) is still struggling to keep its head above water with another negative result for February, after being briefly in positive territory for January.

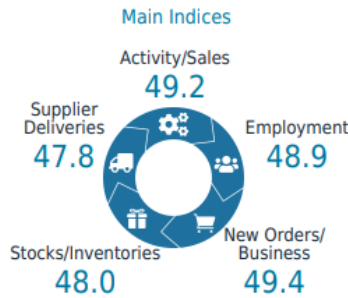
The PSI for February was 49.1 (a PSI reading above 50.0 indicates that the service sector is generally expanding; below 50.0 that it is declining). This was down 1.3 points from January and further away from the average of 53.0 over the history of the survey.

BNZ - BusinessNZ PSI Time Series

January 2019 - February 2025



For the sub-index results, Activity/Sales (49.2) fell 4.6 points after displaying the highest sub-index value for the previous month. New Orders/Business (49.4) slipped back to the same level of activity that was seen in December, although Employment (48.9) did display its highest value since August, albeit still in contraction.



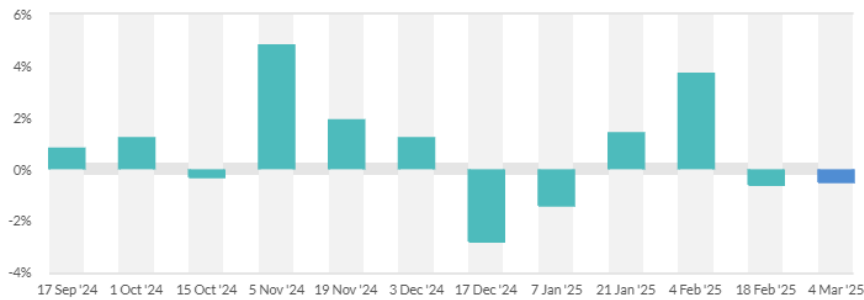
Despite a return to contraction, the proportion of negative comments for February (57.8%) was down from January (61.9%), although still up from 57.5% in December and 53.6% in November. The overall tough economic climate remained the key observation from comments made.

Agriculture

Higher commodity prices have given the agricultural sector a shot in the arm with dairy prices in particular at elevated levels while meat prices remain solid. This, combined with a significantly lower NZ dollar is increasing returns to producers when converted into NZ dollars which is boosting the rural economy. Input costs which plagued the sector over Covid have also fallen away which is providing for increased profitability for the sector.

While the last two Global Dairy Trade (GDT) auctions showed a slight reduction in prices, overall prices have increased significantly from a year ago.

Change in GDT Price Index



The current \$10/kgMS Fonterra farmgate milk price is set to help rural regions with close to a \$20 billion payout for the current season.

At that level, the payout would be the largest ever, up around \$4.5 billion from last season.

Other parts of the sector are also contributing strongly, with kiwifruit export volumes up 44% per annum, apple exports up 14% per annum and fish exports up 7.6% per annum.

Boosts in agricultural product prices, has been positive for NZ Terms of Trade.

The terms of trade increased by 3.1 percent in the December 2024 quarter with export prices for meat products (which are NZ's second largest export commodity by value), up 6.8 percent, lamb prices rose 7.0 percent, while beef and veal prices rose 6.1 percent.

Despite all the positive news on the commodity price front, the agricultural sector still faces issues.

The Agricultural Minister Toood McClay recently announced drought conditions in the Northland, Waikato, Horizons and Marlborough-Tasman regions as a medium scale adverse event, recognising the worsening conditions faced by many farmers across the country.

Below average rainfall continues to make it difficult for farmers as soil moisture levels dry out and stock feed and water become tight in some areas.

Construction

The construction sector continues to do it tough with the number of liquidations up significantly.

Building activity remains subdued while building consent numbers remain below par.

The seasonally-adjusted volume of building work in NZ was \$7.4 billion in the December 2024 quarter, down 4.4 percent compared with the September 2024 quarter, according to StatsNZ.

Residential building work fell 4.9% to \$4.5 billion and non-residential building work fell 3.1 percent to \$2.8 billion (seasonally-adjusted) in the final quarter of 2024.

While the Government has talked about the amount of infrastructure projects that are potentially in the pipeline, the big issue is how such projects are going to be funded. Moreover, with the downturn in building and construction activity over several years, it is debatable as to whether NZ has the available boots on the ground able to undertake such work when it is given the green light.

Given that net migration continues to fall away, the demand for housing is arguably not so pressing as it earlier was which may continue to take some of the heat out of house prices going forward.

A number of forecasting agencies are reviewing their earlier predictions of significant house price rises

over the coming year with most predicting increases from around 3% at the bottom end to around 7% at the top end.

The slight pickup in sales over recent months has been relatively sluggish so far and there is quite a bit of stock on the market which will temper how soon prices lift.

High levels of household debt will also act as a constraint on the ability of potential buyers to bid up prices.

Probably the most important factor impacting on the market will be continued weak net migration, and coupled by weak population growth which could potentially lead to further price falls rather than rises over the next few years.

Another factor which will likely contain housing price growth is the Government's stated desire to open up more land for housing and to provide better funding and financing tools for new developments which should make it more attractive for developers.

The Government also intends making some early changes to the Public Works Act to make it easier to acquire land for new development by providing incentives for property owners to obtain a premium on the market value of their property to encourage more timely acquisitions of required properties for development.

There will also be more streamlined processes to deal with any objections (to valuations) rather than going through the Environment Court which can end up taking years to be resolved.

Retail/hospitality

Retail expenditure is starting to tick up again after a long period of being under pressure.

Lower wholesale interest rates are clearly feeding through into lower mortgage interest rates with the majority of mortgage holders due to refix their mortgages within the next six months.

With floating rates and short terms fixed rates (2 years or less) continuing to drop, will provide a welcome boost to households who have been under the pump for several years.

Nevertheless, despite some improvements of late, consumer confidence remains at low levels as outlined earlier.

The total volume of retail sales in NZ increased by 0.9 percent in the December 2024 quarter compared with the September 2024 quarter, according to StatsNZ.

Ten of the 15 industries had higher retail sales volumes in the December 2024 quarter, compared with the September 2024 quarter, after adjusting for price and seasonal effects.

Meanwhile, changes in the value of electronic card transactions for the February 2025 month (compared with January 2025) were:

- spending in the retail industries increased by 0.3 percent (\$22 million)
- spending in the core retail industries increased by 0.5 per cent (\$28 million)

Hospitality is showing mixed results with a number of big-ticket items (particularly summer concerts) providing for some upswing in activity. On the other hand, a continued stream of restaurants, many long-established at the higher end of the market, have closed their doors for a range of reasons, including lack of demand.

The Restaurant Association of NZ viewpoint on summer trading 2024 shows that optimism about trade

and prospects over the coming year is reasonably balanced between those being optimistic and those being pessimistic. Eight percent of respondents were very optimistic for the year ahead, 35% were somewhat optimistic, 22% were neutral, 33% were somewhat pessimistic and 2% were very pessimistic.

Overall, households still appear to have their wallets firmly tucked away with any improvement in activity being heavily dependent on the continued upturn in international tourists.

Tourism

Talking of tourists, tourism numbers are increasingly getting back on track but there is still a decoupling between overseas tourists and the domestic population with the former improving reasonably rapidly but NZ residents showing mediocre activity.

The 59 percent increase in tourism spend translates to more than \$16 billion in the year to March 2024, but the benefits to NZ's economy go much deeper than the dollar value. As our second largest export industry, tourism employs more than 180,000 people across all regions in both rural and urban settings.

However, if NZ wants to remain a top tourism destination, we must continue investing in much-needed infrastructure, so visitors can enjoy a high-quality experience.

A lower NZ dollar of late has meant that NZ is also a more attractive destination, particularly those coming from the United States.

1.4 Labour market – bottoming out?

Forecasts below shows that unemployment is very close to peaking this year and is expected to drift lower in the out years as employment prospects improve.

As employment growth typically lags economic growth, employment growth is expected to remain subdued over the next year.

The unemployment rate is currently 5.1 percent (HLFS for the December quarter) with a number of factors indicating that spare capacity remains. Businesses report that it is generally easier to find staff while there is a greater proportion of people indicating that that would like to work more hours.

Nevertheless, recent data suggests that the labour market, while still containing significant slack, is close to bottoming out with expectations of improving hiring intentions and increasing number of job ads going forward.

The most recent BNZ – BusinessNZ Performance of Manufacturing (PMI) shows that Employment (54.0 in February) rose a further 3.2 points from January and is at its highest level since September 2021. Meanwhile, its sister survey, the BNZ – BusinessNZ Performance of Services (PSI) showed that although Employment (48.9) did display its highest value since August last year, it is still in contraction.

Net migration continues to fall which will also reduce the available labour supply, given that by and large the largest cohort of New Zealanders existing the country are the most talented and youngest of our population. This loss of talent is concerning given that it represents a massive loss of future human capital. While the exodus of Kiwis has been more than offset to date by new migrants and returning New Zealanders, in general their overall skill levels may not be as high as those exiting the country.

This also has significant impacts in terms of productivity given that what NZ really needs is highly skilled individuals who can improve our potential productivity. Unskilled individuals, tend to take more training

and development and hence don't add to productivity as rapidly as higher skilled individuals given the time it takes for them to get up to speed.

Meanwhile, the Government continues to tweak migration visa settings, moves which are generally endorsed by businesses in terms of attracting appropriate migrants to NZ.

Notwithstanding these continued changes to migration visas setting, it is important, longer-term, that NZ has a bipartisan approach to immigration settings, so businesses and prospective migrants have clear and transparent information on which to make decisions about where to live and work. Ad-hoc changes tend to muddy the waters and create further uncertainty which is not what NZ needs if it is to attract the best and brightest to our shores in the face of broad international competition for such people.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Mar 25	Mar 26	Mar 27
Highest	5.3	5.2	4.9
Average	5.3	5.1	4.7
Lowest	5.2	4.7	4.4

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – under control

With relatively weak labour market conditions still prevalent, and headline inflation well within the Reserve Bank's target band, forecasts are for wage growth to steady at around 2 percent per annum in the out years.

Greater efforts by Government to get its expenditure under control through further initiatives aimed at improving the efficiency of the public sector (and potentially further redundancies) should see wage negotiation outcomes much more constrained in the public sector than they have been in the past. The public sector has tended to lead wage growth over recent times through various mechanisms as pay equity settlements in the health sector.

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

	Years Ending		
	Mar 25	Mar 26	Mar 27
Highest	3.0	2.1	2.2
Average	2.9	2.0	2.1
Lowest	2.6	1.9	1.9

Source: ASB, BNZ, Kiwibank and Westpac