BUSINESS NZ

PLANNING FORECAST

SEPTEMBER 2024

NZ Economy: Flicker of light

Executive Summary

The BusinessNZ Planning Forecast for the September Quarter shows a flicker of light at the end of the tunnel, as evidenced by improvements in business and consumer confidence of late.

While both businesses and households are still doing it tough, there are a number of indicators that suggest we are close to or possibly past the worst of the economic downturn and can look forward to improved economic outcomes ahead. However, improvements are largely forecast to be incremental at this stage as outlined in the forecasts below.

Inflation, while still outside the Reserve Bank's target range of 1-3 percent, is heading in the right direction. As inflationary pressures fall, the Reserve Bank has tracked a clear path for further interest rate cuts over the next year or two although it is noted that their position of a "neutral" Official Cash Rate (OCR) is now closer to 3 percent than previously indicated. Nevertheless, there are now much clearer signals to markets and lending institutions that the future direction of interest rates is clearly down. This should provide a shot in the arm to businesses and households burdened by high interest rates over recent times.

NZ still faces significant challenges which should not be underestimated, including an ageing population (implications for future health funding and superannuation), rising Government debt levels (which need to be funded), and regulatory policy challenges, to name a few. However, there are early signs that progress is being made to improve the capacity of the economy to deliver the growth that is needed to provide for the goods and services that New Zealanders should demand as a first world country.

The Government for its part is moving the dial on regulatory policy by trying to strip away some of the archaic rules that are holding many sectors back from reaching their potential while efforts to rein in unnecessary expenditure are assisting the Reserve Bank to get the inflation genie back in the bottle.

In this respect, moves by the current Government to focus the Reserve Bank solely on price stability, rein in unnecessary expenditure and start to address the huge regulatory blockages holding the economy back are to be commended. However, current efforts need to be supercharged in the regulatory reform space.

One big issue which is under consideration currently is in the area of resource management and resource use. The Government has started work addressing some early priorities e.g., the introduction of the Fast Track Approvals Bill to speed up consenting for some major projects, and the Resource Management (Freshwater and Other Matters) Amendment Bill which proposes urgent targeted changes to reduce the regulatory burden on key sectors including farming, mining and other primary industries.

It is noted that the Government is committed to further reforms of the Resource Management system later this Parliamentary term, with new resource management laws based on the guiding principle of the enjoyment of property rights. BusinessNZ supports this approach, given it is necessary to remove blockages to growth as a matter of urgency.

Internationally, significant challenges remain with geopolitical tensions still a significant issue, while greater moves towards trade barriers and protectionism are not helpful in furthering international growth. Despite all these risks, there are some bright spots for the NZ economy with commodity prices starting to improve again, which is good news for NZ producers in the agricultural sector in particular.

HIGHLIGHTS

The NZ economy continues to face significant headwinds with only incremental improvements in economic growth over the forecast period.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 8 for the September 2024 quarter, up 13 on the previous quarter, and up 30 on a year ago. Improvements in business and consumer sentiment, and declining interest rates, have been offset somewhat by weaker labour market conditions.

Both the BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI) have shown incremental improvements of late, but both are still tracking well below par.

Other sectors continue to struggle, with construction activity subdued while retailers and hospitality battle to keep their heads above water as households keep their wallets firmly shut. Tourism, while improving, is still performing at sub pre-covid levels.

The agricultural sector is showing signs of improvement on the back of improving international commodity prices (particularly dairy), although this has been offset by continued high input prices which are impacting on profitability.

Internationally, significant challenges remain with geopolitical tensions still a significant issue while greater moves towards protectionism are creating barriers to trade. Risks continue to remain around shipping routes with elevated costs and delays.

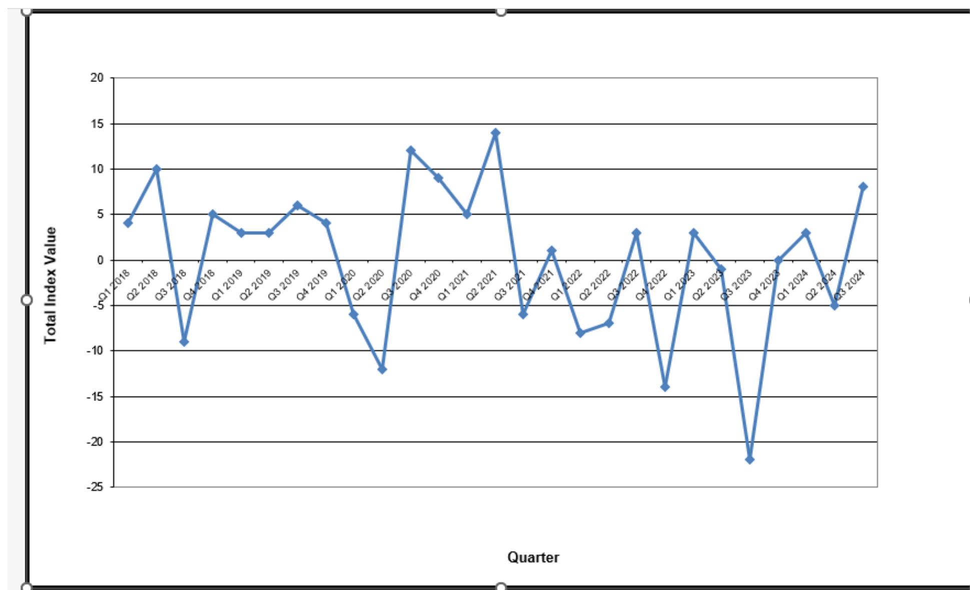
Concerns remain about the world's largest economy, the US, with the US election shaping up as a cliffhanger while concerns remain over the future direction of US trade policy.

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

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 8 for the September 2024 quarter, up 13 on the previous quarter, and up 30 on a year ago. Improvements in the ECI as a result of stronger business and consumer sentiment, and declining interest rates, have been offset somewhat by weaker labour market conditions. Despite continued improvements of late, it needs to be remembered that this is off a very low base and as such, economic growth is still forecast to be mediocre over the forecast period.

N.B. 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 September quarter 2024 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 7 for the September 2024 quarter, up 8 on the previous quarter and up 13 on a year ago. Commodity prices have generally increased of late, which is positive for the agricultural sector, and dairy in particular, with the projected milk payout for the current season improving.

Monetary policy/pricing indicators sit at 4 for the September 2024 quarter, up 2 on the previous quarter, and up 11 on a year ago. With further downward pressures on inflation, interest rates are now starting to ease, which will be of some relief to both businesses and households. However, interest rates are unlikely to reach the consistently low levels seen pre-Covid for a range of reasons outlined below.

Business/consumer confidence indicators sit at 4 for the September 2024 quarter, up 9 on the previous quarter and also up 9 on a year ago. After being at historically low levels, there was only one way that business and consumer confidence could go – up. Improving commodity prices, and perhaps more importantly, the realisation that inflation is being tamed and interest rates are now on the way down, is providing some confidence that there is light at the end of the tunnel. However, business conditions are still tough with lack of demand being the key issue of late.

Labour market indicators sit at -7 for the September 2024 quarter, down 6 on the previous quarter and down 3 on a year ago. The labour market is showing continued signs of easing after being extremely tight for the past 3 years. Declining employment opportunities and rising unemployment are now evident while net migration, after having surged for the past 2 years, is now reversing. The number of Kiwis exiting NZ in pursuit of better prospects overseas is of concern.

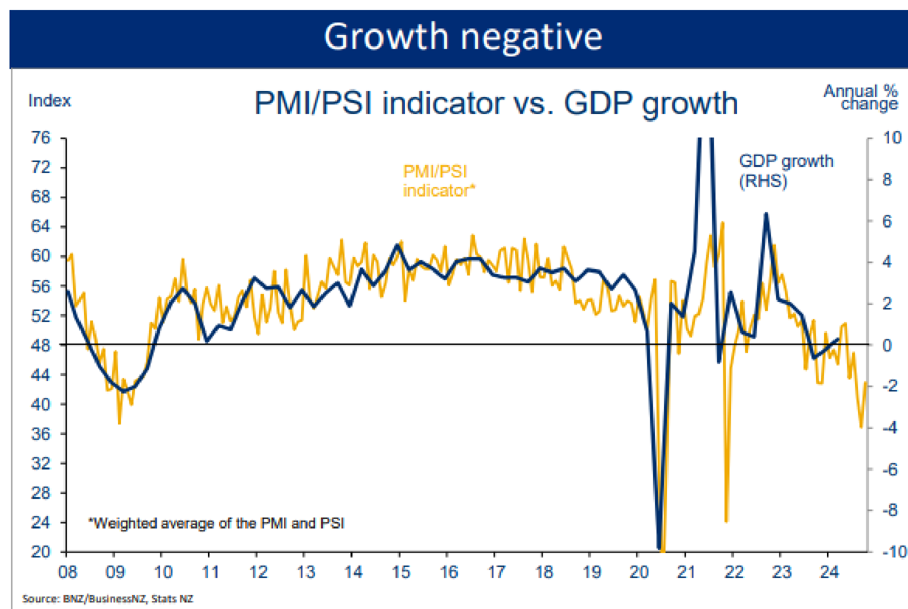
PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING?

1.1 Economic growth (GDP) – incremental improvement

Economic growth is expected to improve incrementally over the forecast period out to September 2026, but off a very low base. Growth over the past few years has been mediocre, and negative when translated into a per capita basis.

The June quarter of negative growth (-0.2%) was largely expected although there have been some improvements in more recent data.

The BNZ-BusinessNZ Performance of Composite Index (PCI) shows historically there has been a close correlation between the PCI and overall economic growth (GDP), with the weak PCI in August suggesting contraction is likely to continue into Q3. More encouragingly, while the manufacturing and services sectors are still contracting, their rate of contraction has eased, adding to a host of economic indicators that have become at least less negative over the past month or so.



Improved business and consumer sentiment may suggest improving growth prospects, although improvements were inevitable after both have been mostly in the doldrums for the past couple of years.

More significantly, both businesses and households can now look forward to further significant interest rate cuts over the next couple of years as the Reserve Bank sets to work in rewinding the significant increases in the OCR since 2022.

Another positive is that international commodity prices for key agricultural products such as beef and dairy have improved of late, which is good news for NZ's regional economies.

Offsetting this to some extent are funding pressures on some sectors: the agricultural sector and those responsible for development of fossil fuels have expressed concerns about their ability to fund ongoing development given that some banks are appearing to take a harder line on lending to such sectors despite the apparent lack of financial risks to banks from lending to them.

Those sectors should be able to access funding no less than any other sector of the economy. It should be noted that fossil fuels were acutely needed during the recent energy crisis, when insufficient renewable hydro- and wind-generated energy sources were available.

Businesses need to be able to get on with the job of providing goods and services demanded within the economy while at the same time maintaining NZ's international competitiveness. Tax and spend policies are unlikely to grow the economic pie and will further encourage NZ's youngest and brightest talent to move offshore.

New Zealanders need to be able to have mature conversations about some of the more long-term issues facing NZ without trying to close down conversations that need to happen.

For issues such as healthcare policies, the future of NZ Superannuation, the management and use of natural resources, immigration settings, issues related to climate change, appropriate management of natural hazards and others, it is important to discuss the costs and benefits of taking early (or no) action and the trade-offs that may be involved.

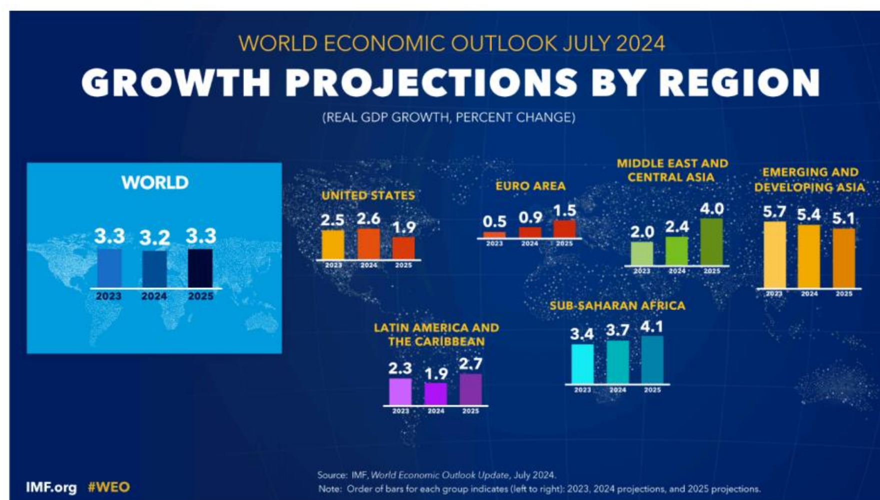
Just about every issue and policy requires trade-offs and it is important that decisions on resource use reflect both the costs and benefits of taking a specific regulatory position.

BusinessNZ has been encouraging political parties, business organisations, and businesses to look for consensus on some of the long-term issues facing NZ, in the interests of policy stability. The objective is to achieve agreement on policies that are based on international best practice, acknowledging that NZ is a small economy, distant from world markets but heavily dependent on international trade for our economic livelihood - therefore our regulatory settings have to be up there with the best in the world.

Internationally, significant challenges remain, with geopolitical tensions still rising and greater moves towards protectionism creating barriers to trade. Elevated costs as a result of restrictions on shipping routes are bringing higher prices and delays.

Key concerns remain about the world's largest economy with the US elections shaping up as a cliffhanger, as concerns remain over the future direction of the US trade policy if either Donald Trump or current Vice President Kamala Harris are elected President in November.

According to the International Monetary Fund (IMF) World Economic Outlook Update (July 2024), global economic growth is projected at a respectable 3.2 percent in 2024 and 3.3 percent in 2025. However, services price inflation is hampering disinflation, which is complicating monetary policy normalisation. Upside risks to inflation have increased, raising the prospects of higher-for-even-longer interest rates, in the context of escalating trade tensions and increased policy uncertainty.



The IMF also pointed out that nominal wage growth remains brisk and above the level of price inflation in some countries, partly reflecting the outcomes of wage negotiations earlier this year and short-term inflation expectations remaining above target.

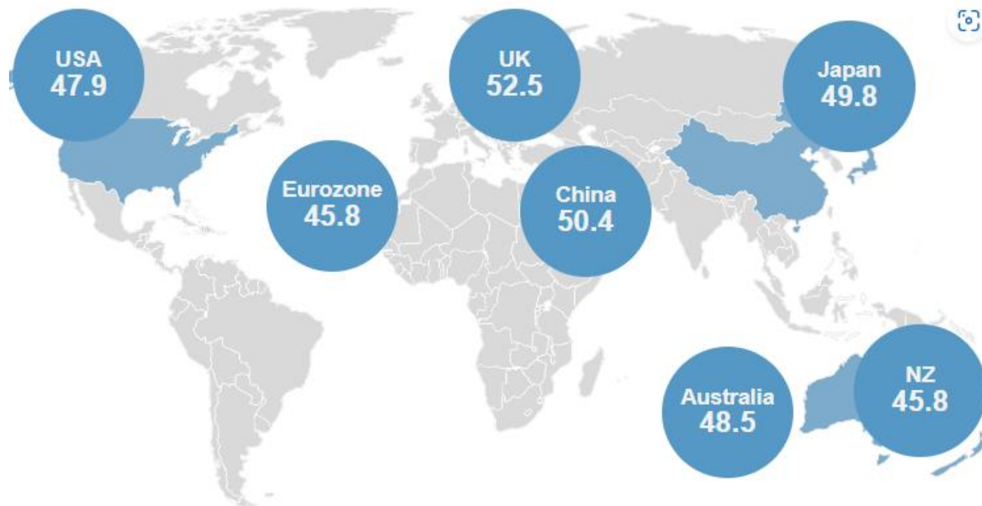
Alongside the risk of evaluated inflation and the potential for interest rates to remain higher for longer, the IMF has also pointed out the potential for significant swings in economic policy as a result of elections this year, with the potential for negative spillovers to the rest of the world. The potential for fiscal profligacy risks will worsen debt while trade tariffs, alongside a scaling up of industrial policies worldwide, could potentially trigger retaliatory action, resulting in a costly race to the bottom.

Meanwhile, globally, manufacturing activity is showing continuing weakness.

International Results

J.P. Morgan Global Manufacturing PMI™
03 Sep 2024

49.5



The JP Morgan Global Manufacturing PMI for August showed that production, new orders and employment posted mild contractions, and global trade flows deteriorated for the third month in a row. The index fell to an eight-month low of 49.5 in August to remain below the neutral 50.0 mark for the second successive month.

Of the 31 surveys for which August data were available, 18 registered a PMI reading consistent with a deterioration in manufacturing operating conditions. This included downturns in the US, the euro area as a whole, and Japan. Although the China PMI moved slightly back above the no-change mark, at 50.4 it remained at a subdued level.

While NZ is responsible for around 35% of world trade in dairy products, it is a trade minnow overall, contributing far less than 1% of world GDP, and is heavily dependent on China and Australia which together account for around 40% of NZ trade.

Given NZ's reliance on China as our biggest trading partner, the outlook for China is critically important for NZ's economic wellbeing. It is therefore concerning that that Chinese economy is yet to fully recover from significant lockdowns during Covid, with property markets still facing cripplingly high debt levels.

Forecasts: Real GDP percent Growth

	Years Ending		
	Sep 24	Sep 25	Sep 26
Highest	0.0	1.3	3.2
Average	-0.2	1.0	2.6
Lowest	-0.3	0.8	2.2

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary Policy – reset

In May, the Reserve Bank intimated that there would be no interest rate cuts this year and further interest rate increases were possible. So, the Reserve Bank's OCR cut in August caught markets somewhat by surprise.

Many in business knew that the economy was facing significant downside risks from mid-2023 which was not only reflected in official StatsNZ data but also other forward-looking indicators such the BNZ-BusinessNZ Performance of Manufacturing Index (PMI) and the BNZ–BusinessNZ Performance of Services Index (PSI). GDP growth closely mirrors these Indexes.

The Reserve Bank has belatedly accepted that inflation is beaten and will likely continue to reduce the OCR over the next couple of years down towards a more 'neutral' level.

Inflation – under the thumb

Inflationary pressures continue to ease and may be within the Reserve Bank's target range of 1-3 percent soon, although we will have to wait for a few weeks to get confirmation from StatsNZ whether this is indeed the case.

The forecasts below show inflation is likely to settle at the mid-range of the Reserve Bank's target range of 1-3 percent by 2026.

While tradeables inflation has been under control for some time, non-tradeables (domestically-generated) inflation remained high through to the last official statistics for the June quarter. However, limited data since that time shows that even non-tradeables inflation is starting to fall away, despite one or two continuing hot spots.

These hotspots include continued increases in council rates, and in insurance costs, as insurance policies are repriced to better align with physical and climate risks facing particular sectors and regions. It is unlikely that these hotspots will cool over the short to medium term, but there is little the Reserve Bank can do about them.

Tradeables inflation has stabilised in tandem with the stabilisation of international energy prices, although there are still delays and elevated costs in supply chains given geopolitical pressures on some shipping routes. Moreover, increased moves towards protectionism though the threat of tariffs and tit-for-tat trade policies may bring further price rises in future.

The Government is regulating for greater contestability for products such as building supplies, provided they meet acceptable international standards. Over time, this should bring lower costs for housing and development.

Significant reductions in household demand have resulted in housing prices consolidating at slightly lower levels. More broadly, reduced demand for goods and services across the board has resulted in excess capacity, with many businesses reviewing pricing systems and also in a number of cases letting staff go or closing down altogether.

Net migration, while still high, is now coming down fast, which will ease demand for housing and other goods and services which households require. This will likely see housing prices and rents stabilise or ease in some cases, possibly according to region, as there are significant regional variations in house and rent price movements, depending on the relative economic strength of each region.

On balance, all the above factors when aggregated would suggest inflation easing over the short to medium term.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Sep 24	Sep 25	Sep 26
Highest	2.7	2.1	2.2
Average	2.5	2.1	2.1
Lowest	2.2	2.0	1.9

Source: ASB, BNZ, Kiwibank and Westpac

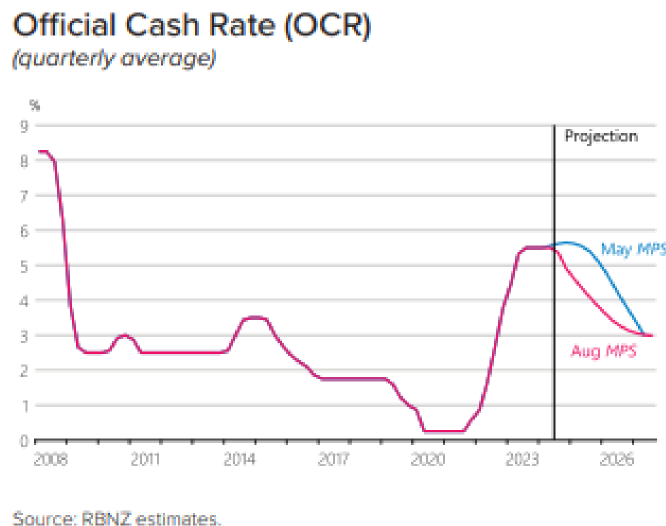
Interest Rates – on the way down, but how far?

The Reserve Bank's latest monetary policy statement pulled the trigger, starting an interest rate-reduction programme. Now the question is how soon - and how far - will the Reserve Bank move towards an OCR at more neutral levels.

Banks are clearly anticipating further significant cuts over the next year or so and have front-loaded mortgage rate cuts to households and businesses in NZ.

While this will be welcome relief for many mortgages holders, it is unlikely that interest rates will retreat to levels seen before Covid-19 struck the economy and resulted in mass pump-priming of monetary policy (quantitative easing), alongside the OCR dropping to 0.25 percent for a sustained period.

The Reserve Bank projections suggest that the OCR will keep falling from here and settle at about 3 percent by early 2027 as can be seen from the graph below.



While it is difficult to predict where the OCR 'neutral' level is, historically, most economists have thought it to be perhaps a little over 2% which aligns with the Reserve Banks's target range for inflation of 1-3 percent. This has certainly been the case over recent years, apart from during Covid and its aftermath.

In the decade preceding Covid, the OCR fell as low as 1% and reached as high as 3.5%, but averaged just over 2% over the entire period.

Today, the Reserve Bank considers that the long-term neutral level of the OCR is just under 3% (2.8%), which is up significantly from 2.3% a year ago and also well above the historic estimates of around 2%.

This is not only the case in NZ, but many other central banks, including the US Federal reserve, have also been revising estimates up from earlier projections.

While economists - or any other person for that matter - can precisely calculate where the neutral rate is at any given point in point, the broad consensus is that it is higher than has been the case in the past.

The obvious question is, why? And what does this mean for future mortgage rates?

There are several factors at play, including geopolitical tensions threatening globalisation and free trade, and moves toward protectionism and insular trade regimes. Additionally, higher levels of Government debt around the world bring increased risk, and hence a risk premium is demanded on borrowing. Issues related to climate change are also a contributing factor.

All these factors increase the risk of inflation and interest rates settling at higher rates than have been seen in the past, and it is unlikely, in our view, that we will see fixed rate mortgages with a 4 in front of them for a considerable period of time, if ever. Longer-term mortgage rates will likely settle in the low 5% mark which might be disappointing for those who thought that interest rates still have a long way to drop yet.

Fixing for around 18 months at just under 6% is probably the best bet for households with mortgages coming up for renewal over the next month or so. Obviously, everyone's situation is different with different considerations, but holding off for substantially lower rates may be wishful thinking, given continuing international and domestic uncertainty.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Sep 24	Sep 25	Sep 26
Highest	5.3	4.0	3.9
Average	5.2	3.6	3.3
Lowest	5.0	3.3	2.9

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – moveable feast

The NZ dollar has moved around recently as many major economies including the US have either cut interest rates or are likely to at the next review.

The Federal Reserve's decision to cut rates by a significant 50 basis points was largely expected by financial markets, given the continuing softening of inflation in the US likely to result in further weakening of the greenback. Many commentators consider the US economy is cooling far more rapidly than earlier considered and this is impacting on exchange rates around the world.

It is also having an effect on recent share market behaviour, with a tendency for some volatility in the Dow Jones Index over recent weeks as markets try to make sense of new data coming through.

The NZ dollar has often been tied to the fortunes of international commodity prices, and in this respect there has been some upward movement in prices over recent months.

Also, the Coalition Government's more business-friendly policies relating to property rights and foreign investment might be helping increase international interest in investing in NZ.

Further reforms of the Resource Management Act along with Government intentions to make better use of NZ's mineral wealth may also help underpin the value of the NZ dollar.

On the other hand, the Government's current account deficit, while still projected to improve (from a low base), is still a cause for concern, showing that NZ is still not paying its way in the world.

Irrespective of all the above, the future direction of the NZ dollar is difficult to predict, as evidenced by the wide range of forecasts presented below:

Forecasts: Exchange Rates

AUD (cents)			
	Sep 24	Sep 25	Sep 26
Highest	0.92	0.94	0.95
Average	0.91	0.91	0.91
Lowest	0.91	0.89	0.88

USD (cents)			
	Sep 24	Sep 25	Sep 26
Highest	0.61	0.66	0.69
Average	0.61	0.64	0.67
Lowest	0.60	0.62	0.64

TWI			
	Sep 24	Sep 25	Sep 26
Highest	70.6	73.0	74.7
Average	70.4	72.0	72.7
Lowest	70.2	70.7	70.1

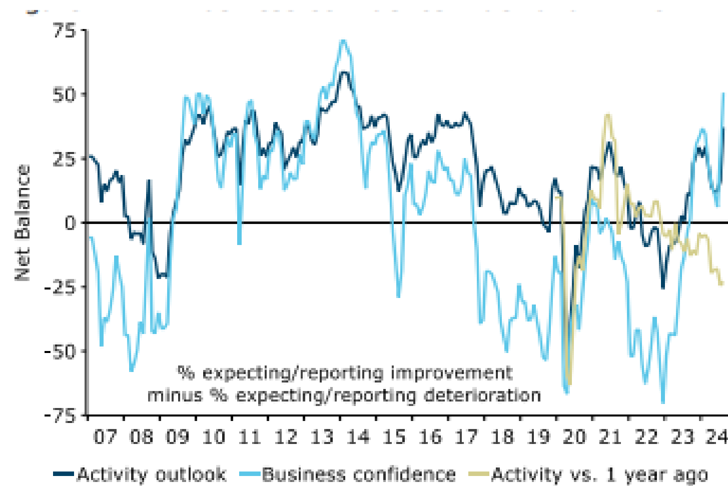
Source: ASB, BNZ, Kiwibank and Westpac

1.3 Business activity and consumer sentiment – improving off a low base

A number of recent business and consumer opinion surveys show sentiment in the future economic outlook is improving. However, while confidence might be improving, it is off a very low base.

According to the ANZ Business Outlook for August 2024, business confidence soared 23 points to +51, the highest level in a decade. While 'expected own activity' jumped 21 points to +37, a 7-year high, 'own experienced activity' rose just 1 point to -21, still very weak.

ANZ NZ Business Outlook



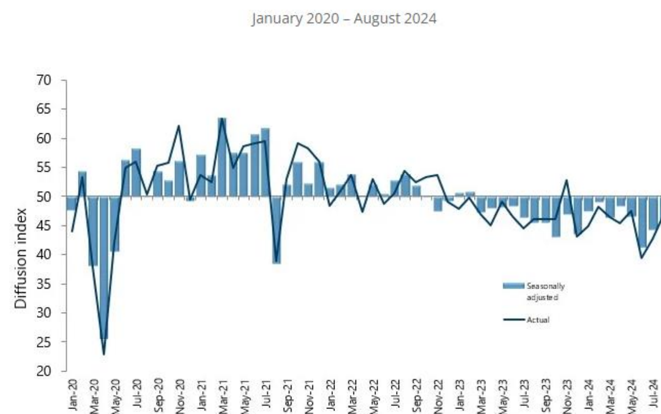
While it is likely that at least some of the upswing in confidence will be as a result of the Reserve Bank cutting the OCR, with further cuts expected over the next couple of years, other activity indicactors show that businesses continue to do it tough and we should not get ahead of ourselves as a result of one or two opinion surveys.

The hard data don't lie, and here the results make for much more subdued reading. Almost all sectors remain under the pump, despite very tentative signs of improvement of late.

Data from Centrix reveal company liquidations continue to rise across NZ. They are mainly recorded in Auckland, which contributed 383 liquidations for the second quarter of 2024, followed by the rest of the North Island (174) and South Island (85).

Over the past year, the manufacturing sector has been particularly impacted and has seen a 15% rise in liquidations, with furniture and fabricated metal manufacturers suffering the most.

The latest BNZ-BusinessNZ Perfomance of Manufacturing Index (PMI) shows manufacturing still in the red. The seasonally-adjusted PMI for August was 45.8 (a PMI reading above 50 indicates that manufacturing is generally expanding; below 50 that it is declining). This was up from 44.4 in July, but still sgnificantly below the long-term average of 52.6. The sector has now been in contraction for 18 consecutive months.



While the PMI is heading back in the right direction, having been firmly in contraction in the last 18 months means there is still some way to go.

The key sub-index results for Production (46.3) and New Orders (46.8) were both the stongest they have been in a few months, with the former improving significantly from June. Employment (46.6) recovered somewhat from its June/July dip, while Finished Stocks (46.2) was all but unchanged from July.

Given the onging improvement in activity for August, the proportion of negative comments stood at 64.2% for the current month compared with 71.1% in July and 76.3% in June. Negative comments were particularly focused on the general economic recession, includinig low demand and cost of living issues.

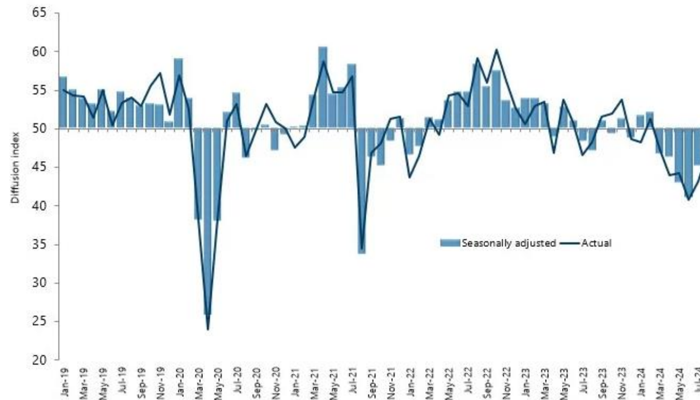
The BNZ–BusinessNZ Performance of Services Index (PSI) is also performing at sub-par levels.

Activity in the services sector inched higher during August, although still remaining in contraction.

The PSI for August was 45.5 (a PSI reading above 50.0 indicates that the services sector is generally expanding; below 50.0 that is it is declining). This was up 0.3 points from July but still well below the average of 53.2 over the history of the survey.

BNZ – BusinessNZ PSI Time Series

January 2019 – August 2024



Despite two consecutive months showing a lift in activity levels, the key index value of Activity/Sales (43.9) remains lacklustre, while New Orders/Business (46.6) dipped slightly from July. On a more positive note, Employment (49.2) lifted to its highest result since March.

Smoothing through monthly volatility, the PSI's 3-month average remains deep in contractionary territory at 43.9. The PSI has been in contraction for six consecutive months which is the longest continued period of decline since the Global Financial Crisis, a decade and a half ago.

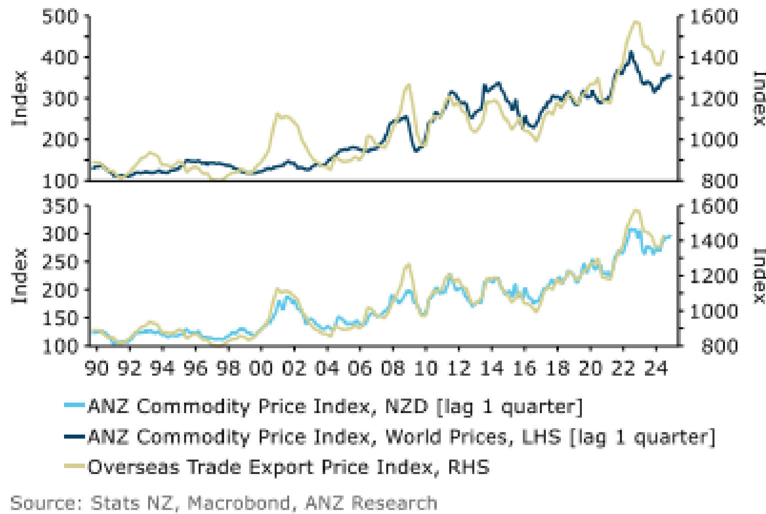
The proportion of negative comments for August stood at 60.8%, which was down from 67.0% in both June and July. Respondents continued to note the high cost of living and general economic conditions as reasons for ongoing tough times.

Indicators from other sectors remain mixed.

The agricultural sector is showing resilience, with generally improving commodity prices, particularly dairy.

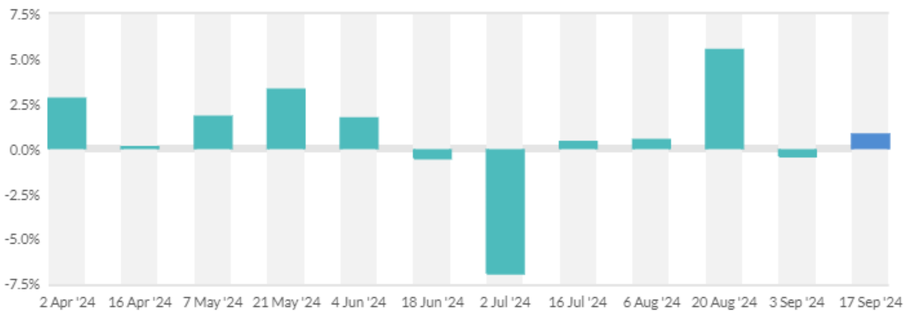
The ANZ World Commodity Price Index increased 2.1% (month on month) in August as prices for meat and dairy had a strong month. In NZ dollar terms, the index lifted 1.5% (month on month) as the NZD Trade Weighted Index fell 0.7%.

In world price terms, dairy prices lifted 3.2% (m/m) in August. There has been a lift in urgency from buyers as they start to secure new-season product from NZ.



Fonterra has recently upgraded its projected payout to suppliers for the new (2024/25 season) from a range of $7.25-$8.75 per kilogram MS in May to $7.75 - $9.25 per kilogram MS on August 23.

The Global Dairy Trade (GDT) continues to generally improve with the latest auction showing a 0.8% gain.



Meanwhile, the meat and fibre index gained 2.7% m/m with the index now up a healthy 18.9% y/y. There is not a lot of beef being processed at present and the tighter supply is supporting prices. Meanwhile lamb returns for cuts being sold into the UK and the US have lifted, but the Chinese market remains tough for exporters.

Input costs remain high, dampening profit margins, while recent weather events may take their toll on new season lambing percentages, including late weather storms affecting particularly the lower South Island.

Debt servicing costs will likely fall, in line with general reductions in interest rates across the board. However, as mentioned earlier, agricultural production is hampered by borrowing constraints given some banks' concerns about supporting an industry which is responsible for significant methane generation through livestock.

The construction sector remains subdued as building consent numbers continue to fall away, and businesses and households await further movements in interest rates before committing to new projects.

The seasonally-adjusted volume of building work in NZ was $8.2 billion in the June 2024 quarter, down 0.2 percent compared with the March 2024 quarter, according to StatsNZ figures.

This is the lowest volume of building activity seen in a June quarter since the Covid-impacted June 2020 quarter.

The seasonally-adjusted volume of residential building work fell 0.7 percent to $5.2 billion over the quarter, and non-residential building construction fell 0.1 percent to $3.0 billion over the same period.

House prices remain subdued for a range of reasons.

First, high interest rates have, until very recently, kept many people out of the housing market.

Second, concerns over future employment prospects have created a degree of nervousness about households buying new or existing houses.

Third, constraints on banks' lending through the provision of Debt-to-Income Ratios (DTIs) and generally more concerns about risks have resulted in lending levels showing little growth.

Fourth, while net migration levels have remained high, they are falling away quite rapidly as the economy faces headwinds, with many New Zealanders now leaving the country in search of more opportunities overseas, particularly to Australia.

Demand for housing over coming months and years is likely to be subdued as a result of lower population growth, probably leading to fewer people in the housing market. In this respect, it is noted that rental accommodation prices have generally stabilised, and have declined in some cases.

On the other hand, changing tax rules to allow for interest rate deductibility on rental properties and reining in the bright line test may not be enough to entice developers back into the market, although declines in interest rates should spark more interest from first home buyers than in the recent past.

Meanwhile, the retail sector is still struggling. Official figures show retail sales volumes have decreased in 9 out of the last 10 quarters through to Q2 this year. The outlook is a contest between income tax relief and interest rate reduction on the positive side, and a deteriorating labour market and subdued housing market on the negative side. Also on the bright side, lower fuel prices will provide some support to the purchasing power of household disposable income.

The Accident Compensation Corporation is currently consulting on ACC levies which will apply from 2025-28 for the Work Account (work-related injuries), the Earners Account (non-work injuries to earners), and the Motor Vehicle Account (which generally funds most accident on roads).

All Accounts are facing significant increases which will eat into the pockets of households. BusinessNZ has serious concerns about the funding of the Earners Account, given its continued underfunding of claims. Significant increases in levies will be required for this Account to get out of the red anytime soon. This will obviously result in increased costs for all levy payers and further erode any benefits from the tax cuts earlier this year.

The hospitality and tourism sectors are showing continuing signs of improvement although overseas tourist numbers have not reached the heights achieved pre-Covid.

The post-Covid recovery in tourism is picking up pace after stalling late last year. Visitor arrivals ticked up 2.3% in July and are now sitting at around 85% of pre-Covid levels. Chinese arrivals have begun to pick up, now sitting at around 70% of pre-2020 levels, up from 60% during the first half of the year. Recent arrivals numbers are promising, but continued soft economic conditions in China are expected to constrain tourism arrival numbers for some time.

The Government's recent decision to increase the visitor levy from $35 to $100 for most people entering NZ has not gone down well with the sector, with some operators saying it will have a detrimental impact on tourism numbers. While this can be debated, it is important that any money taken as part of the visitor levy is targeted at upgrading the services required by overseas tourists, where direct user-pays is not feasible. There is nervousness that, with the Government's coffers very constrained, there could be moves to siphon off levy revenue obtained from tourists to fund departmental activities (which arguably should be funded out of general taxation), rather than funding tourism needs.

There is also a general concern within the business community that Government may be imposing levies on sectors as a de facto means of supporting government activities, potentially diverting the flow of funds between levy payers and the levy purpose.

A number of examples can be cited, such as the Government decision to increase levies on waste going to landfill (beyond normal landfill charges), while using such funds to benefit the wider community. In this respect there is a clear disconnect between the levy payers and the use of the levy funds.

With respect to the funding of Fire and Emergency NZ (FENZ), the Government is reducing further its already small contribution to the funding of the public good aspects of the FENZ. This was announced in the Budget Estimates that accompanied the Budget in May 2024.

With respect to immigration and a number of apparently ad hoc costs imposed on those seeking visas and border entry into NZ, there are concerns that these do not necessarily reflect the costs of the system itself, but are simply easy ways of boosting departmental budgets to carry out 'public good' aspects of migration policy.

In is important that where Government imposes cost on third party users of services, those costs are related to the services in question, and not simply imposed on households and businesses to help offset general government Budgetary constraints. This may be a good area for the Ministry for Regulation to tackle, given the Government's objective of removing unnecessary barriers, red tape and costs facing the business community.

Meanwhile, consumer sentiment remains downbeat, as reflected in a number of credit indicators.

The August Credit Index by Centrix shows a mixed picture for consumer credit.

During July, consumer arrears continued to ease, with the number of people behind on their payments falling to 456,000 - down 9,000 month-on-month. Centrix considers this reflects improved consumer sentiment given lower interest rates and anticipated significant further reductions in future.

Overall, consumer credit demand is down 3% compared to last year, with auto loan demand dropping by 22%, as new car sales continue to decline. Credit card applications are up 5% from last year but remain 40% below 2019 levels.

Meanwhile, mortage delinquencies improved slightly in July, with 21,000 home loans reported as past due, down 500 from the previous month. However, this is still up 12% year-on-year. Mortage demand also remains subdued, with application inquries down 1.5% year-on-year.

The Westpac McDermott Miller Consumer Confidence Index for the September quarter shows consumer confidence rising 9 points to 90.8%. Although that still leaves confidence at low levels, it looks like some of the pessimissm about the outlook is starting to ease with this latest small improvement in confidence.

NZ households continue to report pressure on their finances, and that has been a drag on their spending. Hopefully, with inflation now trending down, associated interest rate cuts will provide for greater confidence in future.

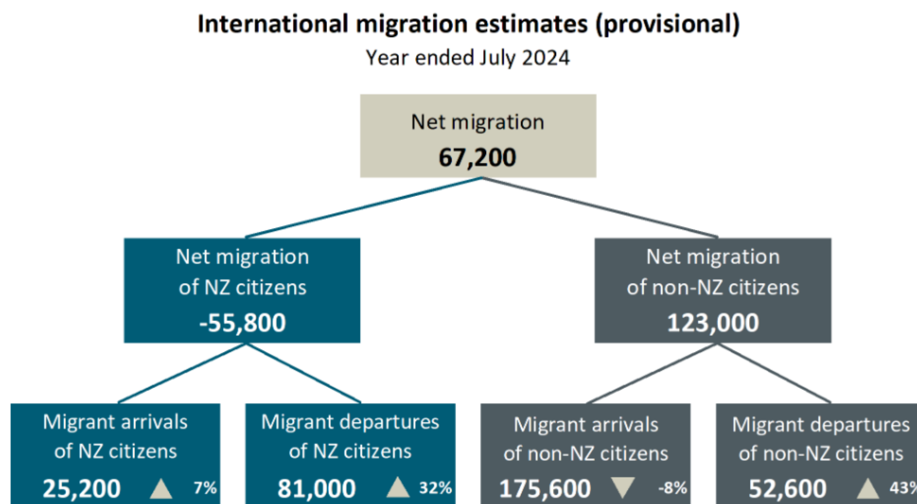
1.4 Labour market – continuing to ease

The latest Household Labour Force Survey (HLFS) for the June quarter 2024 shows labour market pressures continuing to ease. The unemployment rate rose to a 3-year high of 4.6%, although, perhaps somewhat surprisingly, the participation rate rose to 71.7%. The underutilisation rate, a better measure of labour market conditions, lifted to 11.8% from 11.2%, as total hours worked fell 1.2% over the quarter.

Employment growth surprisingly lifted over the June quarter by 0.4% with 12,000 more people employed over the quarter. Annually, employment growth has slowed to just 0.6% from 1.3%.

However, expectations are for further rises unemployment as the second round of jobs cuts hit the public sector, while a number of high-profile private sector businesses have announced that they are shutting up shop, for a range of reasons.

There are increased signs that net migration is slowing rapidly, as the number of people moving to NZ declines and the number of New Zealanders leaving the country increases.



Notes: Estimates are provisional as of 11 September 2024.
Percentage changes are indicative of the July 2024 year compared with the July 2023 year.

Source: Stats NZ

While net migration for the year ended July 2024 was around 67,000 (well above the long-run average), a major concern is the number of NZ citizens leaving the country. For the year ended July 2024, there were 25,000 returning New Zealanders, but close to 81,000 NZ citizens departed.

This potential brain drain is concerning 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.

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 an exposure draft Bill undergoing consultation before being introduced to Parliament, enabling further public participation through the Select Committee Process.

The Government has also announced it will change the Employment Relations Act to provide for an appropriate pathway test for distinguishing whether a worker is an employee or a contactor. The recent Appeal Court finding that four specific Uber drivers are employees, but only when they are logged into the Uber app, has created a high

degree of uncertainty for businesses about the distinction.

BusinessNZ said in a recent media statement that, *"The Government's decision to clarify those relationships in law will be particularly welcomed by all businesses that use digital platforms to contract with workers, and all businesses currently concerned that their contractors could be recategorised to be employees in the future should they decide to take a Court case. Having clarity around the distinction will enable more businesses to use new, innovative business models involving contractors where appropriate."*

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Sep 24	Sep 25	Sep 26
Highest	5.0	5.6	5.3
Average	5.0	5.4	5.1
Lowest	4.9	5.1	4.9

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – moderating over time

While forecasts show further easing in wage/salary pressures are likely over the forecast period, over recent times there has been divergence between wage rises in the private sector compared to the public sector, driven largely by pay equity claims in the public sector.

The Labour Cost Index (LCI) rose by 1.1% for all sectors in the June quarter, which actually lifted the annual growth rate up again from 4.1% to 4.2%. That included a significant 1.9% rise in the public sector for the quarter; the private sector measure rose by 0.9%.

The wage figures were affected by pay increases in health and education, which had been previously agreed and were implemented in stages. These agreements boosted the public sector measure in particular, but also lifted the private sector measure to some degree (there are many providers that are privately owned but publicly funded).

This is concerning for a number of reasons. First, wage increases, unrelated to productivity increases, are inflationary. Second, when the labour market is easing, big pay rises in public sector can flow through into the private sector through generalised inflation. Third, given the Government's constrained budgets, it can mean increased government borrowing is required or that other activities deserving of public funding are neglected.

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

	Years Ending		
	Sep 24	Sep 25	Sep 26
Highest	3.9	3.0	2.7
Average	3.5	2.7	2.4
Lowest	3.2	2.5	1.9

Source: ASB, BNZ, Kiwibank and Westpac