BUSINESS NZ

PLANNING FORECAST

BusinessNZ

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NZ Economy: Improving forecast for some areas

Executive summary

The NZ economy continues to show signs of improvement, with much more respectable growth rates forecast than in recent years.

Despite improved growth forecasts, there are still strong headwinds from domestic and international issues, and policy uncertainty continues.

The BNZ – BusinessNZ Performance of Manufacturing (PMI) and the BNZ – BusinessNZ Performance of Services Index (PSI) took a hammering in May, but other indicators point to improving economic growth over the forecast period:

- Massey University's GDPlive points to a solid GDP improvement while heavy traffic flows, a good real-time indicator of growth, is generally improving.
- Inflation is back in the box (for now).
- Decreasing interest rates will take some of the pressure off struggling businesses and households.
- Agricultural commodity prices remain at high levels with record payouts to dairy farmers which will boost the regional economy.
- Inbound tourism numbers are starting to increase, although domestic tourism numbers remain subdued.
- The Investment Boost tax incentive for businesses that will allow for 20% of the cost of new assets to be deducted immediately from income should provide a shot in the arm for much-needed business investment.

On the other side of the coin, NZ continues to face substantial medium-term risks including, but not limited to:

1. The uncertain, rapidly changing international trading environment
2. Regulation and compliance Issues
3. Increased debt levels (both government and household debt)
4. Aging population pressures
5. A significant infrastructure deficit
6. Persistently low productivity

Internationally, the theme is very much about uncertainty. President Trump's on-again, off-again tariff stance has stymied the traditional rules-based international trading regime, which will lower world trade and growth prospects. For example, China's exports to the US are already down around 25% compared to the same time last year. Given China and the US are NZ's biggest trading partners, NZ will not be immune from the fallout. Numerous wars, including the latest conflict in the middle east will further escalate uncertainty with oil prices briefly spiking.

International economic agencies such as the International Monetary Fund continue to revise growth forecasts while the US dollar is under pressure as capital is diverted elsewhere. Heightened international risks will likely have a chilling effect on global investment and raise the cost of capital.

HIGHLIGHTS

After a significant period of stagnation, forecasts show the economy will likely grow at a little under 3% out to 2027.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 8 for the June 2025 quarter, an improvement of 2 on the previous quarter, and an improvement of 12 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.

Sector performance remains mixed with the BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI), both taking a hammering in May, recording significant contraction.

In contrast, the agricultural sector is the stand-out performer with dairy farmers enjoying record milk prices which will boost the rural economy. Meat prices are also holding up well.

Construction remains downbeat with fewer houses being consented and the value of building work put in place remaining subdued. Housing prices remain flat with some investors exiting the market. Increased housing stock is benefiting first home buyers as interest rates continue to drop.

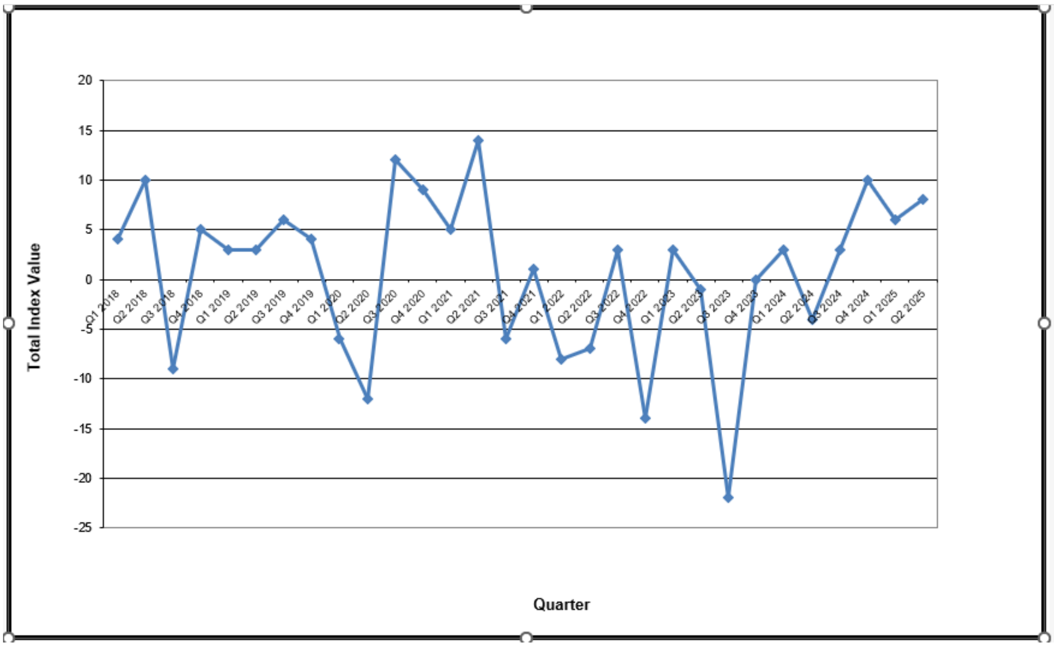
Tourism and hospitality are improving although there has been significant restructuring of late.

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

The BusinessNZ Economic Conditions Index (ECI) is a measure of some of NZ's key economic indicators. It sits at 8 for the June 2025 quarter, up 2 on the previous quarter, and up 12 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 June quarter 2025 are estimates based on available data and 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 June 2025 quarter, the same as the previous quarter but up 6 on a year ago.

Monetary policy/pricing indicators sit at 6 for the June 2025 quarter, up 2 on the previous quarter, and up 2 on a year ago.

Business/consumer confidence indicators sit at 4 for the June 2025 quarter, up 1 on the previous quarter and up 10 on a year ago.

Labour market indicators sit at -7 for the June 2025 quarter, a deterioration of 1 on the previous quarter and a deterioration of 6 on a year ago.

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

1.1 Economic growth (GDP) – improving despite ongoing risks

After a significant period of stagnation and negative growth on a per capita basis, the NZ economy is now expected to grow at just under 3% per annum over the forecast period to 2027.

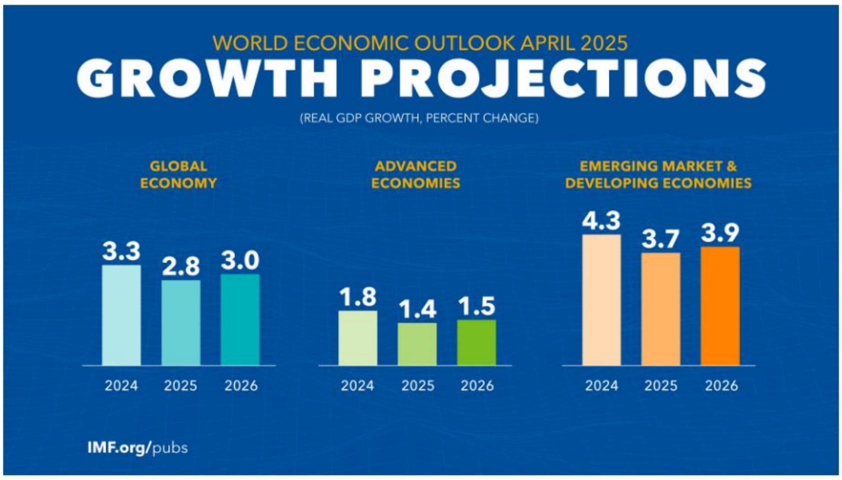
A number of factors will assist growth over the remainder of this year and beyond.

The global environment is very challenging. Policy instability and numerous wars, including the ongoing war in Ukraine and the conflict between Isarel and Iran, are adding to the tensions.

President Trump's on-again, off-again tariff announcements have stymied the traditional rules-based international trading regime, leading to lower world trade and growth prospects. For example, China's exports to the US are down around 25% compared to the same time last year. Given China and the US are NZ's biggest trading partners, NZ will not be immune from the fallout.

International economic agencies such as the International Monetary Fund (IMF) continue to revise their forecasts downward, while the US dollar is under pressure as capital is diverted elsewhere. Heightened international risks will likely have a chilling effect on global investment while adversely impacting on the cost of capital. This will ultimately impact on NZ businesses and households over the medium term unless world politics get back on track – which is far from certain.

The IMF's *World Economic Outlook* (April 2025) expects global growth to decline and downside risks to intensify as major policy shifts unfold. Risks to the outlook are tilted to the downside.



Meanwhile, the latest Organisation for Economic Cooperation and Development (OECD) *Economic Outlook* shows world growth prospects have taken a hit.

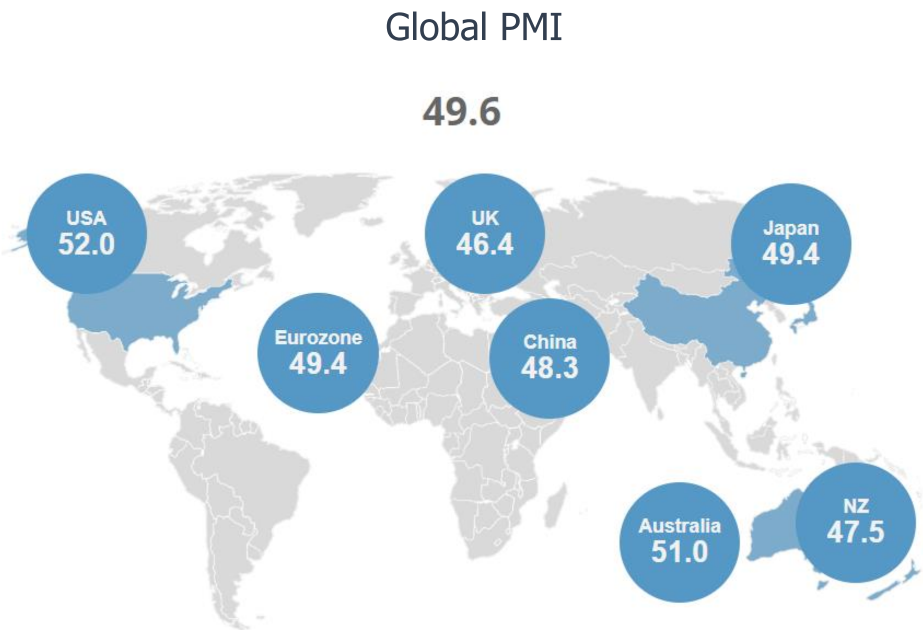
Global economic prospects are weakening, with substantial barriers to trade, tighter financial conditions, policy uncertainty, and diminishing confidence.

The OECD has significantly revised recent projections and now projects global growth slowing from 3.3% in 2024 to 2.9% in 2025 and 2026.

The OCED expresses concern that rising tariffs will bring higher trade costs and further inflation (but notes inflation will likely be partially offset by weaker commodity prices).

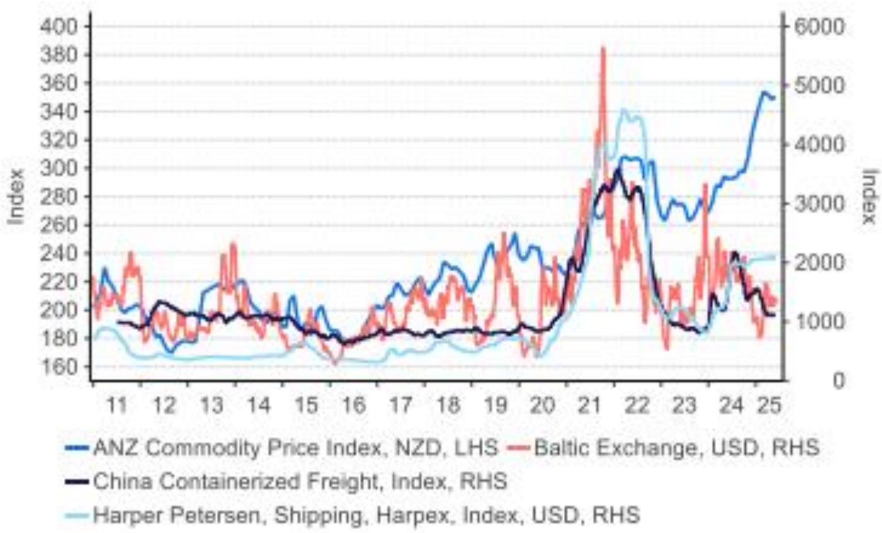
The OECD also cautions that if US bilateral tariffs rates are raised further, global growth could experience an even larger fall.

Meanwhile, the front-loading of purchases ahead of tariffs has supported global manufacturing activity. However, offshore survey indicators suggest that manufacturing activity weakened in May. Similar to NZ, the PMI also declined in Australia, China and the US. Tariff policies are changing regularly. Beyond the policies themselves, the uncertainty associated with them is also dampening activity.



While exporters expect global shipping costs to ease over coming months due to decreased global demand, ongoing conflicts could disrupt supply chains and hence resulted in higher transport costs – at a time when the global economic outlook is slowing.

ANZ Commodity Price Index and Shipping Costs



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

Despite considerable global upheaval mentioned above, there is a range of reasons supporting further growth in the NZ economy this year and beyond. Positives include:

- Massey University's GDPlive points to a solid GDP improvement, while heavy traffic flows, a good real-time indicator of growth, are generally improving.
- Business confidence remains reasonably upbeat although consumer confidence remains sub-par.
- Inflation is back in the box – for now.
- Declining interest rates will take some of the pressure off struggling businesses and households.
- Agricultural commodity prices remain at high levels with record payouts to dairy farmers which will boost the regional economy.
- Inbound tourism numbers are starting to increase, although domestic tourism numbers remain subdued.
- The 2025 Budget's centrepiece of a tax incentive for businesses – "Investment Boost" - allowing 20% of the cost of new assets such as machinery, tools and equipment to be deducted immediately from taxable income, should provide a shot in the arm for much-needed business investment.

Last month's Budget 2025 – "The Growth Budget" - was delivered against a backdrop of a challenging domestic environment and a range of geopolitical uncertainties and risks which will have a chilling effect on global economic growth.

With mediocre growth in NZ over the past few years and a relatively high level of spending still in place (largely due to the fiscal expansion undertaken by the previous Government), Budget 2025 was a largely no-frills affair with limited, but growth-targeted, new spending initiatives.

The current Government has tried to look for additional cost savings and reprioritisations as funding sources for some of the new initiatives including the Investment Boost tax reforms. Budget surpluses are still forecast to be a significant way down the track, while forecasts are for net debt levels to rise over the short term before declining slowly over time. NZ's structural deficit is one of the worst among advanced economies and will only be addressed by the end of this decade, assuming Budget growth projections are achieved.

If the Government is serious about getting back to surplus and paying down debt (currently costing around $9 billion annually in interest costs alone), it must address key expenditure 'elephants in the room' such as the age of entitlement to national superannuation and the continuation of interest-free student loans. Kicking the can down the road on such issues brings serious risks for the future.

While some commentators still make the case for further increases in net debt (given that NZ's net debt by international standards is still relatively low), this fails to address two fundamental issues - first, the rapid rise in debt since 2019 (some attributed to Covid), and second, NZ's high exposure, as a small trading nation, to risks including natural disasters. These issues necessitate a disciplined approach to expenditure and associated debt levels.

It will be essential for NZ to maintain prudent debt levels and ensure continued borrowing is not funding the daily grocery bill but is used to promote critical infrastructure investments that will help the economy grow.

Treasury's *Economic and Fiscal Outlook* out to 2029 indicates, generally, an improving economic outlook over the range of key economic and fiscal economic indicators:

Economic activity (GDP) is expected to increase from -0.8% in the year to June 2025, to 2.9% in 2026 and stabilise at around 2.9% in the outyears to 2029.

Inflationary pressures are expected to slightly decline from 2.2% in the year to June 2025 to around 2% in the outyears to 2029.

Unemployment is expected to decline slightly from 5.4% in the year to June 2025 to reach 4.3% in the year ended June 2029.

The current operating balance of $5.5 billion (deficit) for the year ended June 2025 is expected to improve over the forecast period with a slight surplus expected by 2029.

Core Crown tax revenue is expected to remain relatively stable as a percentage of GDP over the forecast period. It is expected to increase slightly from 27.4% in the year to June 2025 to 28.3% in the year ending 2029.

Core Crown expenses are expected to decline as a percentage of GDP over the forecast period from 32.7% in the year ending June 2025 to 30.9% in the year ending 2029.

Net Core Crown debt will increase from $185 billion (42.7% of GDP) in the year ending June 2025 to $238 billion (45.5% of GDP) in the year ending 2029. Current debt levels as a percentage of GDP have more than doubled over the past 5 years.

Overall, while key figures represent a long-term improvement in outcomes, managing within future allowances will be particularly challenging unless significant expenditure savings are made in the outyears. There are some heroic assumptions about growth rates in the outyears, given the risks surrounding the international outlook in particular.

If growth rates fail to be achieved, then it is likely tax revenues will be at risk, with the potential for a return to surplus by the end of this decade seriously at risk. While debt levels are projected to stabilise and slowly decline in the outyears, debt as a percentage of GDP has doubled over the last 5 years and leaves NZ vulnerable to either another significant domestic event (e.g., natural disaster) or a future slowdown in the global economy. Neither can be ruled out at this stage.

To be fair to the Treasury, its *Economic and Fiscal Update* is clear that the risks are skewed to weaker outcomes:

"There is a lot of uncertainty around the global outlook, partly because of global trade polices but also owing to geopolitical conflicts, and outcomes could prove to be more negative for the New Zealand economy than assumed. There are also domestic sources of uncertainty, including net migration and productivity, that could prove to be stronger than assumed and lead to faster growth. Scenarios in the Economic Outlook chapter show weak global growth is likely to have much larger impact on the fiscal outlook than stronger net migration inflows and higher productivity."

NZ continues to face substantial medium-term risks including, but not limited to:

1. **Uncertain, rapidly-changing international trading environment** NZ, as a small island nation, is heavily dependent on international trade for our economic viability. NZ contributes only 0.5% to world GDP yet contributes around 35% to world trade in dairy. Moreover, over 50% of NZ's trade is with China, the US and Australia, which means we have most of our eggs in a very few baskets. The international trading environment has a significant impact on the standard of living of New Zealanders. NZ's predicament is not enviable: The tense relationship between China & US means that NZ will not want to upset either of them.

2. **Regulation and compliance issues** NZ led the world in introducing the Reserve Bank Act in the late 1980s with a sole focus on maintaining price stability, while Ruth Richardson's Fiscal Responsibility Act in the early 1990s (now part of the Public Finance Act), provided discipline in respect to fiscal policy. The missing link has been regulatory policy, with the same discipline absent from Government decision-making for many years. The Government (and more particularly ACT leader David Seymour who championed the Bill) gets a big tick for introducing the Regulatory Standards Bill to Parliament. It is fundamental that good fiscal and monetary policy frameworks are equally supported by good regulatory policy

decision-making and while a very long time in gestation (probably close to three decades since first being conceived by forward-looking economists), the final birth of this Bill is something that the Coalition Government can take some pride in.

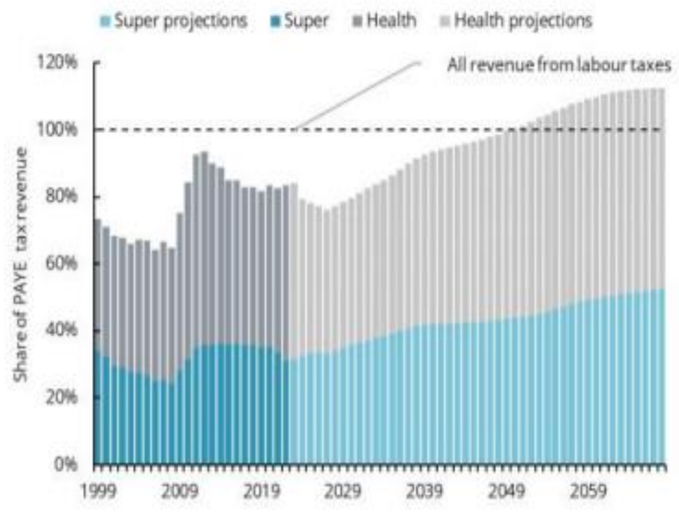
It is to be hoped that this Bill will provide much needed rigour to improving regulatory decision-making by the Government and its agencies, by providing a set of principles which policymakers should adhere to when considering regulatory interventions. The much talked about oil and gas ban under the last Government provided a stark example of the chilling effect on investment that quick decisions without thinking through the implications can have on NZ and international investors. In this respect it is noted that the recent Budget included $200 million set aside for a Crown stake in new gas fields, no doubt to counter international investors' fear that the rug may be pulled from under them if there is a change of Government down the line. The structure of investments is still being worked through, but this signals a willingness, subject to Cabinet consideration, for the Crown to take a commercial stake of up to 10-15% in new gas field developments that feed the domestic market, to address sovereign risk. Gas is critically important to the NZ economy.

While it is acknowledged that this will help encourage new offshore gas fields from exploration to production, it yet again raises the importance of ensuring a stable and reliable regulatory regime going forward in respect to gas exploration and use, including wider use of natural resources in NZ. Greater regulatory collaboration and agreement between the major political parties is required if NZ is serious about encouraging long-term investment.

3. **Increased debt levels (both government and household)** NZ net core government debt has increased rapidly over the past few years – up from around $60 billion (19% of GDP) in 2019 to around $185 billion (43% of GDP) currently, with further increases expected until at least 2029. While this is not out of the ordinary compared to some of our major trading partners, NZ does have particular vulnerabilities. NZ is a small island nation, heavily dependent on international trade and prone to significant natural hazards. In this context, increased debt equates to an increased cost of capital to both the government and ultimately businesses and households as investors build in a risk premium.

4. **Aging population pressures** NZ's aging population brings significant implications for future health and superannuation costs which should be addressed sooner rather than later. Without material change in policy settings, Sense Partners estimates meeting the future cost of NZ's superannuation and healthcare will soak up all income tax revenue by 2049.

Projections of Superannuation and healthcare costs combining population forecasts and costs by age



SOURCE: SENSE PARTNERS

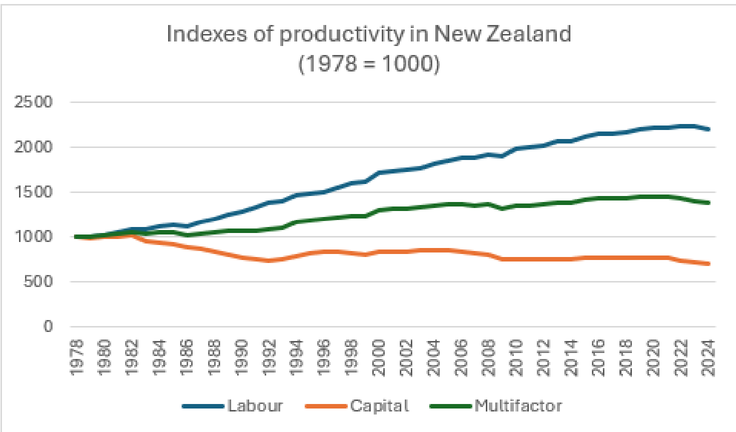
NZ is not alone in facing this challenge, as birth rates are falling across the developed world, but we must distinguish ourselves in how we respond. While there are many ways of addressing the superannuation issue, from increasing the age of eligibility through to various income and asset testing regimes, the importance of early decision-making is crucial to allow people to plan ahead based on realistic assumptions of what they can expect from the government (taxpayers) and what provision they will need to make for themselves.

5. **A significant infrastructure deficit** NZ's persistent underinvestment in infrastructure has become a major long-term challenge for our economy and productivity. Over the last 30 years renewal investment in these assets has not kept pace with depreciation. Chronic underinvestment combined with increased demand means we now have a significant infrastructure deficit. NZ has significant lags in investment for roading, drinking water, water storage (needed for agricultural productivity), and the general upgrade of buildings across the board.

   The Government commitment to replace the current Resource Management Act (RMA) with two new Acts based on the enjoyment of property rights is a step in the right direction. The real benefit is whether the government provides a flexible framework such that both domestic and international investors have confidence that their capital will not be undermined by inappropriate regulatory controls.

   Given the infrastructure deficit NZ faces, capital should be welcomed across the board. In this respect, while there has been some tinkering in respect to the Overseas Investment Act, a much more welcoming approach is required if we are serious about attracting overseas capital required to fill the current void.

6. **Persistently low productivity** Nobel Prize-winning economist Paul Krugman summed up the importance of productivity in respect to economic performance: "Productivity isn't everything, but in the long run, it's *almost* everything." NZ's productivity, in respect to labour, capital and multifactor productivity has been low for many years.



While New Zealanders work relatively long hours compared to many other countries, our output lags.

There are potentially many reasons for low productivity which some argue are the result of NZ's low population, isolation from markets, inability to scale up production, and so on.

Productivity, on all measures, has slipped since 2019, which may be partially explained by Covid-19 and associated lockdowns which would have adversely impacted on productivity.

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

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

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

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

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

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

Forecasts: Real GDP percent Growth

	Years Ending		
	Jun 25	Jun 26	Jun 27
Highest	0.8	2.9	2.9
Average	-0.4	2.4	2.7
Lowest	-0.8	2.2	2.4

Source: ASB, BNZ, Kiwibank and Westpac

1.2 Monetary policy in the limelight

Recent media attention on the reasons for Adrian Orr's abrupt resignation as Governor of the Reserve has tended to divert attention away from what has been a very busy period of monetary policy decision-making.

Significant changes in recent times have included the introduction of Loan-to-Value ratios, proposed introduction of Debt-to-Income Ratios (DITs), and more recently, finalising issues surrounding the Deposit Insurance Scheme.

The Reserve Bank is also reviewing its capital adequacy requirements, which some, including expert commentators and the major banks, say should better reflect NZ's risks rather than the current requirements for banks to hold enough capital to survive a 1-in-200-year financial crisis.

A submission to the Finance and Expenditure Select Committee Inquiry into Banking by banking experts Andrew Body and Simon Jensen indicates that the Reserve Bank's current capital rules add between 0.25 and 0.374 percentage points to mortgage rates compared with Australia. For a million-dollar mortgage, this means between $2,5000 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.

In an interesting move, NZ First has introduced a Member's Bill with the objective of preventing banks from refusing their services to businesses because of the current 'Environmental, Social, and Governance (ESG) Framework,' according to NZ First Leader Winston Peters.

The Financial Markets (Conduct of Institutions) Amendment (Duty to Provide Financial Services) Amendment Bill will mean no NZ business can be denied banking services unless the decision is grounded in law according to NZ First.

The Bill's genesis has been the perception, rightly or wrongly, that banks have not been providing much-needed capital to certain sectors, including agriculture and mining, because of concerns about greenhouse gas emissions, environmental sustainability, and general public sentiment.

The Government has been clear that they are focused on raising economic growth and the living standards of New Zealanders and are willing for that growth to come from multiple sectors as ultimately determined by investors, including those sectors which some members of the public see as somehow undesirable.

While there will no doubt be a number of sectors and businesses who support the sentiment of the Bill, there are some concerns should the Bill pass into law as is. Ultimately, a competitive and open banking sector will provide the best discipline on lenders to make commercial decisions based on actual material risk factors.

Some concerns with the current Bill include the risk of it interfering with private enterprise decisions, potentially undermining the independence of financial institutions to make decisions based on their risk assessments.

Secondly, it could add an inefficient regulatory barrier without clear outcomes, especially if it led to further compliance obligations on banks, as this would ultimately raise the cost of capital to borrowers.

Some legal firms have also questioned the drafting and legal ambiguity around some of the language in the Bill, while suggesting banks already document their commercial rationale for lending policy.

Banks are quite correctly cautious, with many claiming that they follow responsible banking principles and service the law and shareholders, not political agendas. How far this Bill goes will ultimately be up to Parliament - with strongly held views on both sides of the debate.

Inflation – still niggly

The forecasts below, and those of other agencies such as the Treasury and Reserve Bank of NZ (RBNZ) show that inflation is projected to remain well within the Reserve Bank's target range of 1-3% over the forecast period. Nonetheless, both upside and downside risks to these forecasts remain.

Budget 2025 allocated $16.5 million over four years to move from quarterly to monthly Consumers Price Inex (CPI) data from the start of 2027.

There has been long-held frustration from economists and politicians that StatsNZ data has lagged and has sometimes been out of step with the Reserve Bank's OCR decisions. For example, next month, the Reserve Bank reviews the OCR on the 9th of July, while StatsNZ publishes the June quarter CPI data about a week later. Arguably this means that the Reserve Bank will be replying on official data published back in April to make their decision, although to be fair, the Reserve Bank, like other economic forecasting agencies, will be looking at a range of data, including selective release of price indexes, which already include data for May. Nevertheless, the move to monthly data will be supported as it will enable more timely data to allow for better decision-making by the Reserve Bank as well as the business community and households, in making investment decisions, including decisions over mortgage terms.

Headline inflation and inflationary expectations have trended slightly lower of late, although risks remain, given the very fluid international geopolitical situation and continuing inflationary pressures in the domestic non-tradeables sector.

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 geopolitical tensions elsewhere, including the Middle East, have the potential to increase goods inflation internationally, which could impact on NZ.

The potential for disruption to supply chains means added uncertainty and cost pressures. On the other hand, many international economic agencies such as the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) have significantly lowered their world growth forecast, which should, all other things being equal, put downward pressure on resource costs, including transport and shipping.

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 reflecting NZ's unique risk profile. Insurance costs are not only rising for natural hazard risk (Treasury recently consulted on whether to increase the Natural Hazards Insurance Levy by $400), but also for other forms of insurance including healthcare, which is driven by the shortage of medical staff, alongside other cost pressures such as pay equity settlements in the public health sector.

While the Reserve Bank clearly has the ability to see through one-off price increases when arriving at monetary policy decisions, the fact that non-tradeables pressures remain consistently raised 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 have kept wage 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 despite a significant slide in interest rates that should make housing more attractive to first home buyers particularly.

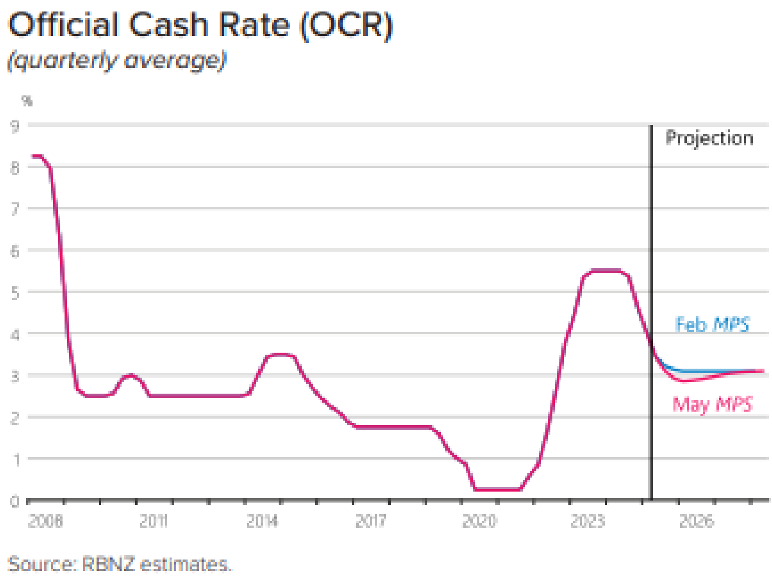
Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Jun 25	Jun 26	Jun 27
Highest	2.8	2.5	2.4
Average	2.7	2.2	2.1
Lowest	2.5	1.9	2.0

Source: ASB, BNZ, Kiwibank and Westpac

Interest rates – difficult calls

It is likely but not certain that there will be at least another cut to the OCR this year, with the general expectation of an OCR at a neutral level of just under 3.0% by the end of the year, as outlined in the Reserve Bank's Monetary Policy Statement. This is still a much higher neutral rate than has traditionally been the case.



Given current heightened geopolitical risk and extreme policy swings coming from US President Trump, it is likely that the Reserve Bank will be cautious in their next move, which will undoubtedly be very data-dependent.

The Reserve Bank's central projection is for the OCR to be sitting at 2.92% by December this year and 2.85% by March 2026 before settling at around 3% thereafter.

This was a slightly more deeply easing cycle than forecast in February this year, when rates were expected to be at 3.14% by December and 3.10% by March 2026.

Regarding a possible further cut in the OCR in the next review (July), while the Reserve Bank committee still sees rates drifting lower, they are not categorically ruling in or out a further cut from the current level, given international policy up-turns and geopolitical risks are ever-present and there are many paths the NZ economy could take outside the central forecast for interest rates outlined above.

Notwithstanding a significant shock over the next couple of months, odds are on for a further cut to 3%, but beyond that, all bets are off.

While markets have largely priced in a further 25 basis points cut to bring the OCR down to 3.0%, there is still concern about non-tradeables inflation, despite spare capacity in the market. This has not been helped by recent data showing inflation looks to be running hotter than expected, firming up the view by some that the Reserve Bank may keep interest rates on hold at the next review in July.

After tradeables inflation increased slightly over recent months as the NZ dollar dropped to a low of 55 cents against the US dollar, it is now starting to recover, which will take further pressure off tradeables inflation over the short to medium term.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Jun 25	Jun 26	Jun 27
Highest	3.3	3.0	4.2
Average	3.2	2.9	3.4
Lowest	3.0	2.6	2.7

Source: ASB, BNZ, Kiwibank and Westpac

NZ dollar in recovery mode

The NZ dollar has recovered much of the ground lost over recent months when it plunged to around US 55 cents. It is currently just above US 60 cents, but expectations are that it will rise further over the forecast period.

Increases in NZ's export prices over recent months have also supported the NZ exchange rate. Notwithstanding the appreciation of the NZ dollar, the Trade Weighted Index (TWI) remains lower than it was over most of 2024. Currently it is all about the direction of the US dollar!

Structural USD downside risks, particularly the erosion of the US dollar's safe-haven identity because of fiscal risks and policy uncertainty, will continue to do most of the work supporting the NZD/USD

Global factors, including tariff developments, are also likely to continue to drive the future direction of the NZ dollar.

Forecasts: Exchange Rates

AUD (cents)			
	Jun 25	Jun 26	Jun 27
Highest	0.92	0.93	0.95
Average	0.92	0.91	0.92
Lowest	0.92	0.88	0.88

USD (cents)			
	Jun 25	Jun 26	Jun 27
Highest	0.61	0.68	0.70
Average	0.60	0.64	0.66
Lowest	0.58	0.61	0.63

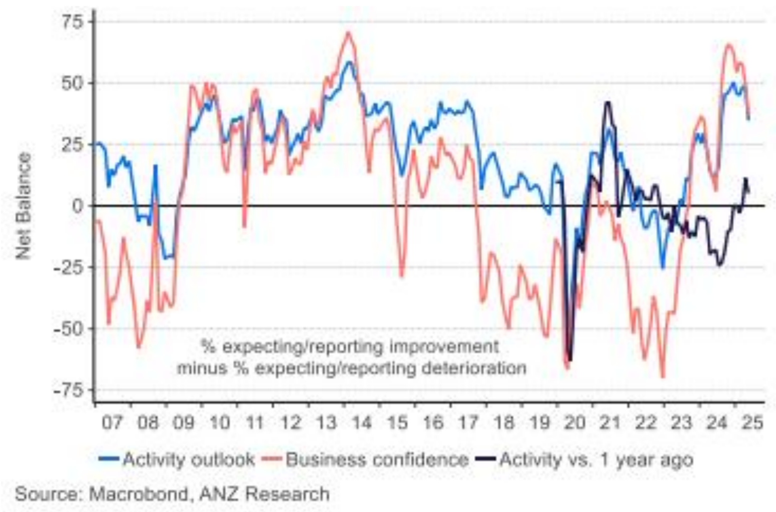
TWI			
	Jun 25	Jun 26	Jun 27
Highest	70.3	74.1	75.5
Average	69.0	71.6	72.5
Lowest	67.4	69.3	69.3

Source: ASB, BNZ, Kiwibank and Westpac

1.3 *Business activity and sector sentiment improving overall*

While overall business confidence remains robust, it is yet to translate into substantial increases in investment, as many businesses and households are taking a cautious approach to new investment.

The ANZ Business Outlook shows that business confidence fell 12 points to +37 in May, and expected 'own activity' fell 13 points to +35. Meanwhile past 'own activity' (the best GDP indicator) fell from 11 to 5, while past employment fell back into negative territory at -10.

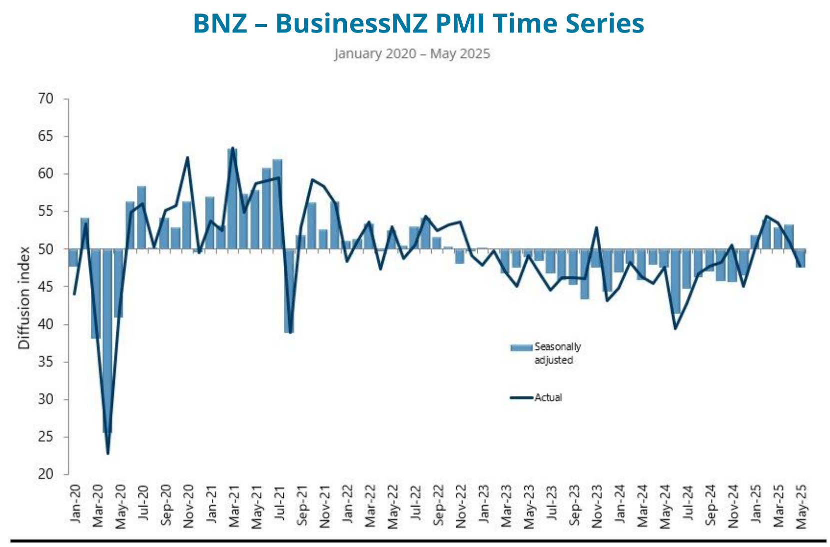


Sector performance remains mixed as outlined below:

Manufacturing **-** down

NZ's manufacturing sector fell back into contraction during May, according to the latest BNZ-BusinessNZ Performance of Manufacturing Index (PMI).

The seasonally-adjusted PMI for May was 47.5 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was down from 53.3 in April and a return to contraction after four consecutive months of expansion. The survey was also well below the average of 52.5 since it began.



The May result was disappointing given the sector had appeared to have turned a corner at the start of 2025 following a tough 2023-2024 period of contraction.

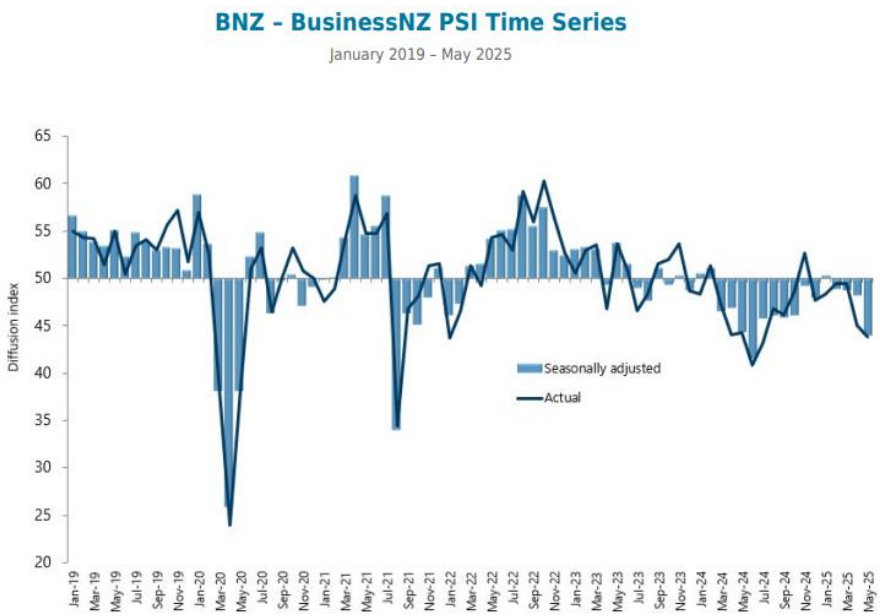
Four of the five main sub-index values were in decline, with New Orders (45.3) showing the strongest level of contraction for May. Following healthy expansion from February-April, Employment (45.7) decreased 8.9 points to be at its lowest level of activity since July 2024.

The return to contraction also saw the proportion of negative comments from respondents increase to 64.5%, compared with 58% in April and 57.5% in March. Comments indicate that manufacturers are reporting a clear return to decline, driven by falling demand, weak orders, and low business confidence. Rising costs, economic uncertainty, and reduced consumer spending are compounding pressures, while forward orders and investment remain stalled.

Hopefully, the recent Budget, with its centrepiece of the Investment Boost tax incentive for businesses, allowing for 20% of the cost of new assets such as machinery, tools and equipment to be deducted immediately from taxable income (on top of normal depreciation) will provide a shot in the arm for much-needed business investment.

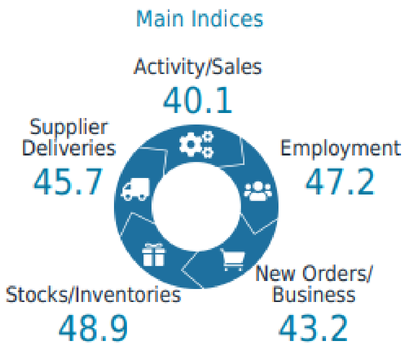
Services - down

NZ's services sector continued to show further decline in activity during May, according to the BNZ – BusinessNZ Performance of Services Index (PSI). The PSI for May was 44.0 (A PSI reading above 50.0 indicates that the service sector is generally expanding; below 50.0 that it is declining).



This was down 4.1 points from April and well below the average of 53.0 over the history of the survey. After a return to small expansion in January, the sector has continually contracted month-on-month since then, reaching its lowest level of activity since June 2024.

For the sub-index results, the key results for Activity/Sales (40.1) and New Orders/Business (43.2) were also the lowest since June 2024. Employment (47.2) fell back into further contraction, while Deliveries (45.7) remained unchanged from the previous month.



The proportion of negative comments for May (65.6%) was up from April (61.8%) and March (56.7%). Many businesses noted reduced demand and falling revenues due to rising costs, economic uncertainty and low consumer confidence. Comments noted customers spending less, delaying decisions, and responding cautiously to inflation, interest rates, and broader market instability.

Agriculture **-** up

On a brighter note, the broader agricultural sector has been going from strength to strength buoyed by high commodity prices and input costs falling away somewhat. The NZ agricultural sector faces a mixed but moderately improving outlook over 2025–2026. While long-term fundamentals remain strong, based on global demand for high-quality food and fibre, short-term challenges persist, particularly around cost pressures, regulation, climate volatility and global market uncertainty.

Assisting the agricultural sector is the current Coalition Government signalling a much more pragmatic approach to environmental regulation in respect to some farming practices (e.g. land use) which will potentially ease some of the regulatory burden for farmers over coming years.

Prices remain solid for most agricultural products.

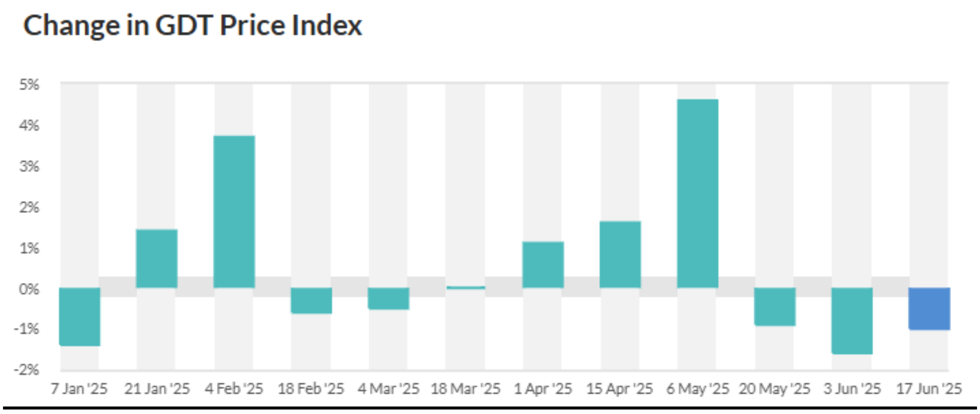
NZ's sheep and beef farmers are delivering record-breaking red meat export sales and driving strong farmgate returns to the rural economy.

March was a standout month for red meat exporters, with a record $1.26 billion in export sales—a 34 per cent increase on March last year. First quarter exports also hit $3.28 billion, up 28 per cent from last year.

Meanwhile, dairy prices are still holding up although there are some risks surrounding future global demand, given world economic growth forecasts are taking a hit as a result of rising geopolitical tensions.

Fonterra recently reconfirmed a payout of $10.00 for the season that has just ended (the highest of all time), while providing an opening forecast for the 2025/26 season of $10.00, within a range of $8.00 - $11.00. While a wide range is relatively normal early in the season, Fonterra has been clear that it expects demand to remain solid - but the ongoing geopolitical uncertainty does present risks.

And while the Global Dairy Trade (GDT) has shown some slippage of late, prices still remain elevated, bringing renewed confidence in the agricultural sector.



Other areas within the agricultural sector are also doing well, with record global sales and strong grower returns from Zespri confirming that NZ's horticulture sector is back on track and growing fast.

Zespri recently announced the achievement of more than $5 billion in global sales for the 2024/25 year, marking a 31% increase on the previous year, with a record 220.9 million trays sold.

Construction **-** flat

The construction sector remains flat with the number of building consents basically stagnant.

Meanwhile, NZ still has significantly higher construction costs than Australia, likely based on factors including labour availability, material supply chains, regulatory environments and economies of scale.

Residential construction costs tend to be 5–20% lower in major cities like Brisbane, Sydney and Melbourne compared to Auckland or Wellington

Obviously, economies of scale in Australia (larger population, bigger projects) help reduce per-unit costs.

In NZ, higher costs are due to a smaller market, more limited labour pool, and higher reliance on imported materials. Generally, more expensive materials in NZ is due to reliance on imported materials (especially steel, timber and specialist components). Given the distances involved, NZ has higher freight and shipping costs.

There are also greater regulatory compliance costs in NZ per project due to localised consenting requirements, while Building Code interpretation inconsistencies across councils is still an issue in NZ, although the Government is looking at streamlining processes where practical.

Finally, seismic risk in NZ demands higher costs than in Australia.

Housing **-** flat

New Zealand's average asking price for residential properties dropped 1.2% in May to $845,250, marking the second consecutive monthly decline, according to Trade Me's latest *Property Pulse Report*.

Of the 15 areas monitored, only Southland, Taranaki, the West Coast and Manawatū/Whanganui saw modest price increases.

Metro regions Auckland, Wellington and Canterbury all posted their lowest prices since September 2024. Auckland's average fell to $1,030,850, down 1.5 per cent from April and 2.5 per cent year-on-year. Wellington saw a 0.6 per cent month-on-month dip to $805,000, while Canterbury recorded a similar 0.6 per cent fall to $705,000.

The question could be asked, given interest rates have dropped substantially from well over 7% to less than 5% (for one- and two-year fixed term mortgages), why have housing prices not increased of late? There are a range of reasons.

First, many investors are exiting the market due to higher compliance costs, falling rents, higher insurance costs and ever-increasing local government rates, although the Government has removed some of the tax disincentives for investors over recent times.

Second, net migration continues to fall rapidly, with less pressure on the market than there was previously.

Third, despite lower interest rates, household debt levels are still high (around 170% of disposable income) and this, combined with uncertain job security, is leading to many prospective homeowners staying on the sidelines.

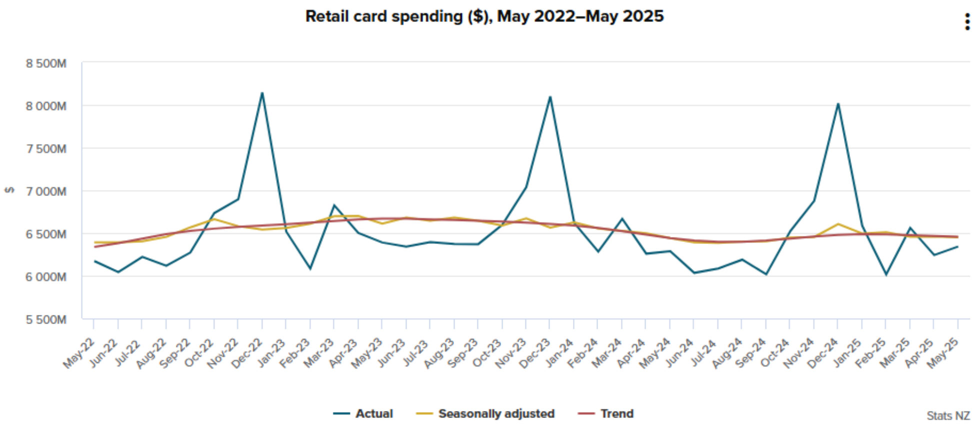
Geopolitical risks are also having an effect on consumer confidence, as reflected in a number of consumer confidence surveys which show confidence still tracking well below par.

Fear of missing out (FOMO) has been replaced by fear of overpaying (FOOP), with prospective buyers having much more negotiating power than for a long time, and it is possible that vendors will need to be more flexible if they want to move stock, despite the fact that house prices in just about all regions are well below the obscene levels experienced in late 2021.

Finally, the Government's proposed reforms to the Resource Management Act (RMA) should result in greater supply of housing as inappropriate regulations and controls are progressively removed. This should, over time, ensure that price increases remain close to the overall rate of inflation.

Retail **-** flat

According to Stats NZ, retail card spending is, at best, flat.



Changes in the value of electronic card transactions for the May 2025 month (compared with April 2025) were:

- spending in the retail industries decreased 0.2% ($9.9 million)
- spending in the core retail industries decreased 0.2% ($11 million).

Consumer confidence remains low and is being reflected in the lack of demand for new products, with many choosing to make do with what they have, or choosing to get repairs to equipment like motor vehicles, rather than simply replace them for newer models.

Hospitality **-** mixed

Hospitality is mixed, with some regions doing well (traditionally tourism-related) while other areas are struggling, e.g Wellington.

A number of operators have closed down or reduced their opening hours amid inconsistent demand and rising input costs.

Again, consumers are being cautious about discretionary spending, given continued uncertainty around job prospects and general uncertainty about the future economic outlook. This is in spite of interest rates continuing to decline over recent months, which is good news for those refixing their mortages for 1-2 years, currently under 5% per annum.

Tourism **–** improving

International tourism numbers continue to improve, although total numbers (including domestic tourism) are yet to get back to pre-Covid levels.

The international visitor survey results show that for the year ending March 2025, international tourism contributed $12.2 billion to NZ's economy, up 9.2% compared to the previous year.

This reflects an increase of 4.3% in international visitor arrivals, with 3.32 million visitors coming to New Zealand, up from 3.18 million in 2024.

When adjusted for inflation, this equates international spending to $9.7 billion or 86% of pre-pandemic levels.

The Government has tried to promote a number of measures to boost tourism by, for example, funding tourism promotions and improving visa settings and processes.

The Government has announced a new $13.5 million investment in international tourism marketing which is expected to deliver an extra 72,000 international visitors.

The funding comes from the International Visitor Conservation and Tourism Levy (IVL) for 2025/26. That is the $100 each international visitor must pay to come into New Zealand. Chinese tourists who come to NZ must currently pay the NZ tourist visa application fee, which is currently NZD $441. That includes the $100 International Visitor Conservation and Tourism Levy. This fee is for one person and increases if additional family members are included in the application, as each person pays the levy. Chinese airlines are currently charging between $1200 and $2000 for a return Shanghai-Auckland trip in economy class. The visa fee thus makes up between 25 and 33% of the airfare.

From November, NZ will trial visa waiver status for Chinese passport holders travelling from Australia with a valid Australian, visitor, work, student, or family visa, allowing them to visit for up to 3 months. Around 240,000 Chinese visitor visas were granted in 2024, and it is important that we do everything we can to expand this valuable market.

It is estimated that in the year ended March 2025, visitors from China contributed around $1.24 billion to the NZ economy.

1.4 Labour market – bottoming out?

Expectations are that the labour market is close to bottoming out, with improvements expected for the remainder of this year and beyond as outlined in the forecasts below.

While most forecasting agencies are expecting improvements to employment growth and lower levels of unemployment, there is still cause for concern as to the speed of recovery.

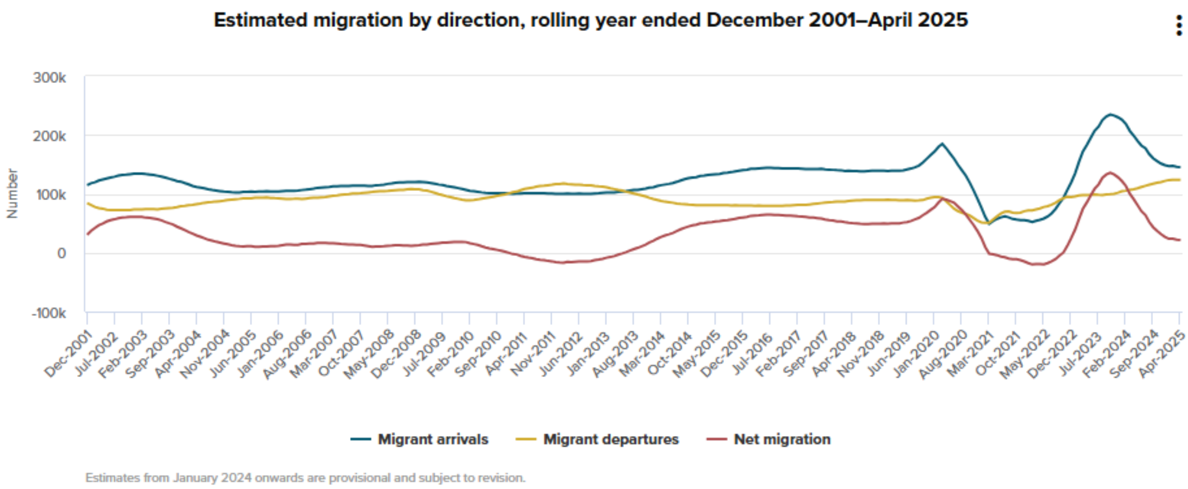
Job ads are still declining and the latest employment results for the BNZ – BusinessNZ Performance of Manufacturing and its sister survey the BNZ – BusinessNZ Performance of Services Index (PSI) make sober reading regarding employment, with both in contraction mode still.

The PMI subindex for Employment was 45.7. For the PMI it was 47.2. (a PMI/PSI reading above 50.0 indicates that manufacturing/services employment is generally expanding; below 50.0 that it is declining).

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

Net migration continues to fall which will reduce the available labour supply, given that by and large the largest cohort of New Zealanders exiting the country are the most talented and youngest of our population.

The provisional net migration gain of 21,300 in the April 2025 year was made up of a net gain of 66,900 non-NZ citizens and a net migration loss of 45,600 NZ citizens.



The continued 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 productivity. Unskilled individuals tend to take more training and development and hence don't add to productivity as rapidly as highly 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.

The Government's new 'golden visa' has netted the country at least $25 million in two months and there is $1 billion in the application pipeline.

The Government in April changed the Active Investor Plus visa settings, creating two categories under which rich foreigners could gain a residency through investment.

Under the 'growth' category, visa recipients are required to provide a minimum of $5m within three years to higher-risk investments, including managed funds. For the 'balanced' category, a mixture of these investments and investment in bonds, shares in a public company, and property developments can gain residency, but the threshold is $10m over five years.

Notwithstanding these continued positive changes to migration visas setting, it is important, longer-term, that NZ has a bipartisan approach to long-term migration policy. Ad hoc changes are in no one's interests.

KiwiSaver Changes

There were a number of changes announced in the recent Budget to the KiwiSaver scheme which has largely been untouched for some years:

- The default rate of employee and employer contributions will rise from 3% of salary and wages to 4% in two steps. From 1 April 2026 the rate will go to 3.5% and, from 1 April 2028, it will go to 4%.
- Employees will be able to temporarily opt down to the current 3% rate if they choose and still be matched at that rate by their employer. However, employees will need to reapply for the temporary savings reduction to remain at 3% every 12 months, otherwise it will default back to the higher rate.
- The Government contribution will extend to 16- and 17-year-olds from July 2025 and extend employer matching for that age group from 1 April 2026.
- However, the annual Government contribution will be halved from $521 to $261 from 1 July 2025. Also, members with an income of more than $180,000 will no longer receive the Government contribution from 1 July 2025.

Given the increasing cost of KiwiSaver for the Government due to high membership levels by the public, tweaks of this nature are not surprising to ensure the scheme remains sustainable for the long term. While the Government has provided some time for employers to accommodate the additional costs of matching contributions, it will still be a cost that they will need to factor in when examining the total cost of labour for their business.

Also, we believe the wider issue of savings regarding where KiwiSaver sits within the context of NZ Super, and the NZ Superannuation Fund is still not being addressed. BusinessNZ would like to see a full review of KiwiSaver to ensure NZ's full savings policy is best geared for the future.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Jun 25	Jun 26	Jun 27
Highest	5.3	5.1	4.9
Average	5.2	5.0	4.6
Lowest	5.1	4.8	4.2

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – continuing to moderate

In line with current excess capacity in the labour market, wage movements are generally expected to be constrained over the near term, with moderate increases expected over the forecast period as labour market conditions improve.

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

	Years Ending		
	Jun 25	Jun 26	Jun 27
Highest	2.4	2.1	2.2
Average	2.3	2.1	2.1
Lowest	2.2	2.0	2.0

Source: ASB, BNZ, Kiwibank and Westpac