BUSINESS NZ

PLANNING FORECAST

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BusinessNZ

NZ Economy: Roller Coaster

Executive Summary

Just when many key economic indicators pointed to the NZ economy bouncing back well in 2021 (including stellar 2.8 percent economic growth recorded for the June 2021 quarter), NZ is side-swiped by a community outbreak of the Delta variant of Covid-19. We should not be surprised by the outbreak given a number of commentators considered it was not a case of if, but when, NZ would get community transmission, despite our largely closed borders.

At the time of writing, it appears the outbreak might have been largely contained with not a great number of new cases being reported each day. Although Auckland has just gone to Level 3, the rest of the country remains in Level 2 plus, with the Government clearly indicating it will be taking a cautious approach to lowering levels further. And while it has conveyed the message that Level 1 criteria will be largely the same as last time, the big question remains - when do we get there? Level 2 or Level 2 plus still impose significant constraints on business activity and on the ability of households and citizens to actively participate in society. This is quite apart from the economic and social scarring taking place, despite government efforts to ease some of the short-term economic pain through various subsidies and support packages to businesses and their employees.

But subsidies are not a long-term substitute for reconnecting with the world in a timely manner. The Government needs to articulate a plan for reconnection beyond the current emphasis on locking down and getting vaccinated. Until then, uncertainty reigns.

While many commentators point to the economy having largely recovered from last year's lockdown, the economic cost has been significant with around $60 billion spent on various Covid programmes. Loose monetary policy supported continuing growth, but with the undesirable outcome of inflating asset prices (particularly housing) which has the potential to lead to significant inequities, creating a population of two halves – the haves and the have nots. Lockdowns are not without considerable economic cost (with some estimates suggesting a cost of around $1.5 billion in lost output per week while the whole of NZ was in Level 4 lockdown) quite apart from the broader social costs and the impact on mental well-being associated with the more draconian forms of lockdown. Until vaccination rates among eligible people exceed around 80 - 85%, it is difficult to see light at the end of the tunnel in terms of NZ reopening to the world.

Numerous countries have stolen a march on NZ and come to the sensible conclusion that the Delta variant is unlikely to be tamed over the short-to medium term and therefore policies need to be put in place so countries can effectively live with it. That will likely involve some loss of life and premature death, but this is what very many populations accept in respect to other diseases that affect health and indeed, in respect to many activities that on a daily basis involve the risk of injury or death, e.g., driving on public roads.

In the meantime, NZ businesses face massive supply constraints and the inability to obtain much needed skilled migrants to produce the goods and services demanded by consumers. Households will inevitably bear the brunt of constraints through higher prices for the goods and services they require.

Supply constraints will likely force the Reserve Bank's hand, with a rise in the OCR almost a given when the October review takes place. Notwithstanding the Reserve Bank's efforts of late to restrict credit growth, housing prices continue to rise. This, in turn, raises equality of opportunity issues given the Government's broader response to Covid-19 over the last year and a half.

HIGHLIGHTS

The BusinessNZ Economic Conditions Index, a measure of NZ's major economic indicators, sits at -15 for the September 2021 quarter, down 30 on the previous quarter and down 27 on a year ago (not surprising given the Delta outbreak and various associated stages of lockdown over the past 5 weeks).

The NZ roller coaster ride with economic growth over the last year or so continues with some commentators considering the economy will take a hit of around 5-10 percent of GDP for the September quarter before recovering relatively strongly in the December quarter. Notwithstanding efforts of late to reduce restrictions, growth is likely to be constrained by continued border restrictions, alongside the potential risk of further lockdowns, until a much greater part of the eligible population is vaccinated.

The two-speed economy will continue over the short to medium term, with supply constraints impacting on the ability to provide much-needed infrastructure, including housing. On the other side of the coin, hospitality, tourism, and retail will continue to face significant headwinds for some time. The latest lockdowns could be the last straw for many in the hospitality and tourism sectors, given the serious constraints imposed on businesses that provide customer-facing services.

On the other hand, the building and construction sector is reporting record levels of consenting for residential housing and the value of work undertaken is rising. However, supply chain constraints are causing delays and forcing up prices.

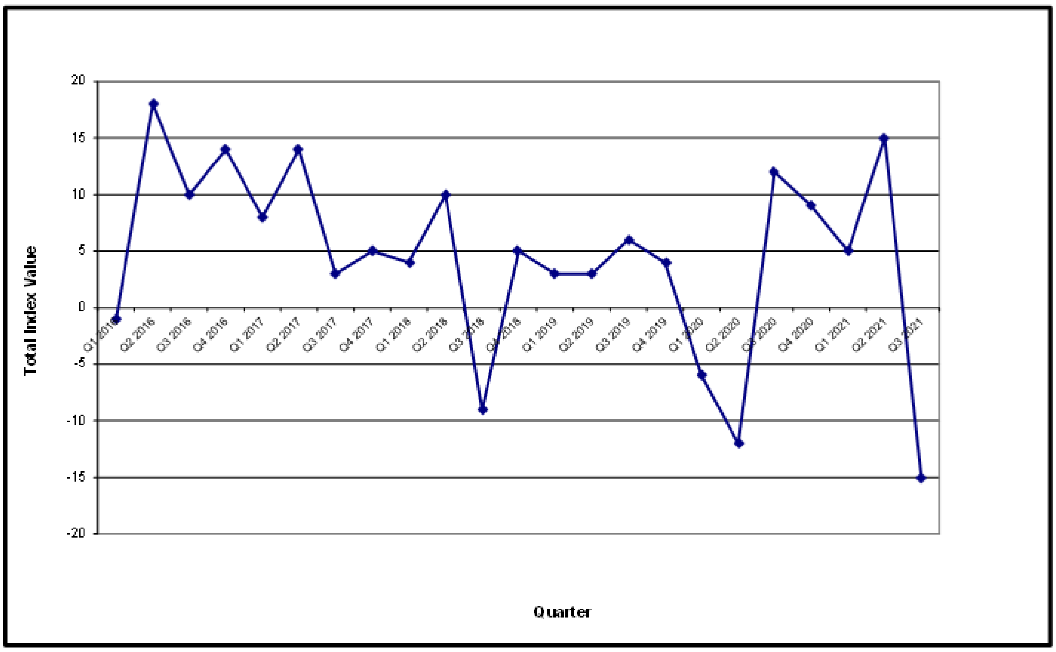
The agricultural sector is still performing well, despite some softening in export prices over recent weeks. Overall, though, international demand is still at satisfactory levels.

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

BusinessNZ Economic Conditions Index (ECI)

The overall BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at -15 for the September 2021 quarter, down 30 on the previous quarter and down 27 on a year ago. This significant drop over the September quarter needs to be put in context given the prolonged period of hard lockdown, particularly in Auckland.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

Data in the ECI is broken up 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 -3 for the September 2021 quarter, down 10 on the previous quarter and down 8 on a year ago. While NZ's terms of trade remain at reasonably high levels on the back of continued support for our key agricultural commodities, shipping capacity is still stretched, leading to delays and potential cost increases for many sectors, with the continued lockdown heightening these problems.

Monetary policy/pricing indicators sit at -4 for the September 2021 quarter, down 2 on the previous quarter and down 5 on a year ago. Longer term interest rates are starting to increase consequent upon increased pricing intentions and continuing supply chain issues and growing inflationary pressures are now increasingly apparent across many sectors. The lockdown, ironically, is exacerbating supply constraints with strictly limited manufacturing output, particularly in Auckland.

Business/consumer confidence indicators sit at -5 for the September 2021 quarter, down 10 on the previous quarter and down 10 on a year ago. Some business and consumer confidence indicators have held up reasonably well, despite lockdown. Nevertheless, uncertainty is still playing on the minds of many businesses with few announcements from the Government as to what will come next after the current lockdown and an increase in vaccination rates.

Labour market indicators sit at -3 for the September 2021 quarter, down 8 on the previous quarter and down 4 on a year ago. It appears many businesses are retaining staff where possible, despite the current lockdown, on the basis that they are very averse to shedding staff given tight labour market conditions and closed borders. Notwithstanding, many businesses will simply have no choice but to close should further lockdowns eventuate.

[1] The ECI tracks over 30 indicators on a quarterly basis. The overall index value for any one quarter represents the net balance of the indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance. Note: The results for the June quarter 2021 are estimates based on available information to date.

<u>Note</u>: Given a very fluid domestic situation at present, the forecasts below, including with respect to economic growth, interest rates, exchange rates, inflation, and unemployment, should be seen for what they are – the best available information to date. Some banks are currently updating their forecasts while other forecasts will likely be subject to significant change as the global and domestic scene continue to evolve over coming months.

<u>PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING?</u>

1.1 Economic growth (GDP) – constrained

The GDP result for the June quarter came out last week at a very solid 2.8 percent for the quarter but recent events have largely confined that result to the dustbin. While it is inevitable the September quarter result will show a 5-10 percent reduction in output as a direct result of the Delta community outbreak and NZ's rapid move into Level 4 lockdown, it is not inevitable that the country will have the rapid rebound that occurred after the last significant lockdown in March/April 2020. As noted above, forecasts of economic growth and other key economic indicators need to be taken with a grain of salt as we are currently living in very uncertain times. The significant variation in forecasts below bears this out.

The Government pump-primed the economy from the June quarter of 2020 with a massive fiscal stimulus package and extremely loose monetary policy settings. This time round, things are likely to be different. Although directing more money at the problem will continue, given the massive increase in debt taken on because of Covid initiatives, building inflationary pressures will probably see credit constrained, associated higher interest rates and an increase in debt servicing costs.

Furthermore, as the Delta variant appears to be much more contagious than the original Covid-19 virus, with impacts across the population rather than largely on those with co-morbidities, and the fact that NZ has been well behind other developed countries in getting its population vaccinated, options are limited. The current situation will likely continue for at least six months, or until it is recognised that the country must learn to live with the fact that Delta is here to stay and an ongoing roll-out of lockdowns is no longer economically or socially feasible.

As stated above, forecasts of growth (and indeed forecasts of other economic indicators) must be taken with a healthy grain of salt. With the very fluid situation in which NZ now finds itself, what is required is a clear plan for re-opening the country to the world, beyond the current lockdown/vaccinations approach.

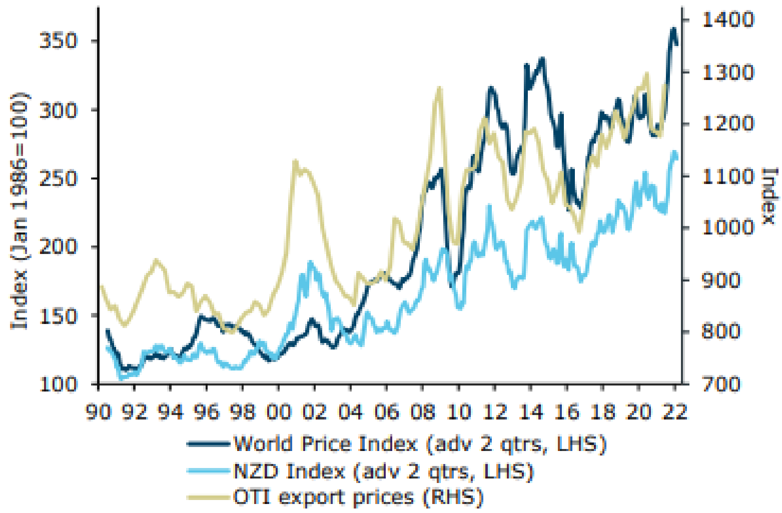
Putting continued uncertainty aside for a moment, there are positive factors which should help rebuild the potential for improved growth over the forecast period, including:

- First, GDP growth for the June 2021 quarter, at 2.8 percent (while now historical in light of recent events), came in much higher than many public and private economic agencies had forecast. Perhaps more importantly, growth was more broadly focused than previously. Service industries, which make up about two-thirds of the economy, rose 2.8 percent. Goods producing industries, which make up about one-fifth of the economy, rose 1.3 percent. Primary industries, which make up the remainder of the economy, rose 5.0 percent.

- Second, NZ's Terms of Trade (a measure of the value of exports required for a given number of imports) are holding up well despite some slight reductions of late.

The ANZ World Commodity Price Index has eased slightly over recent months but is still high by historical standards.

ANZ Commodity Price Index



Source: ANZ, Stats NZ

The index fell 1.6 percent in August, following a similar decrease in July. Dairy and forestry led the index down, offsetting stronger prices in other sectors.

In local currency terms, the index also fell 1.6 percent in August, as the NZ dollar eased just 0.1 percent against the US dollar

- Third, the world economic outlook has continued to improve in light of the generally rapid roll-out of Covid-19 vaccines over a range of countries, despite the continued spread of the Delta variant.

The International Monetary Fund (IMF) in its World Economic Update (WEO - July 2021) shows the global economy projected to grow by a strong 6.0 percent this year and by the slightly more modest rate of 4.9 percent in 2022. The IMF also pointed out that economic prospects have diverged further across countries since its previous April 2021 Outlook, with vaccine access emerging as the principal fault line along which the global recovery splits into two blocs: those that can look forward to further normalisation of activity later this year (almost all advanced economies) and those that will still face resurgent infections and rising Covid death tolls. However, the IMF noted that recovery is not assured, even in countries where infections are currently very low, as long as the virus circulates elsewhere.

Source: IMF World Economic Outlook Update (July 2021)

- Globally, manufacturing activity continues to expand, although it is currently at a six-month low and continuing supply chain issues constrain output growth. This has put upward pressure on input prices across most countries, including New Zealand, with comments from respondents indicating the increased cost of raw materials as a key issue.

Supply chain disruption remained severe in the latest results. This was highlighted by a further significant increase in average vendor lead times. Companies are reporting transportation delays and shortages developing for a wide range of inputs and raw materials.

It is of great significance for NZ that combined, China and Australia account for around 40% of its trade. NZ is therefore heavily reliant on the fortunes of both China and Australia. Until recently, the news here was generally positive but has deteriorated somewhat more recently, which is reflected the results of the PMI for both Australia and China.

Investor sentiment is still waxing and waning with the recent Evergrande Group saga in China also weighing on markets, as investor pounder the broader impact of any default, or worse, collapse. Given that Evergrande is China's second largest property developer, it potentially faces a liquidity crisis under a debt burden of around $US300 billion. To put this is context, this is about 1.5 times the size of the entire NZ economy.

China is crucial not only to the world economy but also to NZ's economic prospects, as growth in its middle class provides added demand for premium NZ protein products.

On the negative side of the equation, there are worrying issues likely to have an adverse effect NZ's growth potential, at least over the short to medium term (2-3 years):

- First, and perhaps most importantly, the relatively low roll-out of the Pfizer vaccine in NZ compared with many other countries is concerning and provides few options over the short term apart from random lockdowns until a much higher percentage of the population is double-dosed. Treasury's 2021 budget forecasts, assuming the country's borders will be open at the start of next year, are now a pipedream.

- Second, the lack of a credible plan for what comes next - after our current lockdowns and a boosted uptake of vaccinations – means massive uncertainty for business and the wider community and a chilling effect on investment and growth.

- Third, while some commentators point to the economy having largely recovered from last year's lockdown, the cost has been significant with around $60 billion spent on various programmes relating to Covid.

Loose monetary policy supported continued growth, but with the undesirable outcome of inflating asset prices (particularly housing) which has the potential to lead to significant inequities creating a population of two halves – the haves and have nots. Lockdowns are not without considerable economic cost (with some estimates suggesting a cost of around $1.5 billion in lost output per week while the whole of NZ was in Level 4 lockdown) quite apart from the broader social costs and the impact on mental well-being associated with the more draconian forms of lockdown. Until vaccination rates among eligible people exceed 80% - 85%, it is difficult to see light at the end of the tunnel in terms of NZ reopening to the world.

- Fourth, while at the time of writing this report Auckland had just gone to Level 3 with the rest of the country remaining in Level 2, it is likely the Government will take a rather cautious approach to lowering levels further and indeed when the levels do drop, significant restrictions could still be in place. The point is that there is unlikely to be a return to a "relative normal" in the near term. This will impact on the amount of activity undertaken until households and businesses see that the coast is reasonably clear, which will also affect investment intentions. While the Government has said current criteria around Level 1 will remain, the big question is - when will we get there?

- Fifth, closed borders are continuing to have significant effects, including on:

  1. Certain regions where many businesses have been particularly affected by a lack of foreign tourists and are hanging on by a thread
  2. The agricultural and horticultural sectors unable to undertake important seasonal work due to a lack of foreign expertise and skilled and unskilled migrant labour, adversely affecting returns and infrastructure projects
  3. Revenue in the higher (tertiary) education sector due to a lack of foreign students
  4. More generally, the ability to source expertise which is acting as a drag on potential economic growth.

- Sixth, supply chain issues are a significant and continuing problem adding to cost pressures and resulting in delays in obtaining materials essential if businesses are to progress at pace. Combined with very strict controls on sourcing foreign expertise for key projects, supply chain issues have delayed some projects while others have simply been put on hold or canned completely. The current lockdown has exacerbated these concerns with many Auckland manufacturing plants still in limbo, creating significant shortages of key inputs into, for example, the construction sector.

- Seventh, housing remains a major concern for many New Zealanders, with prices continuing to rise despite a range of government measures taken to try and dampen demand. The real difficulty is still the supply side, although there is some evidence the increase in building consents is feeding through into the greater value of the work being done.

- Eighth, while the Government's core Crown net debt has increased significantly in response to various Covid-19 support measures (and will continue to do so for the next couple of years with the Government pumping another $7 billon into the Covid fund), overall, debt levels are still relatively manageable. However, there is no free lunch here and debt will need to be paid back at some stage, reducing the choices NZers can make, and potentially raising the risk profile (interest rates) required for investment in NZ.

Forecasts: Real GDP percent Growth

	Years Ending		
	Sep 21	Sep 22	Sep 23
Highest	4.0	5.2	3.4
Average	3.5	4.6	2.6
Lowest	3.0	3.5	1.9

Source: ASB, BNZ, Kiwibank and Westpac

1.2 *Monetary Policy – changes continue*

Significant changes have been made to how the Reserve Bank operates now its mandate has been radically expanded beyond that of targeting inflation.

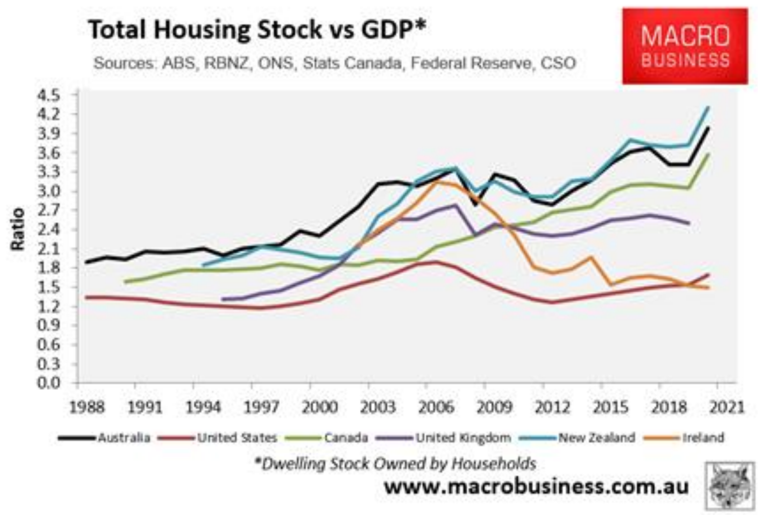
The Reserve Bank proposes looking to use new tools such as Debt-to-Income (DTI) Ratios and the Government has, in principle, given it the green light to try and stem housing demand by restricting capital availability. But such tools are crude and do not take account of the financial situation of people wanting to borrow or of their unique circumstances. Furthermore, trying to constrain housing prices while minimising any impact on first home buyers is far from easy.

The Reserve Bank has also sought views on its proposal to reduce risky mortgage lending by further reducing the amount of high Loan-to-Value Ratio (LVR) lending to owner-occupiers, restricting the amount of lending above an LVR of 80 percent, to 10 percent of all new loans to owner-occupiers, down from the present 20 percent.

According to the Reserve Bank, lending of LVRs greater than 80 percent has nearly tripled since 2017, with a large amount of the lending going to first-home buyers, followed by existing owner occupiers. The bank notes that although its stress testing indicates the financial system is well-placed to weather shocks such as a downturn in the housing market, it is concerned about the potential future risk to economic and financial stability if higher risk borrowing is allowed to continue at its current rate.

NZ's love affair with housing has driven up prices to such an extent that the country risks having all its eggs in one basket. The graph below shows that housing stock was valued at a whopping 4.3 times the nation's GDP in December 2020, versus Australia's also high 4.0 times GDP as at March 2021.

The surge in NZ house prices has taken place on the back of an explosion in mortgage lending, while productive lending to businesses and agriculture has effectively shrunk.

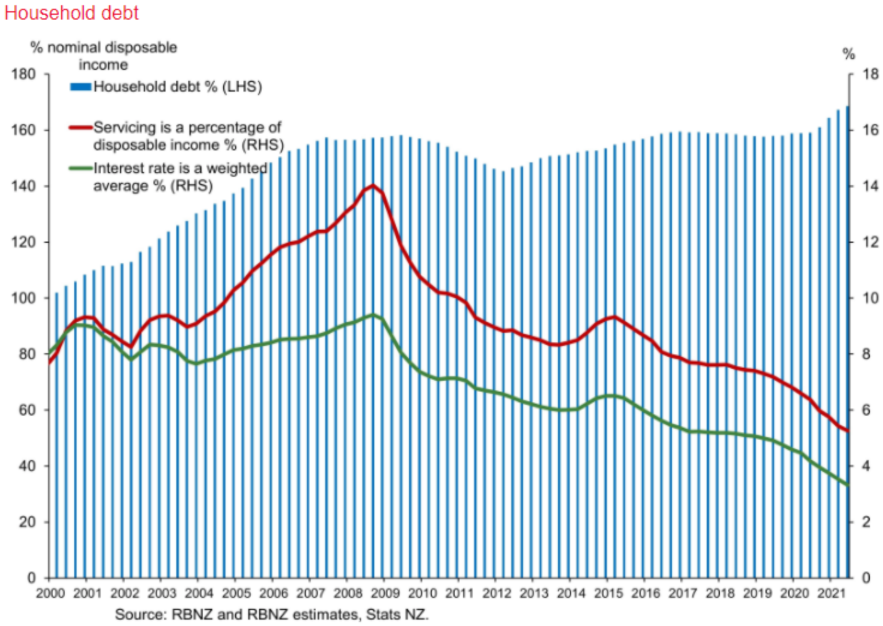


Interest Rates – no second stop

The Reserve Bank would have increased interest rates at the last review (August) had not the Delta outbreak and the resulting lockdown occurred. Barring another major community outbreak of Delta between now and October's next review, there is an almost 100 percent chance of the OCR being raised – if not by 50 basis points, then at least 25, with markets largely having already priced this in.

Ironically, the prolonged lockdown has placed even further pressure on the need to address increasing inflationary pressures given the constraints placed on the ability to supply the goods and services demanded by businesses and consumers. The staggering June Quarter GDP result will only fuel the fire with the economy up against significant (though many artificially created) capacity constraints.

The Reserve Bank, in its last review clearly signalled the pathway to returning monetary policy to a more neutral state. Interest rates will continue to rise, as can be seen from the forecasts below, and with historically high levels of household debt (see graph below), those rises might not need to be significant before starting to impact on households' disposable incomes.



Forecasts: Interest Rates (90-day bills)

	Years ending		
	Sep 21	Sep 22	Sep 23
Highest	0.7	1.8	2.4
Average	0.5	1.6	2.0
Lowest	0.4	1.5	1.7

Source: ASB, BNZ, Kiwibank and Westpac

The NZ dollar – bobbing around

The NZ dollar came under some pressure as a result of the recent lockdown but has since recovered in light of an almost certain increase in interest rates when the Reserve Bank next reviews the OCR.

However, the speed at which interest rates rise around the world will also have an impact on the future direction of currency movements. Central banks are currently reviewing their stance on monetary policy settings, and it is likely that in a range of countries, interest rate rises will occur sooner than originally intended.

Moreover, there is some expectation in the forecasts that the NZ dollar might ease as economic conditions improve globally and central banks embark on monetary policy tightening.

As mentioned earlier, The International Monetary Fund (IMF) in its World Economic Update (WEO - July 2021) pointed out that economic prospects have diverged further across countries since its previous April 2021 Outlook. Vaccine access has emerged as the principal fault line along which the global recovery splits into two blocs: those that can look forward to further normalisation of activity later this year (almost all advanced economies) and those that will still face resurgent infections and rising Covid death tolls.

The NZ dollar is expected to remain relatively stable against the Australian dollar out to September 2023. However, forecasting the future direction of the NZ dollar is fraught with difficulty and a potentially wide range of outcomes is possible, as can be seen below. Australia is facing significant issues in getting the Delta variant under control despite numerous attempts at lockdowns – albeit not as stringent as NZ's approach.

Forecasts: Exchange Rates

AUD (cents)			
	Sep 21	Sep 22	Sep 23
Highest	0.96	0.95	0.94
Average	0.95	0.93	0.93
Lowest	0.93	0.91	0.92

USD (cents)			
	Sep 21	Sep 22	Sep 23
Highest	0.72	0.79	0.78
Average	0.70	0.75	0.74
Lowest	0.69	0.70	0.71

TWI			
	Sep 21	Sep 22	Sep 23
Highest	75.2	76.3	75.6
Average	74.4	75.1	74.4
Lowest	73.2	73.3	73.6

Source: ASB, BNZ, Kiwibank and Westpac

Inflation – lockdown accentuates pressures

Inflationary pressure is starting to rear its head through more than one channel, with shipping capacity constraints, material supplies and labour shortages raising costs and restricting overall growth in the NZ economy. Inflationary pressure is not only a NZ phenomenon but is increasingly being felt around the world as the impact of expansionary monetary and fiscal policies encourages an increased demand for goods and services, fuelled by historically low interest rates.

The Reserve Bank's continued very loose monetary policy stance (the "no-regrets policy") is having a significant impact on asset prices (particularly housing) that will extend the gap between the haves and have nots and has encouraged the continued buildup of household debt. NZ household debt now sits at an historical high with much of it tied into the housing market. Ironically, at the same time, debt servicing costs are at their lowest level for well over two decades.

Notwithstanding the above, business opinion surveys now consistently show stronger inflationary expectations with the majority of respondents reporting an intention to raise prices over the next year – an elevated result compared with historical survey results. At the same time even more respondents are expecting input costs will also rise.

The New Zealand Institute of Economic Research's latest Consensus CPI forecast shows the CPI expected to spike at about 3.9 percent in September 2021 before moderating later in 2022. Annual inflation is forecast to remain above the Reserve Bank's inflation target band through to March 2022.

The forecast below shows the latest Delta outbreak and associated lockdown have exacerbated labour shortages and supply chain disruption, intensifying capacity pressures. Over the longer term, these pressures are expected to ease as appropriate responses to manage further potential outbreaks are put in place and inflation is contained well within the Reserve Bank's inflation target band (1-3 percent) over coming years.

On the other hand, supply chain disruption is now a major international issue with companies internationally facing transportation delays and shortages developing for a wide range of inputs and raw materials. This is not just a NZ issue but will have broader ramifications for monetary policy settings internationally.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Sep 21	Sep 22	Sep 23
Highest	4.2	2.7	2.5
Average	3.8	1.8	1.8
Lowest	3.0	2.1	2.3

Source: ASB, BNZ, Kiwibank and Westpac

1.3 Business activity and confidence – mixed results

Recent surveys of business activity and confidence show confidence has not fallen off the cliff as it did last year during the Level 4 lockdown. There is likely a range of reasons for this outcome, and these are briefly outlined below.

First, we have been there before, and since the 2020m lockdown, businesses have adapted significantly in terms of how they operate under different conditions with new and improved systems and technology in place.

Second, the Government already had a number of business assistance programmes from last year which could be rapidly reintroduced (such as the wage subsidy scheme and other assistance measures). Businesses essentially knew the rules of engagement although there has been some tweaking here and there.

Third, the economy, was performing well in mid-2021, as evidenced by June quarter's stellar GDP result, so businesses were already stretched in terms of capacity constraints as to what more they could pump out.

But despite reasonably positive results from recent business confidence surveys (given we are still in a significant lockdown phase), those surveys also contain some worrying statistics, particularly the continuing evaluated risks, notably over future pricing expectations.

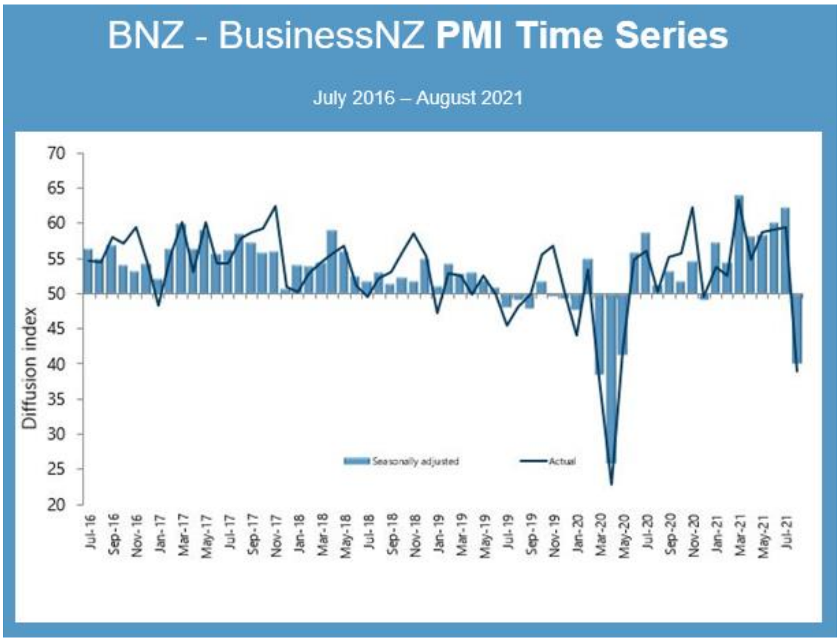
Tight constraints on goods and labour supply are putting upward pressure on prices while at the same time affecting NZ's ability to grow. Nevertheless, most surveys point to improved labour market outcomes and unemployment rates lower than expected.

As mentioned earlier, many sectors were experiencing strong growth up until the recent lockdown, particularly manufacturing, construction and agriculture, but other sectors remained in the doldrums consequent upon the ongoing closure of the border, particularly the tourism and hospitality sectors.

However, things have gone down several gears with the arrival of Delta and this is where to some extent business opinion surveys and actual data part company.

For example, when actual activity is measured the results are not nearly so rosy.

The latest BNZ – BusinessNZ Performance of Manufacturing Index (PMI) - for August 2021 showed a sharp contraction and a similar result is likely for September given Auckland was in a level 4 lockdown for a high proportion of the month.

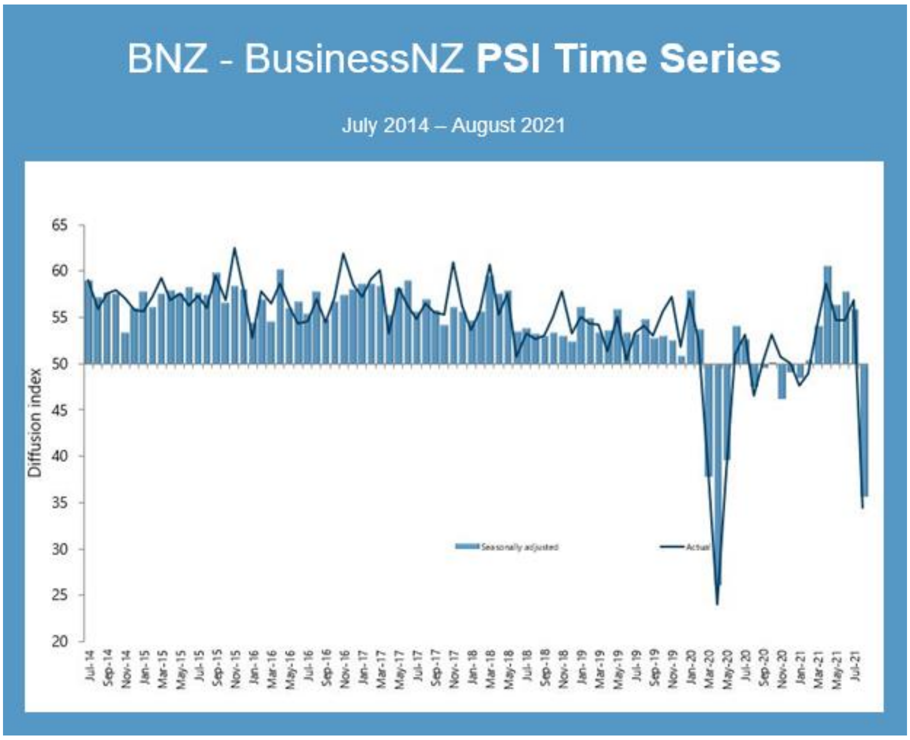


The seasonally adjusted PMI for August was 40.1 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was 22.1 points lower than in July, and similar to the result recorded in May 2020 at the height of the first major nationwide lockdown.

Employment (54.5) managed to keep its head above water, but all other sub-index values were in contraction with Production (27.7) the hardest hit. Although manufacturers outside of Auckland have returned to alert levels that allow business operations to restart, any moves towards the sector getting back into expansion will ultimately depend on how soon Auckland can also return to a lower alert level.

Not surprisingly, the NZ services sector fell back into contraction during August, according the BNZ – BusinessNZ Performance of Services Index (PSI).

The PSI for August was 35.6. (A PSI reading above 50.0 indicates that the service sector is generally expanding; below 50.0 that it is declining.) This was the second lowest level of activity since the survey began with the April 2020 result still the lowest during the national lockdown last year.



Like its sister survey the PMI, the national lockdown was the sole influencing factor causing service sector activity levels to plunge into contraction. Even for those outside Auckland who have moved down alert levels to resume business activity, there will be residual effects at least through September with uncertainty and lower alert level restrictions both playing a part.

A recent survey by the BusinessNZ Network shows that New Zealand businesses are stressed and anxious about lockdowns, low earnings, and uncertainty. They are generally supportive of NZ's Covid policies but want to see more movement on vaccinations, testing and tracing, and want more targeted government support.

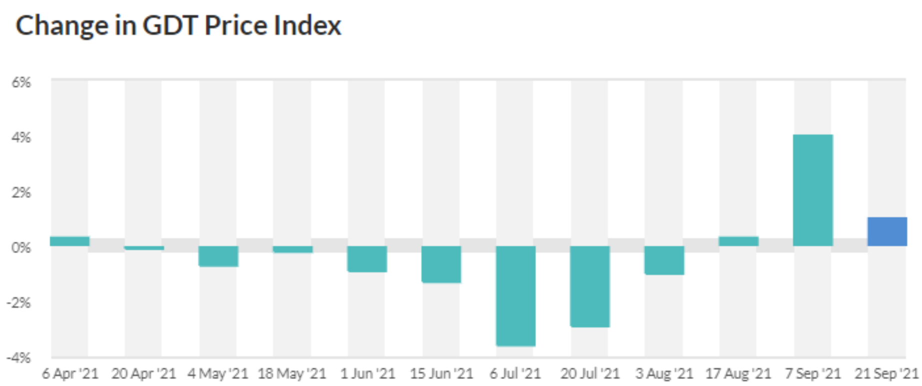
The BusinessNZ Network Pulse Survey was conducted during September 2021, tracking the views of 456 member businesses of the BusinessNZ Network.

It shows that businesses in all parts of the country want improved Covid policies to increase uptake of vaccinations and availability of saliva testing. They support the move to compulsory QR Code scanning and record-keeping in workplaces.

South Island businesses were concerned about getting goods from Auckland during Auckland's Level 4 lockdown and say better Covid policies for testing and tracing would have allowed the South Island to avoid current level 2 restrictions.

84% of businesses throughout the country expect their earnings will be negatively affected over the next 3-6 months.

Meanwhile, on a more positive note, the agricultural sector continues to perform well, largely on the back of solid global demand and commodity prices holding up reasonably well despite some declines in international dairy prices mid-year. There has been some recovery since, as can be seen from the graph below which shows recent movements in the Global Dairy Trade (GDT).



Source: Global Dairy Trade (GDT)

Notwithstanding the solid performance of agriculture over current and previous lockdowns, there is significant concern in both the agricultural community and the mineral extraction sector over the potential impact of aspects of freshwater reform which will adversely affect the ability to use land in an optimal manner. For example, the recent National Environmental Standards for Freshwater Regulations essentially prohibit earthworks on all 'natural wetlands' – the definition of which is extremely broad. This is a prime example of the problem of introducing specific national definitions to the detriment of quarrying and building within existing developments, taking no account of the unique circumstances facing individual regions or communities, or the impact on broader economic development.

It is pleasing to report that after significant concerns expressed by the broader business community and developers the Government has, rightly, seen fit to review decisions made last year. A discussion document is proposing potential changes to the status quo to provide a consent pathway for certain activities, enabling development to occur where necessary while ensuring no net loss of natural wetlands or associated values. This, so far, is a good outcome but does raise the problem of changes to legislation and rules being rushed through without full consultation with affected parties. The potential for unintended consequences is large.

There is more than one such example of government making decisions without thinking through the potential implications for legitimate business activity or the chilling effect on investment if rules unnecessarily limit activity. For example, BusinessNZ and the BusinessNZ Energy Council (BEC) have both registered their opposition to proposed rules for decommissioning oil and gas infrastructure.

The Crown Minerals (Decommissioning and Other Matters) Amendment Bill sets stiff new financial requirements and penalties for companies decommissioning energy infrastructure, which BusinessNZ and BEC say are disproportionate to the risk.

The Bill also has the unusual effect of making a former owner liable for meeting the costs of decommissioning energy infrastructure if its new owner fails to do so.

BusinessNZ and BEC say this proposed rule would create a perpetual liability on energy businesses and should be strongly opposed: *"We can think of no other situation in New Zealand where a business is legitimately sold, and the seller is responsible for any liabilities which might be accrued by the new owner. This is a fundamental change to how business transactions work. It will create significant uncertainty, have a chilling effect on investment and will make New Zealand a less attractive place to invest in or do business."*

There is still plenty of room to improve regulatory processes, including the impact of decision-making on the broader economy and on business confidence. Rapid, and in some cases, debatable regulatory interventions will not necessarily assist businesses with large sunk costs when making investment decisions. The quality of regulatory decision-making is still NZ's Achilles heel and remains an area where sizeable improvements should be made.

1.4 Labour market – artificially tight

Unemployment fell to 4.0 percent in the June quarter 2021 according to the Household Labour Force Survey (HLFS). Under current levels of lockdown, businesses appear desperate to retain staff wherever possible, given the fact that once NZ goes back down the levels there is little hope of securing replacement labour under current border settings. The latest BNZ – BusinessNZ Performance of Manufacturing Index (PMI) for August 2021 showed a sharp contraction in overall activity although Employment (54.5) managed to keep its head above water. But all other sub-index values were in contraction with Production (27.7) the hardest hit. This suggests that businesses are trying to keep staff attached to the workplace, if at all possible, with the various government business assistance packages somewhat helpful in this regard.

Notwithstanding the above, the number of people on Job Seeker Support payments has increased since the latest outbreak of Covid-19, but it is too early to be definitive as to how high this will go given there will be some lag in business closures and associated redundancies. The BusinessNZ Network helpline has fielded many calls from businesses seeking guidance on closing operations given the latest Covid-19 outbreak and associated extended lockdown.

Despite the various financial assistance packages from Government, it is very disheartening to hear from businesses desperate to secure skilled labour from overseas, that given the Government's closed-door policy, they are effectively unable to grow or provide the goods and services demanded in a first world economy.

The picture of NZ leaving fruit to rot on the ground comes to mind, demonstrating that things are simply getting a whole lot harder for employers. The latest lottery for MIQ spots is extremely deficient, with demand outstripping supply of spaces by a factor of around 10. It is understood that around 25,000 – 30,000 people put their name in the lottery for around 3,000 spots available.

Significant concerns remain about employers' ability to source skilled labour from overseas so that projects and seasonal activities can proceed. There does not appear to be a plan from the Government as to how NZ as a country is to reopen up to the world beyond the current emphasis on lockdowns and increasing vaccination rates.

Another concern is that many countries have stolen a march on NZ having vaccinated around 80 percent of their target population. Consequently, many skilled migrants simply seek access to other countries which are now more open to utilising their skills than is NZ. Given there is a global market for capital and labour, NZ cannot afford to keep its head in the sand over the need to address our medium-term border reopening to the world.

It is important for policy makers to understand the contribution migrant employees make to the NZ economy and to individual sectors. These skills cannot - in many if not most cases - simply be replaced by employing NZ citizens made redundant from their current employment or from long-term unemployment.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Sep 21	Sep 22	Sep 23
Highest	4.1	4.1	4.3
Average	4.0	3.8	4.1
Lowest	3.8	3.5	3.7

Source: ASB, BNZ, Kiwibank and Westpac

Labour Costs – rising

It is not surprising that with NZ's extremely tight labour market, the forecasts below show some upward movement in labour costs.

A relatively modest growth in forecast wage rates in aggregate over the forecast period tends, however, to mask significant gains for specific sectors and for individuals within sectors. The inability to source skilled immigrants from overseas may see some job-hopping as businesses compete to obtain required expertise from a diminished pool.

The impact of impending regulatory cost increases also needs to be thrown into the mix of factors driving changes in labour costs. While overall, the proposed reforms might result in increased wage rates for some, they will result in reduced job opportunities, if not actual job losses, for others. The Government needs to recognise the need for flexible labour market practices that allow individuals and companies to agree arrangements best suited to their individual circumstances. Moves back towards more centralised wage bargaining do not take account of the unique pressures facing individual companies in particular markets.

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

	Years Ending		
	Sep 21	Sep 22	Sep 23
Highest	2.6	2.9	3.2
Average	2.3	2.7	2.7
Lowest	2.0	2.5	2.3

Source: ASB, BNZ, Kiwibank and Westpac