BUSINESS NZ

PLANNING FORECAST

JUNE 2018

BusinessNZ

NZ economy – risky business

Executive Summary

Many key economic indicators remain on the positive side of the ledger, although there are a number of risks which could undermine what is currently a generally healthy outlook.

The NZ economy is forecast to grow moderately at around 3 percent over the forecast period out to June 2020.

NZ's terms of trade (a measure of the purchasing power of its exports and a key indicator of the state of the economy overall) are still close to an all-time high, driven largely by higher meat and dairy prices.

Employment continues to grow and unemployment to edge lower. Inflation remains under firm control with little need for the Reserve Bank to lift interest rates over the short to medium term. The exchange rate is relatively stable against our major trading partners.

The Government's accounts are in reasonable shape for now at least, with the May Budget largely meeting market expectations despite major increases in both tax and expenditure over the forecast period.

Consumer confidence is still relatively robust. The share market (NZX) has reached a new high. All very positive stuff.

So what are the lower growth risks? They are by nature both domestic and international, some under and some outside NZ's control but nonetheless combining to keep business confidence in the doldrums.

Current risks, in no particular order, are:

- The mycoplasma bovis issue which will affect the dairy sector's productivity. Some estimates put the potential cost of eradication at around $1 billion not to mention the impact on sector confidence.
- The ongoing issue of household and agricultural debt (particularly dairy).
- The difficulty government has in designing policies to deal effectively with the issues the policies are meant to address without producing adverse unintended consequences. For example, some foreign investors keen to build a hotel in Queenstown, may be somewhat perplexed if they were told that they cannot, under the Overseas Investment Bill, at the same time buy an existing house.
- A political, rather than economic, rationale for effectively banning the issuance of future offshore oil and gas exploration licences and the signal this sends to potential investors.
- The number of Taskforce and Working Groups set up to examine a wide range of issues from tax, monetary policy, local government funding, health, social policy, "fair pay" agreements etc. The jury is still out on whether such mechanisms will provide consistent policy outcomes that promote increased business competitiveness.
- At the international level, concern over the potential escalation of international trade retaliation with more inward-looking international agendas, particularly triggered by moves from the US to increase tariffs on certain products, imposing trade barriers on international trade.
- The impact on company earnings of a potential national and international share market correction, along with rising interest rates, increasing cost structures and uncertainty.

HIGHLIGHTS

The NZ economy is forecast to grow at around 3 percent out to June 2020 but there are risks to achieving this.

The BusinessNZ Economic Conditions Index sits at 9 for the June 2018 quarter, up 2 on the previous quarter and down 5 on a year ago.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI), both continue to show solid expansion.

The agricultural sector is on a bit of a roller coaster ride, with higher lamb and dairy prices on the back of improved global demand. At the same time, however, the outbreak of mycoplasma bovis will affect productivity in the dairy sector.

Business confidence remains in the doldrums despite relatively robust economic data across a range of sectors. Policy uncertainty and some ad hoc changes are likely to be driving this continuing nervousness.

By contrast, consumer confidence remains well into positive territory on the back of relatively strong employment growth, benign inflationary pressures and continuing low interest rates by historical standards.

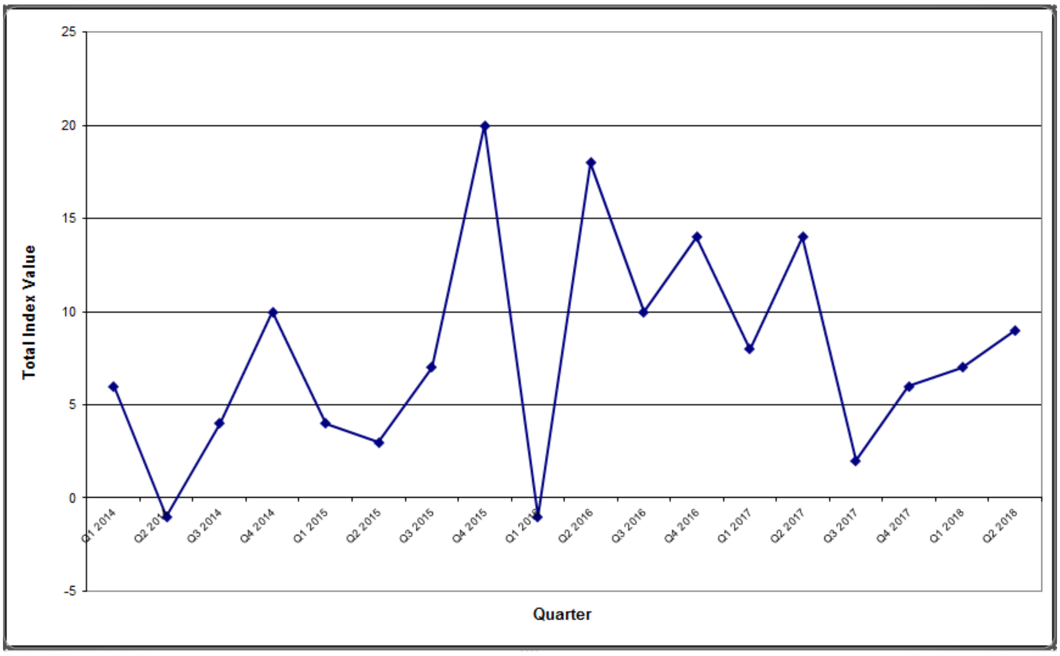
Internationally, growth forecasts are still solid but with higher inflationary pressures resulting in rising interest rates, affecting the cost of capital. Equity markets are continuing to recover from the blip earlier this year but the potential for a significant market correction cannot be ruled out.

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 9 for the June 2018 quarter, up 2 on the previous quarter and down 5 on a year ago.[1]

Overall Economic Conditions Index (ECI)



Source: BusinessNZ

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

Of the ECI sub-groups:

Economic growth/performance indicators sit at 1 for the June 2018 quarter, the same as for the previous quarter but down 6 on a year ago. New Zealand's terms of trade remain close to record levels on the back of improving world commodity prices, including dairy, beef, lamb and horticultural products.

Monetary policy/pricing indicators sit at 4 for the June 2018 quarter, up 4 on the previous quarter and up 1 on a year ago. Domestic inflation remains under firm control, although internationally, inflationary pressures are rising slowly, the consequence of improved commodity prices, including oil.

Business/consumer confidence indicators sit at 4 for the June 2018 quarter, down 1 on the previous quarter and up 2 on a year ago. While consumer confidence is still relatively robust, business confidence remains in the doldrums.

Labour market indicators sit at 0 for the June 2018 quarter, down 1 on the previous quarter and down 2 on a year ago. Employment continues to edge up and unemployment drifts lower but labour market activity appears to have peaked with, of late, a decline in net migration and slowing job ads.

[1] The ECI tracks over 30 indicators on a quarterly basis. The overall index value for any particular quarter represents the net balance of the indicators (generally the number increasing minus the number decreasing) thus providing an overall measure of performance. In general, increases in an indicator are seen as positive (e.g. growth in GDP or employment) and declines as negative. However, this is not always the case; for example, declines in unemployment are seen as positive and increases as negative. The results for the June quarter 2018 are estimates based on available information to date.

PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING

1.1 Economic growth (GDP) – slight easing?

Many key economic indicators remain on the positive side of the ledger, although a number of risks could undermine a generally healthy outlook.

The NZ economy is forecast to grow moderately at close to 3 percent over the forecast period out to June 2020, as can be seen below.

The latest NZIER *Consensus Forecasts* expects a slight downward revision in the growth outlook for the next few years, explained by a weaker prospect for exports and investment.

Notwithstanding the above, NZ's terms of trade (a measure of the purchasing power of its exports and a key indicator of the state of the economy overall) are still close to an all-time high, driven largely by higher meat and dairy prices.

Employment continues to grow and unemployment to edge lower. Inflation remains under firm control with little need for the Reserve Bank to lift interest rates over the short to medium term. The exchange rate is relatively stable against our major trading partners.

The government's accounts are in reasonable shape for now at least, with the May Budget largely meeting market expectations, despite major increases in both tax and expenditure over the forecast period. Looser fiscal policy may well assist with short-term growth although the trade-offs need to be clearly understood.

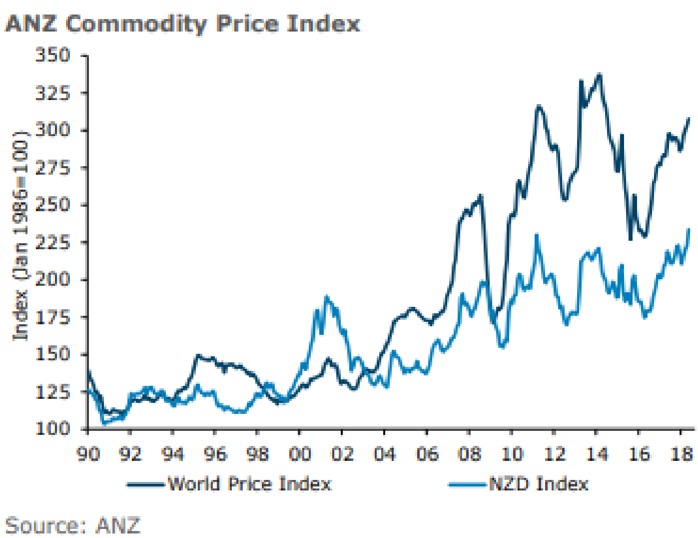
The share market (NZX) has reached a new high. All very positive stuff.

While some key drivers of growth are starting to ease off (e.g. net migration inflows are decreasing but remain at historically high levels and construction activity has eased back somewhat), other sectors, including the manufacturing and services sectors, continue to show solid growth.

Both the BNZ-BusinessNZ Performance of Manufacturing (PMI) and its sister survey the BNZ-BusinessNZ Performance of Services Index (PSI) still show solid levels of expansion.

The agricultural sector faces mixed fortunes. Dairy prices have generally remained solid and Fonterra recently opened its forecast Farmgate Milk Price for the 2018/19 season at $7 per kgMS. On the other hand, the outbreak of the mycoplasma bovis is going to affect dairy sector productivity. Some estimates suggest the potential cost of eradication could be around $1 billion, not to mention the impact on sector confidence. Agricultural debt (particularly dairy) is also an ongoing issue.

Meat prices have improved and the relatively strong demand for both beef and lamb is having a positive effect on world commodity prices. The ANZ commodity price index is showing increased returns to NZ producers when the price achieved is converted back into NZ dollars.



The ANZ World Commodity Price Index lifted 1.5 percent (month on month) in May, the fifth consecutive rise this year. Converted into NZ$, the NZD index increased by 5.0 percent (month on month) in May, lifting annual returns to 6.8 percent.

So what are the risks of lower growth? They are by nature both domestic and international, some under and some outside NZ's control but nonetheless combining to keep business confidence in the doldrums.

There are a number of risks, in no particular order:

- For the agricultural community, the (downside) risks are more likely to be related to domestic, rather than international, policy settings. For example, the sector will keenly assess any proposals coming out of the Tax Working Group for their environmental impact, such as wealth and/or environmental taxes.
- Freshwater reform is still an ongoing issue with the potential allocation of nitrogen something which of late has been testing the minds of government and members of the Land and Water Forum (LWF). With uncertainty in the way forward, there may well be some dampening of land conversions and investment in dairy, quite apart from the difficulty of knowing whether, over time, mycoplasma bovis can be eliminated from NZ.
- Household and agricultural debt (particularly dairy) is an ongoing problem.
- The difficulty government has in designing policies to deal effectively with the issues the policies are meant to address without producing adverse unintended consequences. For example, some foreign investors keen to build a hotel in Queenstown, may be somewhat perplexed if they were told that they cannot, under the Overseas Investment Bill, at the same time buy an existing house.
- The political rather than economic rationale for effectively banning the issuance of future offshore oil and gas exploration licences and the signal this sends to potential investors.
- The number of Taskforces and Working Groups set up to examine a wide range of issues from tax, monetary policy, local government funding, health, social policy, to "fair pay" agreements etc. The jury is out on whether such mechanisms will provide consistent policy outcomes promoting increased business competitiveness.
- At the international level, concern over the potential escalation of international trade barriers and retaliation with more inward-looking international agendas triggered particularly by US moves to increase tariffs on certain products.
- The potential for a national and international share market correction increasing cost structures and uncertainty (along with rising interest rates) to impact on company earnings.

A key issue increasingly facing NZ is that of managing risk, both natural risk such as earthquakes/floods and geopolitical risk (e.g. moves internationally towards greater nationalism and protectionist barriers at the expense of relatively free trade). The associated trade-offs and costs and benefits need to be better understood.

Significant and damaging earthquakes over the last few years show once again that NZ is not immune to risk beyond our ability to control. This raises an important question about the country's overall resilience to adverse events.

At one level, there has to be an optimal amount of risk management. Nothing is foolproof and the cost of trying to eliminate risk or achieve very low risk is likely to be prohibitive. The question for many households, businesses and indeed government over the coming months and even years is whether our risk management strategies are appropriate for both the known and, perhaps more difficult, unknown risks facing society, whether as a result of natural disasters (earthquakes, floods etc.), or human-induced terrorism, food safety risks and so on.

The mycoplasma bovis problem shows the importance of having rigorous processes in place to try and minimize the risk of serious outbreaks, such as outbreaks of disease, which will adversely affect productivity, while at the same time recognising that no process is likely to be foolproof, at least without considerable monetary cost.

Responses to the potential implications of climate change (e.g. impact of rising water levels) for vulnerable housing areas are another case in point. They echo the familiar debate about car crashes and vehicle safety where, like speed limits, the many interventions effectively put a value on life.

Decisions about the future use of Yarrow Stadium in New Plymouth as a venue for the Taranaki rugby team and whether or not to chlorinate drinking water supplies are other real life examples of the same approach.

Another controversial issue is the debate over building/not building more prisons and the risk (cost both in monetary terms and potentially human risk) of either doing so or not proceeding.

While often it is difficult to make precise costings of/returns from particular investments that will reduce risk, in the absence of a risk assessment framework, ad hoc decisions will still likely be made without any regard to the costs and benefits (lives saved/lost and or property protected/consumed) of the different regulatory regimes.

A number of local councils have pointed out NZ's vulnerability to natural disasters and asked whether a centralised risk agency might help with better decision-making on matters such as moving or altering infrastructure, development planning and risk management mechanisms such as insurance. Disruption to transport links and key port infrastructure can have a significant impact. Given councils' - and the general public's - propensity to hold out collective hands for government (taxpayer-funded) assistance when things go pear-shaped, the proposal could have some validity.

The question remains whether such things as significant alternative water supplies or roading networks are justified. The list could go on. It is important to understand that taking into account economic and environmental sustainability of resource use, there must be an "optimal" amount of risk minimisation and regulation. Here the question of who pays is particularly pertinent as it will influence decision-making over how much risk is acceptable.

Moreover, it should be noted that regulators generally have strong incentives to minimise their own risk by imposing higher standards than might arguably be justified. Because regulators do not bear the costs associated with their decisions (costs will ultimately fall on consumers), they may well over-regulate rather than be aware of, or adequately consider, the cost/quality trade-offs consumers are willing to make.

As a country NZ has gone through several phases of managing risk from a "number-8, she'll be right" perspective to a situation where any issue adversely affecting an individual or company is seen as government's fault with taxpayers required to bear the risk of remediation.

While regulation may be appropriate in some situations, individuals, households, and businesses need to be reminded that people make choices. How they manage the risks associated with those choices is something they need to be mindful of when buying property (house and/or land) or a business.

If government (via taxpayers) is going to step up to the plate every time someone stubs their foot, then the incentives on individuals and businesses to effectively manage risk is reduced and taxpayers, essentially, carry the tab. Life, at times, can be a risky business.

Forecasts: Real GDP percent Growth

	Years Ending		
	Jun 18	Jun 19	Jun 20
Highest	2.7	3.3	3.5
Average	2.6	3.1	3.0
Lowest	2.6	2.9	2.3

Source: ASB, BNZ and Westpac

1.2 Monetary conditions – no major change

Although the Reserve Bank Act Review is continuing in the background (including announcements by the Finance Minister of the terms of reference for the Review's phase two), there is little in the way of major change to report in respect to New Zealand's monetary policy settings.

The Minister has virtually ruled out breaking up the Reserve Bank's monetary policy and banking regulation functions but has opened up the prospect of introducing a deposit insurance scheme.

We understand NZ is one of the few OECD countries without any kind of deposit insurance. In effect, if a bank fails depositors have no protection and it is likely the Reserve Bank would have to give other savers "haircuts" in order to recapitalise the failing bank. Ultimately, government (taxpayers) would effectively be subsidising savers.

At the international level, an improvement in the global economy has seen a number of countries raise interest rates, albeit from a very low base. Rising interest rates have resulted in a sell-off in equities markets, particularly in the US but even so, key US equity indexes have recovered some of the ground lost in February this year. However, the potential for trade wars in light of President Trump's decision to impose tariffs on steel and aluminum is having some downward effect on equities.

The US Federal Reserve has recently increased its official interest rate to 2.0 percent, taking it above the Reserve Bank's OCR. The Federal Reserve has signalled two more rate hikes this year and three next, suggesting US rates could potentially rise to over 3.0 percent.

For other countries, including the EU, moving towards more normalised interest rates and monetary policy settings remains a long-way off, with very low or even negative interest rates still the order of the day, as can be seen from the table below.

Summary of current interest rates of a large number of central banks

Name of interest rate	country/region	current rate	direction	previous rate	change
American interest rate FED	United States	2.000 %	↑	1.750 %	06-13-2018
Australian interest rate RBA	Australia	1.500 %	↓	1.750 %	08-02-2016
Banco Central interest rate	Chile	2.500 %	↓	2.750 %	05-18-2017
Bank of Korea interest rate	South Korea	1.500 %	↑	1.250 %	11-30-2017
Brazilian interest rate BACEN	Brazil	6.500 %	↓	6.750 %	03-22-2018
British interest rate BoE	Great Britain	0.500 %	↑	0.250 %	11-02-2017
Canadian interest rate BOC	Canada	1.250 %	↑	1.000 %	01-17-2018
Chinese interest rate PBC	China	4.350 %	↓	4.600 %	10-23-2015
Czech interest rate CNB	Czech Republic	0.750 %	↑	0.500 %	02-01-2018
Danish interest rate Nationalbanken	Denmark	0.050 %	↓	0.200 %	01-19-2015
European interest rate ECB	Europe	0.000 %	↓	0.050 %	03-10-2016
Hungarian interest rate	Hungary	0.900 %	↓	1.050 %	05-24-2016
Indian interest rate RBI	India	6.250 %	↑	6.000 %	06-06-2018
Indonesian interest rate BI	Indonesia	6.500 %	↓	6.750 %	06-16-2016
Israeli interest rate BOI	Israel	0.100 %	↓	0.250 %	02-23-2015
Japanese interest rate BoJ	Japan	-0.100 %	↓	0.000 %	02-01-2016
Mexican interest rate Banxico	Mexico	7.500 %	↑	7.250 %	02-08-2018
New Zealand interest rate	New Zealand	1.750 %	↓	2.000 %	11-10-2016
Norwegian interest rate	Norway	0.500 %	↓	0.750 %	03-17-2016
Polish interest rate	Poland	1.500 %	↓	2.000 %	03-04-2015
Russian interest rate CBR	Russia	7.250 %	↓	7.500 %	03-23-2018
Saudi Arabian interest rate	Saudi Arabia	2.250 %	↓	2.500 %	03-15-2018
South African interest rate SARB	South Africa	6.500 %	↓	6.750 %	03-28-2018
Swedish interest rate Riksbank	Sweden	-0.500 %	↓	-0.350 %	02-11-2016
Swiss interest rate SNB	Switzerland	-0.750 %	↓	-0.500 %	01-15-2015
Turkish interest rate CBRT	Turkey	17.750 %	↑	16.500 %	06-07-2018

Interest rates – hold fire for now

The 90-day bill rate is forecast to edge up slightly by June 2020 (see forecasts below).

At its last review, the Reserve Bank, as widely predicted given some current uncertainty both nationally and internationally, kept the OCR at 1.75 percent. There is little pressure at this stage to lift the rate, certainly the majority – but not unanimous – view of the Institute of Economic Research's (NZIER's) Shadow Policy Board at its most recent review.

Forecasts: Interest Rates (90 day bills)

	Years ending		
	Jun 18	Jun 19	Jun 20
Highest	2.0	2.3	3.2
Average	2.0	2.2	2.7
Lowest	2.0	2.0	2.5

Source: ASB, BNZ and Westpac

The NZ dollar – in the zone

While there is a wide range of forecasts on the future direction of the $NZ, on average it is forecast to remain relatively stable over the period to June 2020.

The above perhaps suggests markets, particularly financial markets, place more weight on NZ's robust economic position – and its sound institutions – than on who the government is, or on marginal policy changes. The Reserve Bank Act (phase two) Review is unlikely to recommend changes radical enough to upset markets.

To date the dollar has stayed higher than forecast, particularly as interest rate differentials (notably against the US), which in normal circumstances would have seen it ease, have more or less disappeared. Increased international commodity prices may also be holding up the dollar given a relatively strong historic relationship between its value and commodity (particularly agricultural) prices. Throw into the mix US policy uncertainty affecting the US dollar's popularity and reliably predicting the NZ dollar's future direction is really hard. Continuation of the status quo might not be too far off the mark.

Forecasts: Exchange Rates

AUD (cents)			
	Jun 18	Jun 19	Jun 20
Highest	0.95	0.94	0.93
Average	0.93	0.91	0.91
Lowest	0.92	0.90	0.90

USD (cents)			
	Jun 18	Jun 19	Jun 20
Highest	0.72	0.72	0.73
Average	0.70	0.69	0.70
Lowest	0.69	0.65	0.67

TWI			
	Jun 18	Jun 19	Jun 20
Highest	74.5	73.2	71.9
Average	73.8	71.8	70.9
Lowest	73.3	70.0	70.3

Source: ASB, BNZ and Westpac

Inflation – benign to date

Forecasts below show inflation likely to remain well within the Reserve Bank's target band of 1-3 percent to June 2020, although gradual rises cannot be ruled out. There are potential pressures from both tradable and non-tradable inflation.

On the tradable side, a continued improvement in the world economy is putting some, at this stage minor, upward pressure on commodity prices, while monetary policies across a range of countries are finally moving back toward more long-term normalised positions. In short, inflationary pressures, while still low internationally, have the potential to escalate over time, particularly as oil prices continue to ramp up in light both of global demand and oil producing nations' artificial restrictions on supply.

Notwithstanding the above, over recent years global competition and innovation have cranked up the development of better products and services at lower cost. Consequently, the old argument that as demand ratchets up prices will rise does not necessarily hold now as it did in the past. Prices over a wide range of products and services are dropping, both in real and nominal terms, a significant shift away from the traditional assumption that generalised inflation is here to stay. Moreover, consumers have much more choice in where they can source their products, including the fact that on-line shopping is now a very fast and efficient method of obtaining goods and services, literally from "paddock to plate", in a very timely manner.

On the domestic front, inflationary pressures are almost in conflict. Reducing net migration from recent highs, stabilisation (generally) of house prices and a highly competitive retail sector are keeping a lid on general price increases. On the other hand, the new Government's generally expansionary fiscal policy, together with its large building programme, could put upward pressure on prices. Other new policy proposals, such as raising the minimum wage to $20 per hour by 2021, are also likely to put upward pressure on wage costs.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Jun 18	Jun 19	Jun 20
Highest	1.7	2.3	1.9
Average	1.6	1.9	1.8
Lowest	1.5	1.6	1.7

Source: ASB, BNZ and Westpac

1.3 Business activity and consumer confidence

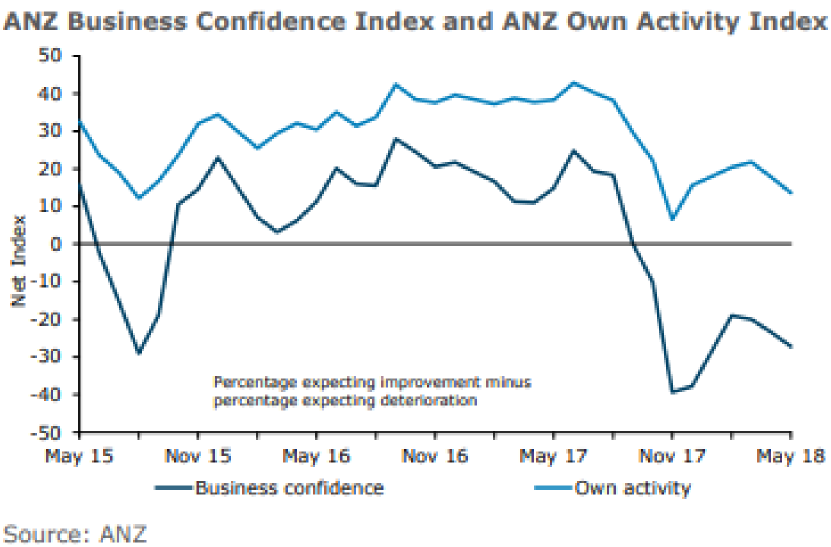
Business activity and business confidence – a game of two halves

While business activity indicators are relatively robust, business confidence remains in the doldrums with little uplift since the post-election drop-off last year. Key quantitative indicators, such as the latest BNZ-Business NZ Performance of Manufacturing (PMI) and its sister survey, the Performance of Services (PSI), continue to show healthy levels of expansion. On the other hand, business confidence is only slowly recovering from a sharp fall in the December quarter.

Perhaps more importantly, businesses' view of their own activity levels, while improving, is still low by historical standards. Some commentators have rightly said that confidence has often fallen post-election in the past but that businesses continue to be concerned about their own business prospects is worrying given the relatively close connection between firms' own prospects and economic growth over time. The other worrying factor is that this concern is evident over a wide range of surveys on business sector confidence, tending to negate any bias factors associated with any particular survey.

There will likely be a range of reasons for such business community pessimism, not least the uncertainty over policy direction and ad hoc changes mentioned earlier in this report.

According to the ANZ Business Outlook (May 2018), both headline business confidence and firms' view of their own activity eased 4 points in May compared with the previous month. The retail and construction industries remain downbeat about their own expectations.



A net 27 percent of businesses are pessimistic about the year ahead, down 4 points from April. Firms' views of their own activity dipped from +18 to +14, the lowest reading since November 2017.

On a much brighter note, the seasonally-adjusted BNZ-BusinessNZ Performance of Manufacturing Index (PMI) for May 2018 was 54.5 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was 4.6 points lower than April, but still the third highest result over the last six months.

While May softened in terms of expansion, the fundamentals behind the main result look solid for now.

Despite the sub index of employment (49.8) dipping slightly into contraction, the remaining sub-indexes stayed in expansion. In addition, the proportion of positive comments in May (55.1%) was the same as March (55.1%), and up on February (51.4%) and January (50.7%). Those who provided positive comments typically noted steady demand and work flow, with some new markets being sought.

PMI Time Series Table

The results are seasonally adjusted.

National Indicies	May 2017	Jan 2018	Feb 2018	Mar 2018	Apr 2018	May 2018
BNZ - BusinessNZ PMI	57.8	55.1	53.4	53.1	59.1	54.5
Production	58.9	53.7	54.0	52.4	60.4	53.7
Employment	55.5	52.7	54.6	53.2	54.5	49.8
New Orders	59.6	55.5	54.4	54.7	60.2	56.7
Finished Stocks	55.7	52.9	51.4	54.3	55.2	51.8
Deliveries	57.5	54.9	53.1	54.7	60.1	58.7

The services sector also remains firmly in positive territory.

A lift in new orders/business contributed to New Zealand's services sector experiencing a lift in expansion levels in May, according to the BNZ-BusinessNZ Performance of Services Index (PSI).

The PSI for May was 57.3, 0.9 points higher than April (A PSI reading above 50.0 indicates that the service sector is generally expanding; below 50.0 that it is declining) and the second highest level of expansion for the last 11 months.

PSI Time Series Table

The results are seasonally adjusted.

National Indicies	May 2017	Jan 2018	Feb 2018	Mar 2018	Apr 2018	May 2018
BNZ - BusinessNZ PSI	58.1	55.9	55.1	58.6	56.4	57.3
Activity/Sales	62.4	59.4	53.7	64.7	56.6	58.1
Employment	53.3	50.9	50.8	50.8	51.6	52.8
New Orders/Business	62.2	59.5	60.8	63.7	61.5	64.6
Stocks/Inventories	54.2	52.5	54.4	55.9	52.0	54.6
Supplier Deliveries	54.8	54.1	54.6	55.7	51.8	53.5

New orders /business (64.6) was at its highest level since January 2017, while the remaining sub-indices were all up from April. Although the proportion of positive comments in May (58.0 percent) was down from April (65.1 percent), comments received took into account a boost in new business, with many outlining more bookings, increased capacity to work more hours and new client acquisitions.

Consumer confidence still relatively robust

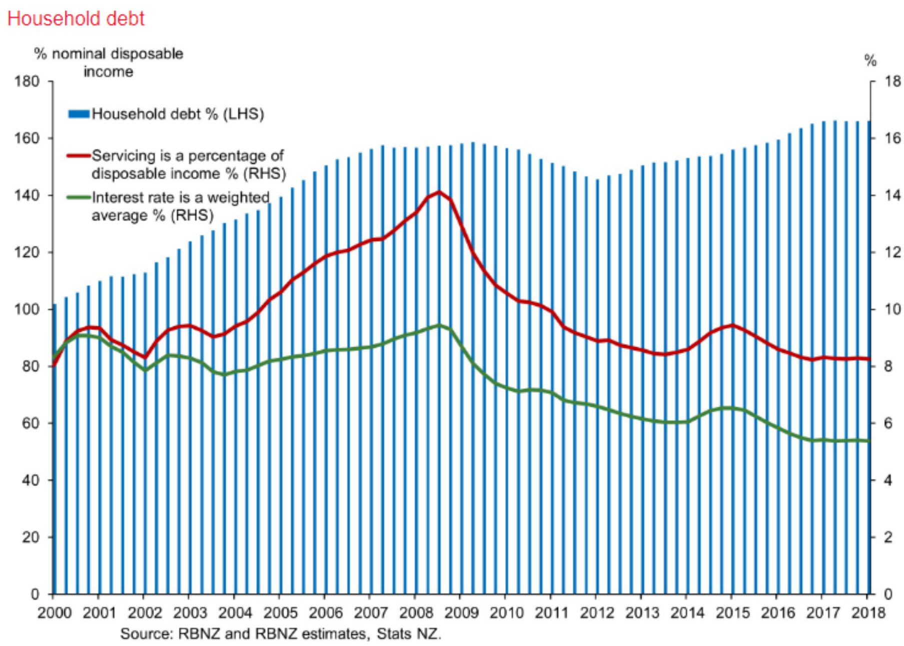
Consumer confidence, unlike business confidence, is still relatively buoyant and is now around its historical average. A number of factors are likely to be at play, including labour market activity remaining strong, inflation under firm control and interest rates remaining at historically low levels reducing the cost of borrowing.

The ANZ-Roy Morgan NZ Confidence Survey showed confidence is still steady at 121 in May this year. While a little off the high reached in September last year, consumer confidence has been more or less solid for the last couple of years, as can be seen below.

ANZ-Roy Morgan Consumer Confidence

While not unduly gung ho, consumers appear to have little enthusiasm for paying down debt and household debt levels continue to edge up despite the threat of higher interest rates down the track. Consumers appear comfortable with the fact that mortgage interest rates have been at historic lows for some time now. However, they do not seem to have factored in an understanding that interest rates will again rise, perhaps sooner rather than later, putting many households, and indeed some businesses, under financial strain.

Levels of household debt remain high at around 166 percent of household income as evidenced by data from the Reserve Bank (see below). It should be noted that household debt comprises mortgage loans, consumer loans such as credit cards, and student loans.



1.4 Labour market – regulatory overkill?

Employment – solid growth for now

According to the Household Labour Force Survey (HLFS), the number of people in employment rose by 0.6 percent (15,000) in the March 2018 quarter. Full-time employment rose by 0.6 percent, while part-time employment rose by 0.5 percent. On an annualised basis, employment growth was 3.1 percent (79,000).

The working age population increased by 0.6 percent (23,000 boosted by continued high net migration), although the labour force participation rate fell from a high of 70.9 percent in December 2017 to 70.8 percent in March 2018.

Unemployment numbers continued to trend down with the official unemployment rate currently sitting at 4.4 percent.

Further falls in unemployment are possible given lower population growth on the back of reduced net migration with growth in labour demand likely to outstrip available supply.

Annual net migration has continued to drift lower after the dizzy heights of the last 5 years. The decline in numbers is largely driven by more non-New Zealand citizens leaving the country. Net PLT migration continued to drop to 66,200 in May after having peaked in July 2017 at 72,400.

Notwithstanding a positive picture overall for aggregate employment growth, associated declines in unemployment, and continued strong growth in job vacancies, significant regional differences remain, and perhaps more importantly, differences in various regional areas' unemployment rates. With levels of youth unemployment and young people not in education, employment or training (NEETS) still relatively high, a great deal of effort will be required to ensure the most vulnerable in society are able to participate actively in the labour market rather than fall into a life of benefit dependency.

As well, the number of "underemployed" (those working part-time who want more hours and are available) saw the underutilization rate reduce slightly to 11.9 percent in March, down from 12.2 percent in December but still reinforcing the need to look through some of the headline rates of employment/unemployment to get a clearer picture of future activity.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Jun 18	Jun 19	Jun 20
Highest	4.4	4.7	4.5
Average	4.4	4.4	4.3
Lowest	4.4	4.2	4.1

Source: ASB, BNZ and Westpac

The big gorilla in the room is the potential impact of labour market changes which the government is busily introducing, either via legislation or through a range of working parties.

Some of these changes are of a technical variety (e.g. the review of the Holidays Act – see below) which is likely to provide employers and employees with greater certainty when it comes to calculating holiday pay.

Other changes have the potential to add significant cost to business and reduce international competiveness. Uncertainty as to final outcomes will be playing on company minds over the short to medium term.

Putting aside for the moment continuing moves to increase the minimum wage, key changes currently being looked at include:

- *Employment Relations Amendment Bill*

The Government's Employment Relations Amendment Bill is currently before the Education and Workforce Select Committee with a report back date of 1 August 2018, an unusually lengthy period. BusinessNZ's submission to the Select Committee can be found at: BusinessNZ's submission

- *Fair Pay Agreements Working Group*

The Government has announced the establishment of a Fair Pay Working Group to be chaired by the Rt Hon Jim Bolger, National Party Prime Minister in 1990 when the Employment Contracts Act was introduced. The Fair Pay Agreements concept is seen by many as taking New Zealand back to something like the national award system where third party-agreed terms and conditions were set for most occupations regardless of employer size or profitability. While the current Amendment Bill does not refer to Fair Pay Agreements, from the changes it would introduce it can be seen as their precursor.

The Working Group itself will have 10 members representing unions, academia, certain industries, and the legal profession. BusinessNZ's Chief Executive, Kirk Hope will represent business. The Group has not been asked to address whether or not Fair Pay Agreements should be introduced but to determine:

- the criteria and process to initiate bargaining on a Fair Pay Agreement
- how bargaining participants will be identified and selected
- what Fair Pay Agreements should cover in terms of scope
- bargaining rules and dispute resolution processes, and ratification and enforcement of Fair Pay Agreements

BusinessNZ has said it will participate constructively in the Group but make no promises in support beyond that.

- *Holidays Act*

Towards the end of May the Workplace Relations Minister, Iain Lees-Galloway announced the Government's intention to carry out a review of the Holidays Act. An increasing variety of work patterns and pay arrangements have made the Act - essentially based on an expectation that holidays will be taken in weeks rather than at short notice for the short periods of time (as now often occurs) – difficult and costly for employers to administer. Currently holiday pay must be calculated on the basis of ordinary weekly pay or average weekly earnings over the previous 12 months with employees paid whichever is the higher of the two amounts. Getting it right is far from easy (as the Novapay debacle clearly illustrated) and the Minister has said he wants the law to be right (with neither side losing out) and to take time to ensure that it is. The Group is to report back within 12 months.

The Working Group will be chaired by Gordon Anderson, a law professor from Victoria University who teaches and writes about employment law and also practises as a barrister in the employment law field. Other members of the group are yet to be selected.

- *"Hobbit Law" Working Group*

The group was set up to address the Governments election commitment to repeal the so called "Hobbit law" which protected the status of contractors in the film industry. Since the election the Government has resiled from a straight repeal of the existing law for fear of discouraging future investment in the New Zealand production of films. The working group's brief is to find means of addressing the various concerns while continuing to provide a welcoming environment for investors.

- *Employment Relations (Triangular Employment) Amendment Bill*

This Bill permits an employee of one organisation who is deployed by their employer to work for, and under the direction of, another employer to be covered by a collective agreement that applies to the second employer. It also permits the employee to take personal grievances against the secondary employer by allowing the employee to join the secondary employer to any personal grievance action taken in relation to their employment with their primary employer. The secondary employer's actions would then be deemed the actions of the primary employer and both would be liable for any remedies awarded.

Currently the Bill is before the Education and Workforce Select Committee with a reasonably lengthy reporting back date of 21 September 2018. If it becomes law, the Bill will almost certainly have significant negative consequences for business.

- *Paid Parental Leave*

The paid leave period will extend to 22 weeks (currently 18) as from 1 July this year and to 26 weeks by 1 July 2020.

- *Pay Equity*

The working group, originally set up by the previous Government, was re-established after the Labour-led Government announced its intention to scrap the previous Government's proposed legislation. The reconvened working group concluded its work and reported to the government at the end of February. Its report recommends the retention of the principles developed by the original working group, but does not include a specific process for selecting comparators. This was deemed unnecessary as job evaluation processes are capable of comparing dissimilar jobs. A new government bill has now been drafted and awaits introduction into Parliament. While it retains the principles agreed by the first joint working group, it is in the form of an amendment to the Equal Pay Act 1972, rather than introducing a new law as proposed by the previous government.

Labour costs – slowly slowly for now

Expectations are that a tighter labour market will not flow through to significantly increased wage pressures, as can be seen below.

Forecasts indicate labour costs in general increasing relatively slowly with a growth rate of just over 2 percent per annum over the forecast period to June 2020.

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

	Years ending		
	Jun 18	Jun 19	Jun 20
Highest	2.1	2.3	2.7
Average	2.1	2.3	2.5
Lowest	2.0	2.2	2.2

Source: ASB, BNZ and Westpac

In some respects it is slightly puzzling that with greatly improved employment growth and firms' reported difficulties in finding skilled staff, wage costs have not yet risen significantly.

Notwithstanding very modest increases in wage rates to date, significant increases in minimum wages over the next couple of years could have flow-on effects to other industries as employees raise relativity arguments. The Government's proposed regulatory regime for labour markets is also likely to ratchet up labour costs, more so than in the past, given a generalised move towards more centralised bargaining arrangements.