

NZ Economy: Heightened Risks

Executive Summary

Despite heightened economic risks at both the international and domestic level, the NZ economy continues to perform reasonably well compared with that of many countries to which we traditionally compare ourselves. Economic growth is still reasonable at over 2.5 percent per annum, on average, over the forecast period while essentially NZ has reached the status of having maximum sustainable employment. Unemployment remains at an historically low rate and inflation is – for now – down and out, as evidenced by the Reserve Bank's perhaps slightly controversial decision to reduce the Official Cash Rate (OCR) to 1.5 percent.

Budget 2019, the first of the Coalition Government's wellbeing Budgets, provided for a significant increase in the Government's expenditure parameters although if the economy does not continue to grow, there will be pressure to maintain current debt levels.

While the various documents accompanying the budget outline many worthy wellbeing indicators, there are certain issues meriting greater consideration and thought.

First, throwing significant money at a problem may not necessarily solve it; what is causing the problem needs to be dealt with first. For example, housing affordability has a lot to do with land availability, along with a host of other factors.

Second, it is crucially important to put the wellbeing indicators into context. For example, the wellbeing Budget provides a degree of rationale for its priorities as, with respect to transforming the economy, when it states that NZ has one of the highest per capita rates of greenhouse gas emissions in the OECD. While such statements might be statistically verifiable, it is important to acknowledge that the vast bulk of NZ agricultural production is exported. Whether emissions, waste, water quality and so on are going up or going down needs to be put in context for sound decisions to be made.

Third, given the number of well-being priorities, it will be important for the Government and government policy makers to determine what sort of trade-offs they are prepared to make and what priorities are highest on the agenda. There simply are not enough resources for significant change across the board. There will be winners and losers and when it comes to bang for buck, therefore priorities must be determined and their rationale (and/or targets) clearly understood and subject to general acceptance.

The Budget's relatively robust outlook is heavily dependent on the economy continuing to deliver growth that will ensure tax rates sufficiently robust to finance the Government's ambitious expenditure programme. Some forecasts even appear heroic given our own recording of how the economy is shaping up. With the Performance of Manufacturing Index (PMI) and the Performance of Services Index (PSI) both displaying slowing expansion, there is cause for concern about future sustained growth. Both are lead indicators closely linked to GDP performance.

Businesses need confidence to invest and must clearly see the benefits of investing in NZ as opposed to taking their capital elsewhere. Low levels of business confidence are therefore a continuing concern.

HIGHLIGHTS

At the international level, projected growth rates have eased on the back of escalating trade and geopolitical tensions. The on-again off-again threats of trade wars, particularly between the US and China (and to a lesser extent Mexico), have caused some jitters in financial markets.

Despite international tensions, the NZ economy is forecast to grow, on average, at over 2.5 percent out to June 2021, with global commodity prices still at reasonably healthy levels.

The BusinessNZ Economic Conditions Index (a measure of NZ's major economic indicators) sits at 6 for the June 2019 quarter, up 1 on the previous quarter but down 4 on a year ago.

The BNZ - BusinessNZ Performance of Manufacturing Index (PMI) and its sister survey, the Performance of Services Index (PSI), generally have continued to show lower levels of expansion and this does not bode well for future economic growth. There has always been a relatively strong relationship between economic growth and the two surveys.

Some sectors, including agriculture, are under pressure from, potentially, added regulatory costs and the uncertainty currently holding business confidence down. Added to these is a concern over the potential for credit rationing and higher interest rates should the Reserve Bank proceed to implement its proposal to ramp up bank capital adequacy requirements.

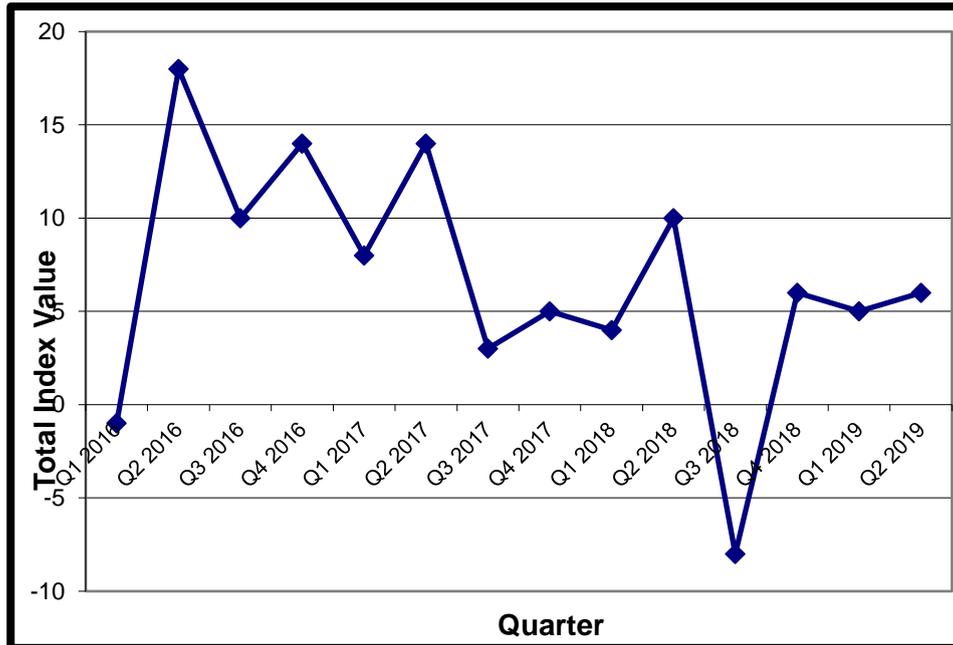
An increased understanding of the NZ's tectonic and other natural hazards has resulted in a move to re-price insurance market risk. The repricing's potential impact could be significant if insurers decide to exit the market, particularly given higher levels of household debt. Areas vulnerable to natural hazards (floods, earthquakes etc.) could be in for a rude awakening as property prices start to reflect risk more clearly.

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 6 for the June 2019 quarter, up 1 on the previous quarter and down 4 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

Economic growth/performance indicators sit at 6 for the June 2019 quarter, up 2 on the previous quarter and up 1 on a year ago. While economic growth is weakening, New Zealand's terms of trade (a measure of the purchasing power of its exports and a key indicator of the economy overall) are still reasonably solid, driven largely by dairy and meat.

Monetary policy/pricing indicators sit at 7 for the June 2019 quarter, up 7 on the previous quarter and up 6 on a year ago. A slightly surprising move by the Reserve Bank to lower the OCR to 1.5 percent has put some downward pressure on interest rates. While tradables inflation is well under control (in fact currently negative), of late, non-tradables inflation is continuing its uplift. This is something the Reserve Bank should be mindful of before pulling the trigger on further cuts.

Business/consumer confidence indicators sit at -4 for the June 2019 quarter, a further weakening of 3 on the previous quarter and down 5 on a year ago. Business confidence indicators remain downbeat with some sectors facing ongoing concerns about regulatory risks. Government's decision to abandon proposals for a Capital Gains Tax (CGT) might result in some uplift in confidence.

Labour market indicators sit at -3 for the March 2019 quarter down 5 on the previous quarter and down 4 on a year ago. Capacity constraints have seen employment growth stall, while unemployment hovers at just over 4 percent. Immigration is still holding up remarkably well although for businesses, trying to source labour is proving increasingly difficult.

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. The results for the June quarter 2019 are estimates based on available information to date.

PART 2: THE NZ ECONOMY – WHERE ARE WE HEADING

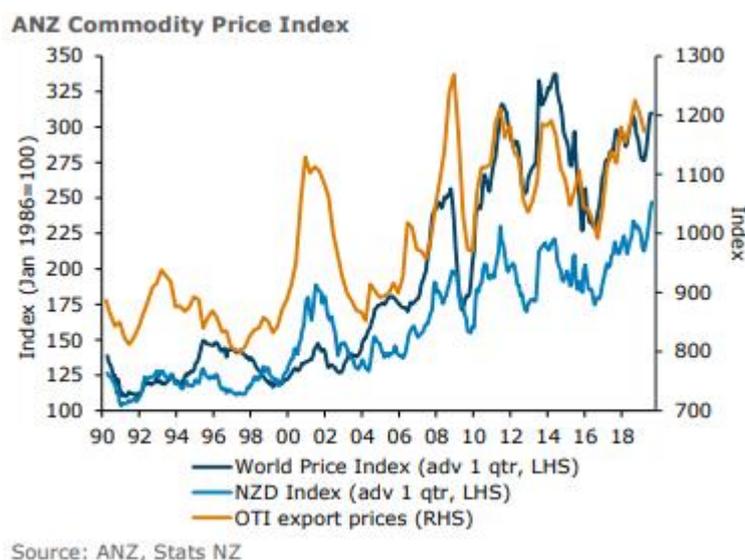
1.1 Economic growth (GDP) – softening

Forecasts out to June 2021 show the NZ economy continuing to grow but at a much slower rate of just over 2.5 percent per annum, on average. However, in our view there are several downside risks to achieving even this result.

First, the positives:

The NZ economy still continues to perform reasonably well over a range of indicators - employment, unemployment, labour force participation, inflation, government debt levels, trade levels (both volume and price) and a sharemarket (NZX) which is still breaking highs - compared with many countries to which we normally compare ourselves. International commodity prices (measured by the ANZ Commodity Price Index - see below) are currently solid, driven significantly by dairy and meat. With NZ's reputation as a favourable destination, net migration levels remain high.

Solid net migration levels and a recent lowering of interest rates should provide a continuing impetus, particularly for housing, although in some areas there are downside risks with respect to housing's future direction, notably from the re-pricing of the insurance risk outlined below.



Another factor likely to help drive the economy forward is a significant increase in the Government's expenditure parameters, some of which will flow through into increased economic activity, providing a boost to growth levels over time.

In his recent Budget speech, the Finance Minister stated the Government is making the significant investment necessary to meet cost pressures that have built up over the previous decade of underinvestment.

To this end "we have increased the operating allowance for new spending in this Budget to an average of \$3.8 billion per year over the four-year forecast period, an increase from the \$2.4 billion set at the last Budget. We have also increased the multi-year capital allowance by \$1.7 billion to \$14.8 billion."

The Government's books are still in a relatively strong state with, at the same time, a greater tax take and an ability to increase expenditure and maintain debt levels (hopefully). However, as previously noted, it is important for the Government to keep reasonably tight control over expenditure as potentially large public sector pay settlements will likely rock the boat should the economy not continue to deliver.

Net core Crown debt is expected to fall slightly from 20.1 percent in 2019 to 18.7 percent in 2023 and the Government has adjusted the Budget responsibility rules beyond 2022 to allow for greater flexibility in addressing debt based on the economic circumstances of the day. After 2022 the debt target will be between 15-25 percent, enabling a better response to needs/pressures than is possible with an unduly constraining and rigid debt target.

There was debate over the pre-Budget announcement of this change with some seeing it as a failing on the back of the Government's promise to remain fiscally responsible. But others saw it as a sensible and pragmatic move, given NZ's relatively low debt levels by both historical and international standards.

Notwithstanding NZ's relatively robust macro-economic outcomes, currently, there are certain real risks, both internationally and domestically focused.

Dealing first with the international scene:

The World Bank, in its June 2019 *Global Economic Prospects: Heightened Tensions, Subdued Investment*, said emerging and developing economic growth is constrained by sluggish investment with risks tilted to the downside. Risks outlined included, raising trade barriers, renewed financial stress, and sharper-than-expected slowdowns in several major economies.

Growth among advanced economies is expected to slow in 2019, especially in the Euro area, due to weaker exports and investment. Growth will hover around 1.4 percent in 2020-21. US growth is forecast to ease to 2.5 percent this year and decelerate to 1.7 percent in 2020.

Trade continues to remain top of the global risk pile and at present President Trump is continuing to keep the financial world guessing with statements on the likelihood of a comprehensive trade deal with China. Recent tweets have simply created more uncertainty.

While in the United Kingdom, President Trump promised Britain a "phenomenal" trade deal after Brexit but did not provide any detail.

And President Trump's on-again off-again threat of tariffs on Mexico, arguably as a measure to try and force the Mexican Government's hand on border security, is yet another ad hoc move. Trade policy should be well thought through; it is not a game where countries toss their toys out of the cot if, in the short term, things are not going their way. At this stage it is still a case of watch this space.

In more than one country, the manufacturing sector is taking a hit on the back of trade tensions. (See graph below for latest international results in respect to the Performance of Manufacturing Index (PMI)). Note, a PMI result above 50.0 indicates that the manufacturing sector is generally expanding: below 50.0 that it is in decline. Internationally, manufacturing is now in contraction – the lowest level since October 2012.



Global interest rates are generally steady or even in decline in several countries as can be seen from the table below.

Central banks – Summary of current interest rates

Country	Current rate	Previous rate
United States	2.5	2.25
Europe	0.0	0.05
Great Britain	0.75	0.5
Canada	1.75	1.5
Japan	-0.1	0.0
Australia	1.25	1.5
NZ	1.25	1.5

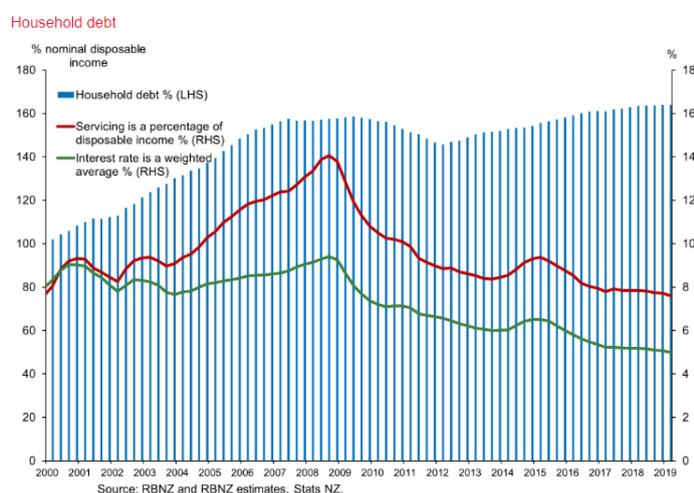
Heightening risks on the domestic scene:

Management of risk is something that central and local government, businesses and households need to build into future thinking otherwise knee-jerk and costly reactions are likely to be the order of the day. A broad range of issues is involved from climate change through to earthquake strengthening. It is concerning in this respect that the Financial Services Council recently commissioned a piece of independent research, *"Risking Everything – Insight into how New Zealanders Manage Risk"*, which found that while New Zealanders are aware of a wide range of financial risks, some don't necessarily follow through by considering how their day to day lives will be affected if they have a sudden loss of income etc.

High levels of household debt are particularly problematic given both the potential for costs to rise and/or the amount of credit to be rationed should the proposed increase in the capital adequacy requirement on banks operating in NZ be implemented. The Reserve Bank's Consultation Paper, *"Capital Review Paper 4: How much capital is enough"*, could well be described as regulatory overkill. The paper proposes placing significantly greater capital requirements on banks to reduce the risk associated with the potential for a 1 in 200-year bank collapse! It is entirely appropriate for the Reserve Bank to look seriously at the soundness of its current prudential management systems to determine whether anything more can be done to manage risk successfully. However, in doing so it should keep in mind the optimal amount of resource available for reducing risk. Only at a much great cost can risk be reduced.

Given the Reserve Bank's recent discussion document on other significant issues such as its proposal for mandatory depositors' insurance, care must be taken such actions, in total, do not result in regulatory overkill. That would simply add to the cost of capital and/or reduce returns to depositors potentially reducing the amount of credit available both to smaller business and to particular sectors of the economy.

The distributional and equity effects of the Reserve Bank's proposed policies would likely have an added impact on the NZ economy in view of households' relatively high net debt, particularly agricultural sector debt. Household debt levels are currently in excess of 160 percent of disposable income (compared with around 100 percent in 2000). Meanwhile, agricultural debt has continued to ratchet up and is currently sitting at around \$63 billion (up from \$12 billion in 2000), with about two-thirds of the debt focused on the dairy sector.

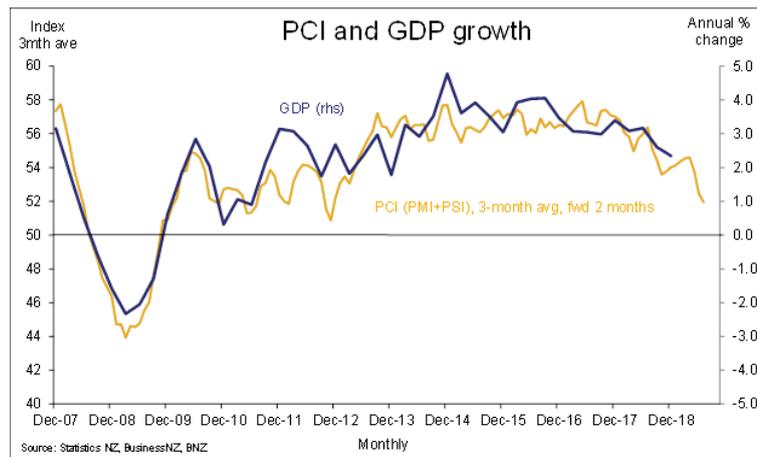


An increased understanding of NZ's tectonic and other natural hazards has resulted in a move by the insurance markets to reprice the risk involved.

The effects of the above are potentially significant if insurers exit the market, particularly given higher levels of household debt. Areas vulnerable to natural hazards (floods, earthquakes etc.) could be in for a rude awakening if property prices begin to reflect risk more clearly, leaving some households with negative net worth.

Low levels of business confidence continue to impact on future investment and employment intentions. Lower investment intentions do not bode well for future productivity growth – an important element when it comes to raising incomes over time. While the Government's announcement that it will not implement a capital gains tax (CGT) while it remains in government might provide some support for improved business growth, there are uncertain policy outcomes that go well beyond the debate over the pros and cons of a CGT.

The Budget's relatively robust outlook is heavily dependent on the economy continuing to deliver growth that will ensure a tax take capable of financing the Government's ambitious expenditure programme. One could even call some forecasts heroic given our own recording of how the economy is shaping up with both the PMI and the PSI displaying slowing expansion. Since these surveys are indicators closely linked to how GDP performs, this is a cause for concern in terms of future sustained growth.

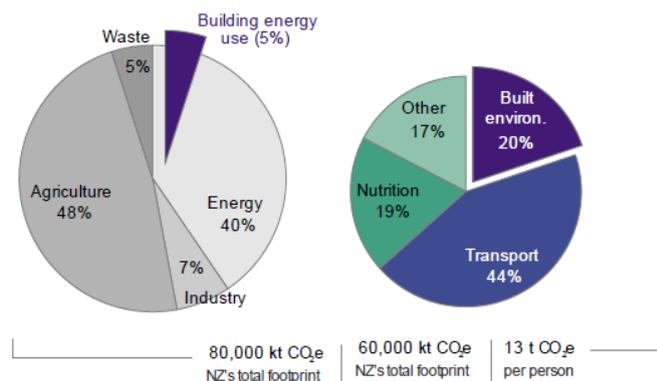


It is crucially important the Government's wellbeing indicators are put in context if sound decisions are to be made. With much of the country's agricultural production exported, decision-making must not unnecessarily punish certain sectors of the economy.

The *Wellbeing Budget* document contains some rationale for its priorities for transforming the economy when it states that NZ has one of the highest per capita rates of greenhouse gas emissions in the OECD. While this might be statistically verifiable, it is important to acknowledge that the vast majority of NZ agricultural production is exported and consumed offshore. Whether emissions, waste, water quality and so on are going up or going down needs to be considered in that context.

Excluding international trade (i.e. focusing on domestic production), NZ produced 80,155 kt CO₂e in 2015, or approximately 17 t CO₂e per capita (see below - left). When trade is considered (i.e. focusing on domestic consumption), the NZ total falls to approximately 60,000 kt CO₂e, or 13 t CO₂e per capita (see below - right). NZ is, therefore, a net exporter of approximately 25 percent of total gross GHG emissions. These emissions are embodied in products – primarily agricultural products – destined for consumption overseas.

A breakdown of New Zealand's carbon footprint in 2015 from (left) a production perspective and (right) a New Zealand consumption perspective



Source: Adapted from "The carbon footprint of New Zealand's built environment: Hotspot or not?" by thinkstep Ltd. (2018)

Low rates of productivity growth are a continuing constraint on improving living standards, as evidenced by a recent research report by the NZ Productivity Commission – *Productivity by the numbers: 2019*. (June 2019)

The report noted that NZ's poor productivity performance has been a persistent problem over decades and turning this around will require considerable effort. The report considered that improving productivity growth requires a focus over many areas: "Candidates for reform include competition policy, infrastructure, science and innovation, and education and the labour market. Firms' management practices and ability to learn (absorptive capacity) need improvement, and there are challenges facing the public sector e.g., regarding policy-making capability (including the use of monitoring and evaluation), regulatory design and practices, and the delivery of services in the education and health sectors."

Quality of regulatory intervention is an important component for ensuring businesses have some degree of comfort to invest in NZ rather than take their capital elsewhere.

In respect to foreign direct investment, some quite recent decisions have resulted in uncertainty for investors engaging in relatively straightforward investing. The recent Oceana Gold decision is a case in point: the Minister of Land declined the Waihi mining company's application to purchase nearby farmland to expand its operations although the Associate Minister of Finance had supported the purchase.

The inconsistency of Ministerial decision-making in this case is of concern since investors require a reasonable degree of certainty when deciding to make investment decisions.

Markets dislike risk and investors require either higher compensation to reflect it, or simply exit the market and seek better and more consistent investment opportunities elsewhere. To some extent, Treasury's recent Consultation Document on Reform of the Overseas Investment Act 2005 reflects these reactions, noting that international surveys rank NZ well down the list of countries welcoming foreign investment, an indication of NZ's struggle to attract the most valuable forms of investment.

While many will understand the Government's continuing commitment to a regime that considers ownership of NZ's most sensitive assets a privilege, it is nevertheless concerning that provision for even greater ministerial discretion could result in increased investor uncertainty with, potentially, a chilling effect on investment.

Capacity constraints, not only in relation to natural resources (e.g. water) but wider constraints on labour supply are continuing concerns. Employers' have limited ability to recruit skilled (and unskilled) workers in key areas to supplement NZ's existing labour force, while changes in educational structures, including the role of polytechnics and ITOs, are also cause for wider business community alarm.

Natural resource constraints and educational changes aside, the impact of significant changes to labour market legislation (including significant rises in the minimum wage) could adversely affect both business costs and the ability of low-skilled persons to enter the labour market.

Forecasts: Real GDP percent Growth

	Years Ending		
	Jun 19	Jun 20	Jun 21
<i>Highest</i>	2.5	3.0	2.9
<i>Average</i>	2.3	2.7	2.7
<i>Lowest</i>	1.9	2.5	2.5

Source: Adapted from ANZ, BNZ, Westpac and Treasury Economic Forecasts

1.2 Monetary Policy – further easing possible but risks attached

At its May review, the Reserve Bank lowered the Official Cash Rate to 1.5 percent, not surprising given previous statements about the likelihood of lowering the rate. However, we believe there was little pressure to lower the rate, certainly the majority – though not unanimous – view of the Institute of Economic Research's Shadow Policy Board at the time.

There are several reasons why the Reserve Bank might have jumped the gun in lowering the OCR.

First, non-tradable (domestic) inflation is still running at 2.8 percent per annum with no signs of reducing.

Second, business confidence is expected to rebound upwards on the back of the Government's decision not to introduce a capital gains tax.

Third, the Bank now has a dual mandate enshrined in the Reserve Bank Act - to take account of both price stability and maximum sustainable employment. These dual objectives are likely to make interest rate decision-making more complex than in the past, at least on the margins. The addition of a monetary policy committee could also add to the complexity.

Fourth, the potential for greater bank capital requirements, as mentioned earlier, could see interest rates rise for households and businesses. It is therefore possible the Reserve Bank will need some scope to lower the OCR in response, if, as expected, such a policy, does put upward pressure on interest rates.

It is possible the Reserve Bank could lower the OCR to try to compensate for any impact a mandatory capital requirement increase might have on mortgage interest rates. But that would call into question the rationale for a greater capital requirement if the immediate effect were to increase mortgage interest rates. Such matters would need to be considered as part of the cost-benefit analysis BusinessNZ recommends the Reserve Bank undertake before deciding on any substantial increase in banks' minimum capital requirements.

Fifth, with the OCR currently sitting at 1.5 percent, there is no real room for any significant reduction; the Reserve Bank must recognise the need to leave a little in the tank should the NZ (or world economy) face a significant downturn (i.e. ability to reduce the OCR).

Interest Rates – at historical lows

The 90-day bill rate is forecast to remain relatively stable, but at low levels, over the period out to June 2021 (see forecasts below).

Given the Reserve Bank's recent stance, it is not beyond the realms of possibility that there will be further interest rate cuts – something firmly off the agenda until recent months.

At the international level, uncertainty over moves to greater normalisation of monetary policy settings has halted interest rate rises, including more recently, in the US. The European Central Bank has acknowledged a recent weakness in European data and put any intention to increase interest rates on hold. Ongoing trade tensions, uncertainty over Brexit and geopolitical tensions mean there is still the potential to derail what at present are still relatively strong growth prospects internationally, likely tempering any future rise in international interest rates.

Forecasts: Interest Rates (90-day bills)

	Years ending		
	Jun 19	Jun 20	Jun 21
Highest	1.8	1.9	2.3
Average	1.6	1.5	2.0
Lowest	1.5	1.2	1.8

Source: Adapted from ANZ, BNZ, Westpac and Treasury Economic Forecasts

The NZ dollar – slightly higher

On balance, the \$NZ is expected to drift slightly higher against both the \$Australian and the \$US out to March 2021.

But despite current forecasts, the risk of wild swings in exchange rates cannot be ruled out. Particular attention will be focused on international economic developments and any substantial changes in interest rates.

Uncertainty over trade deals and uncertainty in general will affect the currencies of countries such as NZ, largely dependent on commodity-based exports.

However, trying to predict the future value of the NZ dollar or any other currency is a fraught exercise. Some volatility continues to be the name of the game, mainly the result of external factors rather than domestic policies per se.

Forecasts: Exchange Rates

AUD (cents)			
	Jun 19	Jun 20	Jun 21
Highest	0.95	0.99	0.98
Average	0.94	0.94	0.96
Lowest	0.93	0.91	0.94

USD (cents)			
	Jun 19	Jun 20	Jun 21
Highest	0.66	0.70	0.72
Average	0.66	0.66	0.70
Lowest	0.65	0.63	0.68

TWI			
	Jun 19	Jun 20	Jun 21
Highest	73.7	75.5	75.8
Average	72.2	71.8	74.1
Lowest	70.2	65.8	72.7

Source: Adapted from ANZ, BNZ, Westpac and Treasury Economic Forecasts

Inflation – a game of two halves

Forecasts below show inflation as measured by the Consumers' Price Index likely to remain well within the Reserve Bank's target band of 1-3 percent to June 2021.

Annual inflation is really a game of two halves. Non-tradable (domestic) inflation is still running at 2.8 percent per annum with no signs of reducing while tradables inflation is still slightly negative.

Despite the relatively stable inflation outcomes expected over the next couple of years, there are both upward and downward risks to maintaining inflation within the Reserve Bank's target band.

Some commentators have suggested recently that the Reserve Bank should not hold back any of its ammunition and should lower the OCR further if conditions warrant it. However, there are risks in doing so.

First, if the Reserve Bank drops the OCR prematurely and inflation pressures rise, then the need for significant interest rate rises could have a significantly harmful impact on many households given high levels of household debt.

Second, lowering the rate prematurely could result in a refueling of house price inflation (combined with the recent government decision to abandon proposals for a capital gains tax) putting upward pressure on inflation and again causing the Reserve Bank to apply the brakes more heavily down the track than would otherwise have been necessary.

Third, the Government's expansionary expenditure plans will likely boost economic activity which, together with current capacity constraints, could see prices rise, it being well-nigh impossible to source further resources (including labour). Combined with significant increases in the minimum wage to date – with more to come – this will likely add to wage pressures.

Forecasts: Percent Change in Inflation (CPI)

	Years Ending		
	Jun 19	Jun 20	Jun 21
Highest	1.8	2.0	2.1
Average	1.8	1.9	1.9
Lowest	1.7	1.9	1.7

Source: Adapted from ANZ, BNZ, Westpac and Treasury Economic Forecasts

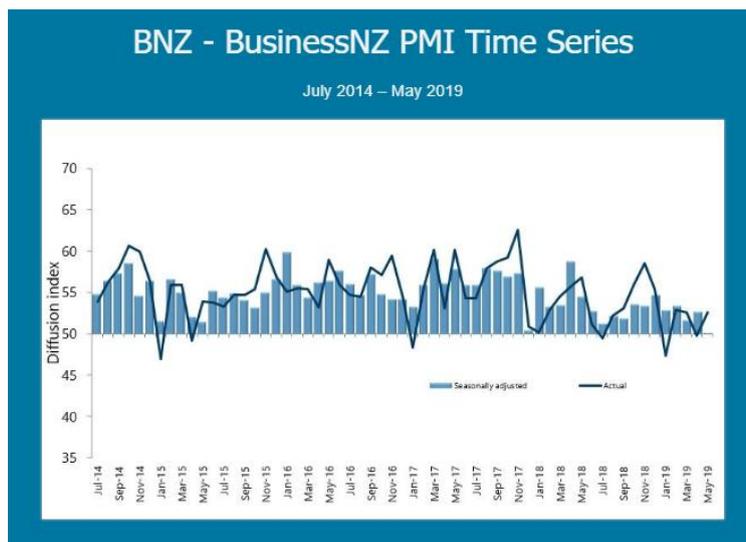
1.3 Business activity and confidence - slowing

Business confidence continues to be downbeat as evidenced by a range of opinion surveys. Low levels of confidence are increasingly reflected in the hard data coming through.

As previously noted, some of forecasts in the Government's recent Budget are heroic. Our own recording of how the economy is shaping up – via the PMI and the PSI - shows slowing expansion. In relation to future growth, this is a cause for concern. Both are lead indicators closely linked to GDP performance.

New Zealand's manufacturing sector was close to no change in activity for May 2019, according to the latest BNZ – BusinessNZ PMI.

The seasonally adjusted PMI for May was 50.2 (a PMI reading above 50.0 indicates that manufacturing is generally expanding; below 50.0 that it is declining). This was 2.5 points down from April, and the lowest level of overall activity since December 2012.



Activity reducing to its lowest level in over six years is a troubling, especially when the sub-index values are examined.

Production (46.4) was at its lowest level since April 2012, while the other key sub-index of new orders (50.4) only just managed to stay in positive territory. That the latter feeds through to the former does not instill a strong belief in the sector showing solid improvement over the next few months.

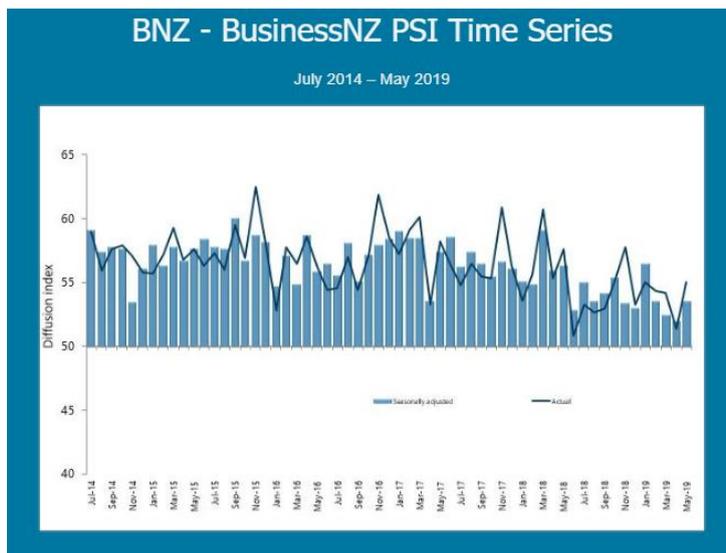


On a more positive note, the proportion of positive comments for May (54.3 percent) improved from April (48.9 percent) with many positive comments focused on business as usual. Negative comments outlined quieter domestic and offshore demand.

The latest PMI result clearly sends a warning signal for near-term growth via its mix of falling production, near flat new orders, and rising inventory.

Activity in New Zealand’s services sector picked up after three consecutive monthly falls in expansion, according to the BNZ-BusinessNZ PSI.

The PSI for May was 53.6, which was 1.6 points up from April, and a return to levels of activity seen in February (A PSI reading above 50.0 indicates that the services sector is generally expanding; below 50.0 that it is declining). However, the May result was still below the long-term average of 54.4 for the survey.



While the pick-up in activity is a positive step, further expansion in the coming months will be dependent on a number of factors.

New orders/business (55.7) has remained around that level for the last three months, below the long-term average of 58.6. As this sub-index feeds through into activity/sales and employment, improving the overall result would require a significant lift.



The proportion of positive comments for May (56.6%) showed an increase from April’s 43.9%, similar to that of March (55.8%). For a sustained improvement in the overall result, a consistent proportion of respondents will need to note positive influences on their business activity.

Overall, the results paint a picture of a slowing economy, which might struggle to live up to most GDP growth forecasts.

1.4 Labour market – constrained

Labour market data for the March quarter 2018 was slightly weaker than expected (as measured by the Household Labour Force Survey (HLFS)) which showed unemployment remaining at just over 4 percent.

While care needs to be taken not to read too much into one quarter's results, it is fair to say the labour market is approaching what could be described as full employment. Indeed, the Reserve Bank and Treasury, together with other economic commentators, suggest employment is now near its maximum sustainable level.

Although the unemployment rate is forecast to remain broadly stable at around 4 percent out to June 2021 (see below), there are potential risks to labour market outcomes. These include a continuing relatively low level of business confidence where both investment and employment intentions have eased and the impact of labour market changes with the potential to reduce flexibility and increase business costs, thereby making businesses less competitive.

Notwithstanding a positive overall picture for aggregate employment growth, associated declines in unemployment and a continued, but moderating, growth in job vacancies, significant regional differences remain with 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.

Tightness in the labour market is expected to flow through to relatively solid wage growth, underpinned by significant increases in the minimum wage over the next couple of years.

Net migration numbers (although StatsNZ has issued several data revisions based on new collection sources making comparisons somewhat fluid), are still relatively high by historical standards but are unlikely to be a panacea for current resource constraints.

Annual net migration has continued to increase over recent months, up to 56,000 in March 2019 and up from around 50,600 in the March 2018 year.

Notwithstanding modest increases in wage rates to date, significant increases in the minimum wage over the next couple of years, plus potential pay equity settlements, could have flow-on effects to other areas as other employees raise relative 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.

The marked increase in the public sector pay settlement for the education sector, with more to follow, will not only put added pressure on the government accounts but will significantly increase wage pressures. The wage relative game is about to begin.

Forecasts: Unemployment percentage (HLFS)

	Quarter		
	Jun 19	Jun 20	Jun 21
Highest	4.3	4.3	4.1
Average	4.2	4.1	3.9
Lowest	4.1	4.0	3.8

Source: Adapted from ANZ, BNZ, Westpac and Treasury Economic Forecasts