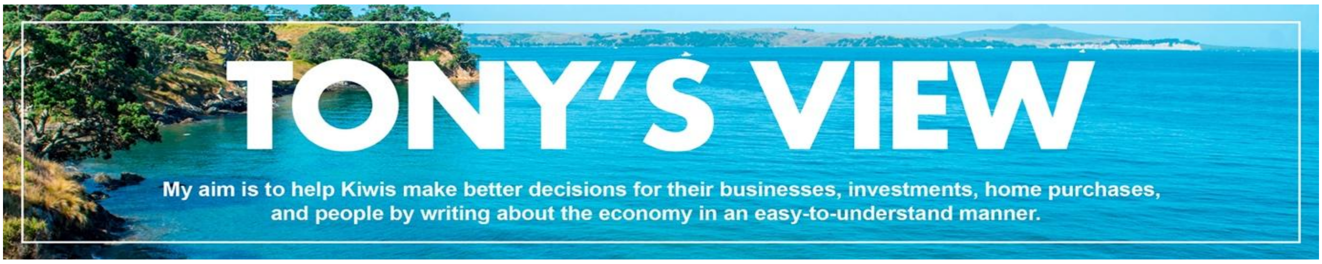

Input to your Strategy for Adapting to Challenges

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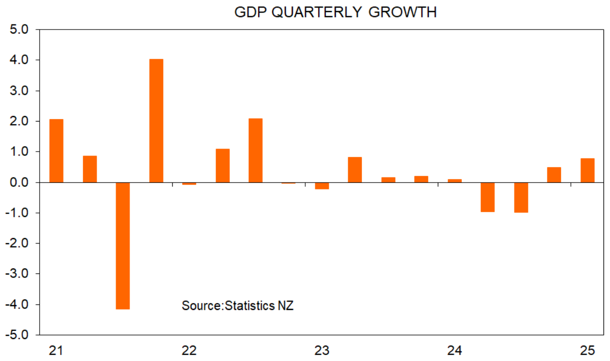
Confused? Here's why

There is a deepening state of confusion regarding how well the NZ economy is performing at the moment and whether we are truly on a growth track after last year's recession. The official data tell us that growth is underway. Our economy grew 0.8% in the March quarter after rising 0.5% in the December quarter. The recession ended late last year, and we have been growing at an annualised rate of 2.6% which is about the average for the past quarter of a century.



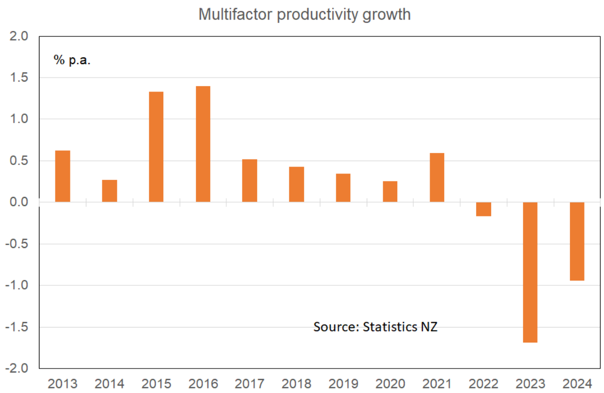
Yet we also have more up to date data in hand telling us of abrupt shrinkage in the manufacturing and services sectors, falling house prices, and falling consumer spending. The recent 1.3% growth surge is highly unlikely to continue.

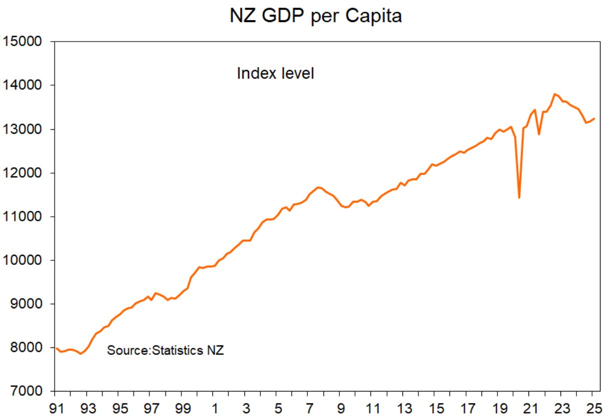
If you feel unsure about what is going on, then you are in good company and one of the worst things you could do is think that you have to take a view one way or the other. That is, it would be a mistake to embrace either a view that we are slipping back into recession or a view that the only way is up.

There are a multitude of positive and negative factors currently in play along with many large areas of high uncertainty. You should place no reliance on anyone's firmly expressed view that we are headed this way or that and definitely not believe that the likes of Treasury and the Reserve Bank with their finely researched yet out of date econometric models can reasonably predict what is going on.

All you can reasonably hope to do is have some awareness of the many factors in play, acknowledge you can't predict the future, and stay focussed on the things you are good at and the things you can control. To help with your understanding I am going to list here many of the negatives in play and the positives. If you are a glass half empty type of person, then you can memorise the first list and wallow in your dystopia. If you are a glass half full person you can focus on the second list. Here goes.

Falling productivity
New Zealand is becoming less productive and therefore is set on a path downward in per capita income rankings globally. Note the 1.7% productivity fall in the year to March 2023 – the year which included the first instance of our new public holiday. Do nothing, get paid. Extra sick leave entitlements from 2021 will also be playing a role here.

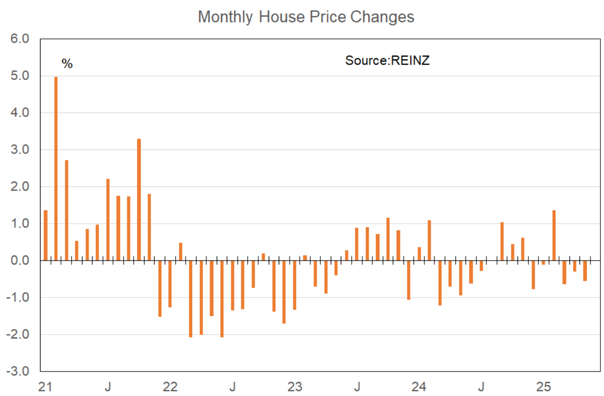




A role will also be played by a lot of spending in our economy going towards fixing past mistakes and meeting higher construction standards for the likes of earthquakes. Such activity yields no output increase for the things concerned yet requires sometimes substantial resources.

Survive to '25 disappointment
Businesses embraced the idea last year of grinding through just to get to the 2025 end of the rainbow. But now they are here they see there is no pot of gold, conditions remain tough, and a strong sense of disappointment is apparent.

House prices are falling
There are more people who like house prices to rise than like having them fall and falling house prices are associated with bad times and decreasing wealth. Average NZ house prices have fallen in each of the past three months.



Household living costs keep rising
We all eat each week and the prices of highly visible things we consume have jumped up – notably butter, cheese, and meat. But we also see costs soaring for our monopoly local councils with promises by local leaders to keep raising their imposts. Electricity prices are also rising with a lot more to come as restrictions on cheaper

traditional generating methods run up against increasing demand brought on by AI and EVs.

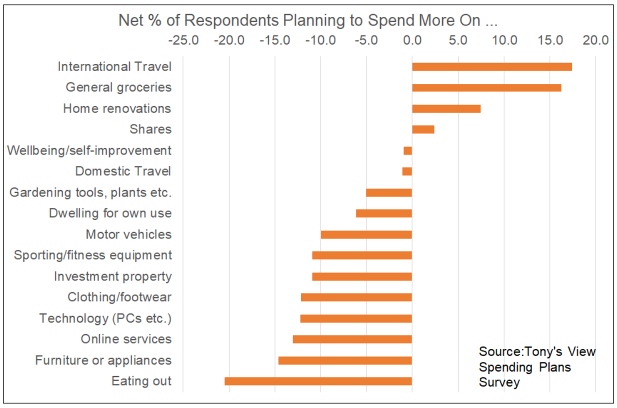
Rising costs mean the generation of people in retirement and those approaching it are having to redo their sums to figure out what they will have to sacrifice to meet their unexpectedly higher living costs. Less eating out maybe, domestic travel, home upgrading and maintenance, etc.

The media depress us

Every day national radio tells us how bad our health system is, and mainstream media generally focus on things not going right in education, housing, social welfare, etc. No wonder people are ditching traditional media to go online and find their own less pessimistic and perhaps often offshore sources of information.

And perhaps our way of describing challenges as crises and embracing of the most negative stories helps explain why so many people are determined to holiday outside the country – just to get away from the pessimism for a while.

In my monthly Spending Plans Survey a record net 17% of people plan travelling overseas. No other spending category bar groceries comes close to this level of spending intention.



IRD tax catch-up

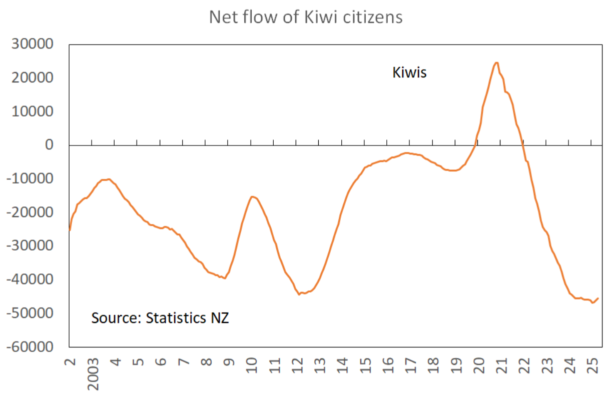
Businesses are having to come up with cash to pay bills to IRD which were allowed to build up for too long because of the pandemic.

Stay off the roads

Just as every week's shopping offends us as we are forced to pay escalating prices, driving our roads exposes us to a multitude of anger-causing road cones aimed at making our journeys harder. The plethora of cycle lanes also reminds us as motorists how hated we are by some groups including councils who are taxing us out of city shopping with more and more sophisticated methods of pinging people not exactly meeting parking rules. This is one reason why some CBDs appear to be dying. The message from councils is stay away, go to your suburban shopping mall. City streets are for cyclists and street people.

Net migration turnaround

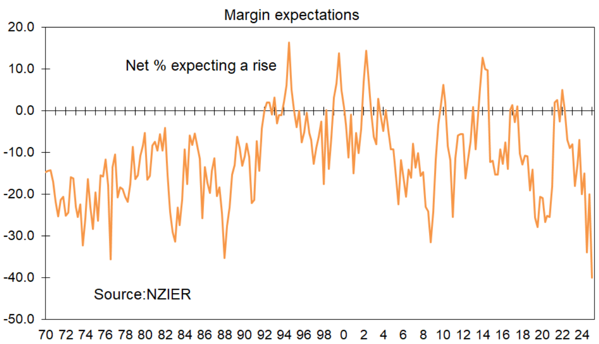
The annual net migration flow has fallen over the past year and a half from 135,000 to just 21,000 and many people have family members heading offshore – kids and increasingly their parents. We Kiwis have traditionally voted with our feet when times are tough and awareness of the net loss of Kiwi citizens at around 45,000 naturally makes us ask if we should be on the move as well.



Return of Labour
In the business sector there is some fear that next year's general election will see the return of Labour and a return to rising taxes, increased regulation, and a focus away from economic growth and efficiency towards favoured social issues bringing higher business costs and more debt.

Margins have shrunk
Business costs keep rising and there are deep and widespread fears and expectations that strong rises will continue. We can see this from surveys by ANZ and NZIER. Businesses do not feel they can copy electricity companies, councils and supermarkets and easily raise their prices to cover increased costs.

A rough margin proxy I create from the NZIER's Quarterly Survey of Business Opinion shows margin expectations at a record low.



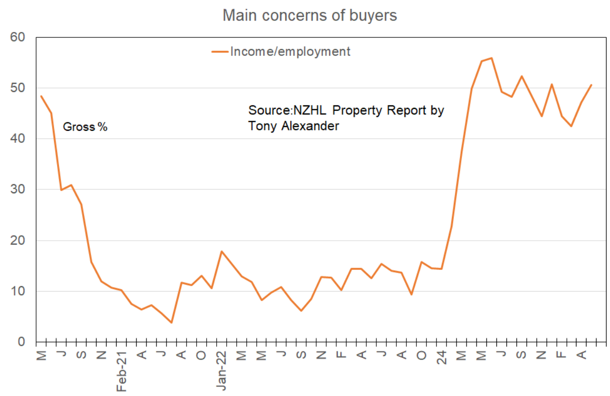
War in the Middle East
People are concerned about events in the Middle East and the potential for disruption to global supply chains and increased oil prices. But no-one knows if disruption will in fact occur or whether oil prices will spike higher.

Tariffs
The US President has initiated a tariff war and there is high uncertainty about what this will do to world and local growth, inflation and interest rates. Explicit policies of America-first bring the corollary of reduced levels of activity elsewhere outside of defence spending.

Additionally, one of New Zealand's key vulnerabilities alongside seismic events, pests and diseases, is access to foreign markets. We are best at producing primary goods which other countries tend to try and keep out in order to artificially support their rural sectors. If the world truly retreats from multilateral trade agreements and open access, we are highly vulnerable to lost income.

Pandemic after-effects
Ripples continue to run through our economy and society as a result of the excessive clampdowns imposed during 2020 into 2022. They can be seen in areas of crime, schooling, productivity, and overall social cohesion. The continuing media presence of some of the key personalities who drove the 2020-22 controls and mistakes acts as a cause of anger for many.

Job insecurity
Data from my monthly survey of real estate agents tell us people are not confident about their jobs. Whereas on average over the past five years 21% of agents have reported that buyers are worried about their incomes and employment, the latest percentage is 51%. This is little changed from the high of 56% in mid-2024.



Tightening fiscal policy

After six years during which Labour blew debt out by 84% and took the Crown net debt to GDP ratio from less than 19% to over 40%, measures have to be taken to get New Zealand ready for the next shock and to avoid a credit rating cut. This means reversing the wasteful 18,000 increase in public servant numbers, installing professional management to some organisations, reining in expansionary actions outside areas of expertise for some (Homes and Communities for example), and trying to reduce welfare dependency. Yet with so many people and households dependent on taxing other people to give them funds, widespread unease by these many dependent people exists and pervades media commentary.

Tourism growth has stalled

Visitor numbers have stalled near 85% of pre-pandemic flows. Tourism operators have shown themselves to be incapable of making good on the promises they made when the borders closed to focus on high value customers in the future. They remain dependent on bulk inflows and as tourism is a low-yielding source of income which does not tend to raise income per capita (Fiji does not look wealthy) many people can see the growth being targeted through recent announcements of extra government assistance will not raise New Zealand's standard of living.

Shrinking rural communities

Parts of the country are experiencing population loss, closure of schools and loss of social cohesion as a result of falling sheep numbers.

China slowdown

Although the Chinese authorities are making efforts to boost economic growth this year, for New Zealand the main gains from China's stellar performance over the past three decades have already been made.

Climate change costs

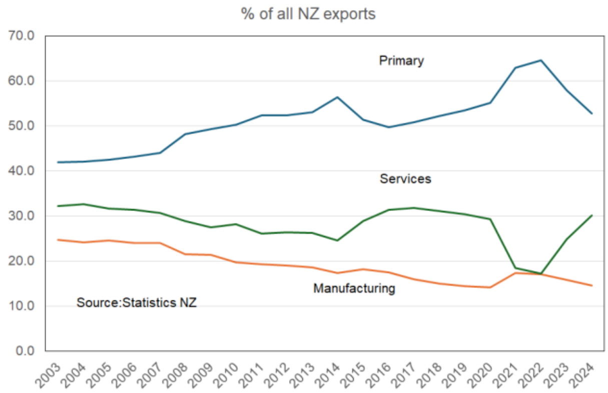
The seeming increasing frequency and/or destructiveness of bad weather events means higher costs for repair, prevention, and mitigation.

Sources of hope

Now for some of the factors justifying a view that the economy is solidly in recovery mode and embracing a recessionary view would be wrong.

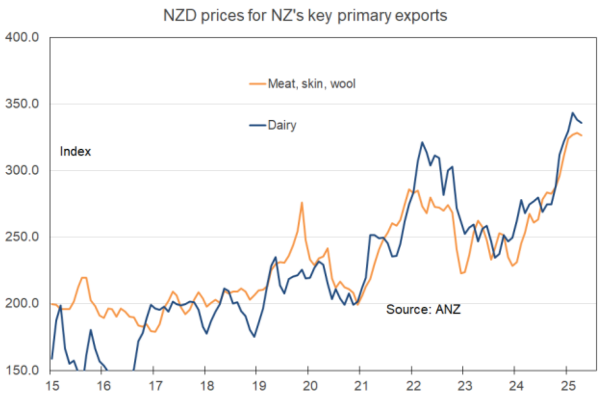
Strong export prices

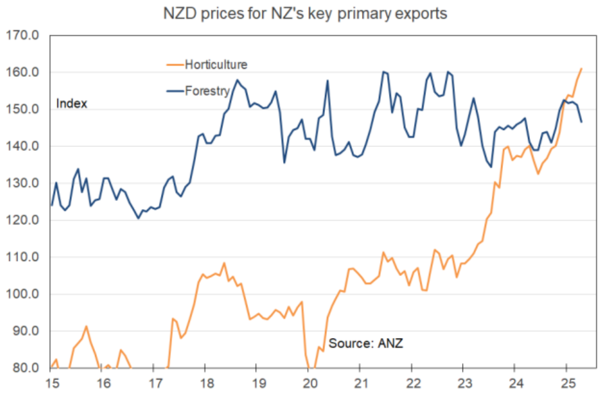
Our economy since the 1790s has been based around and dependent for success on exports from the primary sector. That dependence is trending up and whereas in 2023 42% of our export receipts came from the primary sector, the proportion now is about 53%. Manufacturing has gone from 25% to 15% over the two decades.



Thankfully the prices we receive for our primary exports have risen surprisingly strongly this past year – up 17.2% using the Terms of Trade data.

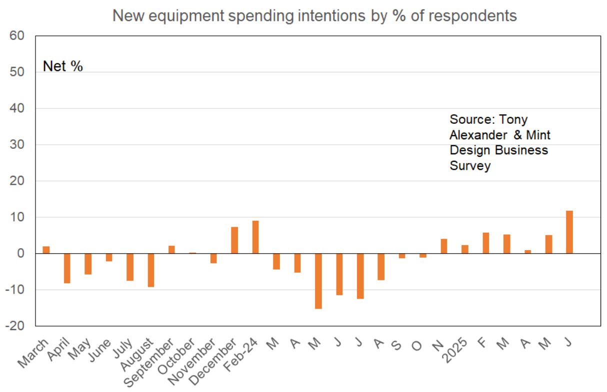
Good growth in incomes in the dairy, red meat, and horticultural sector bode well for regional growth. Note the absence of an upward trend in forest product prices using ANZ Commodity Price Index data in the next two graphs. Which output seems least beneficial for NZ if it were to grow in volume through land use changes?



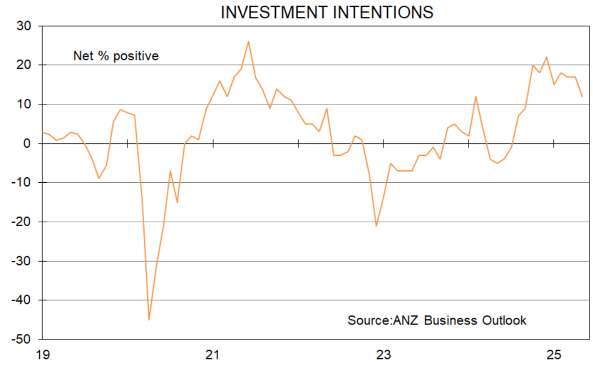


Business investment

A net 12% of businesses in the monthly survey I run with MintHC report that they intend boosting their capital spending over the coming 12 months.



The ANZ Business Outlook which has been running for a number of decades also shows that a net 12% plan higher investment. The ten year average is 4%.



Infrastructure

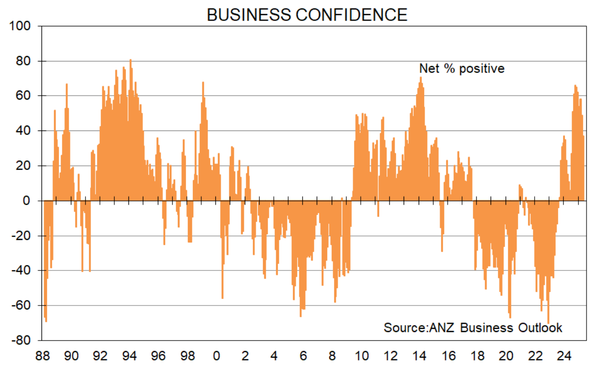
Both government and local authorities plan substantial investment in the country's infrastructure in coming years.

Export education

There is strong scope for increased numbers of foreign students coming to New Zealand now that both America and Australia are making efforts to reduce the numbers in their countries.

Strong business confidence

Despite discussions of woe a net 37% of businesses in the ANZ monthly survey say that they expect the economy to improve in the coming year.

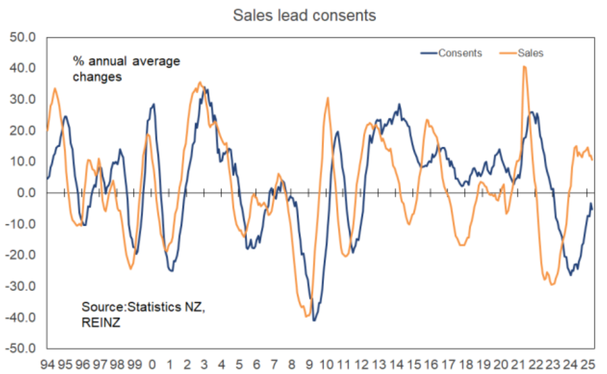


Lower interest rates

The aim of the Reserve Bank from November 2022 when it boosted the official cash rate by 0.75% was to cause a recession in order to get inflation back in the 1% - 3% target range. They have achieved that goal and recession-causing interest rates have now been removed. That is, active restraint on the economy has been removed, but active promotion of growth has not necessarily been implemented with the cash rate at 3.25%.

So far, the recovery of our economy from the unexpectedly sever mid-2024 slump has been greater than expected. That means it is probably mainly a bounceback from that slump rather than a settling of our economy at a near 3% annualised rate of economic growth.

Conditions are likely to remain very challenging for businesses in the retail and hospitality sectors. For home building the picture is hard to discern. The recent flattening of annual consent numbers near 34,000 is consistent with the traditional relationship between changes in sales then changes in consents.



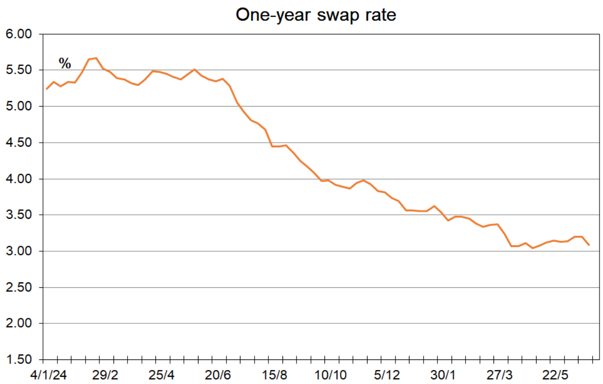
But population growth has slowed, listings of dwellings for sale are at their highest levels since 2015 and developers hold a lot of unsold stock – largely townhouses.

If there is a recovery in house construction about to get underway, I suspect it will be quite mild and as it proceeds a number of operators will continue to be forced to close down.

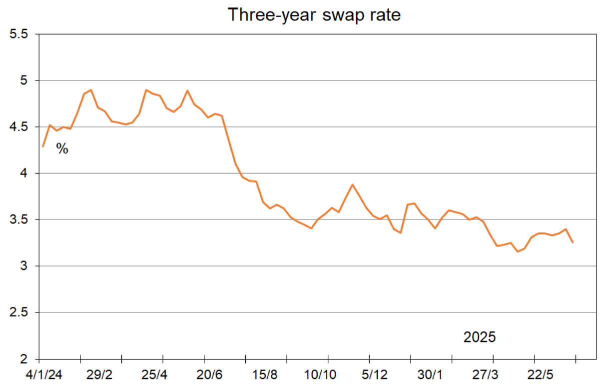
If I were a borrower, what would I do?

Wholesale interest rates edged down in New Zealand this week in response to falls in US rates. Those US declines reflected some weaker than expected economic data and a view that the current truce between Israel and Iran will hold and oil prices will not spike higher for an extended period.

The one year swap rate at which banks borrow to lend fixed one year to borrowers has fallen to near 3.1% from 3.2% last week and is up from the 3.04% low at the start of May. The three year rate has fallen to near 3.26% from 3.4% versus a low of 3.16% two months ago. The five year rate is now near 3.51% from 3.64% last week and a 3.4% low at the start of May.

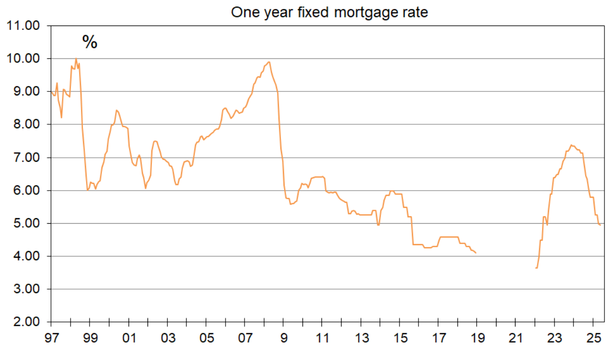


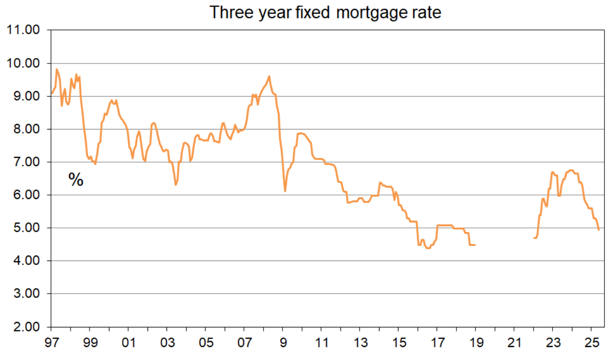
One further cut in the official cash rate from 3.25% is factored into these interest rates though not necessarily at the next review on July 9.

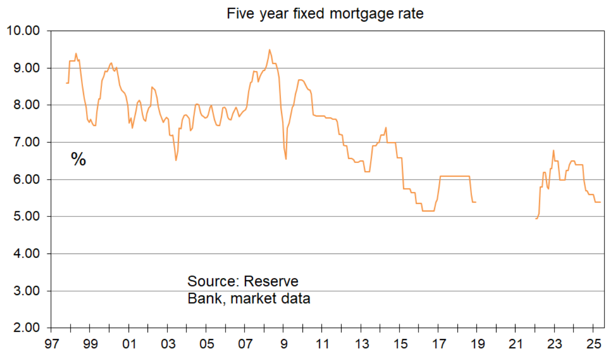


If I were borrowing at the moment, I'd personally opt for fixing three years at 4.99%. The 4.95% rate disappeared a fortnight ago. But I don't have a view as yet that medium to long-term fixed mortgage rates will be embarking on an upward cycle in the next year, so fixing shorter is probably okay. But I'd fix three years and shift my mental energy towards other things.

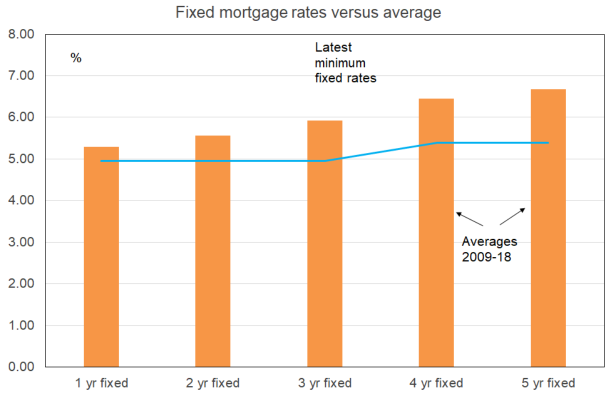
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.







This graph shows how current rates compare with averages from 2009-18.



To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.