NZCTU
Te Kauae Kaimahi

# Monthly Economic Bulletin

August/September 2023

NEW ZEALAND COUNCIL OF TRADE UNIONS
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# Monthly Economic Bulletin

**August/September 2023**

Welcome to the August/September edition of the Economic Bulletin. In this Bulletin, we look at the tax plans that the major parties have put forth this election and discuss what is missing from these plans. We examine some new research which shows that, in New Zealand, our stressed housing market enables landlords to demand a dividend from rising wages. We also take a look at some recent reports on the potential effects of artificial intelligence (AI) on employment, and the likely adoption of AI in New Zealand workplaces.

In our regular updates, we examine the latest economic forecasts from the Reserve Bank, the Treasury, the commercial banks, and the International Monetary Fund. We also discuss the latest statistics for migration, consumer activity, trade, business confidence, and housing. For the employment, wage, social welfare, union membership, and consumer price inflation statistics for the June quarter, please see the July Bulletin. For the GDP and balance of payments statistics for the March quarter, please see the June Bulletin. The CTU will be providing a separate analysis of Treasury's Pre-Election Economic and Fiscal Update (PREFU), which was released on 12 September – so keep your eyes peeled for that.

As always, we welcome your feedback and any suggestions for areas of future investigation.

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# Taxing times

We now have the tax plans of the major political parties of New Zealand in front of us. Despite the popular narrative that there is little to choose from at this election, these plans demonstrate that there is a wide range of possible outcomes. The devil, as always, is in the detail. It's worth looking at what the major parties are offering at the election, and at what either side is not discussing when it comes to tax.

Take, for example, the National party's plans. National would spend around $14 billion in tax changes, financed by cuts to public services and some new revenue measures. These cuts include the loss of public transport subsidies, the loss of universal free prescriptions, and ending 20-hours-free early childhood education placements for two-year-olds. National would also be cutting a range of programmes that the CTU has supported, including Fair Pay Agreements, Workforce Development Councils, and Industry Transformation Plans.

National's tax cuts would deliver $2.15 or less to anyone who earned under $44,000 per year. According to IRD data, this is more than 50% of all taxpayers. Even more troubling is National's proposal to take $2.4 billion from future climate change activity and give $2.3 billion to landlords in the form of new tax advantages. This is dressed up as a "climate dividend" in National's plans. The problem is that landlords appear to be the only shareholders.

There has been plenty of criticism of National's plans to generate revenue from overseas buyers of property and from overseas gambling providers. It's not clear if either policy has been costed properly. For the overseas buyer's tax, a full $20 billion of property sales is needed to generate the money required. If this money doesn't arrive, then more money is required from cuts to public services to make this programme work. To give you some idea of the scale of that, if revenue from these proposals is $2 billion short (out of a total of $3.7 billion) then this would require the size of the cuts to some selected departments to double.

The final part of National's tax plan is $8.5 billion of spending cuts across four years. This would come from a range of sources but includes $2.4 billion of what has been styled as "bureaucracy savings". These are cuts of 6.5% to selected departments, totalling $594 million a year. These are supposed to come from "back office" activities of government, "spending areas that are not critical to core front-line delivery". However, these "back office" activities are not further defined, so it's going to be up to departmental chief executives to find these areas and bring a cuts package to ministers for their approval.

Recent CTU analysis has shown that much of the money under the microscope is currently being expensed on areas that most New Zealanders would consider to be front line. These include the courts, biosecurity, and cybersecurity. These cuts are on top of the cuts that the Labour government has already identified. Labour has sought 1–2% of savings to be made to a wide range of government departments. While these are clearly on a different scale to the National party's proposed savings, the CTU believes that these savings are themselves likely to be self-defeating and will cost New Zealand in the long run. If savings of this nature were available, then we would question why they could not be redirected into existing, and much-needed, services such as health and education.

***Table 1:*** *Areas of spending within scope of National's cuts programme.*

| Department | Service description |
|---|---|
| **Crown Law** | The provision and supervision of a national Crown prosecution service and oversight of public prosecutions. |
| **DPMC** | Supporting activities that address cyber-security threats and improve cyber-security resilience. |
| **DPMC** | Leadership and co-ordination of the government's response to the sequence of extreme weather events that impacted the North Island in 2023. |
| **Minister for the Prevention of Family and Sexual Violence** | A whole-of-government approach to prevent, address, and eliminate family violence and sexual violence, as well as related services and support to ministers. |
| **Serious Fraud Office** | Preventing, detecting, investigating, and prosecuting serious financial crimes. |
| **Customs** | The provision of services relating to goods crossing borders, including trade compliance, and the protection of New Zealand's borders through interventions, investigations, and enforcement. |
| **Ministry for Primary Industries** | Biosecurity monitoring and clearance programmes that manage the biosecurity risk associated with international trade and travel. |
| **Ministry for Primary Industries** | Scientific inputs and development and implementation of food-related standards (including, as appropriate, international and joint Australia/New Zealand standards) and standards related to inputs into food production, imports, exports, new and emerging issues, and the domestic market. |
| **Ministry of Transport** | The coordination of search and rescue activities as authorised by section 9(1) of Land Transport Management Act 2003. |
| **Inland Revenue** | Undertaking investigation, audit, and litigation activities. |
| **Ministry of Justice** | Providing services that support the work of the Supreme Court, Court of Appeal, and High Court. |
| **Ministry of Social Development** | The processing and administrative aspects of payment of veterans' pensions and related allowances. |
| **Department of Internal Affairs** | Providing effective management of New Zealand's records of identity, authenticating official documents, and coordinating the congratulatory message service. |

***Source:*** *CTU analysis.*

The tax proposals that National has put forward appear to have a significant number of challenges to implementation. And unnecessary cuts to public services should be resisted – whether they are from the National party or any other party. The scale of the cuts to public services proposed by National makes them particularly difficult to both deliver and to comprehend.

What is not being discussed at this election by either of the main parties is whether our tax system is delivering the revenue we need and the kinds of economic outcomes that we want to see. A capital gains tax has been called for by international bodies such as the International Monetary Fund. It would stop the distortion in our tax system where gains from property values aren't taxed, but income from labour is. A capital gains tax would help drive more productive growth and would rebalance the tax system away from earned income. Similarly, both major parties have shied away from the necessary discussion around the taxation of wealth. Recent research from the IRD has shown that households with very high levels of wealth are paying roughly half the taxation rate of lower-income households. Taxing wealth would both provide badly needed revenue and help in the fight against growing inequality in New Zealand.

Tax will clearly be centre stage at this election. But the offers from both Labour and National come with problems – namely, the desire to cut spending without there being a compelling economic need for such cuts. Inflation is falling, demand for public services is high, and we have a significant backlog of underinvestment. Yet we aren't – with the honourable exceptions of the Green party and Te Pati Māori – discussing any of the important ways in which tax could be used to tackle the real problems we face as a country.

# The landlord's dividend

Rent price inflation has been strong over the past year. For the year ending August 2023, the rental price index increased 6.2% on the flow measure and 4.1% on the stock measure. The flow measure captures price changes of new tenancies while the stock measure captures price changes across the whole rental population. The flow measure usually increases at a faster rate than the stock measure because landlords have more leverage to set higher prices for new tenants than existing tenants and new rentals are more likely to be of higher quality. In Auckland, Canterbury, and the rest of the South Island, rental inflation for new tenancies has outstripped consumer price inflation for the year. In Wellington and the rest of the North Island, new tenancies have increased at the slower, though still significant, pace of 4.8% and 4.9% respectively.

***Table 2:*** *Rental price indexes – percentage change from same month of previous year.*

| | May 23 | Jun 23 | Jul 23 | Aug 23 |
|---|---|---|---|---|
| **New Zealand, flow** | 3.8% | 3.5% | 4.1% | 6.2% |
| Auckland, flow | 6.8% | 7.3% | 7.1% | 8.3% |
| Wellington, flow | 1.3% | -0.5% | 2.5% | 4.8% |
| Rest of North Island, flow | 4.2% | 2.8% | 5.1% | 4.9% |
| Canterbury, flow | 3.8% | 4.7% | 6.2% | 8.7% |
| Rest of South Island, flow | 8.0% | 7.4% | 6.1% | 7.1% |
| **New Zealand, stock** | 3.8% | 3.9% | 4.1% | 4.1% |

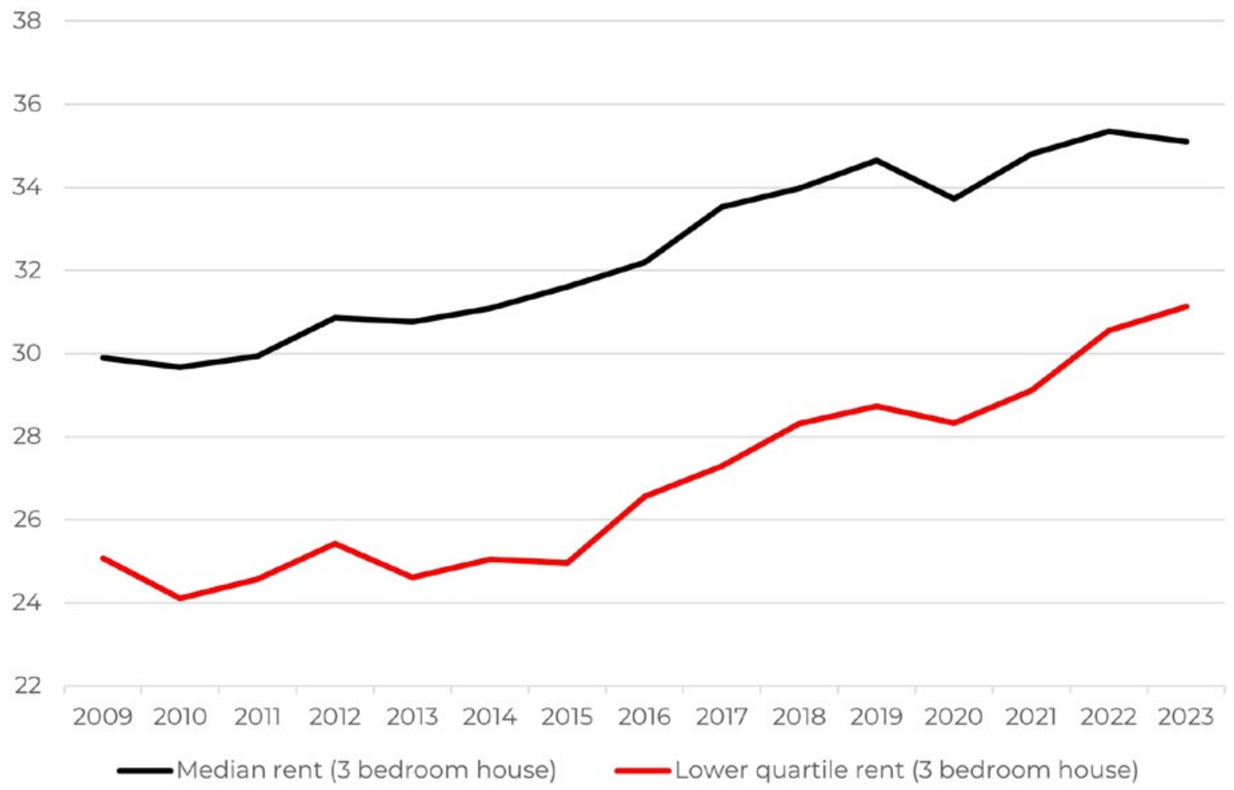
***Source:*** *Stats NZ*.

The CTU's minimum-wage-to-housing index for the March 2023 quarter shows that landlords have been hiking rents faster than the minimum wage has risen. The CTU's index tracks how many hours a minimum wage worker needs to work to pay the rent in New Zealand. We calculate this for the median and lower quartile (cheapest) rents for a three-bedroom house, as this enables a stable comparison over time. Data on median and lower quartile rents are provided quarterly by Tenancy Services, using rental bond information.

Data for the March 2023 quarter show that the median rent was $620, up $30 since the same time last year; meanwhile, lower quartile rent was $550, up $40. Over this same period, the minimum wage was lifted from $20 per hour to $21.20 per hour. For a full-time worker, this provided an extra $39 per week after tax. This means that a minimum wage worker paying median rent has seen 75% of their pay rise go straight to the landlord, while a minimum wage worker paying lower quartile rent has seen 100% of their pay rise go to the landlord. Using our index measurement of hours worked, a minimum wage worker is having to work the same number of hours today to pay rent as they were one year ago.

Taking a longer view, Figure 1 shows that minimum wage workers have been losing the race against rent price inflation for the past 15 years. In March 2009, a minimum wage worker needed to work 30 hours to pay median rent and 25 hours to pay lower quartile rent. As of March 2023, they needed to work 35 hours and 31 hours respectively. And this is despite the minimum wage increasing 77% over this period. The next set of rental bond data will cover the June 2023 quarter, which will allow us to see if the increase in the minimum wage from $21.20 to $22.70, which came into effect this April, has changed the picture at all.

***Figure 1:*** *Hours worked to pay median rent on minimum wage, 2009–23 (March quarter).*




***Source:*** *Tenancy Services; CTU calculations.*

What has been driving rent price inflation? The National and Act parties blame the removal of interest deductibility for landlords, the extension of the bright-line test, and the healthy homes standards that have been brought in by the sixth Labour government. However, a recent report published by the Reserve Bank, the Treasury, and the Ministry of Housing and Urban Development has found that the biggest drivers of rent price inflation are actually wages and the relative supply and demand of dwellings.

The report finds that rents rise in line with nominal wages rise. As the authors note, “When the effect of other factors is excluded, a 1 percent increase in nominal wages leads directly to a 1 percent increase in new tenancy rents”. Thus, over the past 20 years, the rental price index has kept pace with average hourly earnings. While average hourly earnings have increased 87% from 2003 to 2023, the rental price index has increased 83%. When workers get a pay rise, landlords command a dividend.

Landlords can do this because, for decades, we haven’t been building enough affordable houses in New Zealand. This has meant that the proportion of households who rent has increased significantly, from 23% in 1991 to over 32% in 2018 (the date when the results of the last census were published). The decline in home ownership has been most pronounced among people aged 25–34. While well over 60% of this group were owner-occupiers at the end of the 1980s, by 2018 this had fallen to just 35%. For Māori and Pasifika communities, these figures are even more stark.

In short, because home ownership has become unaffordable for many, the demand for rentals has outstripped the supply. This means that landlords have all the power when it comes to bargaining rents. This is especially unfair given that renters are typically lower-income households than owner occupiers, and therefore pay a greater proportion of their income on housing costs. Rental properties also tend to be of lower quality than owner-occupied properties. In other words, renters are, on average, spending a greater share of their income on housing than owner occupiers and are also living in less healthy homes.

The report also finds that rent prices increase as the supply–demand imbalance widens. On average, a 1% increase in people per dwelling leads to a 1.5% increase in rents. This makes intuitive sense – if the number of people renting increases faster than the rental stock, this increases landlords' bargaining power. Indeed, the report finds tentative evidence that the more that demand outstrips supply, the stronger the wage–rent relationship becomes. The two dynamics may be mutually reinforcing.

The findings of this report show that, in the short term, it may be necessary to impose a cap on how much rents can be increased annually. This practice is common overseas, often referred to as "rent control". Rent control ensure that landlords can only increase rents by a certain percentage every year – this could be set at 2–3%, for example, which is the level consumer price inflation usually sits at in New Zealand. In Spain, this has been one of the key lessons of their success story in how to control inflation. Imposing rent control would help to limit rent price increases for existing tenants, but wouldn't prevent the cost of new tenancies going up.

Long term, however, this research shows that the root cause of rent price inflation is our lack of affordable housing. To ensure renters get to keep more of their hard-earned cash, we need to significantly increase the supply of healthy, affordable, and sustainable housing in this country. This must be a priority for any incoming government following the October election. By contrast, the campaign pledges of National and Act to reinstate interest deductibility for landlords, roll back the bright-line test, and lower the healthy homes standards will only serve to bring property investors flooding back into the housing market, which will push up house prices. It means spending $2.3 billion of our money to make life worse for renters.

# AI and the future of work

The release of ChatGPT has sparked a wave of hype about the potential productivity benefits of artificial intelligence (AI) and an accompanying wave of fear about its possible impacts on employment. While tech entrepreneurs are talking up the revolutionary impact AI will have on our lives, a recent report from the OECD finds that three in five workers are worried about losing their job to AI in the next decade.

Innovation is often oversold, and the threat of automation-induced unemployment isn't new. However, this doesn't mean we should be complacent. Economic history teaches us that new technologies only deliver rising standards of living if they create more jobs than they destroy. And we know that technology can be employed in ways that improve our experience of work, or in ways that make it worse. It is therefore important that we are clear-eyed about the potential impacts of new technologies on both the quantity and quality of work.

The OECD's recent report helps to clarify the risks and opportunities that AI presents, finding that AI will likely have an impact on both job quantity and job quality. Thus far, AI has had a negligible impact on job quantity, but this is because relatively few firms have adopted AI, it has so far had a marginal impact on productivity, and early adopters have been relying on "natural attrition" (e.g., voluntary quits and retirements) rather than layoffs to adjust their workforce. However, the past year has seen big leaps in AI's ability to perform non-routine cognitive tasks – things like memorisation and the ability to synthesise large datasets. This has opened up new applications for AI and exposed some higher-skilled, white-collar occupations to the risk of automation. The OECD argues it is likely that these forms of AI will become more widely used in the future and have a greater potential to disrupt the jobs market.

These expectations are supported by the findings of a recent survey commissioned by the Future of Work Tripartite Forum – a partnership between government, the CTU, and BusinessNZ. This survey asked over 200 New Zealand firms about their plans to adopt new technology in the future, and what they thought the employment impacts of new technology might be. Nearly 60% of the firms surveyed reported that they expect to adopt AI technology in the next five years. New Zealand's largest firms are expected to lead the charge here: 72% of firms with over 250 employees plan on deploying AI in the next five years compared to 49% of firms with 250 employees or less. This makes sense, as bigger companies tend to have more sophisticated operational structures and the financial heft to invest in cutting-edge tech.

Strikingly, of the firms who plan on adopting AI in the next five years, only 20% expect it to be a net job creator, while 51% expect it to be a net job displacer. In other words, employers in New Zealand are anticipating that AI will destroy more jobs than it creates. Indeed, AI is expected to be the largest net job displacer of the 28 technologies that employers were asked about in the survey. Text, image, and voice processing technologies, which 67% of businesses expect to adopt, are also expected to be a significant net job displacer. So too are robots, both humanoid and non-humanoid, although far fewer businesses expect to be investing in this technology in the next five years.

***Table 3:*** *Top five net job creators and top five net job displacers.*

| Technology | Adjusted net job creation score* | Unadjusted net job creation score* | Percent of firms likely to adopt |
|---|---|---|---|
| **Climate change mitigation tech** | +26% | +39% | 67% |
| **Education tech** | +19% | +21% | 91% |
| **Big data analytics** | +17% | +30% | 58% |
| **Environmental management tech** | +15% | +18% | 83% |
| **Encryption and data security** | +14% | +16% | 90% |
| **Distributed ledger tech** | -3% | -16% | 17% |
| **Text, image, and voice processing** | -11% | -17% | 67% |
| **Robots, non-humanoid** | -13% | -35% | 36% |
| **Robots, humanoid** | -17% | -79% | 21% |
| **Artificial intelligence** | -18% | -30% | 59% |

** The adjusted measure provides an estimate of the expected job impacts for all businesses; the unadjusted measure provides an estimate of the expected job impacts for businesses who intend to adopt that technology.*

***Source:*** *Future of Work Tripartite Forum*.

Importantly, however, as Table 3 shows, firms are also planning to adopt a range of other technologies that are expected to create more jobs than they destroy. For example, 91% of employers expect to invest in education and workforce development technology, with a positive impact on the number of jobs available. Likewise, 83% expect to adopt environmental management technologies – such as pollution abatement and recycling – and 67% of employers expect to adopt climate change mitigation technologies – such as renewable energy and green transport; and most employers think that these technologies will be big net job creators. This suggests there will be opportunities to assist workers who are displaced by AI to move into new occupations. But this won't happen automatically; it will require active workforce planning to ensure that workers have the skills and opportunities to move into different lines of work.

Helpfully, the Future of Work survey also provided insights into the kinds of skills that employers think they will be looking for in the future. Leadership and social influence, analytical thinking, problem solving and innovation, emotional intelligence, active learning, and coordination and time management are the top five skill sets that organisations are focusing efforts on over the next five years. To address these skills needs, 77% of firms expect to hire new permanent staff with relevant skills, 76% expect existing employees to pick up skills on the job, and 70% expect to retrain existing employees. All up, 55% of the current workforce is expected to require training to meet evolving skills demands over the next five years. These findings are useful in helping to guide education and training policy.

As for the effects of AI on job quality, the evidence suggests it has been, and will continue to be, uneven. Encouragingly, the OECD study found 63% of workers who had experience of working with AI reported that it had improved their job satisfaction and their physical and mental health. This is because AI is often being deployed to improve the safety of machinery or to automate tedious tasks. In performing these functions, AI can free workers up to perform other, more interesting, tasks, and can provide workers with more autonomy in their day-to-day. The OECD study also finds little evidence that AI is having a negative effect on wages – indeed, workers with AI skills are able to demand a wage premium at the moment. Workers who are most likely to report that AI has a positive impact on their job are managers, those who are trained in AI, and workers with tertiary degrees.

By contrast, workers who are managed by AI tend to be less positive about it. Algorithmic management systems, which are used to support or automate management decisions, are becoming more widely used in sectors such as warehousing and logistics. On average, workers who are subject to algorithmic management report that it has increased the intensity and pace of work; they also have concerns about its privacy implications. This is because algorithmic management is based on omnipresent surveillance and data-based performance evaluations. The tech giant Amazon is a notable user of this kind of technology in its warehouses, which is found to significantly increase workers' stress levels and the incidence of injury and burnout.

These studies highlight that we can take charge of how technology impacts the workplace. To ensure that AI is adopted in ways that improve the experience of work and that we deliver a just transition for workers whose jobs might be rendered redundant, we need to do three things. First, we need to continue to build our understanding of how new technologies will impact the world of work. In the case of AI, this is no easy task. As the OECD notes, "the exponential speed of AI development and its growing pervasiveness imply that one is constantly running after the facts". This means that the public sector needs to be sufficiently resourced to research and analyse the potential effects of new technology – to run after the facts.

Second, we need to promote the development of technology that will improve the world of work. In the case of AI, this means robust regulations that ensure labour rights and standards are protected – and even enhanced. It also means ensuring that the benefits of new technologies, such as improved productivity, are shared equitably with workers. Fair Pay Agreements and full employment policy can help to make this a reality – the research shows that firms are incentivised to invest in improving productivity when unemployment is low and wages are high.

Third, we need to ensure that workers who are displaced by new technologies can find good work elsewhere. This means providing workers with the financial and education resources to successfully upskill and retrain. Workforce planning, unemployment insurance, active labour market programmes, and social partnerships – like those already underway in Taranaki and Southland – can help to deliver a just transition in response to the labour market impacts of AI and other technologies.

These are precisely the capabilities that the National and Act parties have said they will cut if they are elected to government. Our view is that a responsible government is one that plans for the long-term health of the country. In the case of AI and other new technologies, this means continuing to invest in our capacity to understand what is coming down the line, to promote the human-centred adoption of technology, and to plan for just transitions.

# Economic outlook

The past month has seen a raft of major economic forecasts released. The Reserve Bank released its forecasts in the August Monetary Policy Statement (MPS), and the Treasury released its PREFU (Pre-Election Economic and Fiscal Update) forecasts on 12 September. The commercial banks have also put their quarterly forecasts out over the past month, and the International Monetary Fund (IMF) has released its Article IV report on the trajectory of the New Zealand economy. As always, these forecasts should be treated with caution – they are informed guesses as to the likely trajectory of the New Zealand economy, not the foretelling of its destiny.

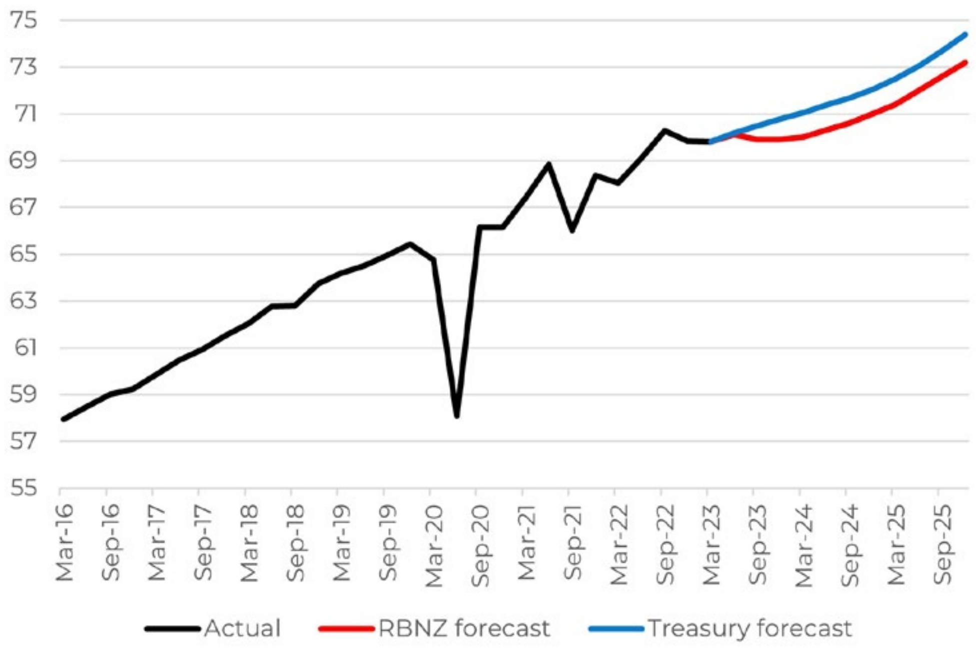
The Reserve Bank expects nominal GDP growth to be relatively flat through to early 2024, possibly dipping into negative in some quarters; the commercial banks' forecasts are broadly similar. By contrast, the Treasury expects nominal GDP to increase at a moderate pace over the next year, driven primarily by high net migration. However, measured on a per-capita basis, the Treasury expects GDP growth to stall through to the end of 2024.

It is worth recalling that the Reserve Bank has been explicitly trying to force the New Zealand economy into recession and increase the rate of unemployment. The effective mortgage rate (the average interest rate that households with mortgages are currently paying) has almost doubled since 2021 and will continue to rise as more households refix at higher rates. This is eating into households' disposable income and is also weighing on residential construction. In turn, weaker demand is causing firms to scale back investment and hiring. According to the Reserve Bank, investment intentions have fallen steeply since the end of 2021 and are below historical norms.

The global economic situation is also putting pressure on the New Zealand economy. Central banks have been raising interest rates around the world, dampening consumer spending. This means less demand for New Zealand's goods exports over the near future. Given its status as our largest export market, China's weaker-than-expected economic recovery is of particular concern. One feature of this weak recovery is falling dairy prices, which are down 20% for the year. Overall, exports are still some way off their pre-COVID levels.

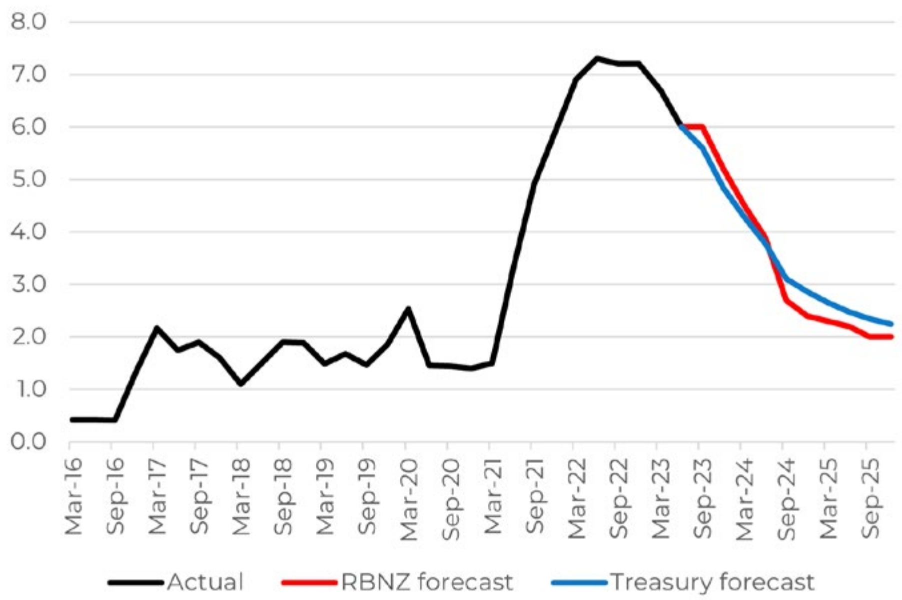
Inflation is expected to continue falling, reaching around 5% by the end of the year and below 3% by the end of 2024. Goods inflation has been falling quickly, but services inflation remains elevated. Tradeables inflation (goods and services that are imported or are exposed to international competition) has fallen as global freight costs have come down and volatility in commodities markets (goods like oil, wheat, and metals) has moderated somewhat. However, non-tradeables inflation (goods and services that are not exposed to foreign competition) appears to be coming down comparatively slowly. It is yet to be seen if the record levels of net migration we have seen in 2023 will have an inflationary impact. On the one hand, high migration should be expected to add to demand and put pressure on already-stretched infrastructure; on the other hand, it is contributing to a weaker labour market, meaning workers have less leverage to bargain for higher wages.

***Figure 2:*** *Quarterly production GDP forecast ($billions).*




***Source:*** RBNZ, Treasury.

***Figure 3:*** *Annual inflation rate forecast (%).*

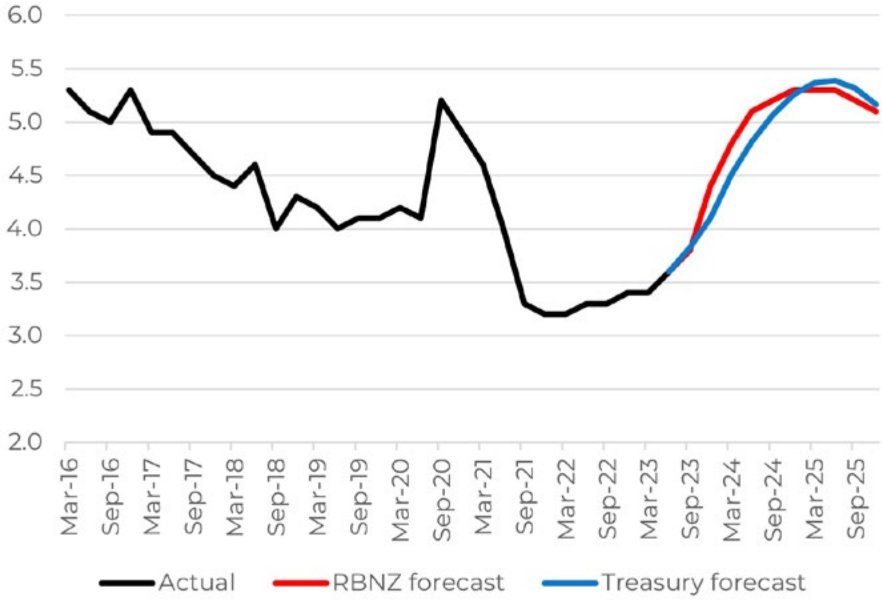



***Source:*** RBNZ, Treasury.

Unemployment is expected to rise to between 5% and 5.5% by the end of 2024. Businesses are reporting more applicants per job due to record net migration and firms are scaling back their hiring in response to weaker consumer demand. The labour market has been incredibly resilient so far, with the headline unemployment level at 3.6% and labour force participation at a record 72.4%. However, leading indicators such as the number of job vacancies, the number of applicants per job, and the number of firms reporting difficulty finding labour suggest that the worm is turning.

The Reserve Bank continues to argue that inflation is driven, in significant part, by workers' wage demands, and that the only way to change that is to reduce workers' bargaining power by driving unemployment north. As the CTU details in a recent report with FIRST Union and ActionStation, the data does not support this argument – in 2021 and 2022 profits were by far the more significant component of rising prices. And as we have pointed out in previous Bulletins, the status-quo approach to managing inflation disproportionately impacts low-income workers who are precariously attached to the labour market. Finding more equitable and sustainable ways to manage inflation, as outlined in our Inflation and Incomes proposal, should be a priority for the next government.

***Figure 4:*** *Unemployment rate forecast (%).*



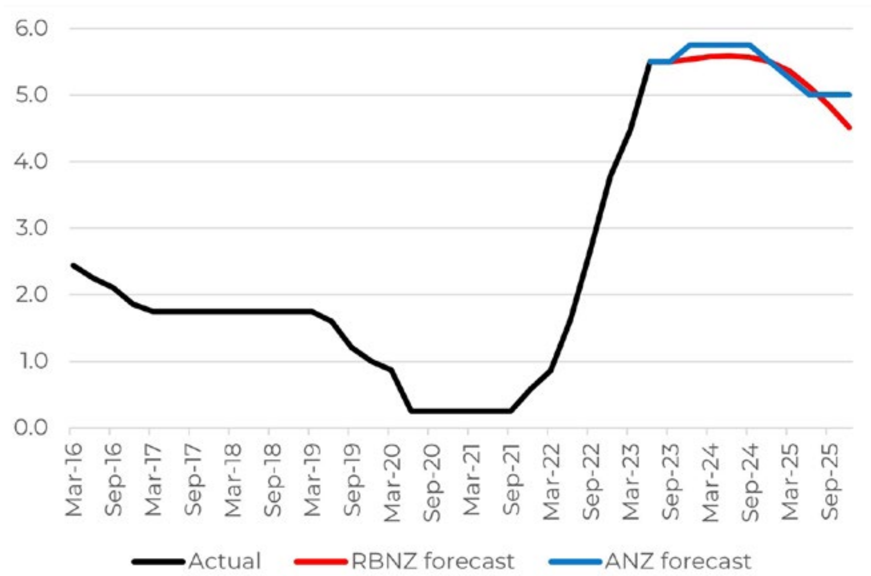

***Source:*** *RBNZ, Treasury.*

House prices appear to have bottomed out, and activity in the housing market is picking up. The consensus position among forecasters is that house prices will begin to lift over the next year, albeit at a relatively (for New Zealand) modest pace. This is due to the high levels of net migration and the sense that the Reserve Bank has mostly completed its tightening cycle. The speed at which house prices inflate will depend, in part, on the outcome of the election. If a National–Act coalition government is formed following the election, interest deductibility for landlords will be reintroduced and the bright-line test will be reduced. This would bring investors back into the housing market in a big way, boosting house price inflation.

While house prices have fallen off the giddy highs of 2021, they are still well up from their pre-COVID levels. Indeed, according to the IMF, New Zealand's house prices are 50% above sustainable levels. As the IMF notes in its Article IV report, "A borrowing capacity approach suggest[s] that median housing prices are 50 percent above the price the median household could afford to finance with a debt service-to-income ratio of 30 percent". In other words, for a median-income household to service a median-priced house at 30% of their income, house prices would need to fall by half. A reflation of the housing market therefore poses a significant economic risk to New Zealand. In a situation where unemployment rises markedly, many households would be unable to service their mortgage debts, leading to mortgagee sales and a potentially destabilising downward spiral in house prices.

The Reserve Bank is forecasting that the Official Cash Rate (OCR) will remain higher for slightly longer than it outlined in its May MPS. On its latest forecast, the Reserve Bank will keep the OCR at 5.5% (or slightly above) until the end of 2024, before beginning to slowly cut rates. The commercial banks have broadly similar forecasts. ASB doesn't expect any further rate hikes at this stage, while ANZ and Westpac both expect at least one more hike in late 2023. The OCR track will ultimately be shaped by how quickly inflation falls over the next two years.

***Figure 5:*** *Official Cash Rate forecast (%).*




***Source:*** *RBNZ, ANZ.*

All up, the picture painted by these forecasts is a challenging one, though by no means dire. At this stage, unemployment remains near historic lows and is expected to rise only modestly.

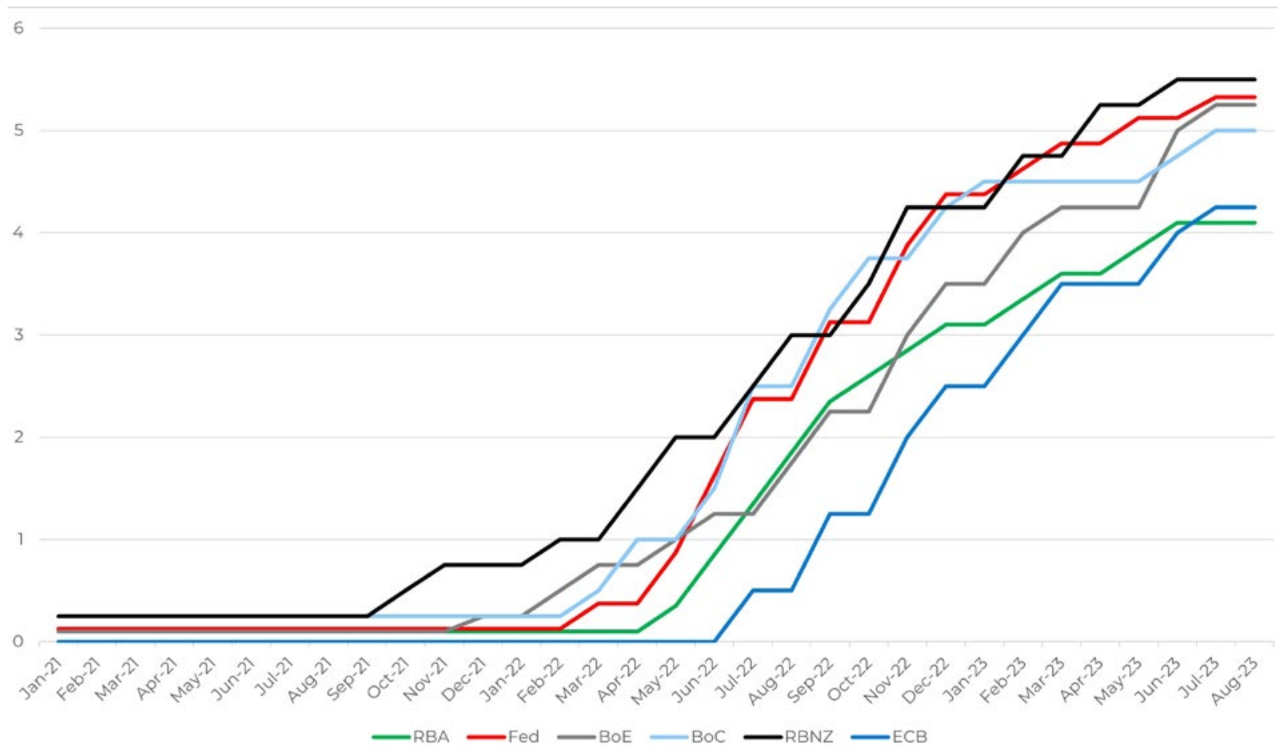
Inflation is forecast to fall steadily over the next two years, while real wage growth is expected to remain robust. Output growth is expected to stall rather than collapse. And the government's accounts remain strong, with very low levels of Crown debt. Thus, while it is fashionable to suggest that the country is facing an economic "crisis", the data simply doesn't bear this out. Our real challenges remain the long-term ones: a $210 billion infrastructure gap, a lack of affordable housing, deepening inequality, persistent child poverty, a stressed health system, and poor productivity relative to our OECD peers.

# Wages and prices

### Central bank interest rates

The Official Cash Rate remains unchanged since our last Bulletin, at 5.5%. The Reserve Bank's August MPS signalled a slightly more aggressive OCR track than had previously been forecast in the May MPS. As discussed above, forecasters are expecting inflation to continue to fall over 2023 and 2024. Globally, the economic commentariat are predicting further rate hikes at major central banks such as the US Federal Reserve, the European Central Bank, and the Bank of England. However, most central banks appear to be near the top of their tightening cycles.

***Figure 6:*** *Central bank interest rates (%) – Australia, USA, UK, Canada, New Zealand, Eurozone.*




***Source:*** *Bank for International Settlements.*

### Food prices

In welcome relief for households, food prices fell in July, down 1.1% after seasonal adjustment before lifting 0.4% in August. In July, the fall was led by a 12.1% decline in the price of vegetables and a 2.2% decline in the price of fruit. In August, vegetable prices bounced back somewhat, increasing 2.8% for the month, as did fruit prices, increasing 1.7% for the month. A breakdown of the seasonally adjusted monthly movements is provided in the table below.

***Table 4:*** *Food price indexes – percentage change from previous month.*

| | May 23 | Jun 23 | Jul 23 | Aug 23 |
|---|---|---|---|---|
| **Fruit and vegetables** | -1.7% | 1.8% | -7.8% | 2.8% |
| **Meat, poultry, fish** | 1.4% | 0.2% | -0.3% | 0.0% |
| **Grocery food** | -0.1% | 0.3% | 0.2% | -0.1% |
| **Non-alcoholic beverages** | 4.5% | -0.3% | -0.1% | -0.9% |
| **Restaurant and ready-to-eat** | 0.8% | 1.1% | 0.4% | 0.3% |
| **Total** | 0.4% | 1.1% | -1.1% | 0.4% |

***Source:*** Stats NZ.

For the year ended August 2023, the food price index (FPI) increased 8.9%, which is down from the figure of 12.5% for the year ending June 2023 and 9.6% for the year ending July 2023. The biggest driver of food price inflation has been grocery food, which increased 10.6% annually and accounted for 42.2% of the overall FPI. Bread rose 12.8% in price and eggs rose 58.3%; however, fresh milk fell 0.8% in price. Restaurant and ready-to-eat meals have been the next biggest contributor, up 8.9% in price for the year and accounting for 28.7% of the overall FPI. Meat, poultry, and fish rose 8% in price, accounting for 14% of the overall FPI. The price of pork increased 16.8%, poultry 7.8%, and beef and veal 2.4%; the price of fish rose 9.3%. The price of fruit and vegetables increased 5.4% for the year, accounting for 9.8% of the overall FPI. Fruit increased 5.9% in price and vegetables 5.2%. Finally, the price of non-alcoholic beverages rose 9.1% for the year, accounting for 10.3% of the overall FPI.

***Figure 7:*** *Annual food price inflation (%).*


***Source:*** Stats NZ.

### Fuel prices

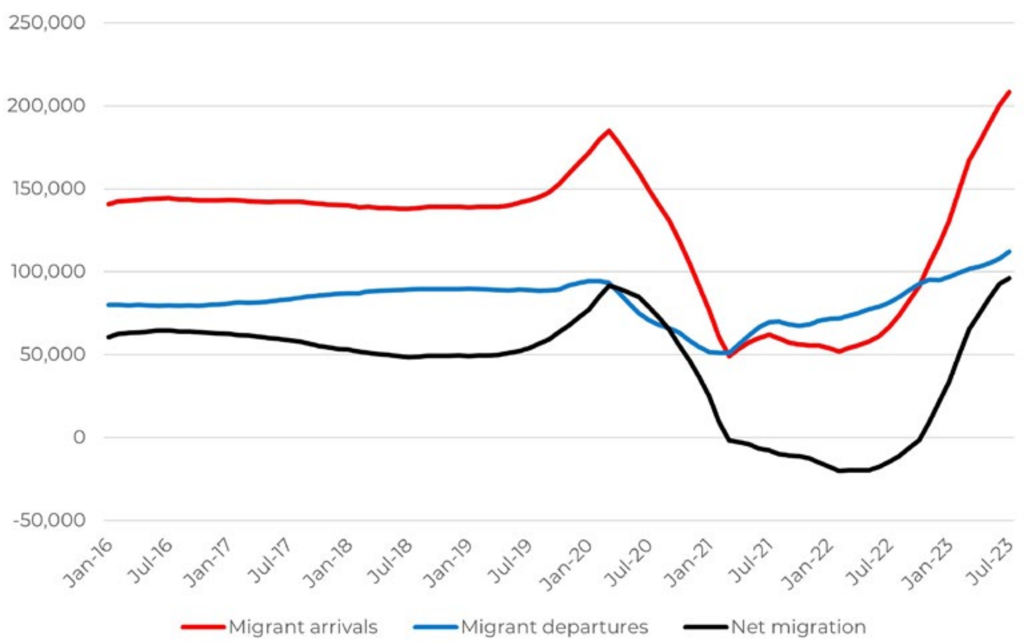
The price of fuel went back up in August, due to the ending of the 25c/litre petrol levy cut and higher oil prices globally. For the week ending 1 September, MBIE's weekly fuel-price monitoring had regular petrol back over the $3 dollar mark, at $3.05 per litre. Premium petrol was at $3.22 per litre and diesel was at $2.30 per litre. Globally, oil prices are up from US$75 per barrel to almost US$90 per barrel.

# Economy

## Migration

Estimated international migration for the year ending July 2023 was the highest on record. All up, there was an estimated 208,400 migrant arrivals, which is significantly above the pre-COVID average of 119,700, and up from the previous record of 184,880 set in the year to March 2020. Migrant departures were also up, estimated to be 112,200 for the year ending July 2023. This produced an estimated net migration gain of 96,200. The immigration surge was driven by citizens of India, with an estimated 32,917 net arrivals, and citizens of the Philippines, with an estimated 26,599 net arrivals. Meanwhile, there was an estimated net loss of 39,378 New Zealand citizens, many of whom moved to Australia. Far more New Zealand citizens are leaving the country now than during the pre-COVID period; the net migration loss of New Zealand citizens averaged 4,600 per year through 2015–2019, and 25,400 per year through 2002–2014.

***Figure 8:*** *International migration.*




***Source:*** *Stats NZ*.

## Retail trade

The retail trade survey from Stats NZ shows that consumer spending fell across most industries in the June 2023 quarter. Measured in 2010 prices, the total volume of seasonally adjusted sales – a measure which strip out seasonal fluctuations and the effect of inflation – was $25.2 billion, down 1% from the March quarter. All up, of the 15 industries surveyed, 11 registered a decline in sales volumes, four registered an increase, and one remained flat.

The largest declines were in hardware, building, and garden supplies, down $108 million (4.8%); clothing, footwear, and accessories, down $61 million (4.8%); recreational goods, down $37 million (4.7%); and food and beverage services, down $117 million (4.4%). The only industry that saw a significant increase in sales volumes was motor vehicles and parts, which was up $134 million (3.7%) from the March quarter. This pull back in discretionary spending is a sure sign that households are feeling the pinch of rising mortgage rates and inflation and that some may also be dialling back spending to prepare for harder times ahead.

The seasonally adjusted total value of all retail electronic card spending – a measure which strips out seasonal fluctuations but doesn't account for inflation – has remained steady over the past three months, at $6.65 billion for both June and July and $6.69 billion for August.

## Overseas merchandise trade

Comparing July 2023 to July 2022, the value of goods exports fell $890 million (14%) to $5.5 billion. This was driven by a fall in exports of milk powder, butter, and cheese, which were down $350 million (19%). Of these, milk powder exports fell significantly, down $326 million (35%), as did exports of milk fats, down $108 million (23%). Exports of meat and offal fell $194 million (21%); exports of preparations of milk, cereals, flour, and starch fell $97 million (44%); and wood exports fell $73 million (18%). The fall in export revenue was driven by weaker demand from China, which bought $407 million (24%) less compared to July 2022. On the other side of the ledger, exports of mechanical machinery and equipment increased $46 million (26%); and fruit exports increased $42 million (9.4%).

The value of total goods imports also fell, down $1.2 billion (16%) to $6.6 billion. This was driven by falls in imports of petrol and diesel, down $511 million (44%); other chemical products – a category that includes rapid antigen test kits – down $147 million (66%); machinery and equipment, down $112 million (11%); and iron and steel, down $86 million (36%). On the other side of the ledger, imports of aircraft and parts rose $242 million (485%); vehicles and vehicle parts imports rose $24 million (2.5%); and imports of beverages, spirits, and vinegar rose $13 million (18%).

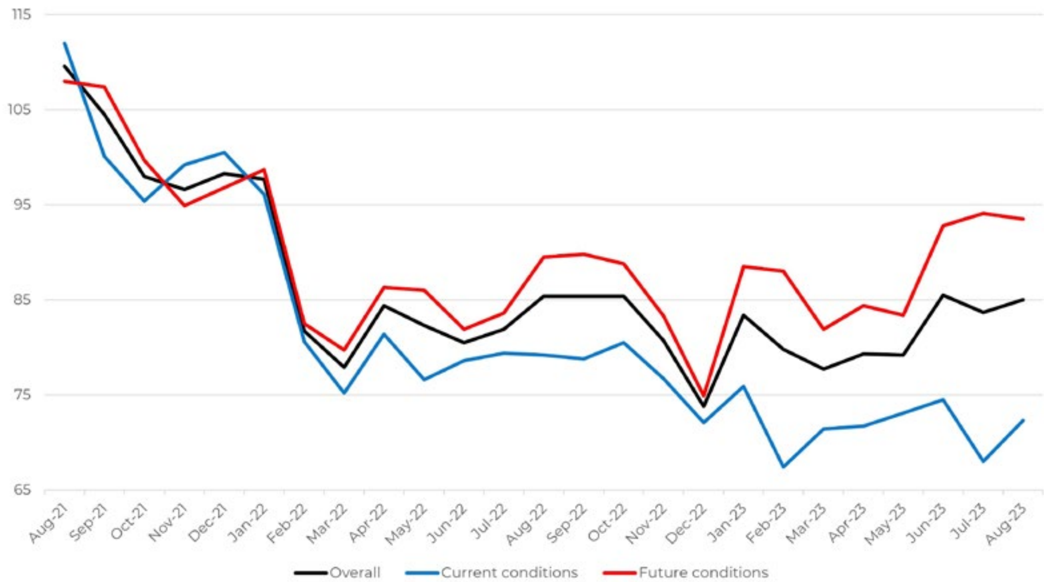
For the year ending July 2023, total good exports were valued at $71.8 billion (up $3.9 billion from 2022) and total goods imports were valued at $87.6 billion (up $7.7 billion from 2022), producing a large trade deficit of $15.8 billion. Of the major goods New Zealand exports, milk powder, butter, and cheese exports increased $2.2 billion (12%) to $20.9 billion for the year; exports of wine increased $434 million (22.3%) to $2.4 billion; and exports of preparations of milk, cereals, flour, and starch increased $426 million (19.8%) to $2.6 billion. Meanwhile, meat and offal exports fell $692 million (7.2%) to $9 billion; fruit exports fell $258 million (6.5%) to $3.7 billion; aluminium exports fell $159 million (9.4%) to $1.5 billion; and wood exports fell $85 million (1.7%) to $4.9 billion.

On the import side, for the year ending July 2023, the value of petroleum imports increased $4 billion (52%) to $11.7 billion; imports of vehicles and vehicle parts increased $1.4 billion (13.2%) to $11.8 billion; imports of aircraft and parts increased $1.3 billion (217%) to $1.9 billion; imports of electrical machinery and equipment increased $759 million (11%) to $7.6 billion; and imports of mechanical machinery and equipment increased $565 million (5.2%) to $11.5 billion. Meanwhile, iron and steel imports fell $552 million (20%) to $2.2 billion; fertilizer imports fell $458 million (32%) to $973 million; imports of other chemical products fell $411 million (27.4%) to $1.1 billion; and plastic imports fell $240 million (7.7%) to $2.9 billion.

## Consumer and business confidence

Consumer confidence remains low. The ANZ-Roy Morgan Consumer Confidence Index for August was 85, which is virtually unchanged from the July reading. A score above 100 on the index demonstrates that consumers have confidence in current and future economic conditions; less than 100, and they are pessimistic. A net 31% of those surveyed reported it was a bad time to buy a major household item, which is a slight lift from last month. This question is seen as the leading indicator of consumer confidence and also a leading indicator of economic growth. When most consumers think it is a bad time to buy a major household item, it suggests that people are concerned with their near-term financial security and so are pulling back on spending. A net 24% of those surveyed reported they were worse off financially than one year ago; however, a net 13% expect to be better off financially by this time next year.

***Figure 9:*** *Consumer Confidence Index.*




**Source:** ANZ.

Business confidence continued to lift in August. While still in negative territory, ANZ's Business Confidence Index rose 9 points to -3.7, its highest level since September 2021. There were significant confidence boosts in retail (up 8 points to 5), services (up 14 points to 2.2), and construction (up 29 points to 11.8). The outlook is slightly negative in manufacturing, at -6.6 (down 1 point) and remains gloomy in agriculture, at -62.1 (down 18 points). The own activity outlook increased across the board, with all sectors reporting expansionary outlooks. Investment intentions also rose slightly; they remain negative in agriculture and manufacturing, but are up in retail and services, and significantly up in construction. Finally, employment intentions also rose in August, moving back into expansionary territory. By sector, employment intentions remain negative in agriculture and construction, but are neutral in retail and positive in manufacturing and services. This more optimistic outlook of business contradicts the popular narrative that the New Zealand economy is currently in some kind of "crisis".

## Performance indexes

The manufacturing sector continues to register a contraction, according to the BNZ–Business NZ Performance of Manufacturing Index (PMI). The PMI is down 1.2 points to 46.3 for July 2023, its lowest level since August 2021 and the lowest it has been, outside of the COVID period, since 2009. The PMI provides an indication of the levels of activity in the domestic manufacturing sector. A figure above 50 indicates that manufacturing activity is generally expanding, while a figure under 50 indicates it is generally declining; the long-term average of the index is 52.9. Of the key sub-indexes, production fell 4.3 points to 42.9, employment fell 2.5 points to 44.3, and new orders rose 1.2 points to 45. The BNZ–Business NZ Performance of Services Index (PSI) was also in contraction for July, down 1.8 points to 47.8. The long-term average of the PSI is 53.5. Across the key sub-indexes, activity/sales fell 11.3 points to 39.6, employment fell 0.1 points to 49, and new orders/business fell 6.5 points to 43.8. Across both the PMI and the PSI, the proportion of negative comments has continued to outweigh the proportion of positive comments, with cost pressures, economic uncertainty, and slowing demand the most commonly mentioned problems.

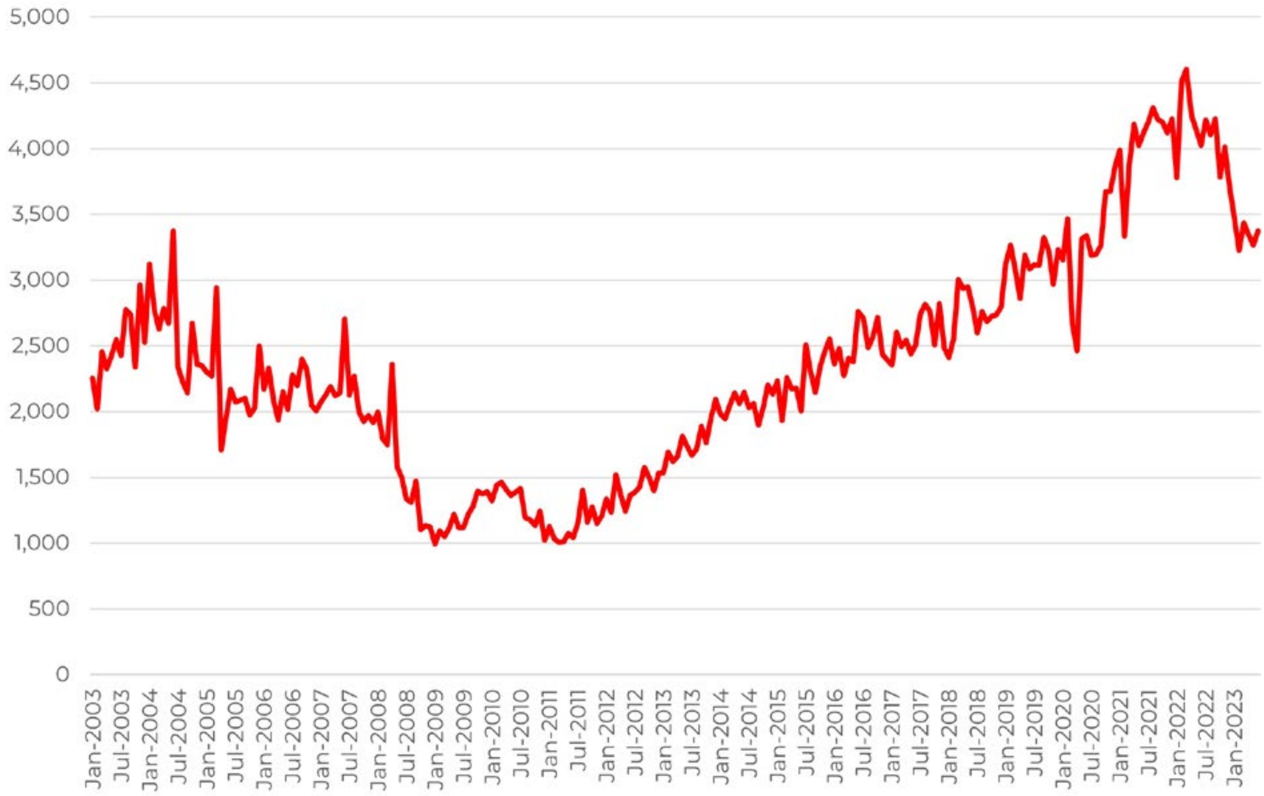
***Figure 10:*** *PMI and PSI.*


***Source:*** *BusinessNZ*.

## Building consents

For the year ended July 2023, there were 43,487 new residential dwellings consented. This is down 14% from the year ended July 2022. As Figure 11 shows, residential construction was booming from 2020 through to early 2022. The fall in new consents issued over the past year is an indication that the highly cyclical construction industry is in a downswing. This is driven largely by the Reserve Bank's monetary policy tightening. However, when measured per 1,000 residents, there is still more new residential dwellings being built than has been the trend over the past two decades. Based on provisional population estimates, the number of new dwellings consented per 1,000 residents was 8.4 for the year ending July 2023, down from 9.9 for 2022, but above the median of 6.25 over the past two decades.

***Figure 11:*** *Monthly building consents for new residential dwellings.*




***Source:*** *Stats NZ*.

### Real estate

As of August 2023, the REINZ House Price Index (HPI) was down 4.7% from the same time last year and 16.1% from its late-2021 peak. However, it is still up an annual compound growth rate of 5.7% from the same time five years ago. And most regions have seen a monthly increase in the HPI. Measured from their peak, the steepest declines have been registered in the North Island. Auckland is down 20.7% from its peak, Wellington is down 23.4%, and Manawatū-Whanganui is down 17.6%. By contrast, Canterbury has only fallen 7.3% from its peak, Otago has fallen 2.7%, and Southland has fallen 3%. The national median house price for August 2023 was $767,000. This is down 4.1% annually and 17.1% from its late-2021 peak. Annually, median prices are down in most regions of the country, except for Northland (up 3.6%), Gisborne (up 14.8%), Nelson (up 0.7%), Canterbury (up 0.8%), and Southland (up 2%). Nationally, sales counts are up 9.2% from this time last year. All in all, this data suggests that the housing market has bottomed out in most parts of the country. As discussed above, forecasters are expecting that house prices will start to move upwards in the next six months.

***Table 5:*** *Median house prices, August 2023.*

| | Price | Monthly | Annually | From Peak |
|---|---|---|---|---|
| **National** | $767,000 | -0.3% | -4.1% | -17.1% |
| **National excl. Auckland** | $670,000 | -1.5% | -4.3% | -13.5% |
| **Auckland** | $1,010,000 | 2.0% | -8.2% | -22.3% |
| **Wellington** | $750,000 | 2.3% | -3.2% | -25.0% |

***Source:*** *REINZ*.