NZCTU
Te Kauae Kaimahi

Economic Bulletin

December 2023

NEW ZEALAND COUNCIL OF TRADE UNIONS
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Welcome to the Christmas edition of the Economic Bulletin. In this edition, we unpack the new government's "Mini Budget", which was delivered alongside Treasury's Half-year Economic and Fiscal Update (HYEFU). The Minister of Finance called for "more transparent and responsible fiscal management", yet the Mini Budget appears to have provided us with the opposite.

We also discuss the new government's decision to remove the Reserve Bank's employment mandate. We show that, contrary to the government's claims, there is no evidence to indicate the employment mandate has contributed to the higher rates of inflation we have experienced in recent years, nor that getting rid of it will reduce the cost of living.

In our regular updates, we examine the latest GDP, retail spending, and balance of payments data, and update our minimum-wage-to-housing index. We also look at food and rental inflation, immigration, and consumer confidence statistics. For the latest employment, wages, and consumer inflation statistics, please see the October/November Bulletin.

The new government's first actions have been revealing of its priorities. In repealing the Fair Pay Agreements Act, the new government is ensuring the low-wage sectors of the New Zealand economy stay low-wage sectors. By expanding 90-day trials to businesses of all sizes, it is reducing workers' job security. And by cutting funding for public services, it is eliminating thousands of good jobs delivering essential services. In 2024, we will continue to use the Bulletin to explore the consequences of the new government's policies, and to map out an alternative path for the New Zealand economy, in which workers are prioritised.

As always, please get in touch if you have any feedback or suggestions for areas of future investigation.

Wishing you all a happy Christmas.

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The "Mini Budget": Clarity called for, but clarity required

Wednesday 20 December is my third favourite day of the year. First is my son's birthday. Second is the Budget in May. Wednesday was the Half-year Economic and Fiscal Update (or HYEFU), and, excitingly, the incoming government promised us a "Mini Budget". This was going to be a great day! Not only would we get to see the state of the government books, but we would get the much-vaunted detail of how the new government would deliver its tax cuts. We would get a sense of what the government wanted to do in terms of its economic policy. We would be told what the government's fiscal strategy was. All of this is important information that any responsible government should provide.

The lock-up for the Budget started at 11am and finished at 1pm. At its close, none of those present were any the wiser about how or what the new government was going to do. The Treasury staff were as kind and informative as ever. There was coffee and biscuits. But information and evidence . . . a complete absence.

What was called the Mini Budget turned out to be essentially nine pages of press release, hurriedly pulled together. There was no information about the tax cut package, except to say that information would be available next year. To quote the Minister of Finance, "The Government is progressing work to deliver meaningful income tax reduction in next year's Budget". So having told everyone on the election campaign of the urgent need for tax cuts, you will need to wait until at least July 2024 to see any change in your paycheck. According to the Minister of Finance, Cabinet hasn't even agreed what the tax cuts are. So there is every chance they may change again before we get to July next year.

Fortunately, the government could provide some clarity for property speculators, by committing to reducing the "bright-line test" for properties from 10 years to two years. This will likely mean higher property prices as property investors boost housing demand looking for tax free gains. The government also found time to reduce welfare payments by $676m over the next four years by linking benefit increases to inflation rather than wages. This will mean thousands of dollars less money in the pockets of some of the most vulnerable households in the country.

The lack of clarity extended to the government's cuts programme. Savings were proposed by the government of $1.5bn a year – or $6bn across the forecast period. However, the government chose to conflate several things to get to that number. Firstly, $2bn of the $6bn are cuts already identified by the previous government – so not new. A further $1.6bn are cuts to spending on contractors – which are being used to pay for reforms to early childhood education funding – so not really cuts but just a cash transfer. That leaves $2.4bn of actual "new" cuts.

These will be delivered in two groups. The first will be to departments who have seen a significant increase in headcount since 2017. They will be required to find 7.5% cuts. Other departments will be required to find 6.5% cuts. A letter will be sent to departments outlining the expected quantum of cuts. But this information was not provided to the public. Nor was the guidance for how cuts should be made provided. Nor was a timeframe for implementation provided, nor any sense of how spending decisions would be traded off.

This process also places Chief Executives of departments at the head of this process. They will be responsible for finding cuts, which will then be agreed by Ministers. Ministers will be able to blame Chief Executives for what has been cut. Chief Executives will be able to say that Ministers make the final decision. Ultimately, it looks an awful lot like an exercise in blame shifting, rather than responsible decision-making.

The cuts programme also extends to ending funding for a range of government actions. Some of these were expected – such as removing funding for Fair Pay Agreements. Two billion dollars was taken from the climate change response fund, to be recycled into tax cuts. One billion dollars comes from money that is inside the National Land Transport Fund. That is money that is largely paid for by duties on petrol, diesel, and other road user charges. That's not really a cut, it's just transferring money from one taxpayer (paying at the pump) to another (a landlord). It's a bit incoherent from a revenue policy perspective.

Normally, HYEFU is accompanied by another document – the Budget Policy Statement or BPS. The BPS sets out two things: the government's priorities for the Budget ahead and the long-term fiscal strategy of the government. It's a signal to government departments and agencies, and to the wider public, about how spending will happen in the next year. It also helps signpost the sorts of programmes that should be brought forward for the next Budget. But we will have to wait until March next year to find out. That's way too late in the process given that the Budget is delivered in May. It also gives markets and New Zealanders no insight into the government's fiscal strategy. So we have no idea about:

- Future revenue levels
- Future spending levels, including future allowances
- Future taxation levels
- The balance of priorities between those things.

The BPS also provides some indication of the kind of economic policy that the government wishes to impose. Famously, the previous Minister of Finance wanted to deliver "Wellbeing Economics", which looked through measures such as GDP growth and concentrated on a wider and richer picture of economic progress. The most we

got yesterday from the new Minister of Finance was a commitment to encouraging private sector growth. So no economic policy.

The Minister of Finance did spend a significant amount of time at the lock-up highlighting what she called "financial time-bombs". This is a complaint that the previous government had not been clear with the incoming government about expected spending. Examples given were the Lake Onslow project, the Income Insurance project, and the Auckland light rail and Let's Get Wellington Moving projects. Given that all of these were highlighted at the Pre-Election Economic and Fiscal Update (pages 83, 97, and 80), it seems hard to argue that these weren't known about.

There was also a discussion on so-called "fiscal cliffs" – where funding was provided for a period of time, but not forever. Some of the complaints are reasonable: providing Pharmac funding as time-limited funding is probably not great fiscal policy. But with some of the other areas of complaint (i.e., the North Island Weather Response), it's much harder to argue that they should be funded forever. The key thing is that, overall, the amount of money we are talking about in these "cliffs" is quite modest in comparison to the total spending of the government each year. It's certainly not enough to prevent a government from being able to tell the public what its spending plans are.

In summary, the Minister of Finance called for "more transparent and responsible fiscal management". Yet the Mini Budget appears to have provided us with the opposite. It was instead an exercise of political theatre dressed in economic garb. It was an opportunity for the incoming government to try and score points against the outgoing government, in order to provide cover for their lack of progress in delivering their election commitments.

The CTU will continue to press for the clarity needed from government on these issues. Public services look set to be squeezed ever tighter despite a rapidly rising population and higher levels of need. Our infrastructure gap grows larger by the day, yet the government is cancelling infrastructure investment. Every New Zealander who uses public services – which is everyone – will feel an increasing sense of what the great economist JK Galbraith called "private affluence and public squalor": tax cuts for those who already have much, delivered regardless of the consequences; degraded public services for those who increasingly have no other choice.

Craig Renney
NZCTU Economist and Director of Policy

The fiscal outlook

As part of her "Mini Budget", the new Minister of Finance said that "The previous Government put New Zealand on a completely unsustainable fiscal path: high levels of public spending left the books out of balance, three times delaying a forecast return to surplus and vastly increasing the burden of public debt".

We can interrogate these claims using the data in Treasury's Half-year Economic and Fiscal Update (HYEFU), which was released alongside the Mini Budget. The fiscal and economic forecasts in the HYEFU aren't particularly useful because they were completed in November, and so don't account for the new government's policy agenda. But HYEFU does provide us with a clear outline of the outgoing government's levels of expenditure, revenue, debt, and operating balance, among other indicators.

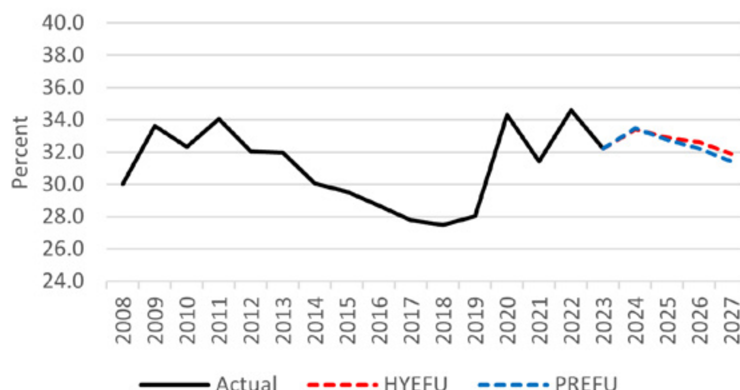
When set in the context of the last 15 years, we can see that there is nothing particularly unusual about the fiscal performance of the previous government. While government debt has risen, and the operating balance has been in deficit since 2020, this is largely because of the once-in-a-hundred years shock of COVID-19. It is wholly misleading of the new Minister of Finance to frame this as constitutive of "fiscal vandalism" and "financial mismanagement". We should be striving for a more sophisticated conversation about the management of the government's fiscal and economic responsibilities.

Fiscal indicators

The fiscal outlook shows core Crown expenditure as a percentage of GDP – a measure of the government's footprint in the New Zealand economy – falling from its COVID peak to below 32% by the end of the forecast period. The new government has argued that government spending is too high, and that the previous administration spent irresponsibly. It has signalled a general intention to reduce government expenditure during its time in office, but, as yet, hasn't fully set out how it intends to achieve this.

Figure 1 suggests that, despite the new government's claims, government spending has been within historical norms in recent years. While spending did increase under the sixth Labour government, this increase was in large part an artifact of the COVID-19 response. It also needs to be set against the decline in spending, and arguable underinvestment, that occurred under the government of John Key and Bill English. Additionally, while it has become political convention in New Zealand that core Crown expenditure should generally not exceed around 30% of GDP, it is important to remember that this is an arbitrary figure. Many wealthy European countries have government expenditure levels of over 40% of GDP and generate better economic outcomes.

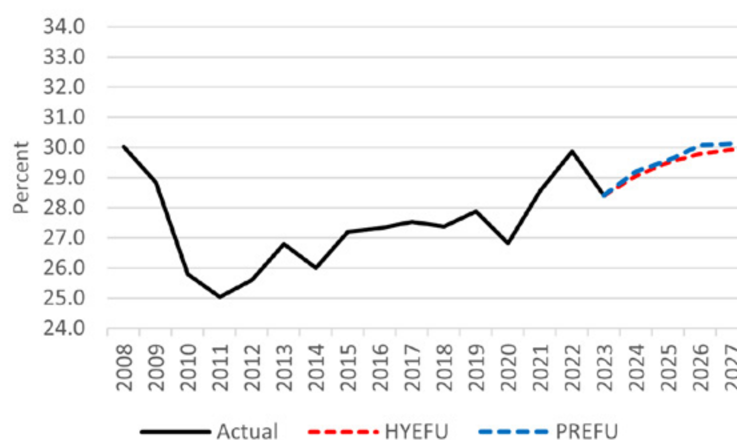
Figure 1: *Core Crown expenditure (% of GDP)*



Source: Treasury

As a proportion of GDP, the tax take – which provides the bulk of the government's revenue – has lifted in recent years and is expected to track up from 28.4% of GDP in 2023 to around 30% of GDP by the end of the forecast period. The new government has argued that the tax burden is too high. Again, however, if we take a longer view, we see that the overall tax take is within recent historical norms. Core Crown tax revenue averaged 28.2% of GDP under the Ardern/Hipkins government, which was higher than the average of 26.7% under the Key/English government, but lower than the average of 29.6% under the Clark government. Reducing the tax take will only make it more difficult to sustainably fund the public investment we need in infrastructure, health and education, and climate change over the coming years.

Figure 2: *Core Crown tax revenue (% of GDP)*



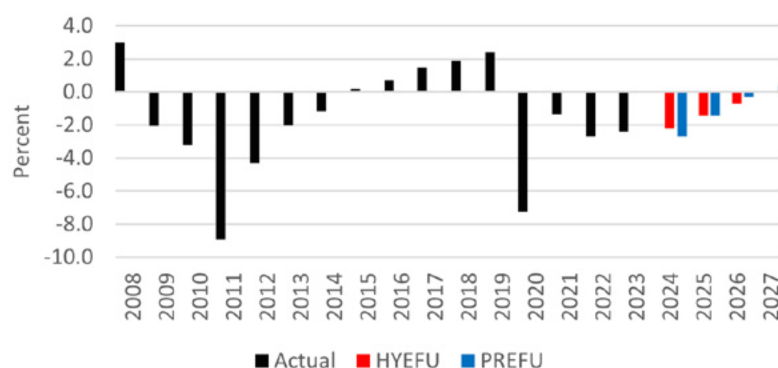
Source: Treasury

One of the indicators that politicians and commentators look at in determining if a government is being fiscally responsible is the OBEGAL (operating balance before gains and losses). The OBEGAL is the difference between the amount of money collected by government, and the amount of money spent (after you subtract large,

one-off items). It's supposed to show if a government is paying its own way or if it's relying on debt to fund its spending. The prevailing wisdom is that if OBEGAL is in deficit, then government debt will be going up; if it's in surplus, then government debt will be declining. Thus, the Public Finance Act requires government to return, "on average, over a reasonable period of time", operating surpluses. In reality, the OBEGAL isn't all that useful as an indicator. For example, it's possible to have a small OBEGAL deficit and for government debt to continue to fall. There's also the question of whether government running a surplus is sensible from a macroeconomic perspective, as it drains demand out of the economy.

As Figure 3 shows, the OBEGAL has been in deficit for much of the past 15 years. Under the Key/English government, deficits were returned for six consecutive years. This was because of the fiscal impact of the 2008-09 financial crisis and the 2011 Christchurch earthquake. The next time it went into deficit was due to the fiscal impact of the pandemic in 2020. Treasury is forecasting that the OBEGAL will return to surplus by 2027. In other words, there is nothing unusual about the OBEGAL deficits of recent years – they are principally a function of the external shocks that have buffeted the New Zealand economy.

Figure 3: *Operating balance (% of GDP)*

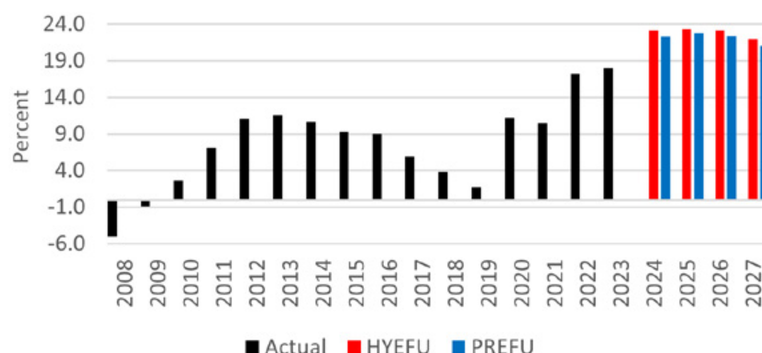


Source: Treasury

Figure 4 shows the government's net debt as a percentage of GDP. Net debt is the preferred measure for determining the sustainability of the Crown's debt. It is forecast to rise from around 18% of GDP in the year ending June 2023 to 23% of GDP in 2024, and to hover around this level over the forecast period. This means that the Crown's debt burden is higher now than it has been in the recent past, which has generated a lot of political noise.

Again, though, it is important to set this in context. In New Zealand, it has become political convention that government debt should be kept exceptionally low. (The Public Finance Act requires government to reduce "total debt to prudent levels" but doesn't identify what a prudent level is.)

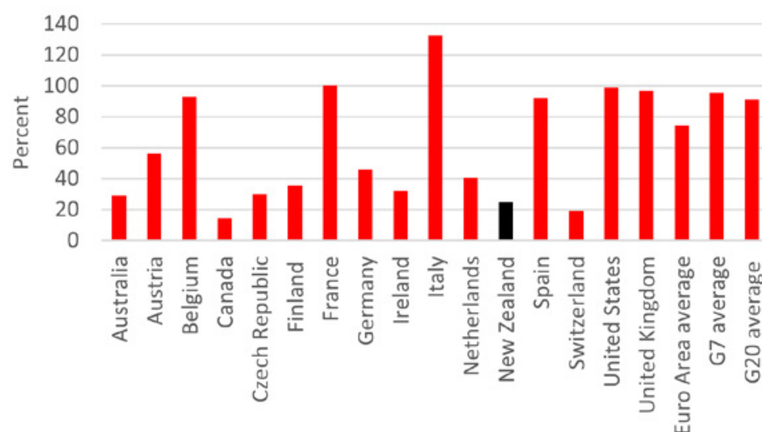
Figure 4: *Net Crown debt (% of GDP)*



Source: Treasury

If we take a comparative approach, as shown in Figure 5, New Zealand's government debt is far lower than most of our OECD peers. Having a low level of government debt is not necessarily a good thing in and of itself. While we have kept government debt low for several decades, we have also accumulated an infrastructure deficit of more than $200 billion over the next 30 years. Government should look to balance the objective of maintaining a sustainable level of debt with the equally important objective of ensuring a sufficient level of investment in New Zealand's public infrastructure.

Figure 5: *Net government debt (% of GDP), 2023*



Source: IMF

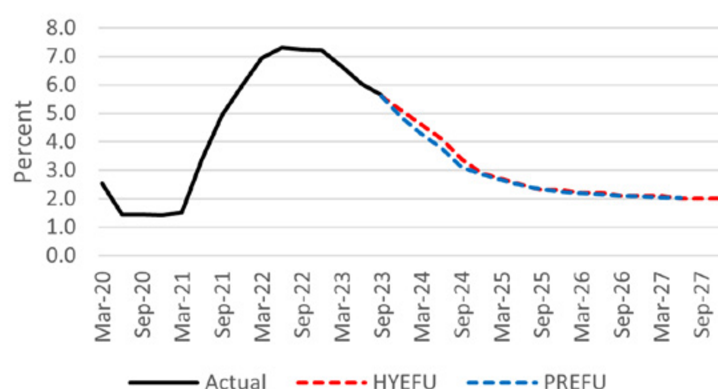
Economic indicators

Treasury's economic forecasts indicate that we are moving into a more difficult period for the New Zealand economy. Output growth is expected to be sluggish; interest rates are expected to stay high, and unemployment is expected to rise in 2024; however, consistent with the trend over the past year, and with previous forecasts, inflation is expected to continue to fall reasonably swiftly. As always, these forecasts are best guesses only.

Nominal GDP is expected to grow weakly over 2024 and 2025. However, per capita GDP is expected to contract 0.7% in the year to June 2024 and 0.1% in the year to June 2025. This indicates that output growth over these years will be driven by population growth.

Inflation is expected to continue to decline at a decent clip, coming within the Reserve Bank's target range of 1–3% by the third or fourth quarter of 2024. This fall is being driven by the unwinding of the price shocks associated with the pandemic and the Ukraine war, high interest rates constraining consumer spending, and a weakening jobs market.

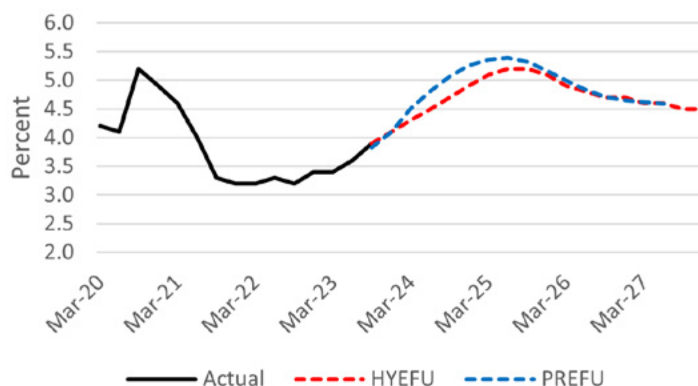
Figure 6: *Annual consumer inflation forecast*



Source: Treasury

Unemployment is forecast to rise to over 4.5% by mid-2024, and peak over 5% in early 2025. However, Treasury's HYEFU forecast is slightly more optimistic than its pre-election forecast was, with unemployment expected to rise more slowly and peak slightly lower. While this forecast rise in unemployment is not desirable, it's not unprecedented, nor is it particularly sharp. The fact that inflation is coming down relatively swiftly without necessitating a large rise in unemployment is likely an indication of the fact that the inflation we have experienced originated from higher import prices, rather than an overly tight labour market driving up wages.

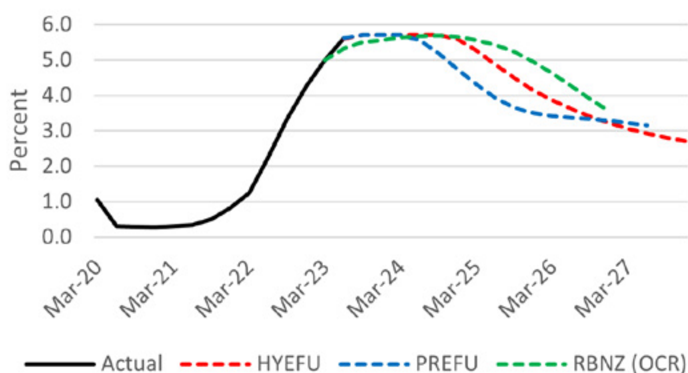
Figure 7: *Unemployment forecast*



Source: Treasury

Both the Treasury and the Reserve Bank are forecasting that the 90-day interest rate/OCR will remain high for longer than was previously anticipated. This is likely because inflation is being kept above the target band in part due to high levels of immigration. The Reserve Bank has indicated it might increase the OCR one more time in early 2024. However, the available data shows that the New Zealand economy has already been significantly impacted by higher interest rates: household spending power has been reduced, business investment has fallen, the jobs market has weakened, and output growth has stalled. In this context, we think that further OCR hikes would be gratuitous.

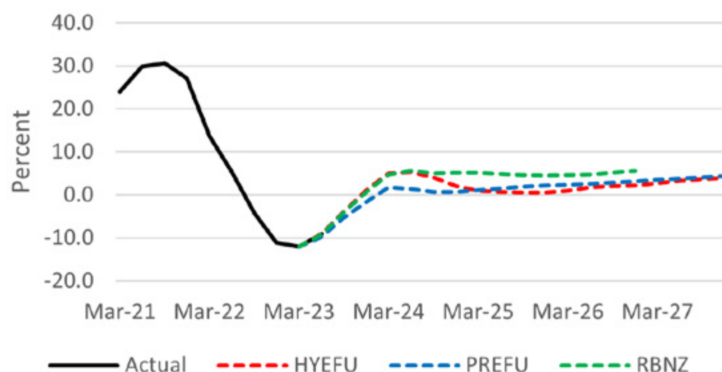
Figure 8: *90-day interest rate forecast*



Source: Treasury; RBNZ

The housing market is widely expected to pick up pace again. Treasury has revised up its previous forecast, and is now, like the Reserve Bank, expecting house prices to be growing at 5% per annum by early 2024, before slowing down again; by contrast, the Reserve Bank is expecting house price growth to be around 5% per annum for the next three years.

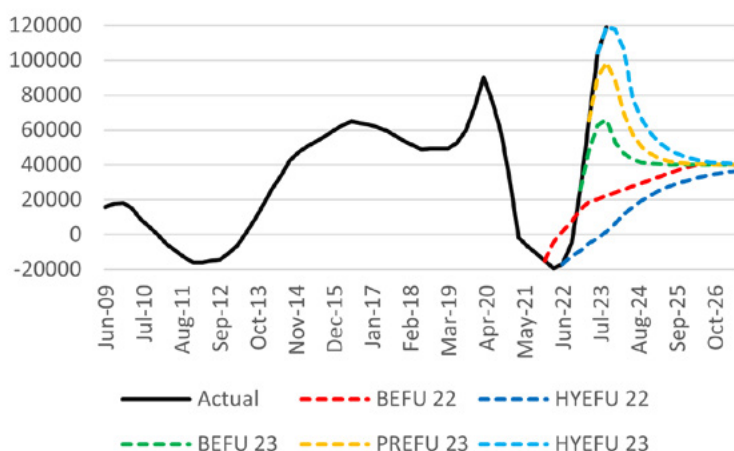
Figure 9: *House price growth forecast*



Source: Treasury; RBNZ

Last, but certainly not least, we have Treasury's net immigration forecast. Treasury is expecting net immigration to top out by the end of 2023 at 120,000 people per annum, and then begin falling swiftly towards the long-run trend. However, as Figure 10 shows, Treasury consistently underestimates the level of immigration to New Zealand. In its previous four forecasts from 2022 and 2023, Treasury has expected net immigration to peak at a far lower level than it has ended up at. This is important because the level of immigration is a significant driver of overall economic activity. When net immigration is rising, it means our population is too, and this increases demand for housing, public services, and infrastructure. If we are consistently underestimating the true scale of our population growth, then this raises the risk that government underinvests in these areas.

Figure 10: *Net migration forecast*



Source: Treasury.

Inflation and the Reserve Bank's employment mandate – link or no link?

With its first piece of legislation – the Reserve Bank of New Zealand (Employment Objective) Amendment Act – the new government scrapped the Reserve Bank's employment mandate. Since 2019 the Reserve Bank has been required to set monetary policy with the goals of:

i. achieving and maintaining stability in the general level of prices over the medium term; and

ii. supporting maximum sustainable employment.

The new government claims these two objectives are in conflict, and that the "dual mandate" has been a driver of the relatively high levels of inflation we have experienced in recent years. Restoring the single mandate of price stability, the government argues, will ensure that the Reserve Bank is properly "focused on putting the lid back on inflation". On 12 December, the government passed legislation to this effect.

While this approach sounds neat in theory, there is vanishingly little real-world evidence to suggest that the Reserve Bank's dual mandate has in any way contributed to inflation, or that getting rid of it will help households struggling with the cost of living.

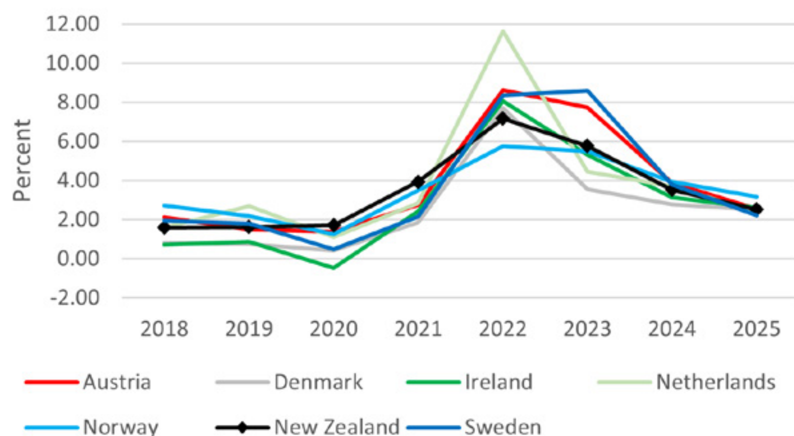
Inflation has been a global challenge over the past two years, and this allows us to compare New Zealand's experience against that of other wealthy OECD countries. Usefully, while some central banks have dual mandates, others are singularly focused on maintaining price stability. On the logic of the incoming government, inflation should have been higher in countries with a dual-mandate central bank. But no such relationship exists.

In New Zealand and Australia – both of which have, or until very recently had, central banks with dual mandates – inflation peaked at 7.2% and 7.8% respectively. But in many single-mandate countries, inflation peaked at a higher rate. In the UK, inflation peaked at 11.1%; in the Eurozone, it peaked at 10.6%; and in Sweden, it peaked at 12.3%.

The lack of any relationship between a country's inflation trajectory and its central bank's monetary policy mandate is well illustrated in Figure 11. This graph shows the inflation paths of New Zealand and six other small, developed economies that have central banks with single mandates. It tracks the inflation trajectory of these countries from 2018–2023, and then the projected rate of inflation for 2024 and 2025.

As this graph shows, all countries in this group have experienced a similar inflation trajectory: inflation started to trend upwards during 2021, peaked in 2022, and then fell through 2023, with continued moderation expected over 2024 and 2025. Despite its dual mandate, New Zealand's inflation trajectory has been decidedly 'middle of the pack'. Inflation neither peaked particularly high nor fell particularly slowly in New Zealand, relative to these other countries.

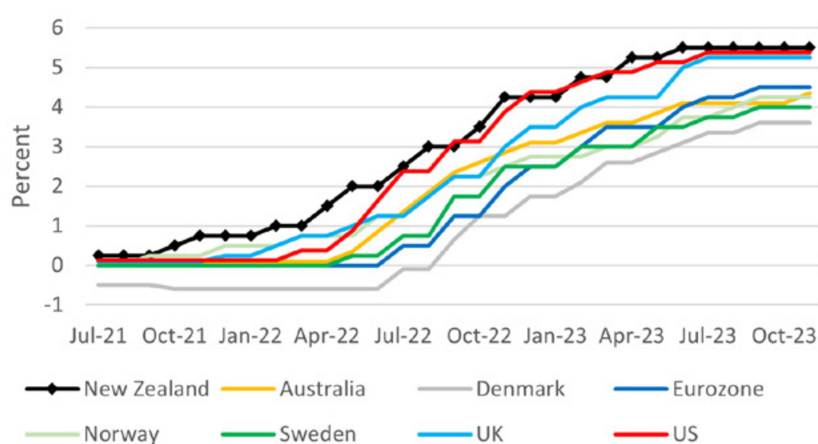
Figure 11: *Average annual inflation*



Source: OECD

Another indicator of whether the dual mandate makes a difference would be the speed and urgency with which different central banks have responded to inflation. Perhaps the Reserve Bank's response to rising inflation was impaired by its dual mandate? Again, an international comparison suggests otherwise. The Reserve Bank was second only to the Norwegian central bank to begin hiking interest rates in 2021. It has also raised interest rates higher and faster than other developed country central banks, as shown in Figure 12.

Figure 12: *Central bank interest rates*

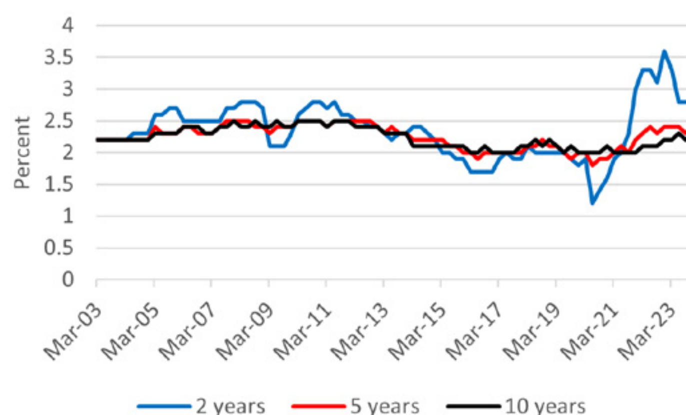


Source: BIS

Yet another measure that we would expect to demonstrate a link between the dual mandate and higher inflation is long-run inflation expectations – what people think inflation will be five or 10 years from now. Long-run expectations are widely used as a measure of a central bank's perceived "credibility" as an inflation manager. While short-term expectations might move around in response to events like a pandemic or an oil shock, the theory is that long-term expectations will remain stable if people think the central bank will act to bring inflation down.

As Figure 13 shows, the Reserve Bank's inflation-fighting credibility has remained rock solid – both before and after 2019. While short-term expectations rose in 2021 and stayed elevated in 2022 – as would be expected during an inflationary shock – long-term expectations have remained well within the Reserve Bank's 1–3% target range and are at the same level as the early 2010s.

Figure 13: *Inflation expectations*



Source: Reserve Bank

The lack of any link between the dual mandate and our recent experience of inflation should not be surprising to anyone familiar with the Reserve Bank's Monetary Policy Framework, which defines maximum sustainable employment (MSE) as the "highest utilisation of labour resources that can be maintained without generating an acceleration in inflation". In other words, it is the level that employment can reach before it starts putting unsustainable pressure on prices.

In the long run, there is no conflict between this measure of employment and price stability because the latter is considered to be conditional upon the former. This is why the Reserve Bank has made no secret of the fact that it expects the rate of unemployment to increase as part of getting inflation down. In its view, this helps to manage inflation by reducing workers' bargaining power over wages. As the Reserve Bank noted in its review of monetary policy decisions published last year: the "inflation and MSE objectives have not been in conflict: During periods when the inflationary outlook was weak, employment was not above its maximum sustainable level. During periods when there were strong inflationary pressures, employment was considered above its maximum sustainable level".

In this context, the principal virtue of a dual mandate is that it gets the Reserve Bank to consider and report on how its monetary policy decisions will affect employment outcomes. During periods in which prices are stable, this puts the onus on the bank to stimulate the economy until MSE is reached. This means more people in work – which is good for everyone.

Under the single-mandate model, which we have now returned to, the Reserve Bank has no cause to consider the employment impacts of monetary policy. In the past, this has contributed to poor decision-making at times. This was exemplified in 2014, when Governor Graeme Wheeler started hiking the Official Cash Rate (OCR) even though inflation was only running at 1.5% and unemployment was at 5.6%. At the time, forecasters were anticipating a slight lift in inflation, which convinced Governor Wheeler to raise the OCR from 2.5% to 3.5% over the course of six months. However, this only served to keep the unemployment rate unnecessarily high for the next two years and actually brought the New Zealand economy dangerously close to deflation. For these reasons, it is widely viewed as a policy mistake. Returning to the single mandate will only make similar policy errors more likely in the future.

In the meantime, the repeal of the employment mandate will do exactly nothing to help households struggling with the cost of living. Inflation is already falling quite rapidly and is forecast to return within the Reserve Bank's target range by the third quarter of 2024, as discussed in our analysis of the Mini Budget and HYEFU. In these respects, the scrapping of the Reserve Bank's employment mandate is the very opposite of evidence-based policy.

The full employment alternative

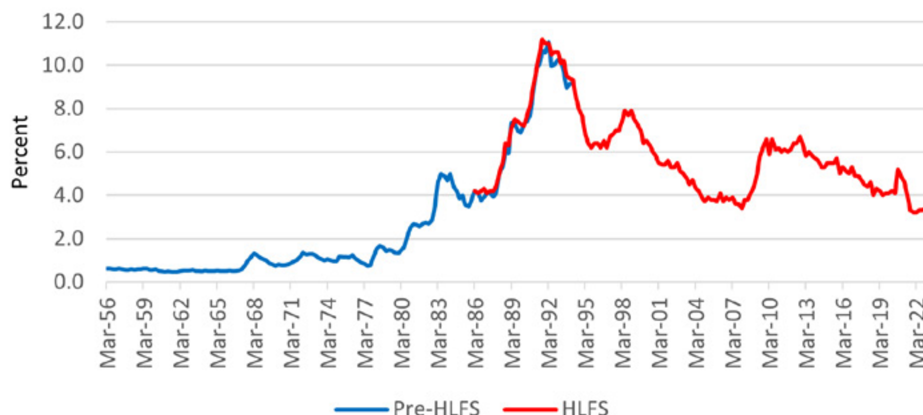
The CTU's view is that full employment should be a central economic objective for New Zealand policymakers. As opposed to the concept of "maximum sustainable employment", which describes the rate employment can reach before it becomes inflationary, "full employment" describes a situation in which every person in New Zealand who is willing and able to work can get a job.

A fully employed society has been a long-standing goal of progressive policy. During the post-war decades, full employment was pursued – and achieved – by Labour and National governments alike. As shown in Figure 14, from the 1950s to the end of the 1970s, the unemployment rate was generally below 1%.

However, during the restructuring of the 1980s and 1990s, the goal of full employment was abandoned. Rather than running the economy to its maximum potential and working to ensure no one who was willing and able to work is without a job, policymakers have instead prioritised low inflation and balanced government accounts.

As Figure 14 shows, unemployment has been well above its post-war levels for the past three decades (averaging 8.2% in the 1990s; 4.7% in the 2000s; and 5.4% in the 2010s). And although it reached a four-decade low of 3.2% in late-2021, it is now creeping back up again, and is forecast to rise to over 5% because of the Reserve Bank's interest rate hikes.

Figure 14: *Unemployment rate, 1956–2023*



Source: Stats NZ. The unemployment rate is currently calculated using the household labour force survey (HLFS), which started in 1986. The pre-HLFS data comes from Simon Chapple (1994) "HLFS-Consistent Labour Market Data", NZIER Working Paper

Getting to full employment again will require more than just a central bank with an employment objective. Nevertheless – and notwithstanding the limitations of the concept of "maximum sustainable employment" – the establishment of a dual mandate for the Reserve Bank in 2019 was a step in the right direction. In its very first piece of legislation, the new government has shifted us off this course. Worse, given the total lack of evidence to support returning the Reserve Bank to a single mandate, it has done so for no good reason.

Wages and prices

Central bank interest rates

The Official Cash Rate (OCR) remains unchanged since our last Bulletin, at 5.5%. However, the Monetary Policy Committee – the arm of the Reserve Bank that sets the OCR – took a slightly more aggressive stance in its November announcement, forecasting a further rate hike in 2024. Barring an unforeseen economic shock, this means interest rates – and therefore mortgage rates – will likely stay high through 2024 and into 2025.

In the CTU's view, the weak state of the economy – see below for a discussion of the latest GDP figures – the speed with which inflation is falling, and the forecast rise in unemployment, mean the Reserve Bank should rule out any further rate hikes.

Food prices

From October to November, food prices rose 0.6% after seasonal adjustment. The price of fruit rose 1.9% and the price of vegetables rose 1.8%. Grocery food rose 0.2% in price. However, the meat, poultry, and fish group fell 0.1% in price.

For the year ended November 2023, the cost of food increased 6% overall. This is well down from the 12.5% recorded for the year ending June 2023. The cost of grocery food increased 7% annually, with bread rising 4%, breakfast cereals rising 10.6%, and eggs rising 48.5%. However, the price of milk fell 4%, and the price of cheese fell 9.4%, due to weak dairy prices globally. The cost of fruit and vegetables rose 4.8% overall, with fruit increasing 7.9% – in part because of damage to crops caused by Cyclone Gabrielle – and vegetables increasing 2.8% in price. The meat, poultry, and fish group only increased 2% in price for the year; pork increased 12.6%, but beef and veal fell 1.9%, and mutton, lamb, and hogget fell 7%. Finally, restaurant and ready-to-eat food increased 7.5% in price for the year.

Figure 15: *Annual food price inflation*

Source: Stats NZ

Property rent prices

Rent price inflation eased in October and November, though remains high. Compared to November 2022, rent prices were up 5.5% on the flow measure and 4.3% on the stock measure in November 2023. 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.

As Table 1 shows, rental inflation has been particularly strong in Auckland, but has eased notably in Wellington. This suggests that Wellington is not experiencing the same level of population growth as other major centres; slower wage growth in the public sector and less demand for student housing may also be contributing to lower rent price inflation in the capital.

Table 1: *Rental price indexes (% change from same month of previous year)*

	Aug 23	Sep 23	Oct 23	Nov 23
New Zealand, flow	6.2%	7.2%	6.1%	5.5%
Auckland, flow	8.3%	9.4%	8.5%	6.7%
Wellington, flow	4.8%	4.4%	-0.2%	0.7%
Rest of North Island, flow	4.9%	6.4%	3.9%	5.6%
Canterbury, flow	8.7%	4.7%	6.3%	7.6%
Rest of South Island, flow	7.1%	7.5%	6.7%	7.0%
New Zealand, stock	4.1%	4.2%	4.2%	4.3%

Source: Stats NZ

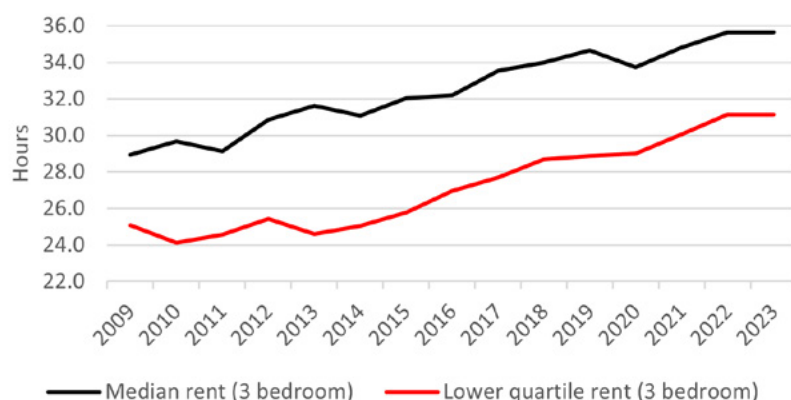
We discussed the structural drivers of rent price inflation in the August/September Bulletin. Contrary to claims that the removal of interest deductibility for landlords, the extension of the bright-line test, and the introduction of the healthy homes standards by the former government are responsible for runaway rent prices, the real driver is the lack of supply, which gives landlords the power to hike rents in line with wages.

One measure we can track this on is the CTU's minimum-wage-to-housing index. Our index for the June 2023 quarter (the latest available data) shows that, over the past 15 years, 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 for the June 2023 quarter shows that the median rent for a three-bedroom house was $630, up $35 since the same time last year, while lower quartile rent was $550,

up $30 from the previous year. Over this same period, the minimum wage increased from $21.20 per hour to $22.70. For a full-time worker, this provided an extra $39 per week after tax. This means that, if they are renting, a minimum wage worker paying median rent has seen 90% of their pay rise go straight to the landlord (or 77% if paying lower quartile rent). Using our index measurement of hours worked to pay the rent, a minimum wage worker is no better off today than they were one year ago.

Figure 16: *Hours worked to pay median rent on the minimum wage, 2009-23 (June quarter)*



Source: Tenancy Services

Figure 16 shows that minimum wage workers have been losing the race against rent price inflation for a long time. From 2009 to 2023, the minimum wage increased 82%. However, median rents increased 110%, while lower quartile rents increased 112%. The result is that a minimum wage worker now needs to work 6.7 more hours per week than they did in 2009 to pay median rent, and 6.1 hours more to pay lower quartile rent.

Fuel prices

The price of fuel has fallen through November and December. For the week ending 8 December, MBIE's weekly fuel-price monitoring had regular petrol at $2.80 per litre; premium petrol was at $2.97 per litre and diesel was at $2.20 per litre. This decline in the cost of petrol is the result of falling oil prices globally over the past three months, as shown below. Oil is currently trading at around US$75 a barrel.

Figure 17: *West Texas Intermediate Crude Oil price, July–Dec 2023*

Source: CNBC

Economy

Gross domestic product

GDP surprised commentators and market participants by contracting 0.3% in the September 2023 quarter. The June quarter's figure of 0.9% growth was also revised down to 0.5%. Measured on a per-capita basis, GDP contracted 0.9% in the September quarter. The contraction in GDP was driven by the goods-producing sector, which fell 2.6%. The services sector registered weak growth of 0.4%, while the primary sector expanded 0.6%.

All goods-producing industries shrank, with manufacturing falling 3.4%, electricity, gas, water, and waste services shrank 2.5%, and construction shrank 1.7%. Together, these industries make up roughly 17% of the national economy.

In the services sector, growth was uneven. Contractions were registered in wholesale trade (-1.9%) and retail trade and accommodation (-0.2%), both of which have now registered at least four consecutive quarters of negative growth. Transport, postal, and warehousing also shrank (-4.5%). However, growth was registered in information media and telecommunications (1.5%), financial and insurance services (1.1%), rental, hiring, and real estate (1.0%), professional, scientific, and technical (0.2%), public administration and safety (0.5%), education and training (1.2%), healthcare and social assistance (2.3%), and arts, recreation, and other (0.4%). All together, these services make up nearly 70% of the economy.

Finally, in the primary sector, agriculture, forestry, and fishing posted 0.8% growth, while mining shrank 1.8%. Together, these industries make up 6% of the economy, the majority of this been agriculture, forestry, fishing.

Expenditure on GDP fell 0.7% in the September quarter, driven primarily by falling investment in fixed capital, which was down 3.4% overall, and household consumption expenditure, which fell 0.6%. Export earnings (-2.6%) and central government expenditure (-2.2%) also fell. A full breakdown of quarterly movements in expenditure is provided in Table 2. Overall, this data indicates that household spending and business investment is firmly in retreat, with this reinforced by falling central government expenditure.

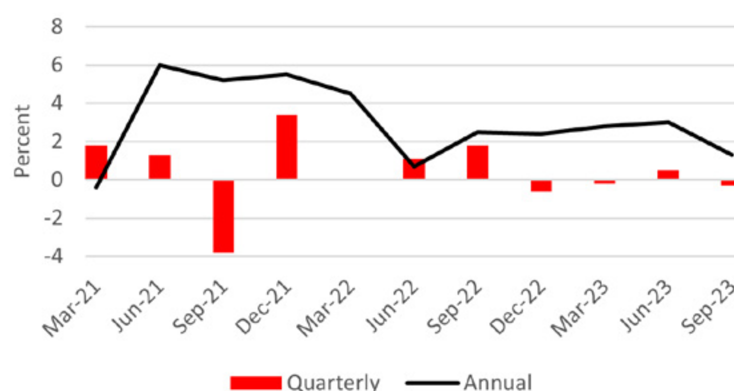
For the year ending September 2023, the New Zealand economy is estimated to be 1.3% larger than it was one year ago (measured by production). The primary sector grew 3.2%, with agriculture, forestry, and fishing expanding 3.7% and mining shrinking 0.2%. The goods-producing sector shrank 2.9%, led by a 6.9% contraction in manufacturing; electricity, gas, water, and waste services grew 2.4% and construction was flat. Finally, services – by far the largest sector – grew 2.2% overall. Reasonable growth was posted in most services industries; however, retail trade and accommodation fell 2.9% and education and training fell 0.3%. Meanwhile, expenditure on GDP increased 1.1% for the year to September 2023.

Table 2: *Expenditure on GDP (quarterly % change)*

	Dec 22	Mar 23	Jun 23	Sep 23
Household consumption	-0.2%	1.1%	0.0%	-0.6%
Non-durables	-0.4%	-2.7%	0.1%	-0.7%
Durables	-2.9%	-0.4%	1.7%	-3.2%
Services	0.7%	2.0%	0.4%	-0.2%
Central government	-3.1%	-1.4%	3.8%	-2.2%
Local government	1.5%	2.3%	0.6%	1.5%
Business investment	-1.1%	1.4%	0.8%	-4.8%
Gross fixed capital formation	-2.6%	1.2%	0.2%	-3.4%
Gross capital formation	1.6%	-3.1%	-5.0%	5.6%
Exports	-1.8%	-1.7%	4.7%	-2.6%
Exports less imports	1.8%	-0.1%	-0.8%	-0.3%
Total expenditure on GDP	-1.0%	-0.6%	-0.9%	-0.7%

Source: Stats NZ

Figure 18: *GDP production growth (year ended September)*



Source: Stats NZ

Measured on a per capita basis, however, the economy is estimated to have contracted 0.3% annually. And measured by real purchasing power – that is, the volume of goods and services that New Zealand residents can purchase – it has contracted 0.9% for the year. This indicates that the output growth we have experienced over the past year is an artifact of population growth. The economy has gotten bigger in an absolute sense, but the product produced per head of population has fallen, as has our ability to purchase goods and services.

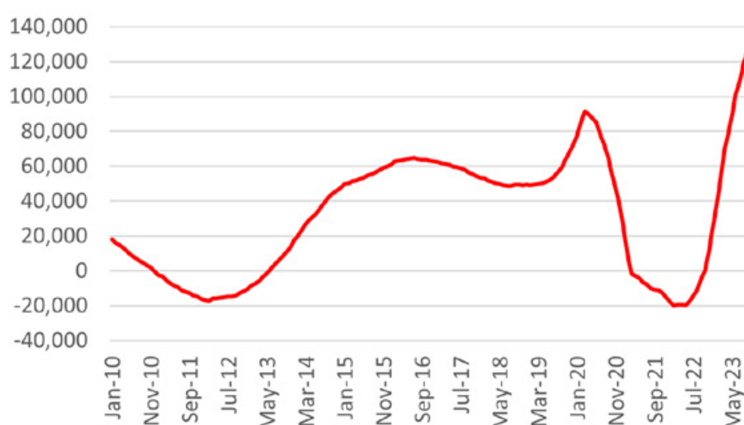
Migration

Estimated international migration for the year ending October 2023 was the highest on record for an annual period. There were an estimated 245,600 migrant arrivals,

which is significantly above the pre-COVID average of 119,700 and up 165% from the previous year. Migrant departures were also up, estimated to be 116,700, a 26% increase from the previous year. This produced a record estimated net migration gain of 128,900 people. This equates to a 2.5% increase in the New Zealand population, a significant population shock. The new government will need to ensure it is matching this breakneck population growth with the requisite infrastructure and investment in housing and public services. This needs to happen quickly to avoid rents and property prices becoming even more unaffordable, and to avoid further stress on the health and education systems.

The net migration surge has been driven by citizens of India, with an estimated 43,595 net arrivals (compared to 8,998 in 2019), the Philippines, with an estimated 34,449 arrivals (compared to 8,874 in 2019), and China, with an estimated 19,618 net arrivals (compared to 4,892 in 2019). There was an estimated net outflow of 44,500 New Zealand citizens – far more New Zealand citizens are leaving the country now than during the pre-COVID period, many of whom are moving to Australia for higher wages, better conditions, and more affordable housing.

Figure 19: *International migration*



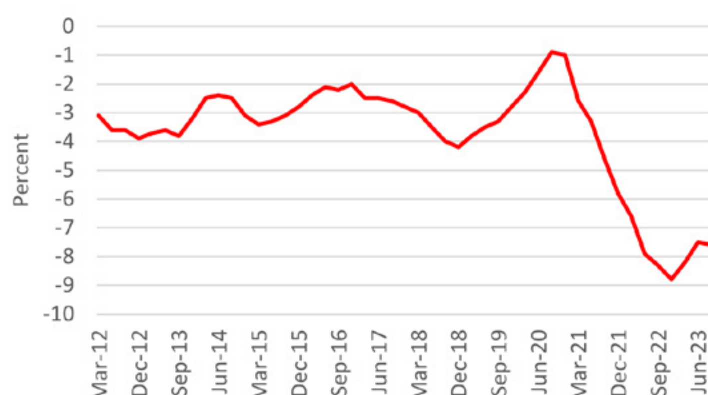
Source: Stats NZ

Balance of payments

The balance of payments figures for the September 2023 quarter show that New Zealand's current account deficit remains large. The seasonally adjusted quarterly current account deficit was $7.4 billion in September, up $0.4 billion from June. For the year ended September 2023, the current account deficit was $30.6 billion – 7.6% of GDP. In nominal terms, this is down 1.8% ($557 million) from September 2022. Goods imports exceeded goods exports by $13.2 billion; services imports exceeded services exports by $5.2 billion; and primary income outflow exceeded primary income inflow by $12.3 billion. This deficit shows that the total cost of imports into New Zealand exceeds the total earnings from New Zealand exports, and that more profits, interest

payments, and dividends are flowing out of the country to overseas investors than New Zealand residents are earning from their foreign investments.

Figure 20: *Annual current account deficit as percentage of GDP*



Source: Stats NZ

For the year ended September 2023, New Zealand's net international position was -$191.9 billion. This position shows the value of financial claims held by New Zealand residents on non-residents against the financial liabilities of New Zealand residents to non-residents. This level is mostly unchanged from the year ended September 2022. As a percentage of GDP, New Zealand's net international investment position is -47.9%.

Our net external debt position is -$187.1 billion, which is slightly down from the same time last year. This means that New Zealand is a net debtor to the rest of the world. Over half of this deficit is accounted for by the commercial banks, who collectively recorded a net debt liability of $115.9 billion to the rest of the world. General government's net debt liability was $44.9 billion, while the Reserve Bank recorded a net asset position of $16.3 billion. As a percentage of GDP, New Zealand's net external debt position is -46%.

Overseas merchandise trade

For the year ending October 2023, total good exports were valued at $69.7 billion, down $1.2 billion from the year ending September 2022. Total goods imports were valued at $84.5 billion, down $266 million from the previous year. This produced a large goods trade deficit of $14.8 billion.

Of the major goods New Zealand exports, the value of milk powder, butter, and cheese exports was unchanged, at $20 billion for the year; exports of preparations of milk, cereals, flour, and starch increased 7% to $2.5 billion; exports of mechanical machinery and equipment increased 12.6% to $2.4 billion; and exports of wine increased 6.7% to $2.2 billion. Exports of meat and offal fell 12.8% to $8.7 billion; wood exports fell 8.7% to $4.7 billion; and fruit exports fell 6.2% to $3.6 billion.

On the import side, for the year ending October 2023, the value of vehicles and part imports increased 7.1% to $11.8 billion; imports of mechanical machinery and equipment were unchanged, at $11.4 billion; the value of petrol imports increased 20.3% to $11.3 billion; and imports of electrical machinery and equipment increased 1.2% to $7.4 billion. Imports of aircraft and parts also increased significantly, up 232% to $2 billion. The value of imports of textiles fell 7.7% to $3.3 billion; imports of plastics fell 16.1% to $2.7 billion; pharmaceuticals imports fell 3% to $2.5 billion; imports of iron and steel fell 29.9% to $2 billion; imports of food residues, wastes, and fodder fell 11.7% to $1.6 billion; and furniture imports fell 16.3% to $1.5 billion.

Of our major trading partners, exports to China fell 7.4% to $19 billion; exports to Japan fell 4.1% to $4 billion; exports to South Korea fell 5.5% to $2.4 billion; and exports to Indonesia fell 20.7% to $1.6 billion. By contrast, the value of exports to Australia rose 3.8% to $8.9 billion; exports to the US rose 9.2% to $8.2 billion; and exports to Singapore rose 10.1% to $1.8 billion. The value of imports from China fell 11.6% to $17.6 billion, while the value of imports from Australia fell 1.5% to $9.2 billion. Meanwhile, imports from the US increased 15.7% to $8.4 billion; imports from South Korea increased 16.9% to $6 billion; imports from Japan increased 7.1% to $5.6 billion; and imports from Singapore increased 12.4% to $4.4 billion.

Retail trade

Stats NZ's retail trade survey shows that consumer spending has remained relatively stable since the last quarter. Measured in 2010 prices, the total volume of seasonally adjusted sales – a measure which strips out seasonal fluctuations and the effect of inflation – was $25 billion. This is down from the 2022 and early 2023 levels, but the same as the June 2023 quarter. Of the 15 industries surveyed, six registered a decline in sales volumes, and seven registered an increase. Of the major industries, sales volumes increased 1% for supermarkets, 2.9% for hardware, building, and garden supplies, 4% for clothing and footwear, and 0.2% for accommodation and food services. Sales volumes decreased 1.4% for department stores, 0.8% for electrical and electronic goods, and 3.4% for both fuel and motor vehicles.

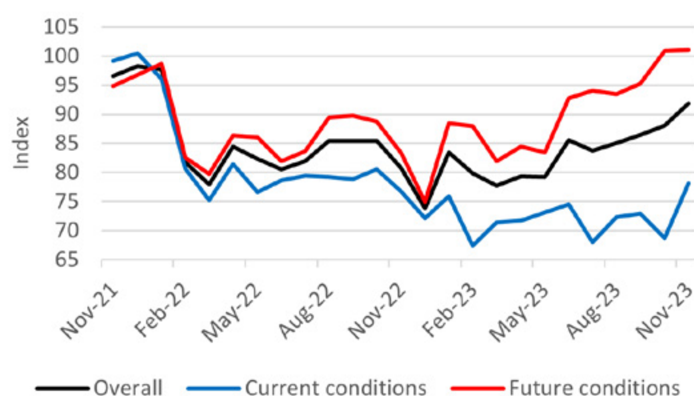
Compared to the September 2022 quarter, spending has fallen in all industries except accommodation. There have been large declines in discretionary spending categories, which indicates that rising interest rates and inflation have been constraining consumer spending power. Sales volumes fell 3.4% for food and beverage services, 9.3% for hardware, building, and garden supplies, 4.9% for recreational goods, 8.8% for furniture and houseware, and 10.5% for liquor. This is unsurprising, given the squeeze put on household disposable income by rising mortgage rates.

Consumer and business confidence

The ANZ-Roy Morgan consumer confidence index rose 4 points from October to November to 91.9. 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. Consumer confidence has been below the 100 mark for two years now.

A net 25% of those surveyed reported it was a bad time to buy a major household item, an improvement from October, but still negative. This question is seen as a leading indicator of consumer confidence and future economic activity. A net 19% of those surveyed reported they were worse off financially than one year ago – again, a slight improvement from previous surveys this year. A net 16% expect to be better off financially by this time next year, unchanged from October. As Figure 12 shows, over the past year, there has been a growing divergence between consumer confidence in current and future conditions. The November survey suggests this gap may now be closing, as consumer confidence in current conditions starts to lift, albeit slowly.

Figure 21: *Consumer confidence index*



Source: ANZ

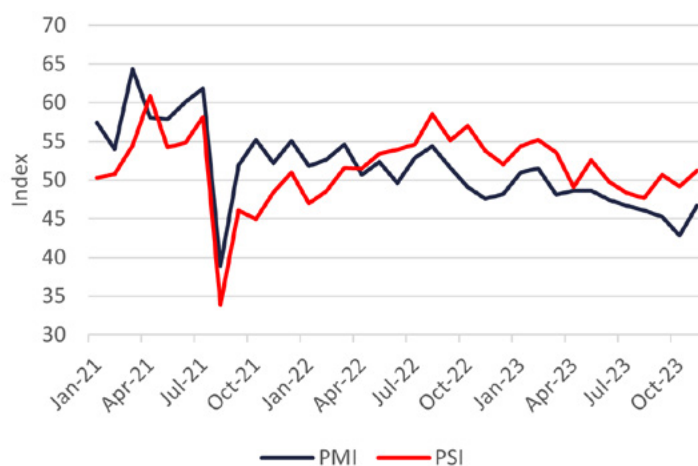
Business confidence continued to lift in November, to reach its highest level since March 2015. This will largely be the result of the election, with business confidence tending to be higher when a National-led government is in power. ANZ's index had business confidence rising 7 points to +30.8 in November. Confidence is in positive territory across all industries. In retail, confidence fell 6 points to +32; in manufacturing, it fell 9 points to +28; in agriculture it rose 22 points to +10; in construction it rose 6 points to +33; in services it rose 14 points to +34. All sectors reported expansionary outlooks. Investment intentions were mixed, with retail at +6, manufacturing at +10, agriculture at -14, construction at -9, and services at +6.5. Employment intentions were also mixed, with retail at -2, manufacturing at +8, agriculture at +10, construction flat, and services at +8.

Performance indexes

The BNZ–Business NZ performance of manufacturing index (PMI) and performance of services index (PSI) provide an indication of the levels of activity in these sectors. A figure above 50 indicates that activity is generally expanding, while a figure under 50 indicates it is generally declining.

The manufacturing sector continues to report contraction, according to the PMI. The PMI for September was 46.7, up 3.8 points from the August reading, driven largely by low demand. The long-term average of the index is 52.9. Meanwhile, the PSI is in weakly positive territory, up 2 points from October to 51.2. The long-term average of the PSI is 53.5. Across both the PMI and the PSI, the proportion of negative comments in the November surveys outweighed the proportion of positive comments, though only slightly.

Figure 22: *PMI and PSI*

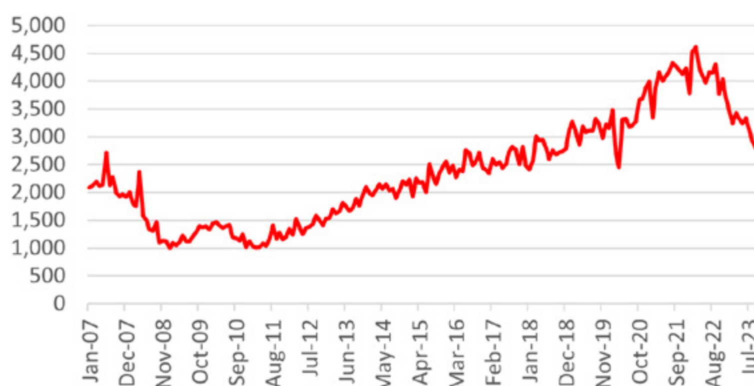


Source: *BusinessNZ*

Building consents

For the year ended October 2023, there were 39,900 new residential dwellings consented, down 21% from the previous year. Of the major centres, consents were down 24% annually in Auckland and Waikato, 16% in Wellington, and 17% in Canterbury. Nationally, consents per 1,000 residents have fallen from 9.8 for the year ending October 2022 to 7.7 for the year ending October 2023. This downswing in new consents is likely driven by the Reserve Bank's interest rate hikes. Combined with the very high level of net immigration New Zealand has experienced over the past year, and the new government's property-speculator-friendly policies, this fall in building consents will likely put upwards pressure on house prices.

Figure 23.: *New dwellings consented, 2007–23*



Source: Stats NZ

Real estate

As of November 2023, the REINZ house price index (HPI) was down 0.2% from the same time last year and 13.8% from its late-2021 peak. However, it is up an annual compound growth rate of 6.1% from the same time five years ago.

The national median house price for November 2023 was $790,000. This is down 2% annually and 14.6% from its late-2021 peak. Annually, median prices are down in every region of the country, except for Canterbury, which is up 5.3%.

However, all signs are that the housing market is heating back up. The monthly indicators show house prices lifting, and the housing index starting to climb northward again. This is likely being driven by the combination of record high inward migration, the sense that mortgage rates have topped out, and the return of a housing-speculator friendly government.

Table 3: *Median house prices, November 2023*

	Price	Monthly	Annually	From Peak
National	$790,000	0.1%	-2.0%	-14.6%
National excl. Auckland	$700,000	1.4%	-1.4%	-9.7%
Auckland	$1,052,000	0.7%	-0.8%	-19.1%
Wellington	$787,000	-0.4%	-1.1%	-21.3%

Source: REINZ