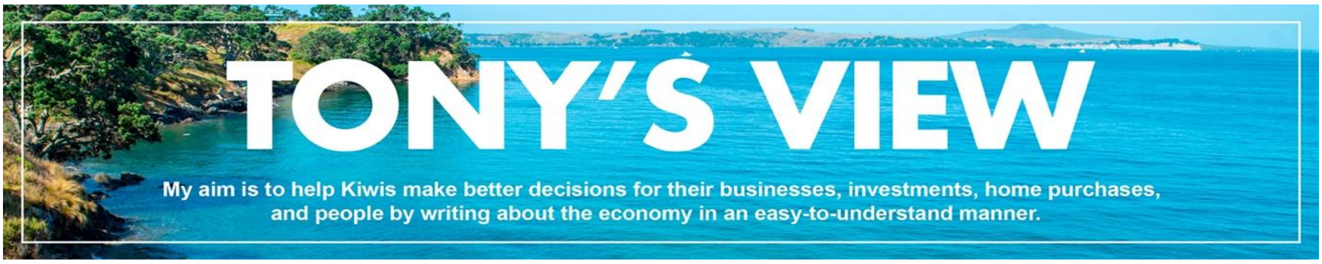

Input to your Strategy for Adapting to Challenges

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Crisis. But which one?

In the lives of all of us there are challenges. The same goes for businesses, sectors, and so on. Unfortunately, these days we have a tendency to catastrophise these things and describe our challenges as crises. Doing so may tend to reinforce a feeling of helplessness and can act against the development and implementation of sustainable long-term solutions in favour of short-term fixes to try and get out of the media or head-space headlines and deliver some wins.

This is possibly one of the many factors explaining the falling level (not rate of growth) of productivity in New Zealand. Other factors would include the growing size of the public sector, rising regulation, rising taxes etc. We could also add in the loss of skills offshore.

To illustrate the extent of the situation I like to once a year make a list of the things described in our common media as being in crisis. I do this by entering the term NZ crisis into Google search (not in quotation marks) and allocating a maximum search time of 20 minutes.

I ran this exercise last week while waiting for the Budget to be released at 2.00pm on Thursday and the search ran out after 11 minutes. It delivered 40 things described as being in crisis. By the definition of people directly affected I am sure the situation feels like a crisis.

But with so many things deemed as being in this state we tend to reinforce the feeling that New Zealand is fundamentally munted and on a daily basis provide more than enough reasons for our children to shift overseas. Increasingly, we are following them. But if you are in this camp, I invite you to run the same exercise for your country of choice and see what you get. That green grass you think you see may be just as lush under the shoes you are wearing.

Here are the crisis areas for this year's search in the order they appeared. Notable exclusions from earlier years include rugby referees and dogfood nutrition.

Freshwater
Sewage
Doctor shortage
Workforce in tourism and hospitality
Meth – largely in Northland
Long covid

Hospital vouchers
Marine
Health leadership
Health
Cost of living
Homelessness
Housing over-supply
Housing
Coffee cost
Infrastructure
Writers' residencies
Flooding
Energy/electricity
Productivity
GPs
Paediatric palliative care
Education
Wine industry
Funding of a running track in Hastings
Gisborne hospital
Social housing
Scams
Kaeo water
Aged care
Pacific housing
Emergency departments
Northland crime
NZ biodiversity
Truancy
Deportation
Mental health
Small businesses
ACC leadership
School lunches

The Budget in summary

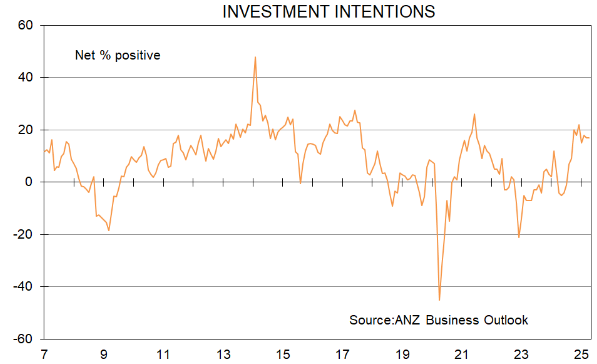
More money was provided largely for health, education, law and order, defence, and infrastructure. KiwiSaver was tweaked a bit towards a slow rise in the minimum contribution rate from 3% to 4%, removal of the government contribution subsidy for those earning over $180,000 a year, and halving of it for those below. But this halved amount of $260.72 a year was extended to 17 and 16 year olds.

Unfortunately no change was made to remove the ability of employers to pay their 3% contribution as extra salary. Experience has shown that what happens is the employer does boost one's salary by this amount, but then they claw it back in following years and end up with no extra expense while the employee is worse off.

The net result is reduced growth in savings in New Zealand and a bastardisation of the KiwiSaver potential.

Business growth has been given greater ability to rise via a 20% depreciation allowance for new capital expenditure in the first year, along with extra (really just redirected) money to attract foreign investment to NZ, plus hefty subsidies for film makers already announced.

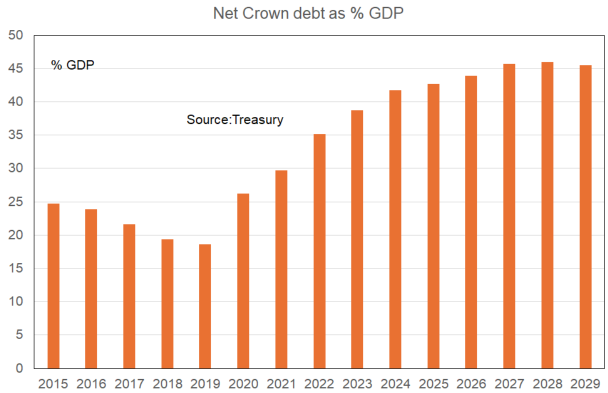
The timing seems good as businesses are firmly indicating they intend boosting their capital spending. In fact, in the ANZ's monthly Business Outlook Survey a net 17% of businesses say they plan raising capital spending in the coming 12 months. This is above the average of 11% and a strong reading by standards of the past couple of decades. But this means the net boost from the extra allowance will probably be quite small as the investment would have happened anyway. Based on the already high investment intentions reading, the 20% allowance isn't needed.



My interest **first** is in whether the policy changes have scope to boost growth in our economy and productivity. At the margin yes, but not to an extent anyone will notice in the near future. Therefore I won't be saying anything different about the economic outlook now compared with a week ago.

Second, do the policy announcements set the fiscal accounts on a more sustainable path? Yes, they do, but at a slow pace which reflects the government's unwillingness to implement true policies of austerity and derail what is so far a fairly mediocre economic upturn, as seen in my monthly survey results.

We are a long way down the track from the net debt to GDP ratio sitting below 20% (18.6% in 2018/19) and the current 43% is set to increase to 46% before easing come 2028/29. That is not fast enough to stop the economic recovery, but also not fast enough to dissuade the credit rating agencies from continuing to emphasise the vulnerability of our credit rating should a new shock come along.



The experience of the past few years suggests we should expect another shock. We just don't know what or when and because of that the scope for any true loosening of fiscal policy outside of whatever is made necessary by a shock looks like not being there in our country for at least the next decade – probably longer given the rising burden of an aging population and interest payments ($9.5bn this year) on the accumulated debt.

The chances of a credit rating downgrade once Labour get back in and increase spending again are high.

Third, is the economic outlook used by Treasury to underpin their fiscal projections realistic? Treasury see our economy growing 2.9% in the year to June 2026, 3.0% to June 2027, and 2.9% to June 2028. Those numbers feel too high considering what I am observing in my surveys as we head into the start of that period, the worrying developments offshore, and the risk that inflation comes in much higher than the 2% assumed by Treasury for each year going forward.

That 2% assumption looks like they don't have a model any longer for forecasting inflation and have reverted to simply assuming the band mid-point for want of anything else.

They see the 90-day bank bill yield at 3% mid-2026 which seems feasible, then 2.6% after that. I think those latter year levels are too low and projecting interest rates falling to the middle of 2027 seems much too long.

At least Treasury note that risks to their growth forecasts do lie on the downside. I concur. Note that their cutoff date for data used in generating their economic forecasts was April 7. Since then the news we have received on our economy has been mildly disappointing.

They see average NZ house prices rising 4% this calendar year, 6% over 2026, 6.4% over 2027, and 5.6% over 2028. Why not? No-one has a respectable record of house price prediction, and these numbers could easily prove accurate. They don't look unlikely.

Does the Budget represent a tightening of fiscal policy? We can answer this by looking at the Fiscal Impulse. This is a measure of the extra boost to growth provided by the government's actions. In the year to June 2024 the fiscal impulse was 1.3% of GDP, and to June 2025 just 0.5%.

In the year to June 2026 that will be 0.18% then -1.1% the year after and -1.3% to June 2028. Fiscal policy is tightening but the policies are not projected to actively drag the economy backwards until 2026/27.

Here is an aside. Go to this url https://www.treasury.govt.nz/publications/efu/budget-economic-and-fiscal-update-2025

Download the Excel table. Go to Table 2.15. It shows how much extra revenue the Crown gets if things change. For instance, a 1% lift in nominal GDP delivers extra revenue of $7.8bn. A 1% lift in wages and salaries boosts revenue by $3.8bn.

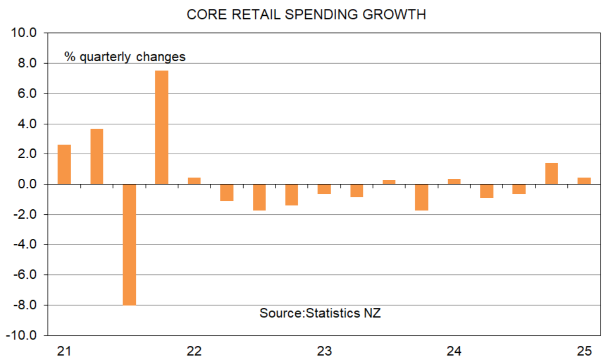
Four years ago a 1% boost to nominal GDP would have only delivered extra revenue of $1.3bn. Should inflation surprise on the upside, the Crown accounts will look quite healthy. This will be a concern for the Reserve Bank. The government is incentivised to encourage higher inflation.

Does this mean they will try to change the 1-3% inflation target? No chance. But I include this comment here so that when someone says to you that the government will want higher inflation to boost their tax receipts, this is where they will be getting their numbers from.

And why won't they pressure the RB or change the target? Because interest rates would immediately soar and the currency decline along with share prices.

Weak retail spending

On Friday Statistics NZ reported that during the March quarter retail spending after adjusting for seasonal factors and inflation grew by just 0.4% for the core measure. This excludes the often highly volatile components covering vehicles and fuel.



This 0.4% gain followed a 1.4% rise in the December quarter and declines of 0.6% and 0.9% in the September and June quarters. In those two

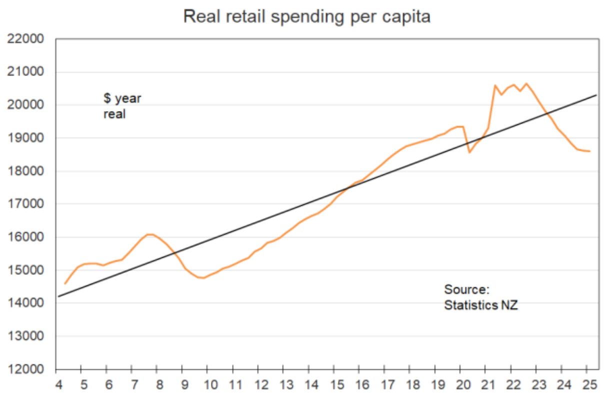
earlier quarters the economy shrank by 1.1% each time.

The graph above shows how there is an underlying improving trend for retail spending. But the 0.4% gain (1.6% annualised) is fairly weak.

This weakness is made more obvious when we look at spending on durable goods which we tend to buy more of when we are confident about our upcoming incomes and fewer of when we are worried. This spending measure weakened by 1.1% after rising over 2% in each of the previous two quarters.

What the data tell us is the same thing seen already in other indicators. The surge in optimism caused by the start of the monetary policy easing cycle from August produced a surge in spending which has now settled down to something positive bit weak.

This graph shows spending volumes per capita. We can clearly see the unsustained pandemic boom. Things recently have been well below trend. The implication is that a catch-up period of growth is increasingly due.



The question is when will this period of strong growth arrive? Not this year given the high level of job insecurity, weak and still easing net migration inflows, plus poor sentiment readings. Maybe 2026.

If I were a borrower, what would I do?

The main event of relevance to NZ wholesale interest rates this week was yesterday's review of the official cash rate by the Reserve Bank. They cut 0.25% as had been expected and, in their forecasts, implied scope for one more cut than indicated three months ago with a potential low-point of 2.75% rather than 3%.

Given the underlying inflationary pressures which I believe are still there in the economy I think a cut to 3% is likely but below that is not guaranteed. Still, there is massive uncertainty about how growth and inflation overseas and offshore will track in response to the United States's trade war and that means caution from our central bank.

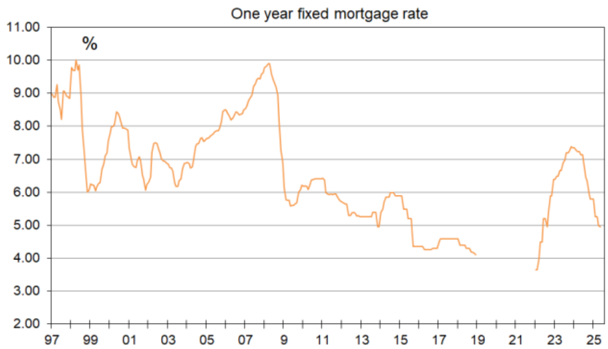
Under the previous RB regime that caution would have been a bias towards the downside for the cash rate. But under current leadership that caution is likely to manifest itself in a more professional manner with less whipping around of the cash rate.

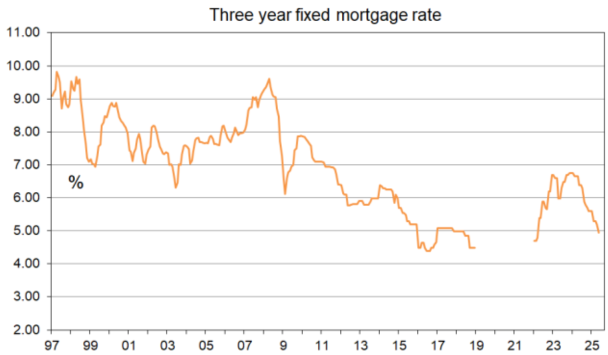
Banks have responded to the cash rate cut by reducing their floating mortgage rates 0.2% or 0.25%. One bank is now offering a three year fixed rate of 4.95%. That would be good enough for me if I were borrowing at the moment.

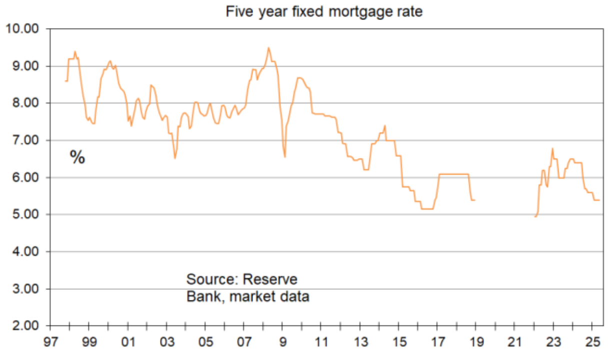
Could that rate go below 4.95%? Maybe. Competition between banks in the form of rate discounting has so far been fairly mild this cycle. But I'd expect any reductions below 4.95% to be fairly minor and because of that would personally lock the rate in for three years and get on with worrying about other aspects of my finances and life.

What will most people do? Probably keep fixing 1-2 years because the time horisons of borrowers here are very, very short.

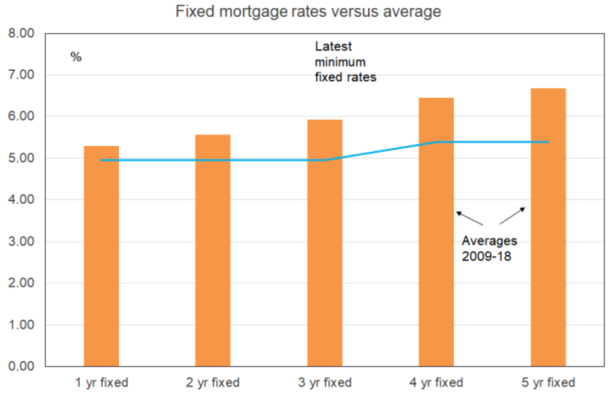
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.







This graph shows how current rates compare with averages from 2009-19.



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

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