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A stormy forecast
New Zealand economic outlook

Deloitte Access Economics review

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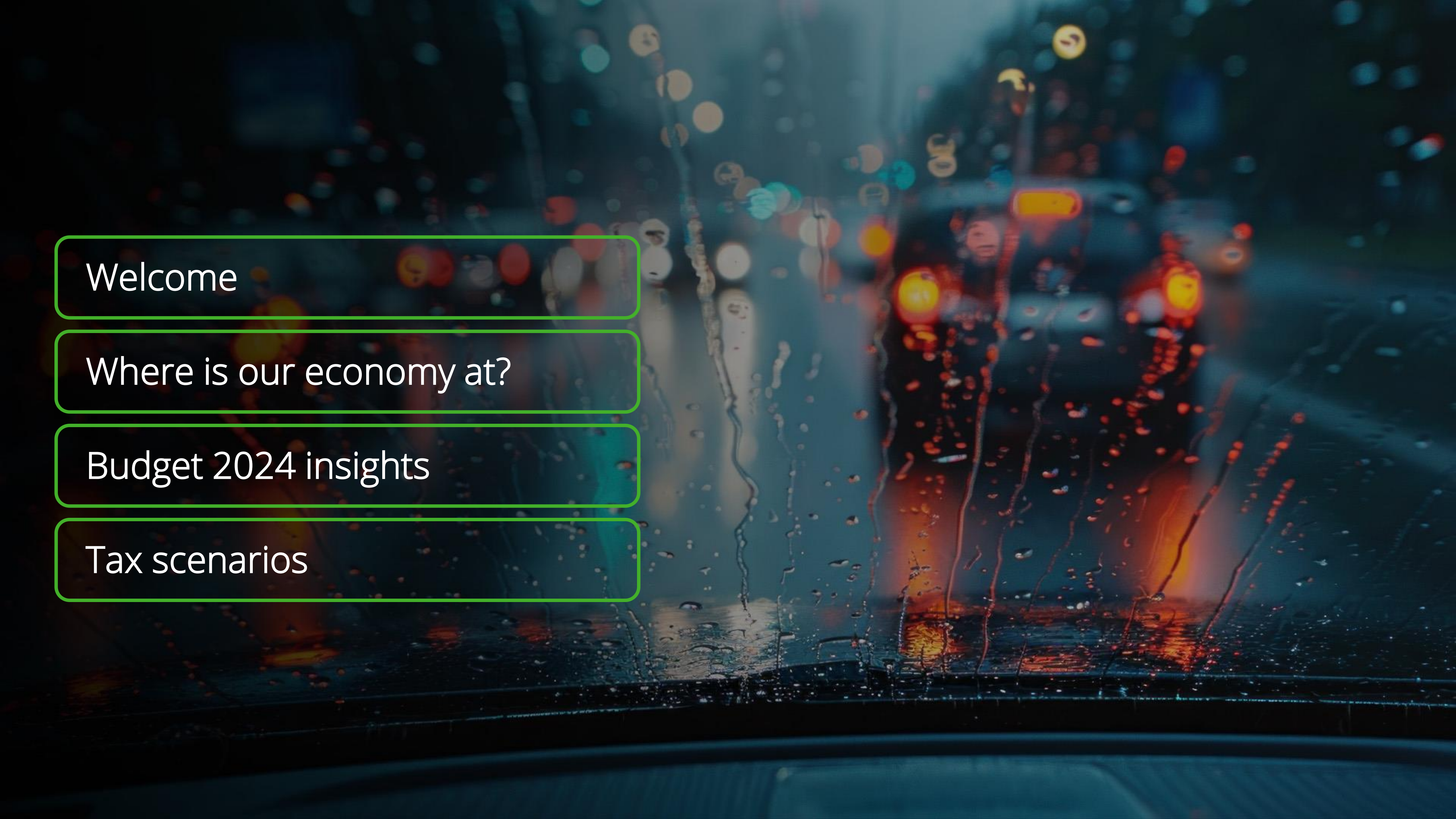


- Welcome
- Where is our economy at?
- Budget 2024 insights
- Tax scenarios

It’s not all bad news

Although the current outlook is not overly bright, historically the New Zealand economy has proven to be relatively resilient through economic shocks

The New Zealand economy is relatively resilient, pre-covid (1991-2018) we only experienced 3 shallow recessions. Key reasons for resiliency include:

- Economic shocks centred largely on the US and Europe, which New Zealand has less exposure to
- Strong local monetary and fiscal policy responses to global shocks
- A relatively diversified economy, focused on agriculture, meaning good exposure to a growing Chinese economy and other emerging markets, compared to a ‘typical’ advanced economy
- Strong population growth, driven by net overseas migration

What does this mean going forward?

- Location of potential economic shocks are important.
- Benefits from further population growth likely to be limited.
- Growth will be centred on transition towards clean energy sources, transition to net zero and emerging technology.
- Continue doing what New Zealand has done previously.

Where is our economy at?

Upside for the New Zealand economy

- ✓ Net migration is boosting GDP and easing labour market constraints
- ✓ Inflationary pressures appear to be subsiding
- ✓ We are likely at the peak of the monetary tightening cycle
- ✓ The agriculture is recovering off the back of improving milk prices and a relatively better global outlook
- ✓ Tourism has rebounded to 90% of pre-Covid levels

Downside for the New Zealand economy

- ✗ Cost of living has hit hard, and consumer spending growth is declining
- ✗ Any further interest rate hikes could bring a “hard-landing” scenario back into play
- ✗ The persistent risk of future extreme weather-related events and natural disasters
- ✗ The slow transmission of monetary policy means even if cuts are signalled soon, the economic impacts will be delayed
- ✗ Geopolitical tensions and slow global economic growth remain a key risk to New Zealand

Potential geopolitical risks and global uncertainties that could shift the economic outlook

China's economic downturn worsens

Economic impact:

- **Weaker exports**
- **Slower growth**

Conflict escalates in the Middle East

Economic impact:

- **Supply chain disruption**
- **Higher inflation**
- **Higher interest rates**

Tensions escalate between China and Taiwan

Economic impact:

- **Supply chain disruption**
- **Trade fragmentation**
- **Higher inflation**

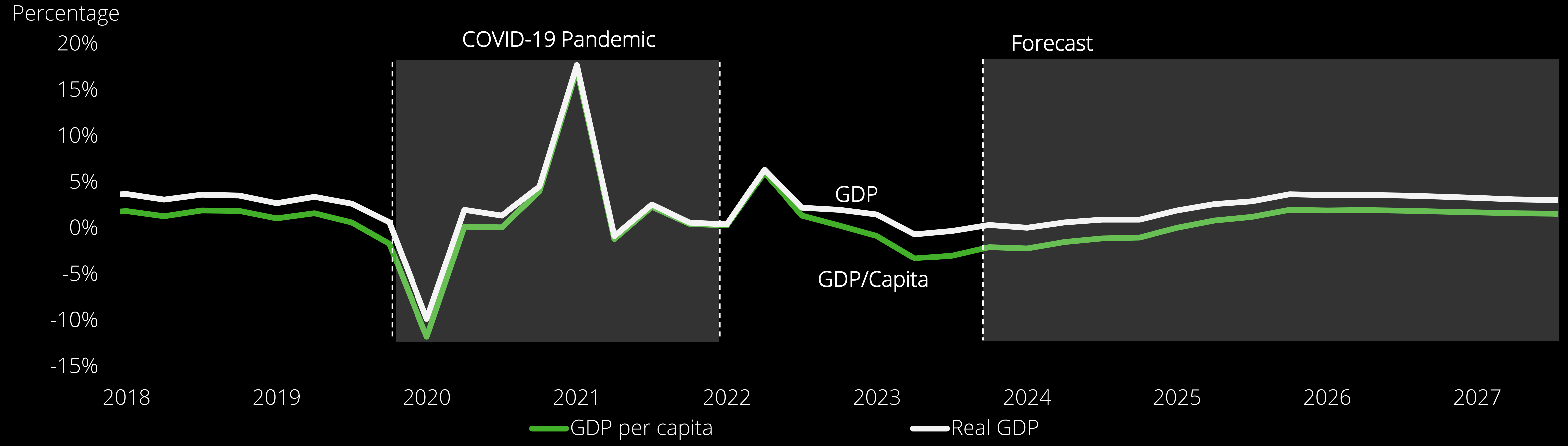
Russian victory in Ukraine

Economic impact: (limited)

- **Higher inflation**
- **Higher interest rates**

Underlying a small headline technical recession is a prolonged contraction in per capita terms

Real GDP and Real GDP per Capita growth (Year-to growth rates, 1988 to 2027)



Source: StatsNZ, Deloitte Access Economics as at May 2024.

- On a per capita basis, the economy is expected to continue contracting, with a recovery trailing that of headline GDP.
- While consumption and investment have remained strong through much of Covid, these are now finally subsiding due to the high interest rate environment.
- While exports rebounded in the year to December 2023, business economic activity and household spending have softened.

Recent growth across sectors reflects some material differences relative 2019

GDP annual growth, 2023 vs 2019 (December year end)

Construction growth was flat at -0.1% in the year-to December 2023, compared to growth of 8.6% pre-Covid.

Visitor arrivals have rebounded since COVID, with 3.1 million arrivals in the year-to March 2024. However, this remains below pre-COVID levels of 3.9 million in the year-to January 2020.

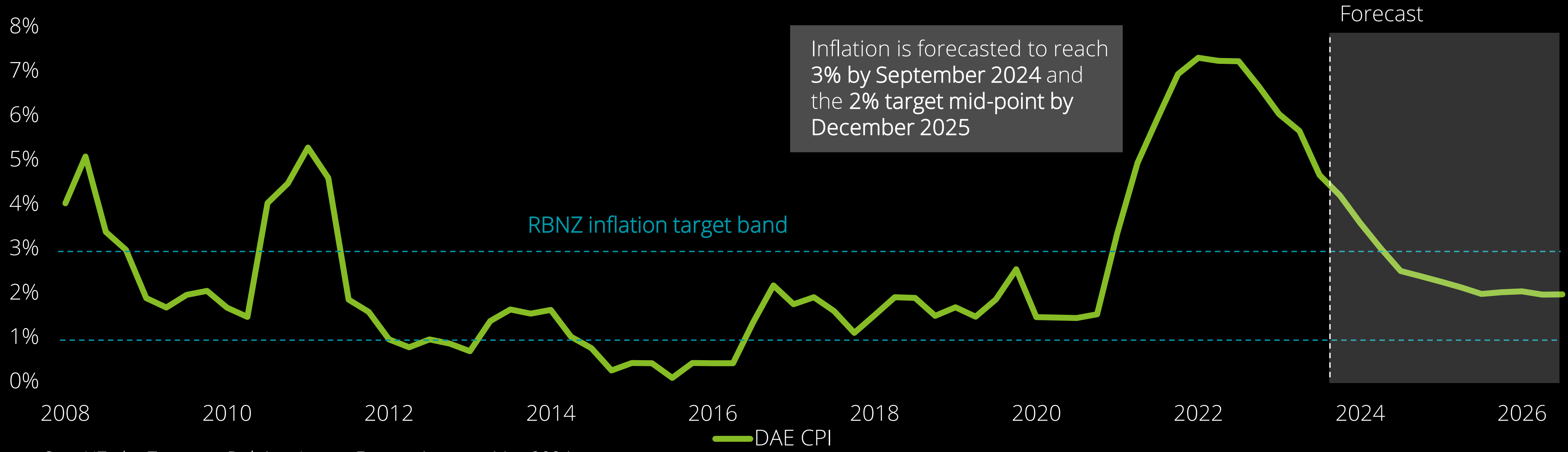
Source: StatsNZ, Deloitte Access Economics

Inflation started to ease in the latter half of 2023

However, uncertainty in the outlook remains, as domestic inflation remains sticky

Consumer price index (2008 to 2027)

Not seasonally adjusted (annual percentage change)



Source: StatsNZ, the Treasury, Deloitte Access Economics as at May 2024

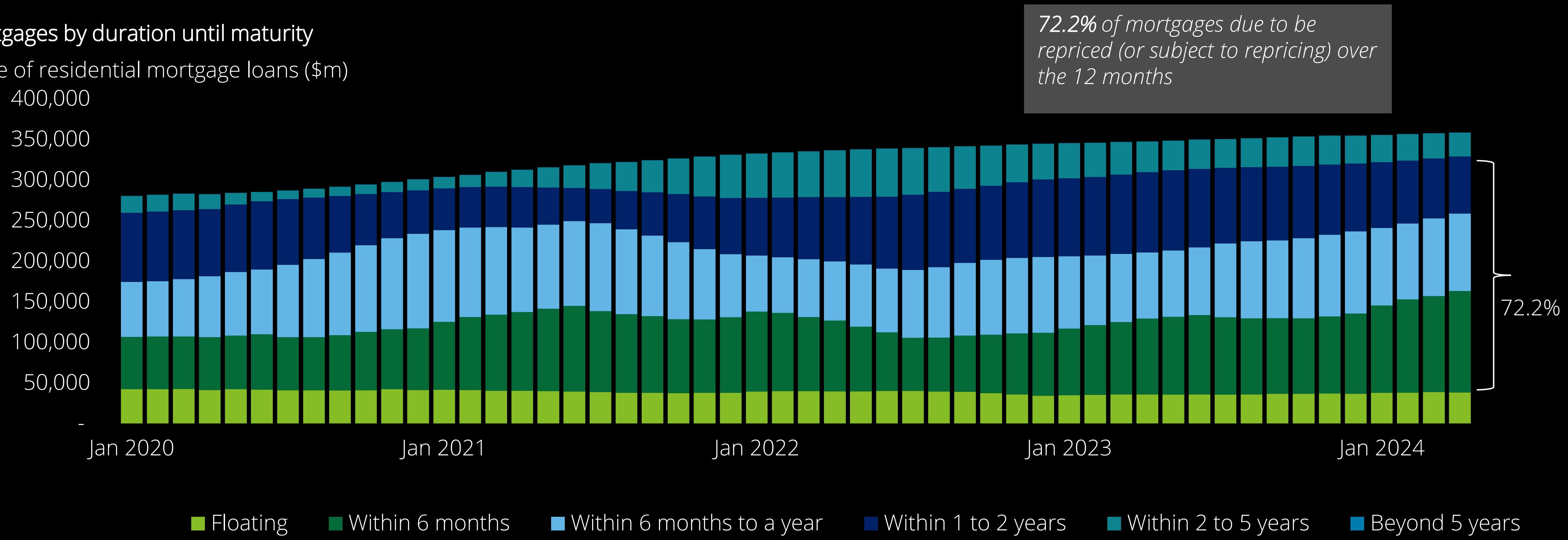
- Inflation appears to be slowly falling, with consumer prices rising 4.0% in the year-to March 2024, down from the 7.3% peak in the year-to June 2022. However, non-tradeable inflation was at 5.8% in the year-to-March 2024, well above the headline rate.
- We expect inflation to continue tracking downwards as domestic capacity pressures continue to ease. Inflation is forecast to fall within the RBNZ's target in late 2024.
- Oil policy changes in the US have taken effect leading to falling global oil prices. We expect this to have a disinflationary impact in New Zealand as tradable inflation falls with the potential of becoming negative. However, sticky non-tradeable inflation suggests a slow return to the RBNZ target band.

But the interest rate pain will continue to be felt

The full impact of current monetary policy settings on households is still ramping up, painting a tough outlook for households and consumers in 2024

Mortgages by duration until maturity

Value of residential mortgage loans ($m)



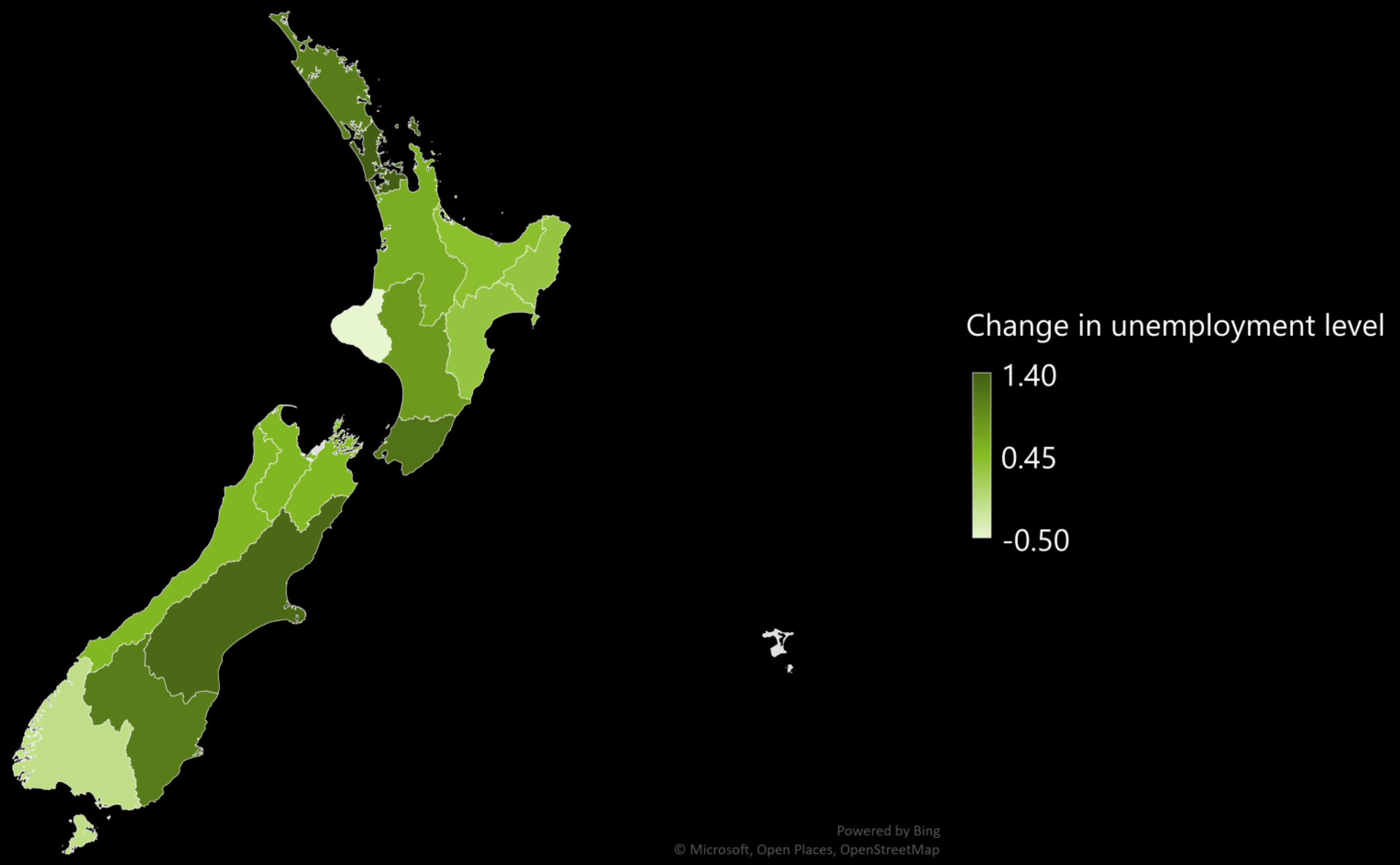
Source: RBNZ

- 72.2% of mortgages will be subject to repricing over the next 12 months
- This is due to households who fixed at low rates during 2020/2021 coming up for refixing and households refixing for shorter durations more recently

Unemployment is hitting some regions harder than others

The impact of job cuts is most prominent in the most populated regions including Auckland, Wellington, and Canterbury and is likely to worsen as the public service job cuts are actioned.

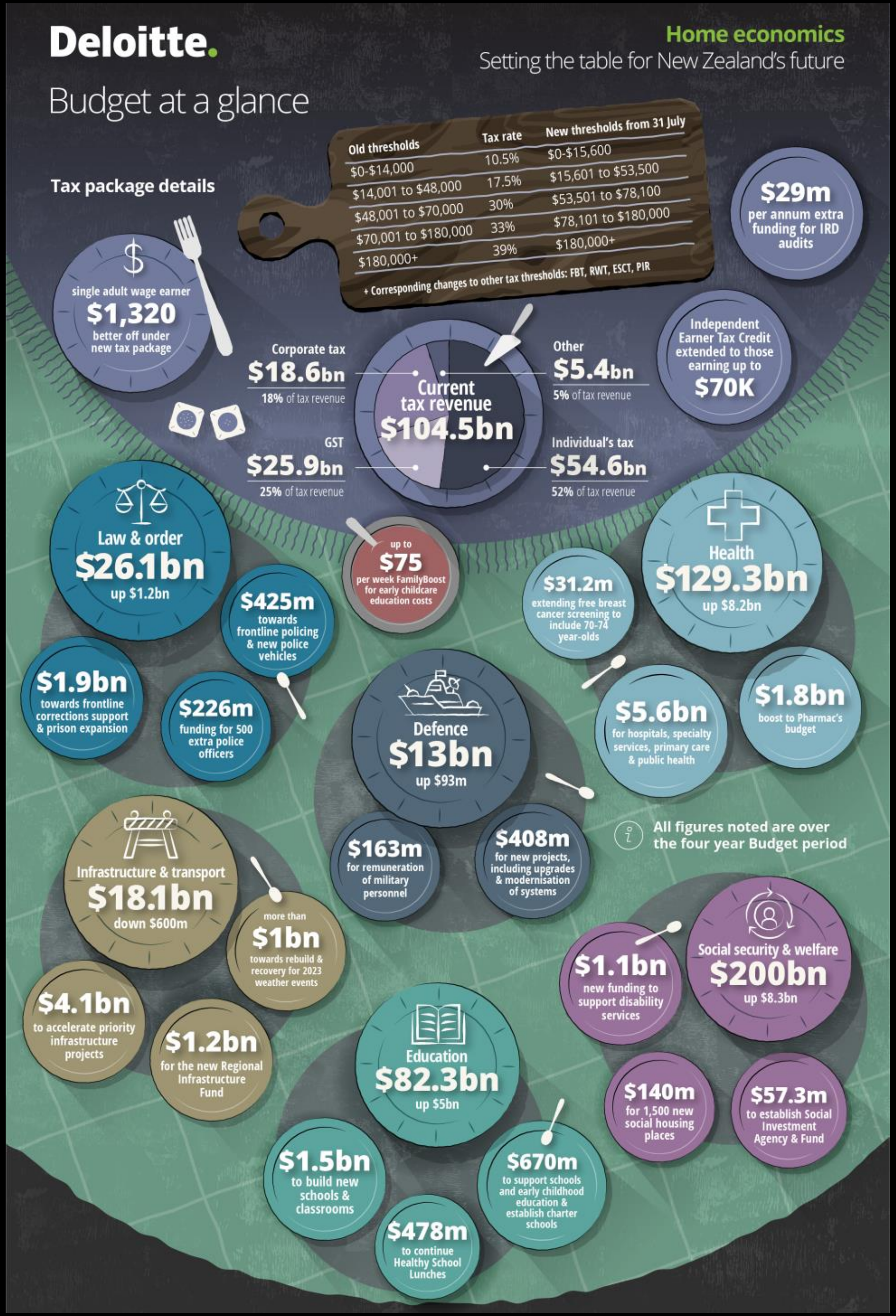
Change in unemployment rate by region (March 2023 versus March 2024)



Source: StatsNZ, Deloitte Access Economics

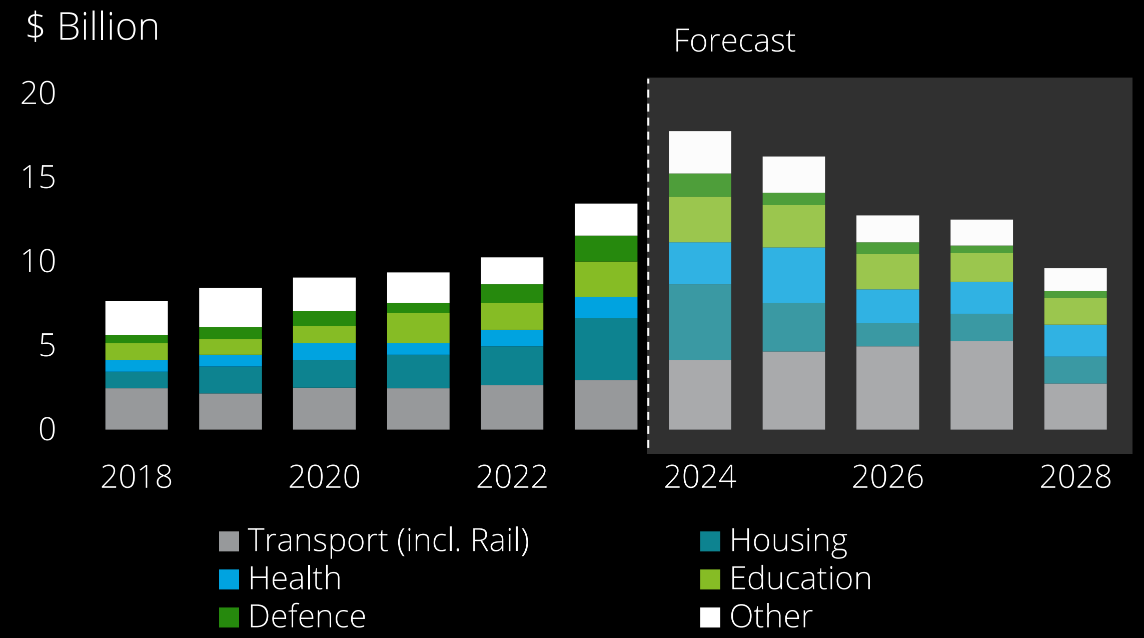
Budget 2024 at a glance

- The Budget is centred on providing **cost-of-living relief** and **some investment with an eye on the future**.
- The **tax relief** outlined in the budget will be welcomed by households and businesses.
- Whether the tax relief will have a material **impact inflation depends** on the **timing of relief versus expenditure cuts** and **how much of the tax relief is spent**, and **on what**.
- A focus of the Budget is on spending to address some of the, **country's long-term infrastructure needs**.
- There is a need for **additional borrowing**, raising the possibility of a problem brewing in the background.



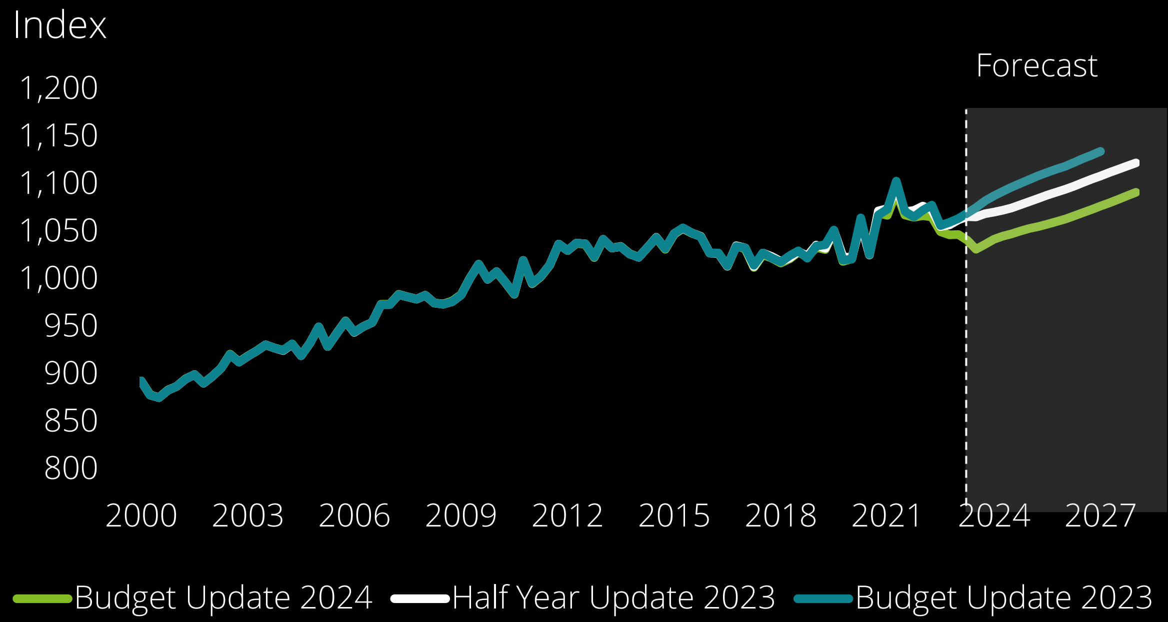
Interesting features of Budget 2024

Treasury annual Government spending by type



Source: The Treasury

Quarterly Labour Productivity (GDP per hour worked)



Source: Stats NZ, the Treasury

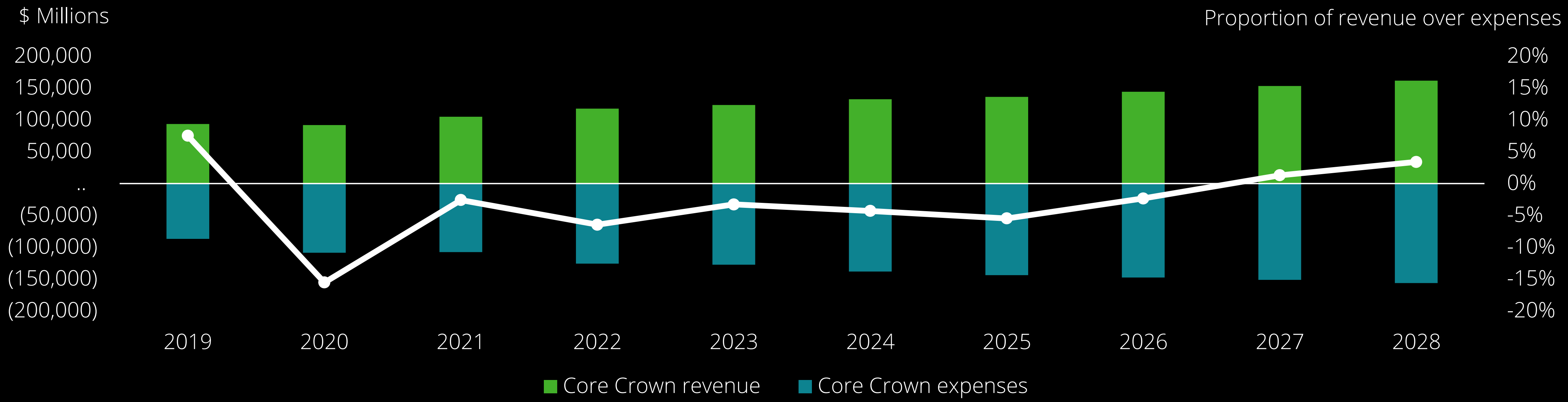
- The governments in Transport Housing, Health, Education and Defence is substantially higher than in previous years. This is at odds with some perceptions that the budget is a low spending one.

- New Zealand's productivity and innovation levels are low compared to similar economics and Budget 2024 shows a further drop in productivity compared to last year's budget.
- Budget 2024 had no initiative for further investment in this space..... More needs to be done in this space to unlock the next stage of New Zealand's economic success.

How are we going to address the gap in Government spending and revenue?

The government last posted a surplus in 2019 and is not expected to return until 2027

Budget 2024 Core Crown revenue vs Core Crown expenses (Millions)

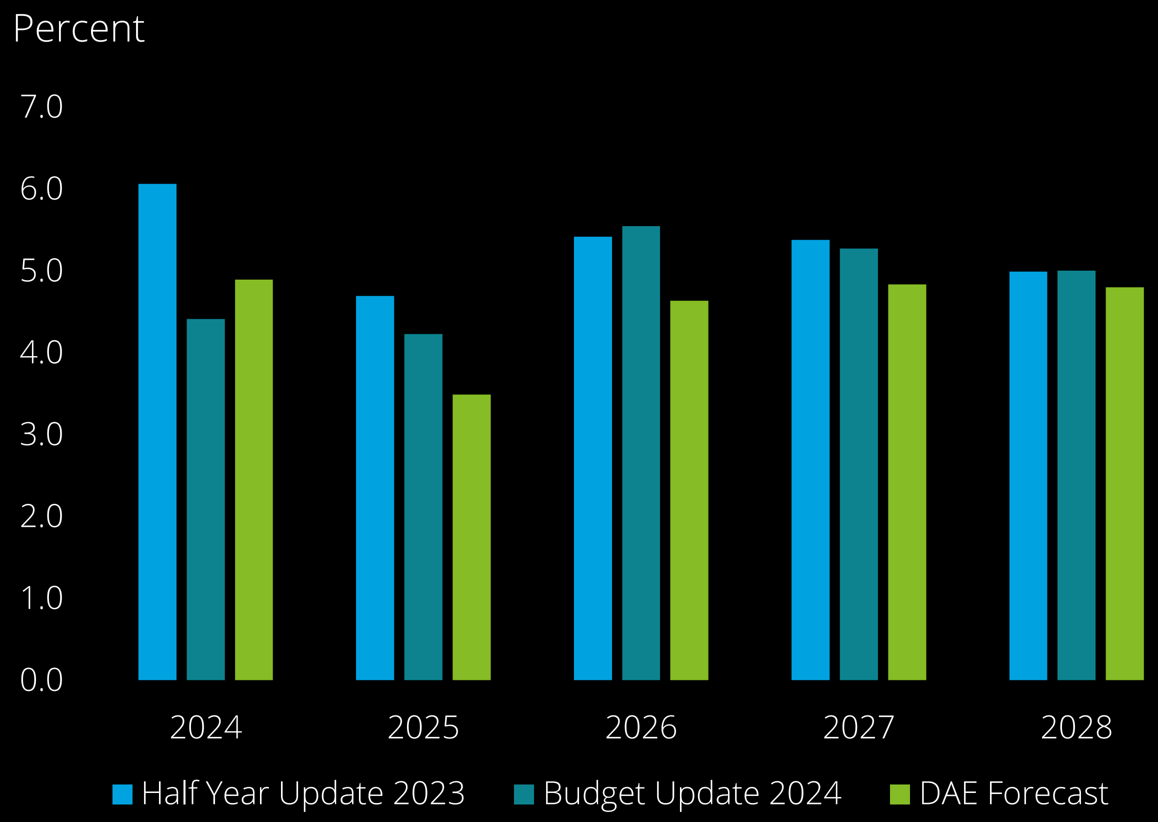


- The budget deficit is expected to grow in 2025, reflecting Budget 2024 is not necessarily a lower spending budget, at least initially.
- A return to surplus is not expected until 2028, reflecting the weak economic outlook.
- Given the challenging outlook for the economy and the need to balance the governments books, what additional tax levers can we look to pull?

Forecasts suggest weak nominal GDP growth

Lower nominal GDP implies a lower tax take making the task of returning to a surplus more challenging

Forecasted nominal expenditure GDP growth (Year ending June growth rates, 2024 to 2028)



Source: The Treasury, Deloitte Access Economics

- The Treasury has substantially revised the level of nominal expenditure GDP growth downwards for 2024 and 2025.
- The downwards revision explains, in large part, why the return to surplus is expected to be a year later in 2027/2028.
- DAE's forecasts for nominal GDP growth are more pessimistic than budget 2024. Our forecast suggests that it will be a more difficult task to balance the nations books and return net positive by 27/28 due to lower tax revenue.

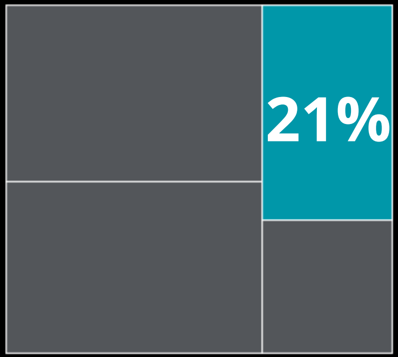
In the long term the New Zealand population is expected to continue aging

This is something we need to prepare for:

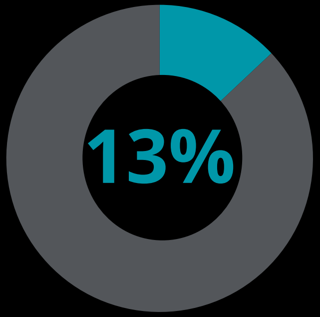
2010

Those between **15-39** made up **34%** of the population

40-64 Made up **33%** of the population



of the population was
Under 15

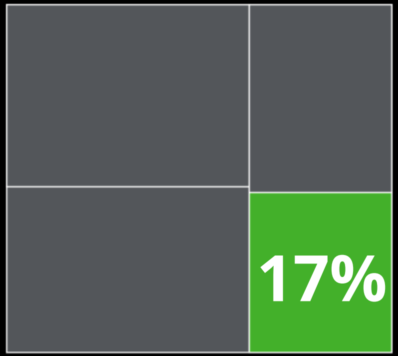


of the population was
65 and over

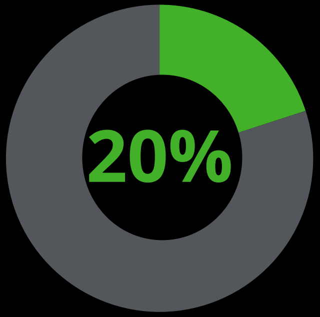
DAE Forecast 2035

Those between **15-39** are expected to make up **33%** of the population

40-64 are forecasted to be **30%** of the population



of the population is expected to be
Under 15



of the population is forecasted to be
65 and over

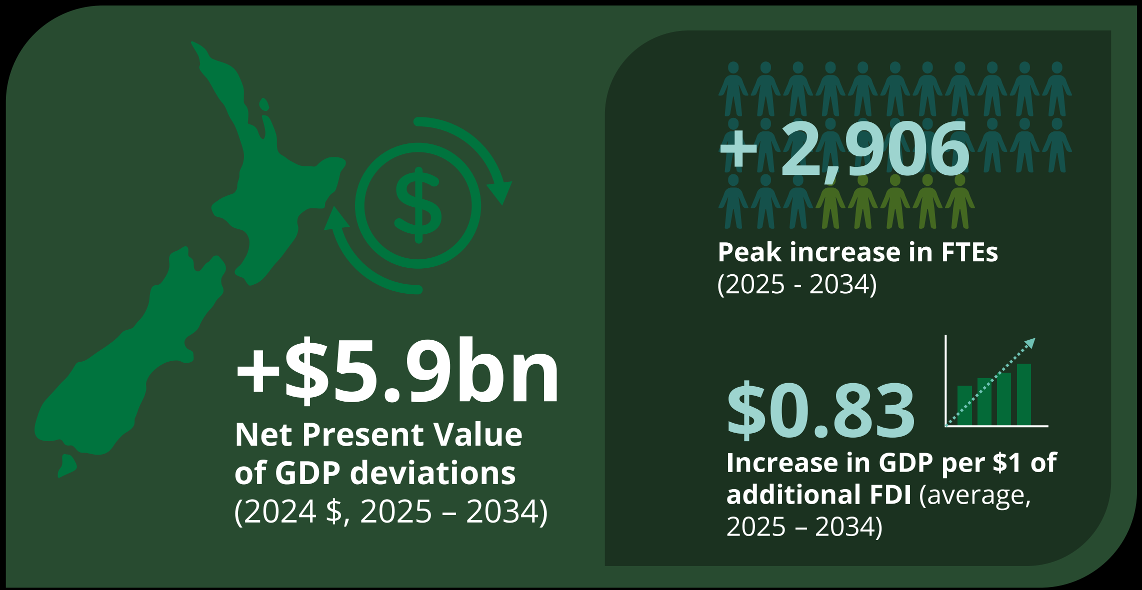
Scenario 1: Increase in foreign direct investment

An additional $1 billion of FDI per year over the next 10 years would on average lead to an additional $0.8 billion of GDP per year

Scenario: New Zealand attracts additional FDI of $1b per year (equivalent to 10% of inward FDI in 2022)

- Attracting foreign investment can help ‘grow the tax pie’ – potentially contributing to future PAYE, GST and Income tax take.
- An additional $1 billion of FDI per year could unlock $6 billion in GDP over the next 10-years.
- However, our results are conservative, not capturing the extent to which this would incentivise further domestic investment, and productivity benefits which often come with foreign capital injections.

Modelled economic impact



Results are indicative and should be treated as ‘what if?’ scenarios rather than forecasts. NPV is calculated at a 5% discount rate over a 10-year period.

Source: Deloitte Access Economics

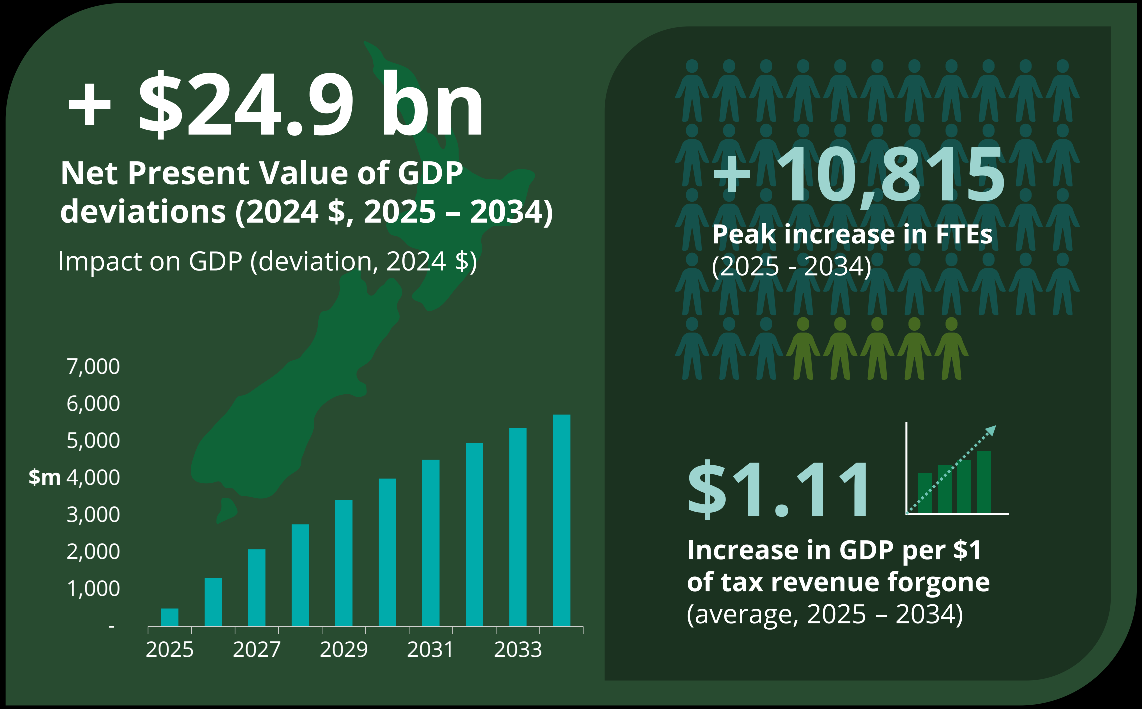
Scenario 2: Reduction in corporate taxes

A reduction in the corporate tax rate could deliver just over an extra $1 of GDP for every $1 of tax revenue forgone

Scenario: New Zealand's corporate tax rate falls 3% from 28% to 25%

- We modelled the economic impact of a lower tax corporate tax from 2025 to 2034, **working to reduce the cost of accessing capital for New Zealand businesses**.
- Our modelling suggests this may **boost economic activity and employment**, both driven by a **substantial increase in investment** – averaging **$10 billion** per year.

Modelled economic impact



Results are indicative and should be treated as 'what if?' scenarios rather than forecasts. NPV is calculated at a 5% discount rate over a 10-year period.

Source: Deloitte Access Economics

Scenario 3: Increase in GST

Tweaking GST settings may be a simple solution to raise revenue, but comes with an economic costs and would not hit households equally

Scenario: New Zealand's GST rate increases 2% from 15% to 17%

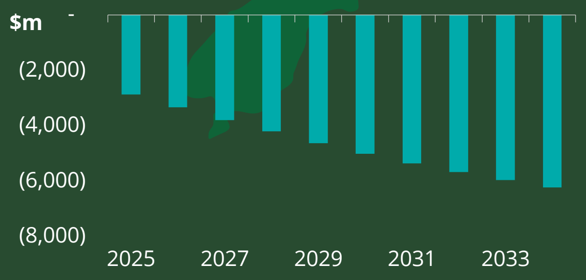
- **Tough decisions lay on the horizon** – and one potential option is tweaking GST settings to raise additional revenue.
- **Similar to high interest rates, a higher GST would dampen demand in the economy**, potentially reducing domestic inflationary pressures – but with a clear economic trade-off.
- However, this would be a blunt solution as GST is a regressive tax – meaning **increases hit lower-income households proportionately harder**, who may be less able to reduce consumption.

Modelled economic impact

- $35.3 bn

Net Present Value of GDP deviations (2024 $, 2025 – 2034)

Impact on GDP (deviation, 2024 $)



- 26,316

Peak decrease in FTEs
(2025 - 2034)

$0.80

Decrease in GDP per $1 of additional tax revenue
(average, 2025 – 2034)

Results are indicative and should be treated as 'what if?' scenarios rather than forecasts. NPV is calculated at a 5% discount rate over a 10-year period.

Source: Deloitte Access Economics


Thank you!
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