Te Waka
Anga Whakamua Waikato

Waikato Economic Radar

October-December 2021

We are writing this summary on Valentine's Day, as the gift that is Omicron really starts to show its bite. It is no longer just a covid story. We have largely dodged the health bullet to date. But the reality of Omicron, and rapidly accelerating exposures, close contacts, and impact on businesses ability to keep their doors open is now palpable.

The primary data contained in this Radar is Q4 2021, with some additions from more recent data or from anecdotal evidence. Whilst the data tells a story, our view is that the numbers are not really yet telling the real story of what is approaching quickly around the corner. Omicron is changing behaviour, and things are evolving rapidly.

Despite early projections of doom and gloom, the New Zealand economy enjoyed a massive tail wind through 2020 and 2021, with metrics far beyond most commentators' forecasts. Now we are dealing with the reality associated with rising Omicron cases over the coming weeks, the enduring impact of Covid, the inflationary consequences of the massive tailwind provided by the Reserve Bank and Government, and a capacity constrained economy that in the words of the OECD is showing signs of "overheating". These present challenges in the near-term, medium term and long-term.

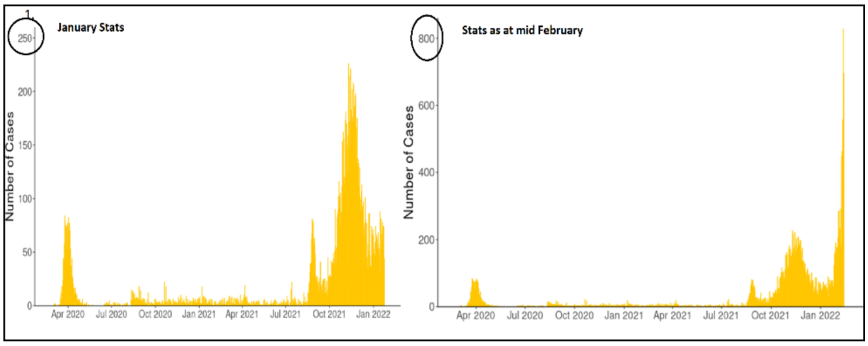
Containing inflation will not be growth or asset price friendly.

Yesterday's Stats NZ release suggests that the CPI is still accelerating, with rents rising in line with expectations, but food prices well ahead of what commentators were expecting. The market view seems to be that CPI inflation still has momentum, and that Omicron could easily add to that in the near term, with ANZ commenting today that 'despite slowing housing and risks to the activity outlook, the inflation impulse provides plenty of reason for the RBNZ to stay the course with OCR hikes' – bringing further pressures to businesses and households alike.

Inflation does have some positives. Witness high commodity prices and a booming dairy pay-out.

A few key things we are watching:

1. **The pace of change - t**he chart below left shows the number of new Covid cases towards the end of January (included in this Radar) vs. the chart below right which is where we are at now (noting the top of the y-axis is more than 3-times higher than just a couple of weeks ago).



We all knew this was coming, the question is whether we (both government and businesses) are able to adapt to the implications. The jury is out for deliberation.

2. **Headline inflation** - is at its highest level since mid-1990 in the period following the increase in GST from 10-12.5% in 1989, and even stronger than when GST was raised in 2011. Housing and petrol are driving a lot of the movement, but inflation pressures risk becoming more entrenched. Ongoing supply chain disruptions and geo-political tensions in Europe won't help this already inflamed situation. This, combined with a tight labour market can be expected to lead to further accelerating pressure on wage bills.

   Some inflation is beyond our control, and we must wait for Covid to subside and supply chains to be fully reconnected. But domestic inflation is rampant and what we must watch are the housing and construction industries as those sectors are key pro-cyclical parts of the economy, and it's unlikely that New Zealand will get domestic inflation down without these sectors showing easing momentum. The same goes for lending growth – inflation will not ease if people are borrowing at a faster rate than incomes.

3. **Monetary response and its impact** - rising inflation will require a monetary policy response from the RBNZ. This suggests we can expect interest rates to be heading up over the course of 2022, with consequences for highly leveraged individuals and businesses. This presents an interesting dilemma for setting policy, with the risk that Covid-related constraints bring things to a sudden halt, but with an inflation overhang leading to monetary policy lagging the real economy. Once again, containing inflation is not growth friendly. Awkward choices reside ahead if inflation is to be suppressed.

4. **Other distractions** – add to that upcoming local government elections, three waters and healthcare reform… It's hard to have confidence that we can be on top of it all at a time which likely represents the most volatile period in a generation.

That's a sobering assessment but is our view on what the data and anecdotal evidence is suggesting. But the market is shifting rapidly, and there is still a myriad of different views across the market. That said, there are many positives that can be taken out of a shifting environment. Top of mind is the potential for change, innovation, and blue-sky thinking. Ultimately it will be the business sector that moves us beyond this Covid mess in conjunction with the government. The status quo doesn't seem to cut it in a world of rapid change and disruption, of which Covid is only one disruptor.

This report and analysis have been prepared with support from and in collaboration with Blair Keenan, Principal Economist, Waikato Regional Council. We also thank our Board member and Bagrie Economics Director, Cameron Bagrie, for his valuable insights.

Ngā mihi,

Hamish Bell | Chair

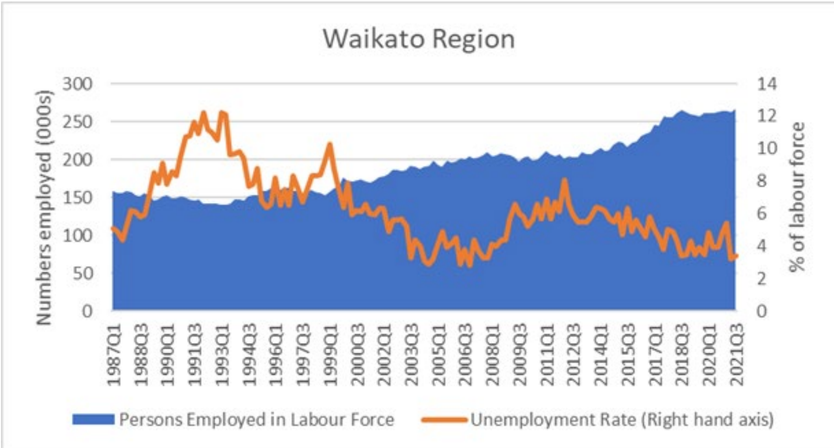
Review Of Recent Data

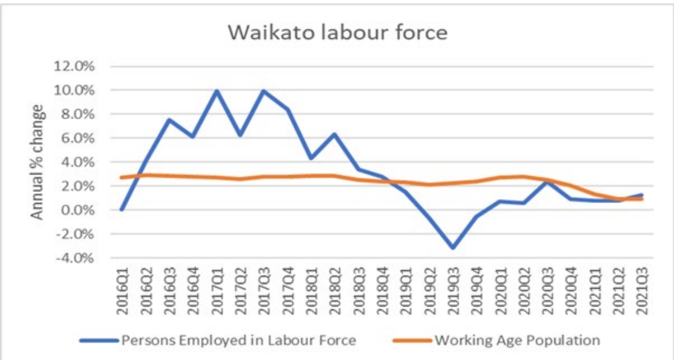
Consumer Spending

The recovery in retail sales went into reverse in the third quarter of 2021 falling by 3.3 percent compared to the previous quarter. This was only half the 6.6 percent quarterly fall New Zealand-wide, although those national figures were heavily influenced by Auckland, where lockdowns were stricter. Total sales in the Waikato region were almost the same as a year earlier (up 0.5 percent on the third quarter of 2020).

Labour Market

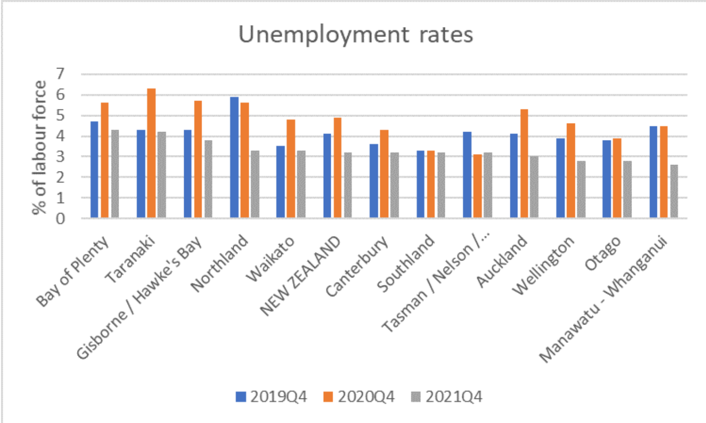
The unemployment rate in the Waikato Region rose slightly, from 3.2 percent to 3.4 percent in the September quarter of 2021. After falling in 2019 (pre-Covid), employment has been slowly but steadily rising through 2020 and 2021. In the year to September 2021, the number of people employed in the region increased by 1.2 percent.





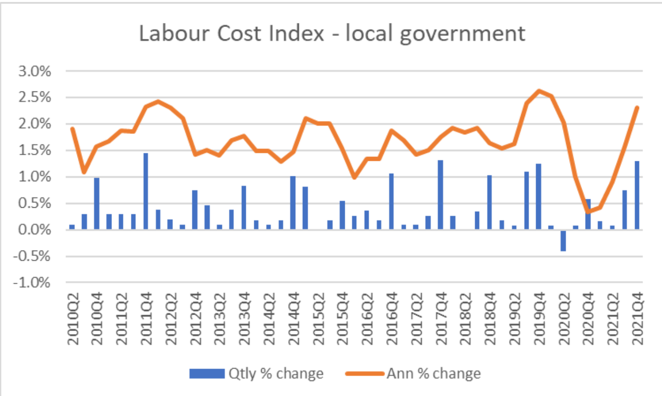
While employment has been growing, the September 2021 quarter is the first time that it has increased faster than the working age population since 2018. The reason why the additional population has not led to much higher unemployment is that they are not actively looking and ready for work (the labour force participation rate has fallen).

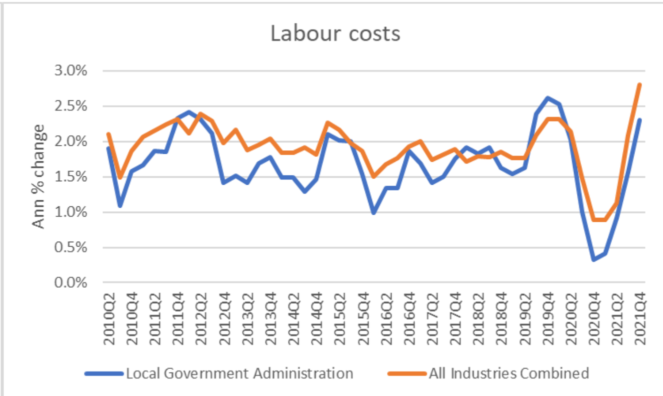
The unemployment rate in the Waikato Region, at 3.3% percent is in the middle of the pack. While there has been some volatility from quarter to quarter and from region to region, the unemployment rate across New Zealand remains remarkably low from a historical perspective – especially given the turmoil of the last two years.



After spiking in late 2020 and early 2021, the youth NEET rate (ie the proportion of 15-24 year olds not in employment, education or training) returned to around pre-Covid levels in the second quarter of 2021 and has remained relatively stable since. The NEET rate for the younger (15-19 year old) cohort, at 12.2 percent is higher than the recent average ((10.4 percent over the last five years). In contrast, the NEET rate for 20-24 year olds, at 12.7 percent is below the five year average of 13.2 percent.

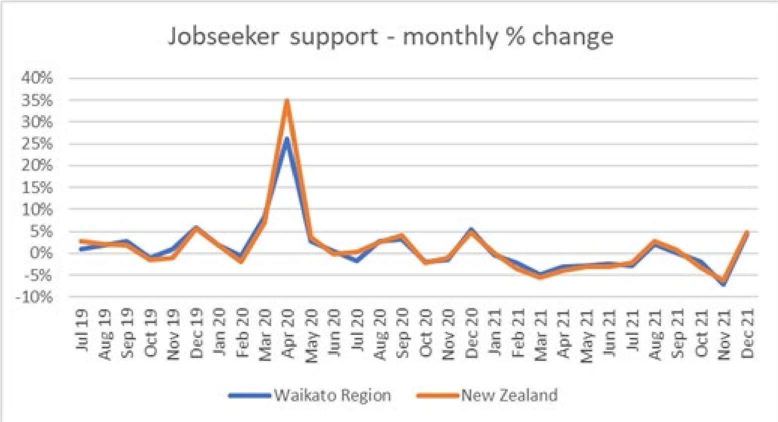
After slowing sharply in 2020, the labour cost index (LCI) has accelerated sharply through 2021. The LCI controls for the quality and type of job, so is a useful indicator of cost pressures faced by employers. The LCI for local government has followed a similar pattern to the overall index, but experienced a deeper slowdown in 2020, and a less rapid increase in 2021.



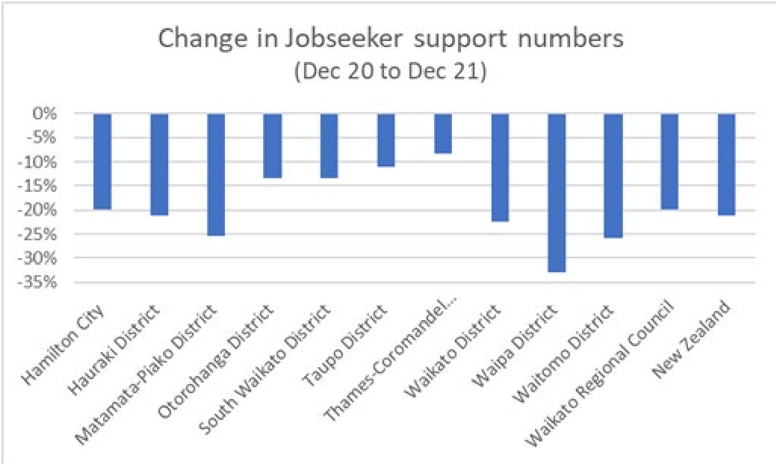


Support

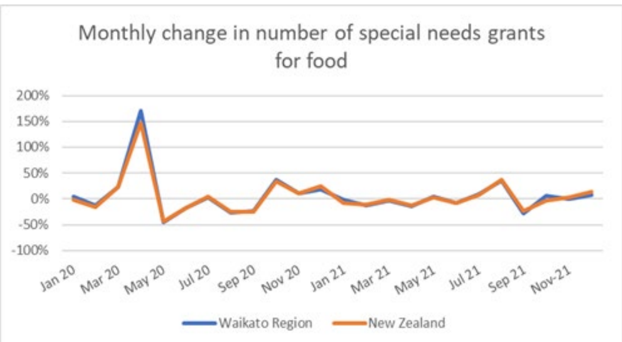
From September to November the number of work-ready people on Jobseeker support in the region rose again in December, rising by four percent in the last month of 2021. Despite the late uptick, the number on Jobseeker support in the region is 20 percent lower than it was at the end of 2020.

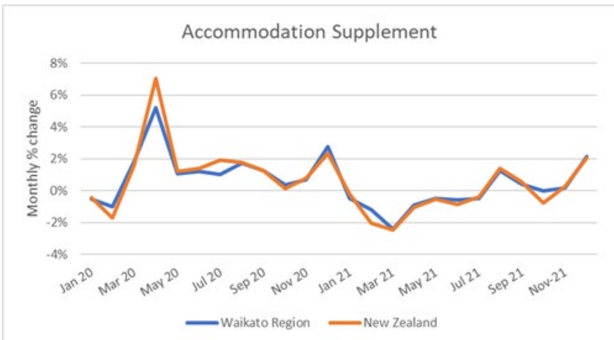


The decline in the numbers on Jobseeker support was seen in all districts of the region. The decline was smaller in Thames-Coromandel and Taupō districts – possibly reflecting the importance of the troubled tourism sector in those districts. The Waipā, Waitomo and Matamata-Piako districts all had decreases in jobseeker support numbers of 25 percent or more.



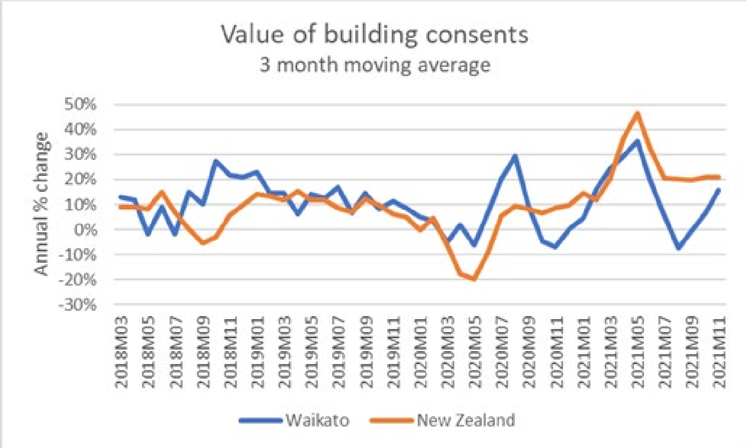
Demand for both special needs grants for food and the accommodation supplement also rose in December, by 8 percent and 2 percent respectively. Nevertheless, both were also lower than at the end of 2020 – food grants down by 18 percent and Accommodation Supplement by 3 percent. These changes are broadly in line with national trends.



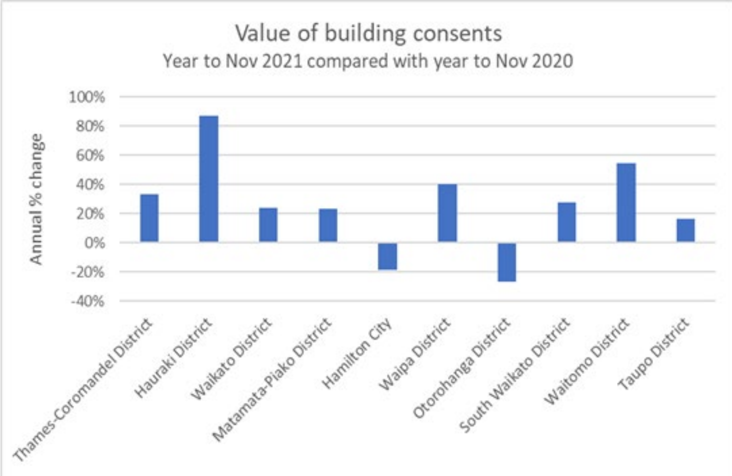


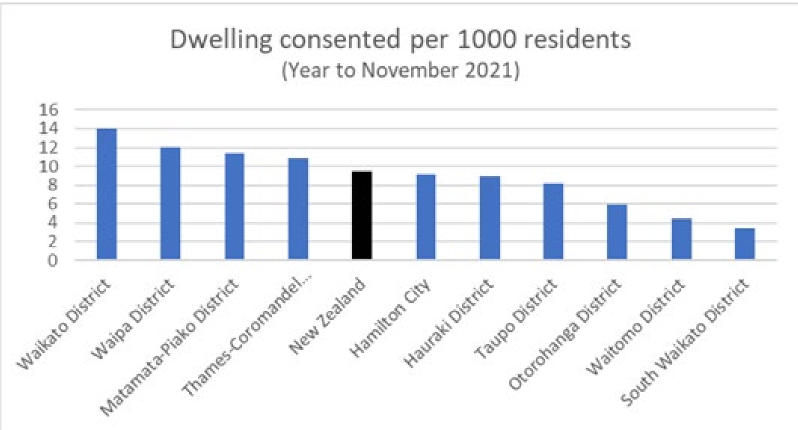
Building Consents

The value of building consents in the Waikato Region bounced back towards the end of 2021 after a brief hiatus in the middle of the year. The overall pattern since the first lockdowns in early 2020 has been for large surges in consent values, followed by slight dips. In contrast, the annual increase for New Zealand has consistently exceeded 10 percent since the end of 2020, and has not been negative since mid-2020 when the first long level four lockdown had been in place.



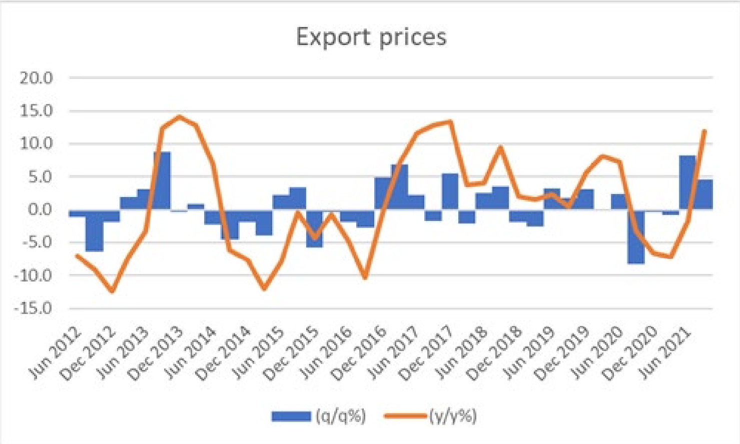
The boom in building consents continues in the Hauraki District, up 87 percent in the year to November 2021 compared to the same period a year before. Waitomo District also saw an increase of more than 50 percent, though this was also due to the subdued activity there in 2020. Hamilton City and Ōtorohanga District both saw a lower value of building consents than a year ago (down 19 and 27 percent respectively). In both these cases, residential consents have continued to increase, and the fall is driven by the more volatile non-residential component.



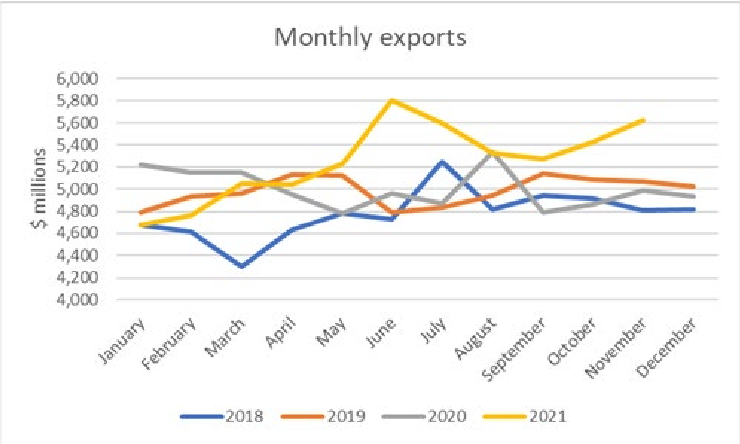


On a per capita basis, the rapidly growing Waikato District has maintained the highest level of consenting in the past year, with 14 consents per 1,000 residents. Waipā, Matamata-Piako and Thames-Coromandel Districts also all have higher rates of consenting than the national average. Ōtorohanga, Waitomo and South Waikato, without the same population pressures, have a level of consents less than half of the Waikato District's.

Exports

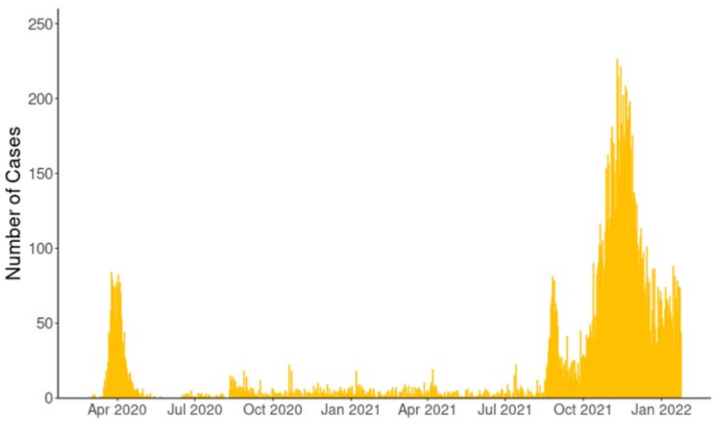


After a period of declining export prices, two consecutive quarters of increasing prices in the June and September quarters of 2021 saw export prices at 12 percent higher than a year before. Global food prices have risen sharply over 2021 and were 23 percent higher than at the end of 2020, according to the UN Food and Agriculture Organisation. This includes 17 percent increases in both meat and dairy prices. Good returns saw Fonterra lift its forecast payout to dairy farmers to $8.90-$9.50.



The total monthly value of New Zealand's exports has been strong over the second half of 2021. The total value of exports in the year to November 2021 was 4.5 percent higher than for 2020. Much of this is a result of the higher export prices mentioned above, with volumes remaining relatively volatile.

Covid



Controlling the delta outbreak has proved difficult and resulted in an extended closure of the border between the Waikato and Auckland. The emergence of Covid delta cases in the Waikato Region on 3 October provided further disruption, while the arrival of the Omicron in the community seems likely to impact early 2022.