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2019 Economic Outlook

Don't reach for the defibrillator yet

The outlook for the economy and various asset classes, including commercial property, looks rockier in 2019 than it was last year. That will present both challenges and opportunities.

There is no need to reach for the defibrillator – yet. But we need to acknowledge that economic circumstances and the risk profile have shifted. The New Zealand economy is late in the business cycle, and asset prices have had a pretty good run.

Five key focal points to watch

- The global scene, and especially China, is looking wobbly. House prices are falling in Australia, and notably Sydney and Melbourne.
- Auckland house prices are weakening as some air gets taken out of an over-inflated tyre. Comparisons are being made with Sydney. Dairy land prices are correcting too.
- Grumpflation is intensifying; that's the combination of grumpy growth and rising costs/inflation pressures which are hitting business margins.
- The business sector, including farmers, continues to look at government policy with a degree of nervousness. Businesses tend to hold fire on investing and hiring when they are nervous. We are starting to see signs of this.
- The banking sector is facing massive change and credit is becoming tougher to get. Sensible heads are required to keep the credit wheels turning.

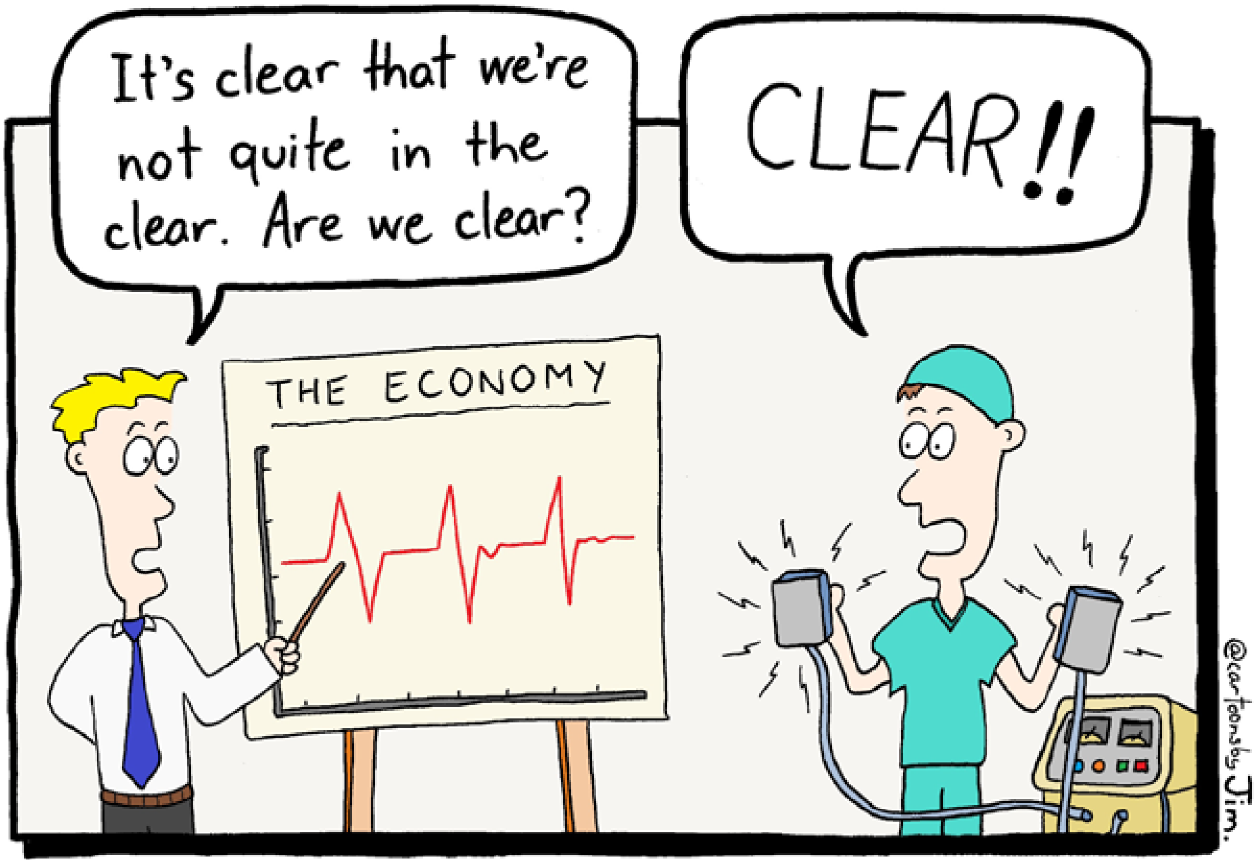
The good news is that New Zealand is well placed to weather these challenges.

> "Inflation and interest rates are low."

Historically, it has been rapid rises in interest rates that have initiated a major turn in the economic cycle.

Expectations have shifted in that the Reserve Bank could cut the Official Cash Rate, and they have scope to. The fiscal position is strong.

Standard and Poor's has just raised New Zealand's credit outlook from stable to



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positive. That reflects a healthy fiscal account and the fact that we haven't built up the normal late cycle excesses that can preclude a shakeout. A weakening Auckland property market has removed a point of vulnerability. That's a good thing provided it remains orderly.

What's under the spotlight?

Some pockets will come more under the spotlight though, notably Auckland property, given trends across the Tasman. Other less affordable and low yielding regions are likely to follow Auckland over 2019. Low yields and a lack of affordability, are a reality check. Other more affordable regions are still seeing price lifts. Dairy land prices might be well down, but other rural land prices are holding up.

Close attention needs to be paid to the banking sector, which will be impacted by events across the Tasman. Banks are likely to try and push up margins. Credit criteria is being tightened, as responsible lending demands bite. That's healthy, but will take some getting used to, as more i's need dotting, and t's crossed to get a loan.

Outlook for Commercial Property

The commercial property sector is seeing mixed results, but is generally stable. Yields are low and we will likely see some pressure on valuations in some areas, but they haven't been driven to the extremes seen in other asset classes. Not being in the cross-hairs of government policy, such as the environment (dairy) and affordability (Auckland housing) helps too, though earthquake strengthening issues linger.

The Bottom line?

The bottom line is that we are late in the cycle. That means extra care needs to be taken, as valuations and economic fundamentals get tested. New Zealand's fundamentals are actually pretty good, but we need to respect that cycles come and go. The good news is that cycles can present opportunities too.