


Thursday, 23 February 2023

focus

An aerial satellite-style photograph of a large, swirling cyclone over the ocean. The eye of the storm is visible in the center, surrounded by dense, white clouds that spiral outwards. The surrounding ocean is a deep blue-grey color.

When it rains it pours: Cyclone Gabrielle a further challenge for the New Zealand economy

Since the start of 2023, New Zealand has been battered by two storms in as many months. Severe flooding in Auckland over Anniversary weekend caused damage to thousands of properties. Clean-up operations in the City of Sails were just beginning in earnest when Cyclone Gabrielle wreaked further havoc across the North Island. The pictures and reports are shocking. For those impacted, you have our sympathies.

...Cyclone Gabrielle will be the most expensive weather-related event in New Zealand's history...



While it is too early to get an exact handle on the total extent of devastation, it is already clear that Cyclone Gabrielle will be the most expensive weather-related event in New Zealand's history. The government's very early estimates put the bill at around \$13 billion, or around 3% of New Zealand's GDP, although history suggests that initial estimates may prove too light.

The economic impact will be bumpy

At the start of this year there was a meaningful risk that the New Zealand economy would experience a mild recession in the later part of 2023. The weather events will add volatility to the economic picture. Lost trading days, reduced spending, and lower agricultural production from the storms have dented economic activity. But household and business spending in impacted regions is likely to swing higher in coming months, as insurance claims are settled and people look to repair and rebuild homes and replace household goods and cars. There is also a significant pipeline of infrastructure work required to get these regions back up and running.

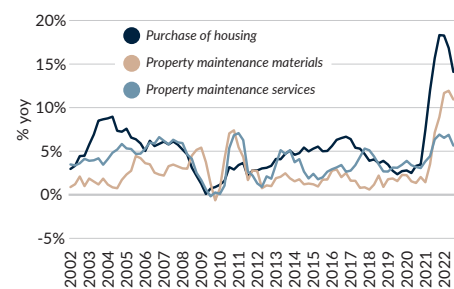
With capacity constraints still apparent in the construction sector, it is likely that the reconstruction will be slow and drawn out. For comparison, the Canterbury rebuild was originally forecast to total about \$15 billion with most of the work expected to be completed by 2016. The final spend totalled over \$40 billion and the work extended out to 2020 (and beyond). The Reserve Bank has estimated that the rebuild activity will add about 1 percentage point to economic growth over the next few years.

Adding to inflationary pressures

Inflation in New Zealand is already at the highest levels in decades. The storms will add to price pressures, including for housing, rents, food, and insurance. Some of these impacts will be short-term while others, such as construction costs, are likely to remain elevated for an extended period.

Over 2022, the cost of building a new home rose +14% (albeit the pace of increases had shown some signs of easing at the end of last year). Costly materials and the price of labour have driven prices higher. The storms have now added a large pipeline of additional repair and rebuild work. Boosting immigration of construction workers is on the table – this will help with labour shortages but won't be a silver bullet; capacity pressures will remain.

HOUSING COSTS A LARGE DRIVER OF RECENT INFLATION



Source: Statistics NZ, Forsyth Barr analysis

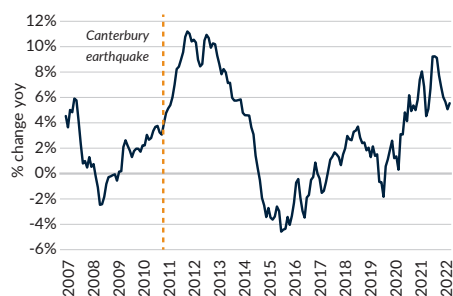


...dwelling insurance increased over 40% in the wake of the Canterbury earthquakes...

With many people displaced while their homes are being repaired or rebuilt, the rental market in impacted regions is already showing signs of getting squeezed. Again, the Canterbury earthquake provides a useful parallel – rents in the region rose rapidly in the years post-quake. Canterbury house prices also rose around 9–10% year-on-year during this time as people competed to buy existing housing stock rather than waiting to rebuild. About 500 properties in Auckland have been red-stickered to date, but the number is likely to be much higher in the Hawke's Bay and Gisborne regions, creating housing shortages in those areas.

CANTERBURY RENTS:

ANNUAL PERCENTAGE CHANGE

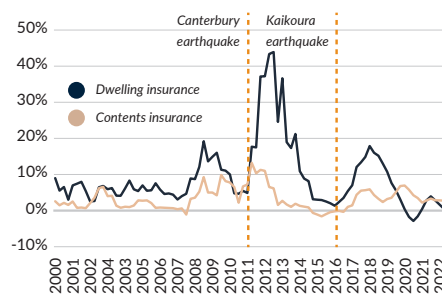


Source: Statistics NZ, Forsyth Barr analysis

The devastation to such a large area of food production (Hawke's Bay and Gisborne in particular) will also likely translate into higher prices for fruit and vegetables. Fruit and vegetable prices rose 20% over 2022 and the loss of supply will likely see food price inflation remain elevated in the near term.

The combination of earthquakes and weather-related events in New Zealand in recent years means that insurers have had a particularly rough time of things. Insurance premiums tend to move higher after a natural disaster – dwelling insurance increased over 40% in the wake of the Canterbury earthquakes as an example. Tower Insurance (which has about 9–10% of the household insurance market) has estimated it alone will pay out a minimum of \$95–125 million of claims for just the January Auckland flood event.

INSURANCE COSTS OFTEN MOVE HIGHER AFTER A NATURAL DISASTER



Source: Statistics NZ, Forsyth Barr analysis

Government books in a robust position

While estimates for the total repair bill remain very much up in the air at this stage, the government's May Budget is being recast to deal with the cost of this disaster. Spending allocations will be re-cut in order to funnel much needed cash towards replacing severely impacted infrastructure as quickly as possible and get transport routes back up and running. Waka Kotahi's early estimate for roading repairs is

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\$1 billion, restoration of electricity lines is anticipated to be \$100 million, and a \$50 million discretionary fund has been established to provide grants to small businesses impacted by the cyclone. These may well just be the tip of the iceberg. Despite the lift in New Zealand's Government debt over recent years, our balance sheet remains relatively strong and has scope to take on additional debt to help pay for the rebuild work.

Building back better

While the immediate focus will be getting the country back up and running, there is a key longer-term question – how do we build back with greater resilience to help better endure natural disasters in the future? There is clear evidence to suggest that these types of extreme weather events are becoming more common. Replacing assets on a 'like-for-like' basis seems unwise given the vulnerabilities these events have exposed. A more strategic rebuild approach will be required to shore up the resilience of at-risk communities and public resources. There are a myriad of options available, from creating 'spongier' cities to a full scale retreat from at-risk regions. All of these options will add a varying degree of time and cost to the process, although ultimately are a necessary investment to mitigate the impact of such catastrophes in the future.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.



Zoe Wallis
Investment Strategist

0800 367 227

[forsythbarr.co.nz](https://www.forsythbarr.co.nz)