SALT INSIGHT

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27 July 2026

Luck is a relative concept

This article first appeared in the NBR

For much of the past three decades, the economic comparison between New Zealand and Australia has been relatively straightforward. Australia has generally enjoyed stronger productivity growth, faster income growth, a larger and more diversified economy, and a housing market that seemed almost incapable of going backwards. For many New Zealanders, the "golden ticket" to higher wages and greater opportunity was a one-way flight across the Tasman.

That narrative may not be about to reverse, but it is becoming more nuanced.

As investors, we often focus on absolute economic performance. Equally important, however, is relative momentum. And at first blush, the relative outlook over the next couple of years looks rather different from the one we have become accustomed to.

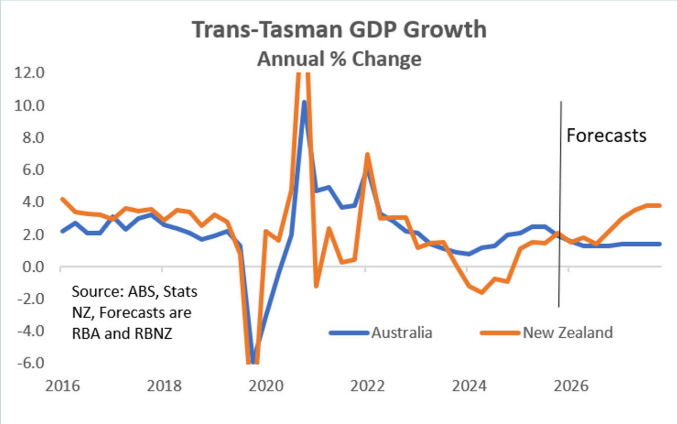
New Zealand appears to be entering the early stages of a cyclical recovery just as Australia's economy begins to lose some momentum. At the same time, Australia's long-held structural advantages—particularly around productivity—are looking less clear-cut. Combined with changing dynamics in the housing market, these shifts could have important implications for exchange rates, migration flows and the relative performance of financial markets.

Two economies moving in different directions

The first part of the story is cyclical. After enduring one of the deepest slowdowns in its recent history, New Zealand's economy now appears to be recovering. Growth remains modest, but business confidence has improved, exports continue to perform well and tourism has largely recovered.

More importantly, the Reserve Bank's decision last week to begin moving interest rates back towards more neutral settings is itself recognition that the recovery has become sufficiently established for emergency monetary settings to be withdrawn. That does not mean the economy is booming. It simply means the direction of travel has changed.

Australia, by contrast, finds itself at a different point in the cycle. Its economy largely avoided the downturn experienced in New Zealand, supported by strong population growth, government spending and a resilient labour market. Those supports, however, appear to be becoming less powerful. Household spending remains constrained, business investment is showing signs of caution and higher interest rates continue to weigh on activity.



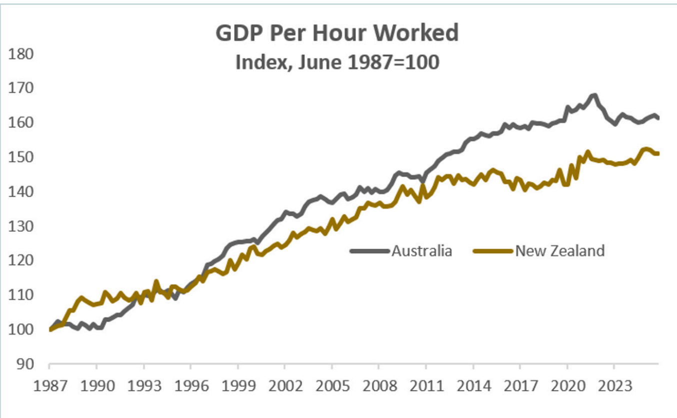
Is Australia's structural advantage beginning to narrow?

The more interesting question, however, is whether the structural gap between the two economies is also becoming less pronounced. For decades Australia has enjoyed a clear productivity advantage over New Zealand. Higher output per worker has underpinned stronger wage growth, higher living standards and superior long-term economic performance.

That advantage remains. What may be changing is the rate at which it is widening. Recent productivity data suggest Australia is no longer pulling away from New Zealand as it once did. Businesses increasingly point to familiar challenges, including regulatory complexity, infrastructure bottlenecks, declining business investment and weaker productivity growth across large parts of the services sector.

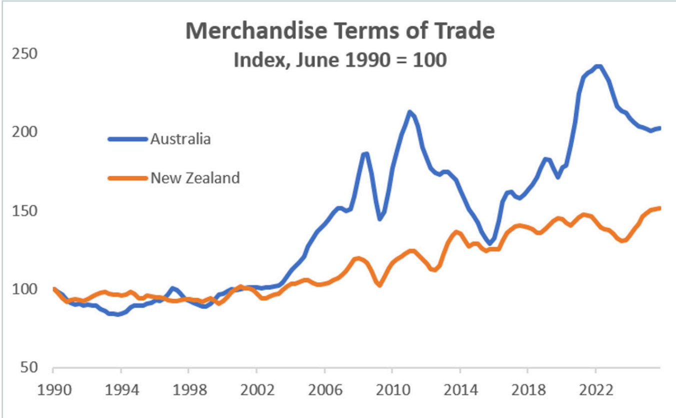
None of this should be interpreted as New Zealand having solved its own productivity problem. It remains one of our greatest long-term economic challenges. But perhaps the more interesting question is whether Australia is increasingly confronting some of the same structural constraints that have held New Zealand back for many years.

If that proves to be the case, the productivity gap between the two countries may continue to exist, but it may no longer widen as relentlessly as it has over recent decades.



A changing commodity story

Australia's extraordinary economic performance also reflected another important advantage. It didn't simply have the right resources. It had the right resources at precisely the moment the world's fastest-growing major economy needed them. China's industrialisation transformed Australia's terms of trade as demand for iron ore, coal and LNG surged. Few advanced economies benefited more from that once-in-a-generation shift.



The next decade may look different. China's economy is maturing. Growth is becoming less dependent on infrastructure and property development and increasingly driven by services, technology and consumption. That does not imply Australia's resource sector faces an imminent decline, but it does raise an important question: can the extraordinary tailwinds of the past twenty years continue to strengthen from here?

New Zealand's export mix tells a different story. Food, horticulture, tourism and education are driven by different global forces. Population growth, rising incomes across Asia, food security and changing dietary preferences may prove more durable drivers of demand than another decade of rapid Chinese construction. Climate change and geopolitical fragmentation may reinforce that trend. In an increasingly uncertain world, reliable food exporters may become strategically more valuable.

This is not an argument that New Zealand's export basket is superior. It is an argument that the relative terms of trade story may be becoming more balanced.

Housing is becoming less of a differentiator

Housing provides another useful comparison. New Zealand has already spent several years working through the excesses created during the pandemic boom. House prices have been broadly flat, affordability has improved modestly and much of the speculative froth has dissipated.

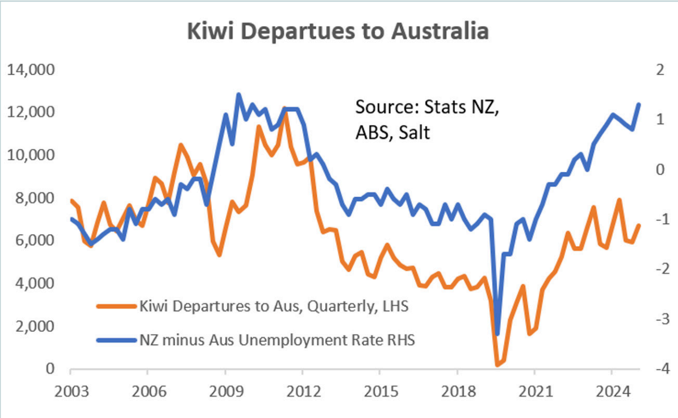
Australia now appears to be confronting many of the same issues. Affordability has deteriorated significantly, borrowing costs remain elevated and recent policy changes affecting residential property investment have added a new layer of uncertainty to the housing outlook.

Housing matters because it is about far more than house prices. It influences household wealth, consumer confidence, credit creation, construction activity and ultimately economic growth. For years, Australia's housing market was another symbol of its exceptionalism. That assumption may now deserve closer scrutiny.

What does this mean for New Zealand?

If Australia's relative advantage narrows, the implications extend well beyond GDP growth. Australia will remain an attractive destination for many New Zealanders. Higher wages and broader career opportunities are not disappearing overnight.

But migration decisions are fundamentally relative. If Australia's labour market becomes a little less compelling while New Zealand's recovery gathers momentum, the long-standing flow of skilled New Zealanders across the Tasman may gradually become less one-sided. That would itself become another supportive influence on New Zealand's medium-term growth prospects.



When luck becomes relative

None of this suggests Australia is about to lose its place as one of the world's most successful advanced economies. It remains larger, wealthier and more diversified than New Zealand, with many enduring competitive advantages.

Nor should New Zealand become complacent. Our own productivity performance remains disappointing and lifting long-term living standards will require sustained policy reform, stronger private-sector investment and a renewed focus on improving productivity.

For much of the past generation, it has been almost instinctive to assume Australia would outperform New Zealand across almost every meaningful economic measure. That assumption has generally been rewarded. The next decade may not overturn that narrative, but it may make it considerably less straightforward.

Implications for Investors

For equity investors, the different composition of the Australian and New Zealand sharemarkets means they should be viewed as complementary rather than competing investments. Australia's market remains heavily weighted towards banks and resource companies, making it more sensitive to the global economic cycle and demand from Asia, particularly China. New Zealand's market, by contrast, has greater exposure to sectors such as healthcare, utilities and infrastructure, giving it a more defensive and income-oriented profile.

That distinction has served investors well for many years. However, if the structural trends discussed above continue to unfold, the relative outlook may become more balanced than it has been in the past. A moderation in Australia's resource-driven growth, combined with a strengthening New Zealand economy, could narrow the performance gap between the two markets.

This is not an argument for replacing Australia with New Zealand. Australia will continue to offer greater market depth, liquidity and exposure to industries that simply do not exist here. Rather, it is a reminder that investors should avoid assuming Australia's stronger historical performance will automatically continue.

The same principle applies to fixed income markets. Australia's bond market is much larger and more liquid than New Zealand's, offering investors a broader range of issuers and maturities. For New Zealand investors, maintaining exposure to both markets can provide useful diversification, not only across issuers but also through currency exposure, as movements in the NZD/AUD exchange rate often reflect the differing stages of the two economies' cycles.

Ultimately, the strength of Australasian portfolios lies in combining the different characteristics of both markets. Australia continues to provide scale and cyclical growth opportunities, while New Zealand offers greater exposure to defensive sectors and domestic recovery. If the relative economic gap between the two countries continues to narrow, investors may find that maintaining a balanced exposure across both sides of the Tasman becomes increasingly rewarding.