

RESEARCH

NEW ZEALAND AT A GLANCE

14 August 2018



Overview

New Zealand threatens to move into a pseudo-stagflationary environment. Growth is slowing and we doubt that even the substantial fiscal stimulus that is being delivered will result in a significant increase in the pace of the expansion. Supply issues such as physical capacity constraints, infrastructure bottlenecks, a low unemployment rate, and declining working age population growth are major factors behind the softening. In turn, these drivers create a modicum of inflationary pressure which is exacerbated by a weakening currency and government charge increases. Against this backdrop, the RBNZ seems reluctant to shift interest rates and appears to be keen to use the full flexibility that a target range permits.

International

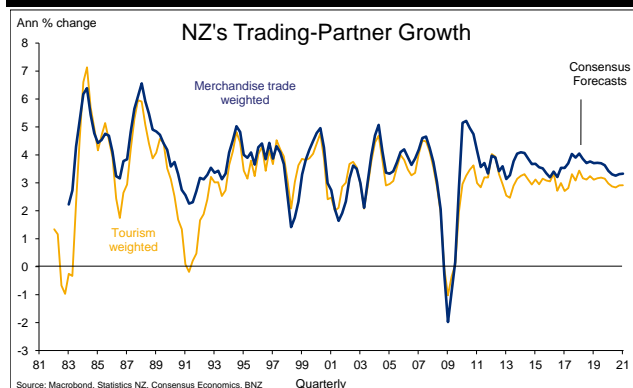
Worries about the global outlook continue to rise as: the threat of a trade war increases; Chinese growth moderates; and Emerging Markets struggle to maintain momentum. Despite this, global inflation is still rising, encouraging the major central banks to tighten monetary policy by reducing (or reversing) quantitative easing and/or raising interest rates. This in turn puts further downward pressure on global activity. Not surprisingly, then, New Zealand trading partner growth is also drifting lower. Growth for calendar 2018 is forecast to be 3.8%, slowing to 3.7% in 2019 and 3.3% in 2020. While moderating, the pace of expansion for the next eighteen months at least, will continue to support New Zealand exporters.

Growth

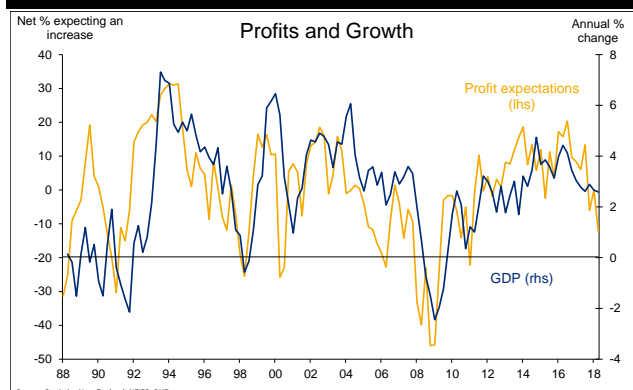
New Zealand's GDP growth is stagnating at around trend. Slowing population expansion is acting as a significant moderating factor and is already playing a part in slowing private consumption and employment growth. Weak business sentiment, if sustained, will also prove problematic with anecdotal evidence suggesting investment decisions are being postponed. In part this is due to some concern over government policy but also reflects, more generally, pressure on profits, as margins are squeezed by rising input costs. But the outlook is not all negative. There remains plenty of momentum in the economy, the government is providing substantial fiscal stimulus and monetary conditions are not only stimulatory but are easing further too.

Key Indicators	December Years					
	Actual			Forecasts		
	2015	2016	2017	2018	2019	2020
GDP production (an avg %)	3.5	4.0	2.8	2.7	2.8	2.7
Consumers Price Index (ann %)	0.1	1.3	1.6	2.1	1.9	2.1
Unemployment Rate (end qtr %)	5.0	5.3	4.5	4.3	4.2	4.2
Current Account (% of GDP)	-3.1	-2.2	-2.7	-3.5	-3.4	-3.4
Fiscal Balance (% GDP June Yr)	0.2	0.7	1.5	1.2	1.0	1.5
NZD/USD (Dec mth avg)	0.68	0.70	0.70	0.70	0.70	0.68
Overnight Cash Rate (Dec mth end %)	2.50	1.75	1.75	1.75	2.25	2.75
10 Year Govt Bond (Dec mth avg %)	3.40	3.30	2.80	3.10	3.70	4.00

Trading Partner Growth Has Peaked



Weakening Profits A Concern



Labour Market

The labour market remains very tight. Yes, the unemployment rate rose to 4.5% from 4.4% in the March quarter but this was simply because the participation rate rose. Annual employment growth was a very robust 3.7%. From here on in we expect employment growth to slow markedly to be sub-2.0% by late 2019. But this does not so much reflect a drop off in demand but, rather, a shortage of supply. Accordingly, we still think the unemployment rate will remain at or below current levels for some time to come. Tightness in supply, coupled with the rising minimum wage and relatively high state sector wage settlements should see labour cost measures rise.

Inflation

Consumer price inflation is trending higher. Annual inflation rose to 1.5% in June from 1.1% in March. We forecast inflation to be through 2.0% by the end of this year and to stay at or above 2.0% for the foreseeable future. Most of the upward momentum is emanating from the current pressure on corporate margins as input costs rise thanks to a combination of: rising global inflation, a weakening New Zealand dollar; increasing labour costs; and government imposed charges. The big question is whether corporates respond to this by simply reducing labour, resorting to capital/labour substitution or increasing selling prices. We expect there will be a combination of the three.

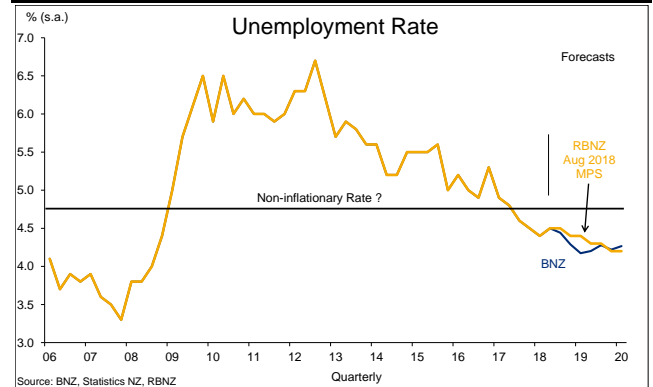
External Accounts

The current account deficit is on an upward growth path. Back in December 2016 the deficit hit a low of 2.2% of GDP. By June it had climbed to 2.8%. We are forecasting it to rise to 3.5% of GDP by the end of this year. Much of the deterioration is due to the fact that the Terms of Trade appears to be peaking. New Zealand product prices will struggle to push much higher whereas output prices elsewhere around the world, especially for fuel, are holding up. Despite the deterioration in the balance it is not sufficient to endanger the improving trend in the net international income balance.

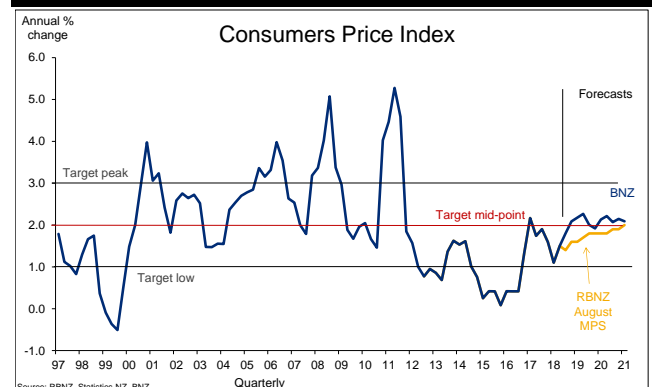
Fiscal Policy

The government is providing major stimulus to the economy via its commitment to infrastructure spending and the significant transfer to the household sector largely via increased welfare payments. Despite this the Government forecasts rising fiscal surpluses and net core crown debt falling to 20% of GDP by 2022. In our opinion, far too much focus is being placed on the debt target. The debate should be more about the quality of the fiscal decisions rather than the level of the target. This will become particularly pertinent soon as we do not think the Government's fiscal targets will be met. GDP growth looks likely to surprise to the downside eating into revenue forecasts while the demands on expenditure will only rise.

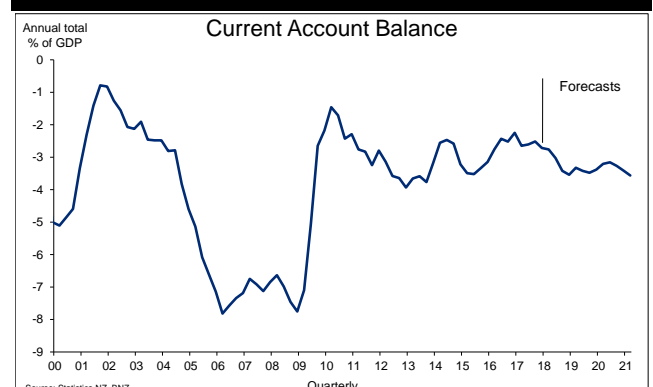
A Very Tight Labour Market



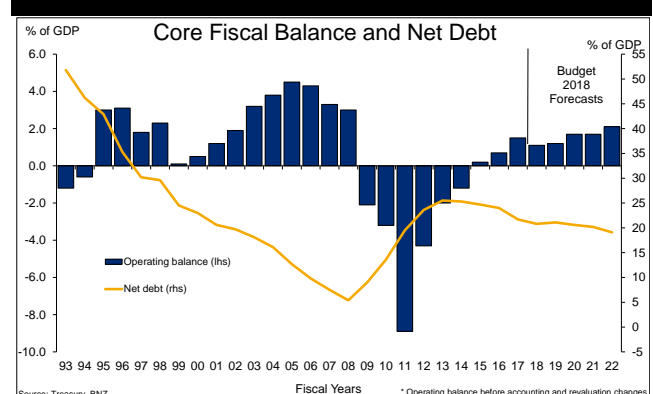
Inflation Trending Higher



Current Account Deteriorates



Fiscal Headroom



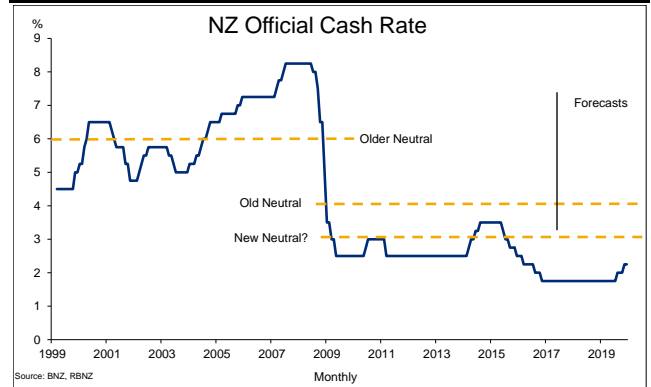
Interest Rates

The new guard at the RBNZ is starting to reveal its true colours. In the August Monetary Policy Statement there was a decided tilt towards a greater fear of lower growth than of higher inflation. This came as a surprise to the market which seemed more prepared for a shift in the opposite direction. Perhaps most importantly, the messaging from the Bank seems to suggest that it will use the full flexibility of its target range in setting policy. Consequently, a move in inflation above 2.0% need not necessarily result in a higher cash rate. Accordingly, we see the RBNZ being unmoved for at least the next 12 months.

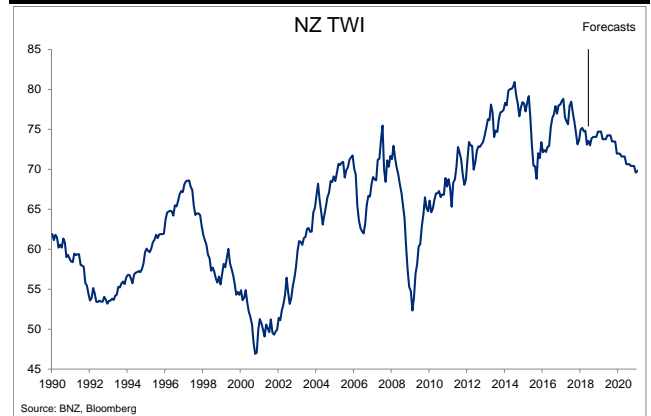
Exchange Rates

The NZD is under pressure. Weakening domestic growth was already weighing on the NZD especially as this was being accompanied by some downward momentum in commodity prices. Very soft business confidence indicators exacerbated this trend. Then, the RBNZ's surprise dovishness saw a marked drop in support for the local currency. To cap things off, Turkish turmoil resulted in peripheral currencies (of which the NZD is one) taking another leg down. There is a good chance that the currency has over-reacted to these events so may bounce back from current levels. However, more generally, the global backdrop and the Reserve Bank's reluctance to increase interest rates are likely to weigh on the currency for some time to come.

Lower For Longer



NZD Under Pressure...



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Quarterly Forecasts

Forecasts as at 14 August 2018

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
GDP (production s.a.)	0.8	0.9	0.6	0.6	0.5	0.8	0.7	0.9	0.5	0.7
Retail trade (real s.a.)	1.5	1.8	0.3	1.4	0.1	0.2	1.2	1.2	0.7	0.6
Current account (ytd, % GDP)	-2.6	-2.6	-2.5	-2.7	-2.8	-3.0	-3.4	-3.5	-3.3	-3.4
CPI (q/q)	1.0	0.0	0.5	0.1	0.5	0.4	0.8	0.4	0.6	0.5
Employment	1.1	-0.1	2.2	0.4	0.6	0.5	0.5	0.5	0.6	0.5
Unemployment rate %	4.9	4.8	4.6	4.5	4.4	4.5	4.4	4.3	4.2	4.2
Avg hourly earnings (ann %)	1.1	1.2	2.0	3.1	4.0	3.3	3.4	3.5	3.3	4.0
Trading partner GDP (ann %)	3.5	3.7	4.0	3.9	4.0	3.9	3.7	3.8	3.7	3.7
CPI (y/y)	2.2	1.7	1.9	1.6	1.1	1.5	1.8	2.1	2.2	2.3
GDP (production s.a., y/y)	3.0	2.8	2.6	2.9	2.7	2.6	2.7	3.0	3.0	2.8

Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor	US 10 yr	NZ-US
		Bank Bills						3 month		Ten year
2017 Jun	1.75	1.95	2.45	2.95	2.25	2.80	3.25	1.25	2.20	0.75
Sep	1.75	1.95	2.45	2.95	2.20	2.70	3.20	1.30	2.20	0.75
Dec	1.75	1.90	2.35	2.90	2.20	2.65	3.15	1.60	2.40	0.40
2018 Mar	1.75	1.90	2.40	2.95	2.20	2.70	3.20	2.20	2.85	0.10
Jun	1.75	2.00	2.35	2.90	2.25	2.70	3.15	2.35	2.90	-0.06
Forecasts										
Sep	1.75	2.00	2.45	2.95	2.25	2.75	3.25	2.30	3.10	-0.15
Dec	1.75	2.00	2.60	3.10	2.40	2.90	3.40	2.55	3.25	-0.15
2019 Mar	1.75	2.10	2.70	3.20	2.55	3.00	3.50	2.75	3.25	-0.05
Jun	1.75	2.35	3.00	3.45	2.85	3.00	3.50	3.10	3.50	-0.05
Sep	2.00	2.60	3.20	3.60	3.10	3.00	3.50	3.35	3.50	0.10
Dec	2.25	2.85	3.35	3.70	3.35	3.30	3.75	3.35	3.50	0.20
2020 Mar	2.50	3.10	3.45	3.80	3.50	3.30	3.75	3.10	3.50	0.30
Jun	2.75	3.25	3.60	3.80	3.50	3.30	3.75	3.10	3.50	0.40
Sep	2.75	3.25	3.60	3.80	3.50	3.50	3.90	3.10	3.50	0.40

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.66	0.73	1.14	1.28	111
Sep-18	0.69	0.73	1.15	1.32	109
Dec-18	0.70	0.75	1.18	1.38	110
Mar-19	0.70	0.75	1.22	1.45	108
Jun-19	0.71	0.75	1.22	1.47	106
Sep-19	0.71	0.75	1.25	1.53	104
Dec-19	0.70	0.75	1.30	1.55	102
Mar-20	0.70	0.75	1.32	1.55	100
Jun-20	0.69	0.74	1.34	1.57	99
Sep-20	0.69	0.74	1.36	1.60	98
Dec-20	0.68	0.73	1.38	1.60	98

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.66	0.90	0.58	0.52	72.9	71.7
Sep-18	0.69	0.94	0.60	0.52	74.7	74.1
Dec-18	0.70	0.93	0.59	0.51	77.0	74.7
Mar-19	0.70	0.93	0.57	0.48	75.6	73.8
Jun-19	0.71	0.94	0.58	0.48	75.3	74.2
Sep-19	0.71	0.94	0.57	0.46	73.8	73.5
Dec-19	0.70	0.93	0.54	0.45	71.4	72.0
Mar-20	0.70	0.93	0.53	0.45	70.0	71.6
Jun-20	0.69	0.93	0.52	0.44	68.3	70.6
Sep-20	0.69	0.93	0.51	0.43	67.6	70.4
Dec-20	0.68	0.93	0.49	0.43	66.6	69.6

TWI Weights

14.0% 20.7% 10.3% 4.8% 6.8%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Annual Forecasts

Forecasts as at 14 August 2018	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2017	2018	2019	2020	2021	2016	2017	2018	2019	2020
GDP - annual average % change										
Private Consumption	5.5	3.8	2.9	2.4	1.7	5.1	4.4	2.8	2.6	1.8
Government Consumption	1.9	4.9	2.1	1.8	1.7	1.6	4.6	2.7	1.8	1.7
Total Investment	5.6	3.9	4.7	3.7	3.8	6.4	3.5	4.8	4.1	3.6
Stocks - ppts cont'n to growth	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.3	-0.1	0.0
GNE	4.8	4.0	3.4	2.6	2.2	4.7	4.2	3.7	2.7	2.2
Exports	0.7	3.9	3.6	4.3	4.0	1.6	2.3	3.4	4.6	4.0
Imports	5.1	7.0	5.2	3.5	2.2	3.4	6.7	6.3	3.7	2.4
Real Expenditure GDP	3.6	3.1	2.8	2.8	2.7	4.1	3.0	2.7	2.9	2.7
GDP (production)	3.7	2.7	2.8	2.7	2.7	4.0	2.8	2.7	2.8	2.7
<i>GDP - annual % change (q/q)</i>	3.0	2.7	3.0	2.6	2.8	3.4	2.9	3.0	2.6	2.8
Output Gap (ann avg, % dev)	1.4	0.9	0.9	0.7	0.4	1.4	1.0	0.9	0.8	0.5
Household Savings (% disp. income)	-2.8	-1.8	-2.8	-2.6	-1.8					
Nominal Expenditure GDP - \$bn	270.3	286.4	299.0	315.4	327.9	266.1	283.4	294.9	311.6	325.1
Prices and Employment - annual % change										
CPI	2.2	1.1	2.2	2.1	2.1	1.3	1.6	2.1	1.9	2.1
Employment	5.7	3.1	2.1	1.6	1.6	5.8	3.7	2.1	1.9	1.6
Unemployment Rate %	4.9	4.4	4.2	4.3	4.2	5.3	4.5	4.3	4.2	4.2
Wages - ahote	1.1	4.0	3.3	3.4	2.8	1.1	3.1	3.5	3.5	3.0
Productivity (ann av %)	-1.9	-0.8	-0.2	0.8	1.2	-0.8	-1.4	-0.5	0.6	1.1
Unit Labour Costs (ann av %)	3.8	3.9	3.7	2.8	2.2	2.7	4.0	4.2	2.9	2.3
External Balance										
Current Account - \$bn	-7.2	-7.9	-9.9	-10.1	-11.7	-6.0	-7.7	-10.4	-10.5	-11.1
Current Account - % of GDP	-2.6	-2.8	-3.3	-3.2	-3.6	-2.2	-2.7	-3.5	-3.4	-3.4
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	1.5	1.2	1.0	1.5	1.5					
Net Core Crown Debt (excl NZS Fund Assets)	21.7	20.8	20.6	19.7	18.3					
Bond Programme - \$bn	8.0	8.0	8.0	9.0	9.0					
Bond Programme - % of GDP	3.0	2.8	2.7	2.9	2.7					
Financial Variables ⁽¹⁾										
NZD/USD	0.70	0.73	0.70	0.70	0.68	0.70	0.70	0.70	0.70	0.68
USD/JPY	113	106	108	100	98	116	113	110	102	98
EUR/USD	1.07	1.23	1.22	1.32	1.38	1.05	1.18	1.18	1.30	1.38
NZD/AUD	0.92	0.94	0.93	0.93	0.93	0.96	0.91	0.93	0.93	0.93
NZD/GBP	0.57	0.52	0.48	0.45	0.43	0.56	0.52	0.51	0.45	0.43
NZD/EUR	0.66	0.59	0.57	0.53	0.50	0.67	0.59	0.59	0.54	0.49
NZD/YEN	79.1	77.0	75.6	70.0	66.6	81.6	78.7	77.0	71.4	66.6
TWI	76.5	74.8	73.8	71.6	70.1	78.1	73.6	74.7	72.0	69.6
Overnight Cash Rate (end qtr)	1.75	1.75	1.75	2.50	2.75	1.75	1.75	1.75	2.25	2.75
90-day Bank Bill Rate	1.98	1.93	2.08	3.08	2.92	2.02	1.88	2.00	2.83	3.17
5-year Govt Bond	2.70	2.35	2.70	3.45	3.55	2.75	2.30	2.60	3.35	3.60
10-year Govt Bond	3.25	2.95	3.20	3.80	3.95	3.30	2.80	3.10	3.70	3.95
2-year Swap	2.30	2.25	2.55	3.50	3.40	2.40	2.20	2.40	3.35	3.50
5-year Swap	3.00	2.70	3.00	3.75	3.85	3.00	2.65	2.90	3.65	3.90
US 10-year Bonds	2.50	2.85	3.25	3.50	3.50	2.50	2.40	3.25	3.50	3.50
NZ-US 10-year Spread	0.75	0.10	-0.05	0.30	0.45	0.80	0.40	-0.15	0.20	0.45

⁽¹⁾ Average for the last month in the quarter

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

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