

RESEARCH

NEW ZEALAND AT A GLANCE

1 March 2018



Overview

Currently the NZ economy is in an enviable state. Growth is robust, employment prospects are good, the housing market is stable, global demand is supportive, we've got fiscal surpluses and interest rates are low. From here, though, things get a little more difficult and we expect economic growth to moderate despite significant fiscal stimulus. Nonetheless, barring a major asset price correction, induced by global monetary tightening, the prospects remain relatively sound for the medium term.

International

Global growth is firing on all cylinders. Our derived Consensus expectation for the world for the next twelve months is sitting just below its highest level since 2011. Importantly, the growth is being shared widely giving it an air of sustainability that many past cycles did not share. However, New Zealand's trading partner expansion appears to be peaking and nervousness about the potential impact of monetary tightening is beginning to spread. We remain cautiously optimistic but, equally, mindful that a significant asset price correction could yet prove destabilising.

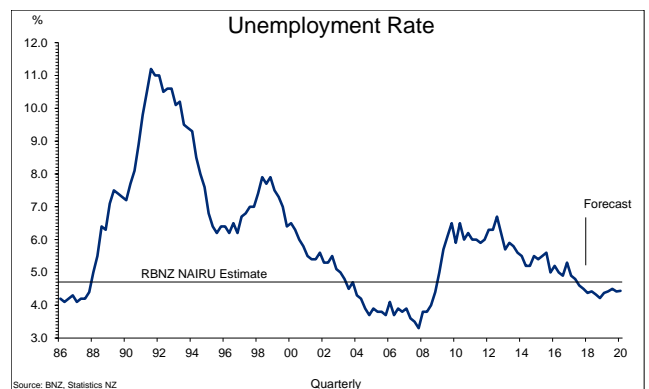
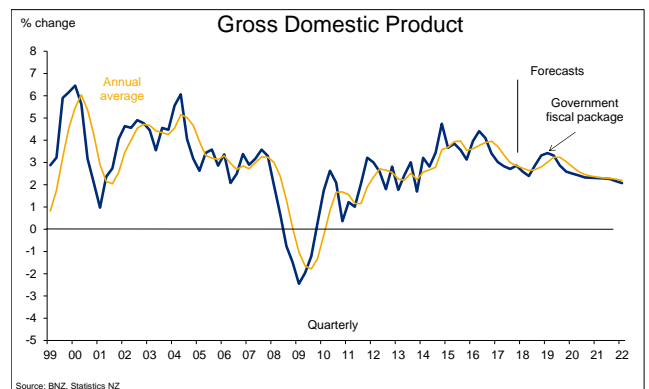
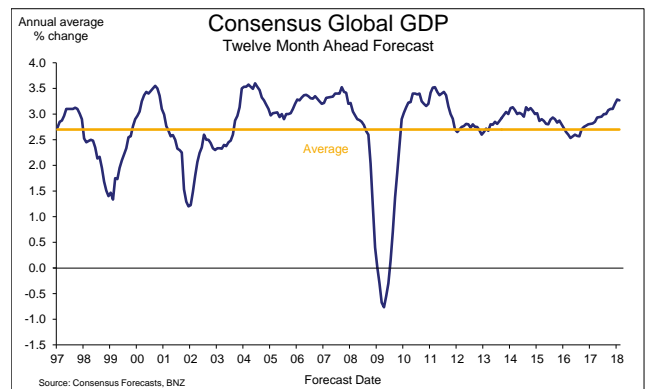
Growth

NZ GDP growth has been moderating. On an annual average basis, the expansion peaked at 4.0% in the fourth quarter of 2016. By Q3, 2017 the pace of the expansion had slowed to 3.0%. Further moderation, on average, is expected, as population growth slows and capacity constraints bite, but we still believe the economy can continue to expand in a 2.5% to 3.0% range for the foreseeable future. A significant driver of growth over the next two years will be the fiscal impulse as the Government delivers a series of handouts to the household sector while pushing ahead with significant investment plans both in terms of housing and infrastructure.

Labour Market

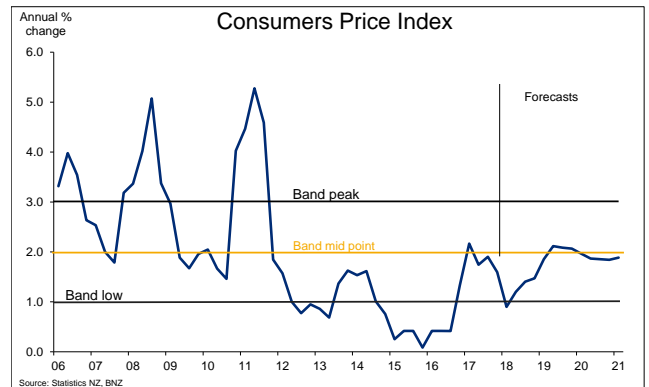
The labour market is getting tighter and tighter. By the end of 2017 the unemployment rate had dropped to just 4.5% - the lowest it's been since December 2008. We think it will drift lower still. Feedback from corporate New Zealand suggests that this level of unemployment means that it has become very difficult to access both skilled and unskilled labour and labour has become a major constraint to higher production. Despite this, wage inflation (at least in nominal terms) remains well-contained. We continue to believe that the strong demand for labour, coupled with aggressive minimum wage increases, will ultimately push wage inflation higher. That said, we concede that we have been saying this for some time.

Key Indicators	December Years					
	Actual 2014	Actual 2015	Actual 2016	Forecasts 2017	Forecasts 2018	Forecasts 2019
GDP production (an avg %)	3.6	3.5	4.0	2.9	2.8	3.0
Consumers Price Index (ann %)	0.8	0.1	1.3	1.6	1.5	2.1
Unemployment Rate (end qtr %)	5.5	5.0	5.3	4.5	4.2	4.4
Current Account (% of GDP)	-3.2	-3.2	-2.5	-2.6	-3.3	-3.2
Fiscal Balance (% GDP June Yr)	-1.2	0.2	0.7	1.5	0.9	0.9
NZD/USD (Dec mth avg)	0.78	0.68	0.70	0.70	0.70	0.70
Overnight Cash Rate (Dec mth end %)	3.50	2.50	1.75	1.75	1.75	2.75
10 Year Govt Bond (Dec mth avg %)	3.80	3.40	3.30	2.80	3.10	3.30



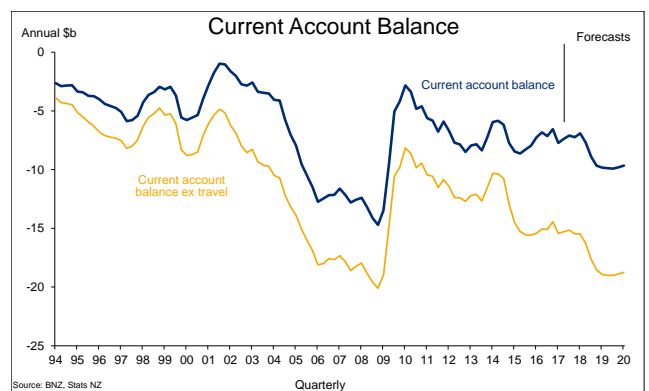
Inflation

Every time you think the scene is set for consumer price inflation to rise, along comes something to smash that expectation. This time around it has been a combination of a weaker than expected Q4 outturn coupled with recent food price partials which have been lower than anticipated. Accordingly, it now looks like it will be June 2019 before annual CPI inflation pushes up to 2.0%. If we are right it means that inflation will have been below the mid-point of the RBNZ's target band for 29 out of the last 30 quarters. For 13 of these it will have been below the 1.0% lower bound of that range. We are not the slightest bit concerned by this as it largely reflects a relative income gain for New Zealanders as the country benefits from imported deflation.



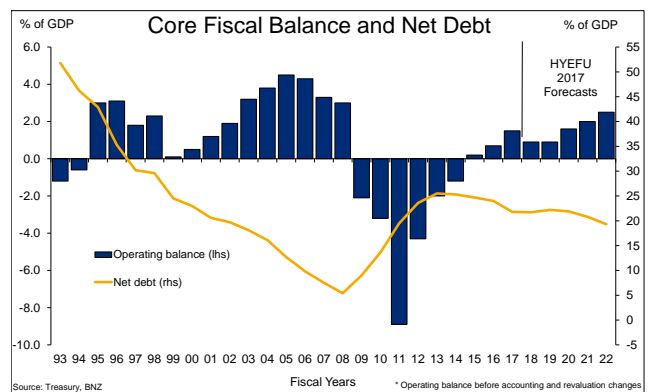
External Accounts

New Zealand's external accounts continue to be propped up by an outstanding travel balance. The current account deficit for the year ended September 2017 equated to 2.6% of GDP. It would have been 5.5% of GDP had it not been for the 2.9% of GDP travel surplus. We expect the travel surplus to keep growing but the current account balance to deteriorate due to weaker dairy volumes, a softening in the terms of trade, and strong domestic-demand-driven import growth all of which contribute to a widening in the goods deficit. There is also a risk that the investment income balance deteriorates as global interest rates rise. Nonetheless, we still believe the current account deficit will remain sufficiently low to ensure that New Zealand's net international investment shortfall continues to fall as a percentage of GDP.



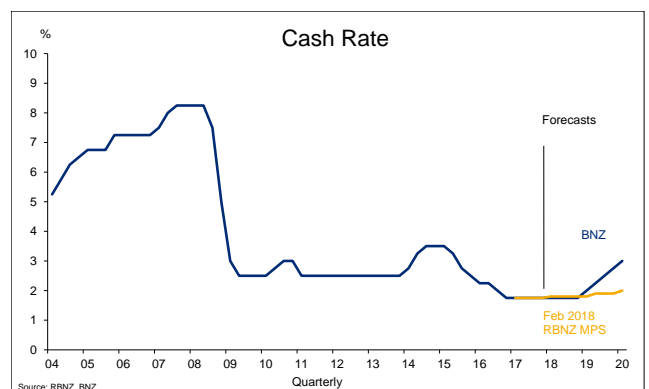
Fiscal Policy

The new government is determined to see net core crown debt fall to 20.0% of GDP over the medium term by continuing the run of fiscal surpluses started in the year ended June 2015. Accordingly, fiscal expansion will be constrained by this objective. However, over the next eighteen months the fiscal impulse to the economy will be significant and the risks are that it will end up even more aggressive than the government currently assumes. Fortuitously, revenues continue to surprise to the upside offering the Government some wriggle room.



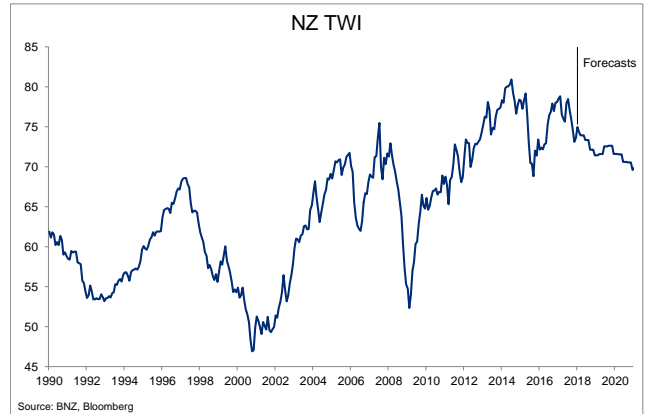
Interest Rates

The Reserve Bank is showing no inclination to move its cash rate in calendar 2018. Indeed, it maintains its view that the cash rate will not be raised until the first quarter of 2020. We share the view that no rate increase is likely this year as inflation remains well anchored below the mid-point of the Bank's target range. However, we do think that a combination of financial stability concerns, a weakening New Zealand dollar and heightened capacity constraints will see the Bank pull the trigger in the first half of 2019. Of course, there is increased uncertainty around the Bank's response given that we will soon be introduced to a new Governor and a likely change in regime (incorporating employment as a dual mandate and decision by committee).



Exchange Rates

We expect the USD to depreciate against the majors as the concern over rising twin deficits more than offsets the positive impacts of rising interest rates. Despite this, we believe the NZD will depreciate against the USD as the yield differential moves in favour of the US and global uncertainty increases which will be reflected in lower demand for peripheral currencies such as the NZD. Deterioration in the terms of trade won't help either. This sees NZD depreciating against all the majors. The exception to the rule may be the NZD/AUD cross which looks set to range trade as the Australian and New Zealand economies display similar trajectories.



Other Key Developments

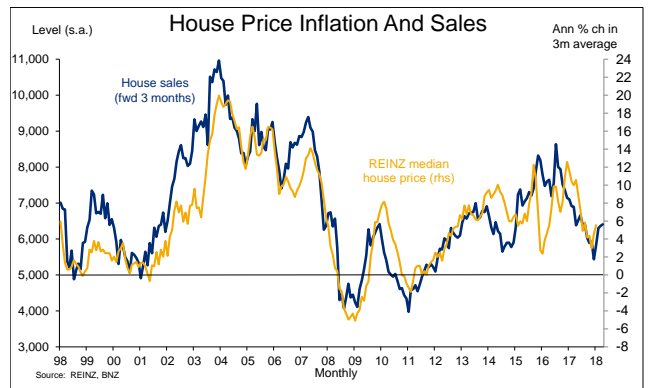
Productivity

We have long assumed that New Zealand's productivity performance has been stronger than the official data suggested. Recent revisions by Statistics New Zealand have supported this hypothesis. A higher GDP profile coupled with an increased estimate of the capital/labour ratio now sees New Zealand productivity growth tracking along at around 1.5% per annum for the majority of the last decade. While this is simply a recasting of history it does lend support to the hypothesis that the economy can continue to track along at a relatively heady pace without creating undue inflationary pressure.



Housing Market

The housing market appears to be stabilising after a period of sharply falling sales and house price inflation. January 2018 recorded the first annual increase in sales since June 2016 and on a seasonally adjusted basis sales are now 18% up on their September 2017 low. Consistent with this, annual house price inflation seems to be settling in a 3.0% to 4.0% range. Auckland and Christchurch inflation sits near zero but the remainder of the country looks a lot more robust. A short term softening in residential building consents may be providing some support but we do expect to see acceleration in activity through the year.



Monetary Policy

The Reserve Bank Act and Policy Targets Agreement (PTA) are under review. It is almost certain that the first stage of this review process (due for release in the next few weeks) will recommend the inclusion into the PTA of some sort of full employment target alongside the current inflation objective. Additionally, the review will demand a move to a committee decision making process from the current legislated single decision maker framework. The composition of that committee will be of great interest with the expectation being that it will comprise the top four RBNZ officials and then a number of independent outsiders. To cap things off, we get a new RBNZ Governor, Adrian Orr, at the end of the month. We doubt these changes will have any meaningful impact on the eventual rate set but we do see the Bank becoming far more communicative and open to debating issues.

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Quarterly Forecasts

Forecasts as at 1 March 2018

Key Economic Forecasts

Quarterly % change unless otherwise specified

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
GDP (production s.a.)	0.7	0.4	0.8	1.0	0.6	0.5	0.5	0.8	1.1	0.9
Retail trade (real s.a.)	1.0	1.4	1.4	1.8	0.3	1.7	1.0	0.7	1.3	1.3
Current account (ytd, % GDP)	-2.7	-2.5	-2.9	-2.7	-2.6	-2.5	-2.4	-2.6	-2.9	-3.1
CPI (q/q)	0.3	0.4	1.0	0.0	0.5	0.1	0.3	0.3	0.7	0.2
Employment	1.1	0.9	1.0	0.0	2.2	0.5	0.6	0.5	0.5	0.5
Unemployment rate %	4.9	5.3	4.9	4.8	4.6	4.5	4.4	4.4	4.3	4.2
Avg hourly earnings (ann %)	1.6	1.1	1.1	1.2	2.0	3.1	3.2	3.0	2.8	2.6
Trading partner GDP (ann %)	3.2	3.5	3.5	3.7	4.0	3.9	4.0	3.8	3.6	3.7
CPI (y/y)	0.4	1.3	2.2	1.7	1.9	1.6	0.9	1.2	1.4	1.5
GDP (production s.a., y/y)	4.1	3.4	3.0	2.8	2.7	2.9	2.6	2.4	2.9	3.3

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
2016 Dec	1.85	2.10	2.45	2.95	2.25	2.65	3.10	0.90	2.10	0.80
2017 Mar	1.75	2.00	2.70	3.25	2.35	3.00	3.50	1.15	2.50	0.80
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	2.30	2.80	2.20	2.65	3.10	1.60	2.40	0.40
Forecasts										
2018 Mar	1.75	1.95	2.50	3.00	2.15	2.75	3.30	1.80	2.75	0.25
Jun	1.75	1.95	2.50	3.00	2.15	2.75	3.30	1.95	2.75	0.25
Sep	1.75	1.95	2.60	3.05	2.30	2.85	3.35	2.20	2.75	0.30
Dec	1.75	2.05	2.65	3.10	2.40	2.90	3.40	2.30	2.75	0.35
2019 Mar	2.00	2.30	2.75	3.10	2.60	3.00	3.40	2.45	2.75	0.35
Jun	2.25	2.55	2.80	3.10	2.85	3.00	3.40	2.55	2.75	0.35
Sep	2.50	2.80	3.00	3.20	3.10	3.00	3.40	2.55	2.75	0.45
Dec	2.75	3.05	3.05	3.25	3.20	3.05	3.40	2.55	2.75	0.50
2020 Mar	3.00	3.20	3.15	3.30	3.30	3.05	3.40	2.55	2.75	0.55

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.73	0.78	1.23	1.40	107
Mar-18	0.72	0.79	1.25	1.44	110
Jun-18	0.72	0.78	1.28	1.45	110
Sep-18	0.71	0.77	1.30	1.47	109
Dec-18	0.70	0.75	1.30	1.48	109
Mar-19	0.70	0.75	1.28	1.46	108
Jun-19	0.71	0.76	1.27	1.45	107
Sep-19	0.71	0.76	1.28	1.45	106
Dec-19	0.70	0.75	1.30	1.46	105
Mar-20	0.70	0.75	1.32	1.47	105
Jun-20	0.69	0.74	1.34	1.48	103

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.73	0.93	0.59	0.52	77.9	75.0
Mar-18	0.72	0.92	0.58	0.50	79.6	73.9
Jun-18	0.72	0.92	0.56	0.50	79.2	73.3
Sep-18	0.71	0.92	0.55	0.48	77.4	72.1
Dec-18	0.70	0.93	0.54	0.47	76.3	71.4
Mar-19	0.70	0.93	0.55	0.48	75.6	71.6
Jun-19	0.71	0.93	0.56	0.49	76.0	72.6
Sep-19	0.71	0.94	0.56	0.49	75.3	72.6
Dec-19	0.70	0.93	0.54	0.48	73.5	71.6
Mar-20	0.70	0.93	0.53	0.48	73.5	71.6
Jun-20	0.69	0.93	0.52	0.47	71.1	70.6

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 1 March 2018	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019
GDP - annual average % change										
Private Consumption	3.9	5.3	3.6	3.4	2.3	3.8	5.0	4.0	3.3	2.7
Government Consumption	2.5	2.0	4.3	2.4	2.2	2.7	1.8	4.2	2.5	2.5
Total Investment	4.7	5.6	2.9	3.7	3.9	4.3	6.4	2.6	3.8	4.0
Stocks - ppts cont'n to growth	-0.3	-0.1	-0.3	0.4	0.0	-0.3	0.0	-0.2	0.2	0.0
GNE	3.5	4.7	3.2	3.8	2.7	3.2	4.7	3.6	3.6	3.0
Exports	5.6	0.7	4.4	2.4	4.1	6.9	1.6	2.5	2.9	4.0
Imports	2.0	5.1	5.4	4.4	3.6	3.7	3.4	5.8	4.6	3.9
Real Expenditure GDP	4.4	3.5	3.2	3.2	2.8	4.2	4.1	2.8	3.2	3.0
GDP (production)	3.6	3.7	2.7	3.0	2.8	3.5	4.0	2.9	2.8	3.0
<i>GDP - annual % change (q/q)</i>	4.0	3.0	2.6	3.4	2.5	3.1	3.4	2.9	3.3	2.6
Output Gap (ann avg, % dev)	1.0	1.3	0.8	1.1	1.1	0.8	1.3	1.0	1.0	1.1
Household Savings (% disp. income)	-1.3	-2.8	-1.8	-2.4	-2.1					
Nominal Expenditure GDP - \$bn	254.7	270.0	286.0	298.2	311.7	251.0	266.0	282.3	295.0	308.3
Prices and Employment - annual % change										
CPI	0.4	2.2	0.9	1.9	2.0	0.1	1.3	1.6	1.5	2.1
Employment	2.0	5.7	3.3	2.0	1.6	1.4	5.8	3.7	2.1	1.8
Unemployment Rate %	5.2	4.9	4.4	4.4	4.4	5.0	5.3	4.5	4.2	4.4
Wages - ahote	2.5	1.1	3.2	2.8	2.7	2.5	1.1	3.1	2.6	2.8
Productivity (ann av %)	1.5	-1.9	-1.2	0.5	1.0	1.2	-0.8	-1.6	-0.2	1.1
Unit Labour Costs (ann av %)	1.3	3.9	4.3	3.2	2.1	1.5	2.7	4.2	4.0	2.0
External Balance										
Current Account - \$bn	-7.3	-7.7	-6.9	-9.8	-9.7	-8.0	-6.6	-7.2	-9.7	-9.8
Current Account - % of GDP	-2.8	-2.9	-2.4	-3.3	-3.1	-3.2	-2.5	-2.6	-3.3	-3.2
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	0.7	1.5	1.0	0.9	1.6					
Net Core Crown Debt (excl NZS Fund Assets)	24.5	22.2	23.3	23.2	22.2					
Bond Programme - \$bn	7.0	8.0	8.0	9.0	10.0					
Bond Programme - % of GDP	2.7	3.0	2.8	3.0	3.2					
Financial Variables ⁽¹⁾										
NZD/USD	0.67	0.70	0.72	0.70	0.70	0.68	0.70	0.70	0.70	0.70
USD/JPY	113	113	110	108	105	122	116	113	109	105
EUR/USD	1.11	1.07	1.25	1.28	1.32	1.09	1.05	1.18	1.30	1.30
NZD/AUD	0.90	0.92	0.92	0.93	0.93	0.93	0.96	0.91	0.93	0.93
NZD/GBP	0.47	0.57	0.50	0.48	0.48	0.45	0.56	0.52	0.47	0.48
NZD/EUR	0.61	0.66	0.58	0.55	0.53	0.62	0.67	0.59	0.54	0.54
NZD/YEN	76.2	79.1	79.6	75.6	73.5	82.1	81.6	78.7	76.3	73.5
TWI	72.2	76.5	73.9	71.6	71.6	73.4	78.1	73.6	71.4	71.6
Overnight Cash Rate (end qtr)	2.25	1.75	1.75	2.00	3.00	2.50	1.75	1.75	1.75	2.75
90-day Bank Bill Rate	2.41	1.98	1.95	2.28	3.20	2.78	2.02	1.88	2.03	3.03
5-year Govt Bond	2.40	2.70	2.50	2.75	3.15	2.95	2.75	2.30	2.65	3.05
10-year Govt Bond	2.90	3.25	3.00	3.10	3.30	3.45	3.30	2.80	3.10	3.25
2-year Swap	2.30	2.30	2.15	2.60	3.30	2.80	2.40	2.20	2.40	3.20
5-year Swap	2.60	3.00	2.75	3.00	3.40	3.15	3.00	2.65	2.90	3.30
US 10-year Bonds	1.90	2.50	2.75	2.75	2.75	2.25	2.50	2.40	2.75	2.75
NZ-US 10-year Spread	1.00	0.75	0.25	0.35	0.55	1.20	0.80	0.40	0.35	0.50

⁽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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