

RESEARCH

NEW ZEALAND AT A GLANCE

31 May 2018



Overview

The NZ economy continues to perform relatively well. And there is much to sustain momentum. This includes a sizable fiscal stimulus, which kicks in proper from mid-year. From a broader perspective, however, growth still looks inclined to settle a bit lower. That said, inflation is primed to increase, as a consequence of chronic capacity constraints, resurgent commodity prices, and a tiring NZ dollar. This will press the case for the cash rate to rise, although we expect the RBNZ will lag in this process. Risk factors coalesce around currently-stretched asset prices – here and abroad – in the context of ongoing removal of global monetary stimulus, led by the Fed.

International

After a concerted push during 2017, global economic growth is close to its fastest pace since 2011. Having said this, there have been signs of fraying of late, especially in emerging-market economies. Based on Consensus expectations, New Zealand's trading-partner GDP growth is on track for 3.8% in calendar 2018 and 3.5% for 2019. This compares to 2017's 3.9% (and the historical average of 3.7%). International financial markets have been choppy this year, after relatively smooth waters during 2017. How this plays out could yet prove significant for the NZ economy and financial conditions.

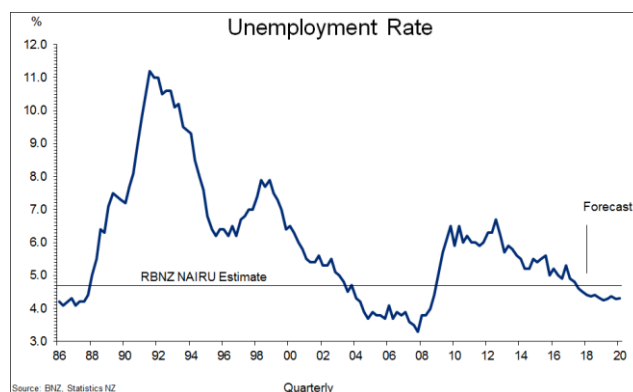
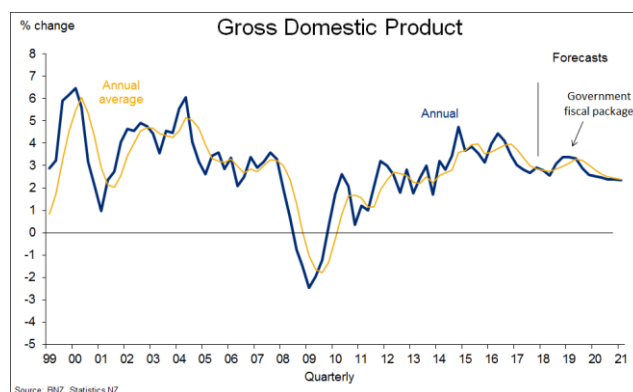
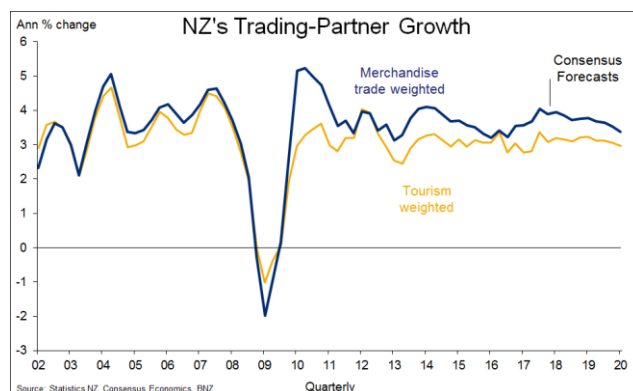
Growth

New Zealand's growth outlook is broadly positive, but with a sense that its strongest is behind it. GDP growth looks to have been patchy in Q1, but is set to strengthen over the rest of 2018, especially with the fiscal stimulus. Beyond this, however, we expect annual average growth to settle down into a range of 2.5 to 3.0%. This is mainly as population growth slows and capacity constraints bite. The post-election slump in business confidence doesn't seem to have halted investment (or employment) for now. However, it's a risk we are monitoring close, as is the cattle disease that the dairy/meat sector is dealing with.

Labour Market

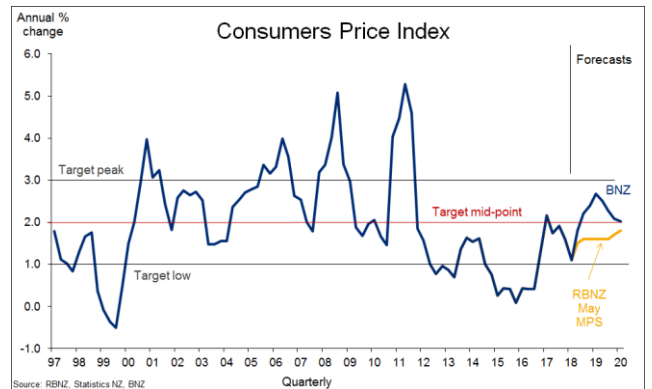
The labour market is getting tighter and tighter. By the first quarter of 2018 the unemployment rate had dropped to just 4.4% – the lowest in more than nine years. We think it will drift lower still, even with a near record high participation rate. This aligns with corporate New Zealand reporting great difficulty in finding both skilled and unskilled labour, as 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, the aggressive minimum wage increases, public sector wage claims, and CPI indexation, will conspire to drive wage inflation higher.

Key Indicators	December Years					
	Actual			Forecasts		
	2015	2016	2017	2018	2019	2020
GDP production (an avg %)	3.5	4.0	2.9	3.0	3.0	2.4
Consumers Price Index (ann %)	0.1	1.3	1.6	2.4	2.1	2.0
Unemployment Rate (end qtr %)	5.0	5.3	4.5	4.3	4.3	4.5
Current Account (% of GDP)	-3.1	-2.2	-2.7	-3.5	-3.1	-2.7
Fiscal Balance (% GDP June Yr)	0.2	0.7	1.5	1.0	0.9	1.6
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	2.50	3.00
10 Year Govt Bond (Dec mth avg %)	3.40	3.30	2.80	3.20	3.80	4.00



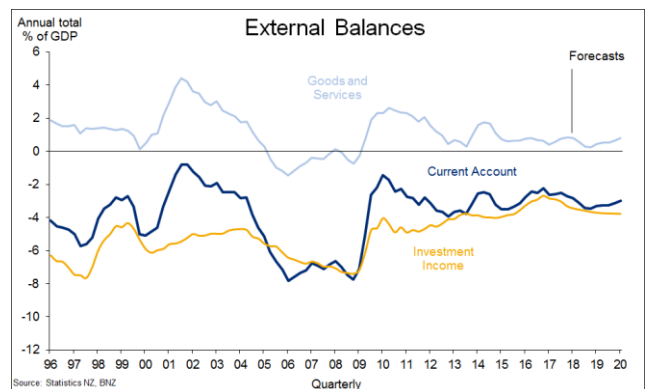
Inflation

We forecast annual CPI inflation to pick up to 2.7% by the March quarter of 2019, from its recent dip to 1.1%. While this is provoked by the recent surge in oil/fuel prices, continued wavering in the trade-weighted exchange rate is also a factor, along with a lagged response to the broadly stretched economy. Of course, a spike to 2.7% is nothing to be alarmed about (much like inflation being a bit below 2% isn't either). Nonetheless, if we're right, then headline inflation will certainly bolster inflation expectations and, very likely, cost-of-living wage claims too. Our CPI view is also a marker to the RBNZ needing to strengthen its annual CPI inflation track, which, in the May MPS, got to just 1.6% by early 2019.



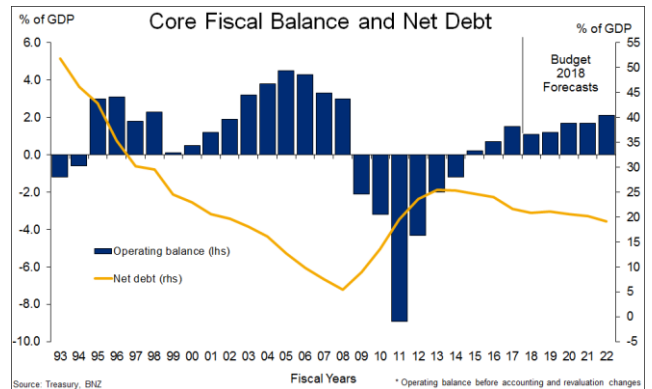
External Accounts

New Zealand's current account deficit for the year ended December 2017 equated to 2.7% of GDP. We forecast it to expand to 3.5% in 2018, owing to weaker dairy volumes, a softening in the terms of trade (from a record high in 2017) including the hit from higher oil prices, and strong domestic-demand-driven import growth – all of which contribute to a widening in the goods deficit. Also, there is a risk that the investment income deficit widens as global interest rates rise. But barring another global cataclysm – affecting the nation's intrinsic international funding requirement – we believe New Zealand's external accounts will remain agreeable enough for the various rating agencies.



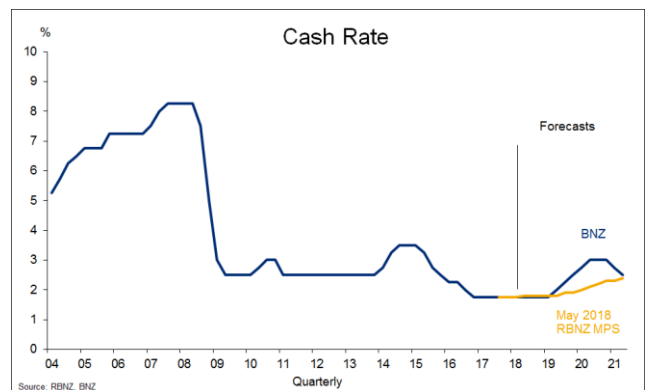
Fiscal Policy

The May Budget fully satisfied the surplus and debt parameters that the government campaigned on, albeit largely thanks to a continuing windfall in actual and forecast tax revenue. Allocating some of the borrowing requirement to the Housing NZ balance sheet also helped in getting net Crown debt down to/below the targeted 20% of GDP by 2022. All considered, the Budget indicated a clear net fiscal stimulus for 2018/19. And although the impulse peters out after that, the Budget built in some chunky allowances for future spending decisions. In this there are the makings of sustained late-cycle fiscal pressure, reminiscent of the previous Labour-led government's last term (2005-08).



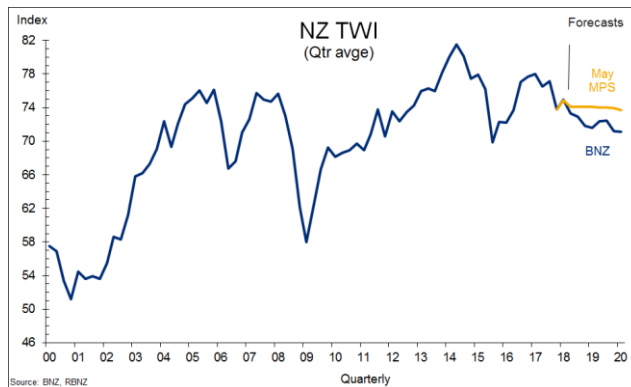
Interest Rates

Rightly or wrongly, New Zealand's interest rates have been largely immune to the upside forces bearing upon international yields of late. Then again, there have been no obvious swings in local funding costs, overall. The Reserve Bank is certainly showing no inclination to follow the Fed's lead, or even the RBA's clear tightening bias. The May MPS did signal an OCR hike, but not until 2020 – and while stressing that the very next move stands as much chance of being down as up. The markets expected more positivity. Rhetoric noted, our base case is that strengthening (core) inflation; heightened capacity constraints; financial stability considerations, and; a weakening currency, will see the Bank nudging its OCR toward its own view of "neutral", starting mid-2019.



Exchange Rates

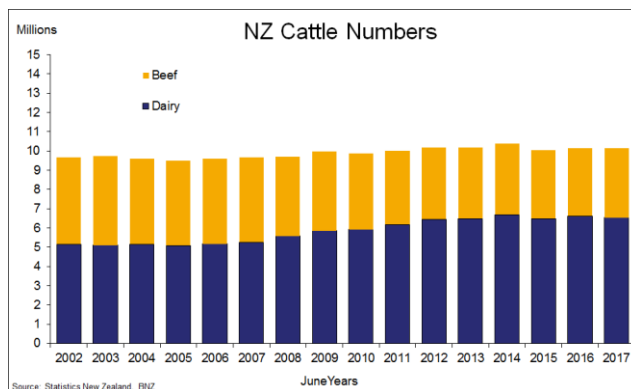
We expect New Zealand’s trade-weighted exchange rate (TWI) to continue to drift lower, as macro factors keep losing their relative edge. And this is despite forecasting a resumed moderation in USD, as the Federal Reserve’s monetary lead on the world hits a frontier, and America’s prospective twin (fiscal and current account) deficits pique concerns. Consequentially, we expect the slippage in the NZ dollar to play out more against the likes of JPY, GBP and EUR. NZD/USD, NZD/AUD and NZD/CNY look relatively steadier, from present levels. Meanwhile, global risks have resurfaced, notably in emerging markets (but also European politics). Things of this ilk have the potential to cause a bigger fall in NZD than we presently project.



Other Key Developments

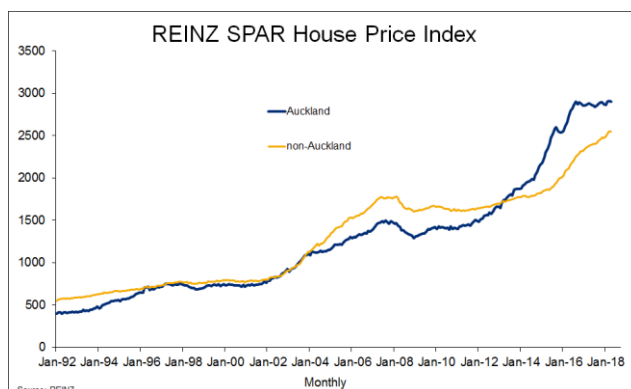
Cattle Disease (Mycoplasma bovis)

The economic risks associated with the cow-disease Mycoplasma bovis are rising. While it presents no food safety risk to humans it is a bane for the rural economy. The Government has brokered an attempt to eradicate (rather than contain, or just live with) the disease. This involves culling 152,000 cows over the next year or two, at a cost of \$886m (shouldered 32/68% between industry and the taxpayer). This is approximately 1.5% of NZ’s total cattle population (with the dairy herd, at 6.5m, most affected, and the beef herd around 3.6m head). While this establishes a certainty of approach, there remain many other uncertainties, disruptions, and costs to consider.



Housing Market

Melding March and April – which gets around Easter shifts – presented a moderate pulse on home sales rather than anything stronger. We got a similar impression from the various house price indices published by the REINZ for April. Its composition-controlled SPAR index, for instance, eased 0.1%, slowing its annual inflation to 3.8%, from 4.2%. A relatively slower-to-negative tone was still in evidence in Auckland. Outside of Auckland (and Canterbury) there was still more substance to house price inflation, although this was showing signs of petering now too. The RBNZ described April’s housing data as “soft again”. Meanwhile, dwelling consents have perked up, as have house price expectations amongst the populace.



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Monetary Policy Mandates

The review of the Reserve Bank Act and associated mandates has proved as non-threatening as we figured on. At least with respect to Phase One, that is. Yes, ahead of any actual change to the Act, the new Policy Targets Agreement added employment to the existing price target. But the wording, for monetary policy to “...contribute to supporting maximum sustainable employment within the economy” was arguably vague enough to keep everyone happy. As for the new Governor, Adrian Orr, he has proved cautious, if not slightly dovish, so far. The potentially important committee structure (and membership) is not in place yet, and seems unlikely to be until much later in the year, at the earliest.

Quarterly Forecasts

Forecasts as at 31 May 2018

Key Economic Forecasts

Quarterly % change unless otherwise specified

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Forecasts				
						Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
GDP (production s.a.)	0.4	0.7	0.9	0.6	0.6	0.6	0.7	1.1	0.9	0.6
Retail trade (real s.a.)	1.4	1.5	1.8	0.3	1.4	0.1	0.5	1.3	1.3	0.7
Current account (ytd, % GDP)	-2.2	-2.6	-2.6	-2.5	-2.7	-2.8	-3.1	-3.4	-3.5	-3.3
CPI (q/q)	0.4	1.0	0.0	0.5	0.1	0.5	0.7	0.9	0.3	0.8
Employment	0.9	1.1	-0.1	2.2	0.4	0.6	0.5	0.5	0.6	0.6
Unemployment rate %	5.3	4.9	4.8	4.6	4.5	4.4	4.4	4.4	4.3	4.2
Avg hourly earnings (ann %)	1.1	1.1	1.2	2.0	3.1	4.0	4.0	3.8	3.7	3.4
Trading partner GDP (ann %)	3.6	3.6	3.7	4.1	3.9	3.9	3.9	3.7	3.8	3.8
CPI (y/y)	1.3	2.2	1.7	1.9	1.6	1.1	1.8	2.2	2.4	2.7
GDP (production s.a., y/y)	3.5	3.0	2.8	2.7	2.9	2.8	2.6	3.1	3.4	3.4

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 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	2.35	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
Forecasts										
Jun	1.75	2.00	2.50	2.90	2.25	2.75	3.20	2.25	3.00	-0.10
Sep	1.75	2.00	2.65	3.15	2.25	2.90	3.45	2.45	3.25	-0.10
Dec	1.75	2.00	2.75	3.20	2.40	3.00	3.50	2.55	3.25	-0.05
2019 Mar	1.75	2.10	2.85	3.25	2.55	3.10	3.55	2.65	3.25	0.00
Jun	2.00	2.35	3.15	3.55	2.85	3.10	3.55	2.75	3.50	0.05
Sep	2.25	2.60	3.35	3.70	3.10	3.10	3.55	2.75	3.50	0.20
Dec	2.50	2.85	3.50	3.80	3.35	3.40	3.85	2.75	3.50	0.30
2020 Mar	2.75	3.10	3.60	3.85	3.50	3.40	3.85	2.75	3.50	0.35
Jun	3.00	3.25	3.70	3.85	3.50	3.40	3.85	2.75	3.50	0.40

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.70	0.76	1.17	1.33	109
Jun-18	0.71	0.75	1.20	1.38	111
Sep-18	0.71	0.77	1.23	1.42	110
Dec-18	0.70	0.75	1.25	1.45	108
Mar-19	0.70	0.75	1.26	1.50	106
Jun-19	0.71	0.76	1.27	1.52	104
Sep-19	0.71	0.75	1.28	1.53	102
Dec-19	0.70	0.75	1.30	1.55	100
Mar-20	0.70	0.75	1.32	1.55	99
Jun-20	0.69	0.74	1.34	1.57	98
Sep-20	0.69	0.74	1.36	1.60	98

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.70	0.92	0.60	0.53	76.1	73.6
Jun-18	0.71	0.93	0.59	0.51	78.3	73.3
Sep-18	0.71	0.92	0.58	0.50	78.1	72.9
Dec-18	0.70	0.93	0.56	0.48	75.6	71.8
Mar-19	0.70	0.93	0.56	0.47	74.2	71.6
Jun-19	0.71	0.94	0.56	0.47	73.8	72.4
Sep-19	0.71	0.95	0.56	0.46	72.4	72.4
Dec-19	0.70	0.93	0.54	0.45	70.0	71.2
Mar-20	0.70	0.93	0.53	0.45	69.3	71.1
Jun-20	0.69	0.93	0.52	0.44	67.6	70.2
Sep-20	0.69	0.93	0.51	0.43	67.6	70.1

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 31 May 2018	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
GDP - annual average % change										
Private Consumption	3.9	5.4	4.0	3.2	2.2	5.0	4.5	3.3	2.5	1.4
Government Consumption	2.5	2.0	4.9	2.9	2.2	1.7	4.7	3.3	2.5	1.9
Total Investment	4.7	5.6	3.8	4.0	3.9	6.4	3.3	4.4	4.0	3.6
Stocks - ppts cont'n to growth	-0.3	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
GNE	3.5	4.8	3.5	3.1	2.6	4.7	4.0	2.9	2.9	2.1
Exports	5.6	0.7	4.0	1.7	4.2	1.6	2.5	1.7	4.2	4.5
Imports	2.1	5.1	6.2	3.5	3.6	3.4	6.6	3.7	3.9	3.0
Real Expenditure GDP	4.4	3.6	3.2	2.6	2.8	4.1	3.0	2.5	2.9	2.4
GDP (production)	3.6	3.7	2.8	3.1	2.8	4.0	2.9	3.0	3.0	2.4
<i>GDP - annual % change (q/q)</i>	4.0	3.0	2.8	3.4	2.5	3.5	2.9	3.4	2.6	2.4
Output Gap (ann avg, % dev)	1.0	1.3	0.9	1.2	1.0	1.3	1.0	1.1	1.1	0.7
Household Savings (% disp. income)	-1.3	-2.8	-2.5	-3.5	-3.3					
Nominal Expenditure GDP - \$bn	254.7	270.3	287.0	298.4	312.0	266.0	283.5	295.2	308.5	322.7
Prices and Employment - annual % change										
CPI	0.4	2.2	1.1	2.7	2.0	1.3	1.6	2.4	2.1	2.0
Employment	2.0	5.7	3.1	2.2	1.6	5.8	3.7	2.2	1.9	1.2
Unemployment Rate %	5.2	4.9	4.4	4.2	4.3	5.3	4.5	4.3	4.3	4.5
Wages - ahote	2.5	1.1	4.0	3.4	3.3	1.1	3.1	3.7	3.4	3.0
Productivity (ann av %)	1.5	-1.9	-0.8	0.6	0.9	-0.8	-1.3	0.2	0.9	1.1
Unit Labour Costs (ann av %)	1.3	3.8	3.8	3.2	2.5	2.7	4.0	3.8	2.4	2.3
External Balance										
Current Account - \$bn	-7.0	-7.2	-8.2	-9.9	-9.4	-6.0	-7.7	-10.2	-9.7	-8.8
Current Account - % of GDP	-2.8	-2.6	-2.8	-3.3	-3.0	-2.2	-2.7	-3.5	-3.2	-2.7
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)	24.0	21.7	20.8	20.7	19.7					
Bond Programme - \$bn	7.0	8.0	8.0	8.0	9.0					
Bond Programme - % of GDP	2.7	3.0	2.8	2.7	2.9					
Financial Variables ⁽¹⁾										
NZD/USD	0.67	0.70	0.73	0.70	0.70	0.70	0.70	0.70	0.70	0.68
USD/JPY	113	113	106	106	99	116	113	108	100	97
EUR/USD	1.11	1.07	1.23	1.26	1.32	1.05	1.18	1.25	1.30	1.38
NZD/AUD	0.90	0.92	0.94	0.93	0.93	0.96	0.91	0.93	0.93	0.93
NZD/GBP	0.47	0.57	0.52	0.47	0.45	0.56	0.52	0.48	0.45	0.43
NZD/EUR	0.61	0.66	0.59	0.56	0.53	0.67	0.59	0.56	0.54	0.49
NZD/YEN	76.2	79.1	77.0	74.2	69.3	81.6	78.7	75.6	70.0	66.0
TWI	72.2	76.5	74.8	71.6	71.1	78.1	73.6	71.8	71.2	69.2
Overnight Cash Rate (end qtr)	2.25	1.75	1.75	1.75	2.75	1.75	1.75	1.75	2.50	3.00
90-day Bank Bill Rate	2.41	1.98	1.93	2.08	3.08	2.02	1.88	2.00	2.83	3.17
5-year Govt Bond	2.40	2.70	2.35	2.85	3.60	2.75	2.30	2.75	3.50	3.65
10-year Govt Bond	2.90	3.25	2.95	3.25	3.85	3.30	2.80	3.20	3.80	3.95
2-year Swap	2.30	2.30	2.25	2.55	3.50	2.40	2.20	2.40	3.35	3.50
5-year Swap	2.60	3.00	2.70	3.10	3.85	3.00	2.65	3.00	3.75	3.90
US 10-year Bonds	1.90	2.50	2.85	3.25	3.50	2.50	2.40	3.25	3.50	3.50
NZ-US 10-year Spread	1.00	0.75	0.10	0.00	0.35	0.80	0.40	-0.05	0.30	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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