

RESEARCH

NEW ZEALAND AT A GLANCE

1 November 2018



Overview

Economic growth is expected to remain near potential, having slowed from an above-trend pace over recent years. Supply issues such as physical capacity constraints, infrastructure bottlenecks, a low unemployment rate, and declining working age population growth are material factors acting against faster expansion. Associated cost pressures coupled with high energy prices and a falling NZD sees business margins under pressure. This, and some concern around government policy, has resulted in weak business confidence. It is a risk to investment. Meanwhile, rising costs are driving some upward pressure on inflation, although the RBNZ seems in no hurry to move interest rates in either direction. A possible El Nino weather pattern over coming months is a risk to pastoral agriculture and the type and cost of electricity generation.

International

Worries about the global outlook continue to rise as: US monetary conditions tighten, US-Chinese trade tensions persist; Chinese growth moderates; and Emerging Markets struggle to maintain momentum. Despite this, global inflation is still rising, encouraging the major central banks to remove monetary stimulus in its various forms. This in turn puts further downward pressure on global activity. Equity market volatility has increased. Not surprisingly, then, New Zealand trading partner growth is forecast to slow. Growth for calendar 2018 is forecast to be 4.0%, slowing to 3.7% in 2019 and 3.4% in 2020. While moderating, the pace of expansion will continue to support New Zealand exporters. And not all trade developments have been negative, with the CPTPP trade agreement coming into force at year's end.

Growth

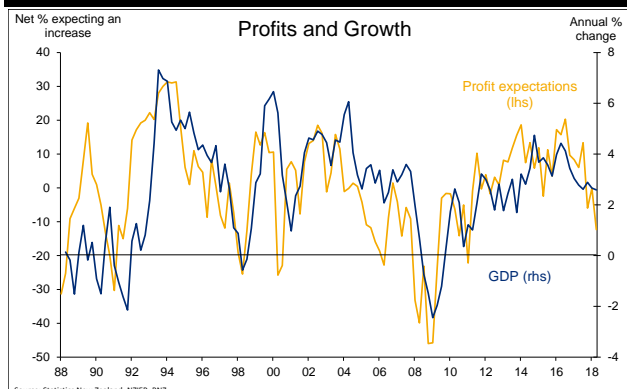
New Zealand's GDP growth has moderated. Easing net migration, from extreme highs, is slowing population growth, while the terms of trade is peaking, and capacity constraints are binding. Meanwhile, deeply negative business sentiment clouds the investment outlook. Profit margins and activity are under pressure from rising costs. For all that, economic growth to date has held up rather well, in the circumstances, at around trend pace. Economic momentum remains positive, fiscal stimulus is supportive, and monetary conditions are very accommodative. Meanwhile, population growth remains relatively strong and service sector and tourism activity continue to grow. Overall growth is expected to remain near potential over the coming years.

Key Indicators	December Years					
	Actual			Forecasts		
	2015	2016	2017	2018	2019	2020
GDP production (an avg %)	3.6	4.0	2.8	2.9	2.8	2.6
Consumers Price Index (ann %)	0.1	1.3	1.6	2.2	2.0	1.7
Unemployment Rate (end qtr %)	5.0	5.3	4.5	4.3	4.2	4.2
Current Account (% of GDP)	-2.9	-2.1	-2.9	-3.9	-4.4	-4.1
Fiscal Balance (% GDP June Yr)	0.2	0.7	1.5	1.9	1.1	1.2
NZD/USD (Dec mth avg)	0.68	0.70	0.70	0.65	0.69	0.69
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	2.90	3.50	3.80

Trading Partner Growth To Slow



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 June 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, although we are watching an easing in employment intentions, 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 inflation rise.

Inflation

Consumer price inflation is close to target and trending higher. Annual inflation rose to 1.9% in Q3 from 1.5% in Q2. We forecast inflation to be through 2.0% by the end of this year and to stay at or above 2.0% for all of next year. 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. Most importantly, capacity pressure is putting upward pressure on underlying inflation. The big question is whether corporates respond to this by simply reducing labour, resorting to capital/labour substitution or increasing selling prices. Most likely we'll see a combination of the three.

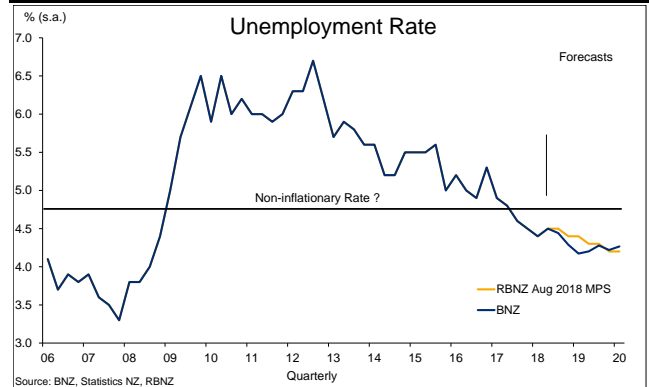
External Accounts

The current account deficit is growing. Back in calendar 2016 it hit a low of 2.1% of GDP. The following year it had climbed to 2.9%. We are forecasting it to rise to around 4.0% by the end of this year and to 4.5% of GDP through 2019. This stems from an expected retreat in the terms of trade while imports continue to expand as a result of reasonable domestic demand and ongoing domestic capacity constraints. Further expansion of the services surplus will provide some offset. The overall deterioration is not sufficient to endanger the improving trend in the net international income balance, but it will slow progress. Near term, a possible El Nino weather pattern poses a risk to primary export volumes.

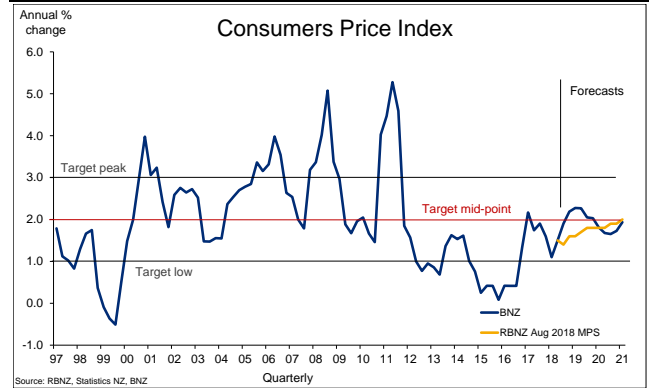
Fiscal Policy

The government is providing major stimulus to the economy via infrastructure spending and the significant transfers to the household sector. However, some of this spending has taken time to ramp up such that the 2017/18 fiscal year surplus came in well ahead of Budget at 1.9% of GDP. This saw net debt drop to 19.9% of GDP, strictly achieving the government's stated intention to have it around 20% within five years. Net debt bounced back to 20.9% of GDP as at end of September, although remains below Budget baselines. The challenge will be to stay there as GDP growth looks likely to disappoint forecasts.

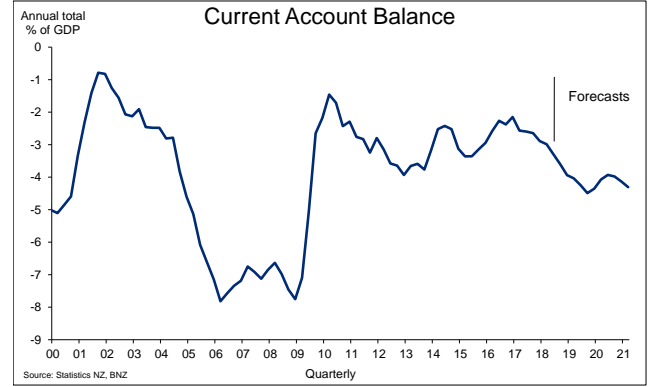
A Very Tight Labour Market



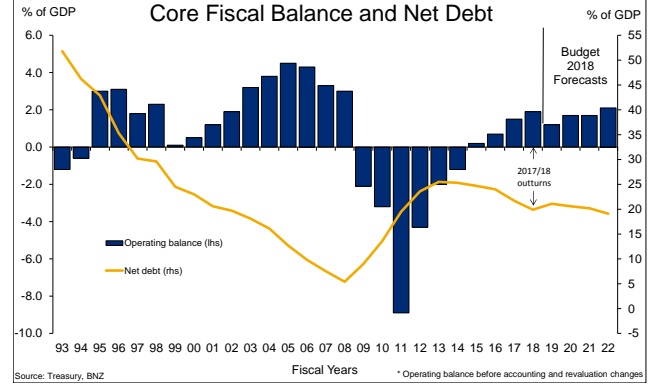
Inflation Trending Higher



Current Account To Deteriorate Further



Fiscal Headroom



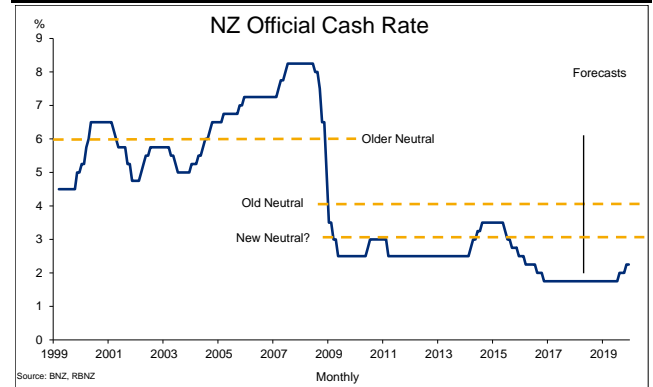
Interest Rates

With economic growth and inflation printing significantly above RBNZ forecasts, pressure on the Bank to raise interest rates has risen and we think will rise further. These data have certainly lessened the chance of a cut. But we sense the RBNZ is in no hurry to move interest rates in either direction. We suspect language to that effect will be included in the upcoming 8 November Monetary Policy Statement. Previous focus on data outcomes may give way to global risks and equity market volatility. Recent messaging from the RBNZ seems to suggest that it will use the full flexibility of its inflation target range with an eye also on its employment objective when setting policy. Consequently, a move in inflation above 2.0%, as we forecast, need not necessarily result in a higher cash rate in the first instance. Accordingly, we see the RBNZ being unmoved until at least well into 2019.

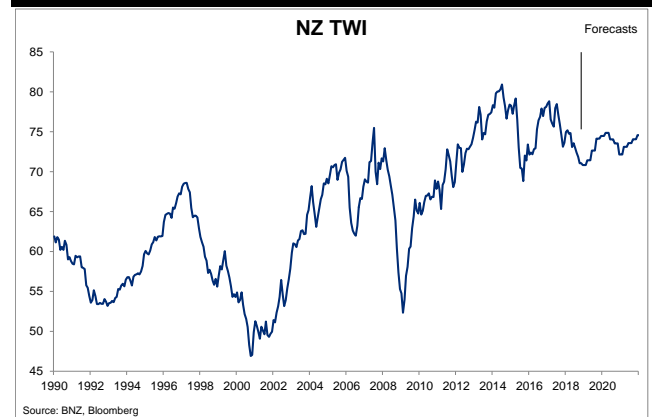
Exchange Rates

Downside risks to the NZD remain, following a period of clear depreciation. Declining relative interest rate support, falling terms of trade, a rising current account deficit, and rising global risk are headwinds for the NZD. Global factors have been critical to NZD movements of late, although, it is fair to say, the NZD has held up reasonably well considering the slump in equity markets and the fall in risk appetite of late. It brings the possibility that NZD selling pressure over the past six months could be nearing an end. We think it is too early to declare that. We anticipate the NZD TWI to drift lower near term, before finding support. We expect downward pressure against the JPY, EUR, and GBP but range trading against the AUD and USD. Domestic factors have a chance to affect the NZD ahead, with the release of the RBNZ's next Monetary Policy Statement on 8 November.

Lower For Longer



NZD Downside Risks Remain



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Quarterly Forecasts

Forecasts as at 1 November 2018

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19
GDP (production s.a.)	0.8	0.6	0.6	0.5	1.0	0.8	0.8	0.4	0.7	0.7
Retail trade (real s.a.)	1.6	0.3	1.3	0.3	1.1	1.1	1.0	0.7	0.6	0.6
Current account (ytd, % GDP)	-2.6	-2.6	-2.9	-3.0	-3.3	-3.6	-3.9	-4.0	-4.2	-4.5
CPI (q/q)	0.0	0.5	0.1	0.5	0.4	0.9	0.4	0.6	0.4	0.7
Employment	-0.1	2.2	0.4	0.6	0.5	0.5	0.5	0.6	0.5	0.4
Unemployment rate %	4.8	4.6	4.5	4.4	4.5	4.4	4.3	4.2	4.2	4.3
Avg hourly earnings (ann %)	1.2	2.0	3.1	4.0	3.3	2.9	3.0	2.8	3.4	3.6
Trading partner GDP (ann %)	3.7	4.0	3.9	4.1	4.1	3.9	3.8	3.8	3.7	3.7
CPI (y/y)	1.7	1.9	1.6	1.1	1.5	1.9	2.2	2.3	2.3	2.1
GDP (production s.a., y/y)	2.8	2.6	2.9	2.6	2.8	3.0	3.1	3.0	2.7	2.6

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 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
Sep	1.75	2.00	2.25	2.80	2.20	2.65	3.10	2.35	3.00	-0.45
Forecasts										
Dec	1.75	1.95	2.25	2.85	2.00	2.55	3.15	2.40	3.25	-0.40
2019 Mar	1.75	1.95	2.35	2.90	2.20	2.65	3.20	2.60	3.25	-0.35
Jun	1.75	2.05	2.60	3.15	2.40	2.65	3.20	2.95	3.50	-0.35
Sep	2.00	2.30	2.80	3.30	2.70	2.65	3.20	2.95	3.50	-0.20
Dec	2.25	2.55	3.00	3.45	3.00	2.90	3.45	3.20	3.50	-0.05
2020 Mar	2.50	2.80	3.15	3.55	3.20	2.90	3.45	3.45	3.50	0.05
Jun	2.75	2.95	3.30	3.55	3.20	2.90	3.45	3.45	3.50	0.15
Sep	2.75	2.95	3.35	3.55	3.20	3.10	3.60	3.45	3.50	0.20
Dec	2.75	2.95	3.35	3.65	3.40	3.10	3.60	3.45	3.50	0.25

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.65	0.71	1.13	1.28	113
Dec-18	0.65	0.71	1.18	1.26	112
Mar-19	0.65	0.72	1.20	1.28	110
Jun-19	0.66	0.73	1.22	1.30	110
Sep-19	0.68	0.75	1.25	1.34	108
Dec-19	0.69	0.75	1.30	1.40	106
Mar-20	0.70	0.76	1.32	1.43	104
Jun-20	0.70	0.77	1.34	1.46	102
Sep-20	0.70	0.76	1.36	1.49	100
Dec-20	0.69	0.75	1.38	1.52	99
Mar-21	0.70	0.75	1.38	1.52	98

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.65	0.92	0.58	0.51	73.7	72.1
Dec-18	0.65	0.91	0.55	0.51	72.5	70.8
Mar-19	0.65	0.90	0.54	0.51	71.5	71.4
Jun-19	0.66	0.90	0.54	0.51	72.6	72.6
Sep-19	0.68	0.91	0.54	0.51	73.4	74.1
Dec-19	0.69	0.92	0.53	0.49	73.1	74.5
Mar-20	0.70	0.92	0.53	0.49	72.8	74.9
Jun-20	0.70	0.91	0.52	0.48	71.4	74.0
Sep-20	0.70	0.92	0.52	0.47	70.0	73.5
Dec-20	0.69	0.92	0.50	0.45	68.3	72.1
Mar-21	0.70	0.93	0.51	0.46	68.6	73.1

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 1 November 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	5.1	3.8	3.2	2.3	1.6	4.8	4.4	3.0	2.7	1.7
Government Consumption	1.9	4.8	3.9	1.7	1.7	1.6	4.5	4.2	2.1	1.7
Total Investment	5.6	3.8	2.4	3.5	3.8	6.4	3.4	2.9	3.3	3.6
Stocks - pts cont'n to growth	-0.1	-0.1	0.1	0.0	0.0	0.0	-0.1	0.3	-0.2	0.0
GNE	4.6	3.9	3.8	2.5	2.2	4.6	4.1	4.0	2.7	2.2
Exports	1.3	3.0	4.7	3.9	3.8	2.1	1.8	4.2	4.4	3.9
Imports	5.1	7.2	6.8	3.2	2.5	3.4	7.0	7.4	3.9	2.3
Real Expenditure GDP	3.5	2.8	3.1	2.7	2.5	4.1	2.7	3.0	2.8	2.6
GDP (production)	3.7	2.7	3.0	2.7	2.5	4.0	2.8	2.9	2.8	2.6
<i>GDP - annual % change (q/q)</i>	3.0	2.6	3.0	2.7	2.4	3.4	2.9	3.1	2.6	2.5
Output Gap (ann avg, % dev)	1.1	0.7	0.7	0.5	0.2	1.2	0.8	0.7	0.5	0.2
Household Savings (% disp. income)	-2.8	-1.8	-3.8	-3.7	-2.5					
Nominal Expenditure GDP - \$bn	270.6	285.9	298.6	313.6	325.4	266.5	283.0	294.8	309.8	322.9
Prices and Employment - annual % change										
CPI	2.2	1.1	2.3	1.8	1.9	1.3	1.6	2.2	2.0	1.7
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	2.8	3.9	3.4	1.1	3.1	3.0	3.8	3.6
Productivity (ann av %)	-1.9	-0.8	0.0	0.8	1.0	-0.8	-1.4	-0.3	0.6	1.0
Unit Labour Costs (ann av %)	3.9	3.9	3.5	2.8	2.4	2.7	4.0	4.0	2.9	2.4
External Balance										
Current Account - \$bn	-6.9	-8.5	-11.8	-13.2	-14.9	-5.7	-8.2	-11.5	-13.5	-14.2
Current Account - % of GDP	-2.6	-3.0	-4.0	-4.2	-4.6	-2.1	-2.9	-3.9	-4.4	-4.4
Government Accounts - June Yr, % of GDP										
OBEHAL (core operating balance)	1.5	1.9	1.1	1.2	1.3					
Net Core Crown Debt (excl NZS Fund Assets)	21.7	19.9	19.6	19.0	17.8					
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	2.8					
Financial Variables ⁽¹⁾										
NZD/USD	0.70	0.73	0.65	0.70	0.70	0.70	0.70	0.65	0.69	0.69
USD/JPY	113	106	110	104	98	116	113	112	106	99
EUR/USD	1.07	1.23	1.20	1.32	1.38	1.05	1.18	1.18	1.30	1.38
NZD/AUD	0.92	0.94	0.90	0.92	0.93	0.96	0.91	0.91	0.92	0.92
NZD/GBP	0.57	0.52	0.51	0.49	0.46	0.56	0.52	0.51	0.49	0.45
NZD/EUR	0.66	0.59	0.54	0.53	0.51	0.67	0.59	0.55	0.53	0.50
NZD/YEN	79.1	77.0	71.5	72.8	68.6	81.6	78.7	72.5	73.1	68.3
TWI	76.5	74.8	71.4	74.9	73.1	78.1	73.6	70.8	74.5	72.1
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	1.95	2.78	2.87	2.02	1.88	1.95	2.53	2.95
5-year Govt Bond	2.70	2.35	2.35	3.15	3.30	2.75	2.30	2.25	3.00	3.35
10-year Govt Bond	3.25	2.95	2.90	3.55	3.75	3.30	2.80	2.85	3.45	3.75
2-year Swap	2.30	2.25	2.20	3.20	3.25	2.40	2.20	2.00	3.00	3.40
5-year Swap	3.00	2.70	2.65	3.45	3.60	3.00	2.65	2.55	3.30	3.65
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	-0.35	0.05	0.25	0.80	0.40	-0.40	-0.05	0.25

⁽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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