New Zealand At A Glance

25 August 2017

Overview

New Zealand's growth cycle looks set to be extended for a further three years (or more). Low interest rates, fiscal stimulus and population growth are the key to this. Growth is, however, being adversely impacted by capacity constraints, particularly in the labour market. Normally, such an environment would portend significant inflationary problems but inflation (at least that measured by the Consumers Price Index) is absent. Accordingly, the Reserve Bank is on hold for some time. Meanwhile, the recently robust NZD looks set for a modest correction against the USD while strengthening against the AUD.

International

There remain multiple uncertainties about the global growth outlook but, in aggregate, New Zealand's trading-partner growth looks likely to remain only modestly below average through the remainder of this year and 2018. Some moderation is expected thereafter as the Chinese growth rate continues to trend lower and the major economies begin to feel the impact of monetary policy normalization. More generally, trading-partner growth will continue to be supported by New Zealand's ongoing increased dependency on the emerging markets of Asia. The softening in growth in China is not seen as being sufficient to undermine this impact albeit that there are clear risks in the event that the Chinese slowdown becomes disorderly.

Growth

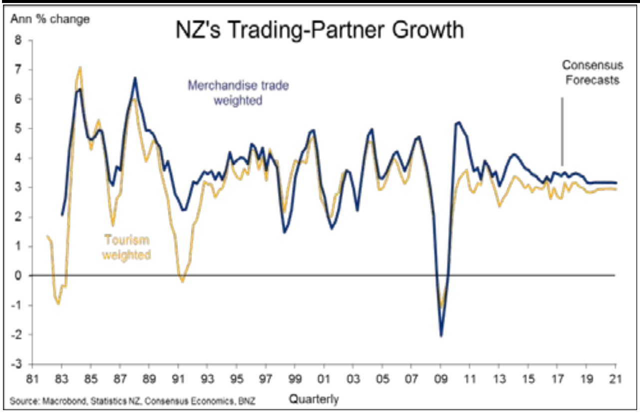
New Zealand's economic expansion is now over six years old and there is no reason to assume it will come to an end any time soon. While the expansion from here will be far from spectacular, we are still forecasting 2.5% growth for 2017, rising to 3.0% in 2018 before dropping back to 2.6% the year after. The economic expansion will be driven by stimulatory fiscal policy (tax cuts supporting private consumption and significant infrastructure spending); low interest rates (the cash rate staying well below neutral); a record high terms of trade; and migration-driven population growth.

Labour Market

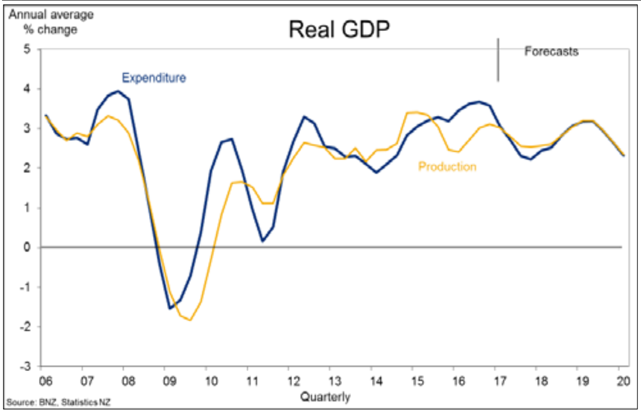
The labour market continues to tighten. The unemployment rate has fallen to its lowest level since 2008, at 4.8%, and threatens to go even lower. At the same time, an increasing number of businesses are reporting heightened difficulty in finding staff and a recent survey revealed that 21% of New Zealand businesses see labour shortages as being the single most important factor inhibiting sales growth. Despite this, wage inflation remains muted. We continue to forecast wage growth to accelerate modestly but accept downside risks remain. Nonetheless, with CPI inflation so low, real wage expansion still remains positive.

Key Indicators	December Years					
	Actual			Forecasts		
	2014	2015	2016	2017	2018	2019
GDP production (an avg %)	3.4	2.5	3.1	2.5	3.0	2.6
Consumers Price Index (ann %)	0.8	0.1	1.3	1.5	1.9	1.8
Unemployment Rate (end qtr %)	5.5	4.9	5.2	4.7	4.7	4.8
Current Account (% of GDP)	-3.2	-3.4	-2.8	-2.4	-2.7	-2.8
Fiscal Balance (% GDP June Yr)	-1.2	0.2	0.7	1.4	1.0	1.2
NZD/USD (Dec mth avg)	0.78	0.68	0.70	0.70	0.70	0.73
Overnight Cash Rate (Dec mth end %)	3.50	2.50	1.75	1.75	2.25	3.00
10 Year Govt Bond (Dec mth avg %)	3.80	3.40	3.30	3.10	3.60	3.90

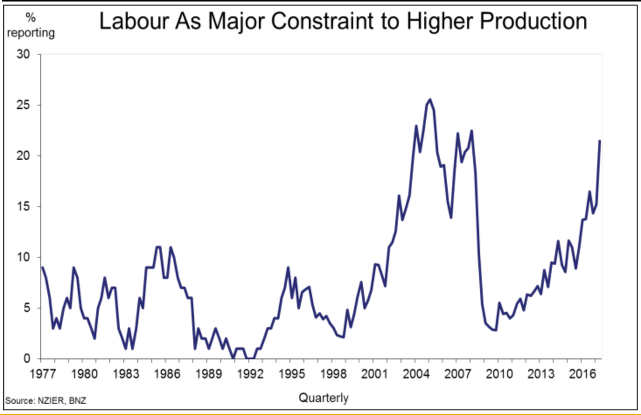
Trading partner growth stable



Growth solid but unspectacular



Labour shortages bite



Inflation

Annual consumer price inflation has been above the mid-point of the Reserve Bank's target band just once in the last 23 quarters. It poked up to 2.2% in the year to March 2017 but is now headed lower again. Indeed, it could well fall below 1.0% by March 2018 driven down by a combination of the recent past appreciation in the New Zealand dollar and plummeting prices for anything impacted by technological change. More importantly, ongoing weakness in tradables prices means it is unlikely that headline CPI inflation will significantly push above 2.0% in the foreseeable future.

Housing

The housing market is cooling rapidly. Based on REINZ data, house sales are slumping. In July sales were 25.4% down on year earlier levels. This is flowing through into house prices with annual house price inflation now down at just 1.2%, the lowest it's been since mid-2011. Auckland is bearing the brunt of the correction as it suffers from affordability issues which, in turn, have made the region most vulnerable to the RBNZ-imposed tighter LVR restrictions. This sort of momentum tends to feed on itself so further near term weakness can be expected. However, it is hard to believe a substantial correction will occur when demand for housing continues to exceed supply.

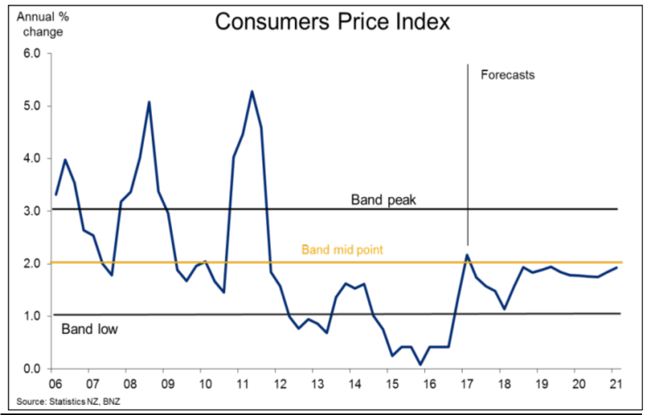
External Accounts

New Zealand's external accounts continue to look unthreatening. The current account deficit, as a proportion of GDP, sits at just 3.1% and it should go lower over the next twelve months. The significant surplus on services continues to provide most support for the accounts largely driven by the ongoing strength in tourism inflows. Additionally, the soaring terms of trade is helping prevent a sharp deterioration in the merchandise trade balance. The relative strength in the current account is resulting in an improvement in the country's net international investment position whose net liability, at 58.5% of GDP, is the lowest it has been in decades having peaked at 84% in 2009.

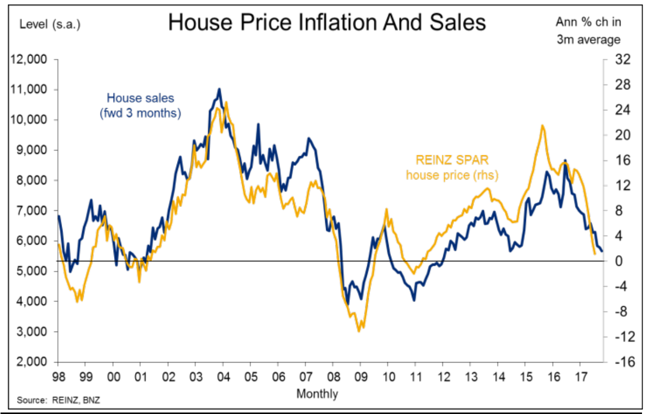
Commodities

New Zealand's terms of trade is in the throes of registering to a record high even passing the peak seen during the 1950s Korean War wool boom. This reflects the combination of strengthening agriculture sector output prices at the same time that oil prices have come under downward pressure. The world price of New Zealand commodity prices has risen 21.1% in the year to July. This translates into a 17.8% increase for New Zealand producers. Nearly all of New Zealand's commodity prices have pushed higher but dairy has led the charge increasing 45.2% in world price terms. We remain optimistic for the overall commodity outlook but note that a modest downward correction from current levels now looks likely.

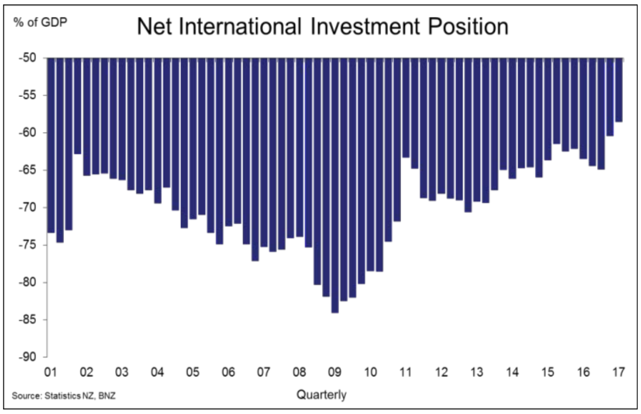
Inflation remains absent



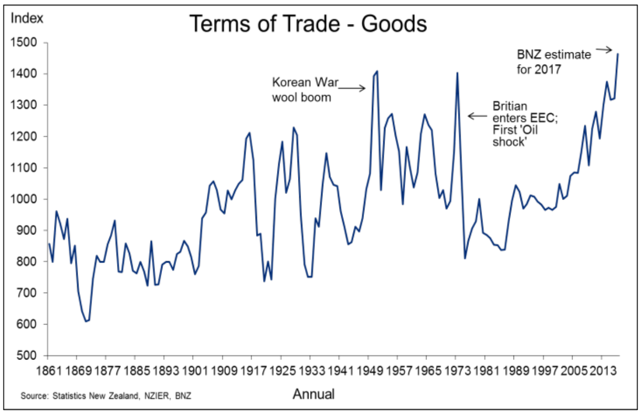
Housing market correcting



External accounts improving



Terms of trade approaches record high



Fiscal Policy

New Zealand is in the enviable position of being able to ease fiscal policy while still repaying debt and forecasting rising fiscal surpluses. This reflects both sensible past fiscal behaviours and windfall tax gains as the pace of growth in the nominal economy surprises despite lower than expected inflation. The fiscal surplus for the year ended June 2017 is estimated by Treasury, to be 1.4% of GDP. It drops to 1.0% in 2018, before rising to 2.0% by June 21. This allows the Government to reduce net debt to 18.8% of GDP over the period from an estimated starting point of 22.5%.

Interest Rates

New Zealand's cash rate is stuck at 1.75% where it's been since November 2016. We are forecasting the first rate hike in the cycle to be in August 2018 but the balance of risk is later rather than sooner. The Reserve Bank is displaying no hurry whatsoever to move. It's still forecasting rates on hold until December 2019. With the RBNZ stuck in neutral, shorter dated swap rates are likely to trade in narrow ranges near current levels. Longer dated paper is at risk from a global sell off. If the Federal Reserve sticks to its forecast rate track then the New Zealand yield curve is likely to steepen.

Exchange Rates

The New Zealand Dollar has surprised with its strength, especially against the USD. Rather than reflecting anything to do with New Zealand this has largely been the result of a string of weaker than expected data out of the US, reduced expectations for fiscal stimulus as the Trump Government fails to deliver, and reduced expectations for Fed tightening. Stronger New Zealand commodity prices would have helped at the margin. We still believe the NZD will weaken through to the end of the year as the Fed delivers on its tightening cycle and US indicators improve. Weakness against the EUR is also expected. Positive relative economic and commodity performance should deliver some NZD appreciation against the AUD.

Politics

The General Election is on September 23. It looks highly likely that New Zealand First will determine who the next Government is as neither National or Labour (along with their respective coalition partners) seems able to gain a majority. It had been widely assumed that New Zealand First would side with National but a change in the Labour Party leadership has the potential to markedly improve the relationship with NZ First. A change in Government would bring with it some significant policy changes. Generally, Labour governments tend to be more redistributive than National equivalents. Look also for possible changes to the Reserve Bank's Policy Targets Agreement.

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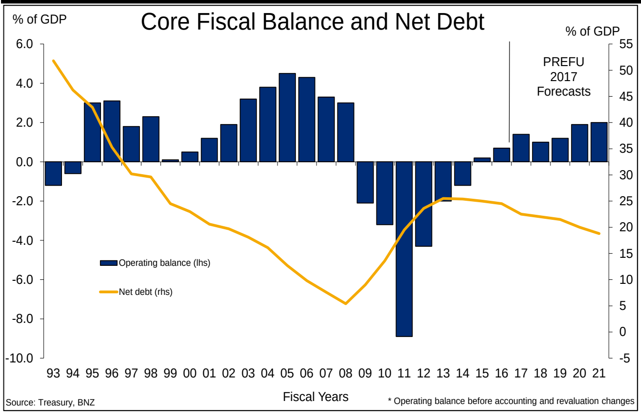
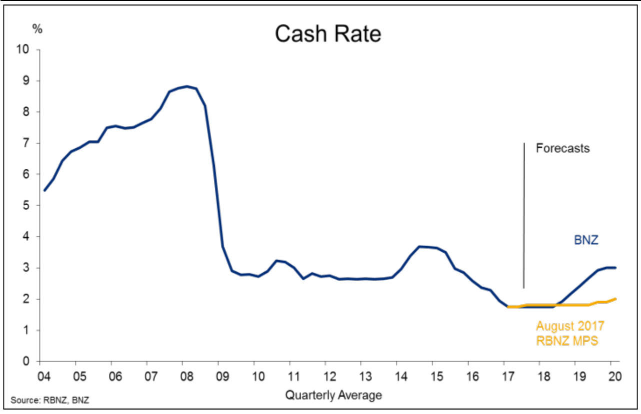
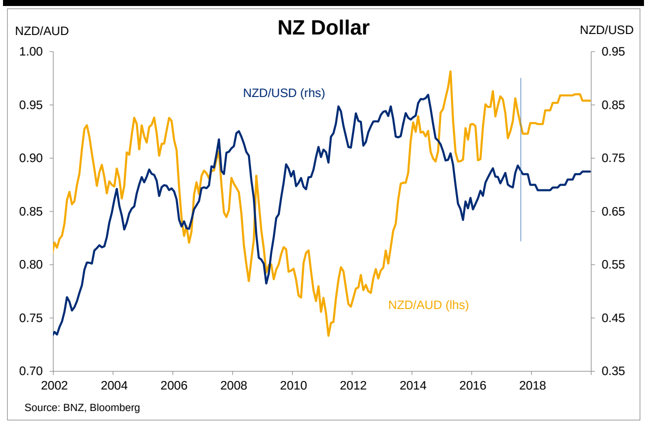
Fiscally strong



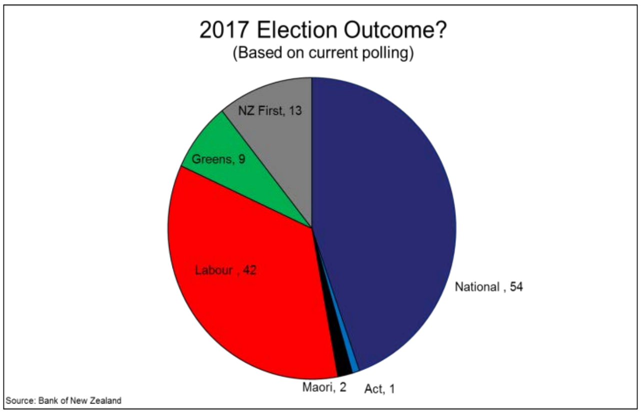
Cash rate going nowhere



NZD well supported



NZ First in the box seat



Quarterly Forecasts

As at 25 August 2017

Key Economic Forecasts

Quarterly % change unless otherwise specified | Forecasts

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
GDP (production s.a.)	0.7	0.8	0.8	0.4	0.5	0.9	0.6	0.6	0.6	1.0
Retail trade (real s.a.)	0.8	2.0	0.8	0.9	1.6	2.0	-0.4	0.8	0.7	1.6
Current account (ytd, % GDP)	-3.1	-2.9	-3.0	-2.8	-3.1	-2.9	-2.7	-2.4	-2.0	-2.3
CPI (q/q)	0.2	0.4	0.3	0.4	1.0	0.0	0.2	0.2	0.7	0.4
Employment	1.2	2.4	1.4	0.7	1.1	-0.1	0.8	0.7	0.7	0.6
Unemployment rate %	5.2	5.1	4.9	5.2	4.9	4.8	4.7	4.7	4.7	4.7
Avg hourly earnings (ann %)	2.5	2.1	1.6	1.1	1.1	1.2	2.0	2.7	2.8	2.6
Trading partner GDP (ann %)	3.2	3.4	3.2	3.5	3.4	3.4	3.5	3.4	3.4	3.5
CPI (y/y)	0.4	0.4	0.4	1.3	2.2	1.7	1.7	1.5	1.2	1.6
GDP (production s.a., y/y))	2.9	3.6	3.4	2.7	2.5	2.6	2.4	2.6	2.6	2.8

Interest Rates

Historical data - qtr average
Forecast data - end quarter

		Cash	Government Stock			Swaps			US Rates		Spread
			90 Day Bank Bills	5 Year	10 Year	2 Year	5 Year	10 Year	Libor 3 month	US 10 yr	NZ-US Ten year
2016	**Jun**	2.25	2.35	2.20	2.60	2.25	2.45	2.90	0.65	1.75	0.85
	Sep	2.10	2.30	1.95	2.25	2.05	2.15	2.50	0.80	1.55	0.70
	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	0.60
Forecasts											
	Sep	1.75	1.95	2.55	3.00	2.20	2.80	3.30	1.30	2.50	0.50
	Dec	1.75	1.95	2.65	3.10	2.20	2.90	3.40	1.45	2.75	0.35
2018	**Mar**	1.75	1.95	2.90	3.35	2.30	3.15	3.65	1.55	3.00	0.35
	Jun	1.75	2.05	2.95	3.40	2.40	3.20	3.70	1.70	3.00	0.40
	Sep	2.00	2.30	3.05	3.50	2.60	3.30	3.80	1.95	3.00	0.50
	Dec	2.25	2.55	3.15	3.60	2.85	3.40	3.90	2.20	3.00	0.60
2019	**Mar**	2.50	2.80	3.25	3.70	3.10	3.50	4.00	2.30	3.00	0.70
	Jun	2.75	3.05	3.30	3.75	3.20	3.50	4.00	2.30	3.00	0.75
	Sep	3.00	3.20	3.35	3.80	3.30	3.50	4.00	2.30	3.00	0.80

Exchange Rates (End Period)

	USD Forecasts					NZD Forecasts					
	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.72	0.79	1.18	1.28	109	0.72	0.91	0.61	0.56	78.9	76.3
Sep-17	0.72	0.78	1.19	1.28	112	0.72	0.92	0.61	0.56	80.6	76.7
Dec-17	0.70	0.75	1.17	1.27	116	0.70	0.93	0.60	0.55	81.2	75.8
Mar-18	0.69	0.74	1.18	1.29	118	0.69	0.93	0.59	0.54	81.4	74.9
Jun-18	0.69	0.73	1.20	1.29	118	0.69	0.95	0.58	0.54	81.4	74.9
Sep-18	0.70	0.73	1.22	1.28	120	0.70	0.95	0.57	0.54	83.4	75.4
Dec-18	0.70	0.73	1.20	1.26	120	0.70	0.96	0.58	0.56	84.0	76.0
Mar-19	0.71	0.74	1.20	1.25	120	0.71	0.96	0.59	0.57	85.2	76.7
Jun-19	0.72	0.75	1.18	1.24	118	0.72	0.96	0.61	0.58	85.0	77.6
Sep-19	0.73	0.76	1.18	1.25	116	0.73	0.95	0.61	0.58	84.1	77.6
Dec-19	0.73	0.76	1.17	1.24	117	0.73	0.95	0.62	0.59	84.8	77.6
						TWI Weights					
						14.0%	20.7%	11.3%	4.6%	6.4%	

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

Annual Forecasts

As at 25 August 2017

	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019
GDP - annual average % change										
Private Consumption	2.8	4.6	3.3	3.5	2.2	2.9	4.1	3.8	3.3	2.6
Government Consumption	2.7	2.6	2.4	1.6	1.3	2.6	2.4	2.9	1.7	1.2
Total Investment	2.5	5.6	3.9	4.0	2.8	2.1	5.5	4.2	4.0	3.3
Stocks - ppts cont'n to growth	-0.2	-0.2	0.2	0.0	0.0	-0.3	0.0	0.2	-0.1	0.0
GNE	2.5	4.2	3.2	3.3	2.2	2.3	4.0	3.7	3.1	2.6
Exports	5.5	1.0	3.6	3.5	4.0	6.8	1.9	1.4	4.2	4.0
Imports	2.1	5.1	4.8	3.8	3.4	3.7	3.4	5.5	3.9	3.6
Real Expenditure GDP	3.4	3.1	2.6	3.2	2.3	3.2	3.6	2.3	3.1	2.6
GDP (production)	**2.4**	**3.0**	**2.6**	**3.2**	**2.3**	**2.5**	**3.1**	**2.5**	**3.0**	**2.6**
GDP - annual % change (q/q)	*2.9*	*2.5*	*2.6*	*3.3*	*2.1*	*2.2*	*2.7*	*2.6*	*3.4*	*2.2*
Output Gap (ann avg, % dev)	0.9	1.0	0.9	1.3	1.1	0.8	1.0	1.0	1.2	1.2
Household Savings (gross, % disp. income)	1.2	0.4	0.1	0.5	1.1					
Nominal Expenditure GDP - $bn	250.6	264.7	281.7	296.0	308.4	247.5	260.8	278.1	292.1	305.3
Prices and Employment - annual % change										
CPI	0.4	2.2	1.2	1.9	1.8	0.1	1.3	1.5	1.9	1.8
Employment	2.0	5.7	2.0	2.4	1.7	1.4	5.8	2.5	2.5	2.0
Unemployment Rate %	5.2	4.9	4.7	4.7	4.8	4.9	5.2	4.7	4.7	4.8
Wages - ahote	2.5	1.1	2.8	2.8	2.7	2.5	1.1	2.7	2.6	2.8
Productivity (ann av %)	0.3	-2.6	-0.3	0.6	0.3	0.1	-1.6	-1.1	0.4	0.4
Unit Labour Costs (ann av %)	2.4	4.6	3.0	2.5	2.7	2.6	3.6	3.6	2.7	2.6
External Balance										
Current Account - $bn	-7.8	-8.1	-5.4	-7.0	-7.9	-8.3	-7.2	-6.5	-6.9	-7.7
Current Account - % of GDP	-3.1	-3.1	-1.9	-2.4	-2.6	-3.4	-2.8	-2.3	-2.4	-2.5
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	0.7	1.0	1.2	1.6	2.0					
Net Core Crown Debt (excl NZS Fund Assets)	24.5	22.9	22.2	21.3	19.7					
Bond Programme - $bn	7.0	8.0	7.0	7.0	7.0					
Bond Programme - % of GDP	2.8	3.0	2.5	2.4	2.3					
Financial Variables (1)										
NZD/USD	0.67	0.70	0.69	0.71	0.73	0.68	0.70	0.70	0.70	0.73
USD/JPY	113	113	118	120	116	122	116	116	120	117
EUR/USD	1.11	1.07	1.18	1.20	1.19	1.09	1.05	1.17	1.20	1.17
NZD/AUD	0.90	0.92	0.93	0.96	0.96	0.93	0.96	0.93	0.96	0.95
NZD/GBP	0.47	0.57	0.54	0.57	0.58	0.45	0.56	0.55	0.56	0.59
NZD/EUR	0.61	0.66	0.59	0.59	0.61	0.62	0.67	0.60	0.58	0.62
NZD/YEN	76.2	79.1	81.4	85.2	84.7	82.1	81.6	81.2	84.0	84.8
TWI	72.2	76.5	74.9	76.7	77.9	73.4	78.1	75.8	76.0	77.6
Overnight Cash Rate (end qtr)	2.25	1.75	1.75	2.50	3.00	2.50	1.75	1.75	2.25	3.00
90-day Bank Bill Rate	2.41	1.98	1.95	2.78	3.12	2.78	2.02	1.95	2.53	3.20
5-year Govt Bond	2.40	2.70	2.90	3.25	3.45	2.95	2.75	2.65	3.15	3.40
10-year Govt Bond	2.90	3.25	3.35	3.70	3.90	3.45	3.30	3.10	3.60	3.85
2-year Swap	2.30	2.30	2.30	3.10	3.20	2.80	2.40	2.20	2.85	3.30
5-year Swap	2.60	3.00	3.15	3.50	3.70	3.15	3.00	2.90	3.40	3.65
US 10-year Bonds	1.90	2.50	3.00	3.00	3.00	2.25	2.50	2.75	3.00	3.00
NZ-US 10-year Spread	1.00	0.75	0.35	0.70	0.90	1.20	0.80	0.35	0.60	0.85

(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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