

5 May 2017

Overview

The New Zealand economy continues to perform well and we anticipate reasonable growth ahead. High immigration is playing a role but momentum is broad-based. Still, we believe the growth phase is broadly maturing/peaking. This is manifesting in capacity constraints and slowing productivity. As this plays out, inflation is firming up, which will, in time, force a reluctant RBNZ to lift its cash rate. We expect the currency to drift slightly lower over 2017, but broadly underpinned by favourable relativities in GDP, positive fiscal accounts and a limited external deficit. Risks to the outlook relate mainly to the local property cycle and many matters global. It's also an election year for New Zealand.

International

World growth indicators continue to firm, having been a bit below par last year. Forecasters expect global growth to be better in 2017 than it was in 2016 – and better still in 2018. Meanwhile, there has been a push higher in inflation, supported by the bounce in world commodity prices as well as indications of lessening spare capacity. In the US, the Fed is slowly (but surely) taking its foot of its policy rate gas, while looking to start unwinding its QE later this year. This process will be important for markets to digest. As will rising geo-political tensions, potentially aggravated by Trump, while Brexit negotiations also get serious from now on.

Growth

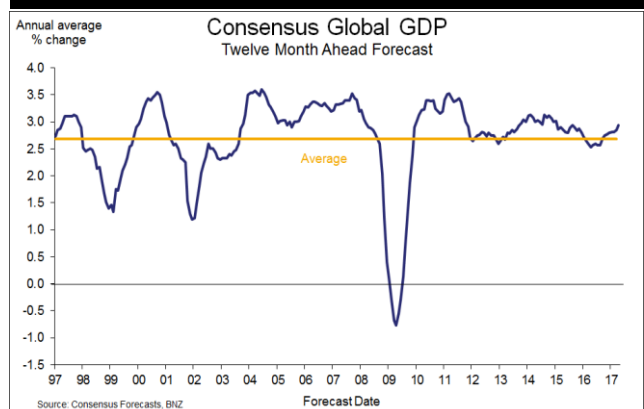
We forecast annual NZ GDP growth to slow to 2.7% this year and 2.5% in 2018. This is after posting a creditable 3.1% expansion in 2016. Activity was modestly disrupted by the 14 November Kaikoura earthquake but, ultimately, this will add to (re)building activity. In addition to immigration, economic momentum is coming from a robust labour market and investment cycle, commodity income (including a decent recovery in dairy income), soaring tourism, and improving global growth. Generally speaking, consumer confidence is robust and business expectations strong. Indeed, they suggest we might yet be too conservative with our GDP forecasts for the coming period.

Labour Market

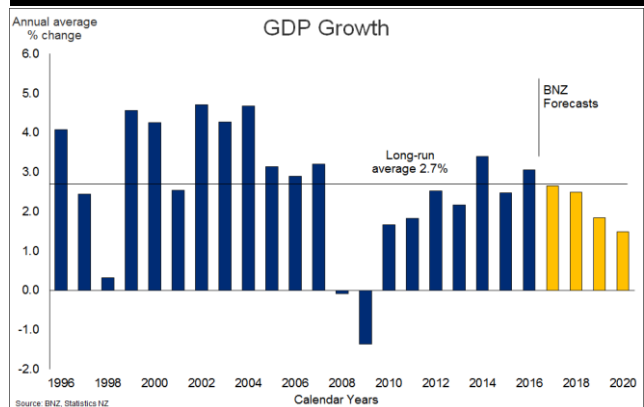
New Zealand's labour market still has a lot of momentum about it. Employment growth remains well strong enough to absorb the rapidly increasing labour supply, amid record highs in net inward migration and the participation rate. Hiring intentions are, by and large, still better than average. On balance, the unemployment rate continues to edge lower; being 4.9% in Q1 2017. Nominal wage pressures are, for the meantime, contained. However, we expect these to pick up, as skill shortages become even more obvious and widespread, and cost-of-living claims strengthen in line with (already) resurfacing CPI inflation.

Key Indicators	December Years					
	Actual 2014	Actual 2015	Actual 2016	Forecasts 2017	Forecasts 2018	Forecasts 2019
GDP production (an avg %)	3.4	2.5	3.1	2.7	2.5	1.8
Consumers Price Index (ann %)	0.8	0.1	1.3	2.3	2.1	1.7
Unemployment Rate (end qtr %)	5.5	4.9	5.2	5.0	5.4	5.6
Current Account (% of GDP)	-3.2	-3.4	-2.7	-2.4	-3.5	-3.4
Fiscal Balance (% GDP June Yr)	-1.2	0.2	0.7	0.4	1.2	1.8
NZD/USD (Dec mth avg)	0.78	0.67	0.70	0.67	0.69	0.73
Overnight Cash Rate (Dec mth end %)	3.50	2.50	1.75	1.75	2.50	3.50
10 Year Govt Bond (Dec mth avg %)	3.90	3.40	3.30	3.30	3.60	3.80

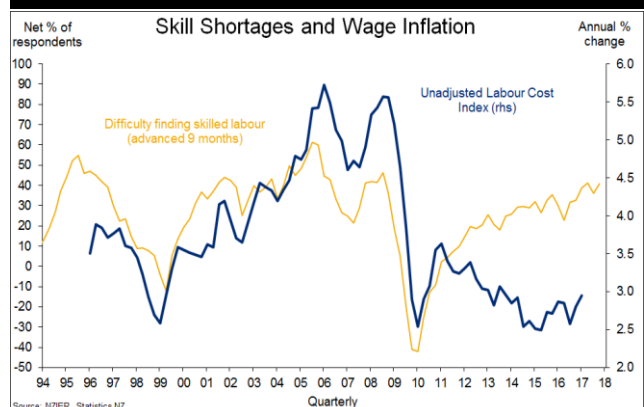
Global Growth Looking Better



NZ Growth Solid But Peaking



Wage Growth Still Missing in Action



Inflation

Inflation is becoming more evident, including now in the headline CPI. For the year ended March 2017, CPI inflation was 2.2%, up from 1.3% over calendar 2016 (and 0.1% in 2015). While some of this reflects a rebound in global commodity prices, it also fundamentally reflects above-trend demand and a tightening labour market. Also of note, annual rates of core inflation are now clustered closer to 2% y/y. We forecast annual CPI inflation to stay at or just above, the mid-point of the Reserve Bank’s 1.0 to 3.0% target band this year, and beyond. This is predicated on the trade-weighted exchange rate (TWI) completing its moderation over the remainder of 2017.

Housing

The housing market is losing steam in Auckland, peaking in Canterbury, but still stretching its legs most, everywhere. In Auckland, sale prices have been going sideways for about six months (albeit at levels doubled from five years ago), while turnover is now running below par. This probably reflects Auckland being most impacted by the RBNZ’s further tightened loan-to-value ratio (LVR) restrictions, especially around investors. This policy is evidently denting home sales around the rest of the country too, but, not so clearly, when it comes to inflation. The RBNZ is currently seeking a debt-to-income lending cap tool but the government is sounding reluctant to grant it this new lever.

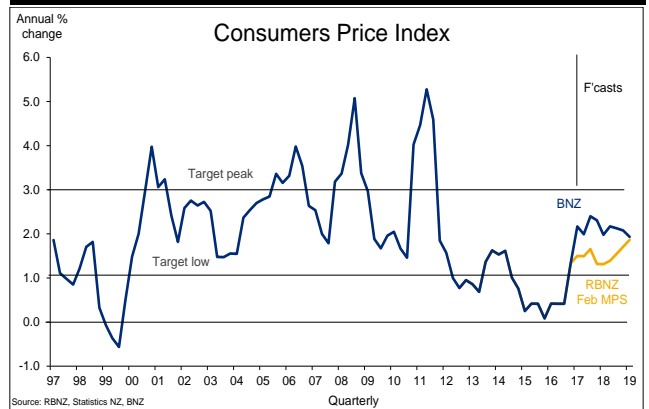
External Accounts

Despite surging domestic demand, and a prior run of weak dairy prices, New Zealand’s external accounts have held together quite nicely. For calendar 2016 the current account deficit was just 2.7% of GDP. We believe it will drift a bit lower throughout 2017, as recovering dairy export returns spill in. All the while, the travel balance is being boosted by booming tourist arrivals. The biggest reason the external deficit has shrunk so much, however, from its 7.8% of GDP peak in 2008, is a pruned deficit in international investment income. This is now just 3.0% of GDP – reflecting much lessened net international liabilities, and lows in interest rates.

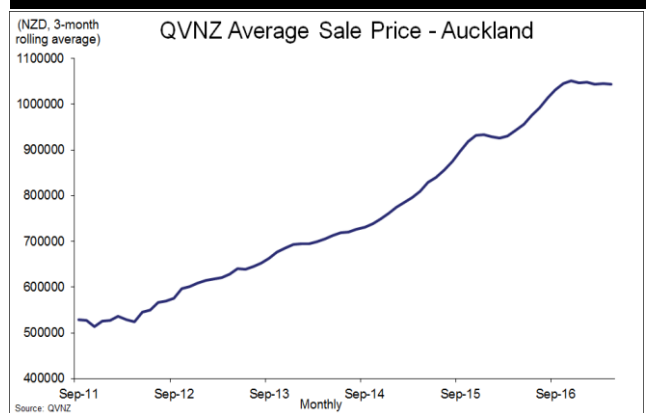
Commodities

New Zealand’s commodity export prices are generally in a good space. Notably, dairy export prices have recovered very well, from worryingly low levels barely a year ago. This means dairy farmers will be back to reasonable (but not buoyant) profitability this season. We see a similar story for next season. There has also been increase in other commodity export prices of late, to decent levels. This includes meat, forestry, seafood, aluminium, even horticulture. All up, commodity prices, in world terms, increased 24% in April, from a year ago. Converted to NZ dollars the annual lift has been about 20%. It’s consistent with a reclaimed record high in the goods terms of trade.

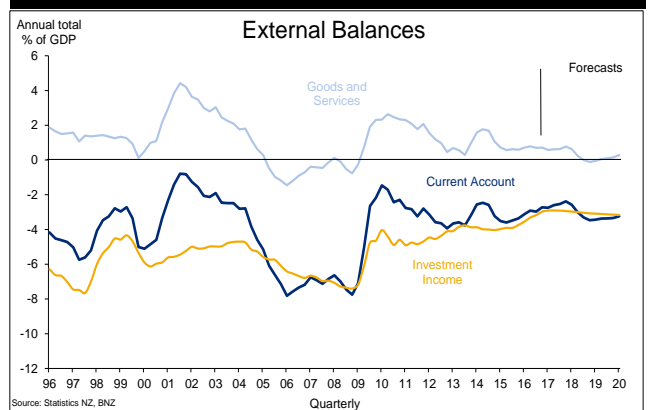
Middling Inflation, Here to Stay



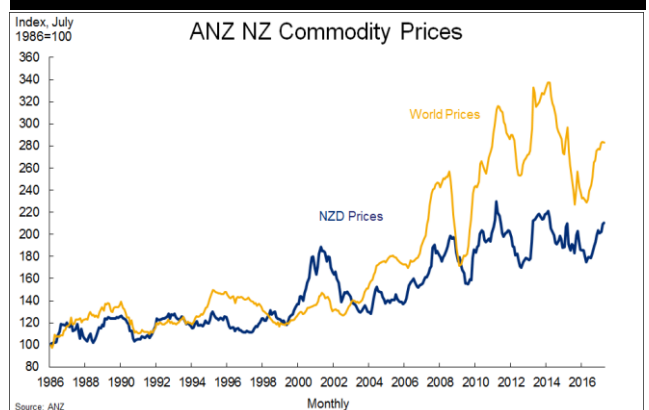
How’s the Air Up There?



External Accounts Well Behaved



Much Improved



Fiscal Policy

The government’s accounts just keep getting better, mainly on the coattails of a strong economy. A third successive (core) operating surplus for 2016/17 could yet be stymied by Kaikoura earthquake costs. But beyond that it’s looking increasingly positive. This gives the government plenty of options for its 25 May Budget including: extra spending; income tax relief (already well signalled) and; enough left over to keep paying down debt – to between 10 to 15% of GDP by 2025, on a net basis, as has become the newly extended government target.

Interest Rates

Interest rates, across the board – even mortgage rates – have started to push up off recent extreme lows. This is part of a global trend, but to do with local factors too. This includes a pinch from domestic funding, relative to the strengthening demand for credit. Our formal forecasts have the RBNZ hiking its cash rate mid-2018, but we can understand market pricing for something earlier than that. The only thing preventing us from bringing our rate hike call into 2017 is the Bank’s expressed intent to leave its OCR unchanged right the way into 2019. We can’t believe the Bank can hold to the length of this view at its 11 May Monetary Policy Statement, especially with pressure for it to lift its CPI inflation forecasts.

Exchange Rate

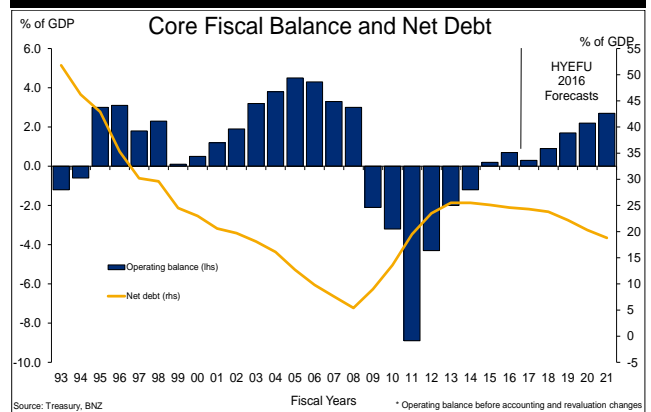
The currency continues to reflect New Zealand’s relatively good economic underpinnings. Sure, at near 0.7000, NZD is down from its 2014 peak of around 0.8800, but mostly because of a rebound in the US dollar. The trade-weighted exchange rate (TWI) has also moderated over this period but remains relatively high on any long-term chart. But then, why wouldn’t it be? There is above trend growth, rising inflation, a lean current account deficit, the terms of trade retesting all-time highs, and rising fiscal surpluses. We forecast NZD to base around 0.6700 late this year. However, there remains the very real risk that the exchange rate will hang up for longer, until such time that the economy’s wheels fall off, for whatever reason.

Politics

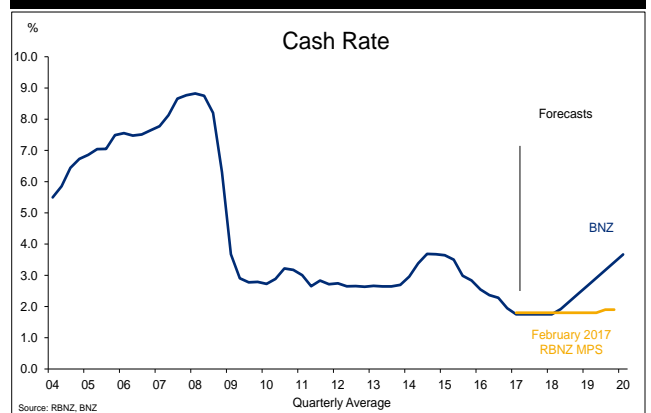
The 2017 General Election will be held on 23 September. Recent trends in polling suggest it’s becoming an increasingly tight run thing. It seems almost certain that the incumbent National party will win more seats than any other party but, equally, the only way that it will be able to rule is with the help of minor parties. Moreover, there is a very real chance that NZ First will be in the box seat to decide who gets the nod – National, or a Labour/Greens bloc. There is still some time to go, campaigning to occur, and, not to forget, a Budget due 25 May (with its likely tax relief). But also watch business and consumer sentiment in the lead into the election.

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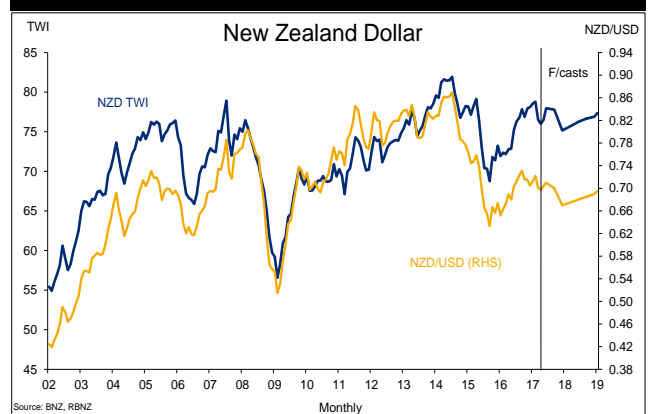
An Envious Fiscal Position



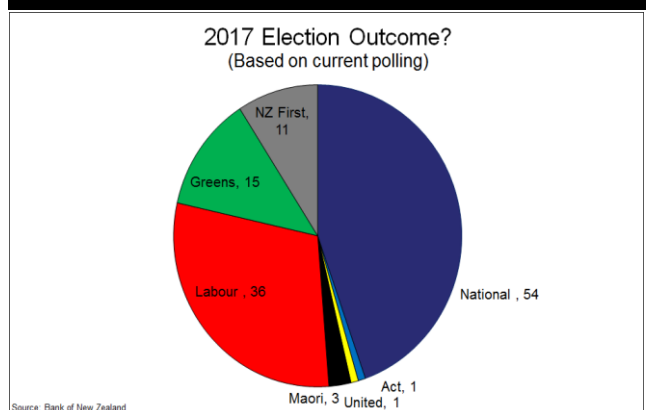
Interest Rates Headed Higher



NZD Correction Nearing Completion?



Election 23 September



Quarterly Forecasts

As at 4 May 2017

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
GDP (production s.a.)	1.0	0.7	0.8	0.8	0.4	0.7	0.7	0.7	0.6	0.6
Retail trade (real s.a.)	1.3	0.9	2.2	0.7	0.6	0.7	1.0	0.6	0.5	0.7
Current account (ytd, % GDP)	-3.4	-3.1	-2.9	-3.0	-2.7	-2.7	-2.6	-2.5	-2.4	-2.6
CPI (q/q)	-0.5	0.2	0.4	0.3	0.4	1.0	0.2	0.7	0.3	0.7
Employment	1.1	1.2	2.3	1.4	0.7	1.2	0.7	0.6	0.5	0.4
Unemployment rate %	4.9	5.2	5.0	4.9	5.2	4.9	4.9	5.0	5.0	5.2
Avg hourly earnings (ann %)	2.5	2.5	2.1	1.6	1.1	1.1	1.1	1.9	2.7	2.9
Trading partner GDP (ann %)	3.2	3.1	3.3	3.2	3.5	3.4	3.4	3.6	3.4	3.4
CPI (y/y)	0.1	0.4	0.4	0.4	1.3	2.2	2.0	2.4	2.3	2.0
GDP (production s.a., y/y)	2.2	2.8	3.5	3.3	2.7	2.7	2.7	2.6	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
2016 Mar	2.45	2.55	2.60	3.05	2.50	2.80	3.30	0.60	1.90	1.15
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	1.90	2.25	2.05	2.15	2.45	0.80	1.55	0.70
Dec	1.85	2.10	2.40	2.95	2.25	2.65	3.10	0.90	2.10	0.80
2017 Mar	1.75	2.00	2.70	3.25	2.40	3.00	3.50	1.15	2.50	0.80
Forecasts										
Jun	1.75	2.00	2.70	3.30	2.40	3.00	3.60	1.30	2.50	0.80
Sep	1.75	2.00	2.75	3.30	2.50	3.05	3.60	1.40	2.50	0.80
Dec	1.75	2.00	2.75	3.25	2.60	3.05	3.55	1.60	2.50	0.75
2018 Mar	1.75	2.10	2.80	3.25	2.80	3.10	3.55	1.60	2.50	0.75
Jun	2.00	2.40	3.10	3.55	3.10	3.40	3.85	1.90	2.75	0.80
Sep	2.25	2.65	3.20	3.60	3.20	3.50	3.90	2.10	2.75	0.85
Dec	2.50	2.90	3.30	3.65	3.40	3.60	3.95	2.40	2.75	0.90
2019 Mar	2.75	3.15	3.35	3.65	3.50	3.65	3.95	2.55	2.75	0.90
Jun	3.00	3.40	3.40	3.70	3.60	3.65	3.95	2.80	2.75	0.95

Exchange Rates (End Period)

USD Forecasts

	EUR/USD	USD/JPY	GBP/USD	NZD/USD	AUD/USD
Current	1.09	112	1.29	0.69	0.75
Jun-17	1.10	114	1.31	0.71	0.75
Sep-17	1.11	116	1.29	0.70	0.73
Dec-17	1.13	118	1.27	0.67	0.70
Mar-18	1.15	120	1.26	0.68	0.70
Jun-18	1.15	120	1.25	0.68	0.70
Sep-18	1.17	122	1.24	0.69	0.70
Dec-18	1.19	122	1.22	0.69	0.70
Mar-19	1.20	120	1.25	0.71	0.70
Jun-19	1.20	118	1.25	0.71	0.71
Sep-19	1.21	116	1.27	0.72	0.72

NZD Forecasts

	NZD/EUR	NZD/JPY	NZD/GBP	NZD/USD	NZD/AUD	TWI-17
Current	0.64	77.8	0.54	0.69	0.92	75.6
Jun-17	0.65	80.9	0.54	0.71	0.95	78.1
Sep-17	0.63	81.2	0.54	0.70	0.96	77.9
Dec-17	0.59	79.1	0.53	0.67	0.96	75.3
Mar-18	0.59	81.0	0.54	0.68	0.96	75.8
Jun-18	0.59	81.6	0.54	0.68	0.97	76.3
Sep-18	0.59	83.6	0.55	0.69	0.98	76.7
Dec-18	0.58	84.2	0.57	0.69	0.99	77.0
Mar-19	0.59	84.6	0.56	0.71	1.01	78.3
Jun-19	0.59	83.8	0.57	0.71	1.00	78.5
Sep-19	0.60	83.5	0.57	0.72	1.00	78.8

TWI Weights

0.1135 0.0635 0.0456 0.1398 0.2073

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

Annual Forecasts

As at 4 May 2017

	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
GDP - annual average % change										
Private Consumption	3.1	2.8	4.7	2.7	2.1	2.9	4.3	3.2	2.2	1.7
Government Consumption	3.1	2.7	2.4	2.1	1.0	2.6	2.3	2.5	1.1	1.0
Total Investment	6.8	2.5	6.1	5.7	4.2	2.1	5.6	6.0	4.7	2.2
Stocks - ppts cont'n to growth	0.5	-0.3	0.1	0.0	0.0	-0.3	0.2	0.2	-0.1	0.0
GNE	3.9	2.4	4.9	2.9	2.4	2.1	4.8	3.3	2.5	1.7
Exports	4.3	5.5	1.1	1.9	3.9	6.8	1.6	0.7	4.0	4.1
Imports	7.4	2.1	6.0	4.0	3.7	3.6	4.2	4.9	3.7	3.2
Real Expenditure GDP	3.1	3.4	3.7	2.3	2.4	3.1	3.9	2.3	2.5	1.8
GDP (production)	3.4	2.4	3.0	2.6	2.4	2.5	3.1	2.7	2.5	1.8
<i>GDP - annual % change (q/q)</i>	3.1	2.8	2.7	2.6	2.2	2.2	2.7	2.7	2.4	1.5
Output Gap (ann avg, % dev)	0.8	0.8	1.1	1.2	1.1	0.8	1.1	1.2	1.2	0.8
Household Savings (gross, % disp. income)	1.8	1.2	0.2	0.4	-0.4					
Nominal Expenditure GDP - \$bn	240.8	250.4	265.7	282.3	294.4	247.4	261.2	278.9	291.4	302.2
Prices and Employment - annual % change										
CPI	0.3	0.4	2.2	2.0	1.9	0.1	1.3	2.3	2.1	1.7
Employment	3.2	2.0	5.7	2.2	1.5	1.4	5.8	3.0	1.6	1.2
Unemployment Rate %	5.4	5.2	4.9	5.2	5.4	4.9	5.2	5.0	5.4	5.6
Wages - ahote	2.6	2.5	1.1	2.9	3.0	2.5	1.1	2.7	2.9	2.8
Productivity (ann av %)	-0.1	0.3	-2.6	-0.3	0.7	0.1	-1.7	-1.2	0.6	0.5
Unit Labour Costs (ann av %)	2.2	2.5	4.6	2.9	2.4	2.6	3.6	3.6	2.5	2.6
External Balance										
Current Account - \$bn	-8.5	-7.8	-7.3	-7.3	-10.2	-8.3	-7.1	-6.7	-10.2	-10.2
Current Account - % of GDP	-3.5	-3.1	-2.7	-2.6	-3.5	-3.4	-2.7	-2.4	-3.5	-3.4
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	0.2	0.7	0.4	1.2	1.8					
Net Core Crown Debt (excl NZS Fund Assets)	25.1	24.6	24.2	23.4	21.7					
Bond Programme - \$bn	8.0	7.0	8.0	7.0	7.0					
Bond Programme - % of GDP	3.3	2.8	3.0	2.5	2.4					
Financial Variables ⁽¹⁾										
NZD/USD	0.75	0.67	0.70	0.68	0.71	0.67	0.70	0.67	0.69	0.73
USD/JPY	120	113	113	120	120	122	116	118	122	114
EUR/USD	1.08	1.11	1.07	1.15	1.20	1.09	1.05	1.13	1.19	1.23
NZD/AUD	0.97	0.90	0.92	0.96	1.01	0.93	0.96	0.96	0.99	1.00
NZD/GBP	0.50	0.47	0.57	0.54	0.56	0.45	0.56	0.53	0.57	0.57
NZD/EUR	0.69	0.61	0.66	0.59	0.59	0.62	0.67	0.59	0.58	0.59
NZD/YEN	89.9	76.0	79.2	81.0	84.6	82.1	81.7	79.1	84.2	83.2
TWI	78.3	72.2	76.5	75.8	78.3	73.2	78.1	75.3	77.0	79.2
Overnight Cash Rate (end qtr)	3.50	2.25	1.75	1.75	2.75	2.50	1.75	1.75	2.50	3.50
90-day Bank Bill Rate	3.63	2.42	1.98	2.08	3.13	2.74	2.03	2.00	2.88	3.88
5-year Govt Bond	3.20	2.45	2.70	2.80	3.35	2.90	2.75	2.75	3.30	3.50
10-year Govt Bond	3.35	2.95	3.25	3.25	3.65	3.45	3.35	3.25	3.65	3.80
2-year Swap	3.55	2.30	2.35	2.80	3.50	2.80	2.40	2.60	3.40	3.75
5-year Swap	3.65	2.60	3.00	3.10	3.65	3.15	3.00	3.05	3.60	3.80
US 10-year Bonds	2.05	1.90	2.50	2.50	2.75	2.25	2.50	2.50	2.75	2.75
NZ-US 10-year Spread	1.30	1.05	0.75	0.75	0.90	1.20	0.85	0.75	0.90	1.05

⁽¹⁾ Average for the last month in the quarter

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