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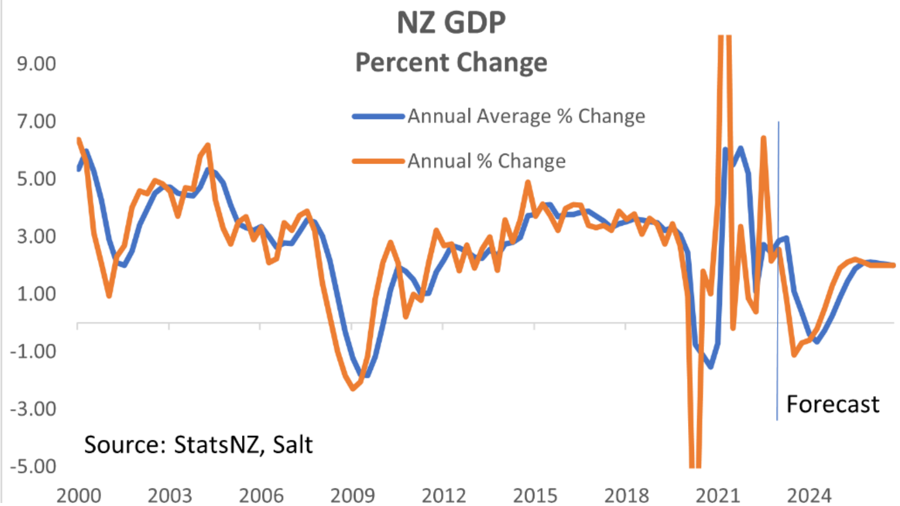
New Zealand Chartbook

June 2023

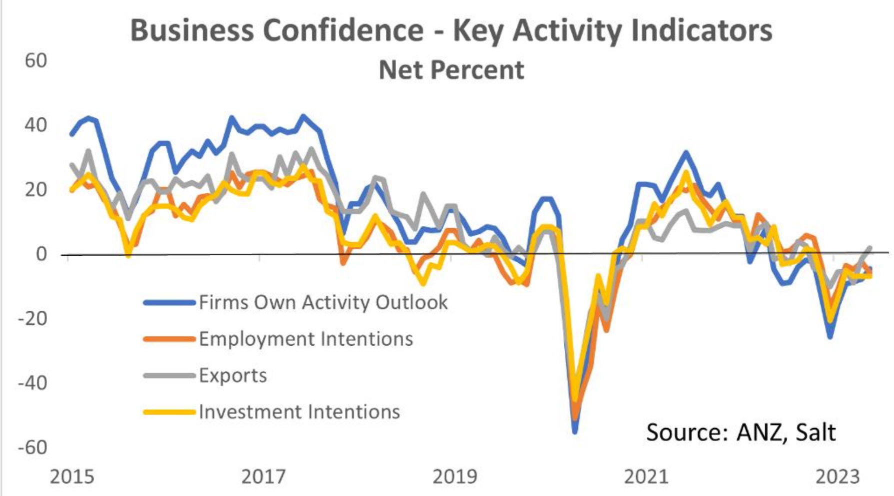
Highlights

- **Downside factors still dominate the New Zealand growth outlook over 2023. We expect annual growth to bottom out at -1.0% in the third quarter of this year.**
- **Net migration is surging higher. This will lead to higher aggregate demand in the economy, but also help take the pressure off wages.**
- **The housing market appears to be stabilising in the middle of 2023. Overall, we see a peak to trough decline of around 18%.**
- **The unemployment rate is expected to move higher over the next few months. We see this peaking at 5%.**
- **Headline inflation is moving lower, though core measures remain sticky.**
- **The RBNZ has pushed pause on the rate hiking cycle. We concur, but don't expect interest rate cuts until the second half of next year.**

Downside factors still dominate growth outlook



Tighter monetary policy, the higher cost of living and the recent weakness in house prices are conspiring to take a toll on economic activity through this year. However, higher population growth via strong net inward migration, the rebuilding efforts following cyclone Gabriel and a more stimulatory than expected Budget will provide some offset. We see annual GDP growth bottoming out at -1.0% in Q3 2023.



The ANZ Business Outlook Survey turned sharply negative following the RBNZ's more hawkish than expected November Monetary Policy Statement. The subsequent improvement in early 2023 has stalled leaving the key activity indicators in negative territory, including investment and employment intentions. This supports our expectations of a contraction in activity in the period ahead.

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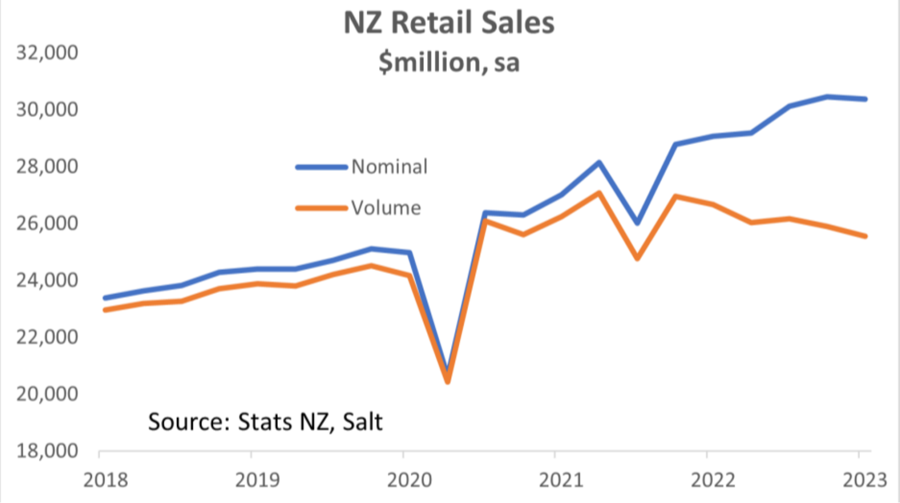
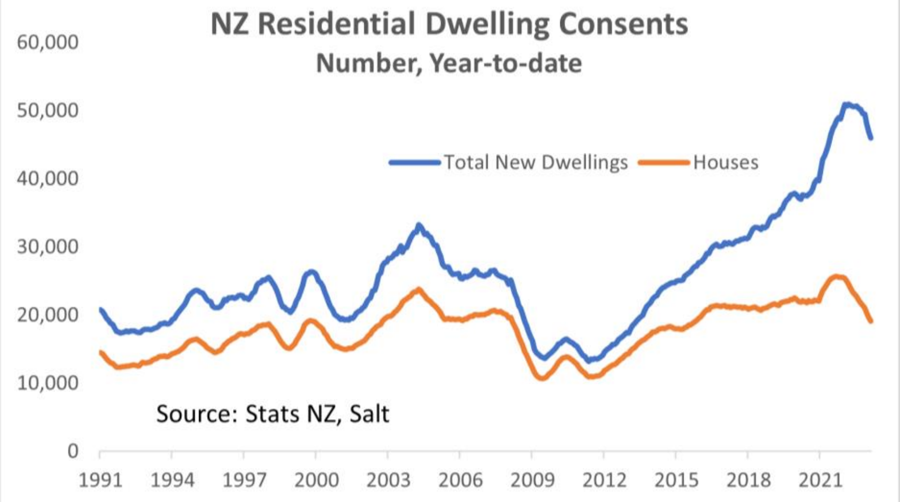
Activity indicators weakening

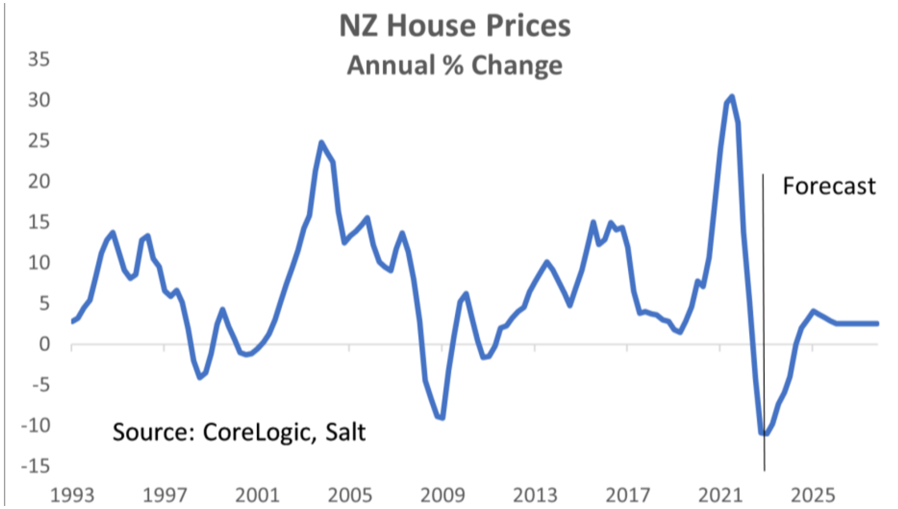


Nominal retail spending has held up well so far, reflecting the strength of wage growth. But as inflation surged, an increasing proportion of our spending was being consumed by inflation, leaving a downward trend in sales volumes. We've been spending more money but buying less stuff. We expect the trend decline in sales volumes to continue over the remainder of the year.

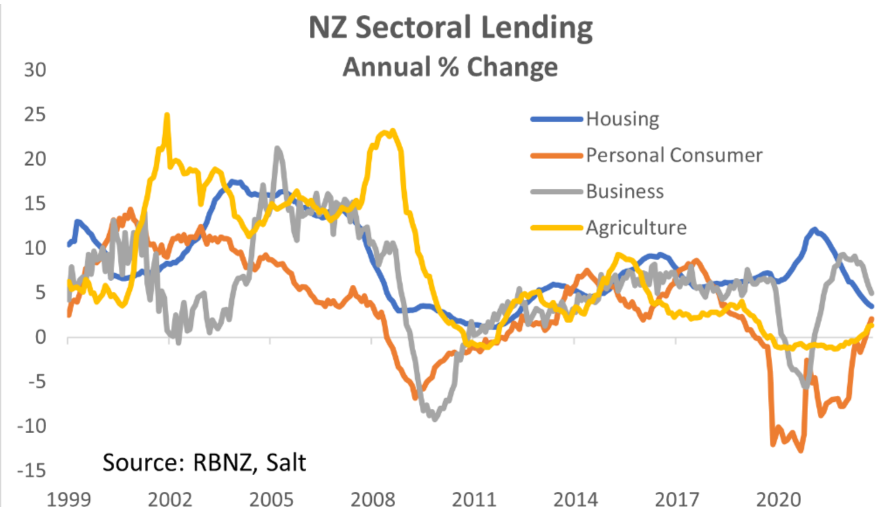


The annual rate of new dwelling permits consented peaked at over 50,000 in 2022. That number remained impervious to the early stages of the tightening cycle, though mostly due to the ongoing strength in permits issued for apartments and units. The number of permits for standalone houses turned down earlier. The total square meterage permitted across all dwelling types is now down 32% on a year ago.

House prices stabilising

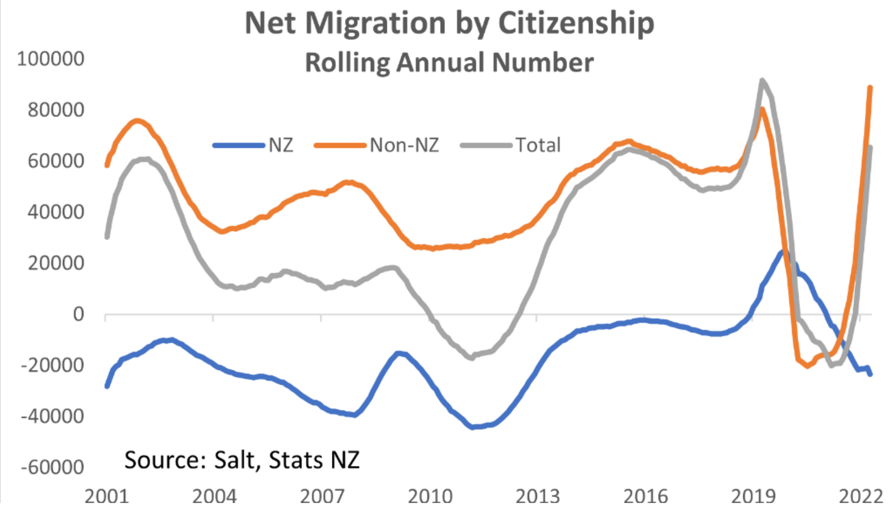


The housing market appears to be stabilising in the middle of 2023, though seasonal weakness through winter will likely see further price falls over the next few months, before we see some positive numbers start to emerge as we head into spring. This will result in a peak to trough decline of around 18%.

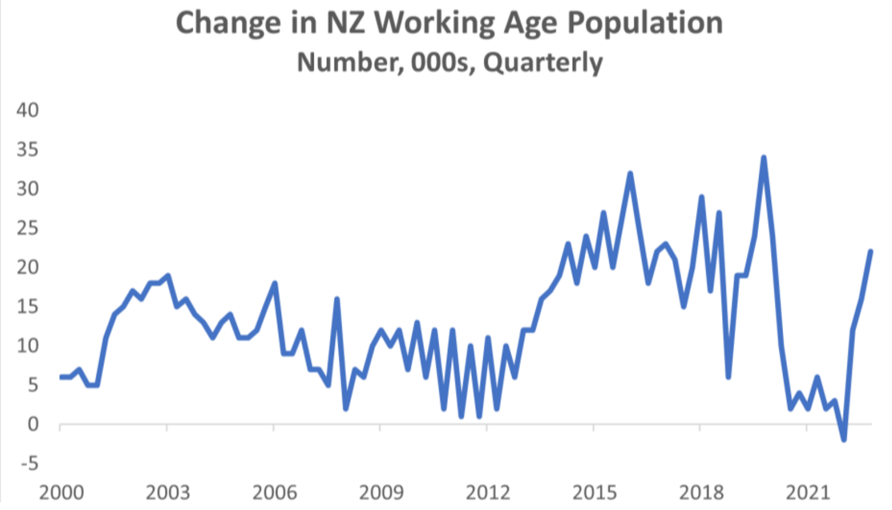


Sectoral lending data for the housing market and business sector support the weakness across those sectors. The annual rate of lending for housing is now at its lowest level since 2012. Agriculture sector lending is less influenced by the domestic economic cycle.

Strong recovery in net migration

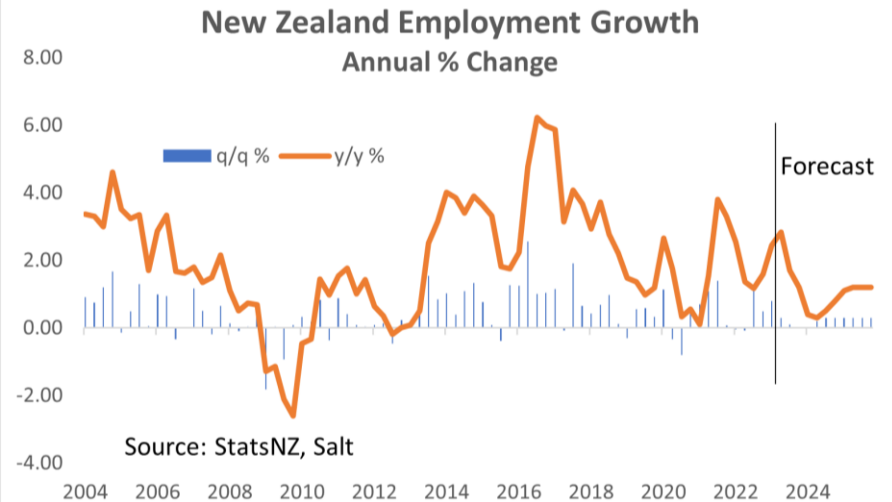


Net migration has turned sharply positive as the net departure of New Zealanders has slowed and the net arrival of foreigners has surged as borders re-opened. This has positive and negative implications for monetary policy. More people in the labour market will take some of the pressure off wage growth, however it also means stronger population growth and more demand in the economy.

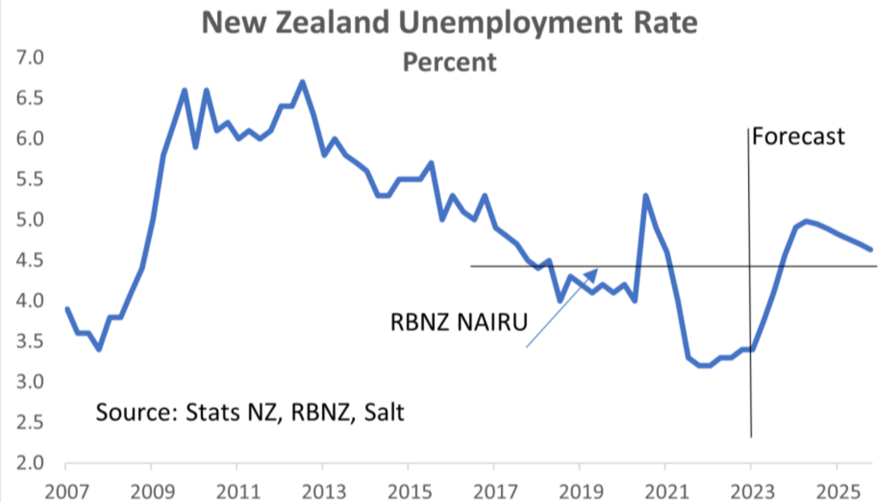


The sharp increase in the net inflow of migrants since the middle of last year has resulted in a significant increase in the working age population (WAP). After turning briefly negative in the June quarter of last year, latest Household Labour Force Survey data showed the WAP increased 22,000 in the March quarter and is up 50,000 in the last nine months. That is helping alleviate pent-up demand in the labour market.

Labour market remains tight, for now



Employment growth remains strong as a result of pent-up demand for labour now being satisfied by the recent turnaround in net migration and increase in the WAP, plus a further increase in our already high (by OECD standards) participation rate. Employment growth is expected to move only slightly negative in the latter part of the year.



The unemployment rate is nudging slowly higher, but at 3.4% is only just off its cyclical low of 3.2%. We still expect a higher unemployment rate in the quarters ahead, though this will only be partly as a result of job losses. The increasing supply of labour will eventually collide with weakening economic activity meaning people won't step so easily into work. We see the unemployment rate peaking at 5%.

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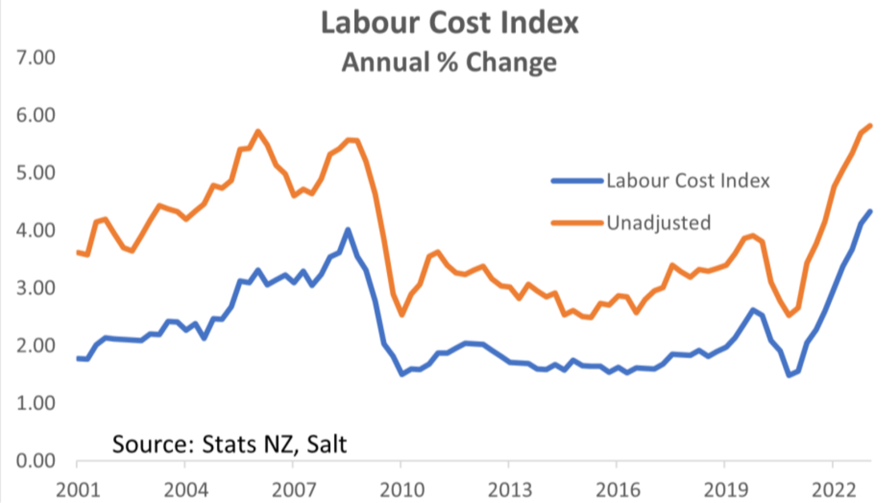
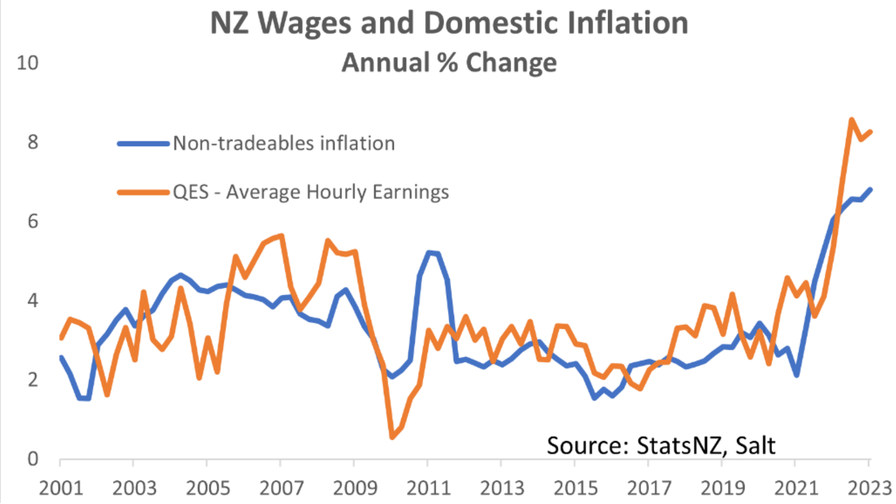
Wage growth peaking?

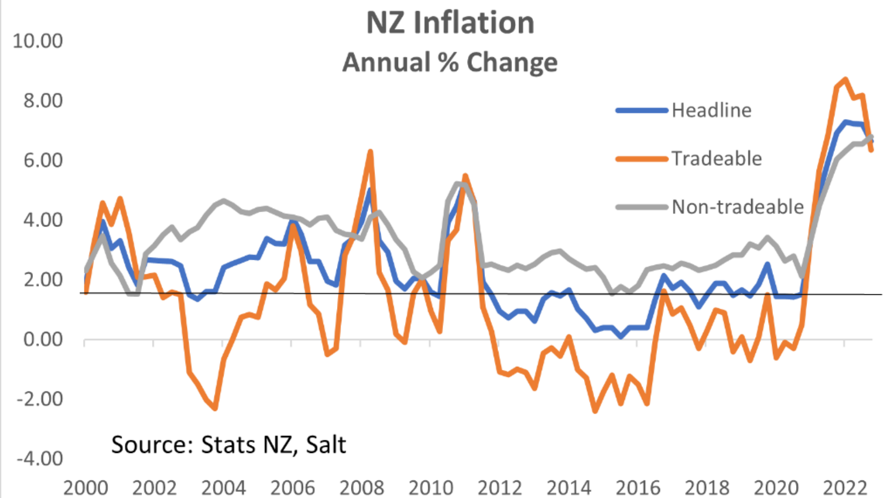




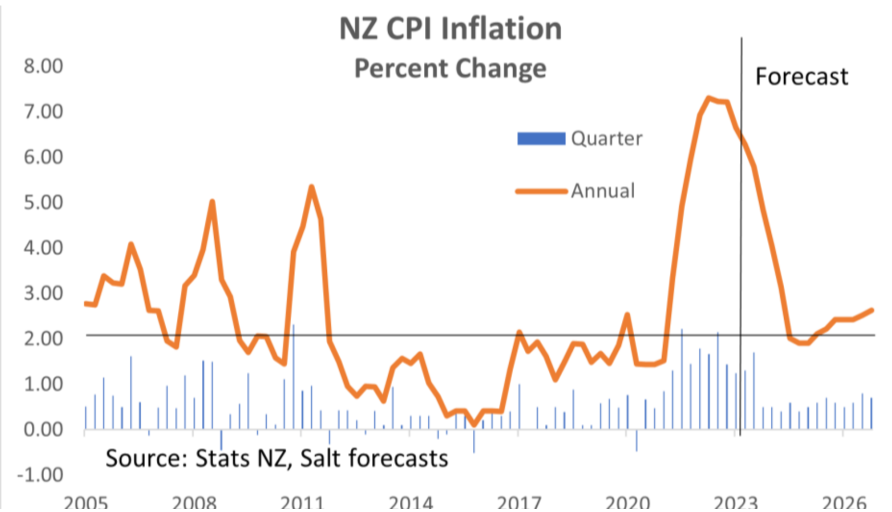
A key factor the RBNZ needs to get under control if they are to see inflation return to target is wage growth. If we are right and the recent increase in labour supply starts to moderate wage growth, we should start to see that soon. In the meantime, we have to be satisfied that the latest Labour Cost Index (a measure of unit labour costs) increase came in weaker than expected by the RBNZ.

Furthermore, nominal wage growth as reported by the Quarterly Employment Survey appears to have peaked. The critical question now is how fast this retreats. We think private sector wage growth will moderate faster than public sector wage growth as there are still a number of significant public sector wage negotiations still to be settled.

Latest inflation data lower than expected



March quarter CPI data came in below market expectations, though remains disconcertingly high. The annual rate of headline CPI inflation came in at 6.7%, well below market and RBNZ expectations of over 7.0%. The downside surprise came through mostly on the tradeables side, where annual inflation has moderated from a peak of 8.7% to 6.4%. Non-tradeable inflation reached a fresh high of 6.8%.



While the latest data was lower than expected, inflation remains stubbornly high. Progress back to target will be slow given the sticky nature of non-tradeable/services inflation as the labour market remains tight and wage inflation remains significantly higher than the level consistent with target inflation. Furthermore, global structural headwinds continue to point to greater inflationary pressure ahead.

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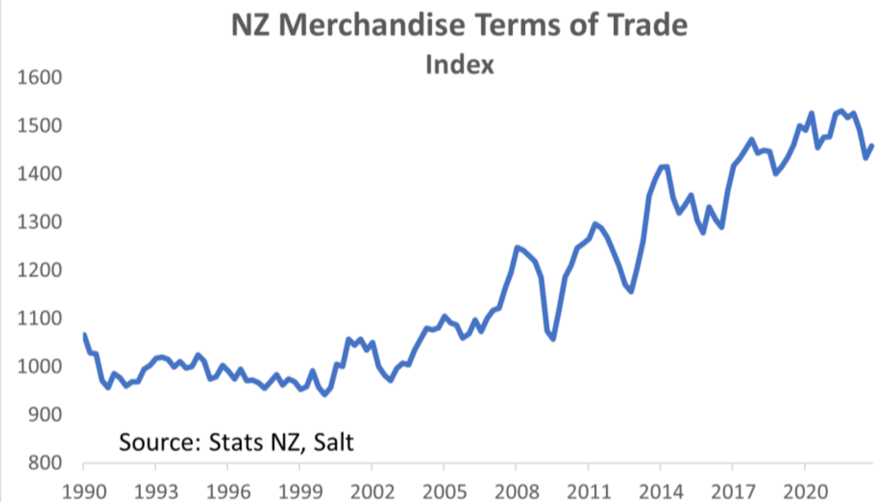
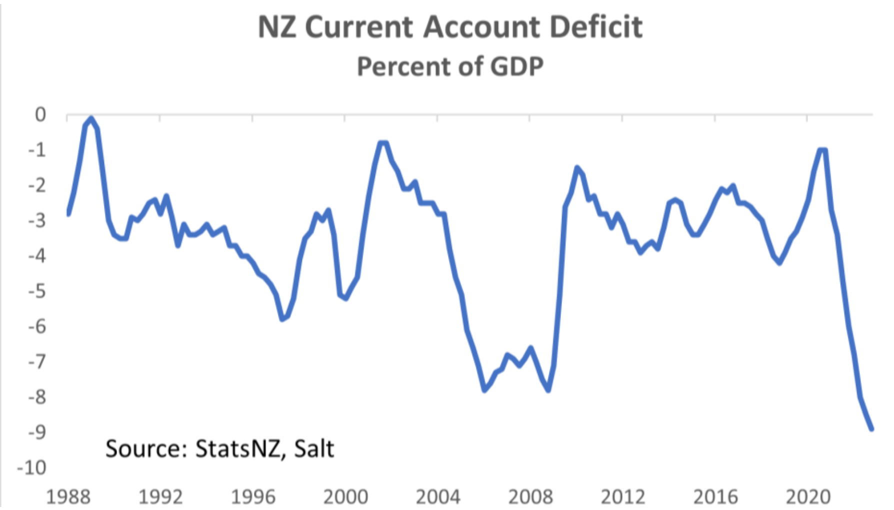
Headwinds in the external sector

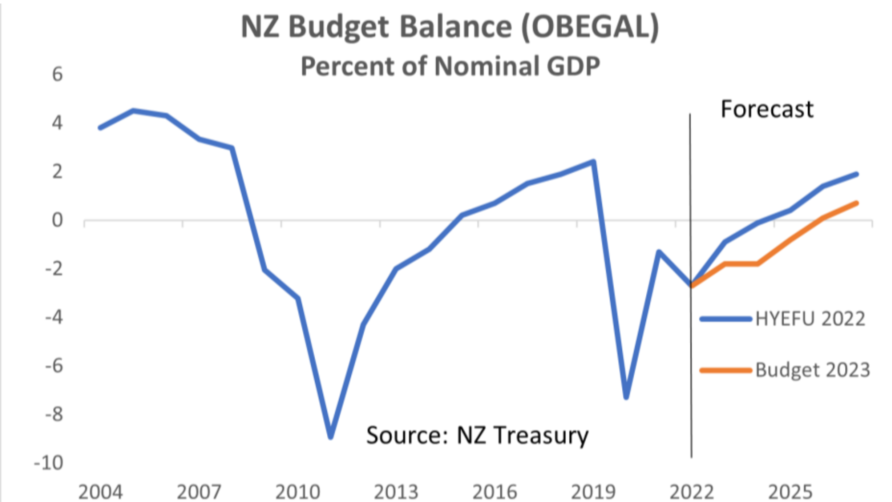


The goods terms of trade rose 1.8% in the December quarter, driven by lower petrol prices. Export prices dipped 0.6%, as falls in agricultural product prices were partially offset by gains in the prices of manufactured goods. However, the improvement in the terms of trade may be short-lived as more recent weakness in dairy prices is yet to be reflected in the index.

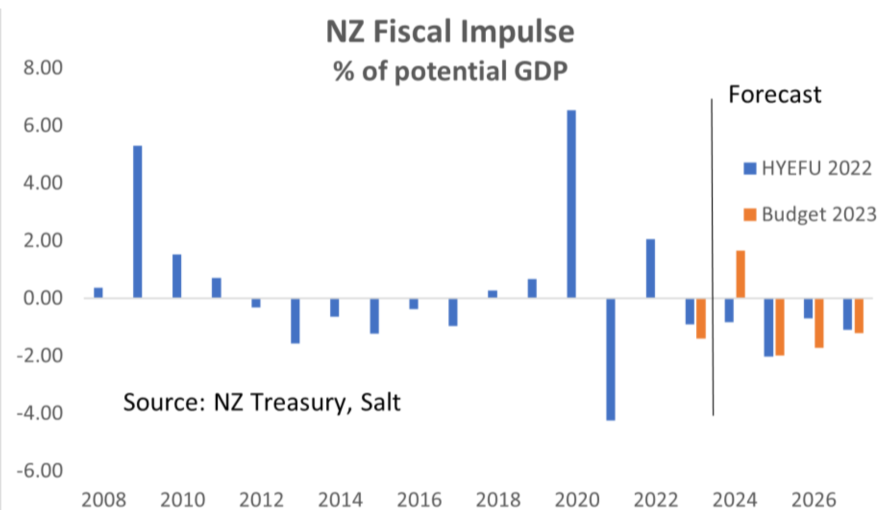


The current account deficit deteriorated sharply over 2022 and is now at 8.9% of GDP, its lowest level in records going back to 1987. There are reasons to believe the deterioration may be temporary, particularly the recent absence of international tourists. However, there are also signs it could prove more persistent with higher debt servicing costs on foreign currency debt and lower exports following the recent floods, particularly on the east coast.

Budget 2023 more expansionary than expected

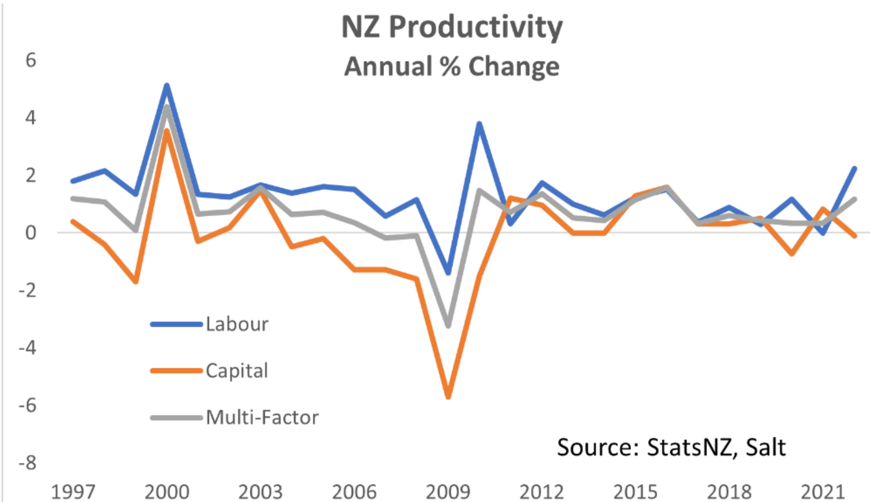


Budget 2023 was more expansionary than expected. The return to fiscal surplus was pushed out to 2025/26 and the subsequent surpluses are not much bigger than margin for error - small shift in the macro-outlook could easily push those numbers back into deficit. The debt ratios were higher and with that came additional debt issuance of $20b over the next 5 years.

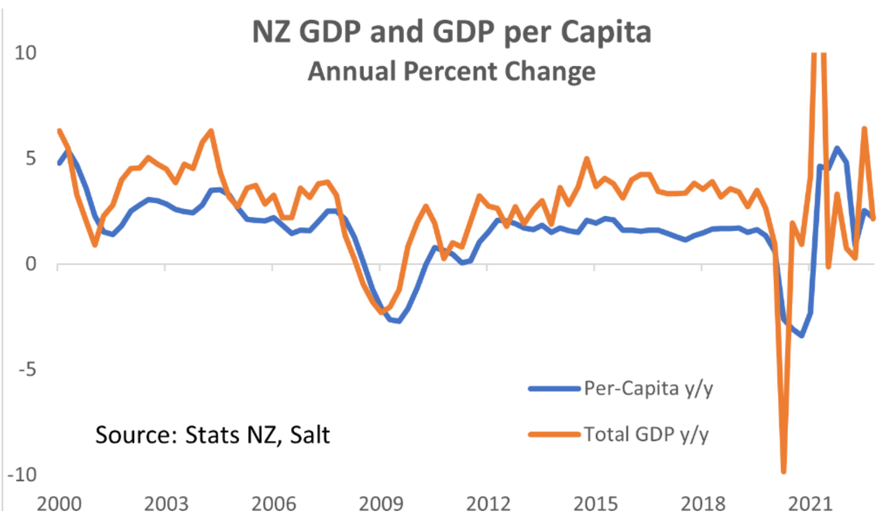


The near-term shift in the fiscal impulse – or the extent to which fiscal policy is contractionary or expansionary – was significant. The impulse for fiscal 2024 went from a contraction of -0.8% of GDP to an expansionary +1.7%. Policy was more contractionary in the out-years.

Our biggest challenge - productivity



We are not reading too much into the apparent lift in New Zealand's rate of labour productivity growth in the year to March 2022. This is likely due to Covid-related data volatility and needs to be seen in the light of no change in the year to March 2021. Productivity is hard to measure so it's best to look at trends in this data rather than any single data point. The reality is the growth in productivity of our labour and capital is low.



Low productivity growth manifests as low per-capita GDP growth. Per-capita growth removes the impact of population growth from GDP and is a better measure of the growth in our wealth as a country. Since 2000 and up to 2019, before Covid disruptions started to disrupt the data, our per capita GDP growth rate averaged 1.6% per annum.

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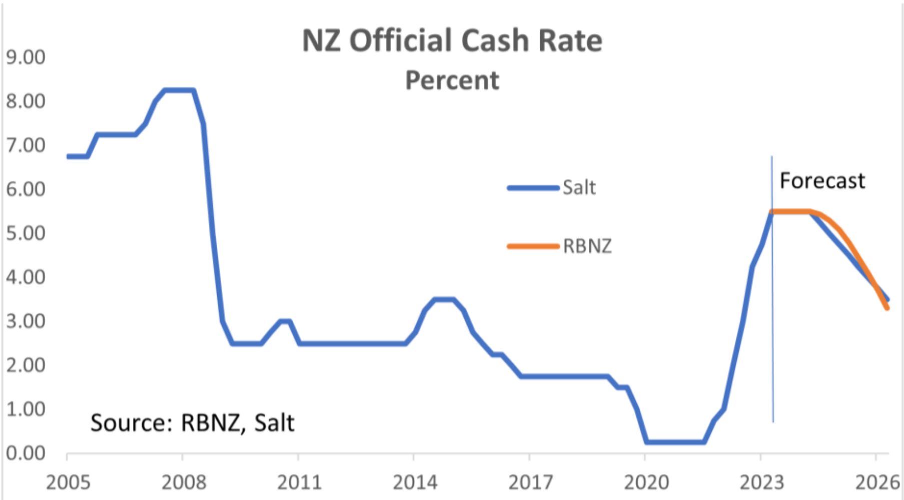
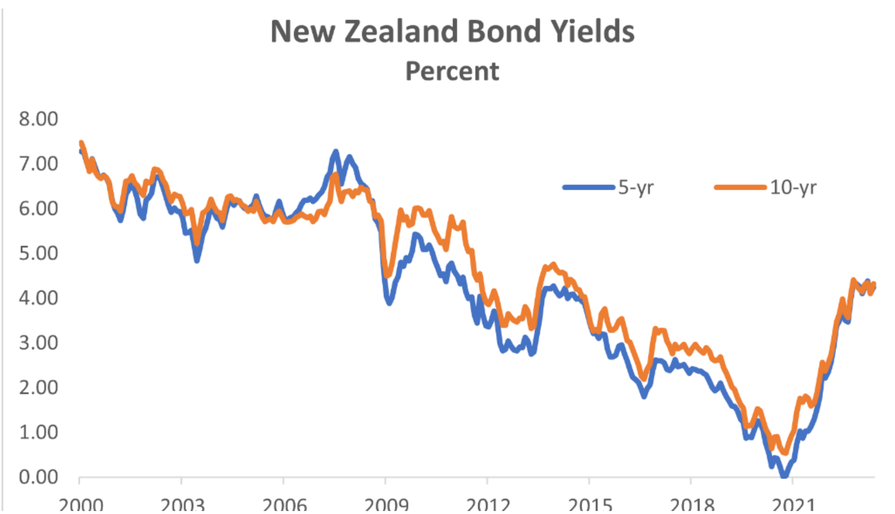
OCR has peaked



The RBNZ hiked the OCR 25bp to 5.5% in May and pushed pause on the rate hiking cycle. We're ok with that as we believed the RBNZ had already done enough. For us, the question now is how long the OCR remains at this level. We concur with the RBNZ that it will be the latter part of 2024 before conditions are right for an easing in monetary settings.



We believe bond yields have peaked, with most of the risk to that view emanating from offshore, particularly in the near-term as the US debt ceiling negotiations unfold. Increasing supply will tend to support yields. The Budget saw a $20 billion increase in bond issuance over the next five years and the RBNZ is continuing its quantitative tightening to the tune of $5 billion per month.

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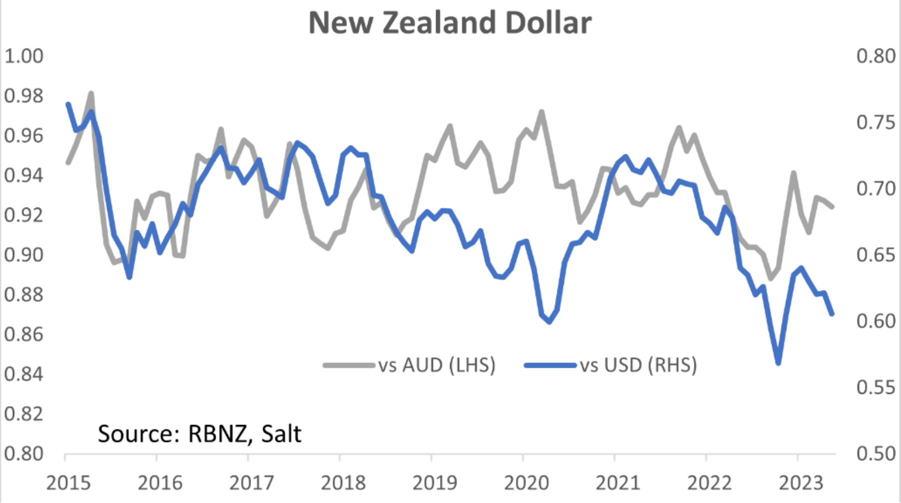
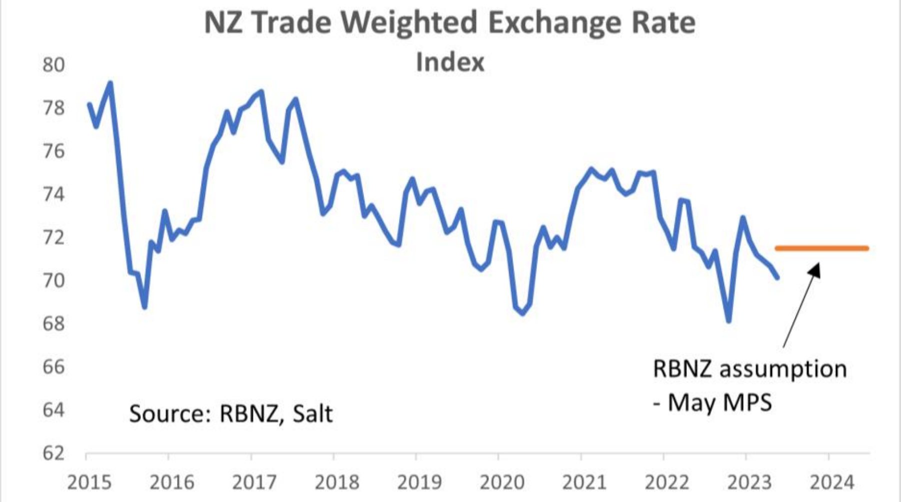
Exchange rates



The RBNZ's more dovish than expected May Monetary Policy Statement has seen the NZD fall to its lowest level in 6-months against the USD, breaking out of its recent range of 0.61-0.635 range. Medium term we see upside for NZD/USD as we think the Fed has finished tightening for this cycle. We expect downside against the AUD as Australia remains better placed to benefit from the recovery in China.



We see plusses (against the USD) and minuses (against the AUD) ahead for the Trade Weighted Exchange Rate Index (TWI). In short that means nothing that is immediately obvious to us that could threaten the RBNZ's technical assumption of an index level of 71.5 over the medium term.

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