



SALT INSIGHT

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Keep calm and ignore the data volatility

This commentary first appeared as an opinion piece in the New Zealand Herald.

If you'd asked me at the end of last year if I would be surprised if the NZ economy did not grow in the first half of 2025, the answer would have been "disappointed, but not shocked."

Am I now surprised that no GDP growth in the first half of 2025 was the sum of +0.9% in the first quarter, followed by -0.9% in the second quarter? Unequivocally "yes". Before-hand, I would have put a 1% probability on such an outcome but only because after 35 years in financial markets I've learnt to never give anything zero probability.

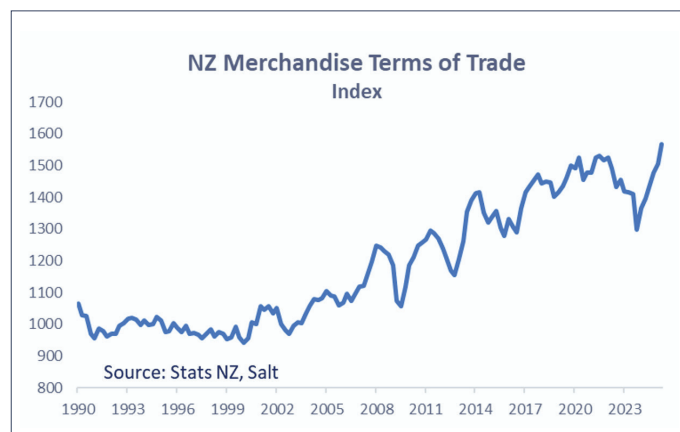
Yet here we are.

The answer to the first question would have been consistent with our view that the optimistic mantra of last year needed a bit of a tweak, as follows: "Survive until the SECOND HALF of 2025".

In the absence of the two traditional tailwinds of NZ GDP growth, population growth and house price inflation, the improving growth was always going to be a grind, and ultimately reliant on the pass through of lower interest rates into household disposable income. This only happens with a considerable lag.

The good news is that another tailwind has emerged in the form of the Terms of Trade which has been on a tear over the last few months. Since its most recent low at the end of 2023, the index has soared over 20% to a record high, reflecting a 17% rise in export prices and a 3% fall in import prices. No wonder the provinces are generally

doing far better than the cities, particularly Auckland and Wellington.



As the first half of 2025 evolved, it became quite clear that the NZ economy was weaker in the second quarter than it was in the first. GDP growth surprised to the upside in the three months to March, but it was very narrowly focussed.

The news flow then deteriorated in the three months to June. The reasons are debatable but certainly the unfolding trade war between the US and everybody else could have been a contributing factor.

So, the pattern of reported GDP growth over the first half of the year does make sense. But I think the upwardly revised +0.9% growth recorded in the 3-months to March probably overstated that quarter, while the -0.9% for June probably overstates the weakness now. For the record, I thought we'd see -0.4% in the June quarter with a high probability that the March quarter would be

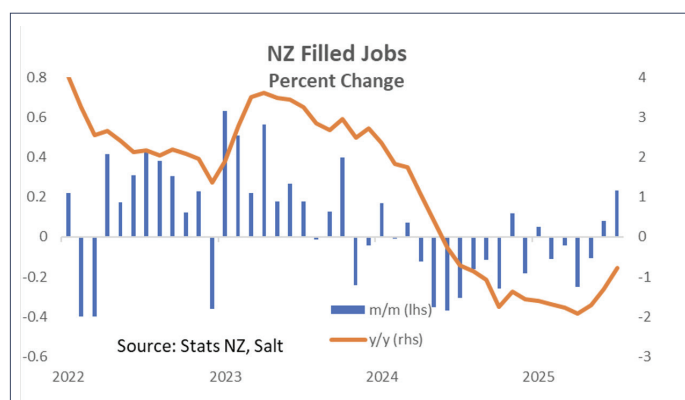
revised down. Instead, it was revised up from the initially reported +0.8%.

When I look under the hood of the headline data, the upside sectoral surprises in the first quarter were the ones that proved to be downside surprises in the second quarter. This is particularly the case in both the manufacturing and professional services sectors.

So, what will the RBNZ make of all this? For a start, the -0.9% June quarter result was well below their estimate of -0.3%. Technically speaking the apparent output gap, or the amount of spare capacity in the economy, is now a lot larger than they assumed.

However, unlike some commentators, there are several reasons why I think the RBNZ won't be panicking. Firstly, nearly half the June quarter decline was attributed to the "balancing item". Without going into a technical description of this component, suffice to say we expect this will reverse out by the end of 2025.

Secondly, the good news is that as the second half-year data starts to come in, green shoots are emerging. Despite the overall weakness in the June quarter, retail sales in that quarter came in stronger than expected. More recent electronic card transaction data bodes well for September quarter retail spending. Also, recent filled jobs data suggests the labour market may be turning the corner.



Such is the improvement in the data, that I think the RBNZ's September quarter GDP forecast of +0.3% is looking a bit light. I've got +0.6% pencilled in. Assuming that proves correct, adding the three quarters together gives +0.6%

growth for the first nine months of the year, compared to +0.8% in the RBNZ's last set of forecasts published in August, a -0.2% difference. Neither here nor there really.

Thirdly, the RBNZ has already performed a dovish pivot. Having recognised the June quarter weakness, they added in an extra interest rate cut into their projections at the time of their last Monetary Policy Statement.

For now, we think that means the RBNZ will stick to their projections and deliver two more 25bp rate cuts, one in October and one in November. If they have been rattled and feel they need to move faster, especially if the recent green shoots show signs of wilting, we could instead see 50bp in October.

But I'd be surprised if they added in more easing for a lower terminal OCR than already signalled. The RBNZ will be conscious of not wanting to overdo the easing. NZ's potential growth rate, the rate of growth that is consistent with target inflation, remains low. That means that once the spare capacity is used up, we hit growing pains early, and the RBNZ need to hit the brakes again.

That's why the Government needs to become far more focused on improving our perennially moribund productivity performance. That means focussing on things like expenditure efficiency, education, skills, the regulatory environment, infrastructure and digital transformation, to name a few. Until we get these things right, low interest rates will only ever provide a temporary sugar-hit before the lid goes back on the cookie jar.

Gathering the fortitude to make potentially courageous changes to lift productivity is how the Government should be measured rather than panicking in response to a blame-game over a GDP number that will soon become ancient history.

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