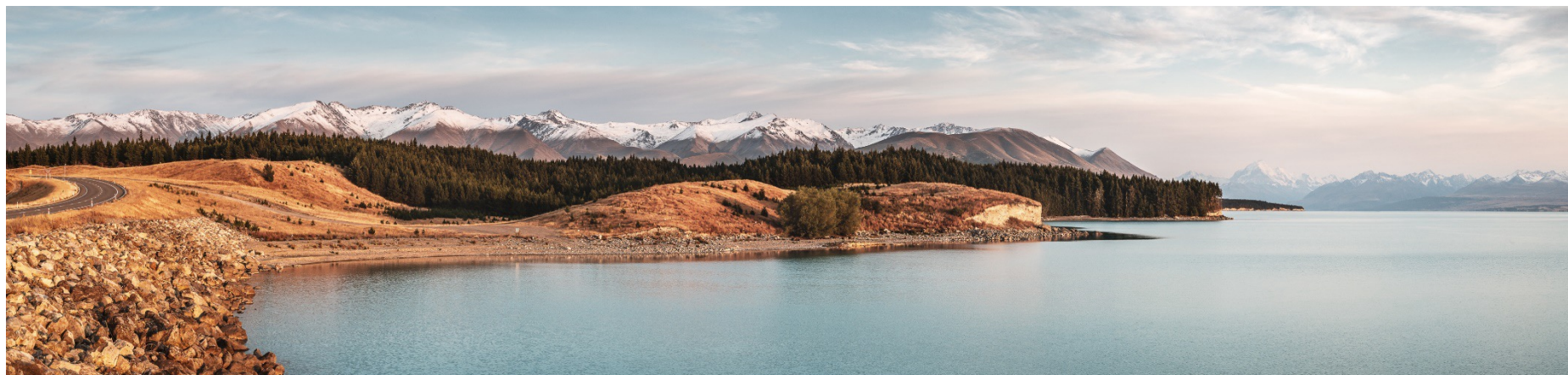


SALT

New Zealand Chartbook

Bevan Graham, Economist

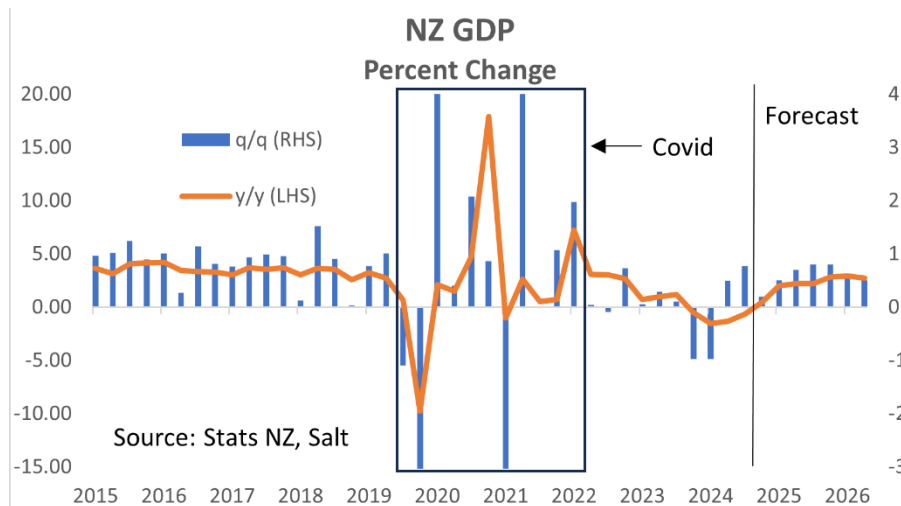
July 2025



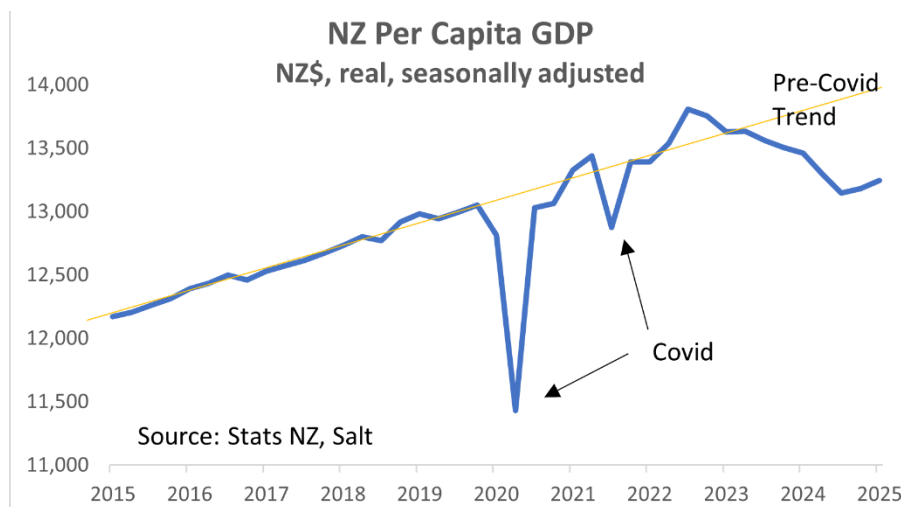
Highlights

- **March quarter GDP data was stronger than expected but the growth was narrowly focussed. More recent activity data has been considerably weaker.**
- **We continue to believe we will see a more sustained pick-up in activity later this year, reflecting strong commodity prices and the delayed impact of interest rate cuts. However, two traditional tailwinds of New Zealand growth, population increases and house price inflation, are expected to remain weak keeping the overall recovery in growth only modest.**
- **As yet there are no definitive impacts on NZ exports resulting from the change in US trade policy, but it is early days.**
- **The labour market will likely remain soft for a few months yet. The unemployment rate is expected to peak at around 5.3% in mid-2025, with no meaningful improvement until 2026.**
- **Annual CPI inflation is rising and is expected to be back around the top end of the RBNZ's 1-3% target band in the September 2025 quarter. We see this as a “blip” with inflation heading back towards 2% through 2026.**
- **The Official Cash Rate has been lowered 225bps to 3.25%. We have pencilled in one further 25bp cut at the August MPS for a low of 3.0%. Further cuts beyond that are possible if activity indicators remain weak and inflation plays out as expected.**

Bouncing along the bottom

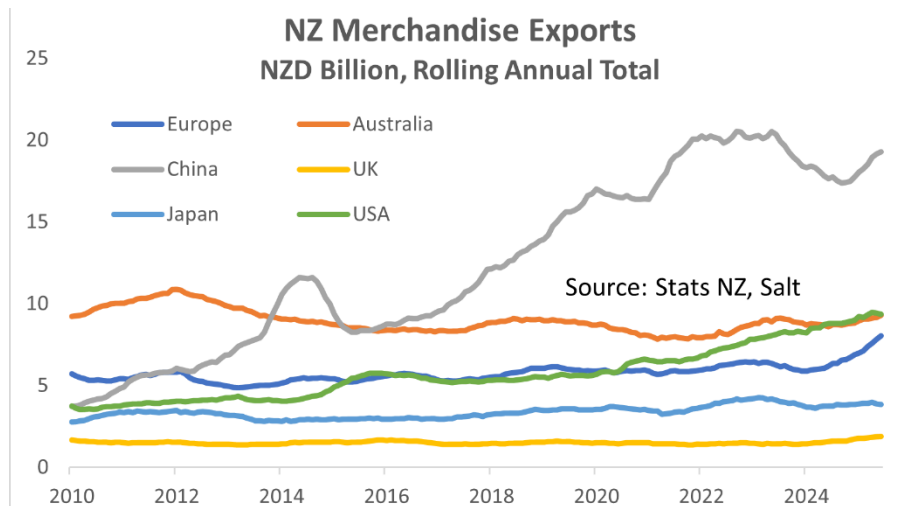


GDP growth came in stronger than expected in Q1 of 2025 but was narrowly focused. It is still too early for a sustained pickup in activity. To prove the point, June quarter data is looking considerably weaker. We continue to expect a better second half of the year as lower interest rates continue to feed through into household budgets, though we remain wary of trade (tariff) related disruptions.

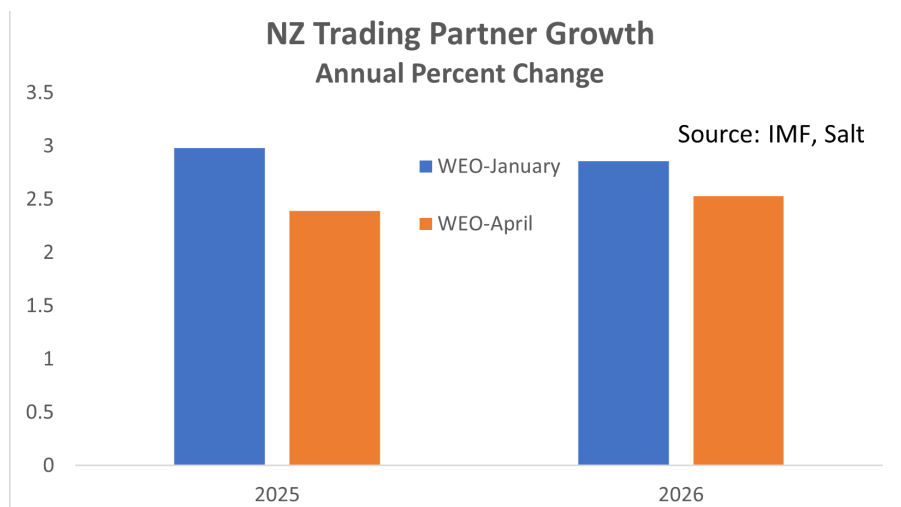


Per-capita GDP is recovering but is still 4% below the peak in September 2022, and around 5% below where the pre-Covid trend line would have had us. It will be a long recovery just to get back to where we started. The forthcoming growth cycle will be a bit of a grind as traditional tail winds remain subdued.

No definitive tariff impact yet

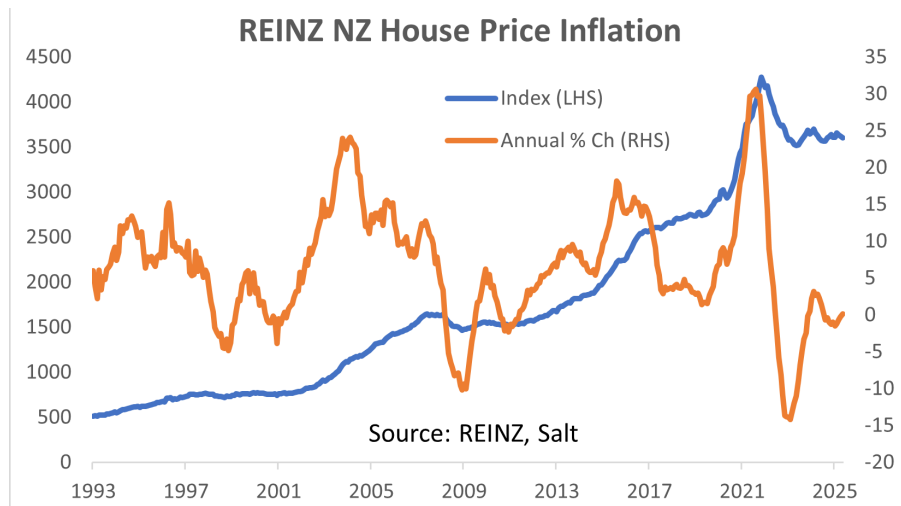


Trade data is showing no definitive impact from the shift in US trade policy, but it's still early days. There appears to have been a degree of front-loading of exports to the US in the early months of 2025, but the evidence is only anecdotal. We will keep a close eye on trends in this data.

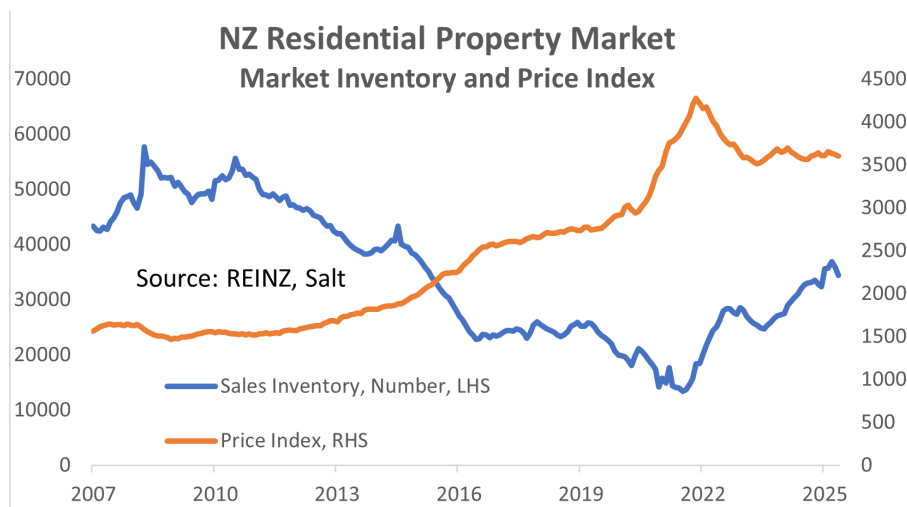


The likely more significant impact on New Zealand of tariffs is the second-round effect of lower growth amongst our trading partners. Comparing forecasts from the IMF's January and April editions of their World Economic Outlook, forecast trading partner growth is likely to be around -0.6% lower in 2025 and -0.3% lower in 2026.

No tailwind from house price inflation...

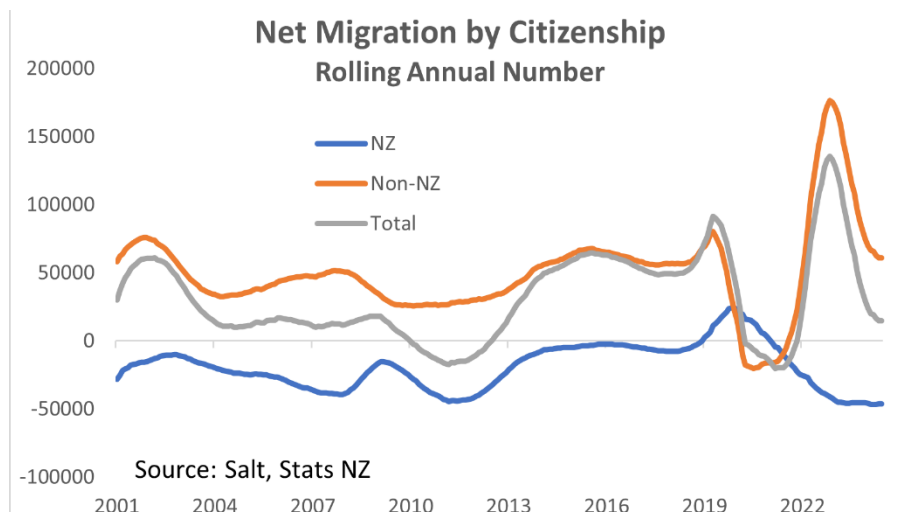


House price inflation has been a traditional tailwind to economic growth as households have benefitted from the wealth effect of higher prices. However, house prices remain soft in the early months of 2025. The annual rate of change has improved to +0.1% in the year to May, with future gains expected to remain modest for a host of cyclical and structural reasons.

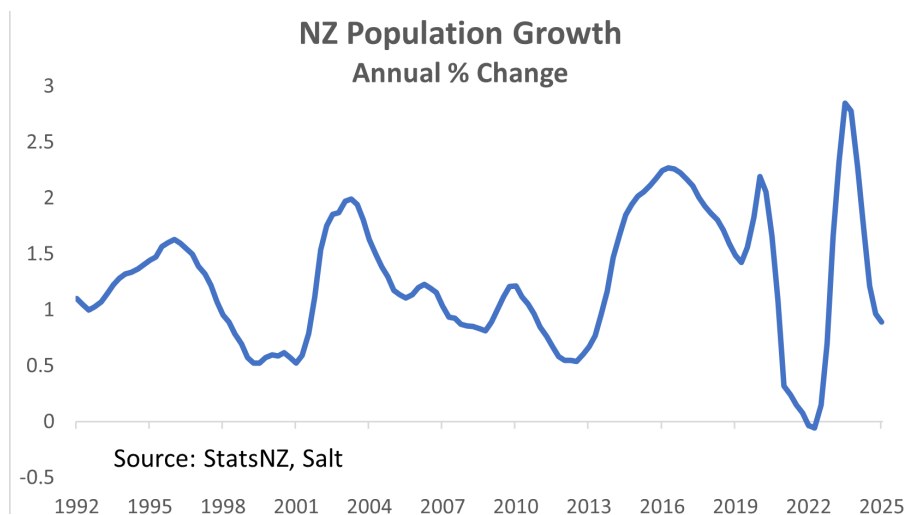


The key constraining factor is the level of inventory which remain at close to decade highs. Lower population growth, still high interest rates relative to the last cycle, too high vendor price expectations, the ageing population and public policy initiatives that have boosted the housing supply and land availability are key factors that are expected to keep house price inflation in check in the period ahead.

...nor population growth

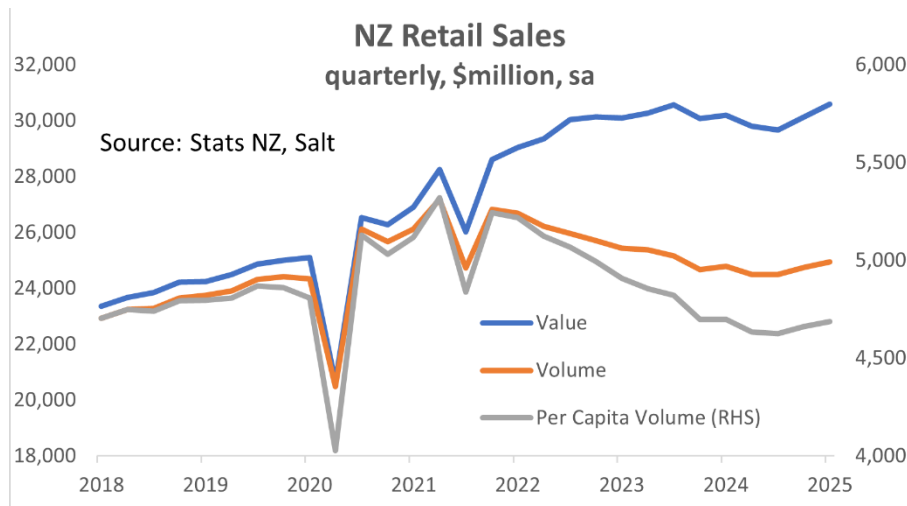


Net migration has now fallen to around +14,800 and appears to be forming a base. This is well down on the post-border-opening peak of 135,500 peak of October 2023. The decline is a function of strong net outflows of NZ citizens and lower net inflows of non-NZers. This lower level of inward migration has obvious implications for economic activity but also labour market supply.

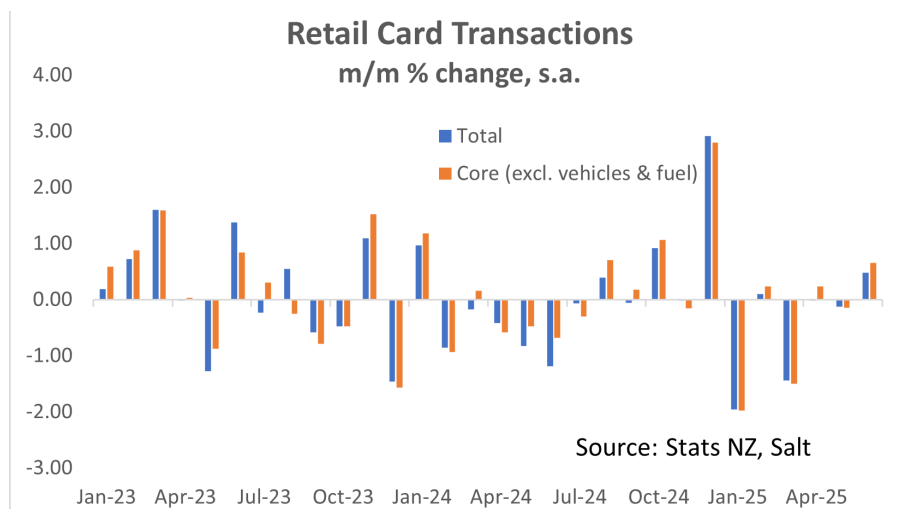


Net migration explains much of the volatility in New Zealand's population growth. As migration peaked at the end of 2023, population growth peaked at +2.8%. As migration has slowed, so too has population growth, coming in at +0.9% for the year to March 2025. This slower growth has obvious implications for the expected rate of growth in activity in the period ahead.

Retail spending recovering slowly

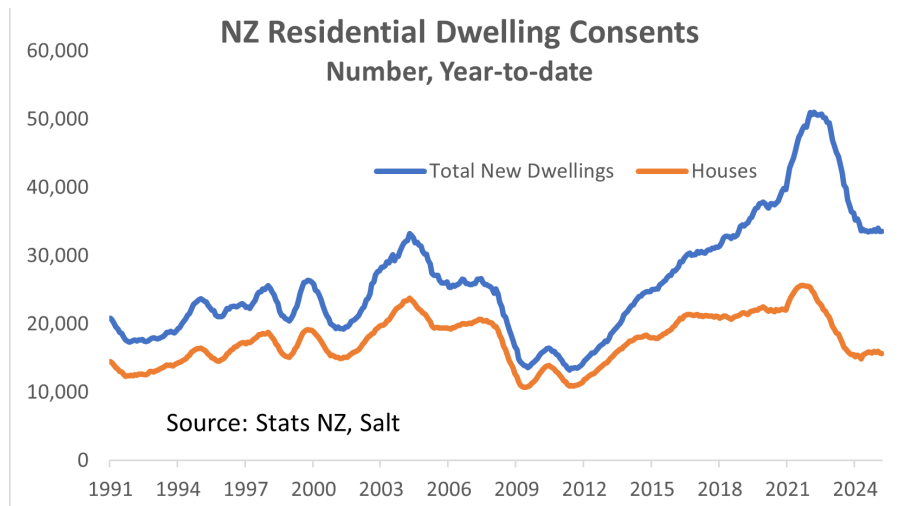


Consumers started to open their wallets as the end of 2024 approached with a bounce in retail spending in the final three months of the year. However, higher prices are still accounting for much of the turnaround. Volumes were up +0.8% in the March 2025 quarter for an annual gain of +0.7%. It will be long journey back to a full recovery, especially per-capita sales, but at least sales have stopped falling.



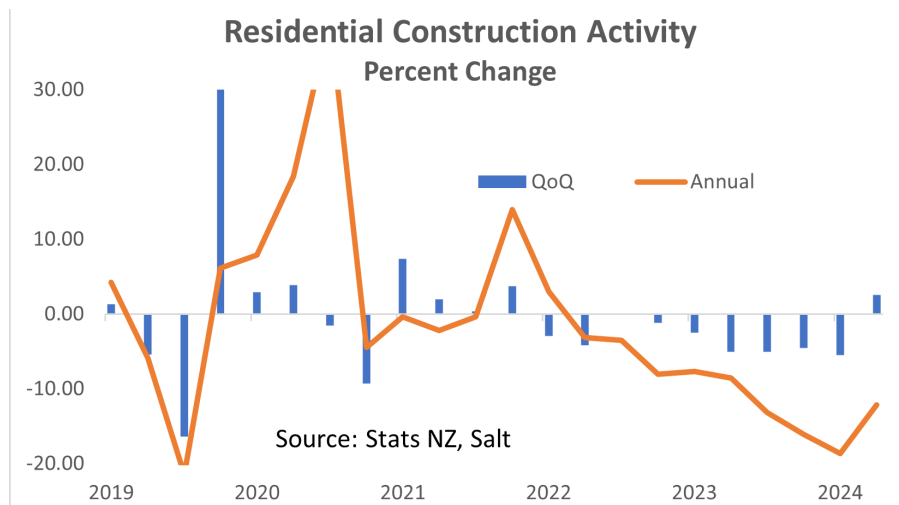
Caution about the pace of recovery in spending in the early part of 2025 has been reinforced with recent retail card transaction data showing that spending has been a stop-go affair over the first few months of 2025. The good news is the June month saw the best result of 2025 so far, but with this data being nominal, higher prices will account for at least some of the increase.

Residential construction stabilising, but no strong rebound



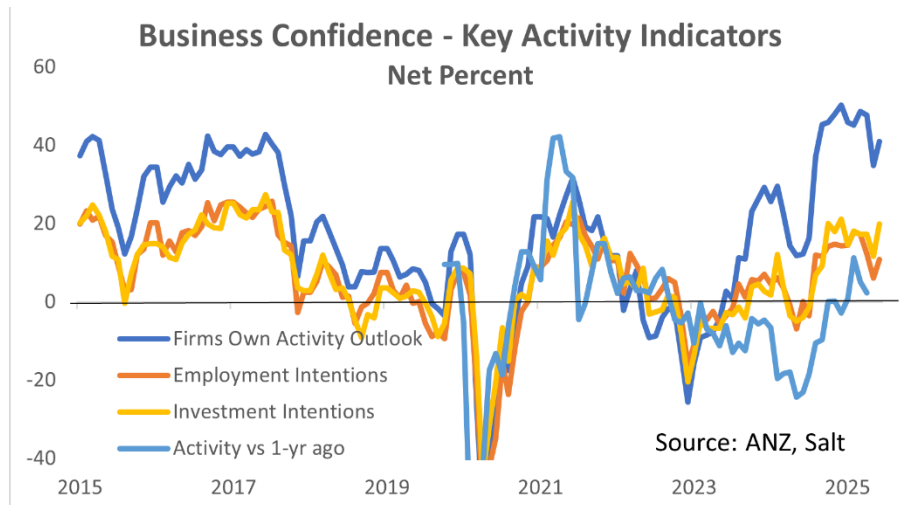
Consents for new dwellings have fallen sharply over the last couple of years but now appear to be finding a floor (pun intended). With interest rates now falling and house prices stabilising, a recovery is likely in the months ahead.

However, the slowdown in the rate of population growth will provide something of a brake on any sharp recovery.

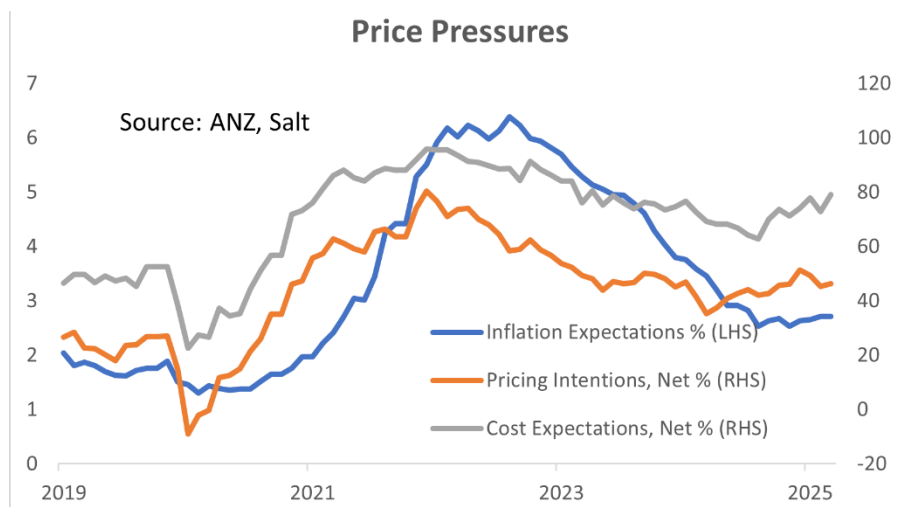


Residential building work put in place rose for first time in over two years in the March quarter of 2025. While it was good to see the start of a turnaround, activity remains 12% lower than a year ago and 25% lower than the peak level of activity in the September 2022 quarter.

Business confidence still upbeat

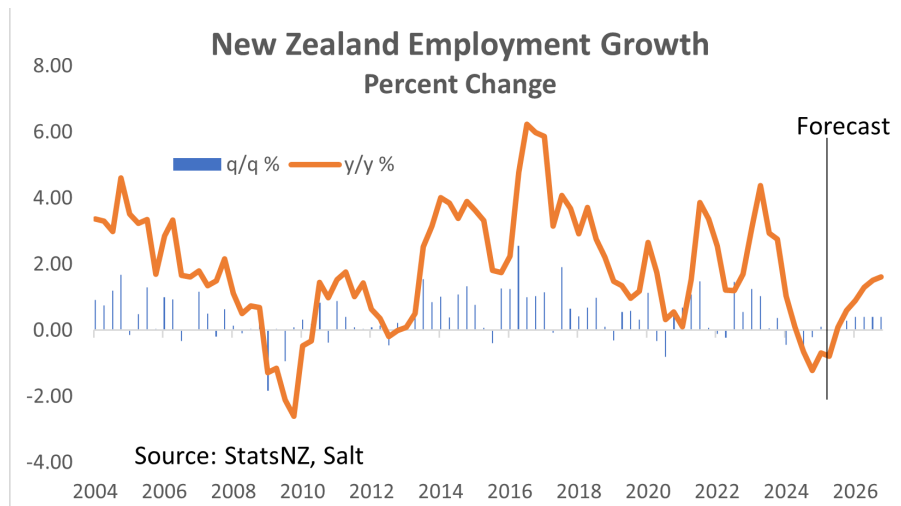


The ANZ's Business Outlook survey saw a recovery in the key forward looking indicators after May's likely tariff-induced slump. However, the question asking respondents about activity relative to last year was down again, which is consistent with recent partial activity data indicating growth has cooled somewhat relative to the March quarter.

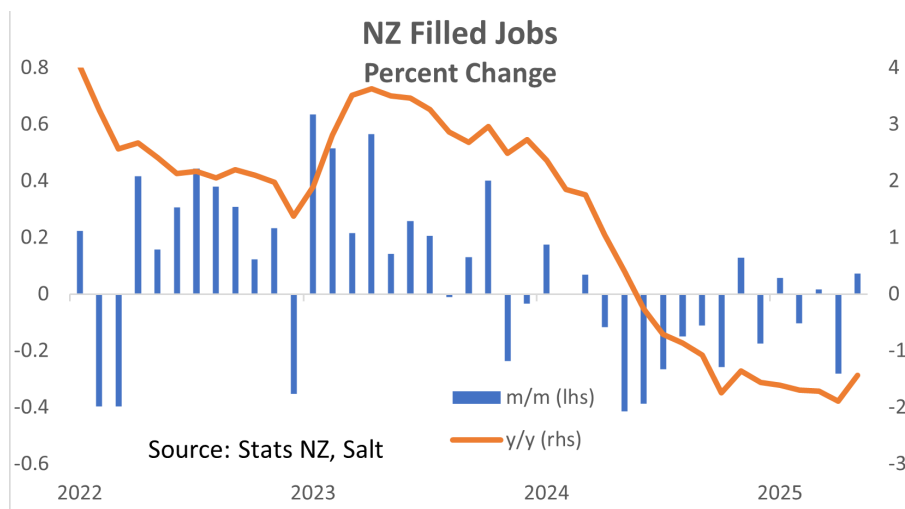


Pricing intentions and cost expectations remain high, in fact too high in our view to be consistent with the RBNZ's inflation target. That said, at 2.71%, inflation expectations look ok.

Employment conditions still soft

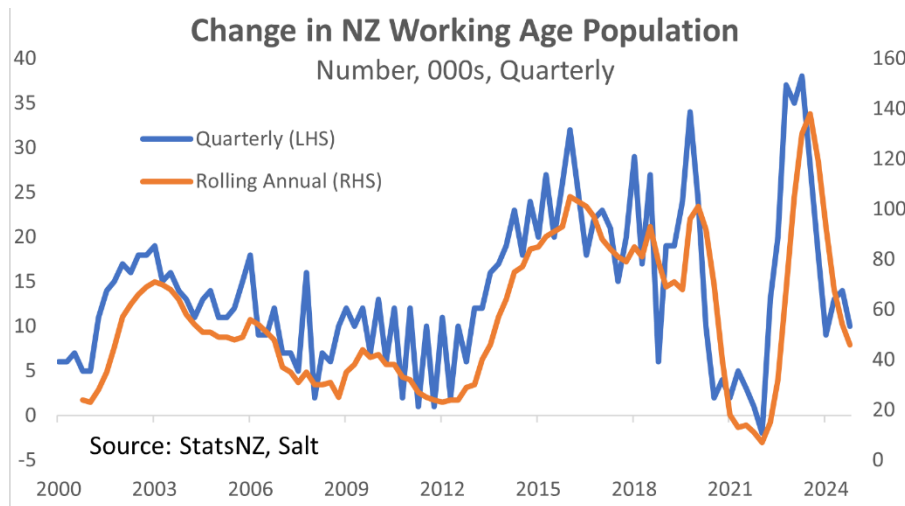


Employment rose a fragile +0.1% in the March quarter, but is still -0.7% below year ago levels. We expect no change in the June quarter. Looking towards the end of the year, the expected recovery in employment will be subdued, in line with our expectations of an only modest recovery in activity.

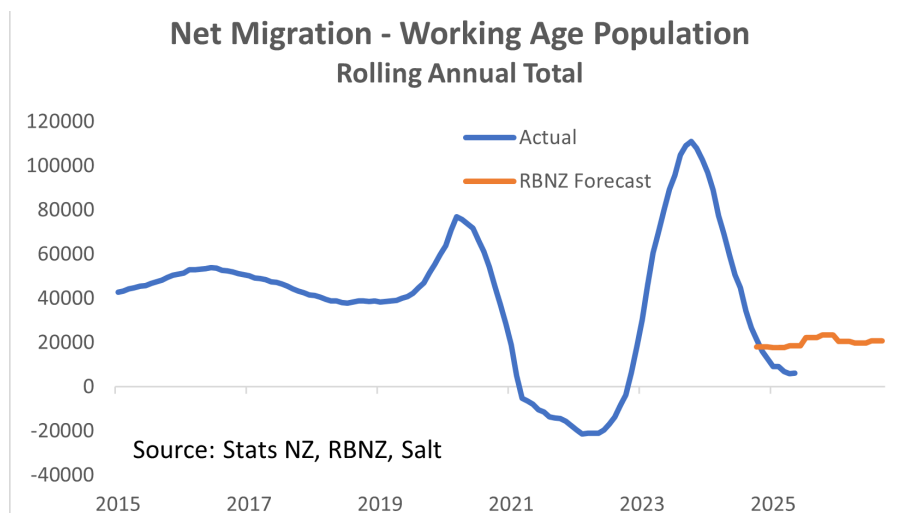


More recent filled jobs data supports the story of the subdued employment market and suggests downside risk to our June quarter flat employment result in the Household Labour Force Survey.

Labour market supply more constrained

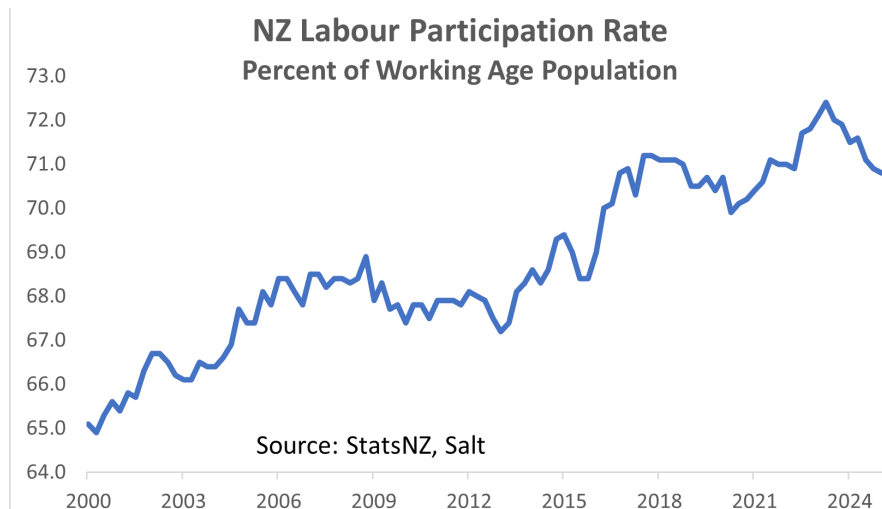


As demand for labour has remained soft, growth in the supply of labour has also slowed, limiting the rise in the unemployment rate. This followed a period of rapid growth as borders reopened following the Covid pandemic and was a key contributor to the moderation in wage growth and inflation that followed. We expect only modest growth in the working age population in the period ahead.

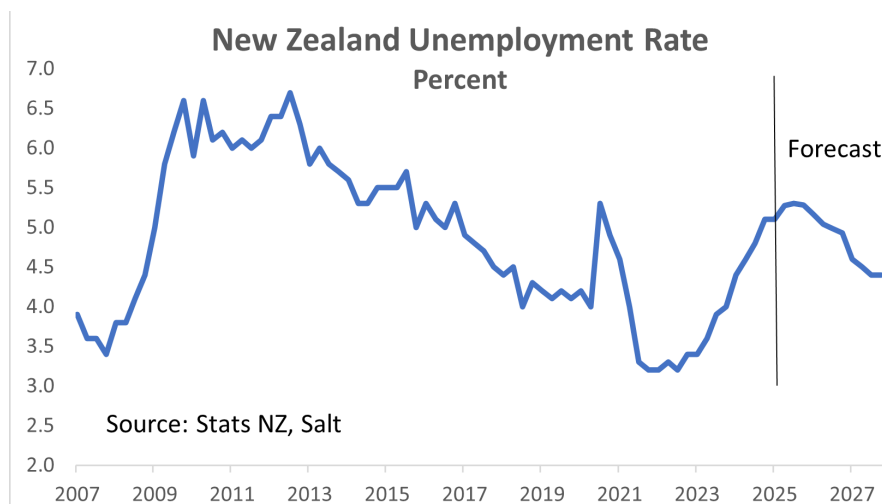


The biggest source of recent growth in the working age population has been net migration. This is a critical input into measures of potential GDP growth (the speed at which the economy can grow without generating excess inflation). Latest revisions to migration data suggests the RBNZ will likely be revising their estimates of growth in the working age population and potential GDP down in the August MPS.

Labour market slack still increasing

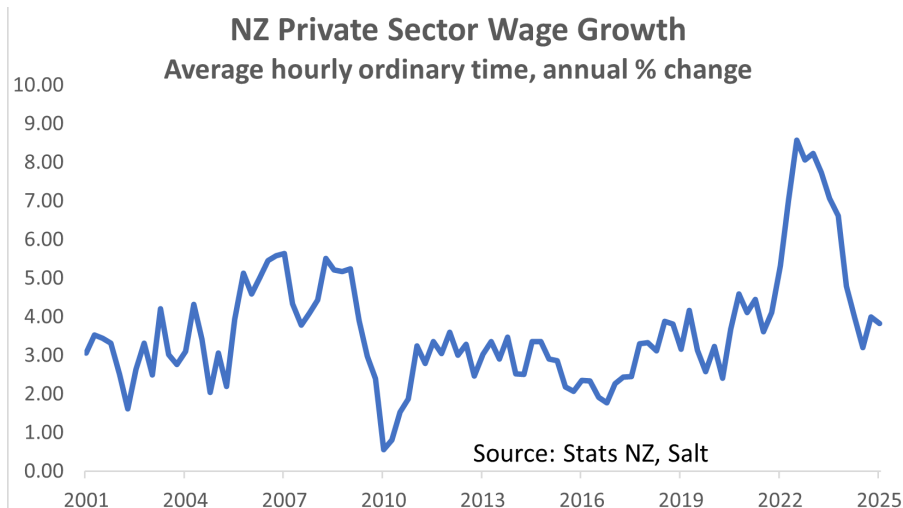


A further moderating influence on the rise in the unemployment rate has been the recent decline in the participation rate (the proportion of the working age population that is either in or actively seeking work). During recessions people can become discouraged at the prospect of finding work and drop out of the labour market. We are going through such a period currently.

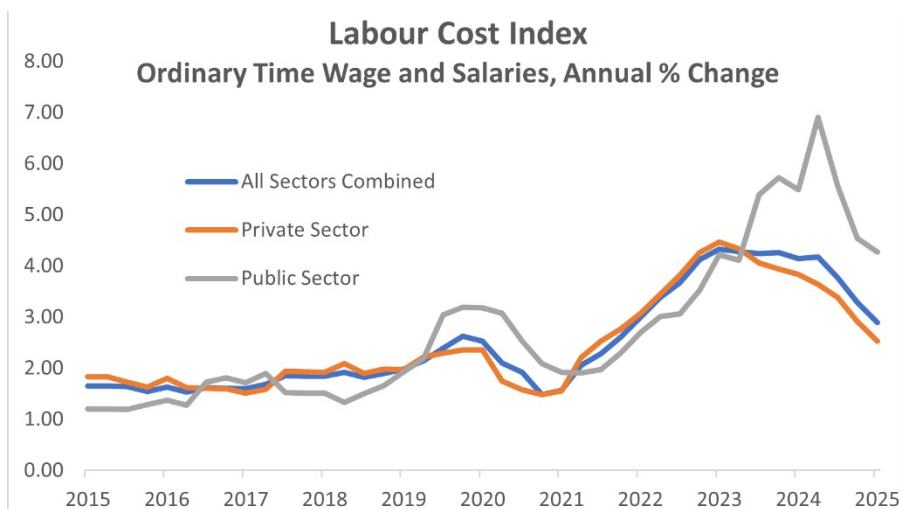


The unemployment rate has risen sharply over the past two years as demand as employment has contracted. The unemployment rate stood at 5.1% in the March 2025 quarter with the decline in the participation rate preventing a sharper rise. We still see this peaking at around 5.3% in mid-2025, though the forecast recovery will be modest, in line with the economy generally.

Wage growth moderating

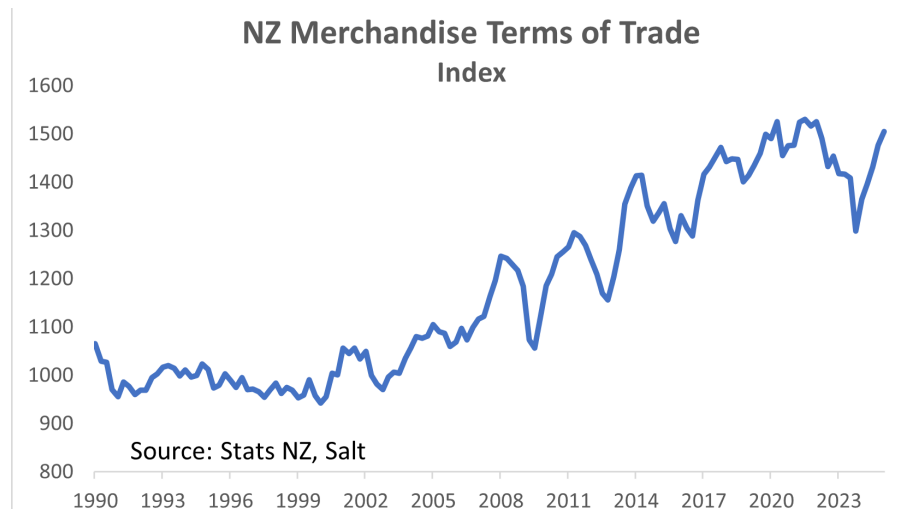


Nominal wage growth surged as labour demand recovered at the same time borders were still closed and the supply of labour was suppressed. As the economy has weakened, labour demand has slowed while supply has remained positive, leading to a sharp fall in nominal wage growth. Annual growth peaked at 8.6% in September 2022 and has subsequently fallen to 3.8% as at March 2025.

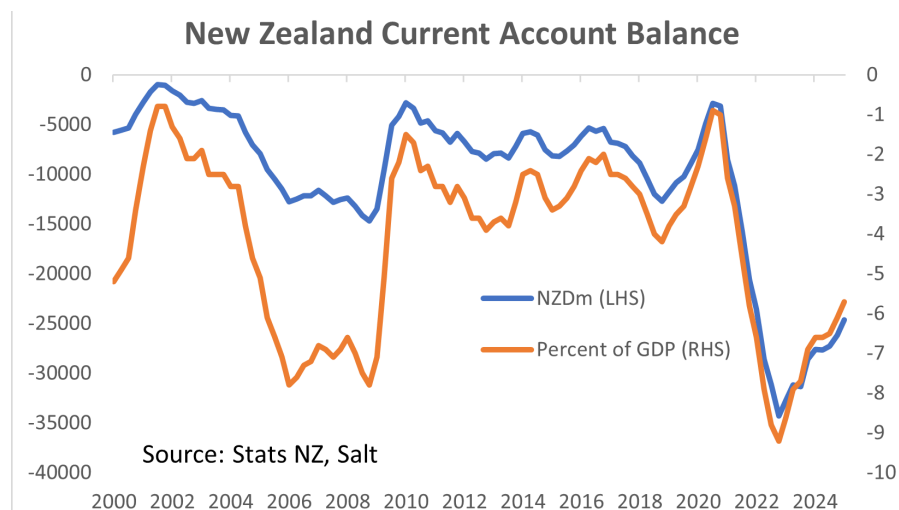


Wage inflation (unit labour costs) as measured by the Labour Cost Index continues to moderate. The key measure for the RBNZ is for the private sector as it is the measure they can most influence. From a peak of 4.5% this has now fallen to 2.5% as at March 2025, close to the 2% that would be consistent with target inflation. Ongoing softness in the labour market will lead to further moderation in the months ahead.

Terms of trade on a tear

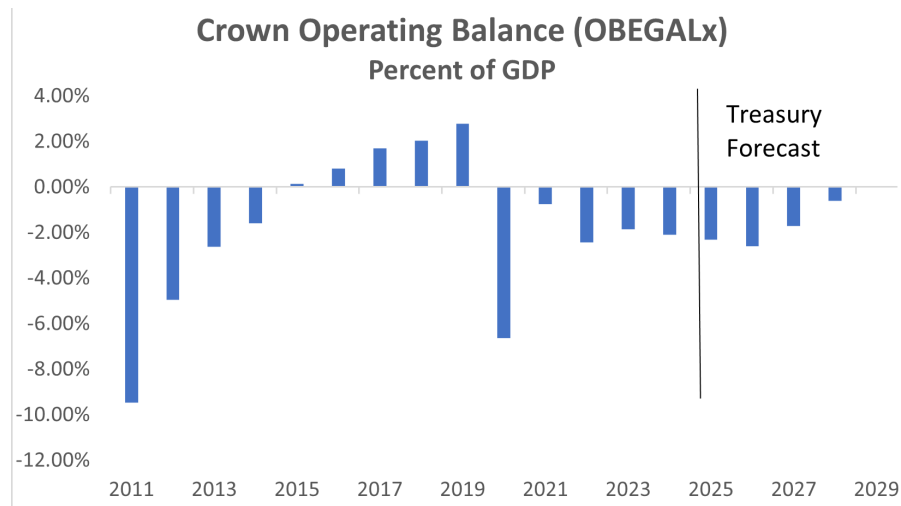


NZ's Terms of Trade index has now risen 15.9% off its recent lows and is now only around 1.4% shy of its peak of March 2022. The impact of recent trade policy uncertainty is difficult to determine. Export prices are likely to be lower on the back of lower global growth, but so too are import prices. The net effect is anyone's guess right now.

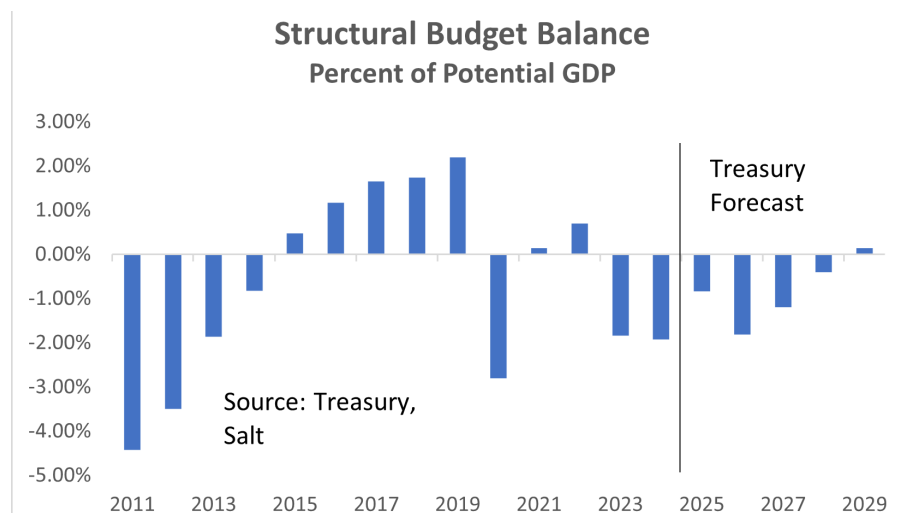


The improved terms of trade is leading to a more significant improvement in the current account deficit than we had previously been anticipating. The annual deficit improved to -5.7% of GDP in the March 2025 quarter. The deficit is still uncomfortably large, but we now see this improving to around -4.5% of GDP, better than the -6% of GDP we were anticipating earlier in the year.

Fiscal position is challenging

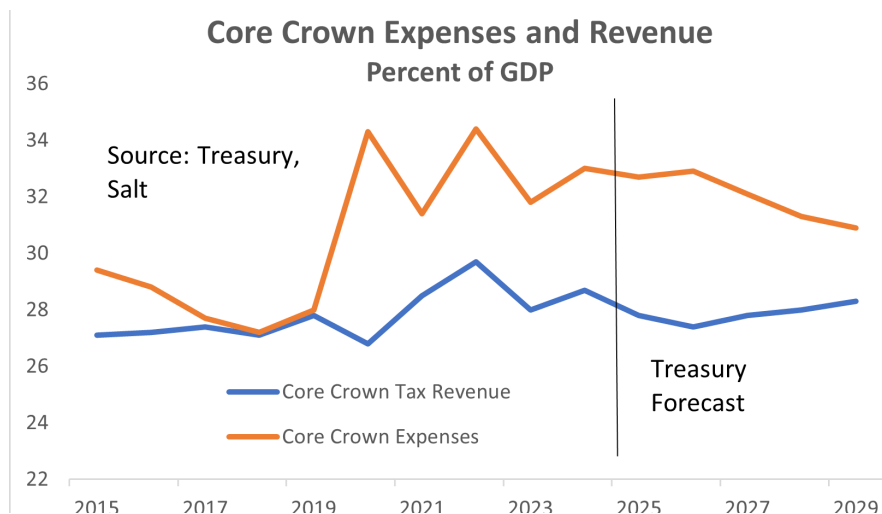


The Government continues to target a return to surplus in 2029, but that forecast surplus is wafer thin, rounding to zero as a percentage of GDP. Furthermore, we believe the fiscal forecasts are based on growth assumptions that are at the optimistic end of the spectrum. The Treasury is forecasting average GDP growth of 2.8% in the period 2026-2029. Our own forecasts average 2.3%.

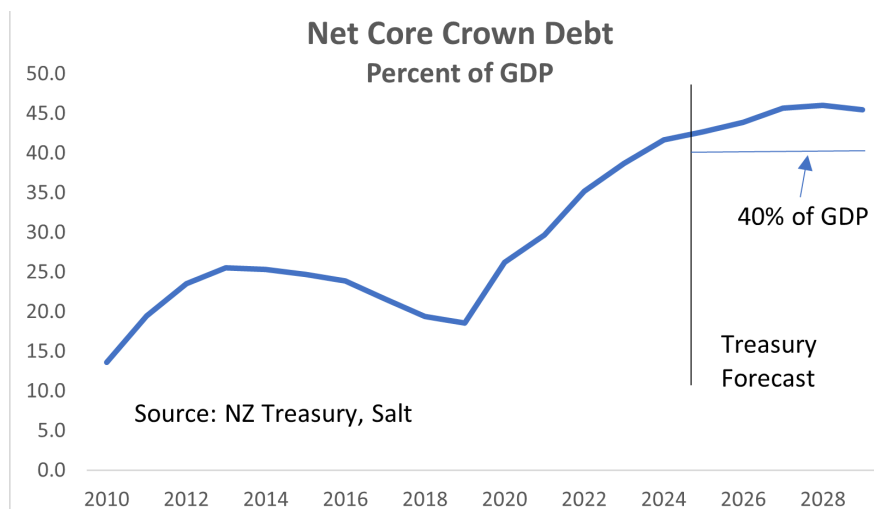


Trade disruptions aside, adjusting for the economic cycle reveals that the budget deficit problem is structural, meaning that just a pick-up in growth (to its current potential) is insufficient to solve the deficit problem. We need either higher potential growth, reductions in current levels of expenditure, or new sources of revenue.

No easy fix

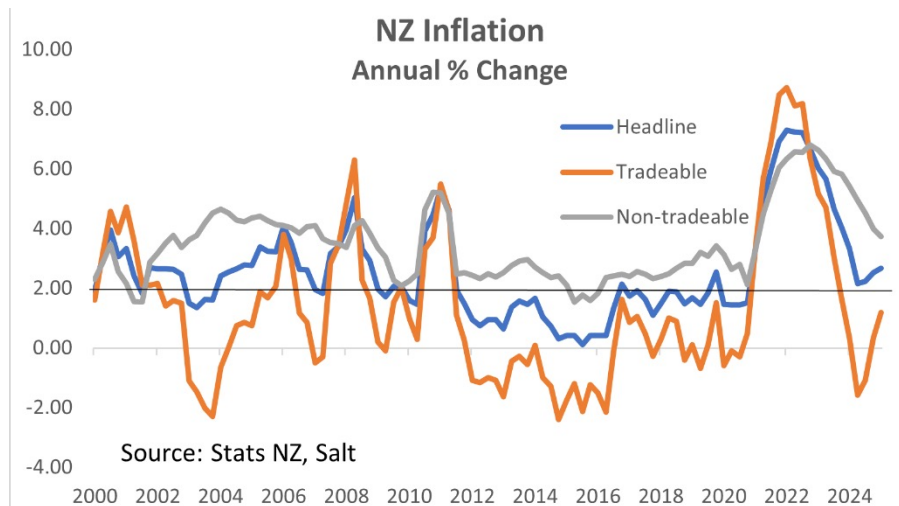


While the Government has stabilised the Crown expense ratio, expenses remain significantly higher than prior to the pandemic. From here, a more strategic approach to cost cutting will be required. For those advocating higher taxes as the answer, it should be noted that tax revenue is already forecast to rise as a percentage of GDP.

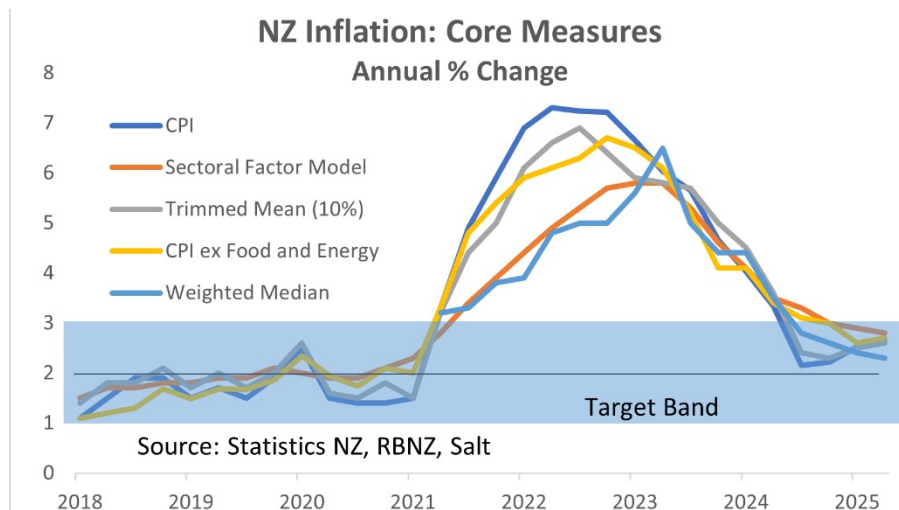


The Government remains committed to its 40% target for net Crown debt, which we fully support. It is essential we restore a buffer for whatever the next crisis is that gets thrown at us. Allowing a higher debt level, along with the associated higher debt servicing costs, is not the answer. Higher debt servicing simply crowds out more important expenditure.

Rising, but still in the band

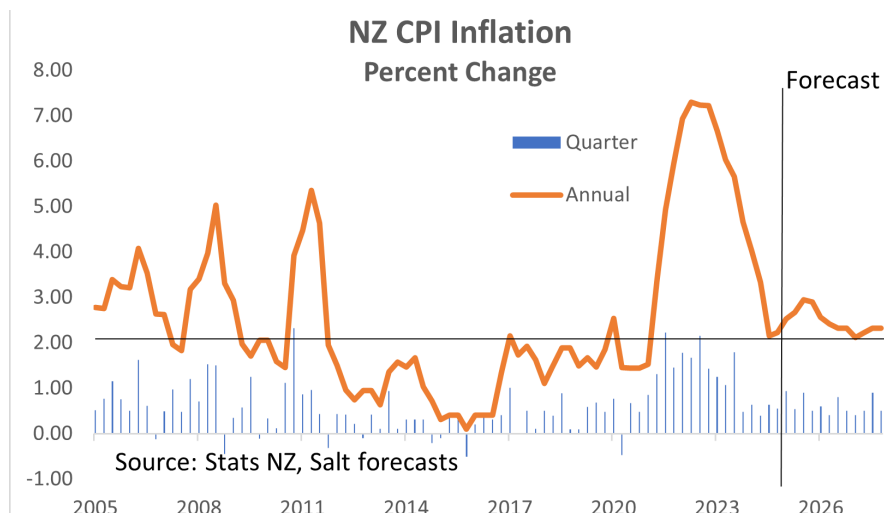


The annual rate of CPI inflation came in at 2.7% for the year to June 2025, its second consecutive increase but still within the RBNZ's 1-3% target band. The result showed the expected rebalancing between tradable and non-tradable inflation as the former rose but was partially offset by continued domestic disinflation.

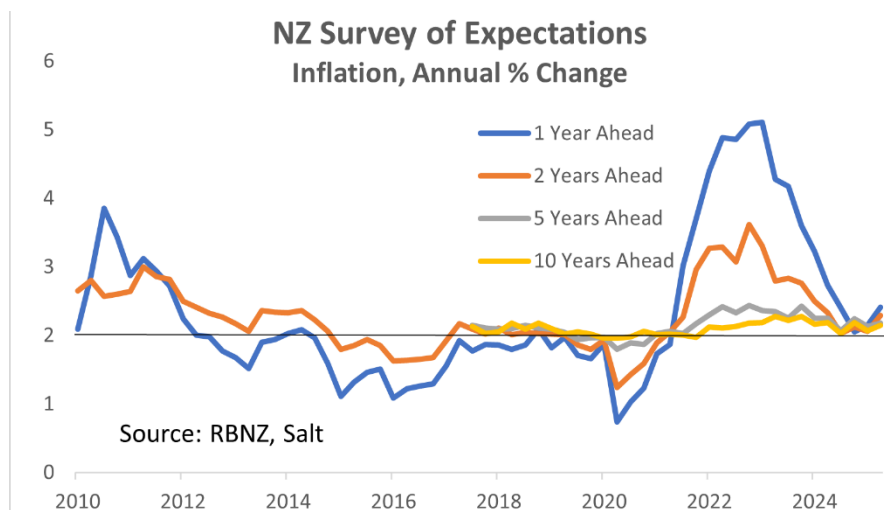


All the core measures of CPI inflation are comfortably within the target band. This should give the RBNZ the confidence to follow through with the further easing in monetary policy they have already signaled.

A blip, then back to 2%

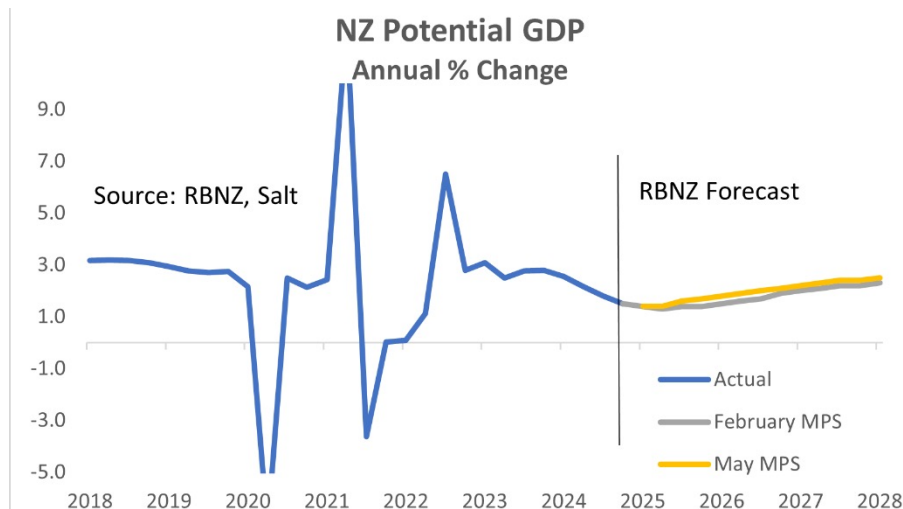


We see the annual rate of CPI flirting with 3% in the year to September as higher food and energy prices continue to impact. However, we see this as a temporary blip higher which is supported by the so far well-behaved core measures. We see annual inflation moving back to 2% during 2026.

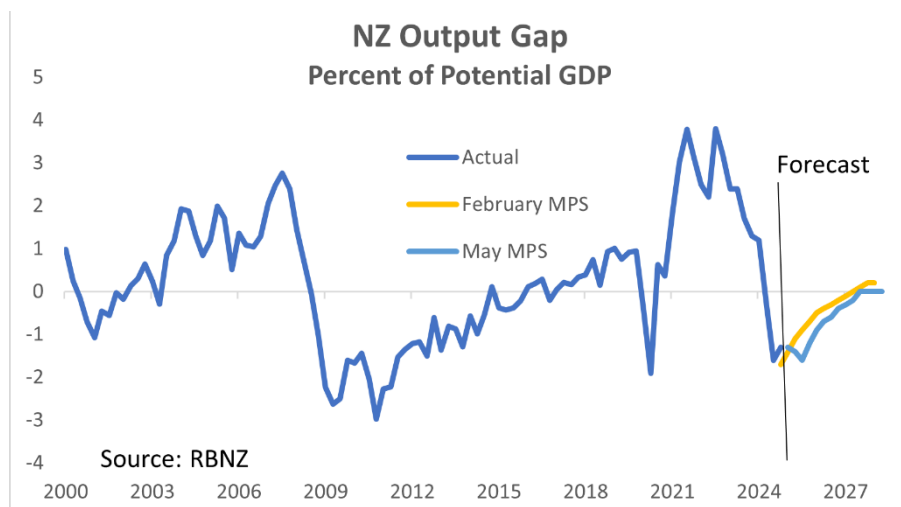


Inflation expectations ticked higher in the June quarter, no doubt reflecting the rise in actual inflation in the March quarter. Shifts in US trade policy possible also had an impact. The RBNZ will be watching expectations closely, especially as we move through this period in which actual inflation is expected to move higher.

Spare capacity, but how much?

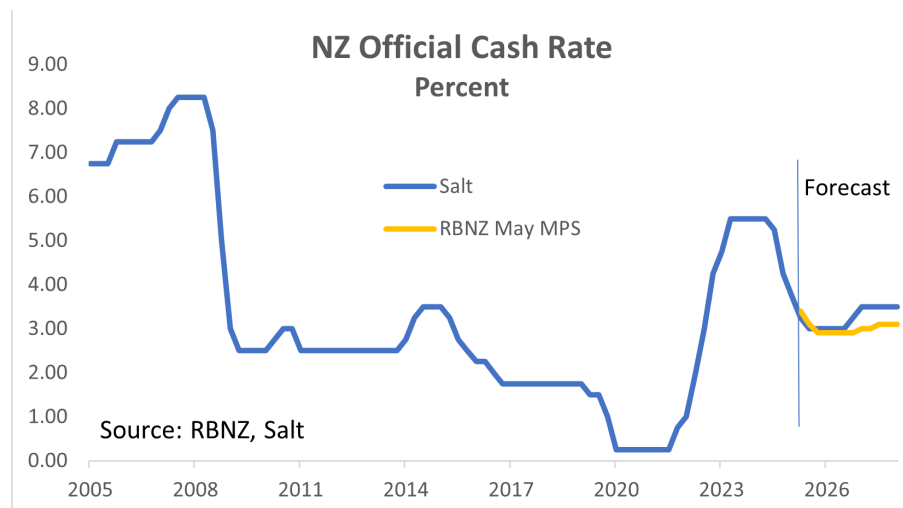


Critical to the outlook for inflation and monetary policy is how fast the economy can grow while achieving low and stable inflation, or its **potential growth rate**. This is a function of factors such as growth in the working age population and productivity. This will likely be revised down a tad in August given the latest revisions to net migration and its implications for growth in the working age population.

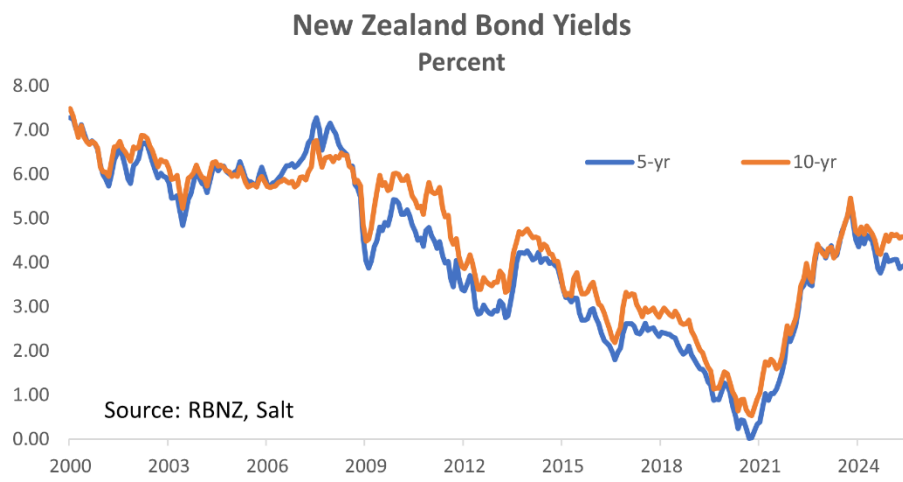


Likely revisions aside, we currently have a large **negative output gap**. Given the likely modest growth in the period ahead, this will take some time to close. When it is closed, sustainable growth in the economy is then constrained by our potential growth rate.

A bit further to go

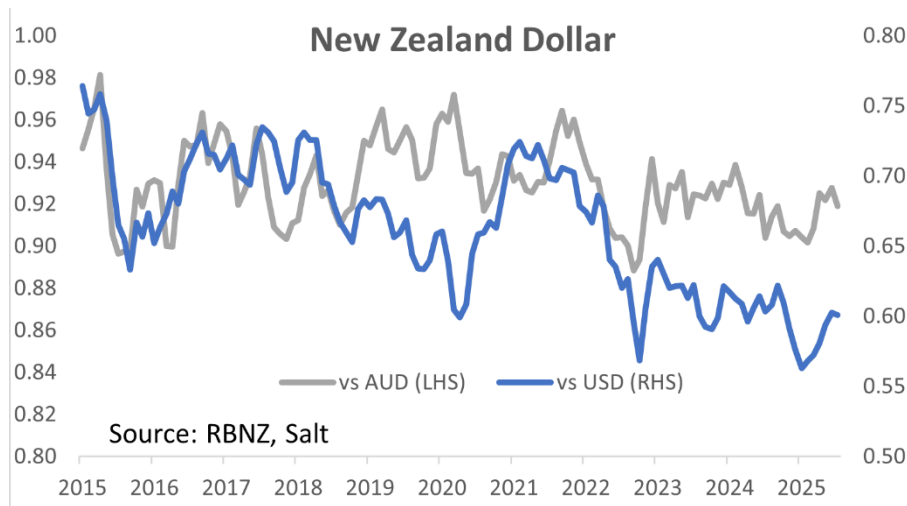


The RBNZ has cut the OCR a total of 225 basis points since August 2024 and we believe we are close to the bottom of the cycle. We have one more 25bp pencilled in for a low of 3.0%, while the RBNZ is flagging the possibility of a further cut, which we wouldn't rule out given the renewed weakness in some of the recent activity indicators.

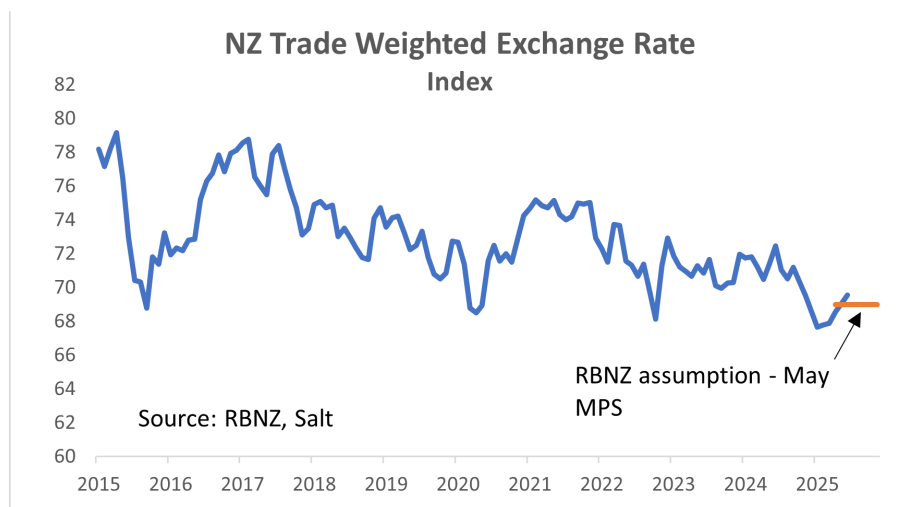


The shorter end of the bond curve is lower than at the time of our last report as monetary policy has continued to ease, not just in New Zealand but globally. The long-end hasn't been as strong given increasing concern about fiscal sustainability in much of the developed world. Yield curves are generally steeper as monetary policy expectations keep the shorter end of the yield curve anchored.

US dollar has become less exceptional

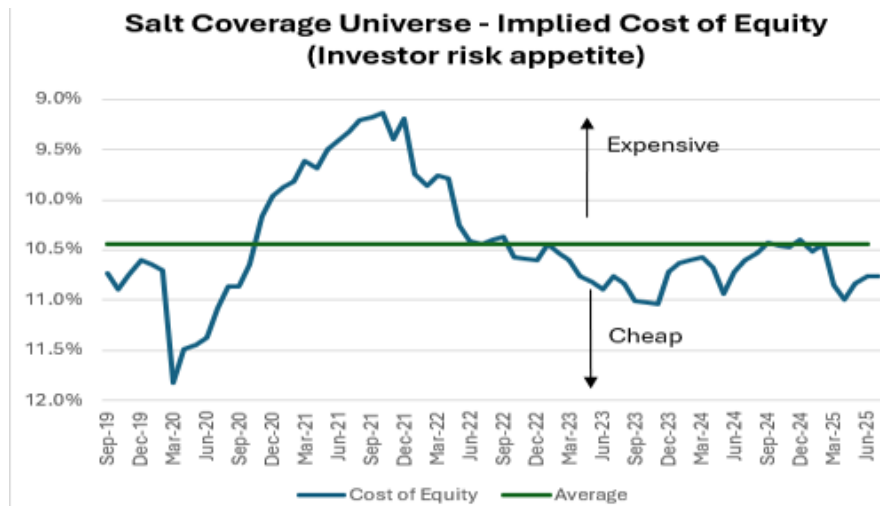


The NZD has risen sharply in recent weeks, or rather the USD has fallen sharply as the gloss has come off US assets in the aftermath of the US administration's Liberation Day tariffs and the erratic announcements since. The NZD has also been firmer against the AUD as concerns about Chinese growth have hit the AUD harder.



What matters most for the RBNZ is how the NZD moves on a trade weighted basis. The TWI has risen around 3.0% since its recent lows in March but only takes the TWI back to where it was in early December. At the time of writing the TWI is tracking at around 69.5, just slightly ahead of the 69.0 assumed by the RBNZ in their May MPS.

NZ share valuations reflect slower economic recovery



We view the Salt stock coverage universe as moderately cheap relative to its 5-year average investor risk appetite. Equities bounced off the recent low in April 2025 as investor fears around tariff uncertainty and the risk this posed for short-medium term earnings reduced. Through CY24 & into early CY25 investors were increasingly looking through a downgrade cycle that many believed was nearing an inflection point. However, expectations of an underlying macro recovery have now extended out to late CY25 at the earliest, with the potential still for tariff risk to drive earnings downgrades in the short-term at least.

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