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New Zealand Chartbook

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August 2024

Highlights

- The New Zealand economy continues to struggle. While the economy managed to eke out a modest GDP increase in the March quarter, more recent partial data has been weaker. We expect to see contractions in activity in both the June and September quarters before stabilising.
- Tax cuts took effect on July 31st. Our forecasts assume they will just partially offset deepening negatives elsewhere in the economy.
- Conditions in the labour market are continuing to deteriorate. The unemployment rate has risen to 4.6% and we expect it will be around 5.5% by early 2025.
- Headline inflation continues to moderate, coming in lower than RBNZ forecast in the June quarter. We expect the headline CPI will be back within the 1-3% target band when September quarter data is released in October.
- Concern about ongoing strength in non-tradeable (domestic) inflation pressures is being elevated by signs in recent business surveys that firms are experiencing reduced pricing power on the back of weak activity. That bodes well for continued disinflation.
- We have consistently held to the view that interest rates would be able to be cut by the end of this year, even after the RBNZ’s surprisingly hawkish May Statement. Based on latest activity data, the weakening labour market and the increasingly apparent loss of pricing power amongst firms, we see no reason to delay the start of the easing cycle.

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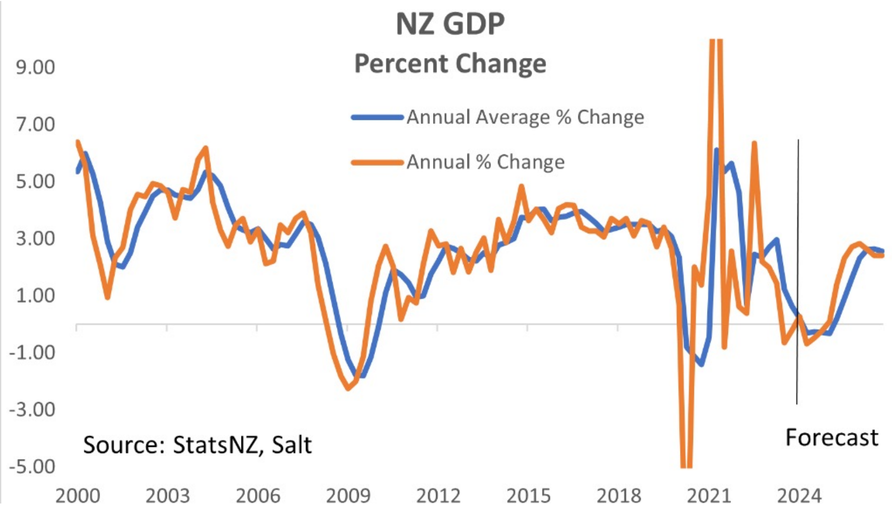
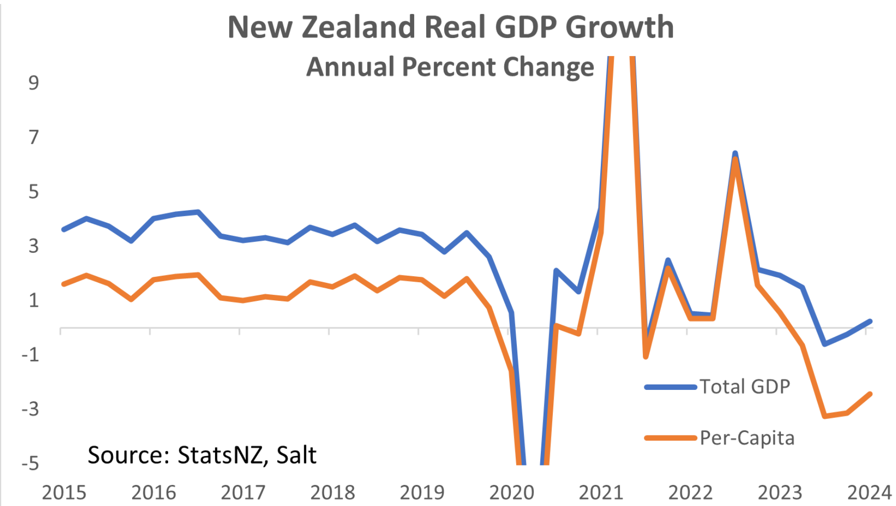
New Zealand Economy is Struggling



The NZ economy managed to eke out 0.2% growth in the March quarter of 2024. Partial activity data since then has only weakened, indicating another negative quarter in June. We don't expect any significant uplift in growth from the tax cuts; they will only serve to offset growing negatives elsewhere in the economy. We don't expect to see any meaningful pickup in growth until 2025.



The recession would have been significantly deeper had it not been for the recent very strong population growth. Strong net inward migration saw NZ's population grow by 2.5% in the year to March. Adjusting December year total GDP growth for population growth, GDP contracted -2.4% on a per capita basis. If you want to argue the toss about whether we are in an actual recession, a per capita recession is undeniable.

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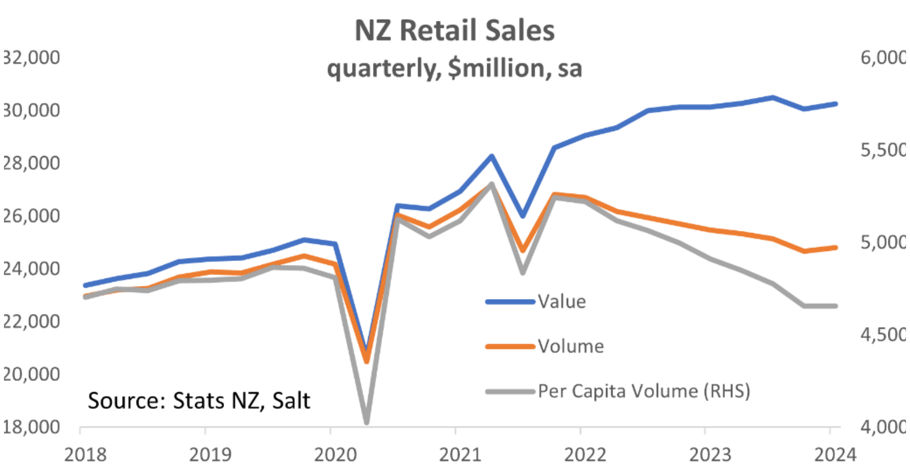
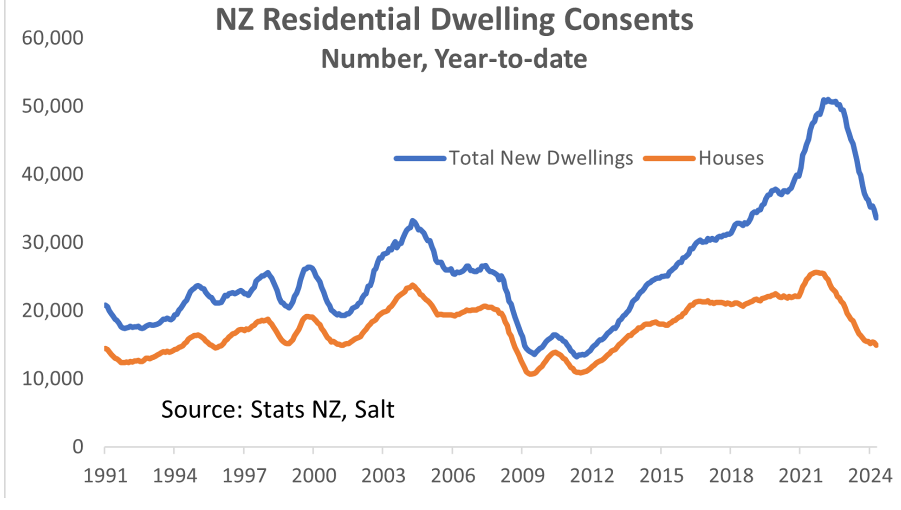
Weakness in interest rate sensitive sectors



It's tough going in the retail sector. Retail spending is being hit by weakness in the labour market and higher interest rates. On the plus side, wage growth has been strong, as has population growth. In the year to March 2024, the volume (inflation adjusted) of sales were down -2.4%. Adjusting further for population growth, the annual rate of per capita sales volumes are down -5.2%.



Residential construction has also been hit hard by falling house prices and higher interest rates. The strong population growth is playing out via higher rental costs. We don't expect to see any significant pick up in construction activity until interest rates start to fall, making that a story for 2025.

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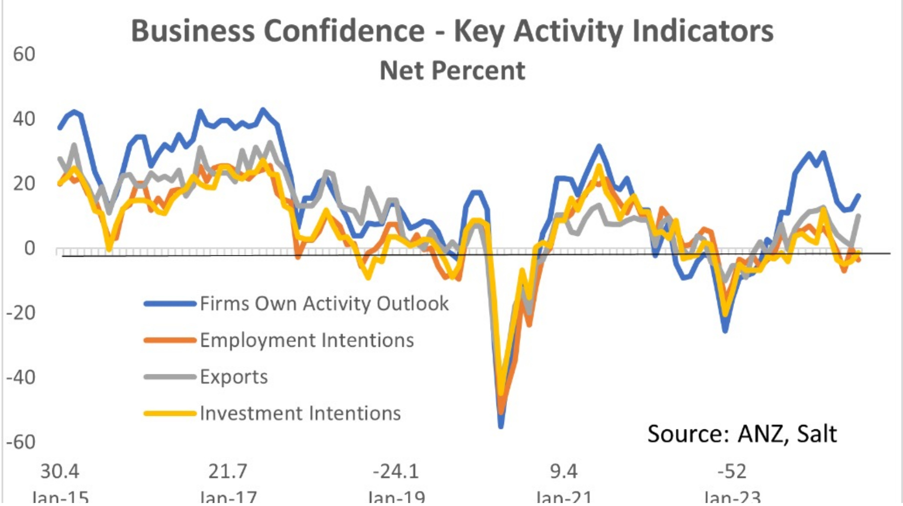
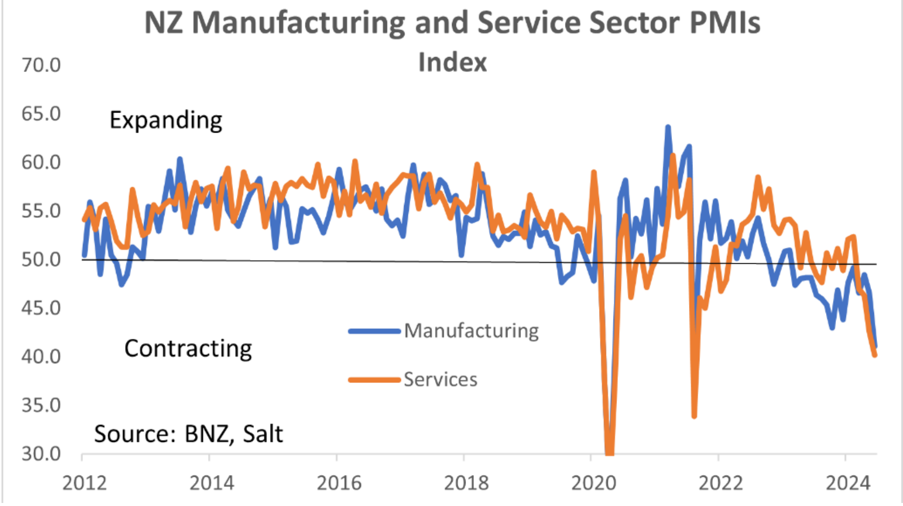
Business confidence bounces



Business confidence had been softening in recent months, though ticked higher in July. There is no reason for this other than growing optimism of some interest rate relief in the not-too-distant future. Importantly, employment and investment intentions remain in negative territory.



The BNZ's manufacturing and service sector PMIs are going from bad to worse. The manufacturing index has been weak for some time now, though that weakness appears to be accelerating. The bigger news has been the sharp deterioration in the services index over the last few months. Tighter monetary policy is finally hitting the service sector. This is important because this is where the last vestiges of sticky inflation reside.

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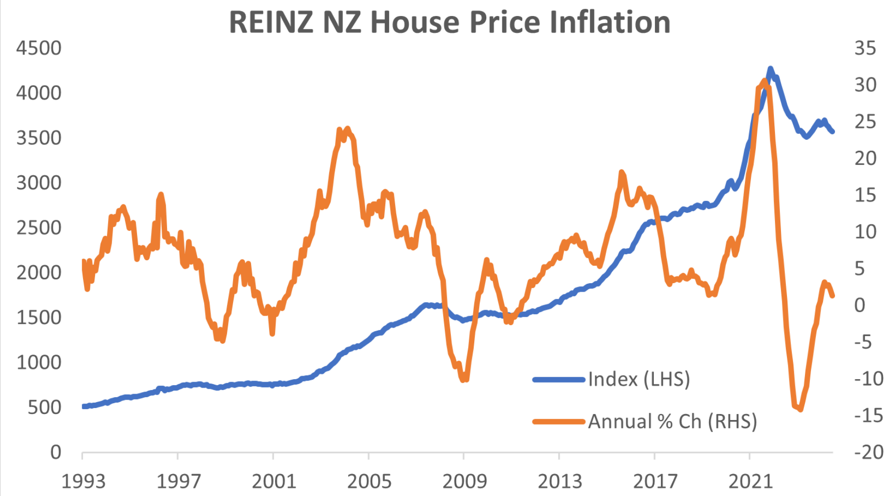
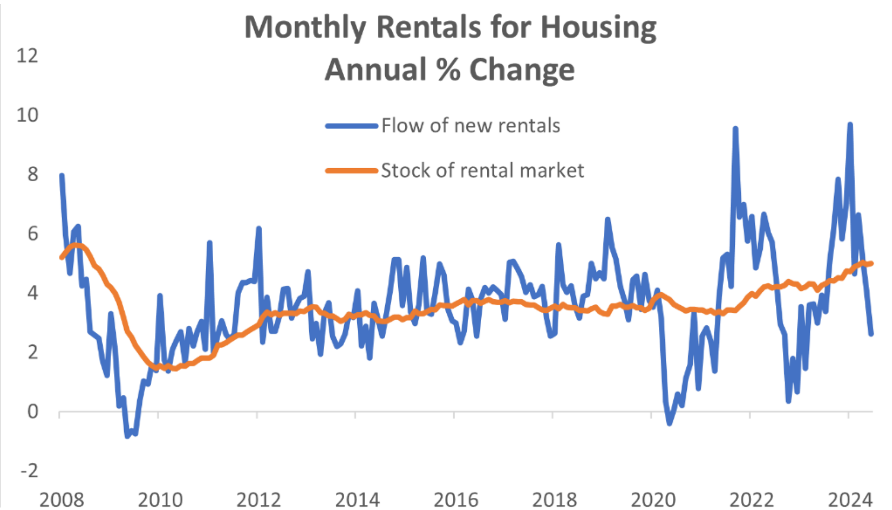
Housing market stabilising, but no strong rebound



Prices of existing homes remain subdued despite strong population growth. Annual house price inflation was 1.4% in the year to June. The number of listings is up but is rising faster than sales, so inventory is increasing. That dynamic is preventing price pressure coming back into the market. We think there will be greater confidence from buyers once interest rates fall and the labour market stabilises.



With residential construction in the doldrums at the same time we are seeing very strong population growth via net inward migration, rents have been the housing escape valve. Strong monthly growth in new rental prices (the flow) is now moderating given slowing migration and the weaker labour market. The stock will continue to rise reflecting prior increases in the flow measure.

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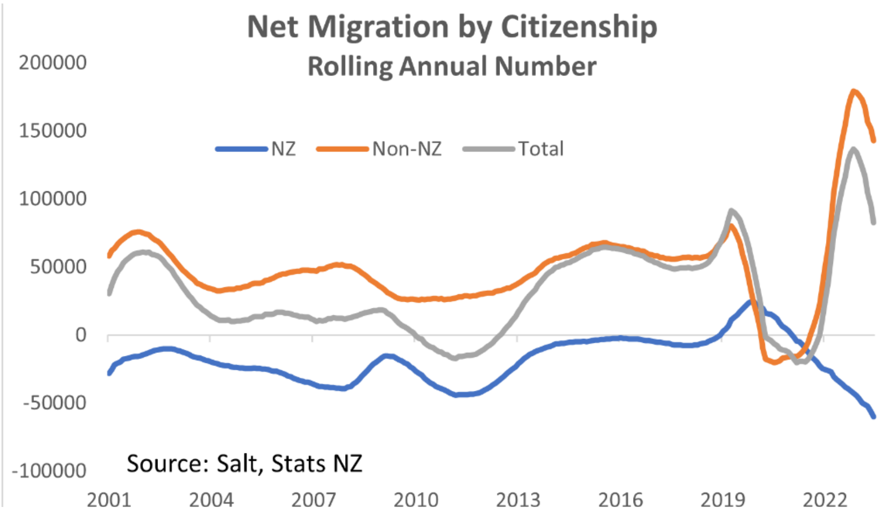
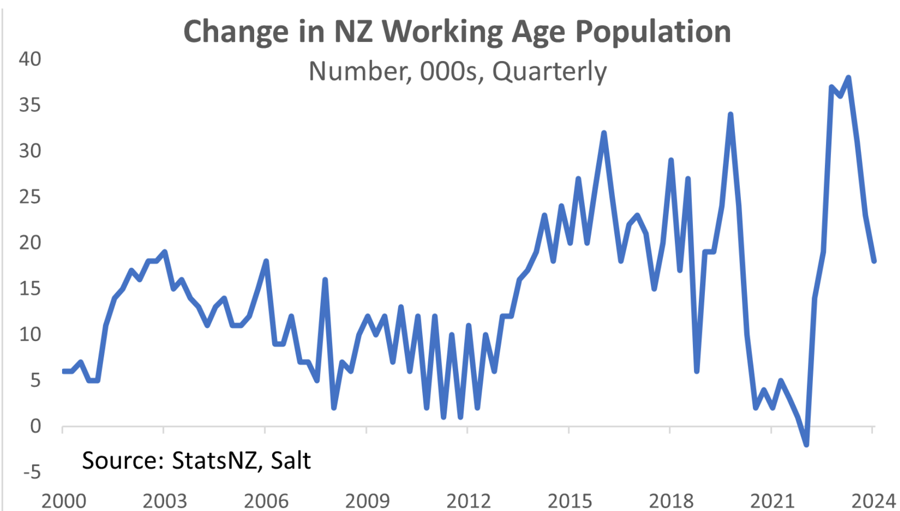
Net inward migration now slowing





Net inward migration slowed to 82.8k in the year to May, a sharp decline from the peak of 136.5k in the year to October 2023, including the first monthly net outflow since June 2022. A net 2043 people left New Zealand in May. While arrivals appear to have stabilised recently, it's departures that are rising and that's of both Kiwi's (delayed OE?) and non-New Zealand citizens (deteriorating labour market?).

While the significant net inflow of people has added to demand at a time when the RBNZ has been trying to cool the economy down, it has also led to a significant boost in labour market supply with over 200,000 people added to the working age population over the last two years. That has played a key role in the moderation in wage growth seen recently.

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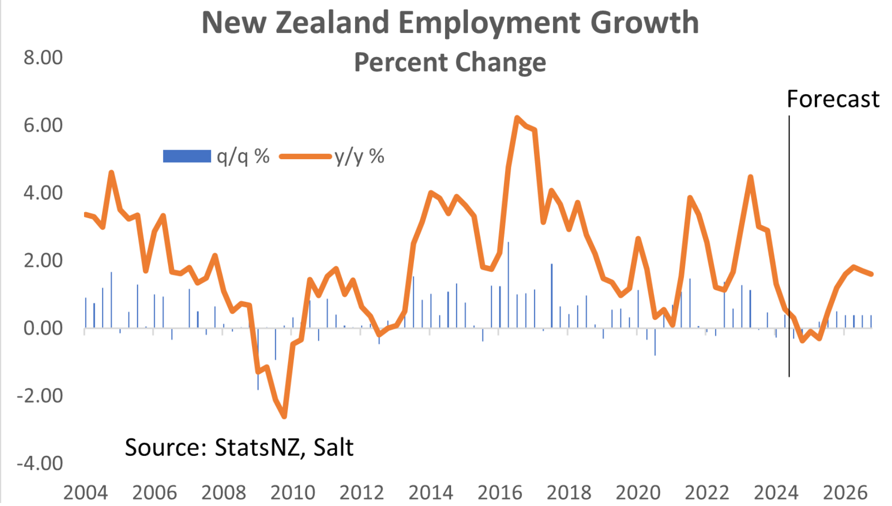
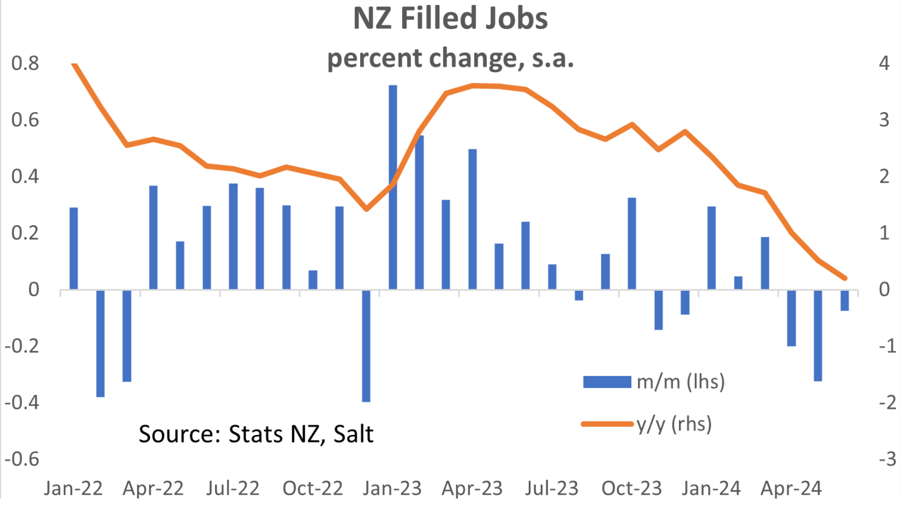
Employment conditions deteriorating

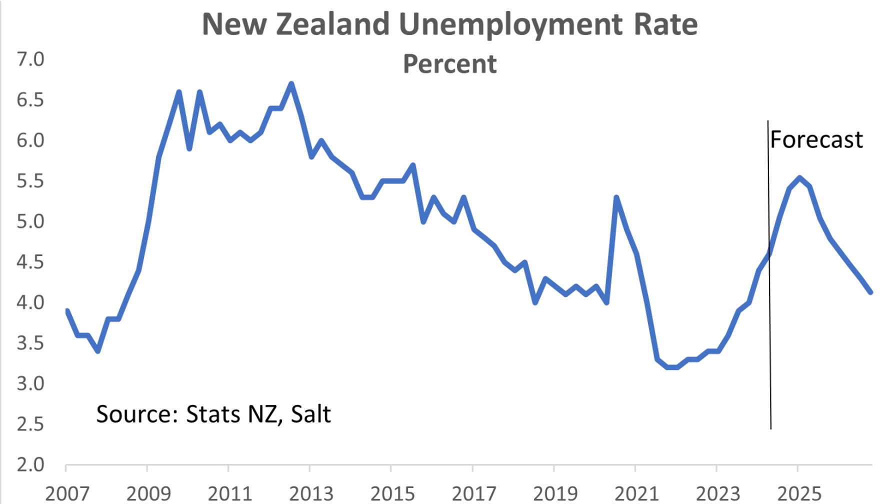


Employment growth is slowing sharply. While employment growth in the Household Labour Force Survey has been quite volatile and showed surprising strength in the June quarter, other measures have been weaker. The annual rate of employment growth is the better indicator of the trend. We expect this will be negative by the end of the year.

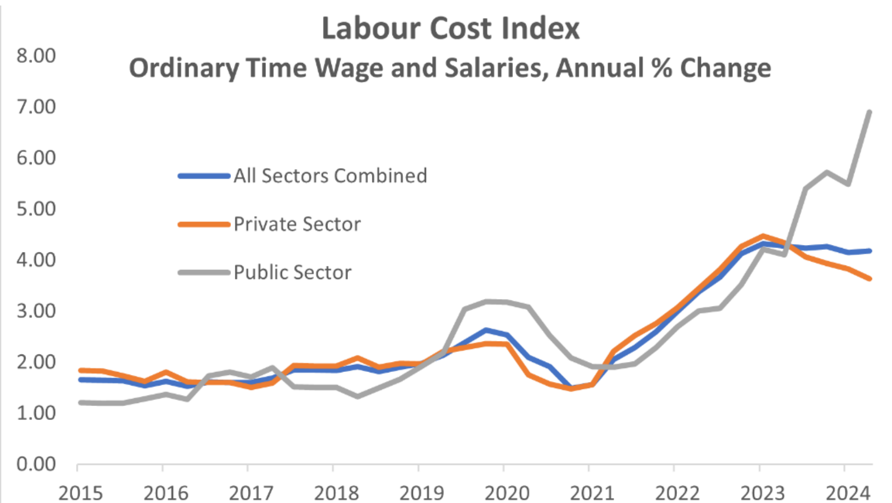


Data on filled jobs comes from firms' tax filings at the Inland Revenue Department. This makes it an employment measures similar to the US payrolls data that comes from their survey of establishments. While the household survey showed surprising strength in employment in the June quarter, filled jobs fell -0.3% over the same period.

Labour market slack increasing

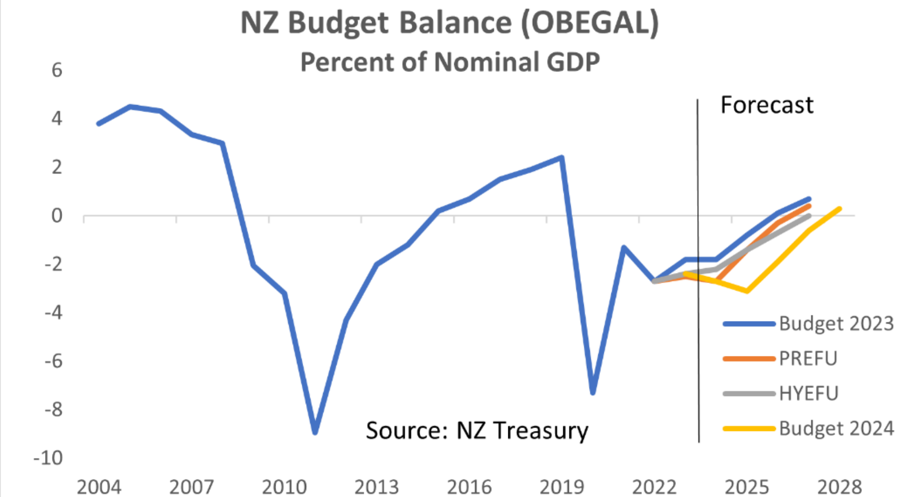


Weakening employment conditions combined with still strong migration-led increases in the supply of labour is generating a sharp rise in the unemployment rate. This now stands at 4.6% as at June 2024, up from a low of 3.2% in March 2022. We expect this will reach a high of around 5.5% by early 2025.

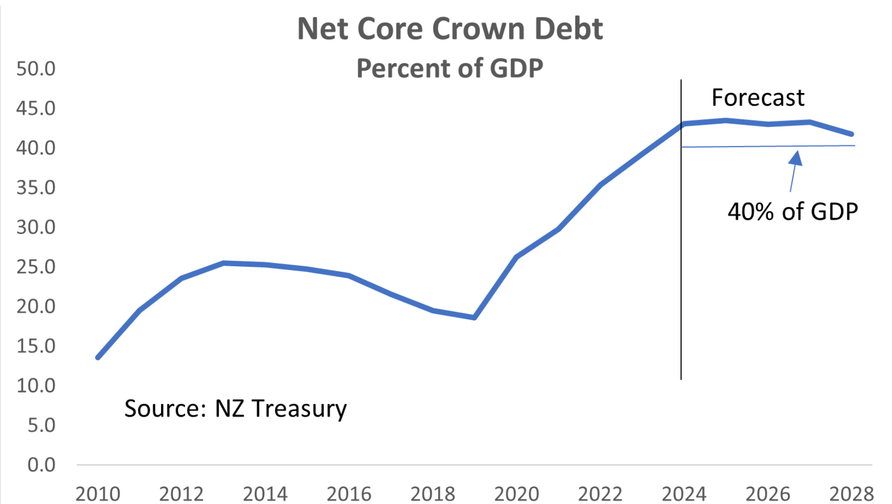


The RBNZ is most interested in private sector wages as that is the sector over which they have most influence. Growth here has continued to moderate and is now down to 3.6%. The RBNZ will want to see this back closer to 2.0% to be confident of a sustained return to target inflation. So not there yet but heading in the right direction.

Fiscal position is tight



Budget 2024 highlights the recent cutting and reprioritisation of existing spending will remain a key feature of the fiscal landscape for some time. Treasury made a meaningful downward adjustment to their growth and revenue forecasts, pushing the return to fiscal surplus out to 2027/28. Treasury's forecasts remain more optimistic than ours. We don't expect a surplus until 2028/29.



The debt to GDP ratio remains higher than the 40% target throughout the forecast horizon. This will act as a meaningful constraint on future fiscal largesse. Budget 2024 marks the start of a very challenging period for fiscal policy. Any new initiatives will require offsetting savings elsewhere, as we have just seen with the tax cuts. Immense discipline will be required to achieve the necessary fiscal consolidation.

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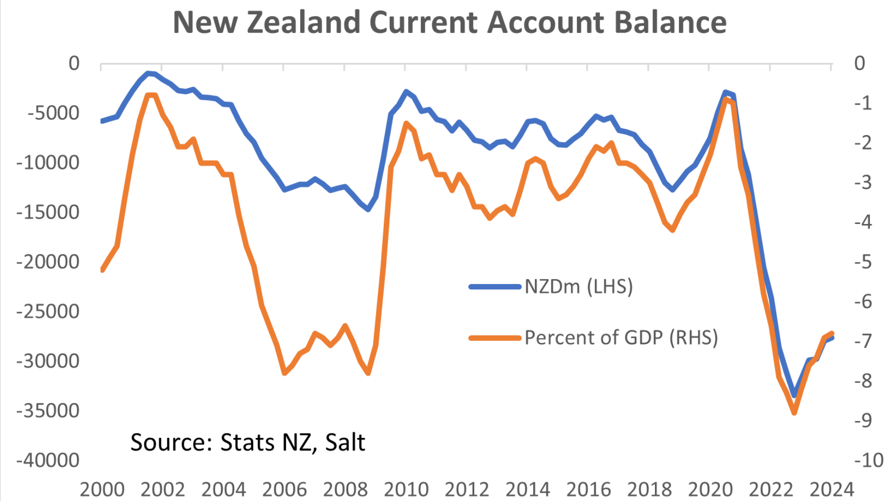
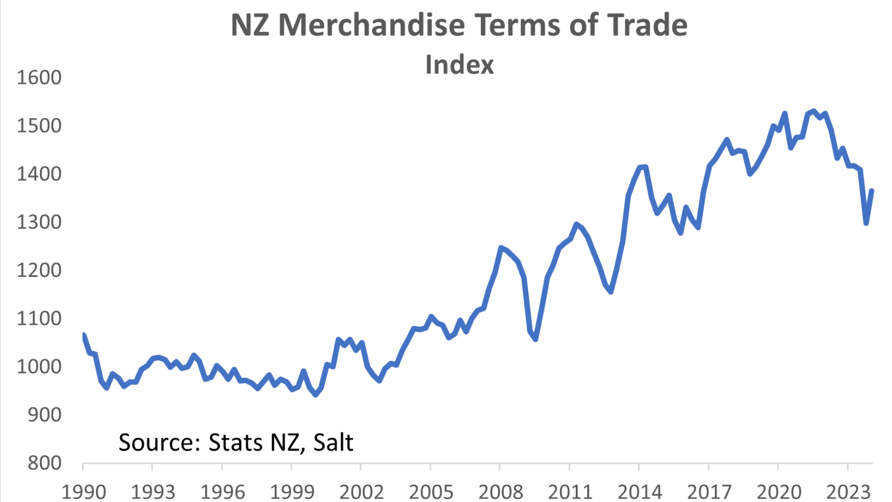
Vulnerabilities in the external sector



Our Balance of Payments deficit improved slightly in the March quarter, moving from -6.9% of GDP to -6.8%. That's better than the -8.8% low point at the end of 2022, but the deficit remains well shy of anything remotely sustainable, therefore leaving us vulnerable to economic shocks. We expect further modest improvement from here, mostly on the back of the weak economy and lower imports.



The recent trend decline in our Terms of Trade reversed somewhat in the March quarter, though it was driven by weaker import prices rather than stronger prices for exports. We expect a degree of stabilisation from here, though recent dairy trade auctions suggest some upside potential.

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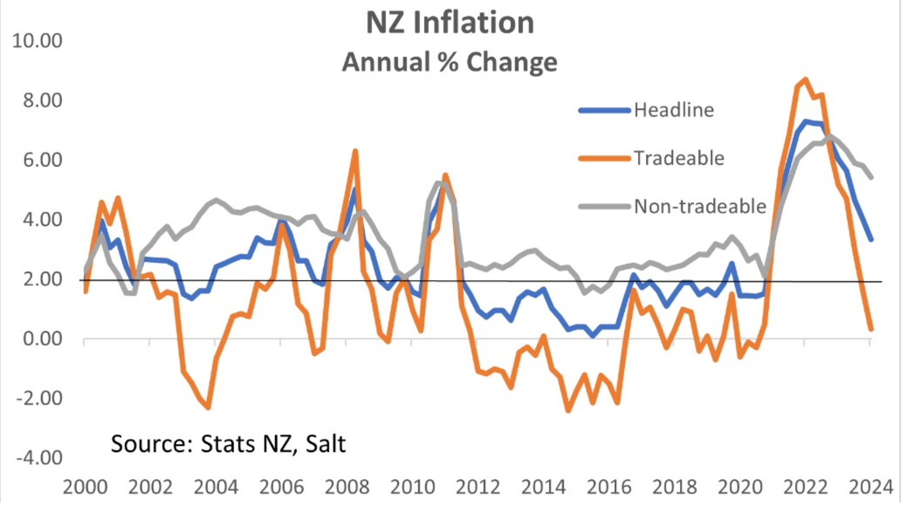
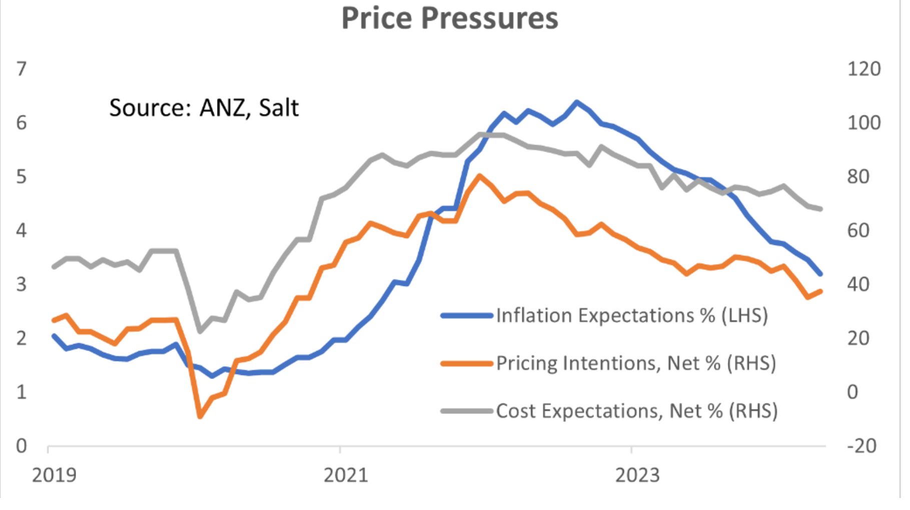
Inflation continues to moderate

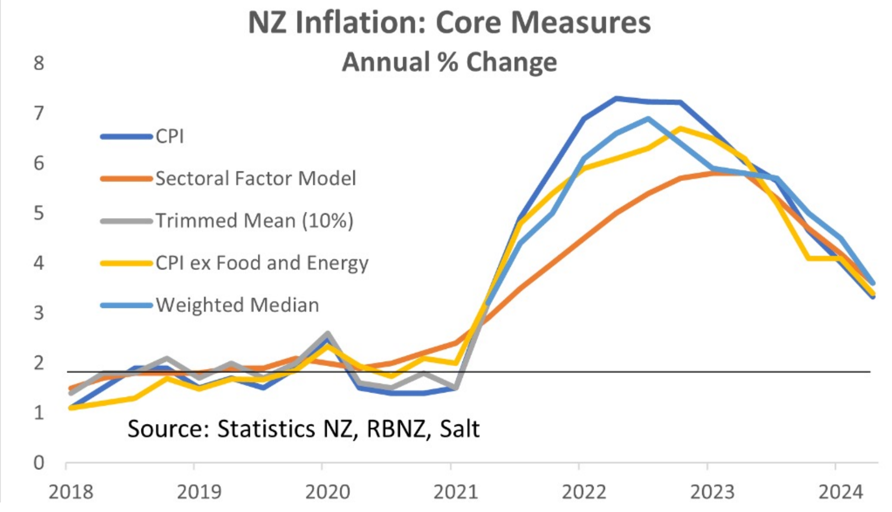


The June quarter CPI came in at +0.4%, lower than my pick of +0.5% and the RBNZ's +0.6%. That saw the annual rate come in at +3.3% for the year to June, down from +4.0% in the year to March. Non-tradeable inflation again came in above RBNZ expectations, though it was the lowest quarterly increase since March 2021.

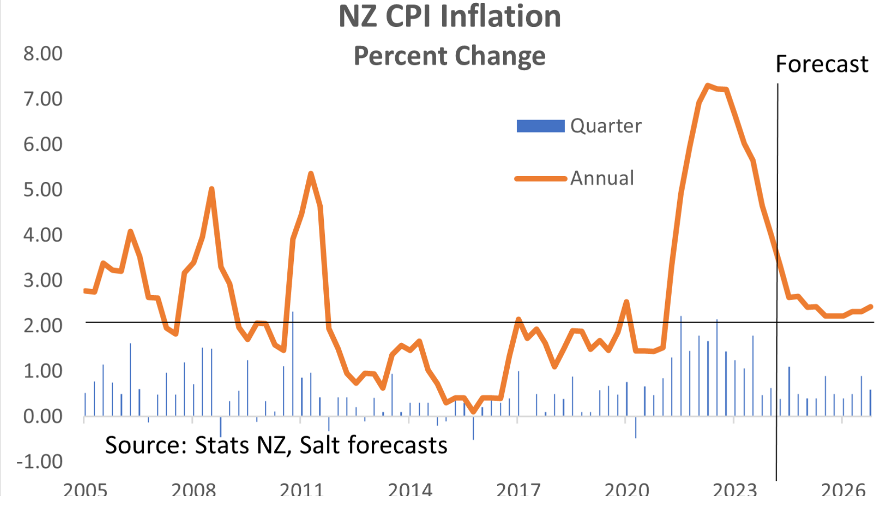


Slow progress on domestic (non-tradeable) inflation has been a key factor behind ongoing RBNZ hawkishness. The good news is that recent surveys point to reduced pricing power in firms. That's a direct result of the weak economy and is great news for the RBNZ. It's a key reason why we believe the RBNZ will be able to cut interest rates far earlier than their latest projections.

Inflation back in the target range next quarter



The RBNZ monitors a range of core inflation measures. All are heading in the right direction and converging on the target band. There's still work to be done but the increasingly full range of economic indicators are pointing towards a sustained return to target inflation. This again reinforces a more imminent start to reducing the current level of monetary restrictiveness.



We expect headline inflation to be back inside the 1-3% target band with the release of September quarter data in mid-October. Further progress towards 2% is expected to be made through 2025.

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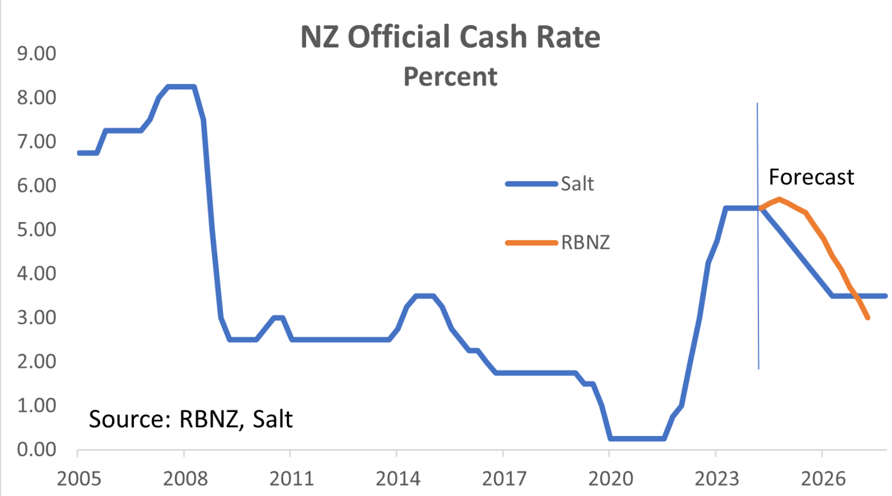
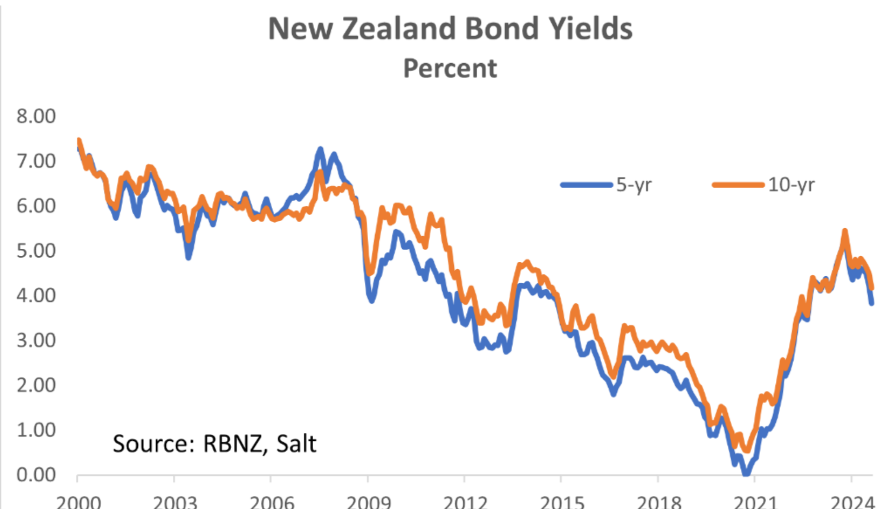
No reason for the RBNZ to delay cuts



We have consistently held to the view that interest rates would be able to be cut by the end of this year, even after the RBNZ's surprisingly hawkish May Statement. Based on latest activity data, the weakening labour market and the increasingly apparent loss of pricing power amongst firms, interest rate cuts are not far away and could come as early as the August MPS.



NZ bond yields have rallied significantly in recent weeks. More recently this has been due to the growing expectations that interest rate cuts in New Zealand are imminent. Global interest rates have also rallied as signs of weaker growth in the United States has started to emerge.

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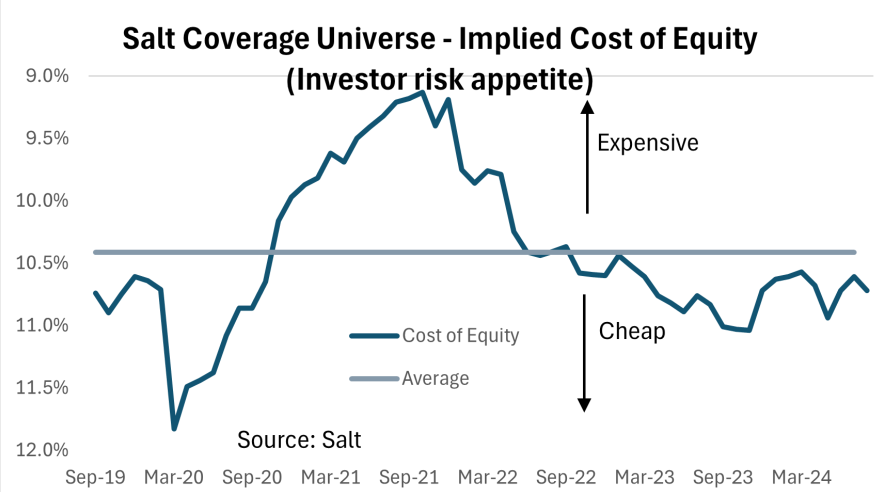
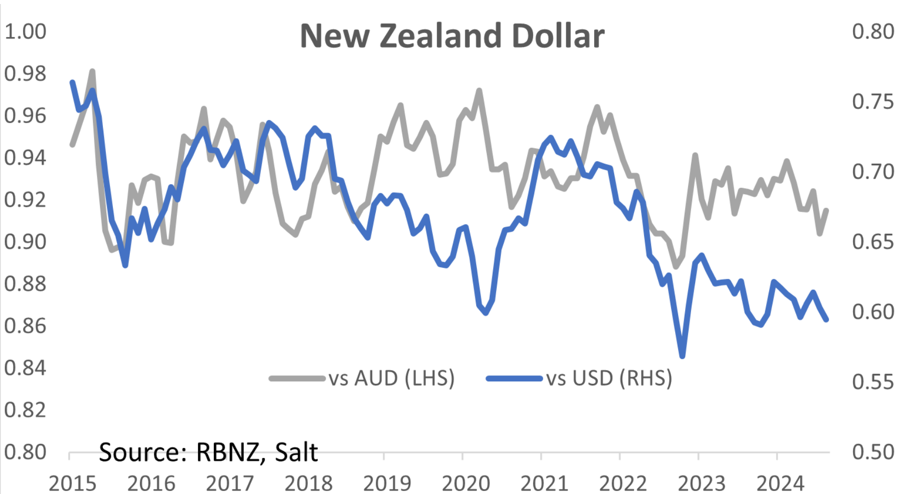
NZ shares modestly cheap



We view current pricing of the Salt stock coverage universe as being modestly cheap vs its 5-year average, with New Zealand equities priced at around a 7% discount to Australian equities based on bottom-up DCF valuation methodology. The main risk to equities remains earnings downgrade risk, with our expectation that the current earnings cycle will likely bottom by early CY25.



The NZD has struggled on the back of expectations of easier domestic monetary policy, lower commodity prices and reduced risk appetite. The NZD/AUD was particularly weak as the AUD benefitted from expectations of tighter monetary policy, though that reversed with the release of the latest Australian CPI which saw markets pivot to a likely hold from the RBA.

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