New Zealand Chartbook

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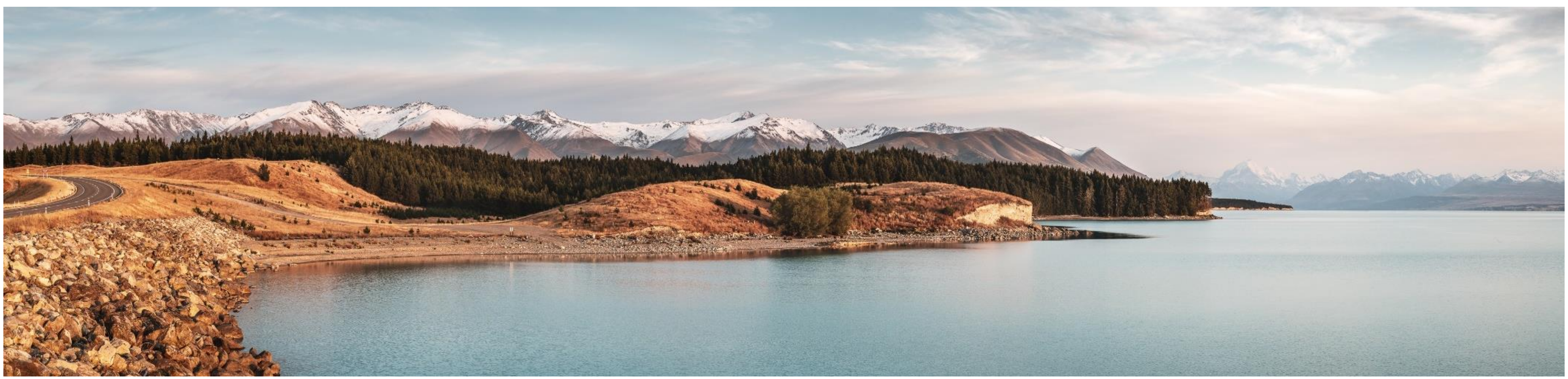
January 2025



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Highlights

- The New Zealand economy is likely in or close to a turning point. We expect a modest recovery to build through 2025.
- The labour market will likely remain weak for a few months yet. The unemployment rate is expected to peak at over 5% by mid-2025.
- Annual CPI inflation is well contained within the RBNZ's 1-3% target band and is expected to remain there through 2025, though there will be a welcome rebalancing between tradable and non-tradable inflation.
- The Official Cash Rate has been lowered 125bp to 4.25%. We expect a further 100bp's of cuts to a low of 3.25%.
- The housing market is stabilising as interest rates have been cut, however lower population growth and the weak labour market remain headwinds to a more robust recovery.
- The Half-Year Economic and Fiscal Update showed the challenges facing a return to fiscal sustainability. This will require a more strategic approach to cost containment.

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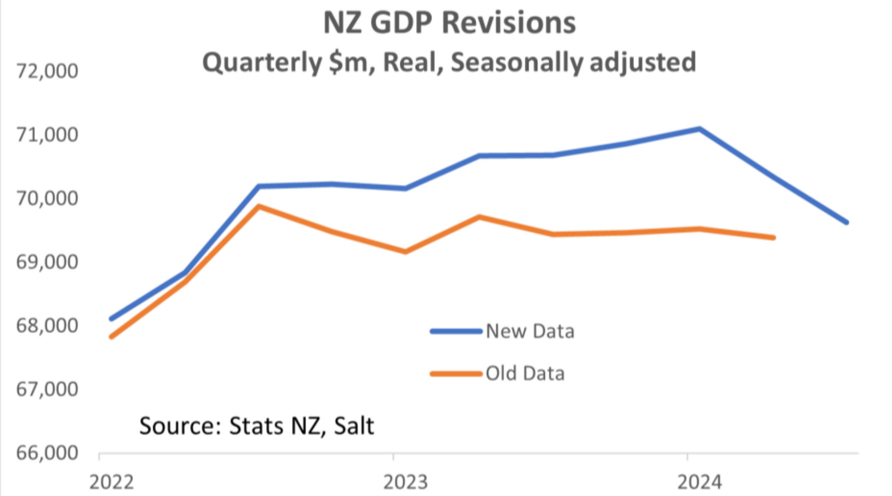
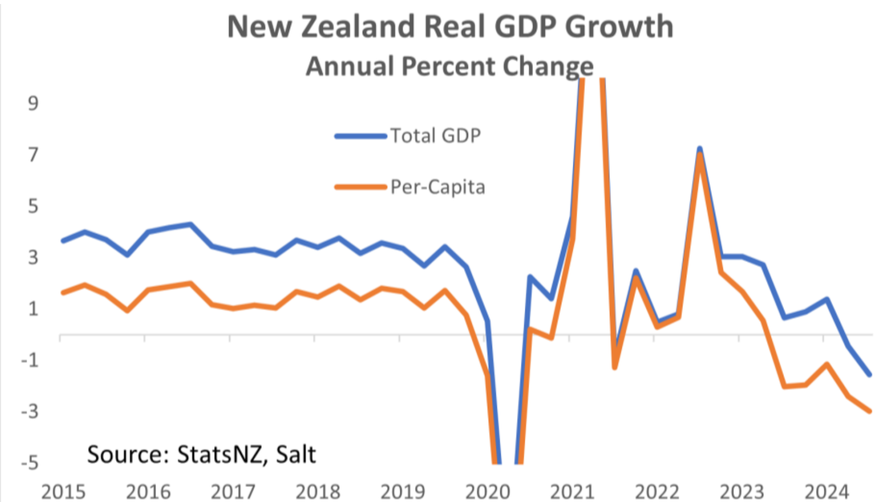
Later and deeper

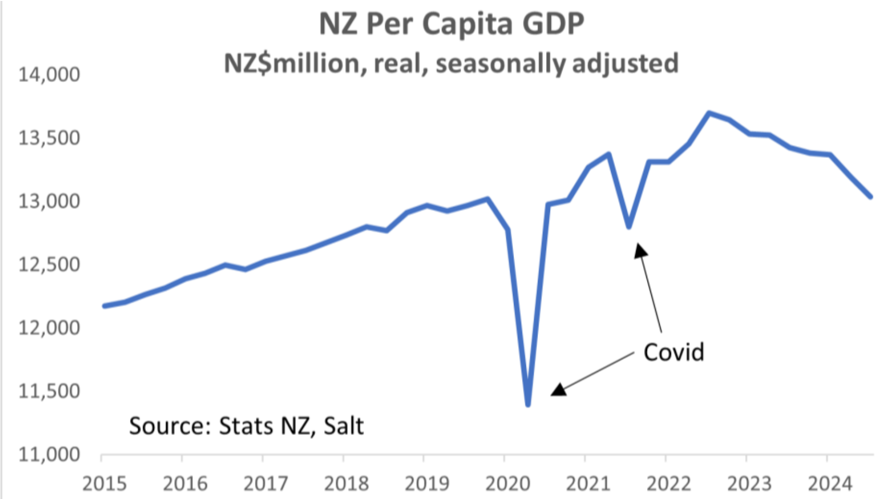


Revisions to historical GDP growth released with Q3 data in December changed the recent trajectory of growth. The data now shows the economy performing better through 2023 and into early 2024, followed by a sharper decline in the middle two quarters of 2024. While the level of GDP is now higher in September than the old data had it in June, the extent of the now more recent recession is disconcerting.

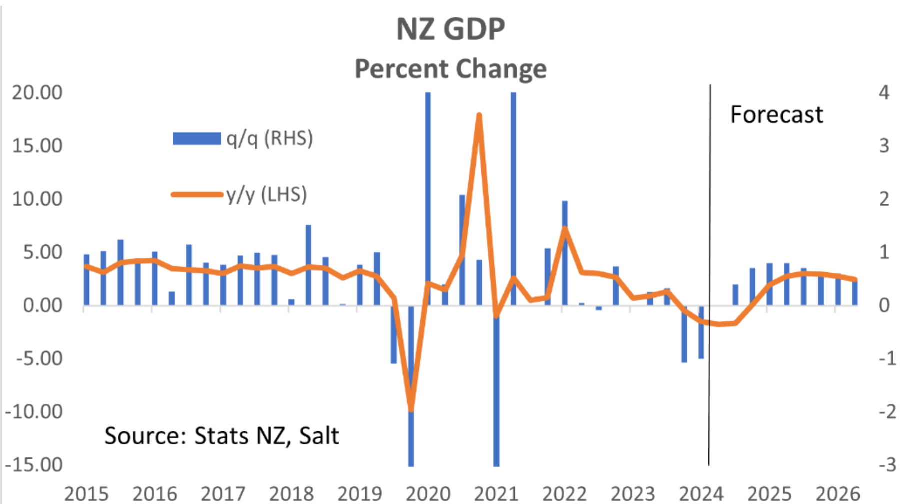


The later, deeper recession has also altered the profile of the more serious demise of per capita GDP growth, which has also come later but is not, at least at this stage, deeper. GDP growth came in at -1.6% for the year to September while per capita GDP fell -3.0% over the same period.

Picking the bottom



Per capita GDP has been on a downward trajectory for two years. In September 2024, per capita GDP was 4.8% below its peak level in September 2022. It will be some time (years) before this gets back to its previous peak.



Such is the extent of the weakness in the economy in the second and third quarters of 2024 that it becomes difficult to pick the likely turning point. We wouldn't be surprised by another smaller negative in Q4 of 2024, but neither would we be surprised by a small positive. Right now, we have zero penciled in for Q4 2024 with a modest recovery starting in the March quarter of 2025.

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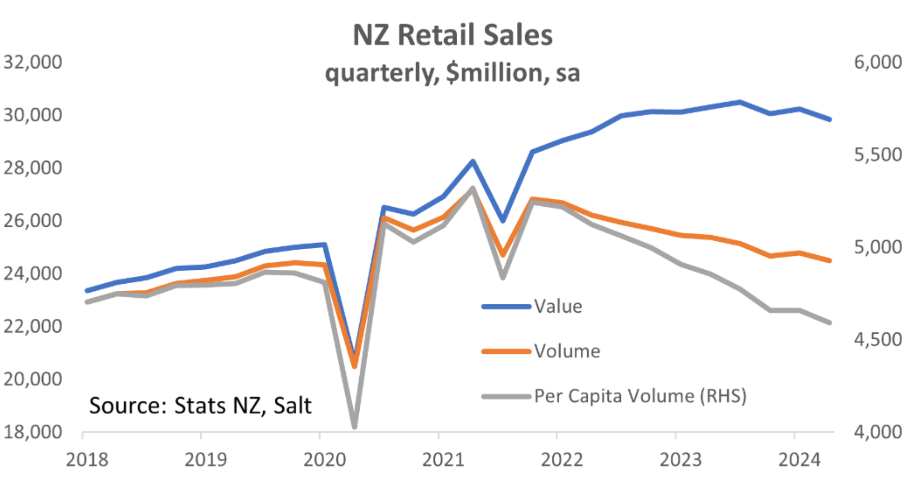
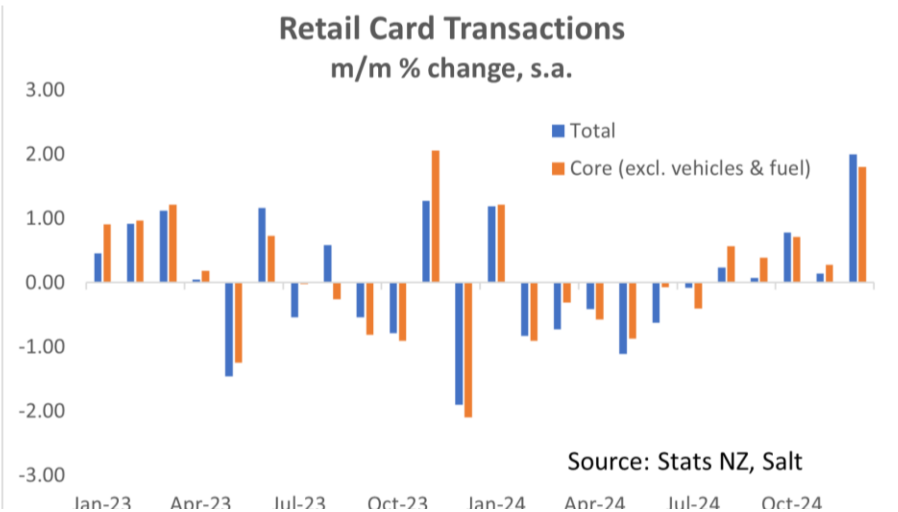
Light at the end of the retail spending tunnel



September quarter retail sales volumes fell a modest -0.1% q/q, helped up by stronger sales in motor vehicles and fuel. Core sales (which exclude vehicles and fuel) were weaker at -0.8% q/q. Recovery will come in the months ahead as lower interest rates impact household disposable income, though lower population growth and ongoing weakness in the labour market will provide near-term headwinds.



Latest nominal card spending data up to December last year supports the story of at least a stabilisation, if not an emerging recovery in retail spending. Card transactions for the December quarter are up 1.7% over the September quarter, which we'd expect to lead to a small rise in retail sales volumes over the quarter.

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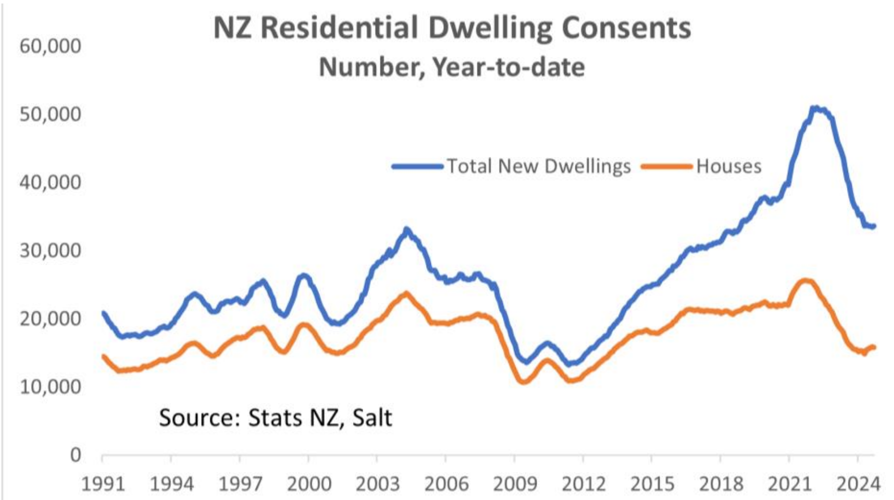
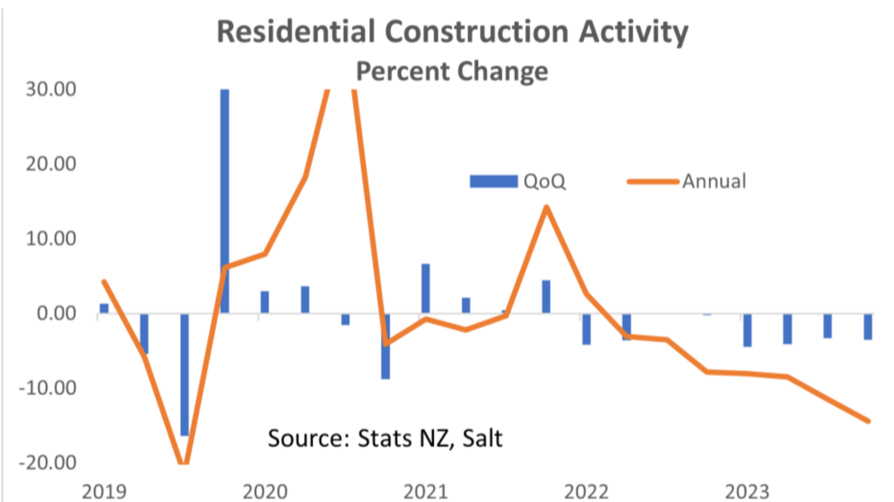
Housing market stabilising, but no strong rebound



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, falling population growth will provide something of a brake on any sharp recovery.



While consents have stabilised, it may be a while yet before we see any significant recovery in construction work. The annual rate of growth in residential construction work has been declining for two years. A modest pick up is expected through 2025.

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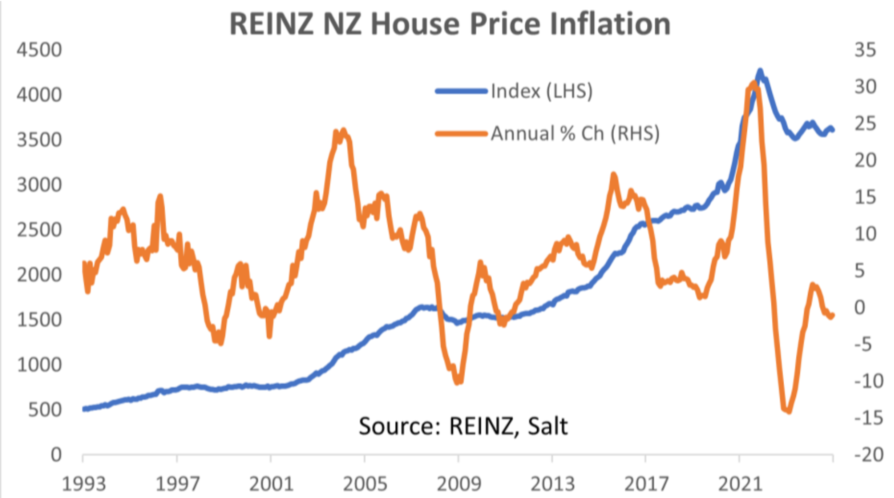
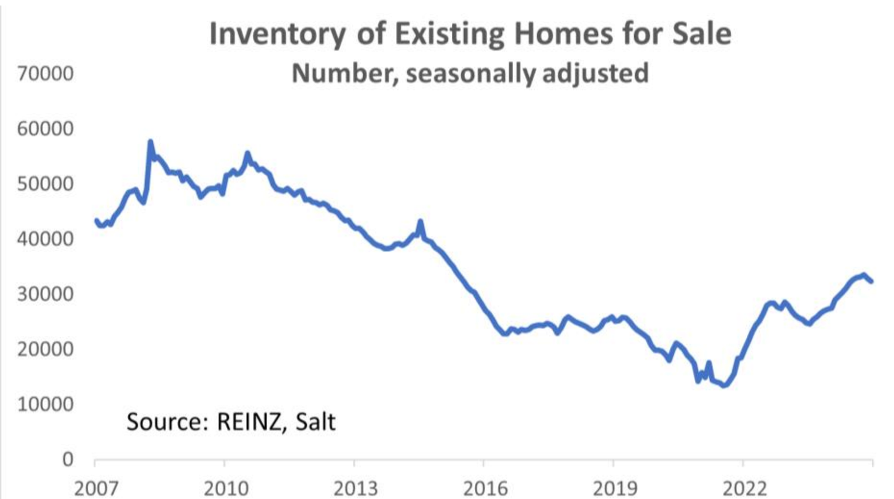
House prices stabilizing also



House prices remain soft into the end of 2024, showing the normal pattern as we headed into the quieter months of the year for house sales. The annual rate of change came in at -1.1% for the calendar year. We expect prices will show a modest firming in 2025 but will be constrained by the weak labour market and slower population growth.



Prices in the existing home market are also being kept contained by high inventory levels. It remains very much a buyer's market with many houses failing to sell due to still too-high vendor price expectations.

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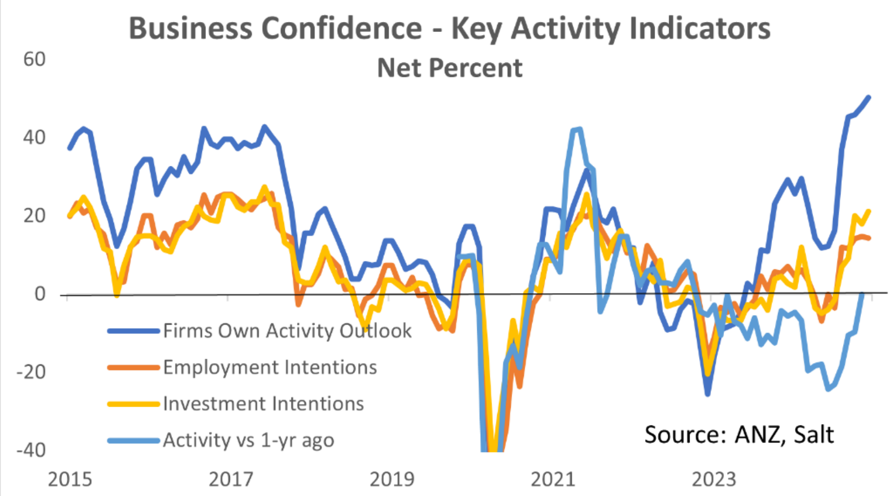
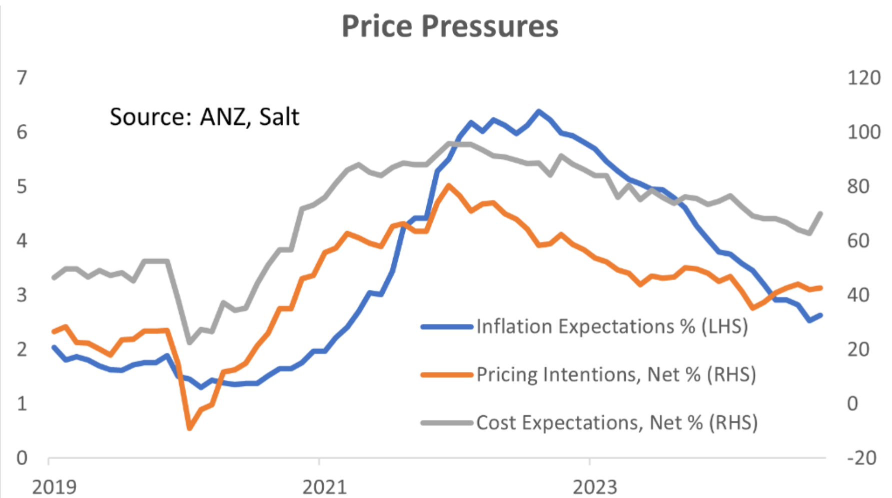
Business confidence still upbeat



Business confidence has been on a tear in recent months, likely due to anticipation of better times ahead rather than anything else. That said, the biggest improvement more recently has been firms' expressions of current conditions with the same period last year, which is now back to zero. This supports the view that the economy has turned the corner or is at least close to it.



Not such good news in the prices component of the survey with inflation and cost expectations ticking higher. We put this down to the recent depreciation of the NZD and expectations of higher costs of imports in the period ahead. Better news with pricing intentions levelling off, though at a still relatively high level.

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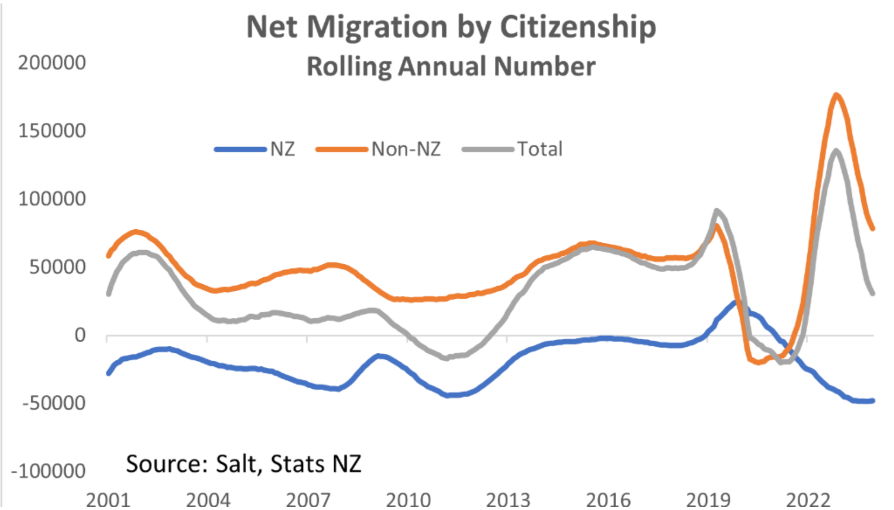
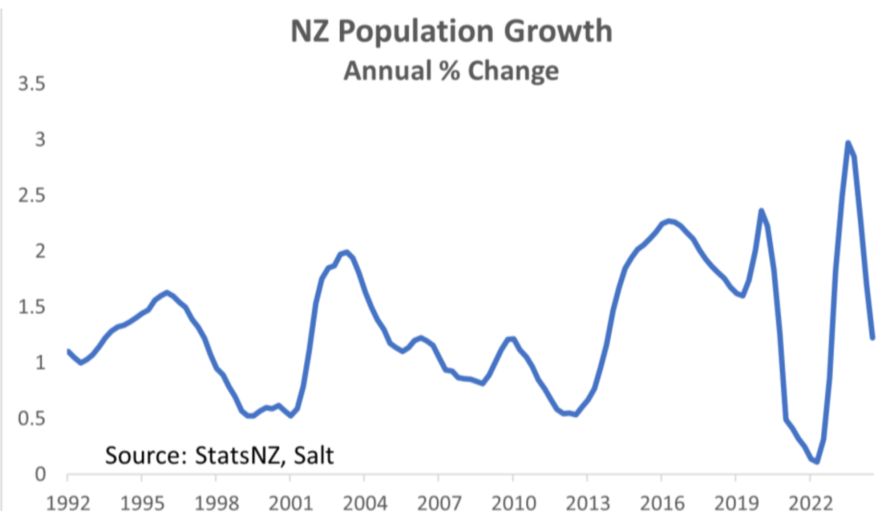
Net inward migration slowing sharply

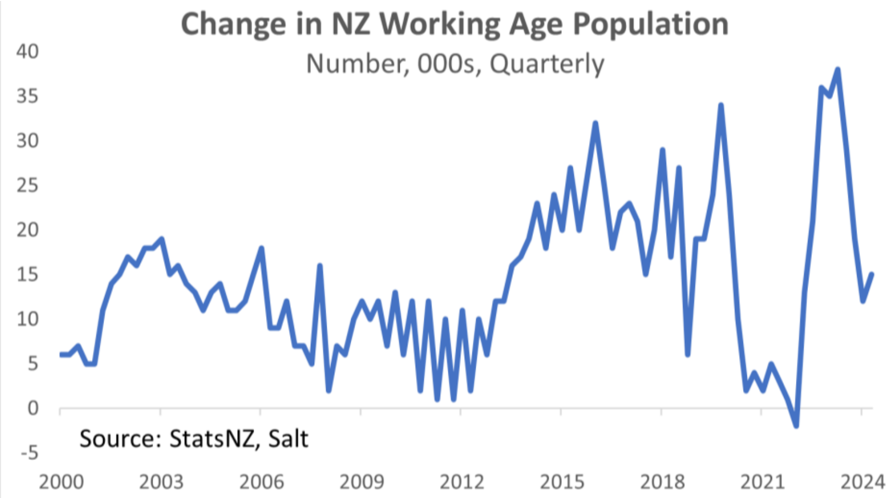


The annual net inflow migrants continued to slow into November with the annual inflow slowing to 30,500. That's well down on the peak of 135,000 in the year to October 2023. There are lots of factors at play here, but I think we are starting to see some early signs of stabilisation, most notably in the net outflow of New Zealand citizens. We are penciling in a low of a net inflow of 15,000.

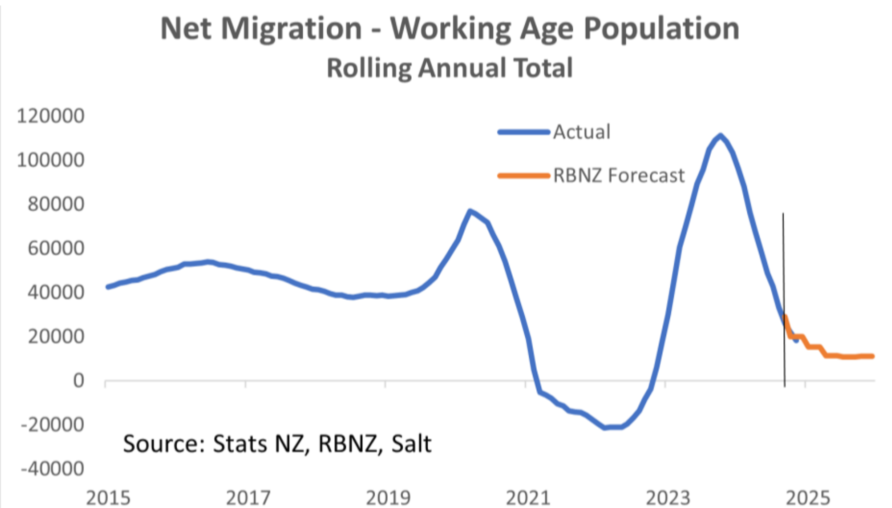


Net migration explains much of the volatility in New Zealand's population growth. As migration peaked at the end of 2023, population growth peaked at 3.0%. As migration has slowed, so too has population growth, coming in at +1.2% for the year to September 2024.

Working age population matters for the labour market



From the perspective of the labour market, it's the growth in the working age population that matters. This had previously been growing rapidly as net migration surged. The growing supply of labour was a key catalyst for the early stages of the moderation in wage growth. Looking ahead, slower growth in labour supply could prove a constraint on future growth.



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, that is the speed at which the economy can growth without generating excess inflation. Current forecasts from the RBNZ have the net inward migration of working age people slowing further but remaining positive.

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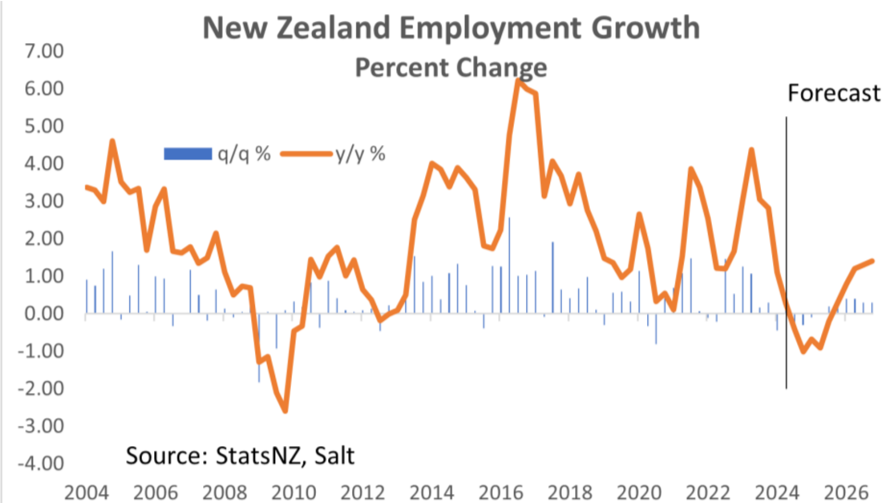
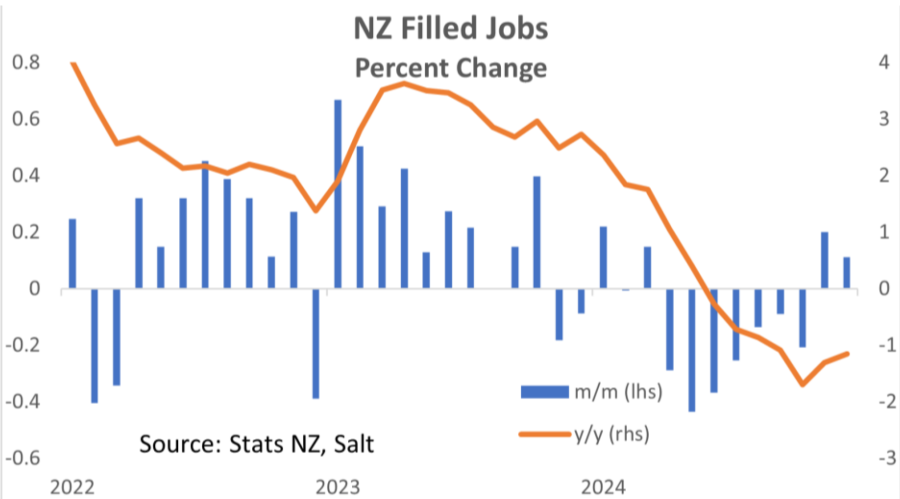
Employment conditions still deteriorating



Employment fell -0.5% in the September 2024 quarter to be down -0.4% y/y. We see further weakness in the period ahead given the labour market generally lags the trend in economic activity. We see employment growth bottoming out at around -1.0% y/yin the December 2024 quarter. No meaningful recovery is expected until mid-2025.



Filled jobs is an alternative measure of employment, this time from firm’s tax returns to the IRD. That makes this measure similar to the US monthly payrolls data. This measure appears to be bottoming out already, but with annual growth averaging -1.4% over the last three months, the household survey above unfortunately still has some catching up to do.

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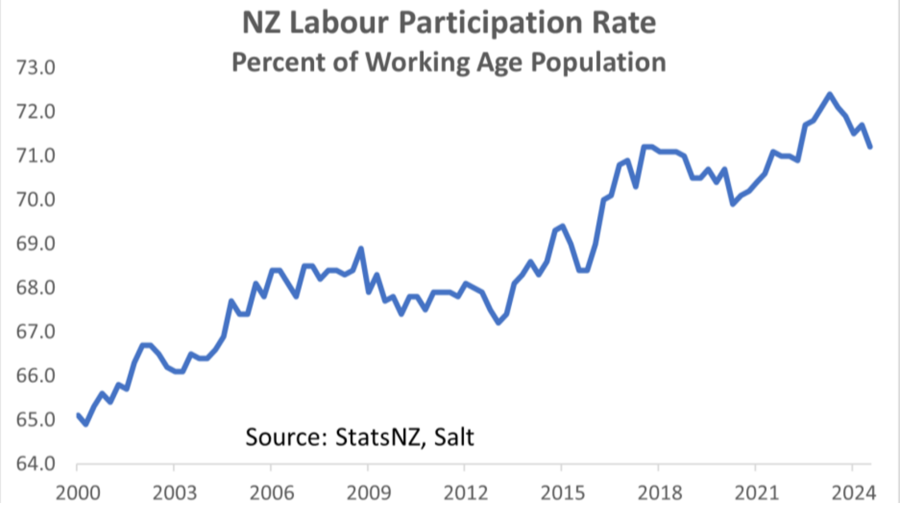
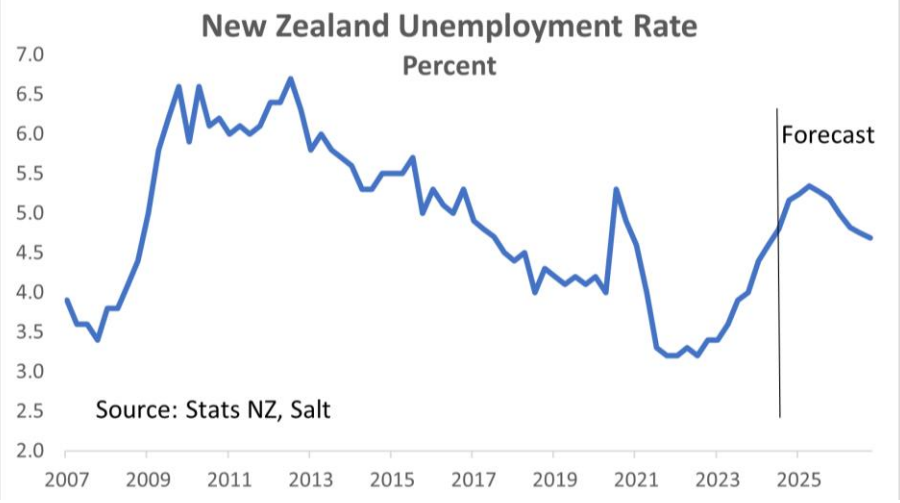
Labour market slack still increasing



NZ's participation rate (the proportion of the working age population that is either in or actively seeking work) has been on a rising trajectory for many years but goes through the occasional bout of weakness. 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 for labour has slowed while the supply, while slowing, has continued to rise. The unemployment rate stood at 4.8% in the September 2024 with the decline in the participation rate preventing a sharper rise. We see this peaking at around 5.3% in the middle of 2025.

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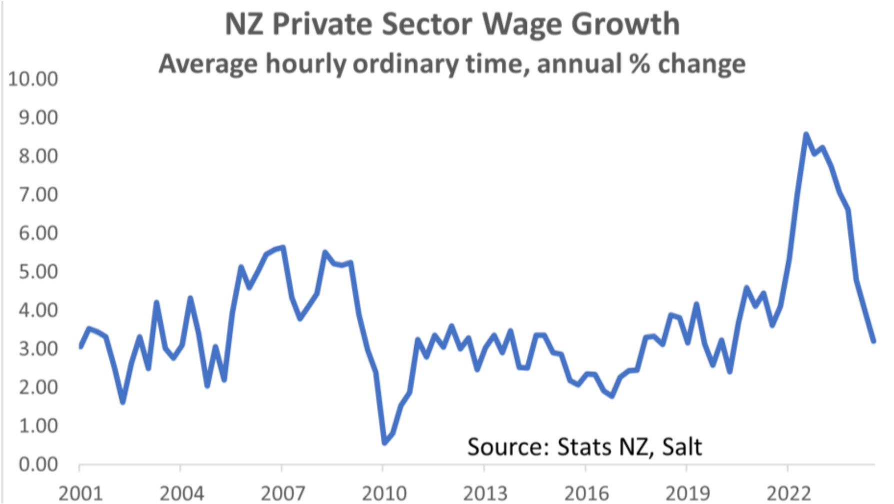
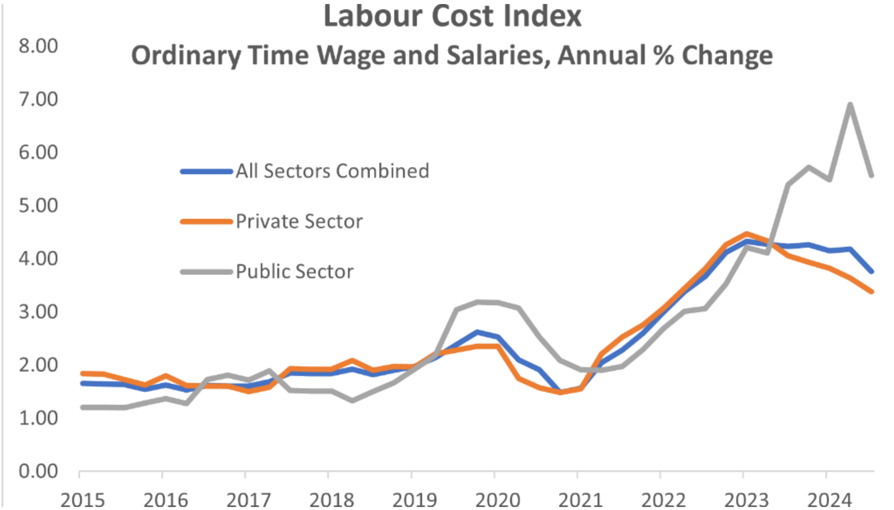
Wage growth moderating

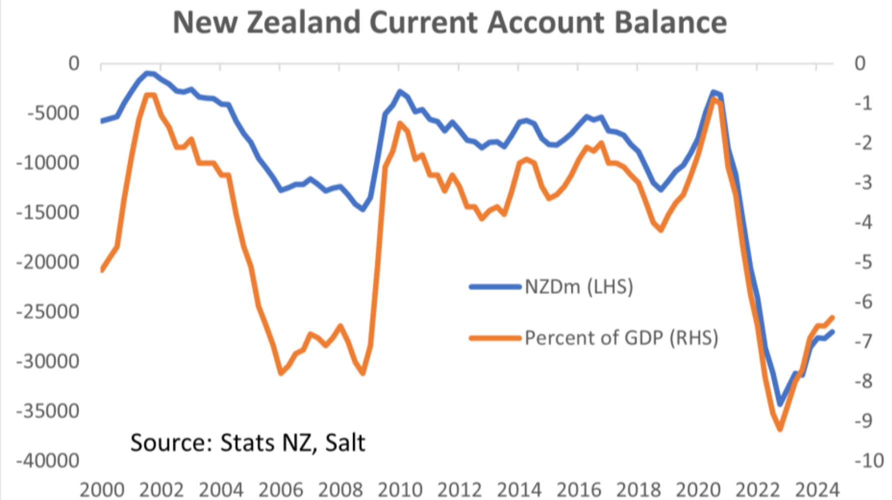


Nominal wage growth surged as labour demand recovered at the same time borders were still closed and the supply of labour was suppressed. As the economy has weakened, labour demand has slowed while supply has remained positive, leading to a sharp fall in nominal wage growth. Annual growth peaked at 8.6% in September 2022 and has subsequently fallen to 3.2% as at September 2024.

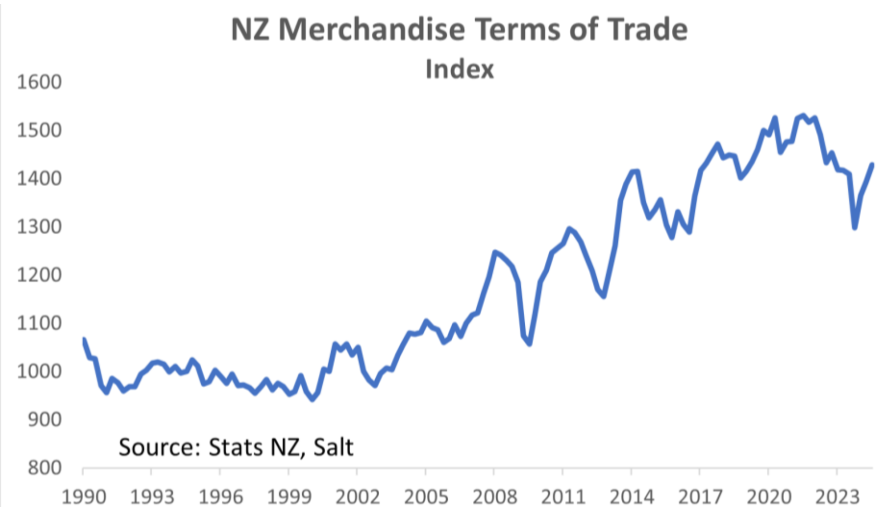


Wage inflation (unit labour costs) as measured by the Labour Cost Index continues to moderate. The key measure for the RBNZ is for the private sector as it is the one they can most influence. From a peak of 4.5% this has now fallen to 3.4%. The RBNZ would prefer to see closer to 2%, consistent with target inflation. Ongoing weakness in the labour market will lead to further moderation in the months ahead.

Vulnerabilities in the external sector

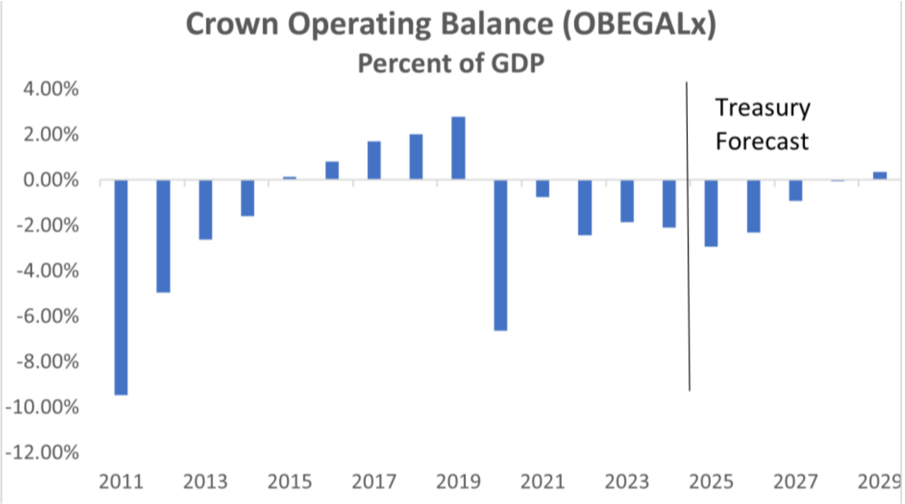


The September 2024 annual current account deficit saw a modest improvement to -6.4% of GDP. We see no catalyst for an improvement from these levels anytime soon. That will ensure the rating agencies will continue to keep an eye on this, especially in light of persistent government budget deficits.

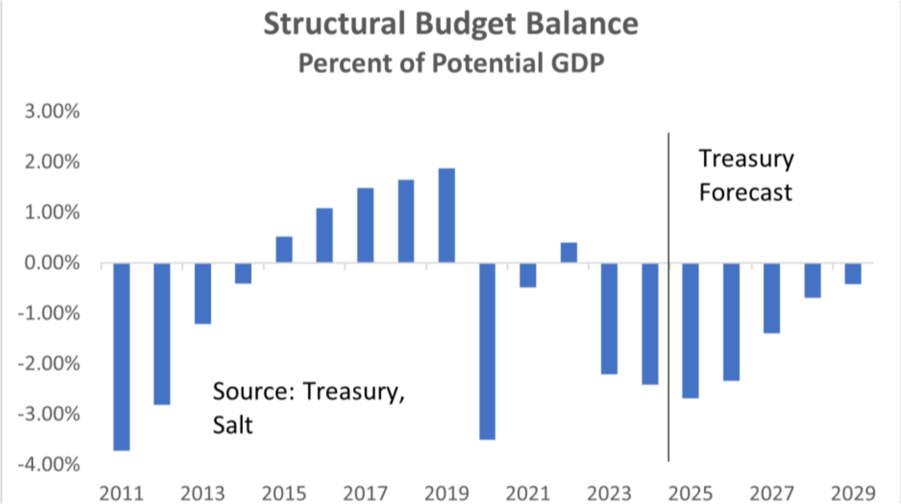


The Terms of Trade continues to claw back some of its recent losses. The index has now risen 10% off its lows, but that was after a 15% fall from its recent peak. In the September quarter the improvement was driven by a modest increase in export goods prices of +0.7%, combined with a -1.7% decline in the price of imported goods.

Fiscal position is challenging

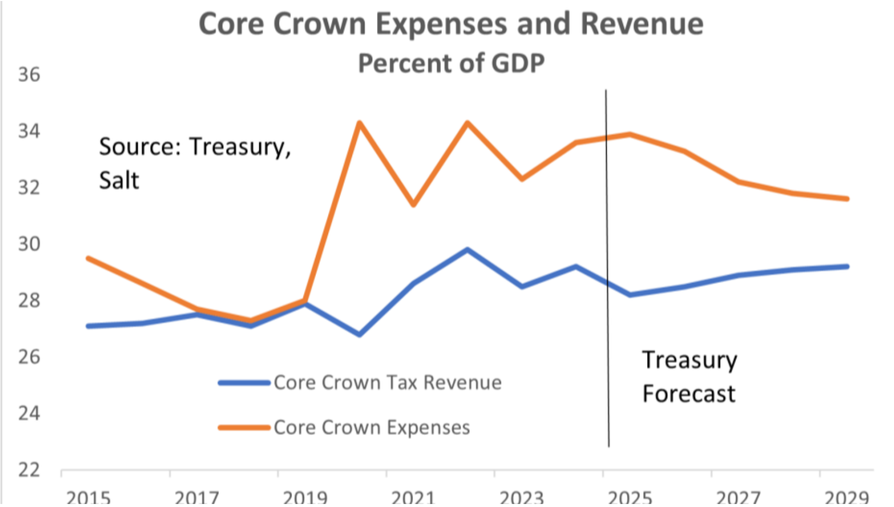


Ongoing downgrades to growth have led to ongoing downgrades to the fiscal outlook, including bigger deficits, delays to the return to surplus and higher debt levels. The Government's new deficit measure OBEGALx (which excludes ACC expenses and revenues) only returns to surplus in Fiscal Year 2028/29, and that appears to us to still be built on optimistic growth assumptions.

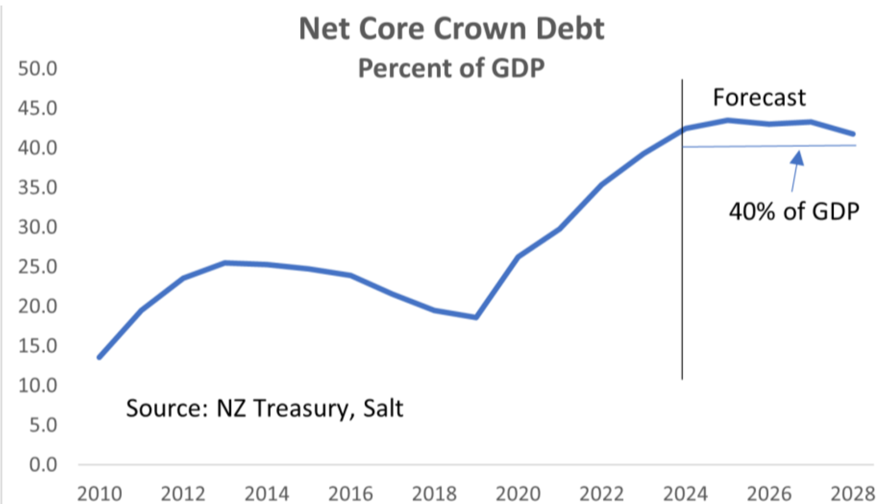


Adjusting for the economic cycle reveals that the budget deficit problem is structural. Meaning that just a pick-up in growth (to its current potential) will be insufficient to solve the deficit problem. We need either higher potential growth, reductions in current levels of expenditure, or new sources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

No easy fix

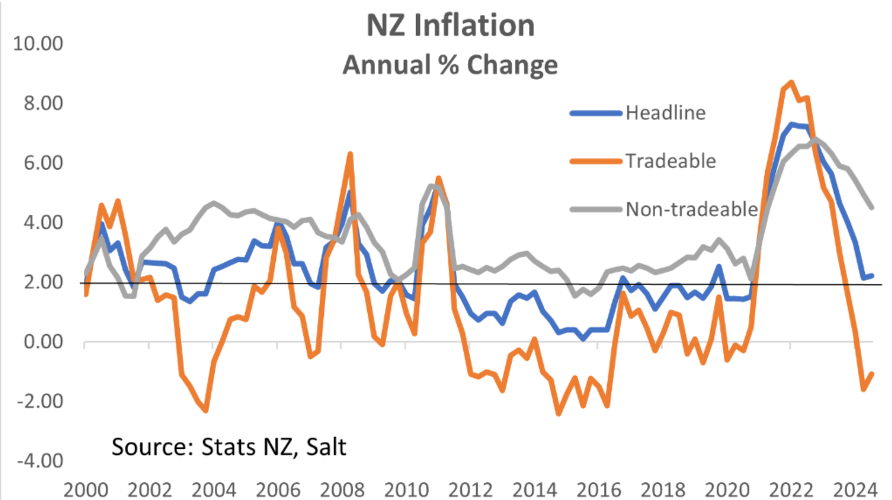


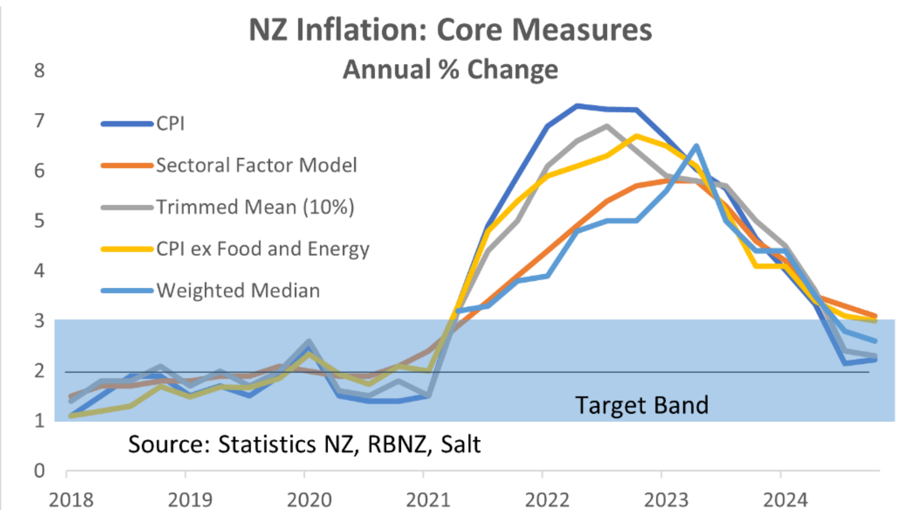
While the Government has stabilised the Crown expense ratio, expenses remain significantly higher than prior to the pandemic. The scale of what is requited requires a strategic approach rather than just across the board percentage savings. Higher taxes aren't the answer as tax revenue is already rising as a percentage of GDP.



It is therefore not surprising that it is proving challenging to return net debt to below the Government's self-imposed limit of 40% of GDP. In our view, the risk to this measure remains to the upside in the near-term as the economy remains weak.

Back in the band

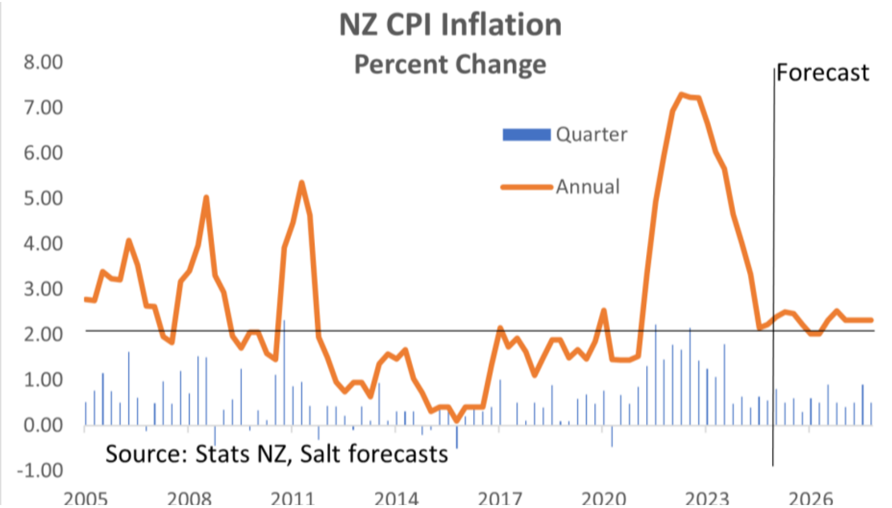




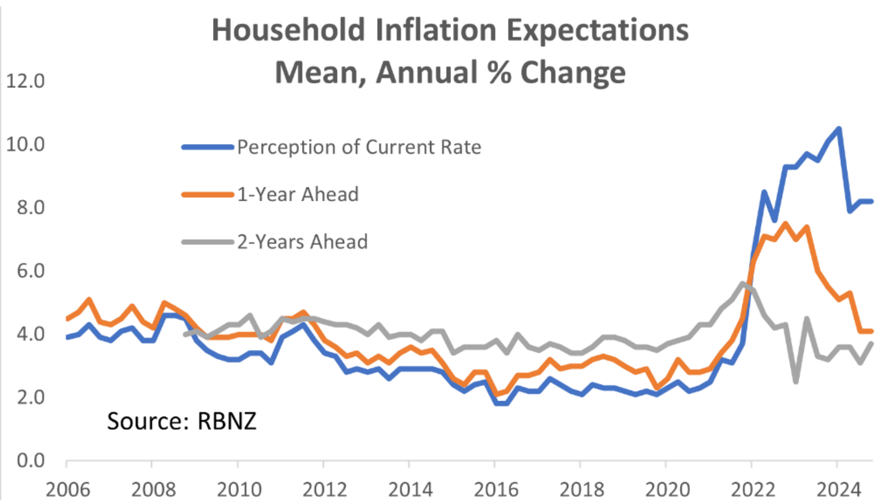
The annual rate of CPI inflation came in at 2.2% for the year to December 2024, remaining comfortably within the RBNZ's 1-3% target band. The annual rate of traded goods prices rose slightly from -1.6% in the year to September to -1.0% in December. The annual rate of increase in non-traded goods came in at +4.5%, down from +4.9% in the previous quarter and below the RBNZ's forecast of +4.7%

The lower-than-expected non-tradable increase will have been welcome news for the RBNZ. Alongside that, all the core measures of inflation are either within the target band or very close to.

Seeking better balance

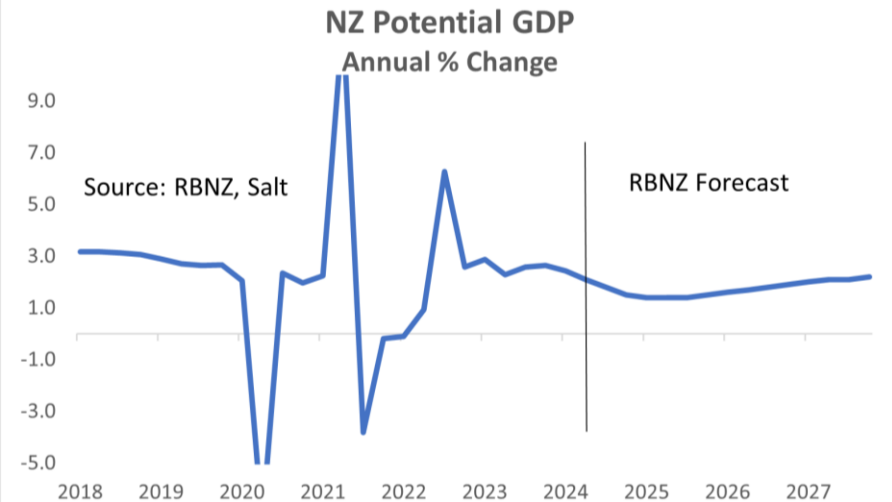


The recent depreciation in the NZD has had the effect of pushing up our annual CPI forecasts later this year from tracking just below 2% to a bit over. So, still comfortably within the target band and, importantly, while we now have a bit more upside in traded goods prices, we still see non-tradeable (domestic) inflation moderating. This greater balance in the outlook will be welcomes by the RBNZ.

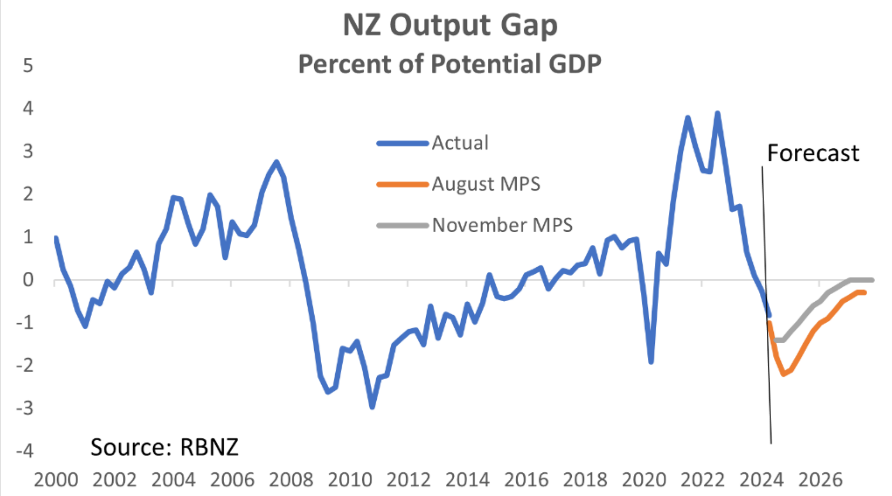


Household inflation expectations have improved, but remain slow to adjust, The RBNZ will be watching this survey closely over the next few months. Household expectations are formed mostly (in our view) at the supermarket and the petrol station. The recent depreciation in the NZD and the rise in the international price of oil has seen petrol prices rise sharply in the last few months. Watch this space.

Spare capacity, but how much?

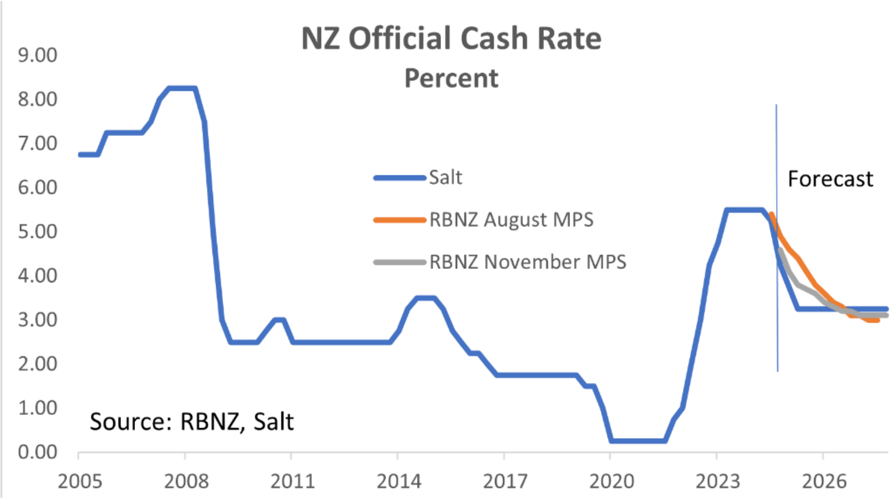


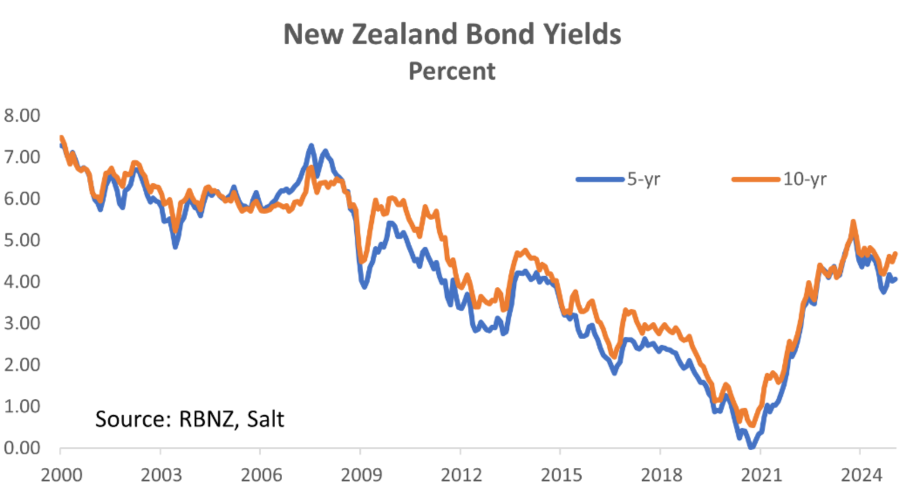
Critical to the outlook for inflation and monetary policy is how fast the economy can growth while achieving low and stable inflation, or its potential growth rate. This is a function of factors such as growth in the working age population and the rate of growth of productivity. The RBNZ lowered its potential growth estimates in its last MPS, a function of lower growth in working age population.



This lead the RBNZ to revise up their estimate of the output gap, or the difference between the economy's actual growth rate and its potential growth rate. That meant that while the RBNZ forecast lower GDP growth in their last set of projections, their estimate of the terminal OCR rate was little changed at a just a bit over 3%. The profile of the output will have changed with the recent GDP revisions. Watch this space.

A bit further to go





The RBNZ has cut the OCR 125bp thus far to 4.25%. Prior to the GDP revisions we saw them cutting to a low of 3.5%. Given the changed trajectory of the GDP numbers we have added in another 25bp in the form of a 50bp cut in February (we were previously assuming 25bp). A further two 25bp takes that OCR to a low of 3.25% in May. Deeper cuts than that risk a return to rate hikes in 2026.

It's been harder work at the other end of the yield curve. New Zealand yields have not been immune from recently higher global bond yields as interest rate markets have adjusted their expectations of interest rate cuts by the US Federal Reserve, become increasingly focused on fiscal policy and focused on the likely policy scenarios under the new US president.

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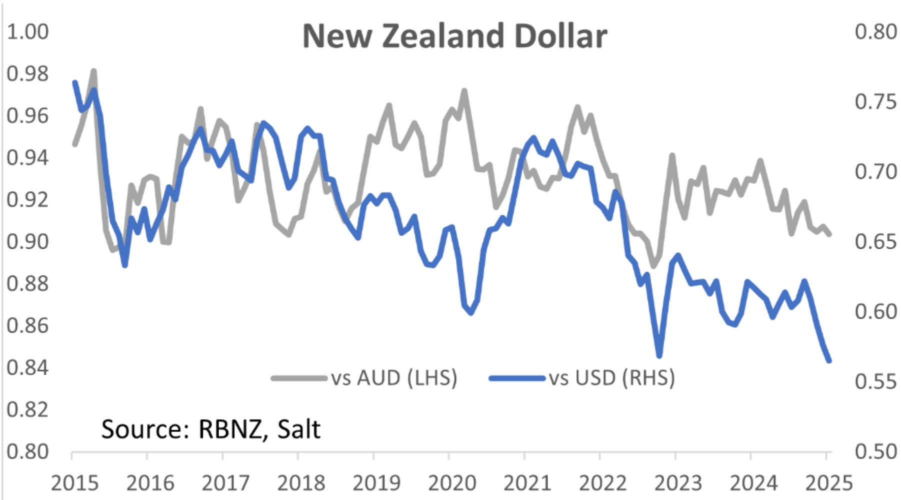
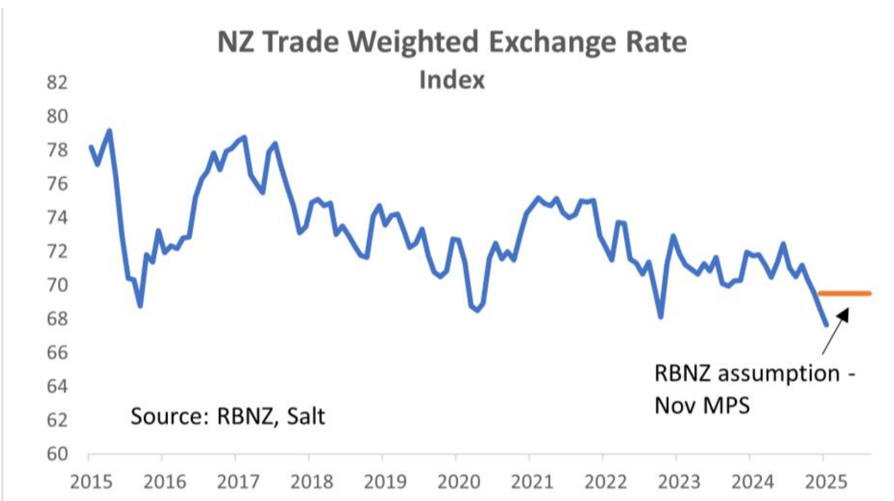
NZ dollar is unexceptional amidst US exceptionalism



The USD has been on a tear since the start of the fourth quarter and the NZD has been one of the hardest hit, falling 11% over this time. The AUD has been just a weak against the USD and therefore relatively stable against the NZD. The weakness against the USD has been for different reasons – in NZ it's the weak economy and interest rate cuts, whereas in Australia, it's the implications of the weak Chinese economy.



What matters most for the RBNZ is how the NZD moves on a trade weighted basis. Since its recent peak, the TWI is down about 5.5%. But some of that was already captured in the RBNZ's November MPS. At that time, the RBNZ assumed a 69.5 level for the TWI' leaving it currently 3% below that projected level.

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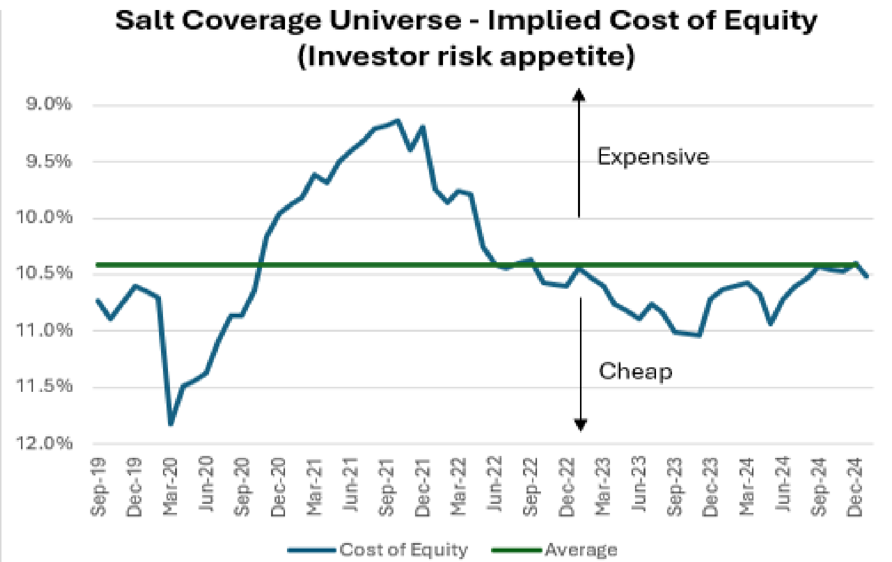
NZ shares close to fair value



We view current pricing of the Salt stock coverage universe as being close to fair value vs its 5-year average, with New Zealand equities priced at around a 6% discount to Australian equities based on bottom-up DCF valuation methodology. We calculate a median PE multiple for NZ equities of 17x which is well below the market weighted PE of 30x. The main risk to equities remains earnings downgrade risk, although investors are now starting to look through these in expectation of an improving economy in 2025

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