

Research Economy Watch

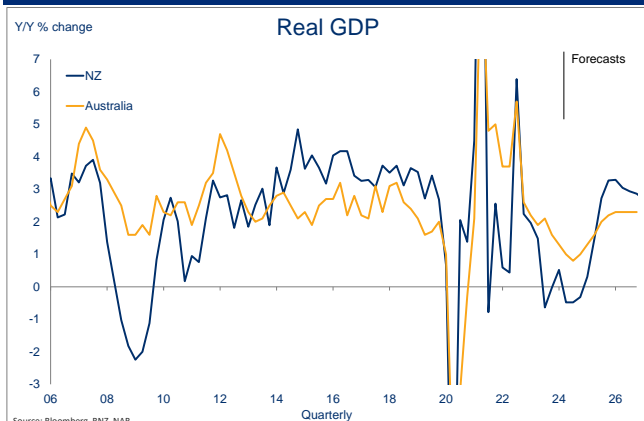
26 September 2024

Comparing Across the Ditch

- **NZ economy underperforming Australia**
- **Especially in interest rate sensitive sectors**
- **Unemployment rising faster in NZ**
- **Net migration outflow to Australia climbing**
- **RBA and RBNZ poles apart, for now**

While Australia's economy faces headwinds, they pale in comparison to New Zealand's. In Q2, NZ annual GDP contracted 0.5%, much weaker than annual growth of 1.0% across the ditch. While NZ is in the midst of a rolling recession, Australia's economy has remained relatively more resilient. But, given the extent of the downturn, there is at least a lower hurdle rate for NZ to achieve positive growth as we head into 2025.

Growth in Australia more resilient

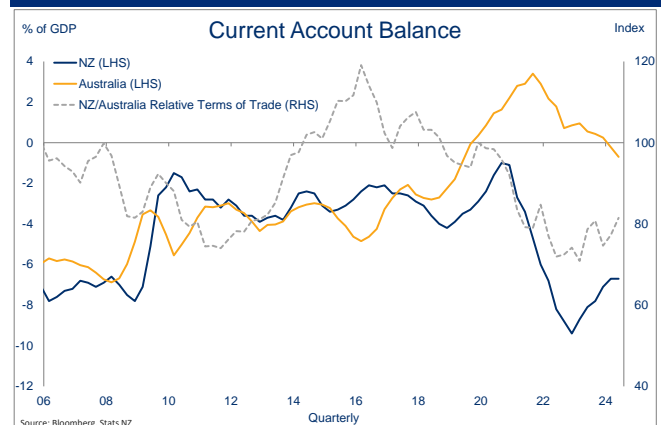


Our economy has been underperforming Australia since the initial bounce-back after the first hit from Covid. Much of the difference can be explained by the relative stance of fiscal and monetary policy but the performance of the external sector will also be a contributing factor. Australia's stronger trade position is reflected in its more favourable current account balance. Higher prices for coal and iron ore have also lifted Australia's terms of trade, while NZ's terms of trade have been relatively weaker.

The divergence between NZ and Australia is particularly stark in interest rate sensitive sectors including manufacturing (-2.9% vs 0.2% y/y), retail trade (-3.5% vs -0.6% y/y) and residential investment (-5.8% vs -3.0% y/y). Other indicators such as the PSI, house price growth, and business confidence are all consistent with a relatively more subdued economy in NZ. In Australia, government consumption remains a key support to domestic demand.

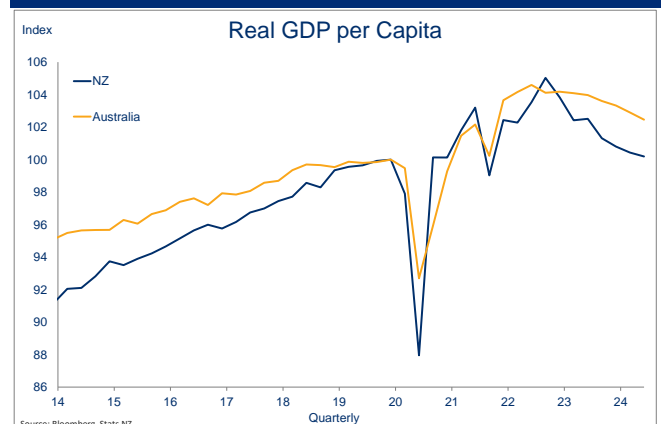
This expenditure component increased 4.7% y/y in Q2, compared to -0.3% y/y in NZ. Our economic forecasts, based on Treasury's projections, are for relatively tighter fiscal policy in NZ maintaining a comparative headwind going forward.

Current account and terms of trade in Australia's favour



With another quarterly contraction expected for Q3, NZ real GDP will have been negative in six of the past eight quarters. Strong population growth masks the performance of the underlying economy which on a per capita basis remains at pre-COVID levels. In contrast, on that basis, Australia's economy is 2.5% larger.

NZ economic underperformance stark

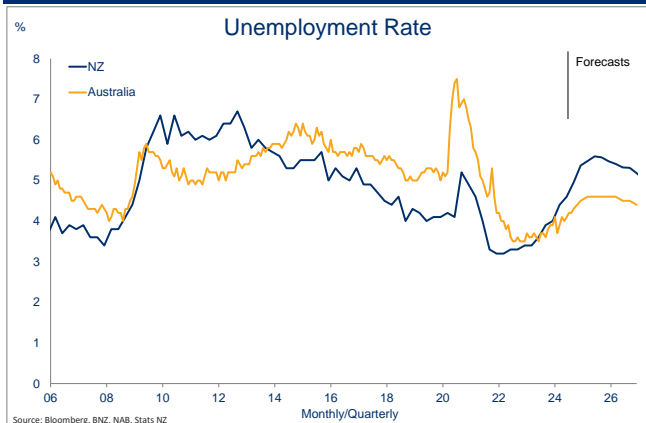


After a period of sub-trend growth, the RBNZ estimates the output gap is currently -1.8% of GDP (in Q3), while the RBA still estimates a positive output gap in Australia (around 1.0% of GDP). The output gap differential is reflected in

NZ's unemployment rate rising beyond Australia's and highlights the scope for a much more aggressive monetary policy easing cycle in NZ.

For most of the past decade, NZ's unemployment rate was consistently below Australia's. No more though. A long period of sub-trend growth in NZ has driven up the unemployment rate from a trough of 3.2% to 4.6%. We think it forges even higher to between 5.5 and 6.0% before all is said and done. The rise in Australia's unemployment rate has been gentler and the gap between the two countries' unemployment rates is expected to be around 1% by early next year, a gap not seen for over a decade.

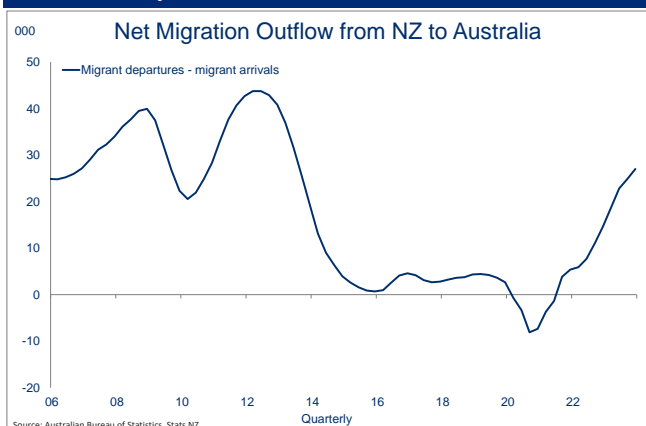
Gentler rise in Australia's unemployment rate



The downward trend in wage inflation is clear across both countries and should moderate input cost pressures for business and, hence, take some pressure off selling prices. Wage growth is expected to decline slightly slower in Australia compared to NZ, consistent with Australia's relatively tighter labour market which the RBA still assesses to be operating above full employment.

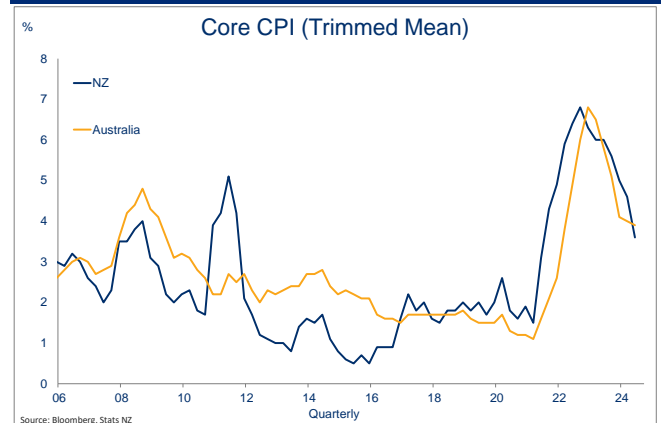
Net migration between NZ and Australia is typically in Australia's favour. But given NZ's recent economic underperformance, the net outflow from NZ to Australia has accelerated to around 30k for the year to December 2023 (the latest available figures). Given the relative near-term outlook for the respective labour markets, ongoing net outflow from NZ to Australia would not surprise.

Brain drain déjà vu?



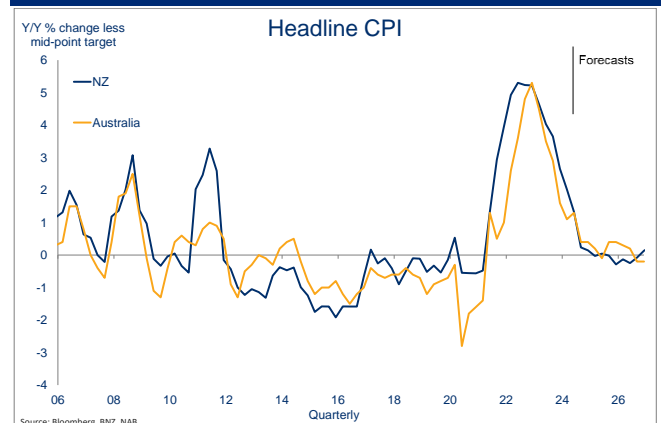
Underlying inflation trends in NZ and Australia have been broadly similar. Both countries are experiencing elevated non-tradeables inflation, which has been offset by low tradeables inflation. Core CPI measures (based on a 15% trimmed mean methodology) show a similar peak in inflation. NZ inflation peaked a quarter earlier and, through to Q2 this year, had fallen by slightly more.

Core CPI inflation similar



The RBA has a higher mid-point target (2.5%) compared to the RBNZ (2%). Adjusting for this, headline inflation has fallen to close to target in both countries, including estimates for Q3. Looking forward, it seems core inflation in NZ may fall faster than in Australia, given more restrictive monetary policy and a large negative output gap.

CPI nearing targets

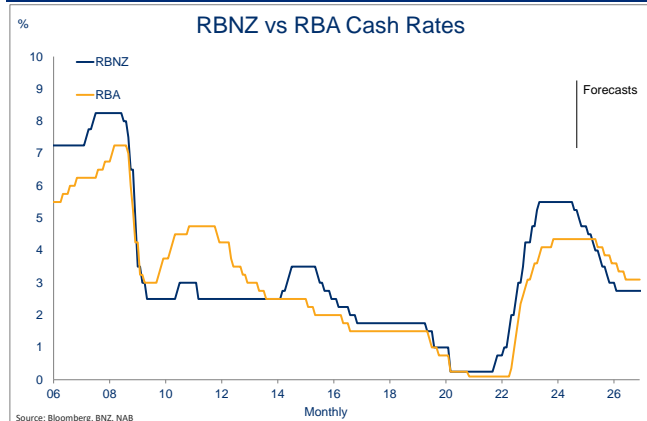


In August, after 15 months of tight monetary policy, the RBNZ lowered the OCR by 25bps to 5.25% and published a rate track which implies a further three 25bp cuts by February next year on its way to an eventual low of 3.0%. Our view remains that the RBNZ will lower rates substantially and get to 3.0% much sooner than it currently projects (and probably a touch lower).

In contrast, our colleagues at NAB continue to expect the first cut for Australia's cash rate (from its current position of 4.35%) in May 2025, albeit with some risk that the cut occurs earlier in the year. Messaging from the RBA continues to highlight that 1) they have not yet seen enough progress on inflation, 2) activity remains a little

stronger and the labour market a little tighter than they consider sustainable, and 3) the level of the policy rate is less restrictive than many offshore peers where central banks have begun to cut. This is a stark contrast to New Zealand where inflation looks set to settle near 2.0%, there is oodles of spare capacity, and the labour market is easing aggressively.

More gradual easing in Australia



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