

New Zealand At A Glance

21 June 2023

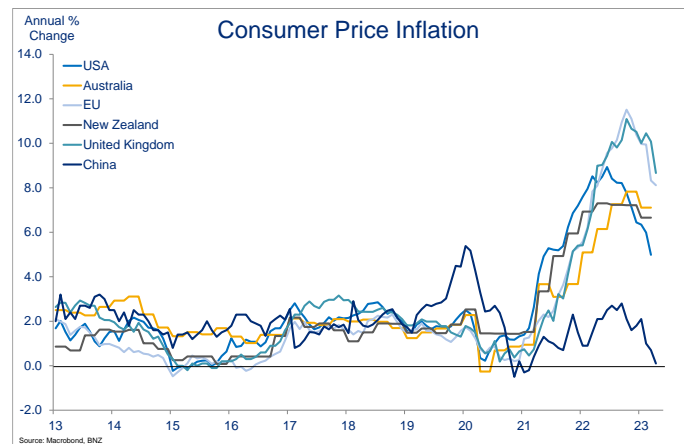
Overview

The New Zealand economy is currently in peak stagflation: two quarters of negative growth; a labour market that is unsustainably tight; and inflation miles above the Reserve Bank’s target. But the worm is turning. Inflationary and labour market pressures are easing, and interest rates have probably peaked. The outlook is brightening with a solid bounce in activity expected in the second half of next year. In the interim, however, there is more pain to be felt as the economy bounces along the bottom torn between rising immigration and higher interest rates. And, of course, politics takes centre-stage as the General Election approaches.

Key Indicators	December Years					
	Actual			Forecasts		
	2020	2021	2022	2023	2024	2025
GDP production (an avg %)	-1.5	6.0	2.7	0.6	0.4	3.0
Consumers Price Index (ann %)	1.4	5.9	7.2	4.5	2.3	2.3
Unemployment Rate (end qtr %)	4.9	3.2	3.4	4.2	5.3	5.4
Current Account (% of GDP)	-1.0	-6.0	-9.0	-7.3	-5.4	-3.2
Fiscal Balance (% GDP June Yr)	-7.3	-1.3	-2.7	-1.8	-1.8	-0.8
NZD/USD (Dec mth avg)	0.71	0.68	0.63	0.64	0.65	0.71
Overnight Cash Rate (Dec mth end %)	0.25	0.75	4.25	5.50	4.25	2.50
10 Year Govt Bond (Dec mth avg %)	0.90	2.40	4.20	4.20	4.00	3.90

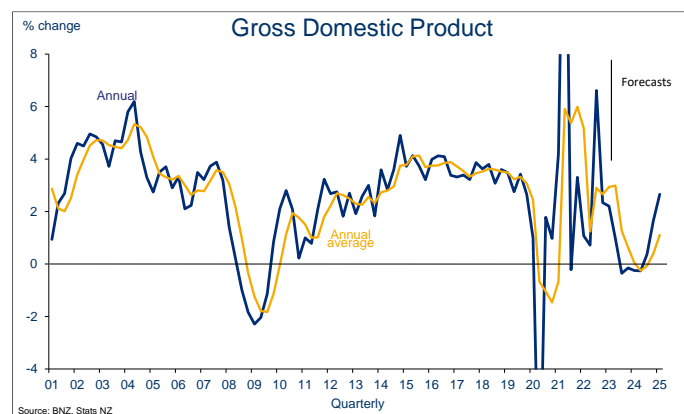
International

The global economy is slowing. The United States may well be headed for a recession and the Chinese economy is under substantial pressure. Meanwhile, geopolitical tensions remain elevated with the potential fall-out from a China – Taiwan disagreement beginning to weigh more heavily in international forums than the ongoing Russian invasion of Ukraine. Against this backdrop, inflation measures are falling rapidly. Importantly, Chinese manufacturing goods are deflating at a 4.6% annual pace, which is the largest decline since the peak of the global deflation angst back in 2016. Slowing global growth and inflation have major implications for New Zealand.



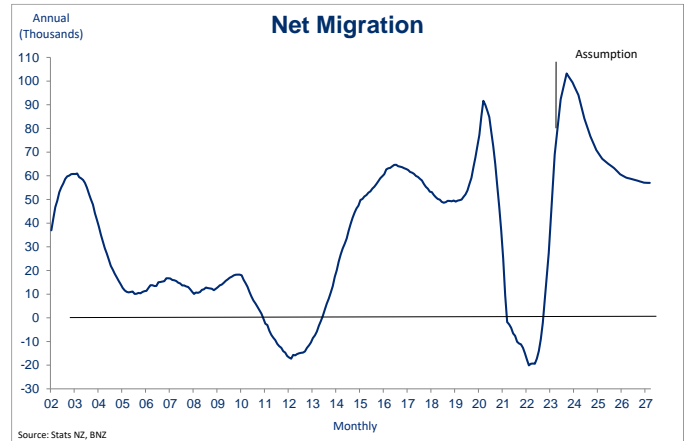
Growth

The New Zealand economy has stalled. It contracted 0.8% over the two quarters to March 2023 and is expected to bounce along the bottom until well into 2024. The final six months of this year will be particularly problematic as the household sector succumbs to the full weight of past RBNZ cash rate increases. At the same time, businesses will continue to face into margin compression and weakening demand, especially for goods (as opposed to services). And with businesses already under pressure, uncertainties about the outcome of the October General Election will likely result in investment activity being postponed.



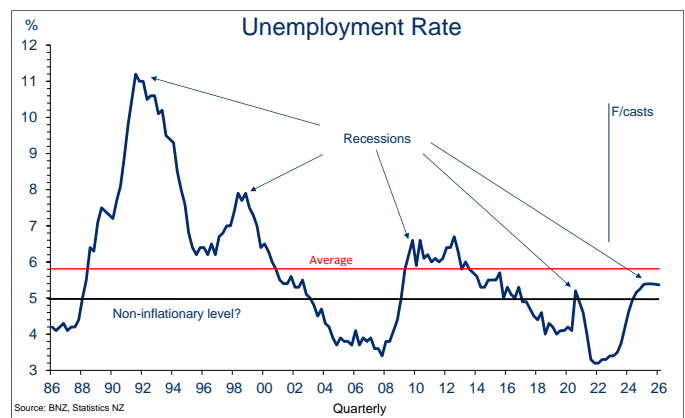
Immigration

Currently net immigration is soaring. On an annual basis, New Zealand reported a net inflow of more than 72,000 people in the year ended April 2023. A year earlier it was an outflow of 19,000. We think the annual inflow will peak at around 100,000. There are two very big questions surrounding these flows. How long will they last and are they inflationary or deflationary? For now, we believe the impact of the surge in supply in moderating labour market tightness and, hence, wage growth is more disinflationary than is the demand side’s inflationary effect. But if net migration maintains its current pace, then demand side effects will start to dominate. Most forecasters are assuming the pace slows but, in all truth, no one really knows. Watch this space. It is important!



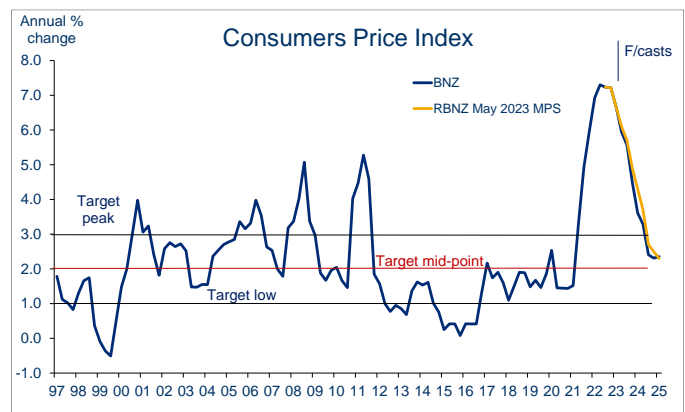
Labour Market

The labour market has been stretched to breaking. This has resulted in strongly rising wages, and labour shortages have significantly constrained businesses’ ability to increase output. Now, however, rapidly rising migration, accompanied by a modest softening in demand, is resulting in a moderation in labour market pressures. While it is still hard to find staff, businesses are reporting that the degree of difficulty is softening. Furthermore, the unemployment rate is trending higher. So far it has only risen from a low of 3.2% (back in December 2021) to 3.4% but we expect it to be through 5.0% by mid-2024. Eventually, these labour market developments will help cap wage inflation, but it might take a while especially given likely adjustments to state sector wages in the year ahead.



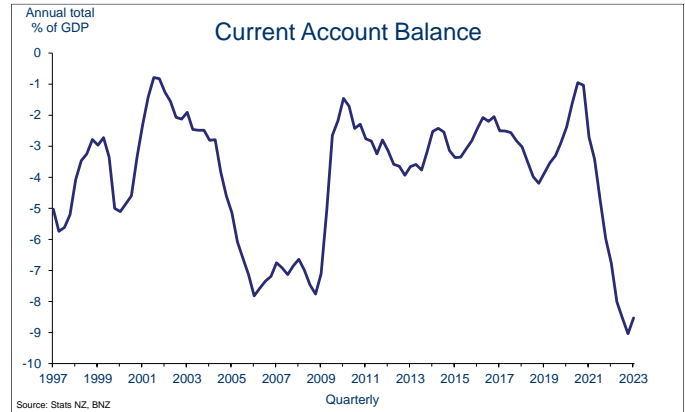
Inflation

Annual CPI inflation peaked at 7.3% back in June 2022. By March 2023 it had fallen to 6.7%. We are convinced the pace of decline will soon accelerate. And inflation is likely to be back within the Reserve Bank’s target band by September 2024. To start with, we expect to see major downward pressure coming from falling airfares, building materials and fresh fruit and veggie prices, as past spikes unwind. But there’s much more that is deflationary. Import and export prices will fall. Commodity prices already are. Supply constraints are easing. Freight costs are falling. Global inflation is declining. And the upward pressure on wages will ease.



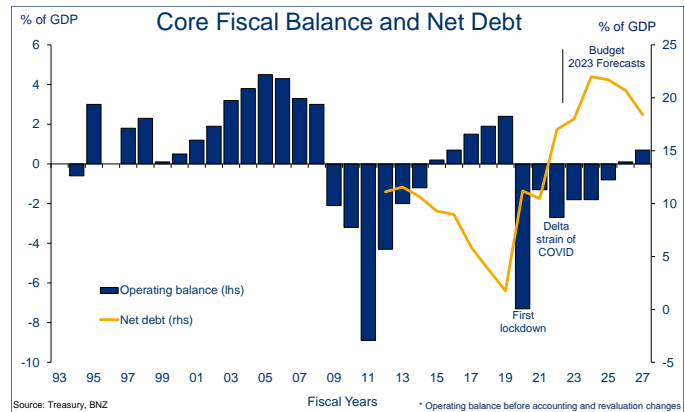
External Accounts

New Zealand’s external accounts have deteriorated rapidly. As recently as December 2020 the current account deficit was just 1.0% of GDP, the smallest it had been since December 2001. But in the space of just eight quarters that deficit blew out to 9.0% of GDP. The last time we experienced such heights was back in the 1970s when New Zealand was referred to as a “banana republic”. The extent of this deficit, when put alongside ongoing fiscal deficits, has caused Standard&Poor’s to express its concern and warn that ongoing twin deficits of the current magnitude could result in a credit rating downgrade. The good news is that it now appears the current account deficit has peaked. It has already fallen to 8.5% in the March quarter 2023. But it’s got some way to go before it falls into a “comfortable” range.



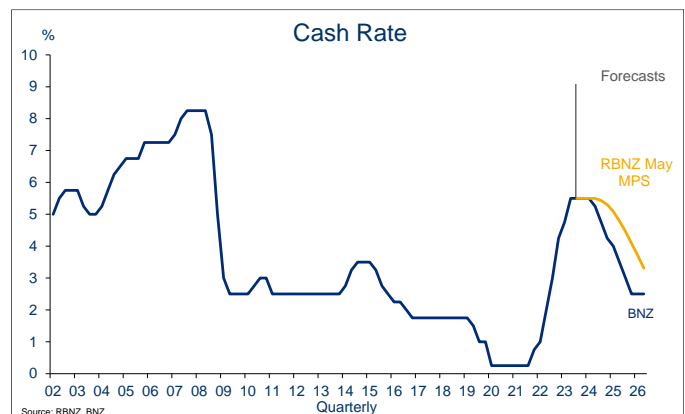
Fiscal Policy

The Government’s books have taken a three-way hit. First up, a stagflationary domestic economy has resulted in rising costs alongside a tumbling tax take. Secondly, floods and cyclones, which have had a huge impact on infrastructure, have required a government response. And, thirdly, policy-led easing has put further pressure on the bottom line. This means the Government is now expecting six consecutive years of fiscal deficit culminating in an eventual surplus in the year ended June 2026. The risk of not achieving a surplus in fiscal 2026, or 2027 for that matter, is rising, with taxes already undershooting the Government’s Budget day forecasts.



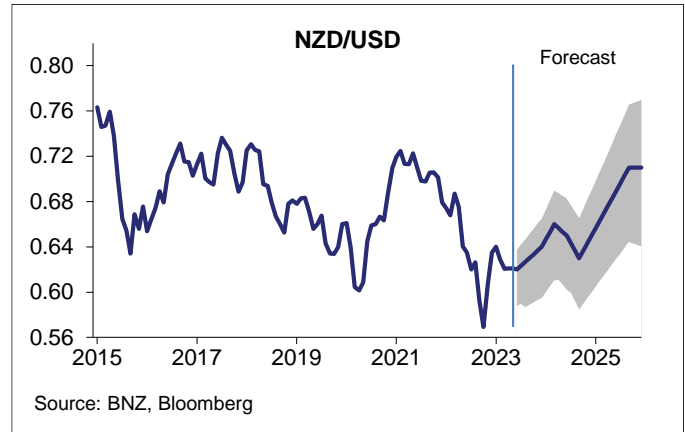
Interest Rates and RBNZ Policy

The RBNZ Monetary Policy Committee has said the tightening cycle is now done and dusted. We have no reason to disbelieve it. Inflation looks set to fall relatively quickly from here on and the labour market is easing. From our perspective, its now a question of when and how much does the OCR fall. Our central view answers this with a first cut in May 2024 and then the OCR progressively falling in the two years thereafter. At this stage we have a low in the cycle at 2.5% but there is a very real chance the trough will end up in the 3s.



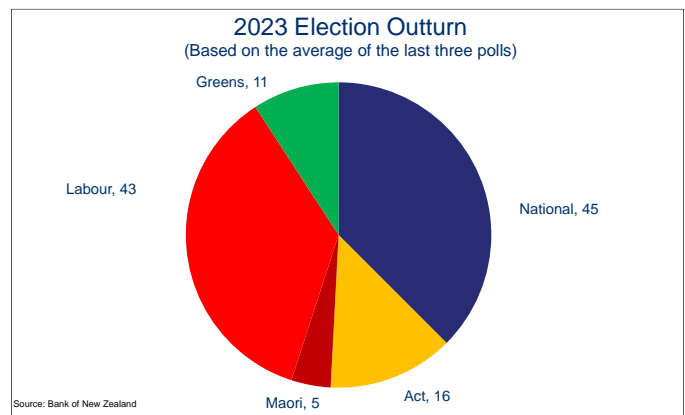
Exchange Rates

By our reckoning the NZD is fundamentally undervalued against the USD. So, against this backdrop, with the US economy potentially headed for recession, and the risk of further rate hikes diminishing, we think there is a reasonable chance the NZD strengthens over the remainder of this year. This forecast is, thus, really predicated on a weakening USD rather than any innate strength in the domestic currency. In contrast, against other currency pairs we expect the NZD to be flat to lower as the NZ economy suffers from declining commodity prices and, eventually, NZ interest rates fall. The weakest currency pair should be NZD/JPY as Japan gets dragged kicking and screaming into a tightening cycle.



Politics

Based on an average of the latest three polls New Zealand would elect a right-leaning government if a vote was held today. But it would be a line ball call. The October 14 General Election is shaping up to deliver one of the closest in a long time. Ultimately, the minor parties will determine the outcome with the only certainty being we will not return a single party majority, as is now the case. Given that the policy prescriptions of the potential governments are quite different, and given the uncertainty of the outcome, investment activity is expected to be postponed until after the election. This increases the potential for the economy to contract in the second half of this year.



stephen_toplis@bnz.co.nz

Quarterly Forecasts

Forecasts as at 21 June 2023

Key Economic Forecasts

Quarterly % change unless otherwise specified

	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Forecasts				
						Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
GDP (production s.a.)	0.1	1.5	1.4	-0.7	-0.1	0.3	0.1	-0.5	-0.2	0.3
Retail trade (real s.a.)	-1.1	-2.4	0.5	-1.0	-1.4	0.0	0.2	0.0	0.4	0.7
Current account (ytd, % GDP)	-6.8	-8.0	-8.5	-9.0	-8.5	-8.3	-8.1	-7.4	-6.8	-6.4
CPI (q/q)	1.8	1.7	2.2	1.4	1.2	1.0	1.8	0.4	0.4	0.7
Employment	0.0	-0.1	1.2	0.5	0.8	0.4	0.2	0.1	0.0	0.1
Unemployment rate %	3.2	3.3	3.3	3.4	3.4	3.5	3.7	4.2	4.6	5.0
Avg hourly earnings (ann %)	5.3	7.0	8.6	8.1	8.2	7.7	6.4	6.6	5.8	5.2
Trading partner GDP (ann %)	3.9	2.2	3.8	2.1	2.8	3.7	2.8	3.0	2.7	2.8
CPI (y/y)	6.9	7.3	7.2	7.2	6.7	5.9	5.6	4.5	3.6	3.3
GDP (production s.a., y/y)	1.1	0.7	6.6	2.3	2.2	1.0	-0.4	-0.1	-0.2	-0.3

Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor	US 10 yr	NZ-US
		Bank Bills						3 month		Ten year
2021 Dec	0.65	0.80	2.15	2.40	2.10	2.45	2.60	0.15	1.55	0.87
2022 Mar	0.90	1.25	2.60	2.75	2.65	2.95	3.00	0.50	1.95	0.83
Jun	1.83	2.24	3.55	3.68	3.83	3.92	3.95	1.50	2.90	0.76
Sep	2.83	3.33	3.65	3.77	4.12	3.95	3.95	3.00	3.10	0.67
Dec	4.00	4.27	4.34	4.31	5.10	4.67	4.55	4.50	3.80	0.49
2023 Mar	4.58	4.99	4.27	4.26	5.11	4.51	4.40	5.05	3.65	0.68
Forecasts										
Jun	5.50	5.60	4.50	4.35	5.15	4.75	4.55	5.60	3.75	0.60
Sep	5.50	5.60	4.35	4.20	5.00	4.60	4.40	5.85	3.70	0.50
Dec	5.50	5.50	4.25	4.20	4.75	4.50	4.40	5.85	3.70	0.50
2024 Mar	5.50	5.35	4.15	4.10	4.55	4.40	4.30	5.60	3.50	0.60
Jun	5.25	5.00	4.10	4.20	4.15	4.35	4.40	5.10	3.50	0.70
Sep	4.75	4.50	3.85	3.95	3.95	4.10	4.15	4.60	3.25	0.70
Dec	4.25	4.25	3.70	3.95	3.50	3.95	4.15	4.10	3.25	0.70
2025 Mar	4.00	3.75	3.60	3.95	3.10	3.85	4.15	3.60	3.25	0.70

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.62	0.68	1.09	1.28	142
Sep-23	0.63	0.71	1.13	1.28	133
Dec-23	0.64	0.72	1.17	1.31	125
Mar-24	0.66	0.74	1.20	1.35	120
Jun-24	0.65	0.73	1.19	1.33	115
Sep-24	0.63	0.71	1.17	1.32	113
Dec-24	0.65	0.73	1.19	1.34	111
Mar-25	0.67	0.75	1.21	1.36	108
Jun-25	0.69	0.77	1.22	1.38	106
Sep-25	0.71	0.78	1.23	1.39	105
Dec-25	0.71	0.78	1.23	1.39	105

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.62	0.91	0.57	0.48	87.7	71.3
Sep-23	0.63	0.89	0.56	0.49	83.8	70.1
Dec-23	0.64	0.89	0.55	0.49	80.0	70.0
Mar-24	0.66	0.89	0.55	0.49	79.2	71.4
Jun-24	0.65	0.89	0.55	0.49	74.8	70.6
Sep-24	0.63	0.89	0.54	0.48	71.2	68.8
Dec-24	0.65	0.89	0.55	0.49	72.2	70.4
Mar-25	0.67	0.89	0.55	0.49	72.4	71.7
Jun-25	0.69	0.90	0.57	0.50	73.1	73.2
Sep-25	0.71	0.91	0.58	0.51	74.6	75.0
Dec-25	0.71	0.91	0.58	0.51	74.6	74.9

TWI Weights

13.8% 16.5% 9.8% 3.1% 6.1%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Annual Forecasts

Forecasts as at 21 June 2023	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2022	2023	2024	2025	2026	2021	2022	2023	2024	2025
GDP - annual average % change										
Private Consumption	6.0	2.4	1.5	0.6	2.4	7.5	3.0	1.5	0.1	2.1
Government Consumption	8.0	2.0	-2.5	-3.3	1.4	8.2	4.5	-2.1	-4.3	1.4
Total Investment	10.6	3.5	-0.2	-1.1	4.2	12.5	3.9	1.1	-2.1	3.3
Stocks - ppts cont'n to growth	0.6	-0.2	-0.3	0.3	0.0	1.3	0.0	-0.8	0.5	0.1
GNE	8.1	2.4	0.3	-0.2	2.6	10.2	3.5	0.2	-0.8	2.3
Exports	2.4	6.2	5.7	5.4	4.3	-2.7	0.0	8.2	6.2	4.7
Imports	17.6	4.9	3.8	0.3	2.7	15.1	5.3	3.8	1.0	2.1
Real Expenditure GDP	4.8	2.6	-0.2	1.0	3.0	6.0	2.3	0.4	0.3	3.0
GDP (production)	5.2	2.9	0.0	1.1	3.0	6.0	2.7	0.6	0.4	3.0
<i>GDP - annual % change (q/q)</i>	1.1	2.2	-0.2	2.7	2.8	3.3	2.3	-0.1	1.7	3.0
Output Gap (ann avg, % dev)	1.5	2.0	0.3	-0.4	0.3	1.6	2.0	0.9	-0.5	0.2
Nominal Expenditure GDP - \$bn	358	387	401	416	438	352	380	399	410	433
Prices and Employment - annual % change										
CPI	6.9	6.7	3.6	2.4	2.2	5.9	7.2	4.5	2.3	2.3
Employment	2.5	2.4	0.7	1.1	2.0	3.3	1.6	1.5	0.6	2.0
Unemployment Rate %	3.2	3.4	4.6	5.4	5.4	3.2	3.4	4.2	5.3	5.4
Wages - ahote (private sector)	5.3	8.2	5.8	3.6	2.5	4.1	8.1	6.6	4.0	2.8
Productivity (ann av %)	2.3	1.0	-1.6	0.6	1.1	4.0	0.6	-1.4	0.0	1.3
Unit Labour Costs (ann av %)	4.0	6.0	7.4	3.8	1.7	2.0	6.1	7.6	4.9	1.8
House Prices	13.8	-12.8	3.5	9.6	14.2	27.2	-10.9	-1.8	7.2	14.8
External Balance										
Current Account - \$bn	-24.2	-33.0	-26.7	-19.4	-12.9	-21.1	-34.4	-29.0	-22.1	-14.1
Current Account - % of GDP	-6.8	-8.5	-6.7	-4.7	-2.9	-6.0	-9.0	-7.3	-5.4	-3.2
Government Accounts - June Yr, % of GDP										
OBE GAL (core operating balance)	-2.7	-1.8	-2.2	-2.2	-1.2					
Net Core Crown Debt (excl NZS Fund Assets)	17.0	18.0	22.0	21.7	20.7					
Bond Programme - \$bn (Treasury forecasts)	20.0	28.0	34.0	32.0	30.0					
Bond Programme - % of GDP	5.6	7.2	8.5	7.7	6.9					
Financial Variables ⁽¹⁾										
NZD/USD	0.69	0.62	0.66	0.67	0.71	0.68	0.63	0.64	0.65	0.71
USD/JPY	119	134	120	108	105	114	135	125	111	105
EUR/USD	1.10	1.07	1.20	1.21	1.23	1.13	1.06	1.17	1.19	1.23
NZD/AUD	0.93	0.93	0.89	0.89	0.91	0.95	0.94	0.89	0.89	0.91
NZD/GBP	0.52	0.51	0.49	0.49	0.51	0.51	0.52	0.49	0.49	0.51
NZD/EUR	0.62	0.58	0.55	0.55	0.57	0.60	0.60	0.55	0.55	0.58
NZD/YEN	81.5	83.0	79.2	72.4	74.2	77.4	85.6	80.0	72.2	74.6
TWI	73.9	71.0	71.4	71.7	74.4	73.0	72.9	70.0	70.4	74.9
Overnight Cash Rate (end qtr)	1.00	4.75	5.50	4.00	2.50	0.75	4.25	5.50	4.25	2.50
90-day Bank Bill Rate	1.45	5.16	5.35	3.75	2.65	0.92	4.55	5.50	4.25	2.65
5-year Govt Bond	2.90	4.40	4.15	3.60	3.40	2.20	4.30	4.25	3.70	3.40
10-year Govt Bond	3.20	4.35	4.10	3.95	3.85	2.35	4.25	4.20	3.95	3.85
2-year Swap	3.00	5.15	4.55	3.10	2.75	2.22	5.21	4.75	3.50	2.75
5-year Swap	3.20	4.50	4.40	3.85	3.65	2.56	4.62	4.50	3.95	3.65
US 10-year Bonds	2.10	3.65	3.50	3.25	3.25	1.45	3.60	3.70	3.25	3.25
NZ-US 10-year Spread	1.10	0.70	0.60	0.70	0.60	0.90	0.65	0.50	0.70	0.60

⁽¹⁾ Average for the last month in the quarter

Source: Statistics NZ, BNZ, NZ Treasury

Contact Details

BNZ Research

Stephen Toplis

Head of Research
+64 4 474 6905

Craig Ebert

Senior Economist
+64 4 474 6799

Doug Steel

Senior Economist
+64 4 474 6923

Jason Wong

Senior Markets Strategist
+64 4 924 7652

Stuart Ritson

Senior Interest Rate Strategist
+64 9 9248601

Mike Jones

BNZ Chief Economist
+64 9-956 0795

Main Offices

Wellington

Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland

80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch

111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

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