New Zealand Chartbook

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November 2024

Highlights

- **Annual CPI inflation is back in the Reserve Bank's 1-3% target band. At 2.2% for the year to September 2024, this is the first time inflation has been in the band since March 2021.**

- **The cost of imports and import competing goods has done most of the heavy lifting. Domestic inflationary pressures remain high. The RBNZ will be watching this closely as they now set their sights on sustaining inflation within the band.**

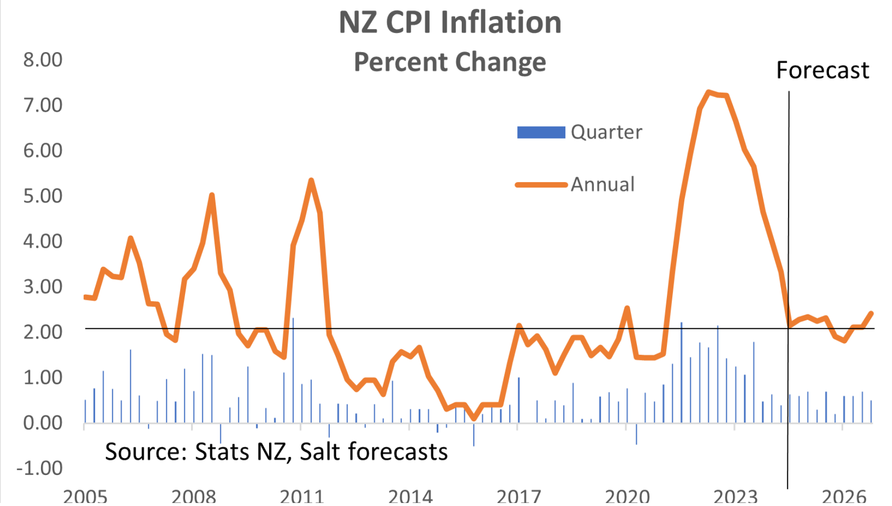
- **The economy is weak, and the unemployment rate is rising. This is continuing to open up spare capacity in the economy, allowing the RBNZ to cut interest rates.**

- **The Official Cash Rate has been reduced twice for a total of 75bp, taking the OCR to 4.75%. We see a further 50bp cut in November, followed by a series of 25bp cuts from February that will take the OCR to a low of 3.5%, the bottom end of our estimated range of 3.5-4.0% for the neutral rate.**

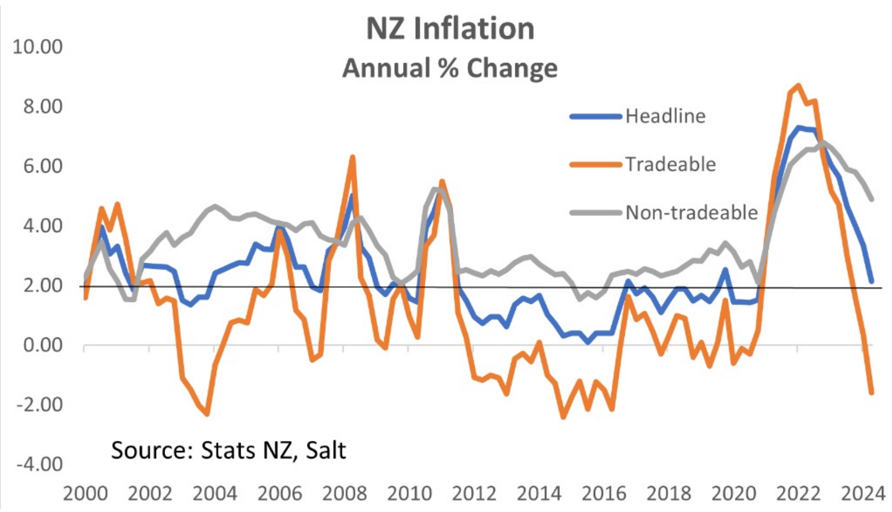
- **Given the slow transmission of lower interest rates into higher activity, we don't see any meaningful pick up in GDP growth until 2025. Falling population growth via lower net inward migration will be a moderating influence on the recovery.**

- **The Government's Budget deficit came in at -3.1% of GDP in the 2024 Fiscal Year Financial Statements, slightly worse than forecast in Budget 2024. Alongside the seemingly stalled improvement in our Balance of Payments deficit at -6.7% of GDP, our twin deficits will continue to be watched by the rating agencies.**

Back in the band

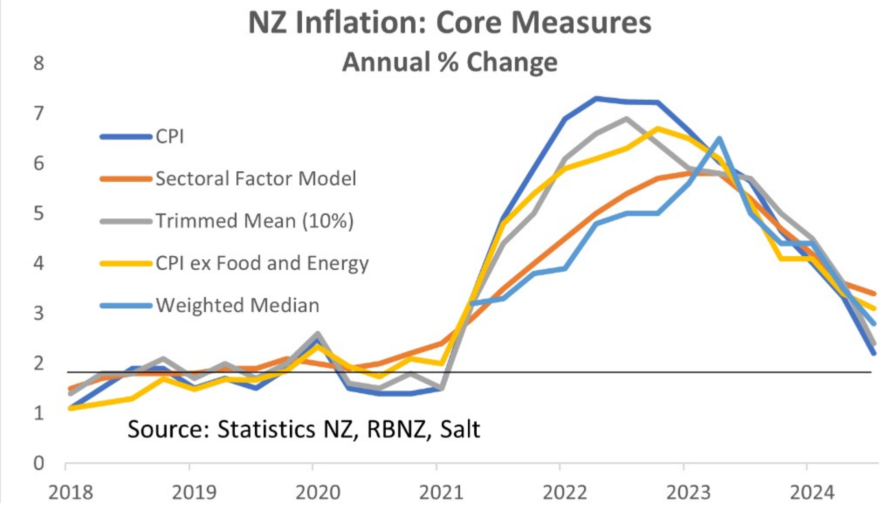


The annual rate of CPI inflation came in at 2.2% for the year to September 2024, down from 3.3% in June. This is the first time annual inflation has been inside the RBNZ's 1-3% target band since the March quarter of 2021. Continued low quarterly prints and helpful base effects are expected to see annual inflation slightly below 2% during the latter part of 2025.

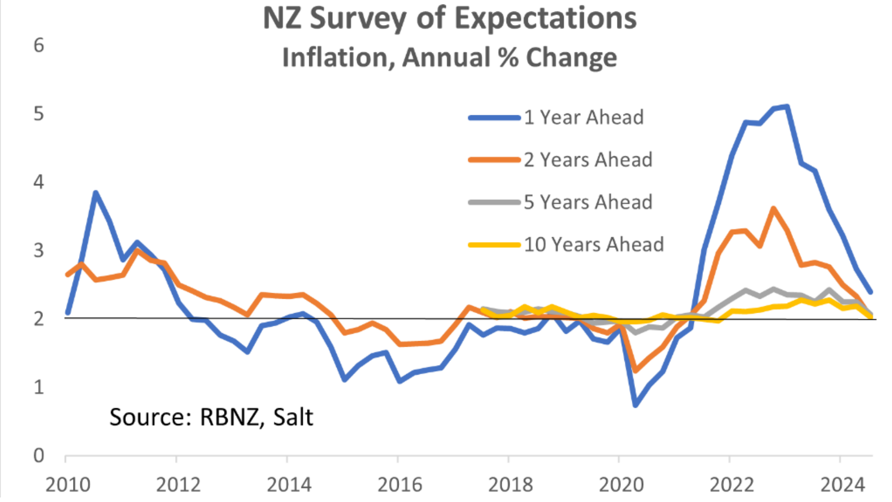


Most of the hard work to date has been done by prices of imports and import competing goods. The annual rate of tradeable inflation came in at -1.6% in September. Non-tradeable inflation is on the way down, but at 4.9% y/y it is still too high. The RBNZ will continue to have an eye on this as they muse on the challenge of now sustaining the annual rate of CPI inflation within the target range.

Heading in the right direction



The RBNZ monitors a range of core inflation measures. All are heading in the right direction, though are falling more gradually than headline inflation. That said all are either inside the target range or close to it. We expect these measures will continue to moderate in the months ahead.



Inflation expectations are converging on the mid-point of the 1-3% target band. The 1-year ahead reading of 2.4% was taken before the latest CPI result was released, so is likely to fall further in the next survey. Further out, the longer time periods are all within a handful of basis points of 2%. Survey respondents are believers in the sustained return to 2% inflation. That's great news for the RBNZ.

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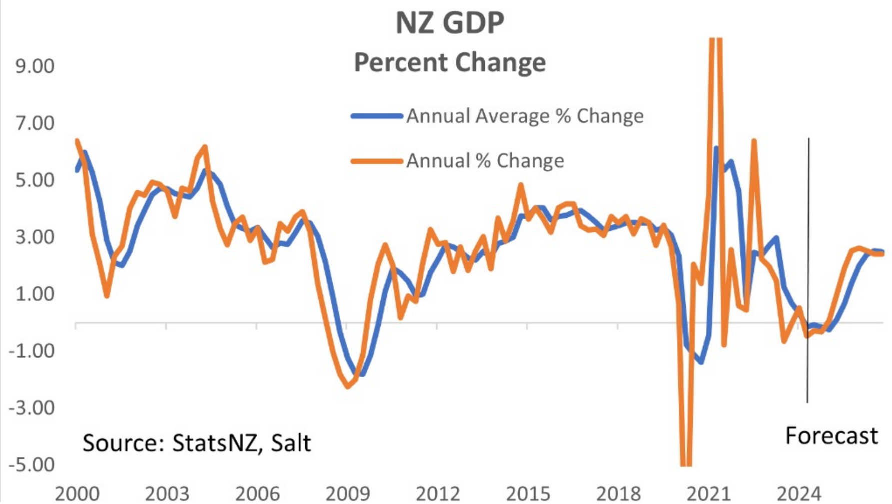
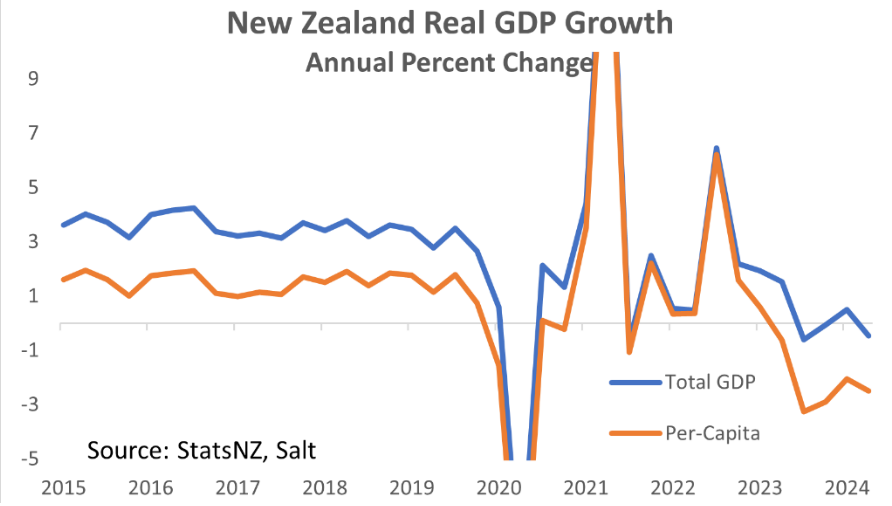
New Zealand economy flat-lining

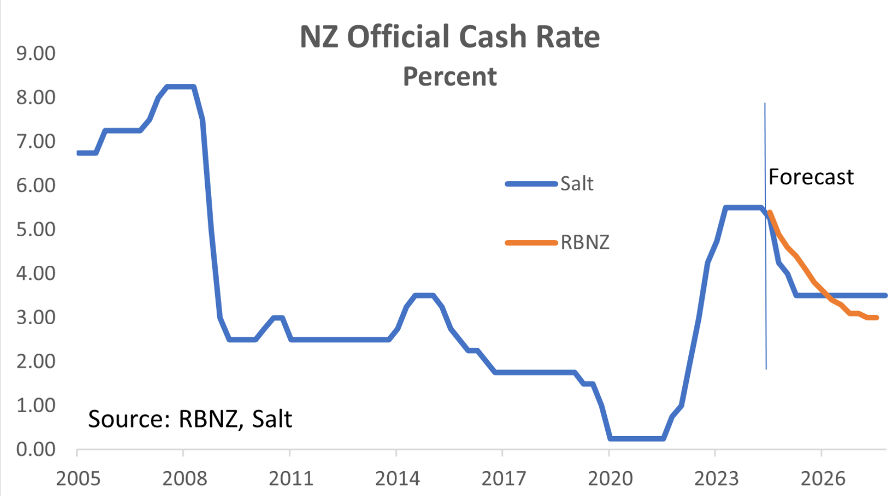


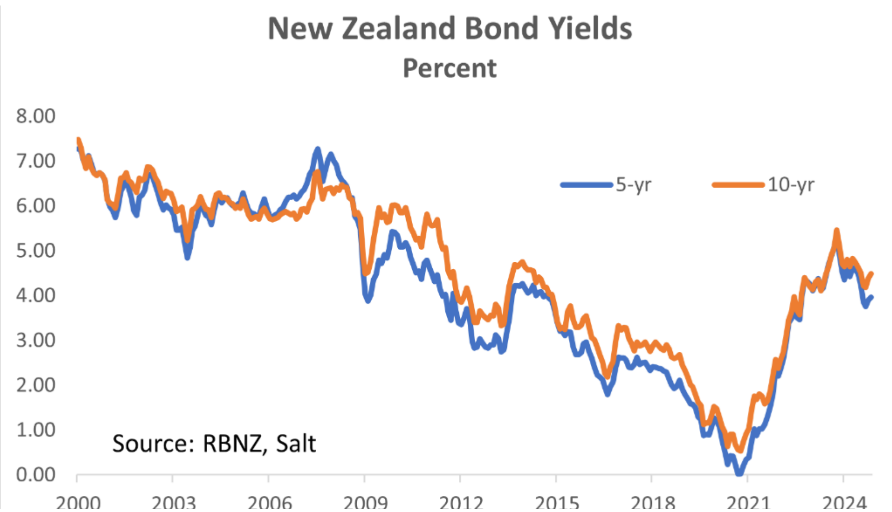
The NZ economy continues to operate on a one step forward, two steps back basis. GDP contracted -0.2% in the June quarter, after rising by the same quantum in the prior quarter. Annual GDP growth is running at -0.5%. It will take a while for lower interest rates to have an impact on activity. We aren't expecting any meaningful pick-up in growth until 2025.



The recession has come at the same time the population has been growing strongly on the back of high net inward migration. In the year to June, NZ's population expanded by 1.8%. Backing this out of total GDP growth shows that our per-capita GDP contracted -2.5% in the year to June. Per-capita GDP is the better measure of our economic health and changes in our standard of living.

The OCR is on the way down





We have consistently held to the view that interest rates would be able to be cut by the end of this year on the back of falling inflation and the weak economy. The Official Cash Rate has now been cut 75bp to 4.75% and we expect another 50bp cut in November. A series of 25bp cuts will likely follow from February to a low of 3.5%, the bottom end of our estimated 3.5-4.0% range for the neutral rate.

It's been harder work at the other end of the yield curve. Longer term interest rates have been rising recently as interest rate markets have adjusted their expectations of interest rate cuts by the US Federal Reserve. At the same time, the US Presidential election has thrown a spotlight on fiscal sustainability.

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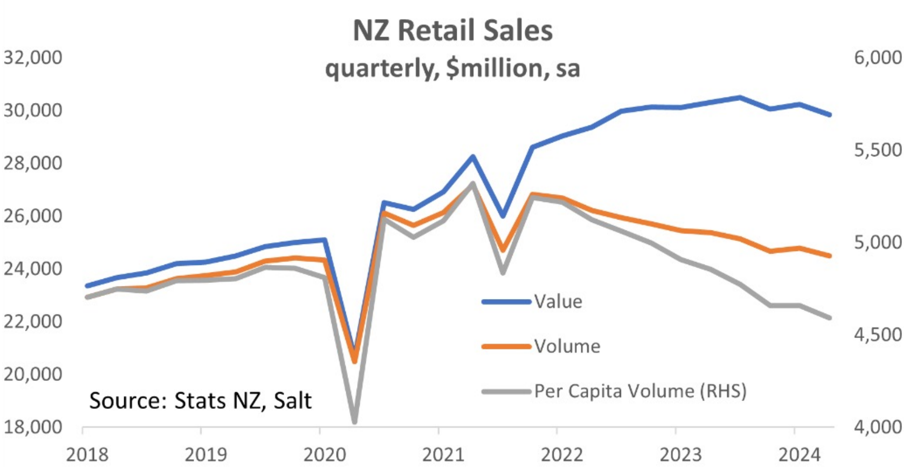
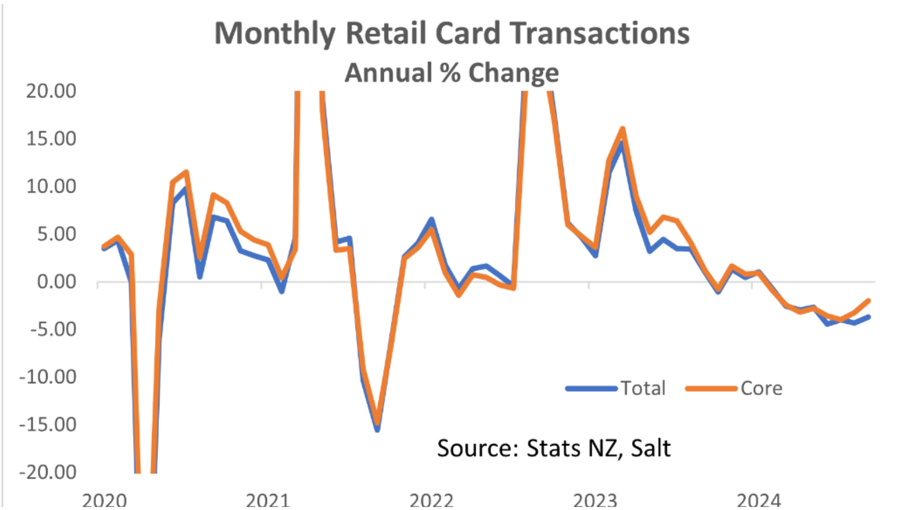
Weakness in interest rate sensitive sectors



It's tough going in the retail sector. Retail spending has been hit by weakness in the labour market and higher interest rates. On the plus side wage growth has been strong, which has helped nominal sales, as has population growth. In the year to June 2024, the volume (inflation adjusted) of sales were down -3.6%. Adjusting for population growth, the annual rate of per capita sales volumes are down -5.4%.



Income tax cuts were effective from July 31st and interest rates are on the way down. More timely and frequent monthly card transaction data suggests some bottoming out of the contraction in spending as a result, though the quarterly retail sales data will likely show a further contraction. Also, population growth is moderating as net migration slows which will act as a brake on any strong recovery in spending.

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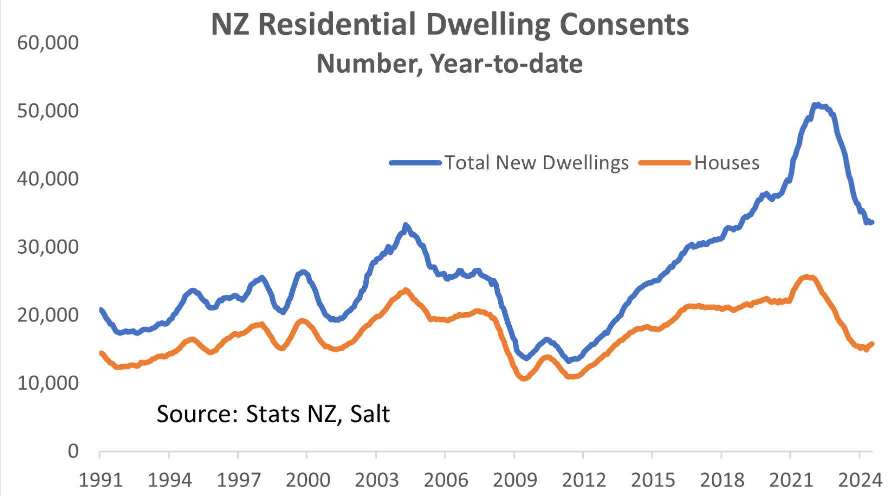
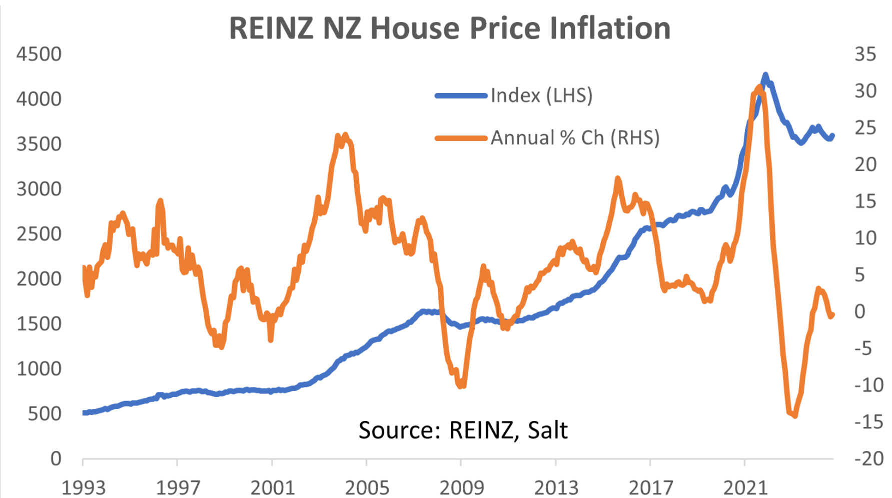
Housing market stabilising, but no strong rebound

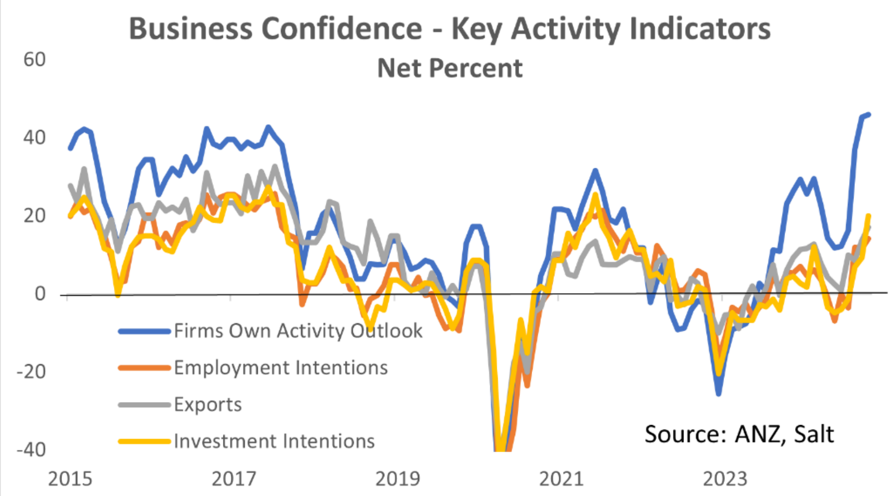


Consents for new dwellings have fallen sharply over the last couple of years but now appear to be finding a floor. With interest rates now falling and house prices stabilising, a recovery is likely in the months ahead. However, falling population growth will provide something of a brake on any sharp recovery.

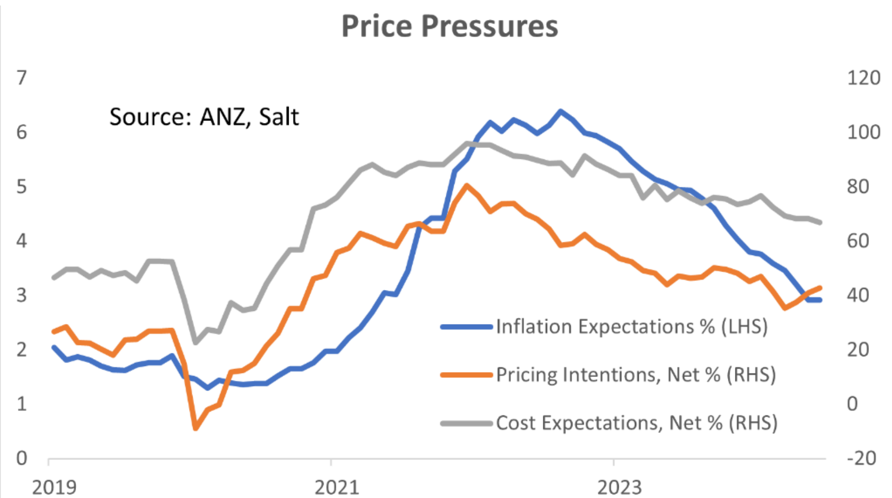


Prices of existing homes are also finding a floor and again, lower interest rates will start to encourage activity in this part of the market. However, we don't expect a strong recovery until the labour market stabilises and fears of job security start to diminish.

Business confidence bounces

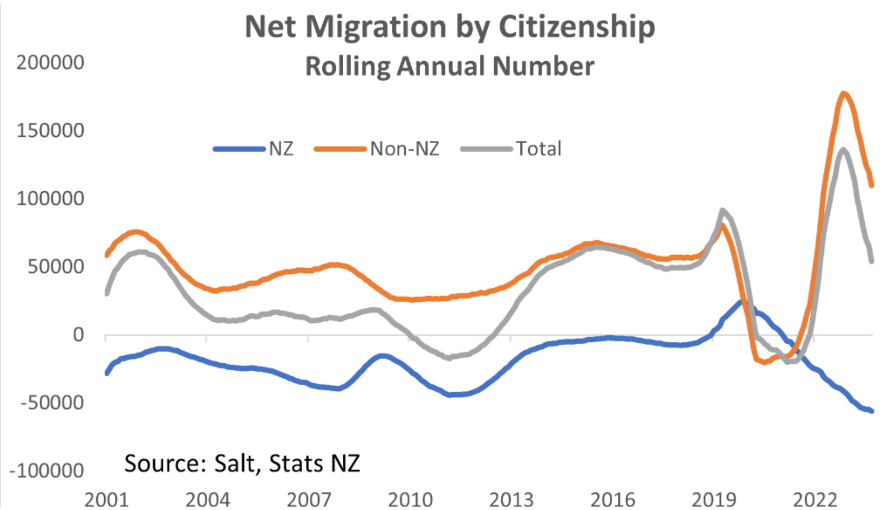


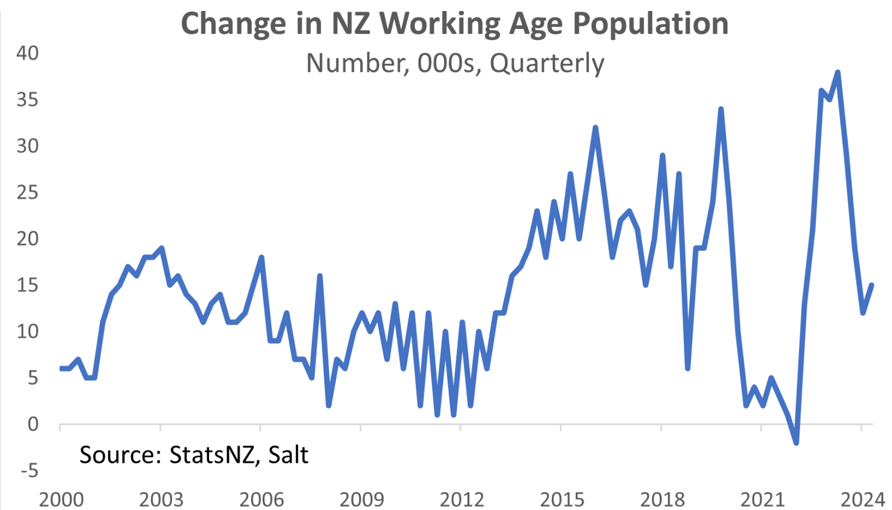
Business confidence has moved sharply higher in recent months. The move to interest rate cuts by the RBNZ is a key catalysts, leading to businesses sensing better times ahead. The optimism may be a little premature as the economy continues to face headwinds, particularly in the labour market.



Cost pressures remain high, but as confidence has improved, firms' intentions to raise prices has recovered. We see this as firms believing that as activity recovers, so too will pricing power, leading to improved profitability. As with the generally improved level of optimism, we think the intention / ability to raise prices is also premature.

Net inward migration slowing sharply

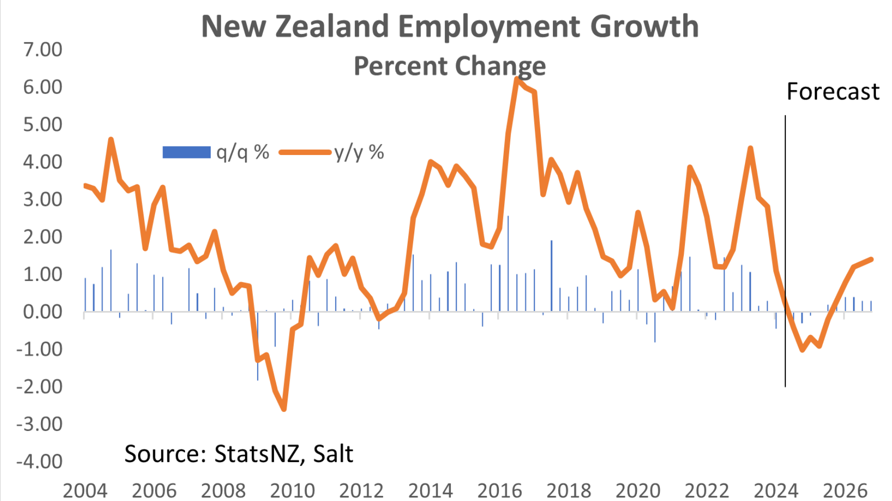




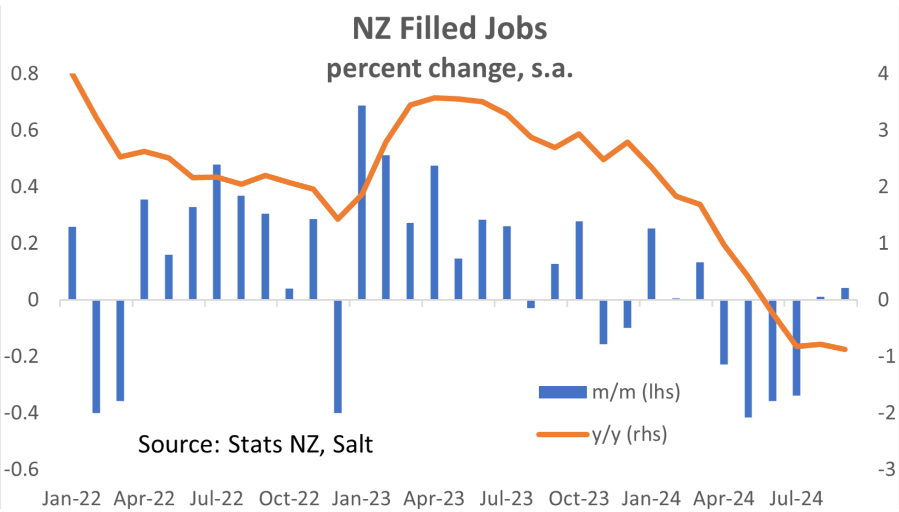
Net inward migration is slowing sharply. After a peak net inflow of 136,000 people in the year to October 2023, the net inflow had slowed to 54,000 in the year to August 2024. This reflects softer arrivals and rising departures of both NZ and non-NZ citizens. This reflects the weak economy, particularly the labour market. We expect the net inflow will continue to slow, potentially hitting zero in early 2025.

As net inward migration slows, slow too does the growth in the working age population. 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.

Employment conditions deteriorating



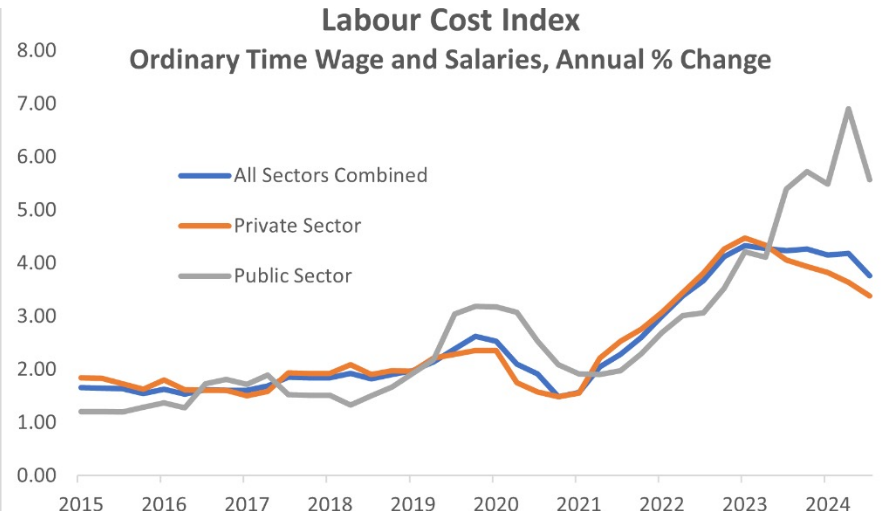
Employment fell -0.5% in the September 2024 quarter to be down -0.4% y/y. We see further weakness in the period ahead given the labour market generally lags the trend in economic activity. We see employment growth bottoming out at around -1.0% in the December 2024 quarter. No meaningful recovery is expected 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 of 0.9% in the year to September, the household survey above still has some catching up to do.

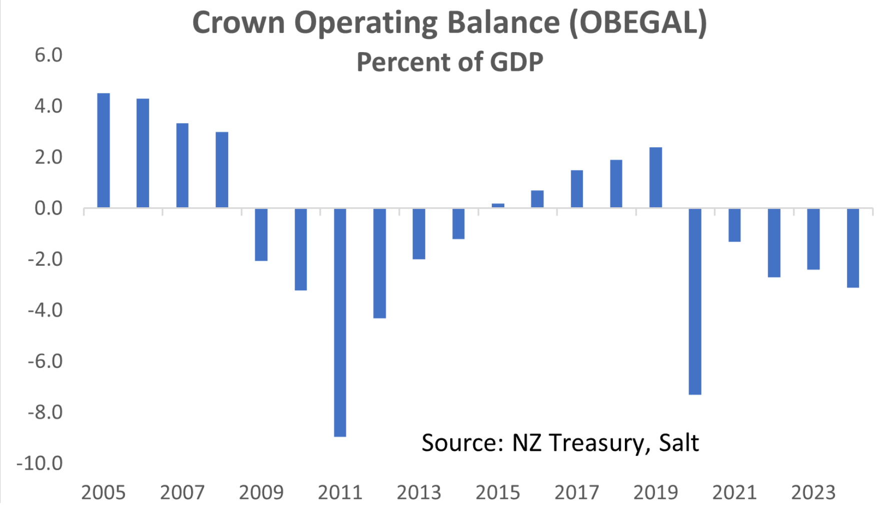
Labour market slack increasing

The unemployment rate rose to 4.8% in the September 2024 quarter on the back of weak employment growth. A sharper rise was averted by the large decline in the participation rate, most likely due to discouraged job seekers dropping out of the labour force. We still see the unemployment rate peaking at over 5.0% in early 2025.

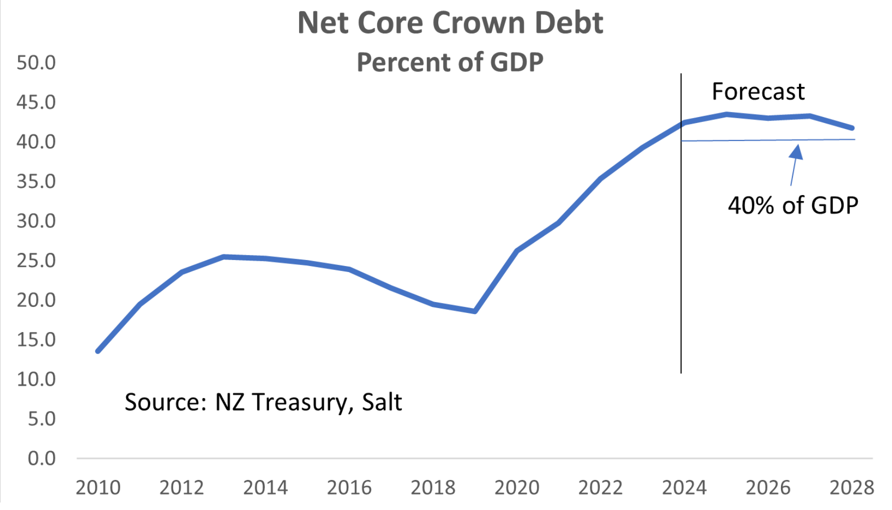


Wage inflation as measured by the Labour Cost Index continues to moderate. The key measure for the RBNZ is for the private sector as it is the one they can most influence. From a peak of 4.5% this has now fallen to 3.4%. The RBNZ would prefer to see closer to 2%, consistent with target inflation. Ongoing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

Fiscal position is tight



Crown Financial Statements for the June 2024 Fiscal Year showed both revenue and expenses higher than forecast in the 2024 Budget. The growth in total revenue was outpaced by the growth in total expenses, leading to the operating balance before gains and losses (OBEGAL) also being larger than forecast at 3.1% of GDP.



Net core Crown debt came in at 42.5% of GDP, slightly lower than forecast in the Budget, but still higher than the Government's target of 40% of GDP. The forecasts in the chart are from Budget 2024. The next set of forecasts will be released in December with the Half Year Economic and Fiscal Update.

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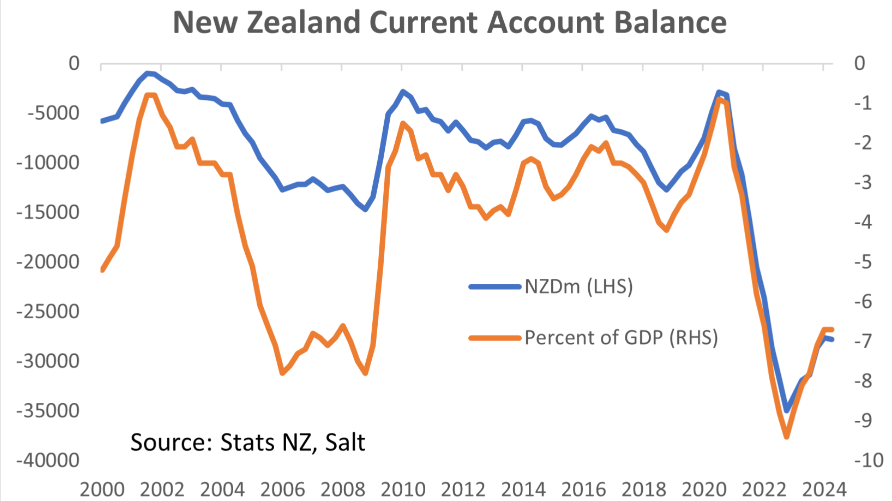
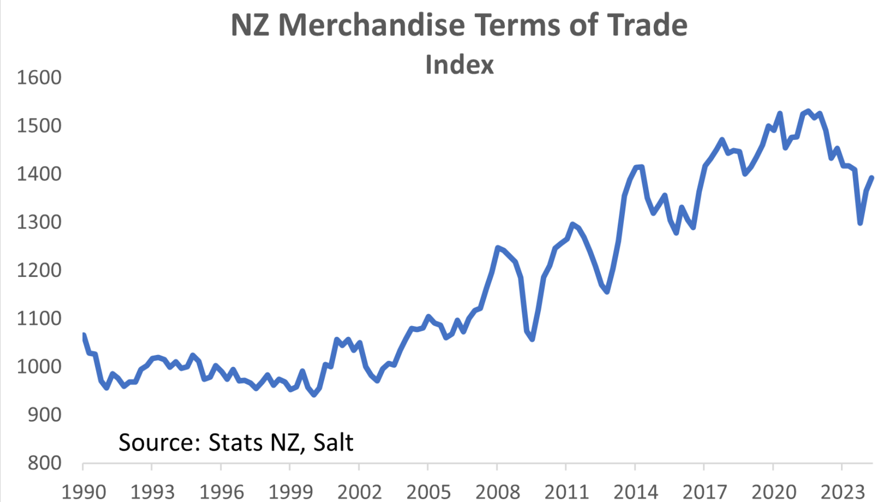
Vulnerabilities in the external sector

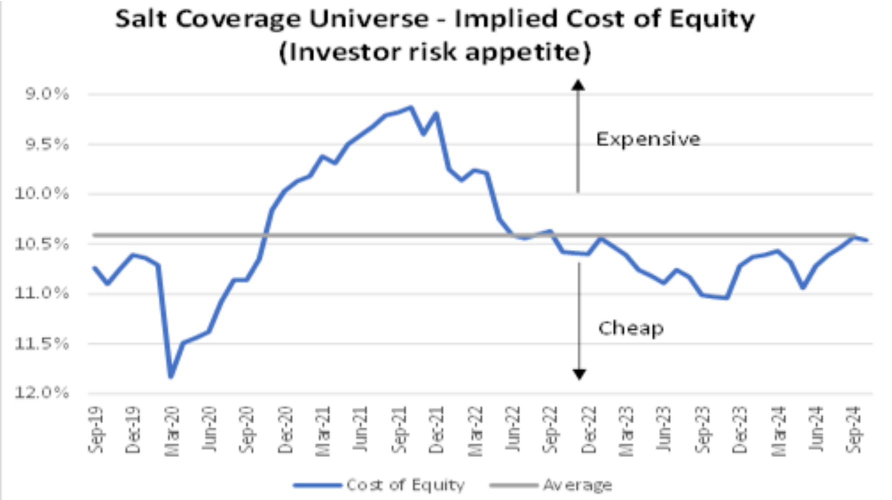


June quarter balance of payments data saw the recent improvement stall at -6.7% of GDP. The previous low of -8.8% of GDP was revised down to -9.4% of GDP. We don't see much of an improvement from these levels anytime soon. That will ensure the rating agencies will continue to keep an eye on this, especially in light of persistent government budget deficits.

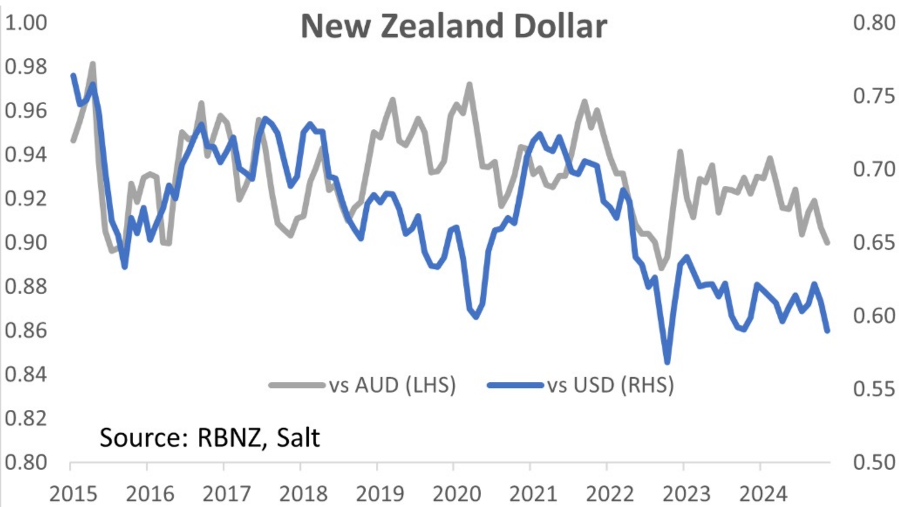


The Terms of Trade continues to claw back some of its recent losses. The index has now risen 7% off its lows, but that was after a 15% fall from its recent peak. In the June quarter the improvement was driven by export prices for goods rising 5.2% more than offsetting the 3.1% rise in import prices.

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 NZ equities priced at around an 8% discount to Australian equities. Earnings downgrades have been the main risk to equities and have been quite significant. However, investors are now starting to look through these in expectation of an improving economy in 2025.



Recent weakness in the NZD against both the USD and AUD is mostly a story of relative monetary policy outlook. The RBNZ looks set to continue easing policy at a faster pace than recently revised expectations in the US. In Australia, no interest rate cuts are expected until next year.

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