

Economic Snapshot: New Zealand

Heading For Zero

A *prima facie* case exists for New Zealand to feel pretty good about itself at the moment. Unemployment fell to an 11-year low of 3.9% in the June quarter, GDP growth remains steady if not spectacular, inflation remains contained below 2.0%, wages are rising faster than inflation, the government budget is in a healthy surplus and net government debt to GDP has fallen below the 20% target. Yet the RBNZ Monetary Policy Committee slashed the official cash rate (OCR) by -50bp to 1.0% and warned that it was not inconceivable that we will see negative interest rates in New Zealand before the end of this cycle. Following the statement, New Zealand rates and the NZD fell. The September 2025 inflation-indexed government bond traded at a yield of 0.00%, flirting with the negative lower range of interest rates. In the words of the RBNZ Governor, the outlook for New Zealand has tilted to the downside with slowing GDP growth, softer employment and inflation expectations, and significantly weaker global trading conditions.

Credit transmission mechanism may be jammed

The usual transmission mechanism for monetary policy is via the currency and credit markets. The NZD has depreciated marginally against the USD this year (-3%) despite our cash rate moving from +1.75% to +1.0%. The NZD TWI remains well above the long-term average so the heavy lifting for monetary policy has been left to the credit markets. However, the lower interest rates have been set, the harder it has been for domestic banks to attract deposits as part of their core capital ratio requirements. This has resulted in a rationing of credit to the domestic market. Concerns about over-exposure to certain sectors like dairy and the housing market has also resulted in domestic banks reigning in their appetite to lend money to domestic borrowers. Despite official cash rates tumbling and mortgage rates following suit, bank credit restrictions still assume borrowers need to service a mortgage rate close to 8.0%. This has jammed up the flow of credit into the domestic economy.

New Zealand partially immune to the global trade recession

Trade makes up around 27% of New Zealand's GDP, so a weaker trend in trading partner growth becomes one of the downside risks to the economy. Because New Zealand exports food and other consumer items, we are somewhat immune to the slump in global demand. Prices have also held up reasonably well for dairy products while the beef and lamb sector is benefiting from the swine fever epidemic in China. Services contribute around 30% of export activity or 8.5% of GDP. The largest component is tourism which has slowed markedly, with a decline in arrivals from China the main reason. Arguably, domestic infrastructure has failed to keep up with the exponential increase in in-bound tourist numbers so a 'catch-up' period should be welcomed. But investment in this sector, like all others, requires a degree of confidence about the outlook for the domestic and global economies. Confidence at the business and household levels is an important ingredient missing in New Zealand at the moment.

Housing ATMs 'out of order'

In the June quarter, house price inflation fell -0.8% in New Zealand. The RBNZ has also reduced its expectation for annual house price inflation to only +1.5% by the end of this year. With house prices a key driver of household spending, consumers may become more cautious in their spending plans, despite the aggressive cut to the OCR. This is a key downside risk to the domestic economy.



Kevin Stirrat

kevin.stirrat@forsythbarr.co.nz

+64 9 368 0069



Key economic data (as at 8 August 2019)

Figure 1. Key economic data

Country	GDP (US\$bn)	GDP % (YoY)	GDP % (QoQ)	OCR (%)	CPI % (YoY)	Jobless %	Govt % Budget %	Govt Debt/GDP
New Zealand	206	2.50	0.60	1.00	1.70	3.90	1.90	19.9

Source: Forsyth Barr analysis, Trading Economics

Recent economic releases

- RBNZ cuts OCR to record low 1.0% in August
- NZ jobless rate surprises by falling to 3.9% in Q2
- NZ inflation rises to 1.7% in Q2

Inflation has gone missing

The RBNZ's preferred factor model for annual inflation has languished below its 2.0% target since 2011, despite a relatively robust economy, strong commodity prices, historically high terms of trade, and decade-low levels of unemployment. Global inflationary expectations have also continued to fall. 10-year forward implied inflation expectations in the US have fallen well below 1.0%, while in New Zealand the same forward 10-year inflation implied rate is around 1.1%. Weaker pricing intentions are flowing from rapidly declining inflationary expectations which suggests the rapid fall in interest rates may not be over and could be here to stay.

For New Zealand investors, 10-year swap rates at 1.30% are historically unappealing. But using Europe and Japan as a guide, investors should get used to the idea that our domestic interest rates can fall to zero or below. Assuming a 10-year bond yields 1.25%, with a 1.25% coupon (par), and falls to 0.75% at the end of a year, the total return for investors includes a capital gain of +4.35% plus the coupon of +1.25%. A +5.6% return from an investment grade bond when inflation is hovering around 1.0%, or lower, remains attractive in this environment.

Fiscal support available but not planned

The planned fiscal stimulus by the government during the current term has finished, according to budget documents. The year to June 2019 saw a significant fiscal stimulus, but for the next two years the net fiscal impulse is planned to be zero. That's not to say the government won't be able to help as budget surpluses are forecast to grow along with a widening gap between revenue and expenses as a share of GDP.

The RBNZ seems more concerned about the ability of the government to provide more support — that is, does the government have the capacity or resources (government services) required to deliver additional support to the wider economy? The consensus at the moment is "no".

Downside risks broad and varied

Weaker global conditions feeding through to the domestic outlook include:

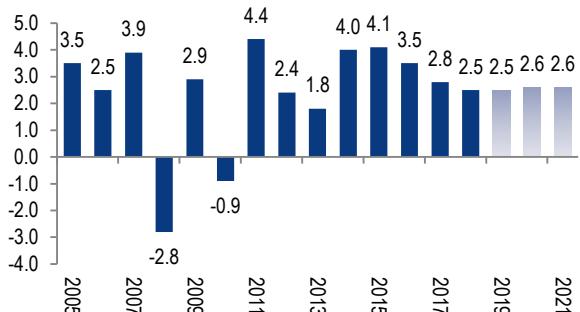
- Declining global trade volumes
- Reduced demand for New Zealand exports (goods and tourism)
- Declining net immigration growth rates
- Lower house price inflation
- Constrained business investment
- Relatively high NZD TWI
- Limited fiscal flexibility

Foreign investment into New Zealand is also likely to lag previous cycles given the government's negativity towards anything to do with drilling and roading. Tax hikes for petrol, increasing environmental costs, collective wage bargaining and the impacts of the Zero Carbon Bill are all contributing to a more cautious investment environment. The RBNZ has recognised this and responded with a 50bp cut. Further cuts to the OCR are likely with the zero lower bound fast approaching.



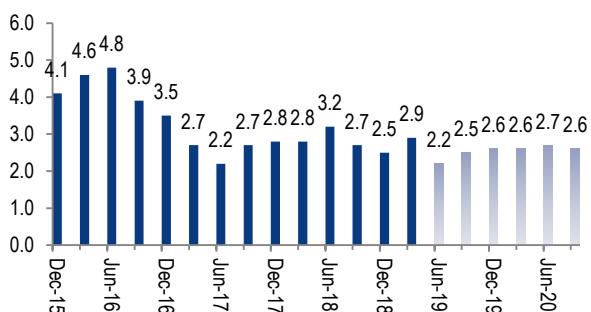
Key economic data (as at 8 August 2019)

Figure 2. Real expenditure based GDP (annual YoY %)



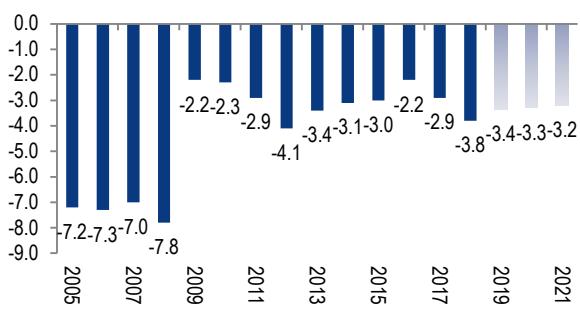
Source: Forsyth Barr analysis, Bloomberg

Figure 3. Real expenditure based GDP (quarterly YoY %)



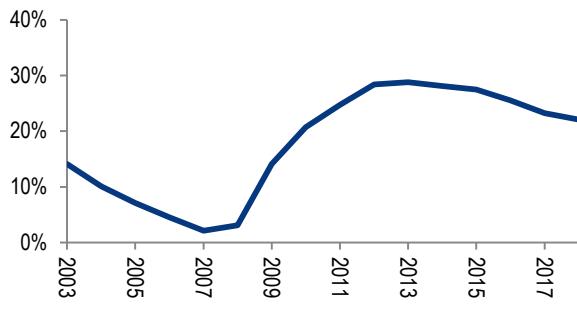
Source: Forsyth Barr analysis, Bloomberg

Figure 4. Current account balance (% of GDP)



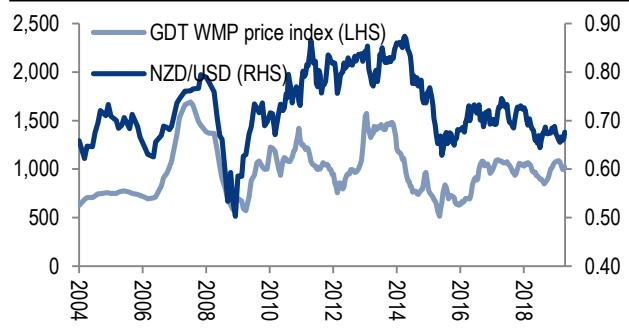
Source: Forsyth Barr analysis, Bloomberg

Figure 5. Net Government debt to GDP (%)



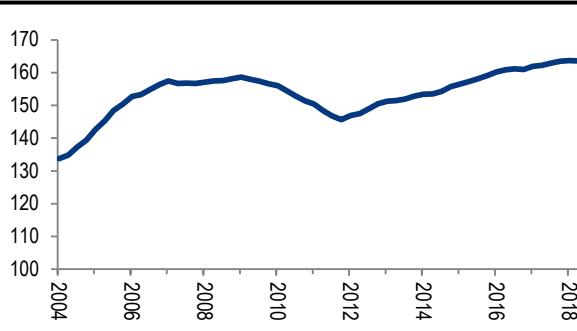
Source: Forsyth Barr analysis, Datastream

Figure 6. Global dairy prices and NZDUSD



Source: Forsyth Barr analysis, GlobalDairyTrade, Bloomberg

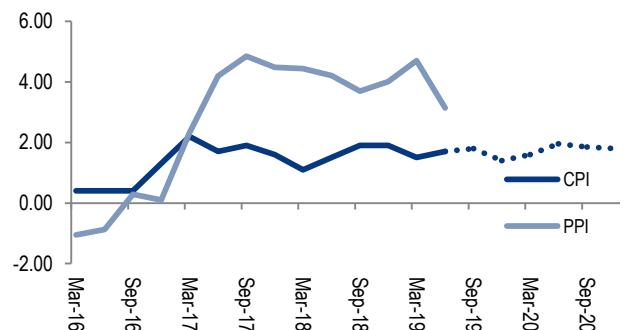
Figure 7. Household debt as % of nominal disposable income



Source: Forsyth Barr analysis, Reserve Bank of New Zealand

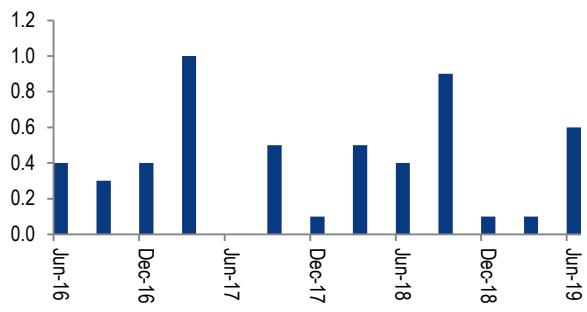


Figure 8. CPI and PPI (YoY %)



Source: Forsyth Barr analysis, Statistics New Zealand

Figure 9. CPI momentum (MoM %)



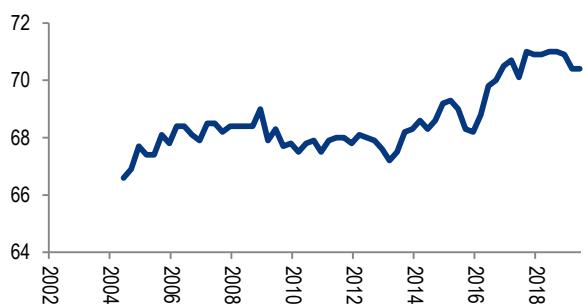
Source: Forsyth Barr analysis, Statistics New Zealand

Figure 10. Unemployment rate (%)



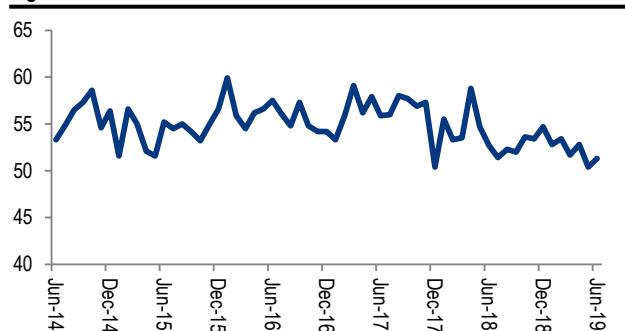
Source: Forsyth Barr analysis, Statistics New Zealand

Figure 11. Labour force participation (%)



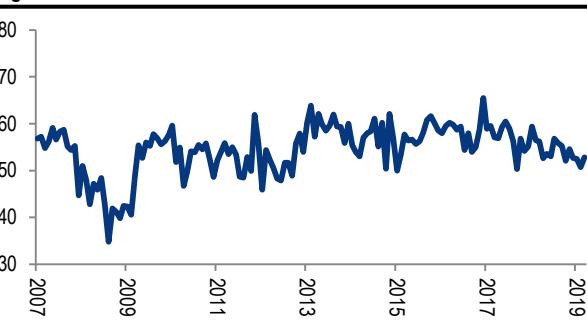
Source: Forsyth Barr analysis, Statistics New Zealand

Figure 12. BNZ business NZ PMI index



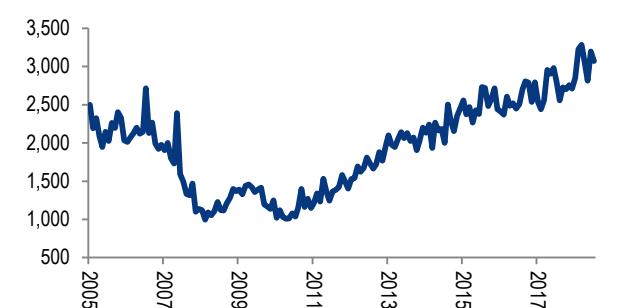
Source: Forsyth Barr analysis, Bank of New Zealand

Figure 13. BNZ business PMI new order index



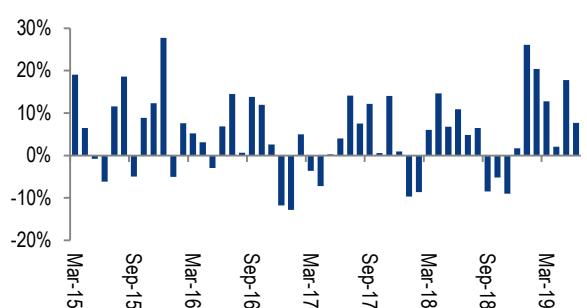
Source: Forsyth Barr analysis, Bank of New Zealand

Figure 14. Number of new dwelling units authorised



Source: Forsyth Barr analysis, Statistics New Zealand

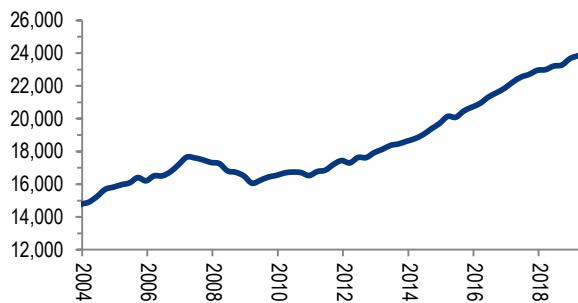
Figure 15. Change in number of new dwellings (rolling six months)



Source: Forsyth Barr analysis, Statistics New Zealand

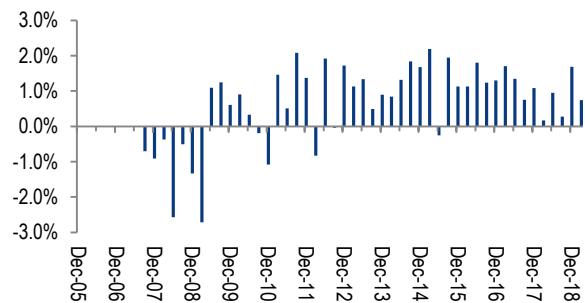


Figure 16. Retail sales ex inflation (NZD millions)



Source: Forsyth Barr analysis, Statistics New Zealand

Figure 17. Change in retail sales (rolling three months)



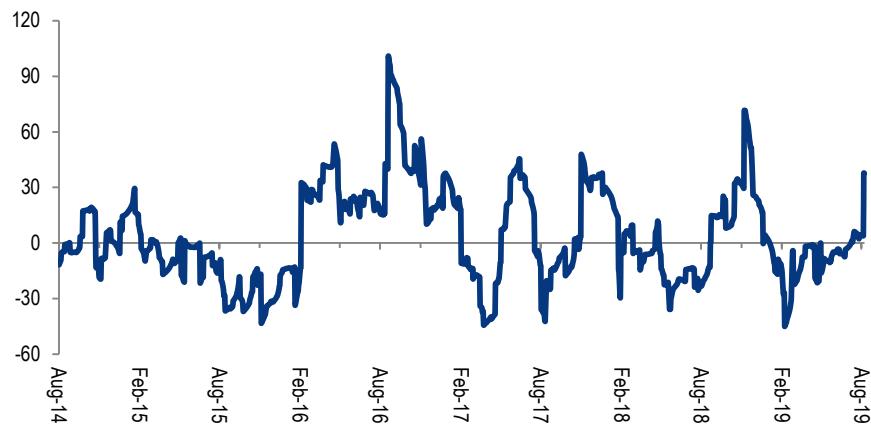
Source: Forsyth Barr analysis, Statistics New Zealand

Figure 18. Economic data

	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
Annual GDP: Nominal (US\$b)	136	122	145	167	175	187	200	175	185	200	203		
Annual GDP: Nominal (NZ\$b)	188	190	200	211	216	228	240	250	266	282	293		
YoY GDP Growth	-2.8%	+2.9%	-0.9%	+4.4%	+2.4%	+1.8%	+4.0%	+4.1%	+3.5%	+2.8%	+2.5%	+2.6%	+2.6%
Current Account % of GDP	-7.8%	-2.2%	-2.3%	-2.9%	-4.1%	-3.4%	-3.1%	-3.0%	-2.2%	-3.4%	-3.4%	-3.3%	-3.2%
Inflation (YoY)	+3.4%	+2.0%	+4.0%	+1.8%	+0.9%	+1.6%	+0.8%	+0.1%	+1.3%	+1.6%	+1.9%	+1.9%	+2.0%
Unemployment Rate	+4.4%	+6.5%	+6.2%	+6.0%	+6.3%	+5.6%	+5.5%	+4.9%	+5.2%	+4.5%	+4.3%	+4.2%	+4.0%
Retail Sales Growth YoY	-3.9%	-3.0%	+2.1%	+2.4%	+3.2%	+4.4%	+4.5%	+5.9%	+5.3%	+5.5%	+3.0%		
New Housing Starts	-28%	-22%	8%	-12%	24%	25%	17%	10%	11%	4%	6%		
Manufacturing PMI	42.4	53.1	53.2	52.1	50.1	55.6	56.4	56.6	54.2	50.4	54.7		

Source: Forsyth Barr analysis, Bloomberg

Figure 19. Citigroup Economic Surprise Index



Source: Forsyth Barr analysis, Citigroup Global Markets



Disclosure: The comments in this publication are for general information purposes only and do not constitute personalised financial advice. No consideration has been taken of your personal financial situation or investment goals in preparing this publication and the distribution of this publication is not a personalised service under the Financial Advisers Act 2008. If you wish to receive personalised financial advice, please contact your Investment Advisor. Forsyth Barr Limited and its related companies (and their respective officers, agents and employees) may own or have an interest in securities or other products referred to in this publication, and may be directors or officers of, or provide investment banking services to, the issuer of those securities or products, and may receive fees for acting in any such capacity in relation to that issuer. Further, they may buy or sell securities as principal or agent, and as such may undertake transactions that are not consistent with any recommendations contained in this publication. Forsyth Barr Limited and its related companies (and their respective officers, agents and employees) confirms no inducement has been accepted from the researched/recommended entity, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication or on our website. **Analyst Disclosure Statement:** In preparing this publication the analyst(s) may or may not have a threshold interest in the securities mentioned in this publication. A threshold interest is defined as being a holder of more than \$50,000 or 1% of the securities on issue, whichever is the lesser. In preparing this publication non-financial assistance may have been provided by the entity being researched. A disclosure statement is available on request and is free of charge. **Disclaimer:** This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr Limited. Accordingly, Forsyth Barr Limited: (a) does not make any representation or warranty (express or implied) that the information is accurate, complete or current; and (b) excludes and disclaims (to the maximum extent permitted by law) any liability for any loss which may be incurred by any person as a result of that information being inaccurate or incomplete in any way or for any reason. The information, analyses and recommendations contained in this publication are confidential to the intended recipients and are statements of opinion only. They have been prepared for general information purposes and whilst every care has been taken in their preparation, no warranty or representation is given (express or implied) as to their accuracy or completeness. Nothing in this publication should be construed as a solicitation to buy or sell any security or other product, or to engage in or refrain from doing so or engaging in any other transaction. This publication should not be used as a substitute for specific advice. This publication is intended to provide general securities advice only, and has been prepared without taking account of your objectives, financial situation or needs, and therefore prior to acting on any information, analysis or recommendation contained in this publication, you should seek advice from your usual Investment Advisor. Forsyth Barr Limited and its related companies (and their respective officers, agents and employees) will not be liable for any loss whatsoever suffered by any person relying upon any such information, analysis or recommendation. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations.