ANZ Research

New Zealand Weekly Data Wrap

16 June 2023

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Contact us

See page 5.

Forecast updates

Recent ANZ NZ Forecast Updates can be found here.

- NZ Forecast Update: the much-needed adjustment
- NZ Forecast Update: milk price forecasts trimmed further
- NZ Property Focus: On the floor, ready to floor it?
- NZ Forecast Update: milk price forecasts revised down

Our other recent publications are on page 2.

What's the view?

- GDP transitioning from acute supply constraints to a softening demand pulse.
- Labour market still tight, but expected to cool.
- Inflation way above target and looking sticky.
- OCR on hold at 5.50% until November 2023, then higher.

Our forecasts are on page 4.

Confused by acronyms or jargon? See a glossary here.

Key risks to our view

- Global growth and financial market risks abound, as markets debate the rates outlook.
- Soaring net migration could see house prices start to rise more quickly.
- Booming migration plus fiscal stimulus could see inflation hold up for longer.
- NZ's large external imbalances could see the market impose a more abrupt adjustment path.

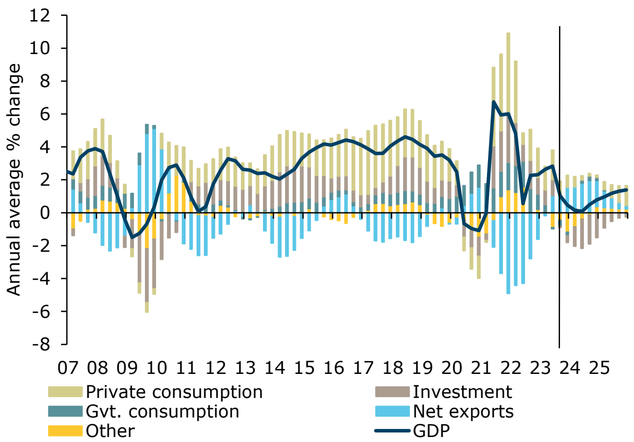
A cyclone-driven recession

The economy contracted 0.1% q/q on a seasonally adjusted basis in Q1. That was weaker than our expectation of +0.2% q/q, and the RBNZ's +0.3% q/q, but broadly in line with the median market expectation.

Migration-induced population growth is bolstering demand for goods and services and adding to the supply of labour, and both will be a positive influence on headline GDP growth. But per capita GDP growth (which came in at -0.7% q/q) shows economic conditions are quite soggy out there for the person on the street. High inflation and higher interest rates are certainly taking their toll.

Given the degree of noise in the GDP data at present, uncertain cyclone impacts, and sticky CPI inflation risks, we don't think the data will be sufficient to knock the RBNZ off the course it set in May to 'watch, worry, and wait' for a period with the OCR at 5.5%. Yes, economic momentum has very clearly softened, but some of that reflects the fact that the economy has run out of economic resource to grow. But perhaps most importantly, a slowdown is unfortunately part of the plan – a necessary correction to more sustainable macroeconomic conditions. In short, it's what the RBNZ needs to see, not a reason for them to think they've made a mistake. Further, while the starting point for GDP may be weaker than our expectation, new economic tailwinds are now emerging before annual non-tradables inflation has even turned a corner. We see upside risks to growth momentum over the second half of the year due to both strong net migration and fiscal stimulus. Now we have Q1 GDP data, we've today updated our macroeconomic outlook for these significant developments.

Figure 1. GDP forecast



Source: Stats NZ, ANZ Research

We're potentially already seeing those risks start to materialise in the housing market. REINZ data for May confirmed that the housing market is a tightening. After seasonal adjustment, sales lifted again in May, jumping back to roughly year-ago levels and prices are on the cusp of lifting. Meanwhile, houses are selling much faster than they were. The RBNZ's tolerance for housing green shoots will depend heavily on the state of the labour market. Things could go either way, but we are forecasting the RBNZ to be back at the hiking table by year-end as the domestic inflation pulse proves a little more stubborn than expected. We expect this to cap any strength in house price inflation, alongside still-stretched affordability and rising unemployment.

Looking ahead

NZ Insights and Analysis

ANZ produces a range of in-depth insights.

- NZ Property Focus: On the floor, ready to floor it?
- NZ Insight: divergence across the Tasman, recession for NZ but not for Oz
- NZ Economic Outlook: moving parts
- NZ Agri Focus: a further lift required
- NZ Insight: Inflation rotation
- NZ Insight: inflationary risks from Gabrielle
- NZ Insight: RBA/RBNZ policy divergence back in the spotlight

NZ Economic News

View latest data and policy releases

- NZ GDP: Cyclone nudges NZ into recession
- NZ REINZ housing data: strengthening
- RBNZ MPS Review: as you were
- NZ CPI Review: relatively good, absolutely bad
- NZ labour market: still super-tight in Q1
- NZ Budget 2023 brings the bonds

Click here for more.

ANZ Proprietary data

Check out our latest releases below.

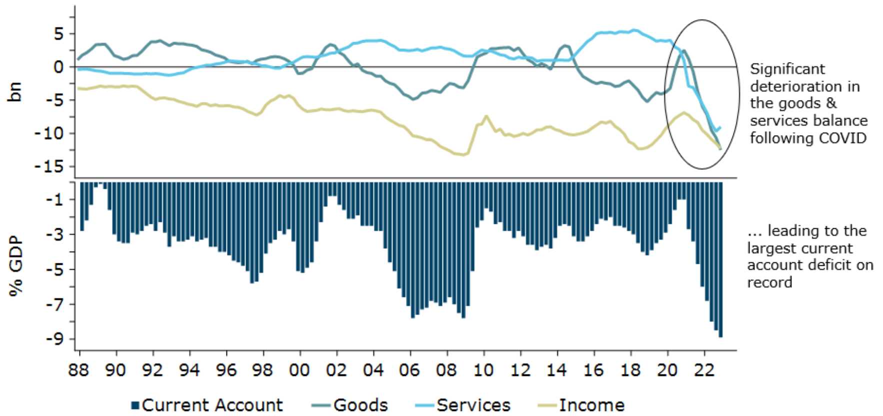
- ANZ Business Outlook
- ANZ-Roy Morgan Consumer Confidence
- ANZ Truckometer
- ANZ Commodity Price Index

Is NZ's wide current account deficit going to be a problem for the Kiwi?

In this section of the Data Wrap, we ask the question; is New Zealand's wide current account deficit going to start weighing on the Kiwi? We think that's a good question given that data revisions this week showed the deficit hit a record -9% of GDP in Q4. Although we did see an improvement in Q1, at -8.5%, it's nothing to be proud of.

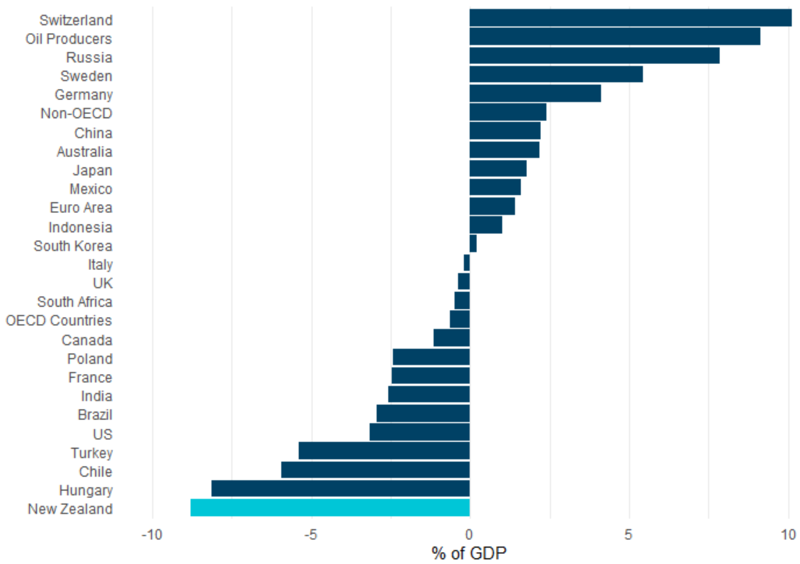
As figure 1 shows, the recent widening has been swift, making the deficit a global standout for the wrong reasons (figure 2).

Figure 2. NZ current account deficit since NZD float in 1985



Source: Stats NZ, Macrobond, ANZ Research

Figure 3. Current account deficit: NZ is a stand-out on a global scale



Source: OECD, ANZ Research

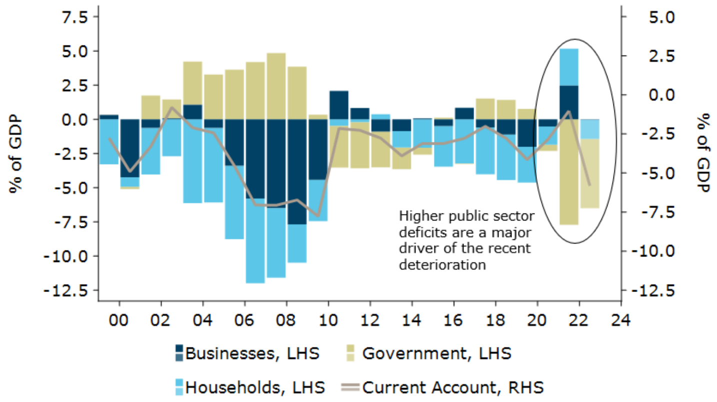
That's not to say that all current account deficits are "bad", per se. There are many fundamental factors that drive a country's current account balance, including national income, demographics, energy requirements, terms of trade volatility, financial depth, net foreign assets, fiscal settings, and the institutional environment.

Countries run deficits for many fundamental reasons, and deficits can be a positive when they are helping fund productive capital investment. A "good" deficit supports smooth transitions – for instance, building productive capacity via accumulating external debt to subsequently boost income, and in time, assets, and then drawing them down as the population ages.

A "bad" deficit is one that is driven by consumption rather than investment, occurs alongside excessive domestic credit growth, follows an overvalued exchange rate or accompanies unrestrained fiscal deficits. This can drive a loss of confidence in the currency and possible depreciation.

So what has been driving the deficits in New Zealand? Looking at the breakdown (figure 3), the widening has been driven by government 'dissaving' widening the primary income deficit, and strong spending on goods imports due to an overheated (overstimulated) economy.

Figure 4. Contribution to the annual current account deficits (calendar years)



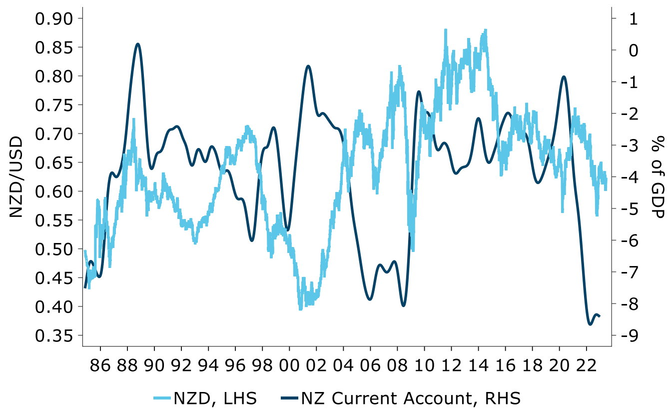
Source: Stats NZ, Macrobond, ANZ Research

The concern for New Zealand is that the recent accumulation of debt falls more into the "bad" deficit category. This might lift market concerns about a potential inability to repay accumulated external debt without a sharp economic adjustment and decline in the value of the Kiwi.

Currency implications

We often hear that countries that run persistent current account deficits tend to have weaker exchange rates. But analysis reveals that it's much more complex than that. Eyeballing the relationship between the NZD and the current account balance shows that the correlation is weak at best, and non-existent or even negative at times.

Figure 5. The NZD and current account often move in opposite directions



Source: OECD, Macrobond, ANZ Research

Note: The current account has been smoothed.

Panel regression analysis across the OECD bears this out too, with an almost-zero coefficient and low statistical significance. For the sake of brevity, we won't publish the results here, but we found that relative interest rates, relative interest rates, terms of trade, and productivity were the influential factors driving exchange rates.

Looking ahead

But that's not to say that current accounts don't matter. While there is scant evidence to tie swings in the NZD directly to swings in the current account, regression analysis and experience tells us that currency markets tend to ignore deficits until they reach a threshold, at which point they can become a major factor. In plain English: it doesn't matter until it does, and then it matters a lot.

Our research shows that currency concerns may arise if deficits become unsustainable and financial vulnerabilities rise. Whether or not the threshold for the deficit being a 'problem' for the currency is breached depends on whether:

- the deficit is persistently large,
- fuels consumption rather than investment,
- occurs alongside excessive domestic credit growth,
- follows an overvalued exchange rate, and/or
- accompanies persistent and/or unrestrained fiscal deficits.

Unfortunately, a number of these conditions currently exist in New Zealand, and that, in turn, is fuelling concerns that the currency may face a more persistent period of underperformance.

Backing up this notion, figure 2 on page 2 shows that the current account does tend to turn sharply once it reaches a certain level – with the upside bounded by zero and the downside by a range of between -8% and -10% of GDP. Of note, the deficit is in that range now, and it's the fact that we are here now that most concerns us.

That's not to say it's today's story, necessarily. Strong demand boosting import growth and widening the current account deficit is not an atypical late-cycle phenomenon, and while that may be a warning sign, it could take a long time to correct. There are also typically some currency positives late in the cycle: strong growth and rising interest rates. That potentially explains why the Kiwi sometimes appreciates even as the current account deficit is widening.

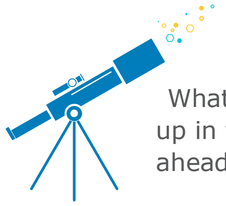
The denomination of foreign debt also matters. New Zealand's foreign debt is almost all denominated in NZD or hedged back to NZD, immunising our foreign debt from the impact of currency fluctuations.

While the point at which it will start to matter for the currency is a matter of some conjecture, our research indicates that the external imbalances are likely to have two important consequences for NZ financial markets: interest rates are likely to be higher than otherwise, and further, that NZD fair value will be lower than otherwise for a given level of interest rates (we estimate by around 1-2 cents).

A different mix of monetary conditions along those lines is all part of the necessary process of getting the economy back onto a more sustainable growth path. But it's a case of righting the ship ourselves, or having others (our offshore funders) impose the discipline on us. The deeper the recession, the faster the current account correction tends to be. But that's not the adjustment path we'd choose.

At the end of the day, the New Zealand economy isn't going to slow because the Reserve Bank has decided it needs to; it's going to slow because we have collectively been living beyond our means for some years, and that's simply not sustainable.

Financial markets update



Data calendar

What's coming up in the months ahead.

Date	Data/event
Mon 19 Jun (10:30am)	Performance Services Index – May
Wed 21 Jun (early am)	GlobalDairyTrade auction
Thu 22 Jun (10:45am)	Merchandise Trade – May
Fri 23 Jun (10:00am)	ANZ Truckometer – May
Thu 29 Jun (1:00pm)	ANZ Business Outlook – Jun
Fri 30 Jun (10:00am)	ANZ-RM Consumer Confidence – Jun
Fri 30 Jun (3:00pm)	RBNZ Sectoral Lending – May
Mon 3 Jul (10:45am)	Building Permits – May
Tue 4 Jul (10:00am)	NZIER QSBO – Q2
Wed 5 Jul (early am)	GlobalDairyTrade auction
Wed 5 Jul (1:00pm)	ANZ Commodity Price Index – Jun
Tue 11 Jul (10:45am)	Electronic Card Transactions – Jun
Wed 12 Jul (10:45am)	Net Migration – May
Wed 12 Jul (2:00pm)	**RBNZ MPR**
Thu 13 Jul (10:45am)	Food Price Index – Jun
Thu 13 Jul (10:45am)	Rental Price Index – Jun
Mon 17 Jul (10:30am)	Performance Services Index – Jun
Wed 19 Jul (early am)	GlobalDairyTrade auction
Wed 19 Jul (10:45am)	**CPI – Q2**
Mon 24 Jul (10:45am)	Merchandise Trade – Jun
Tue 25 Jul (10:00am)	ANZ Truckometer – May
Fri 28 Jul (10:00am)	ANZ-RM Consumer Confidence – Jul
Mon 31 Jul (1:00pm)	ANZ Business Outlook – Jul
Mon 31 Jul (3:00pm)	RBNZ Sectoral Lending – Jun
Tue 1 Aug (10:45am)	Building Permits – Jun
Wed 2 Aug (early am)	GlobalDairyTrade auction
Wed 2 Aug (10:45am)	**Labour Market – Q2**

Interest rate markets

Both short and long-end interest rates have had a volatile week as they reacted to data and central bank decisions. Confirmation that New Zealand was in recession over Q4 and Q1 has naturally weighed on OCR expectations, but policy expectations in Australia, the UK and Europe are firming, posing risks in the opposite direction for short-end rates. Adding to the confusion, while the Fed "skipped" a hike this week, it published a hawkish set of projections implying two more hikes, only for chair Powell to adopt what markets perceived as a dovish tone at the post-FOMC press conference. We continue to expect one more OCR hike (if not two) here by year-end, and thus see upside risks to short-end rates. However, there's a lot of water to flow under the proverbial bridge between now and November, and this week is demonstrative of the volatility we might continue to see. Local long-end rates made new highs for the quarter and markets are wary of the volume of bonds that needs to be absorbed when the new fiscal year begins in July. Although NZ long-end bond yields have come back in the past 24hrs as US yields have corrected lower, and are the most attractive rates in the G10, we continue to see upside risks to them too.

FX markets

The Kiwi is at the week's highs today, thanks largely to USD weakness and the downward correction in US interest rates. Although we are fearful of the negative implications of New Zealand sporting a recession label and the wide current account, going the other way, the USD is itself experiencing a correction. As in interest rate markets, we expect these conflicts to create ongoing volatility.

Key data summary

Electronic Card Transactions – May. Fell 1.9% m/m, the first fall in nominal spending this since February.

Net Migration - April. Monthly net migration inflows slowed to 5800. The annual total rose to 72,300.

Current Account Balance – Q1. The annual current account deficit narrowed more than expected to 8.5% of GDP. See our review.

Food Price Index – May. The index rose 0.3% m/m.

Rental Price Index – May. The stock measure of rents rose 0.3% m/m.

REINZ House Prices – May. On a seasonally adjusted basis, house prices were unchanged while sales picked up.

GDP – Q1. The economy contracted 0.1%q/q. See our review.

Performance of Manufacturing Index – May. A slight improvement to 48.9, but still in contractionary territory.

The week ahead

Performance Services Index – May (Monday 19 June, 10:30am). In April, the index slipped into contractionary territory.

GlobalDairyTrade auction (Wednesday 21 June, early am). Prices are expected to stabilise as lighter offerings help offset negative market sentiment driven by the weaker China economy.

Overseas Merchandise Trade – May (Thursday 22 June, 10:45am). We've pencilled in a deficit of $100million for May as imports remain strong whilst exports ease back due to downward pressure on prices.

ANZ Truckometer – May (Friday 23 June, 10:00am).

Key forecasts and rates

FX rates	Actual Apr-23	May-23	Today	Forecast (end month) Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
NZD/USD	0.618	0.601	0.624	0.620	0.620	0.630	0.650	0.650	0.650
NZD/AUD	0.935	0.927	0.906	0.912	0.912	0.900	0.903	0.890	0.890
NZD/EUR	0.561	0.562	0.570	0.559	0.554	0.553	0.560	0.551	0.542
NZD/JPY	84.3	84.1	87.4	80.6	78.7	78.1	79.3	78.0	76.7
NZD/GBP	0.492	0.486	0.488	0.488	0.484	0.485	0.492	0.485	0.478
NZ$ TWI	70.4	69.9	71.4	69.6	68.8	68.7	70.0	69.4	69.0
Interest rates	**Apr-23**	**May-23**	**Today**	**Jun-23**	**Sep-23**	**Dec-23**	**Mar-24**	**Jun-24**	**Sep-24**
NZ OCR	5.25	5.50	5.50	5.50	5.50	5.75	5.75	5.75	5.75
NZ 90 day bill	5.56	5.69	5.68	5.60	5.77	5.85	5.85	5.85	5.68
NZ 2-yr swap	5.05	5.20	5.35	5.42	5.48	5.21	4.97	4.73	4.48
NZ 10-yr bond	4.09	4.29	4.46	4.50	4.40	4.30	4.00	4.00	4.00

Economic forecasts

	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
GDP (% qoq)	-0.1	**0.4**	**-0.1**	**-0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.4**
GDP (% yoy)	2.2	**1.1**	**-0.5**	**0.0**	**0.4**	**0.3**	**0.7**	**1.2**	**1.3**
CPI (% qoq)	1.2	**0.9**	**1.9**	**1.0**	**0.9**	**0.5**	**0.9**	**0.5**	**0.6**
CPI (% yoy	6.7	**5.9**	**5.6**	**5.2**	**4.8**	**4.5**	**3.4**	**2.9**	**2.6**
Employment (% qoq)	0.8	**0.4**	**0.0**	**-0.2**	**-0.1**	**0.0**	**0.2**	**0.2**	**0.2**
Employment (% yoy)	2.4	**3.0**	**1.8**	**1.1**	**0.2**	**-0.3**	**-0.1**	**0.3**	**0.6**
Unemployment Rate (% sa)	3.4	**3.5**	**3.9**	**4.2**	**4.5**	**4.7**	**4.8**	**4.9**	**5.0**

Figures in bold are forecasts. mom: Month-on-Month; qoq: Quarter-on-Quarter; yoy: Year-on-Year. **Click here for full ANZ forecasts**

Figure 6. GDP level

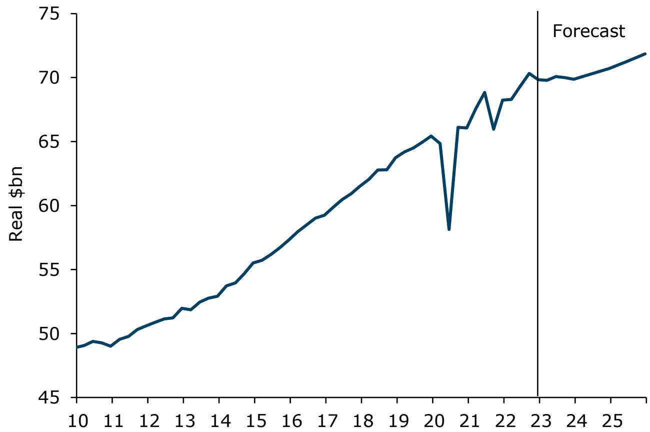


Figure 7. CPI inflation components

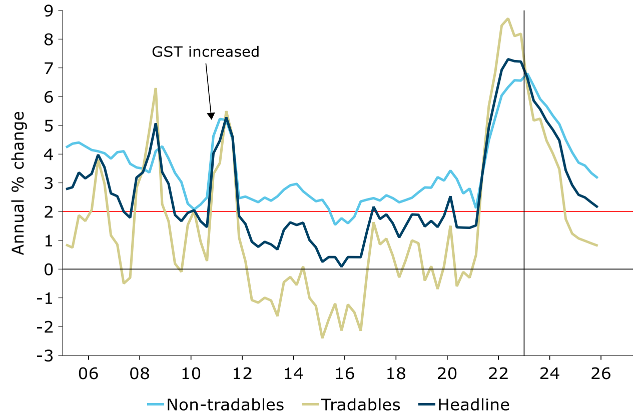


Figure 8. OCR forecast

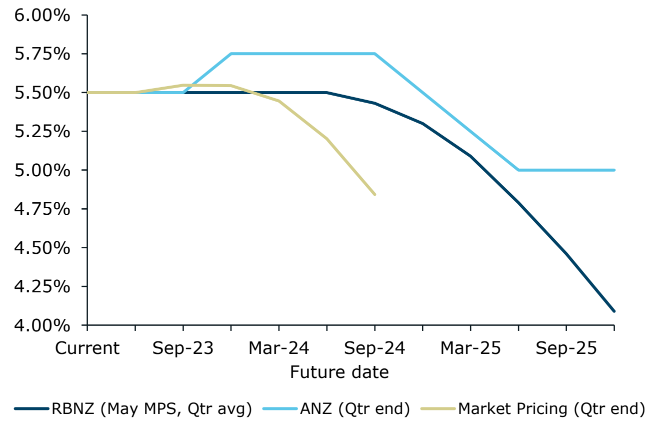
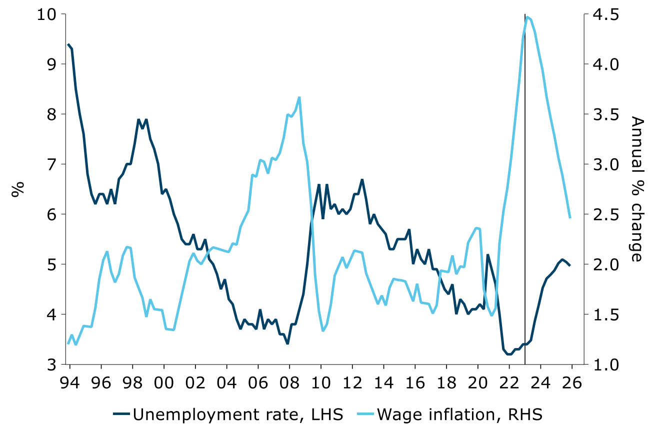


Figure 9. Unemployment and wage inflation



Source: Stats NZ, Bloomberg, RBNZ, Macrobond, ANZ Research

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