

New Zealand Economic Watch

GDP Preview: Bad news are good news

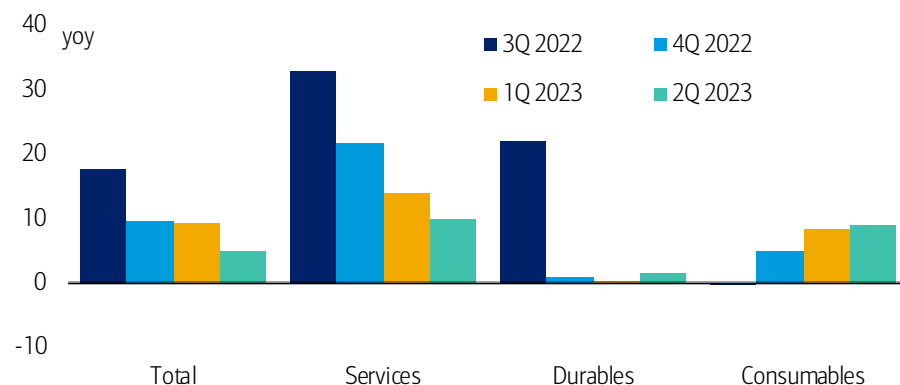
Growth slows further in 2Q

As restrictive policy continues to gain traction, economic momentum softens in New Zealand. GDP data for 2Q will be released on September 20th and we estimate a soft 0.3% qoq rise that would push annual growth down to 1% from 2.2% yoy. While growth remains subdued, a rise in GDP in the June quarter follows a modest contraction in 1Q and suggests rate hikes along with soft global conditions are working their way to address the supply-demand imbalance in the domestic economy.

While we and the Reserve Bank of New Zealand (at 0.5% qoq) expect an expansion in the quarter, this is due to a temporary rise in good exports along with the ongoing recovery in services exports. Consumption, which had proved more resilient than expected, has weakened sharply as reflected in card spending data.

Exhibit 1: Card spending data weakens

Services consumption falls



Source: Macrobond, StatsNZ

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Wider fiscal deficits and higher debt

The Government has published a Pre-Election Economic and Fiscal update ahead of the General Election due on October 14th. The deterioration in economic conditions is reflected in wider deficits as revenues disappointed relative to Budget. The Government now estimates a return to surplus in 2026-27, a year later than anticipated. In the Government's view, high interest rates are driving a sustained period of soft economic growth that is necessary to reduce inflationary pressure.

The forecast 2023-24 New Zealand Government Bond (NZGB) programme has been increased to NZ\$36bn, NZ\$2bn higher than published at the Budget. The forecast NZGB programmes for 2024-25 and 2026-27 have also been increased, by NZ\$3bn and NZ\$4bn respectively. The forecast for the 2025-26 year is unchanged. We see downside risks to our year-end forecast of 0.59 for NZD/USD and expect a gradual trend higher in AUD/NZD towards 1.10.

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Growth is weaker under the surface

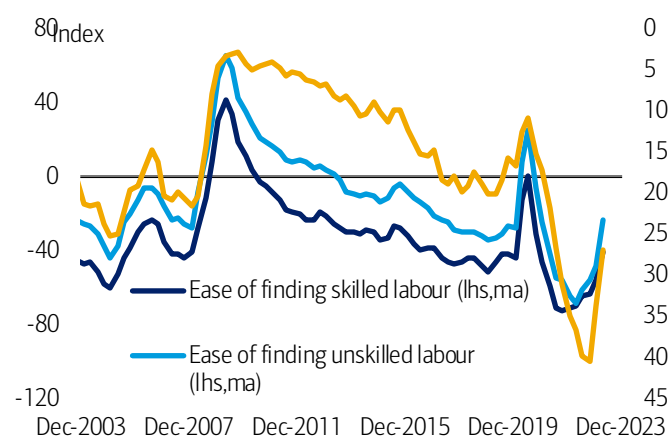
A one-off rise in export volumes combined with softer prices has temporarily boosted growth in 2Q. Also, activity indicators suggest that growth recovered slightly over the June 2023 quarter. The ongoing improvement in demographics is supporting demand and easing labour supply constraints (Exhibit 2). Indeed, overseas visitors coming in with working visas rose sharply since the reopening of the international border (Exhibit 3). This has also boosted demand for housing.

The RBNZ notes that while residential construction has been higher than anticipated, dwelling consents have fallen rapidly this year (Exhibit 4). This is consistent with current high mortgage interest rates, high construction costs and lower house prices relative to their peak in November 2021. The latter adds to the case for weaker growth in 2H 2023, in our view. Private investment is expected to make a modest positive contribution to growth as backlogs ease and some post-natural disaster capital work is completed.

The external sector is expected to have made a large positive contribution to growth in 2Q though the outlook isn't as bright as global demand slows. For 2Q, International trade data suggests a strong rise in goods and services exports while export prices have weakened (Exhibit 5), reflecting softening global demand and increased supply. Notably, the volume of dairy products exported has increased due to exceptionally good pasture growth conditions in parts of New Zealand over the first half of 2023. This is unlikely to persist beyond 2Q.

Exhibit 2: Measures of labour supply constraints are improving

Yet remain elevated

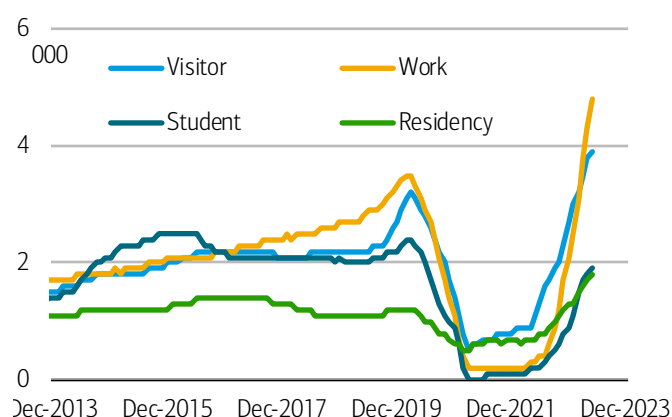


Source: Macrobond

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Exhibit 3: Visitors by visa type

Working visas rise sharply



Source: RBNZ

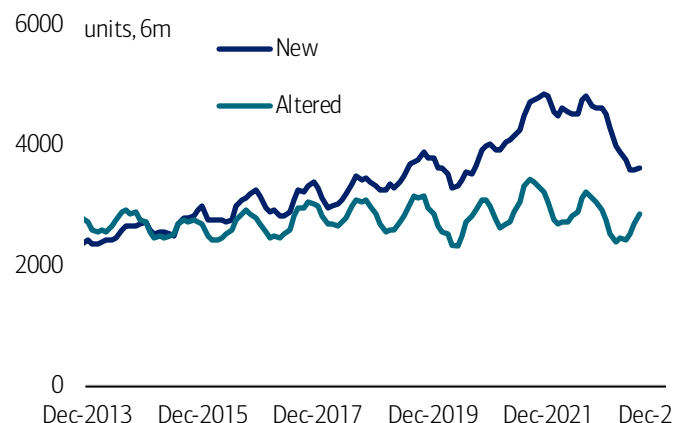
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Lastly, infrastructure investment is expected to have risen in 2Q as repair work associated with the severe weather events in the North Island in early 2023 continues. However, fiscal policy is more likely to be contractive going forward to ensure inflation continues to trend downwards and the fiscal profile does not deteriorate sharply enough to trigger a rating downgrade.

Overall, while various sectors will contribute to growth in the June quarter, we would expect weaker conditions in the 2H of 2023. High interest rates for longer along with fiscal tightening means the economy is likely to contract for the rest of the year. We see GDP averaging 0.9% yoy in 2023.

Exhibit 4: Building permits

Have fallen rapidly this year

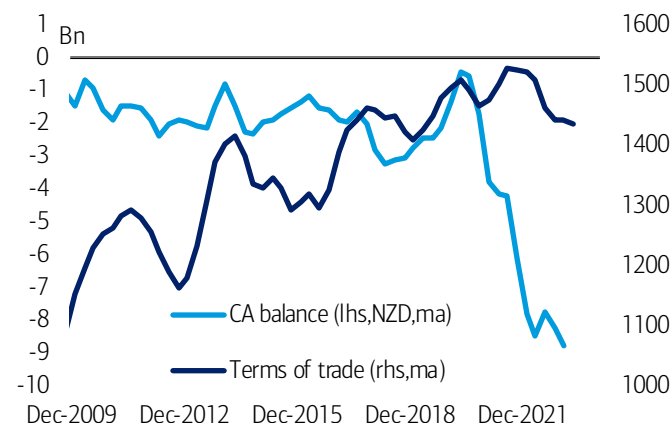


Source: Macrobond

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Exhibit 5: Current account deficit widens

But the terms of trade move sideways



Source: StatsNZ

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Wider fiscal deficits

New Zealand Treasury released its Pre-election Economic and Fiscal Update 2023, which shows some deterioration in New Zealand's fiscal profile. The deficit was upgraded to NZ\$11.4bn from NZ\$7.6bn back in May. Net debt will now peak at 22% of GDP versus 18% at budget time. Weaker global economic conditions particularly in China and the response of the domestic economy to monetary tightening, is a key risk to the fiscal outlook.

Tax revenues have undershot expectations and are the main driver of weaker results for the fiscal position in the current fiscal year and across the forecast period. In addition, the Government's recently announced fiscal sustainability measures and higher expenses, have delayed the return to surplus in the 2026-27 fiscal year, one year later than previously forecast. Assumptions for tax revenue are lower than previously expected by NZ\$3.5bn over the forward estimates. Meanwhile operating expenses remain elevated in the current fiscal year and are NZ\$6.9bn higher across the forecast period than anticipated.

The Government notes that elevated expenses largely reflect decisions at Budget 2023, the rephasing of unused spending from the 2022-23 fiscal year, the response to the North Island weather events, and the increasing costs of debt servicing. Beyond the 2023-24 fiscal year, operating expenses gradually decline to 31.4% of GDP because of the Government's recently announced spending management measures. Residual cash deficits are forecast in all years, leading to a cash shortfall that will be largely covered by additional borrowings and a reduction in financial assets.

Currency implications:

As we approach the end of tightening cycles for most G10 central banks, we expect the focus for FX markets to shift to growth differentials and potential easing cycles in 2024. To the extent the RBNZ began its tightening cycle earlier than most central banks and with the official cash rate (OCR) at highly restrictive levels, the weak mix of growth described above is likely to weigh on the currency, in our view. Meanwhile the current account deficit of 8.5% of GDP remains elevated despite some recent narrowing, with the income deficit likely to continue widening against a backdrop of higher rates. This keeps NZD vulnerable to any global risk-off episodes and even if China surprises positively as our economists hope, the AUD is better positioned to benefit than NZD. We see downside risks to our year-end forecast of 0.59 for NZD/USD and expect a gradual trend higher in AUD/NZD towards 1.10.

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