

New Zealand Macroeconomic Outlook

Overview by PwC Treasury Advisory

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November 2019



New Zealand macroeconomic summary and outlook

New Zealand's economic backdrop has continued to weaken across a number of key metrics over the past year, as forewarned in our March update. Business confidence remains close to decade lows, while GDP growth and inflation have continued to decline. This has driven the RBNZ (and many other global central banks) to loosen monetary policy further in an effort to reignite economic activity and assist higher inflation outcomes. Tighter credit availability as a result of expected regulatory changes is also likely to have a negative impact on credit growth, business confidence and real GDP growth.

For the time being, consumer confidence, household spending, unemployment and commodity prices all remain at relatively healthy levels and are providing vital support to the economy. The housing market has also avoided a sharp downturn thus far. There are early signs of lower interest rates supporting housing (hence consumer). However, should consumer spending weaken over the coming months (for example on higher unemployment), a wider and more rapid economic slowdown would be likely. This remains a key unresolved risk.

The international economic backdrop has also continued to weaken, driven by a range of political and economic uncertainty. Some signs of stability are starting to emerge (at low levels). Given the relatively small size of New Zealand's economy - and reliance on international trade - this uncertainty is also having negative flow on effects.

At a glance...

Int'l outlook



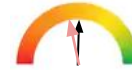
Weakening global outlook dampening NZ growth

Business confidence



At very depressed levels and little sign of material improvement

Consumers



Key factor (as to whether activity holds up)

Housing market



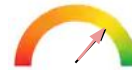
House price inflation soft but positive (ex-Auckland). Possibly could improve

Labour market



Unemployment remains low, but wage growth modest

Commodity prices



Remain firm and providing vital boost to the economy

Inflation



Below RBNZ's 2% midpoint target, expectations lower

Monetary policy



RBNZ likely to cut OCR by further 50bps from here

Credit growth



Availability/capacity concerns key risk.

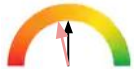
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New Zealand macroeconomic summary and outlook



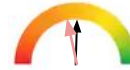
Business confidence

- Business confidence in New Zealand has continued to fall over the course of 2019 and remains at close to its lowest level since the financial crisis.
- This depressed confidence has not yet fully transpired into underlying economic activity, albeit GDP growth has continued to ease towards 2.0%.
- A mixture of political, economic, and regulatory uncertainty is driving these low levels of confidence and may persist for some time yet. **Downside risks to the economic growth outlook over coming quarters remains.**



Labour market

- The labour market remains reasonably tight and employment indices at healthy levels, although weakness in manufacturing employment is starting to translate from a weaker manufacturing sector.
- Wages have continued to rise at a modest pace, but not as fast as employment suggests. **This suggests a bit of slack in the labour market.**



Consumers

- Consumers have remained more upbeat than businesses over recent months, reflected by still robust levels in consumer confidence surveys and willingness to purchase major household items.
- Clouds have started to appear on the horizon as retail sales track wider GDP growth lower with overall economic sentiment and perhaps employment prospects weighing. Potential signs of improvement in house price inflation may help.
- **Outlook for consumer confidence/spending a key determinant for economy over 2020.**



Housing market

- House price inflation has been reasonably subdued across most of the country, with Auckland seeing the weakest growth over the past year.
- **Risks to the housing market are balanced with lack of supply, foreign buyer ban, RBNZ regulatory capital requirements, slowing inward migration, while lower interest rates may be starting to help.**

New Zealand macroeconomic summary and outlook



Commodity prices

- Firm commodity prices continue to provide decent support for the wider economy as reflected in the strong terms of trade.
- Milk prices are expected to increase slightly this year, however, farmers face elevated uncertainty with tightening environmental standards.
- **Weaker trading partner growth remains a key risk for commodity prices and NZ exports.**



Inflation

- Underlying inflation continues to track sideways, despite non-tradable inflation rising to its highest level since 2009 (including administered costs). Inflation expectations continue to decline on a two year ahead basis which should support further OCR cuts by the RBNZ over coming meetings.
- **Strong competition and weaker growth outlook continues to make it harder for businesses to increase prices, meaning slower rising consumer prices.**



Implications for growth and monetary policy

- The RBNZ surprised the market by cutting interest rates by 50 bps at its August meeting, taking the OCR to 1.00%. With the growth and inflation outlook continuing to weaken, we expect the RBNZ will cut interest rates by 25 bps at its November meeting, and by another 25 bps in February, taking the OCR to 0.50%. The risk of further cuts and unconventional monetary policy cannot be discounted, but are arguably slightly less of an acute risk now than a month or so ago. Potential impact of RBNZ capital requirements review (and uncertainty created) remains a key downside risk mainly around the availability of credit to certain sectors.
- The pace of GDP growth has almost halved from around 4% yoy in 2016 to 2.1% in June 2019 and the slowing has been broad based. Tailwinds don't show any meaningful signs of picking up with annual real GDP growth at around the 2% level in coming quarters and possibly slightly below by Dec 19/Mar 20. This is weak relative to historical standards and weak relative to population growth (per capita).

Market trends

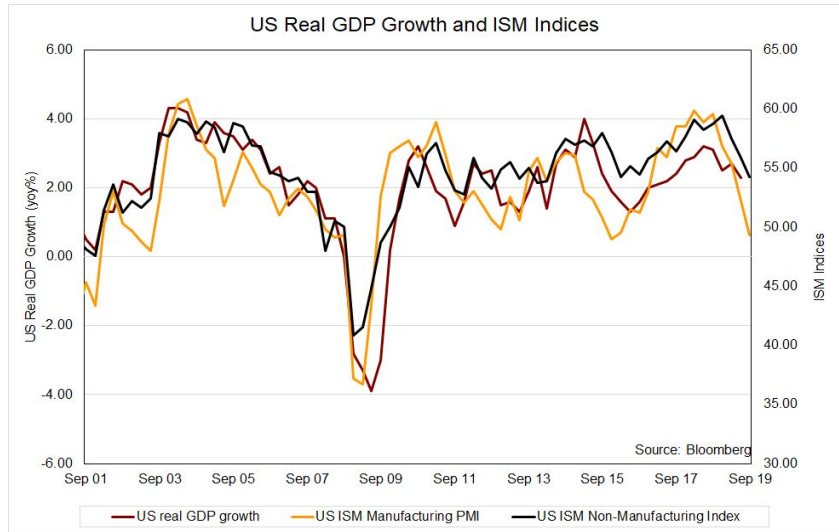
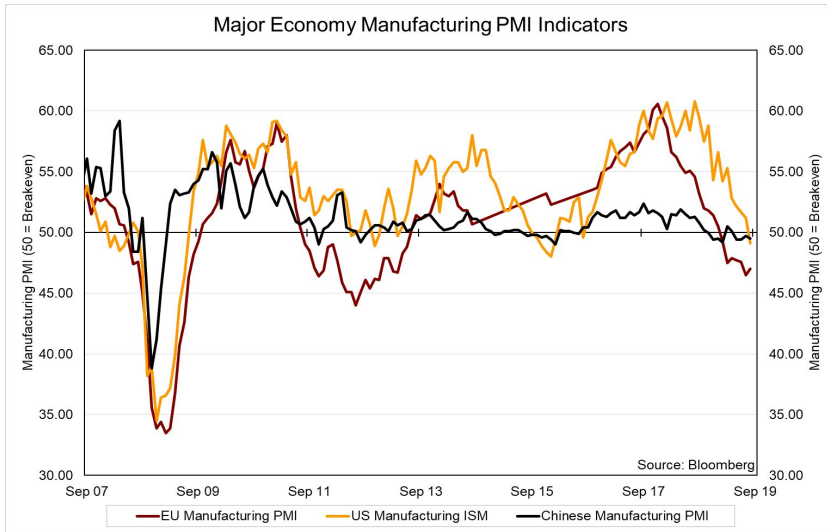
01. International outlook

Key takeaways: The pace of global economic activity has continued to slow, with manufacturing indicators turning negative for a number of major economies including the US, EU, and China. In contrast, global services indicators and retail sales have held up reasonably well so far over 2019, with the strength of the consumer being a vital cog in keeping the global economy growing at present.



Global economic activity continues to slow

The pace of global economic activity continues to slow, with manufacturing indicators turning negative for a number of major economies including the US, EU, and China. Political and economic uncertainty has been a major driver of these negative indicators over the course of 2019; the ongoing and escalating US-China trade war has dampened trade volumes, business investment and business confidence, and disrupted supply chains. Potential signs of stability at low levels may be emerging. On a more positive note, global services indicators and retail sales have held up reasonably well so far over 2019, with the strength of the consumer being a vital cog in keeping the global economy growing at present. Inflation has remained modest to stubbornly low across many major economies, which has motivated central banks to maintain record low interest rates (with outlook lower).



Market trends

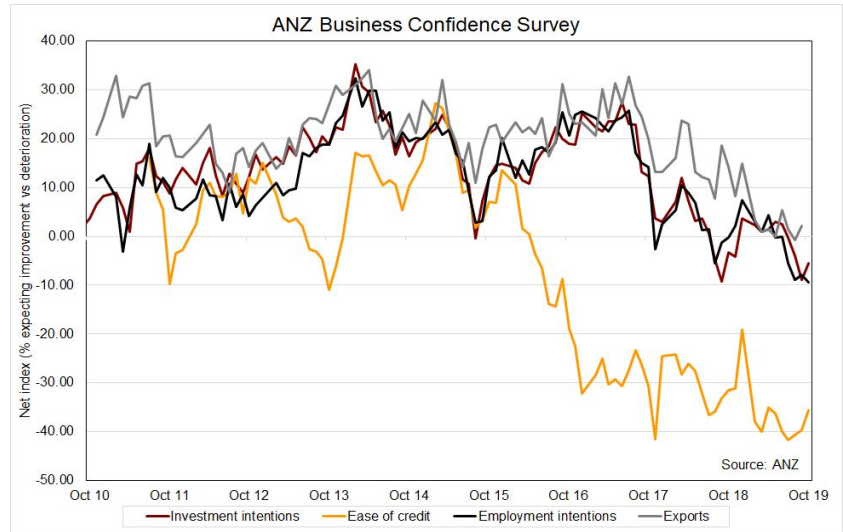
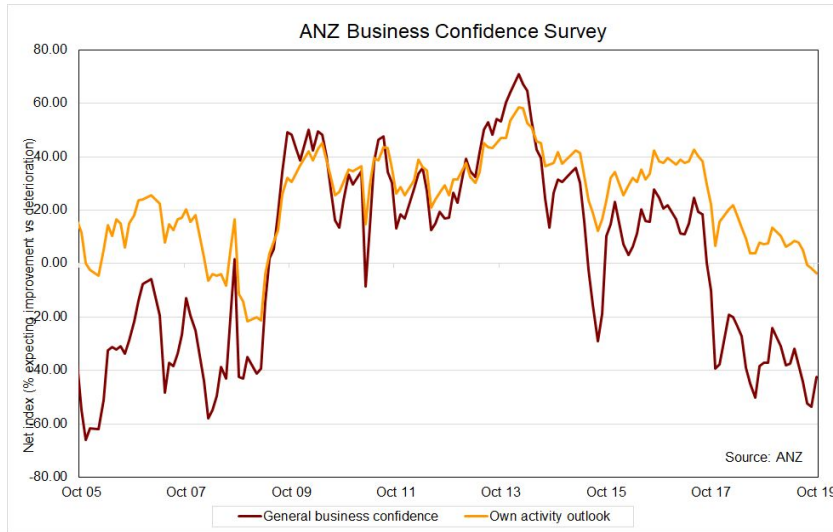
02. Business confidence

Key takeaways: Business confidence in New Zealand has continued to fall over the course of 2019 and sits at levels seen during the financial crisis a decade ago. This depressed confidence has not yet fully transpired into underlying economic activity, albeit GDP growth has continued to ease towards 2.0%. A mixture of political, economic, and regulatory uncertainty is driving these low levels of confidence and may persist for some time yet. The impact of the RBNZ Capital Requirements review remains a key risk/uncertainty weighing on businesses.



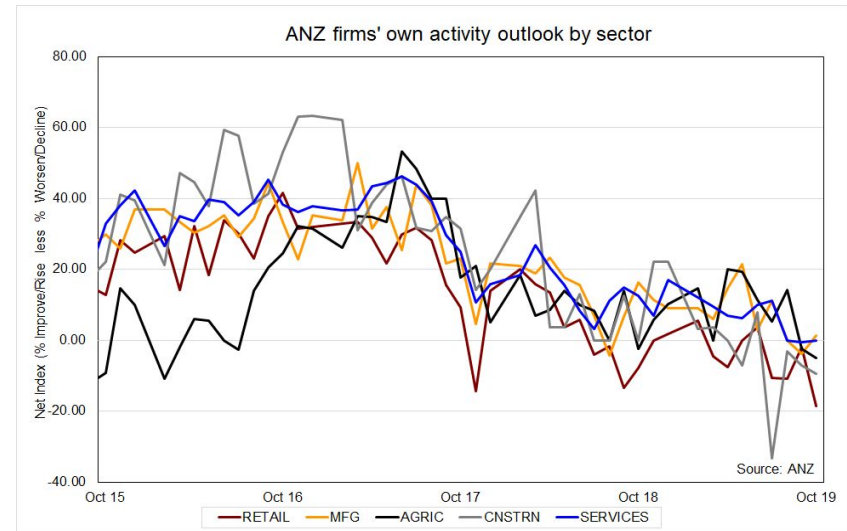
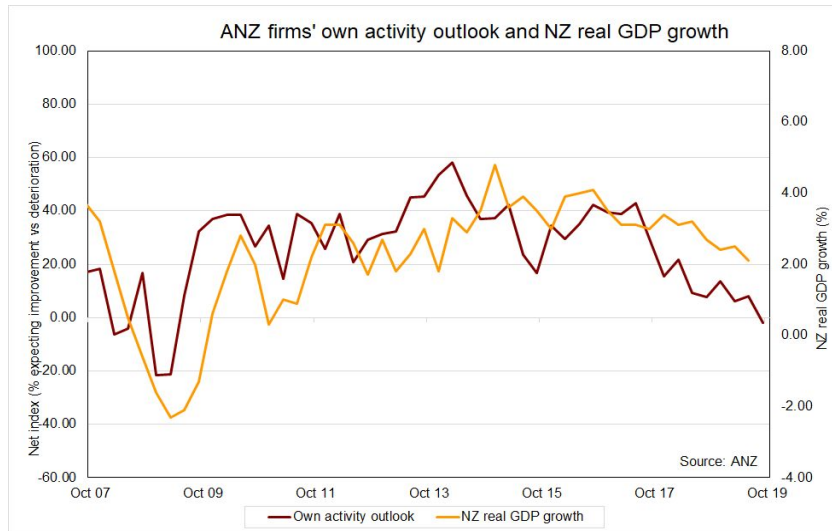
Business confidence at lowest level since financial crisis

Business confidence remains deeply negative, falling to -42.4 in October despite a minor improvement compared to September. This level of business pessimism is at similar levels to that seen during the financial crisis a decade ago. Whether the negativity is feeding on itself or is being driven by new or deeper fundamental concerns is difficult to tell, but there is no doubt that businesses are pessimistic about the economic outlook. There appears to have been no clear initial boost to business sentiment from the RBNZ's 50 basis point cut to the OCR in August. Indeed, it seems that businesses were somewhat spooked by the larger than expected rate cut rather than being buoyed by it (as seen in the aforementioned lower business confidence levels). Many of the sub indices have all declined as well (bottom right chart), with tighter bank lending restrictions seeing the 'ease of credit' measure remain at very subdued levels.



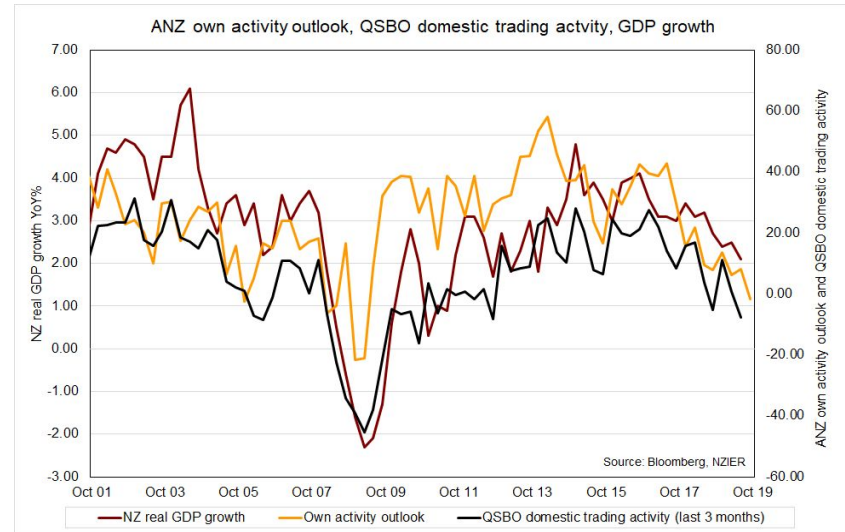
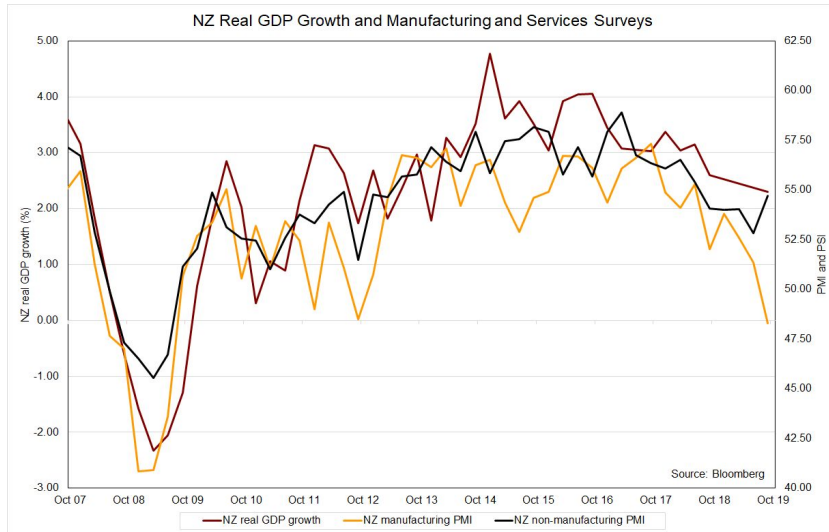
Decline in firms' own activity outlook is more concerning

The outlook for firms' own activity declined to -3.5 at October, the lowest level since the financial crisis. This has been a broad based decline seen across multiple sectors (bottom right chart). The decline in 'own activity' is arguably more concerning than the decline in 'general business confidence' as it is a more accurate measure of business activity (given survey respondents know their own businesses more intimately). The correlation between the 'own activity' survey response and GDP growth is much stronger than against 'general business confidence' (as shown by the bottom left chart). This indicates that GDP growth will likely continue slowing from here over coming quarters.



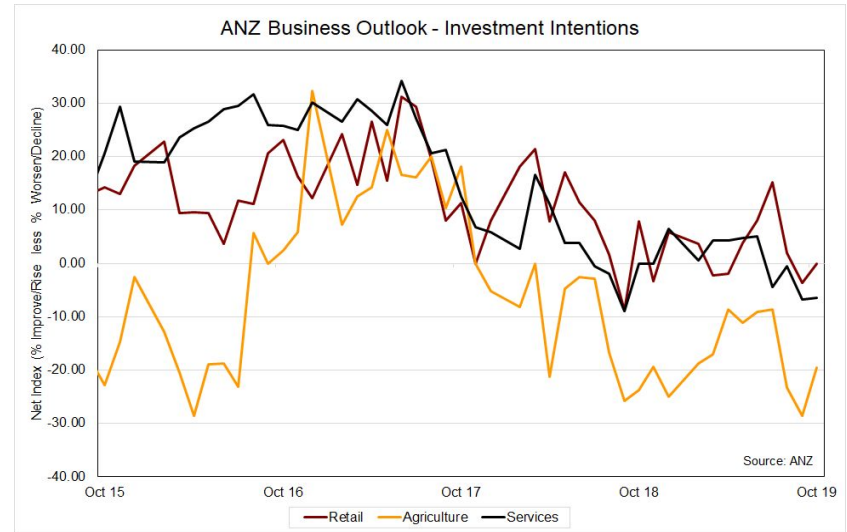
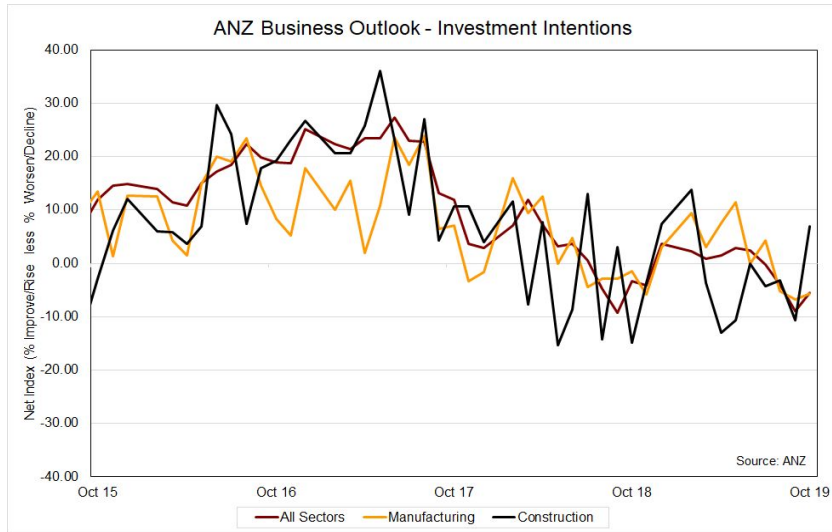
Manufacturing continues to weaken; services holding up better

An assessment of the Purchasing Managers Indices (PMIs) and the Quarterly Survey of Business Opinion (QSBO) also shows a continued weakening of economic activity, although this has been more pronounced in the manufacturing sector (and domestic trading activity) as opposed to services. These declining trends are consistent with what is being seen around the globe (US, Europe, China). A key risk to the NZ economy is whether this decline in manufacturing spills over into the services sector, which would likely have a bigger impact on GDP growth.



Business investment intentions trending downwards

Business investment intentions as measured by the ANZ Business Outlook survey have broadly continued trending downwards over the past couple of years, with all sectors in negative territory at the end of October with the exception of Construction and Retail (the latter flat at net 0%). This is despite a minor improvement in investment intentions over October. Agriculture has been the biggest negative contributor as new environmental regulations have created uncertainty for farmers. Overall, we would expect weaker business investment intentions to lead to a slowing in economic activity as businesses are more hesitant (less able) to deploy capital in productive activities.



Market trends

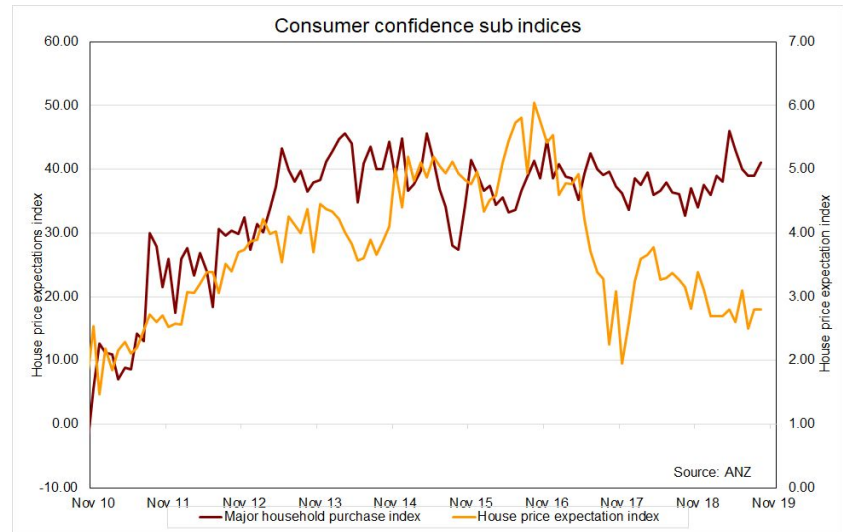
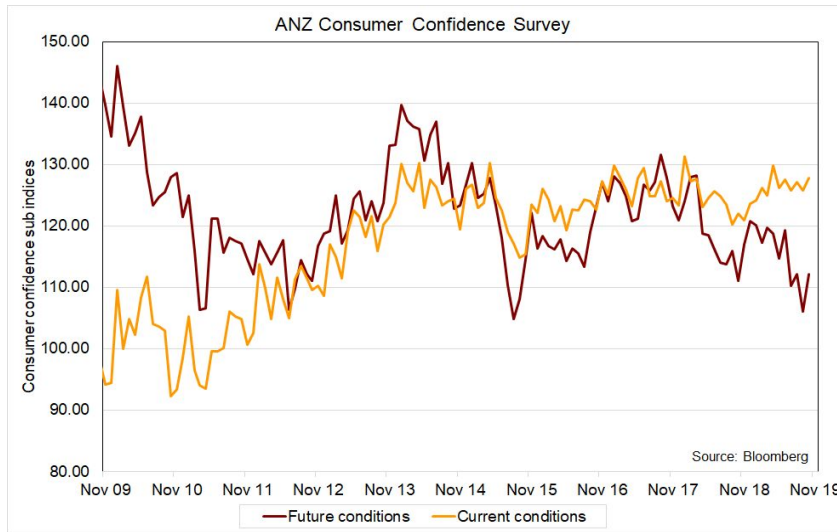
03. Consumers

Key takeaways: Consumers have remained more upbeat than businesses over recent months, reflected by relatively robust levels in consumer confidence surveys and willingness to purchase major household items. Clouds have started to appear on the horizon as retail sales track wider GDP growth lower with overall economic sentiment and perhaps employment prospects weighing. There are potential signs of improvement in house price inflation. These factors remain key determinants of the outlook.



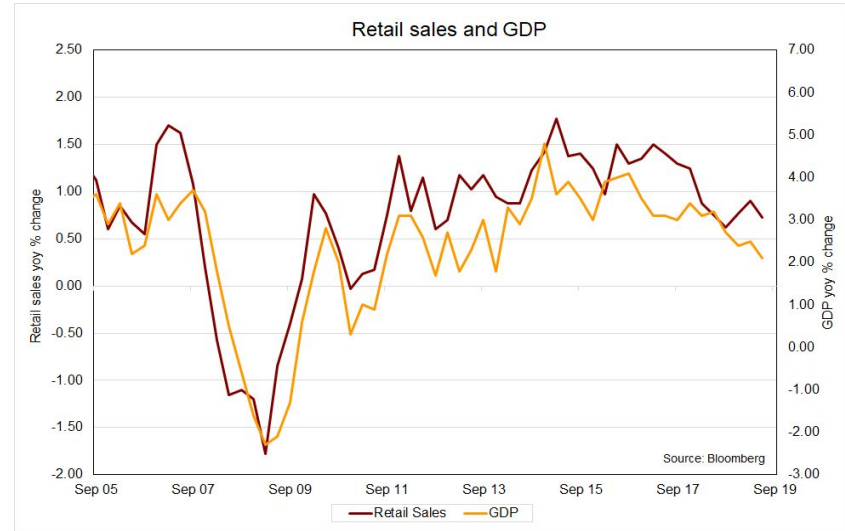
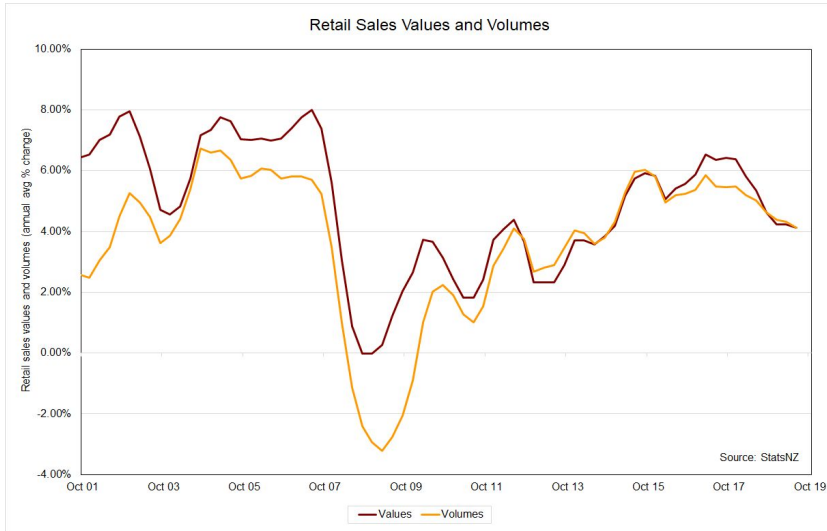
Consumers remain reasonably upbeat, but clouds on the horizon

Households' expectations about the future have been declining, following a similar downward trend to that seen in business confidence. We would expect to see this downward trend start flowing through into 'current conditions' over coming months, but for now this metric is looking robust by historical standards (bottom left chart). Similarly, the major household purchase index remains at a healthy level, while house price expectations have diminished over the past couple of years, the latter driven by a combination of factors such as tighter LVR and foreign buyer restrictions.



Consumer spending continues to weaken

Growth in retail sales growth continues to slow across the economy, echoing company reports from retailers who have signalled a slowdown in same-store sales growth. This closely correlates to the slowdown being seen in wider GDP growth across the economy. Industry group Retail NZ's June-quarter survey, published at the start of August, showed that 58 percent of respondents didn't meet their sales targets for the period – the weakest since the survey began mid-2015. Softening house prices have also likely been dampening the household wealth effect, causing consumers to spend slightly less. The impact of lower interest rates on housing and the consumer is important.



Market trends

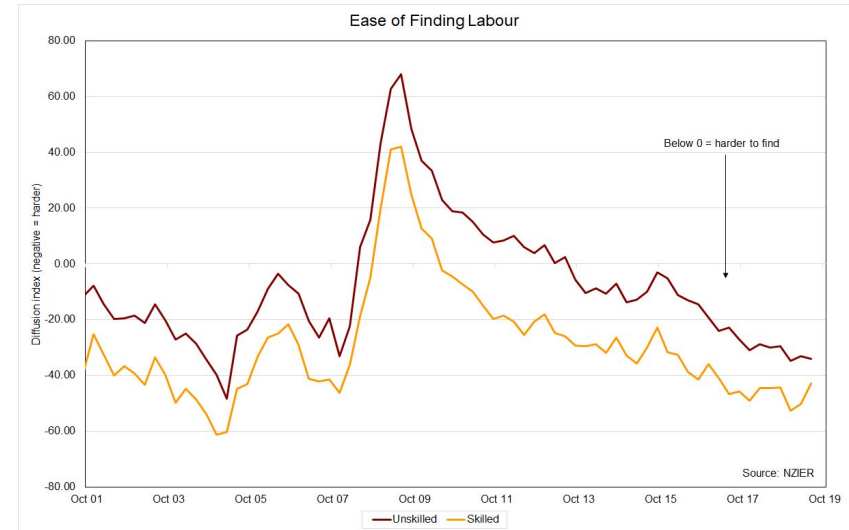
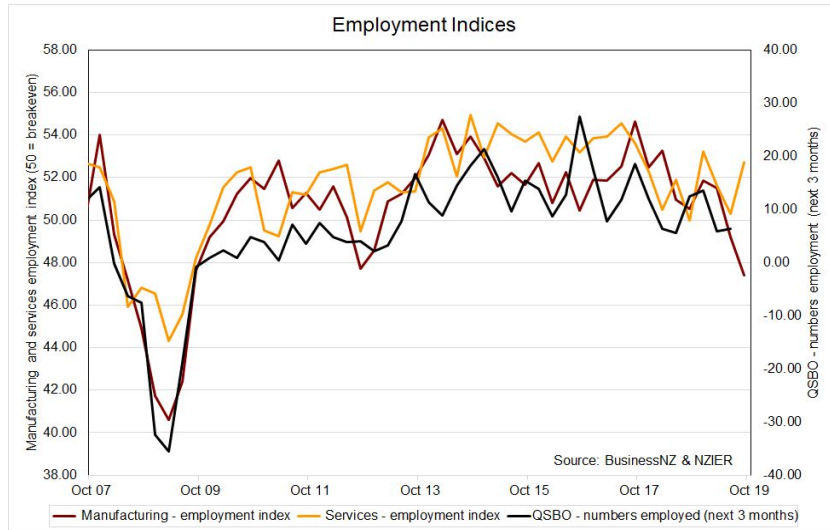
04. Labour market

Key takeaways: The labour market remains reasonably tight and employment indices at healthy levels, although weakness in manufacturing employment is starting to translate from a weaker manufacturing sector. Wages have continued to rise at a modest pace, but not as fast as employment suggests. This indicates a bit of slack left in the labour market.



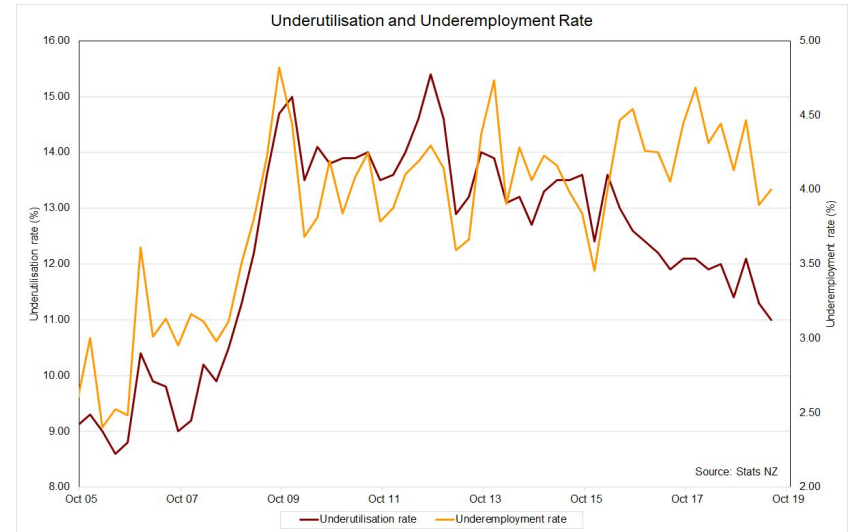
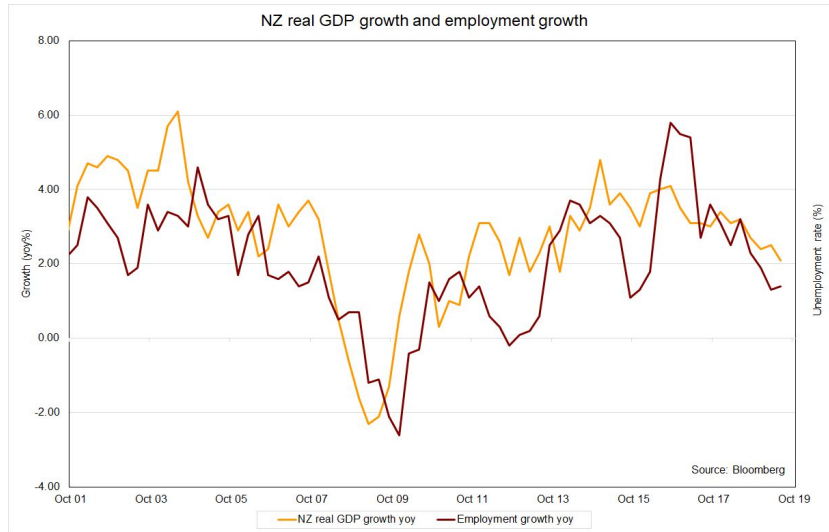
Employment indicators mainly robust; manufacturing the exception

The Manufacturing PMI has started indicating a softening in employment prospects within the sector, consistent with the overall decline being seen in manufacturing activity. Meanwhile, the services employment index has been variable, but currently points upwards, while the QSBO survey (numbers employed) is beginning to trend downwards. Overall the labour market has been pretty tight with strong employment prospects, translating into a degree of difficulty for businesses in finding both skilled and unskilled labour, however immediate prospects look on the weaker side (lagging slowdown in other indicators).



Employment growth slowing alongside wider economy

The wider economic slowdown is also being seen in employment growth, which is now close to an annual rate of 1.5%, down from nearly 6% a few years ago. Underemployment and underutilisation have been falling recently but remain above their pre financial crisis levels, suggesting there is still slack left in the labour market.

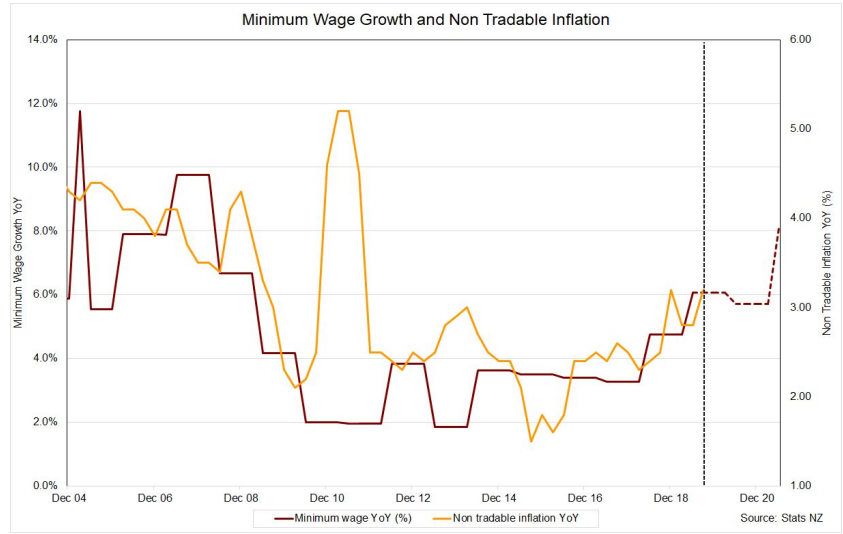
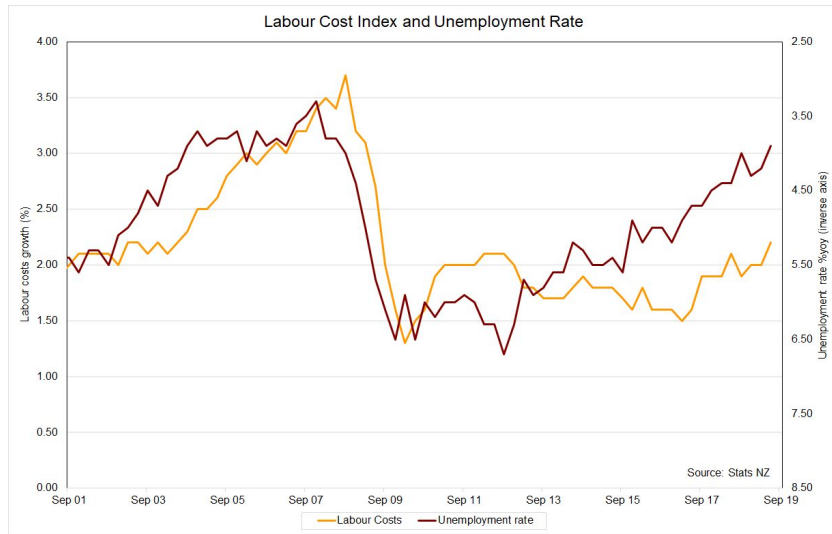


Underemployment = those who are employed part-time (working less than 30 hours a week) and have both the desire and availability to increase the number of hours they work.

Underutilisation = available (underemployed), unemployed and potential labour force.

Wage increases not keeping pace with declining unemployment

Wages have only been lifting gradually despite the labour market remaining tight and unemployment at an 11-year low. Should slack in the labour market open up due to weakening economic indicators, further increase in the minimum wage could end up becoming an additional drag on employment growth. However, further minimum wage increases by the government were made conditional on the economic situation for that reason. If employment growth falls as fast as some of the indicators suggest, the drag on economic growth would be significant, mainly through lower household sentiment and incomes. Limited pressure on inflation from overall wage growth.



Market trends

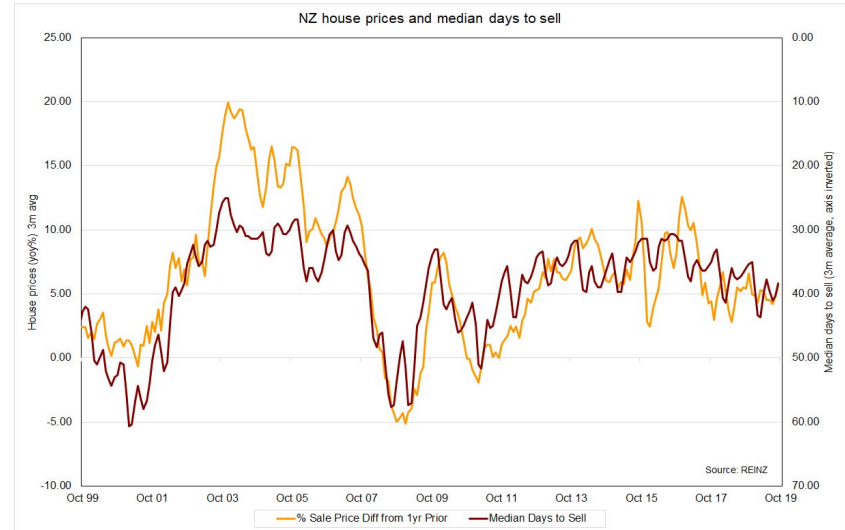
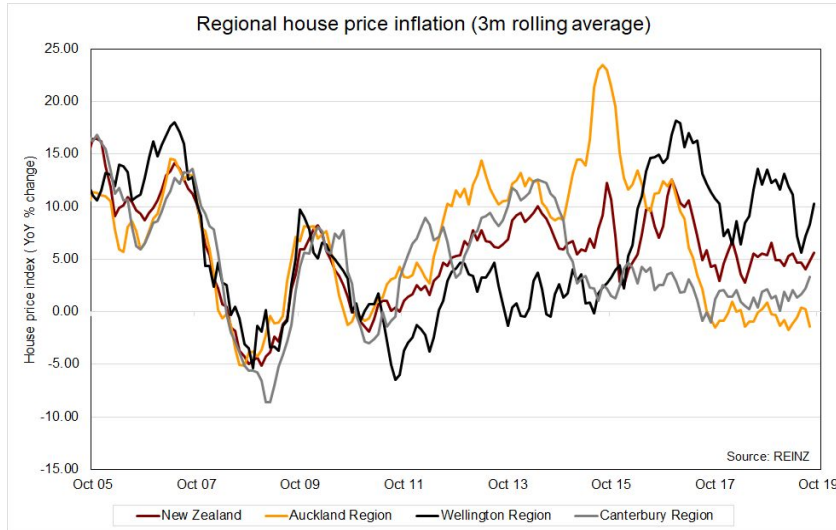
05. Housing market

Key takeaways: House price inflation has been reasonably subdued across most of the country, with Auckland seeing the weakest growth over the past year. Risks to the housing market are balanced with lack of supply, foreign buyer ban, RBNZ regulatory capital requirements, reducing net immigration while lower interest rates may be starting to help. Household debt sits at an all time high on the back of record low interest rates.



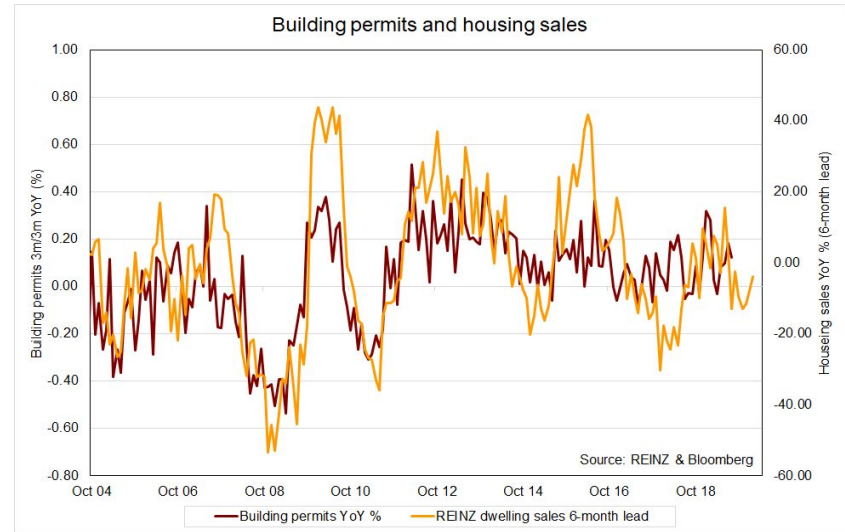
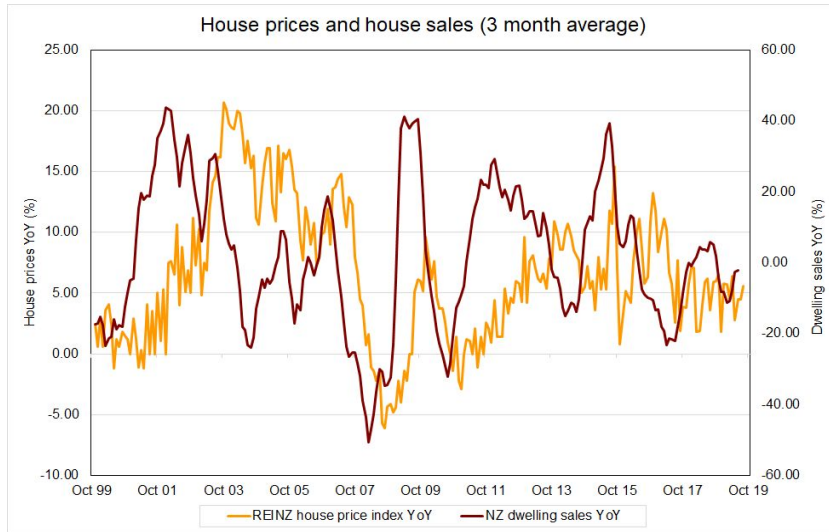
House price inflation subdued

Nationwide, house prices were up 0.9% m/m in September, to be up 1.7% q/q, while annual house price inflation sits at a three month rolling average of approximately 5%. In contrast to recent trends, Auckland house price inflation kept up with the broader market in September as the region showed more signs of activity. Nationwide days to sell – a measure of market slack – dropped from 40 days to 37 (broadly the same as a year ago), supported by an improvement in the Auckland market. Lower mortgage rates appear to have provided a boost to house prices in recent months. The medium-term sustainability of lower interest rates, support for house prices and consumer spending is questionable.



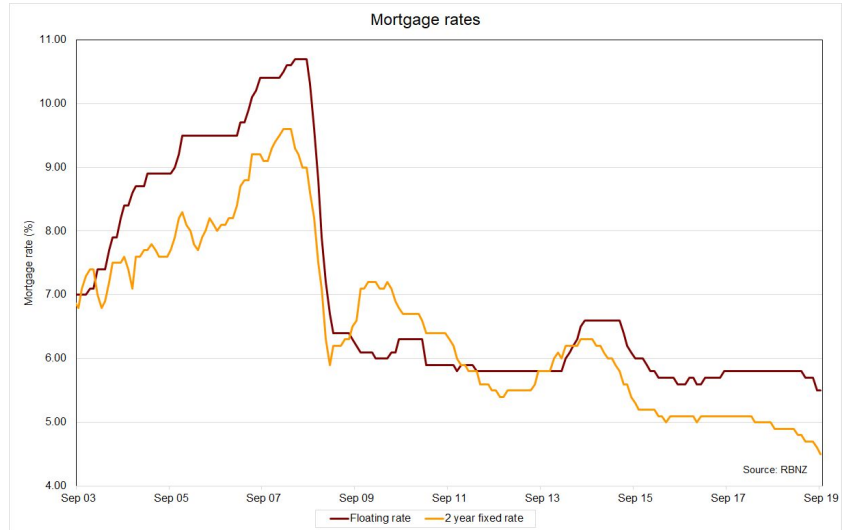
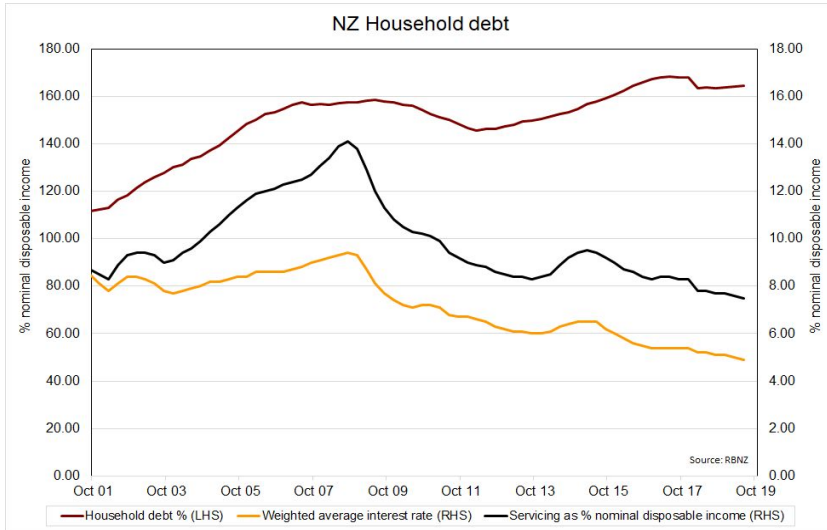
Subdued dwelling sales keep lid on market

Sales volumes and prices tend to be closely correlated, although at times tight dwelling supply can complicate the relationship. House sales fell 0.6% m/m in September following a 7.5% decline in August. House sales in Auckland recovered from a 15% y/y decline only four months ago to be up 7% y/y. Outside of Auckland sales are flat at around year-ago levels.



Household debt increase as interest rates fall

Lower interest rates are keeping debt servicing costs contained while households have taken on more aggregate debt. If households begin to question their employment prospects, they might rebel against the RBNZ's instruction to "go out and spend" and decide rather to pay down that rather uncomfortable pile of debt – currently sitting at an all-time high of 164.4% of disposable income.



Market trends

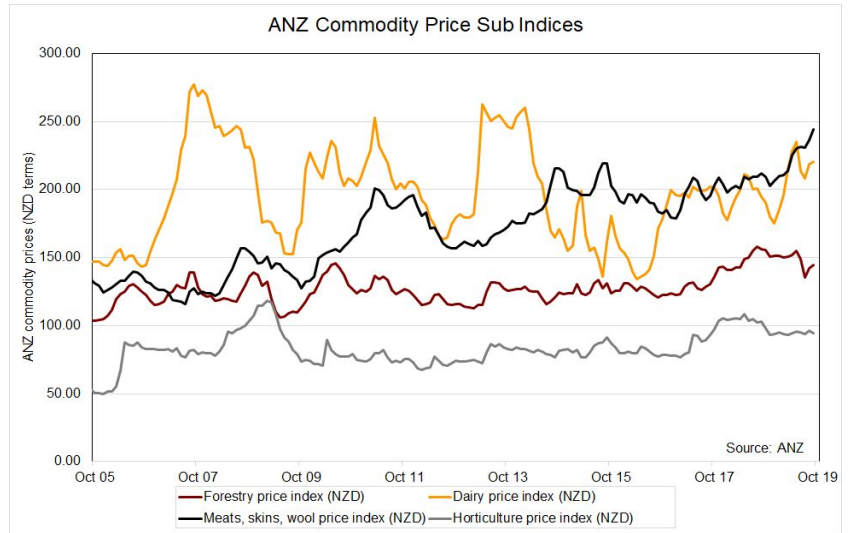
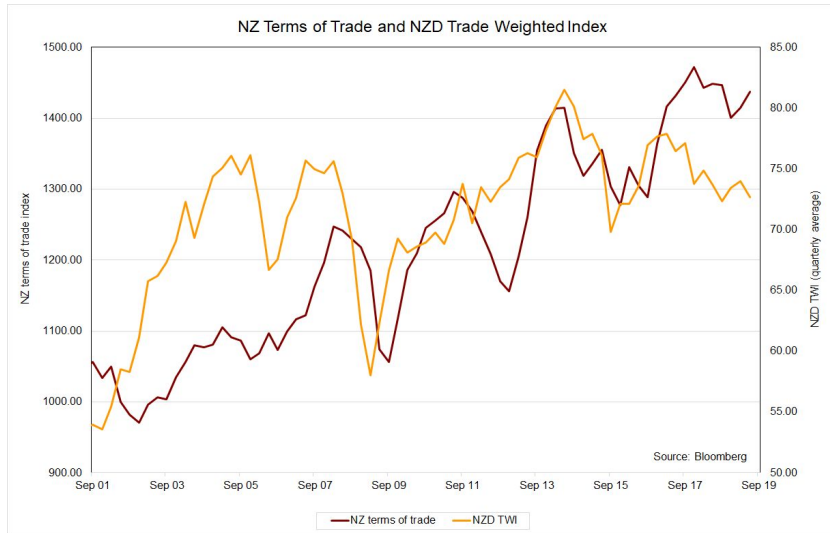
06. Commodity prices

Key takeaway: Firm commodity prices continue to provide decent support for the wider economy as shown in the strong terms of trade. Milk prices are expected to increase slightly this year, however, farmers face elevated uncertainty with tightening environmental standards.



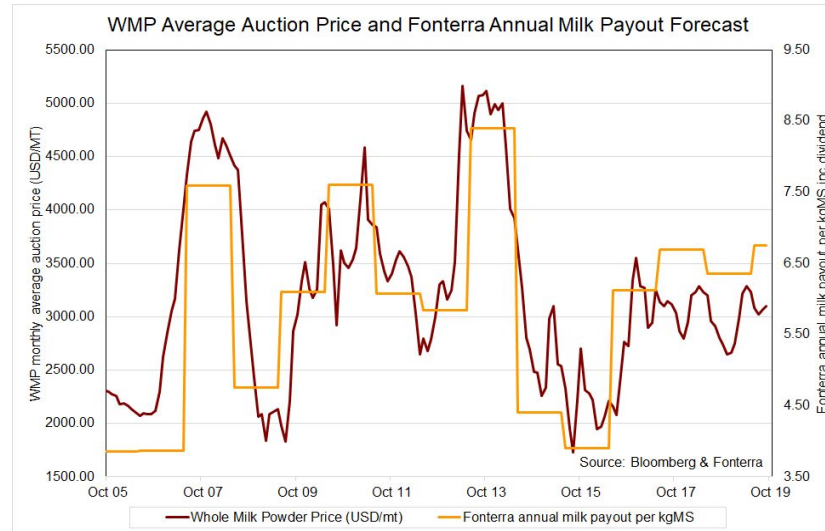
Buoyant commodity prices supporting strong terms of trade

Despite the buoyancy of global food commodity markets, confidence levels of our producers are low. Farmers are moving into uncharted territory with tightening environmental regulations and the fear of unknown waters is limiting confidence and investment in the sector. Also tightening credit availability. Firm commodity prices and a lower NZD are keeping the terms of trade elevated, however, exporters have been more cautious given the murky global backdrop.



Milk prices set to rise but output forecast to fall

Milk prices are forecast to lift this season with Fonterra lifting its guidance range of \$6.55-7.55/kg MS. Milk output in New Zealand is set to fall further in coming years, meaning our dairy companies will need to compete harder for supply to keep processing facilities full. Investment in farms in New Zealand is being constrained by the uncertainty associated with changes in environmental policy. The reduction in investment in dairying is already evident and land values are easing.



Market trends

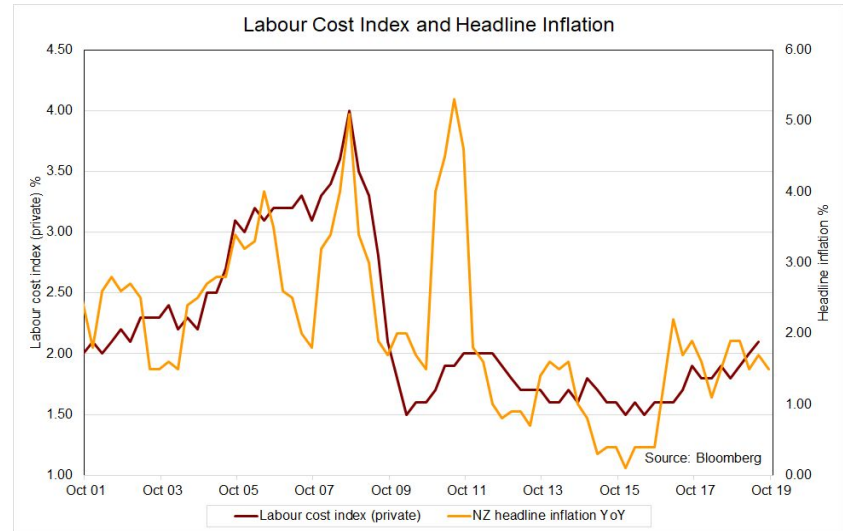
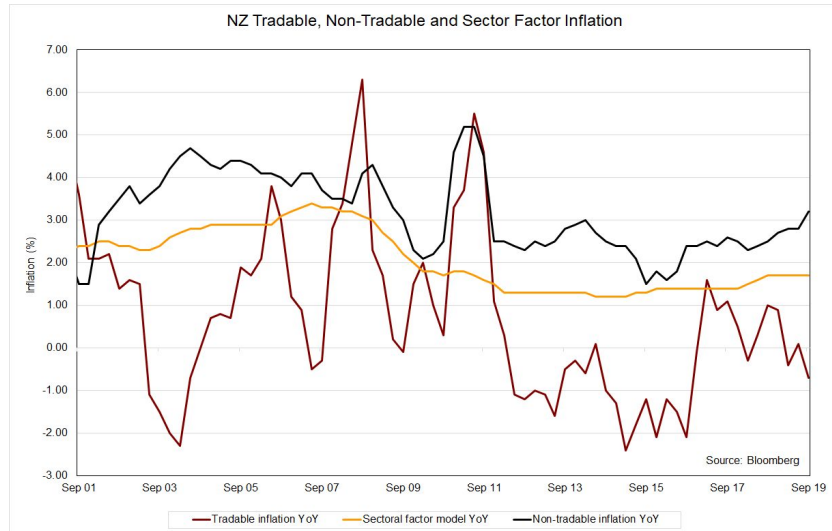
07. Inflation

Key takeaways: underlying inflation continues to track sideways, despite non-tradable inflation rising to its highest level since 2009. Inflation expectations continue to decline which should support further OCR cuts by the RBNZ over coming months - this is expected to be a key area of concern for the RBNZ.



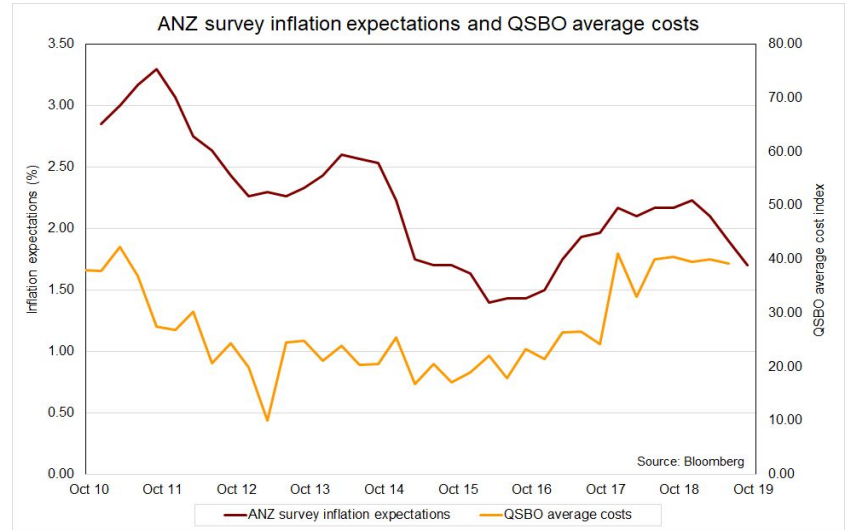
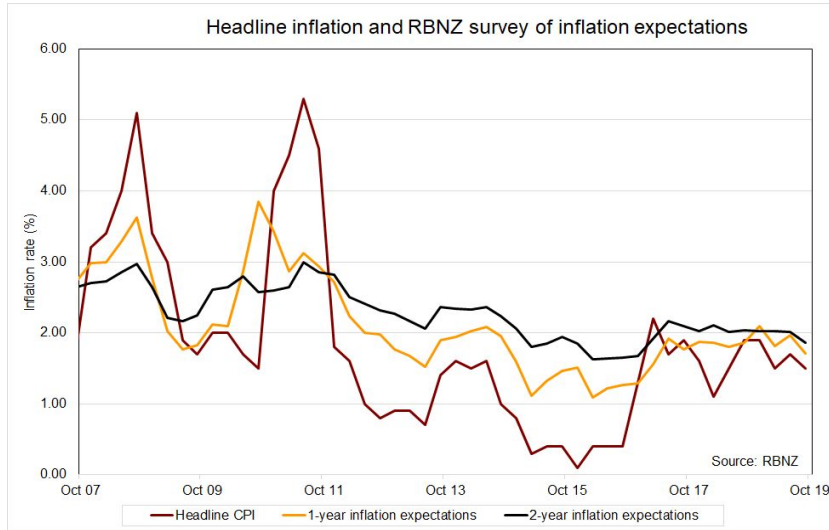
Underlying inflation tracking sideways

Headline CPI increased 0.7% q/q in Q3, a bit stronger than market expectations, however annual inflation ticked down to 1.5% y/y from 1.7%. Annual non-tradable inflation rose sharply from 2.8% to 3.2% – the highest level since 2009 (excluding the GST-induced spike in 2011). Tradable prices continued to provide a drag, (-0.7% y/y), with stronger food prices offset by a decline in apparel, durable goods, and petrol prices. Despite the stronger non-tradable inflation print, movements across core inflation measures (such as sectoral factor model) were mixed, but broadly consistent with underlying inflation tracking sideways. Underlying inflation continues to stabilise just short of 2% following several years of undershooting, which should support further OCR cuts from here.



Inflation expectations at risk of falling further

With headline inflation likely to linger below 2% for some time, inflation expectations are at risk of slipping further and reinforcing low inflation into the future as shown by the two charts below. This is arguably the biggest monetary policy concern of the RBNZ who will not want these to be dislodged lower - and this is a key risk why further monetary policy easing remains a prospect. Unconventional policy is possible but does not appear on the immediate horizon (unlikely within next 12 months).



Market trends

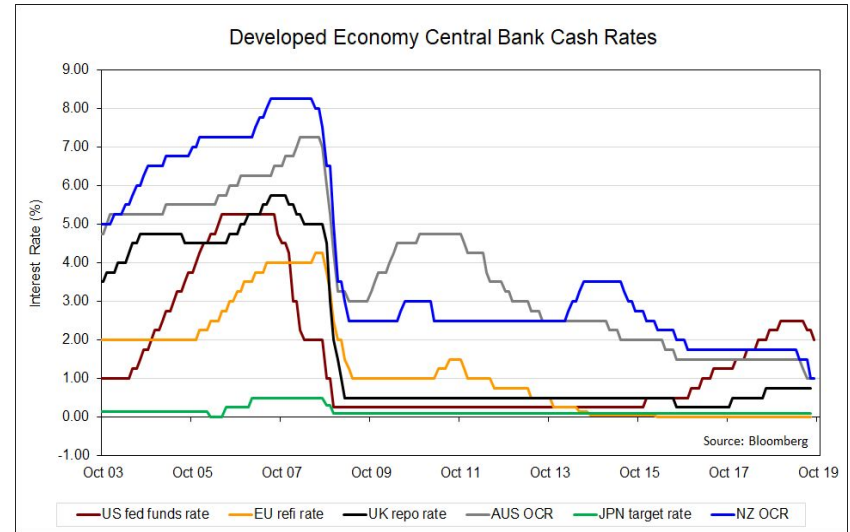
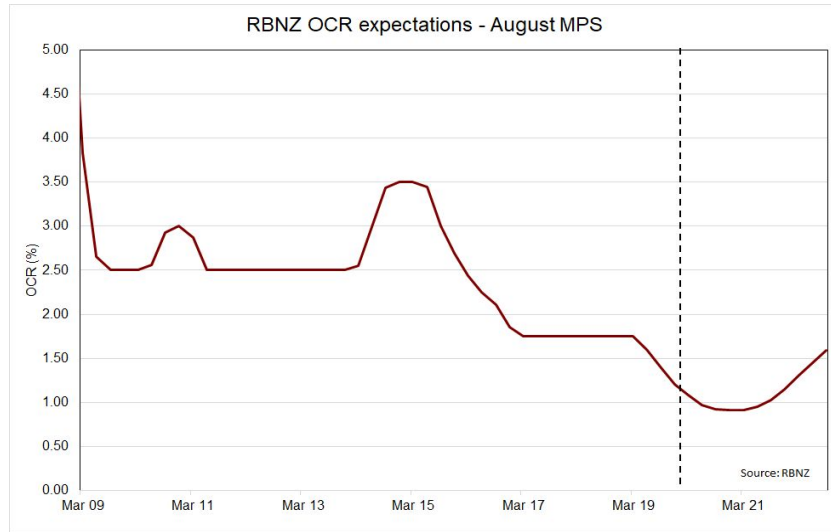
08. Monetary & fiscal policy

Key takeaways: The RBNZ is part of a global trend of central banks rate cutting at present, driven by slowing economic activity and subdued inflation. Lower interest rates are seeing term deposit money leaving banks in search of higher yield at the same time as household borrowing is increasing. This is starting to create a funding gap for local banks and a potential headwind for the economy (as banks' ability to lend diminishes).



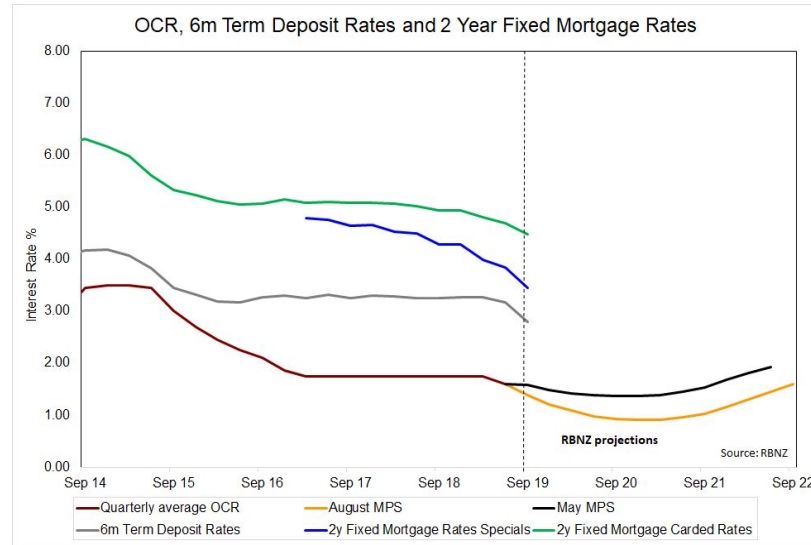
Further OCR cuts expected over coming months

To support the subdued inflation outlook and slowing economic growth, we are forecasting the RBNZ to cut rates by 25bps in November and February, following a similar trend set by many other global central banks. Recent days/weeks have seen the market implied probability of RBNZ OCR cuts reduce. However, the risk of further cuts cannot be discounted, largely based on lower inflation expectations, still global uncertainties (which could flare up again) and tighter credit availability (RBNZ Capital Requirements Review).



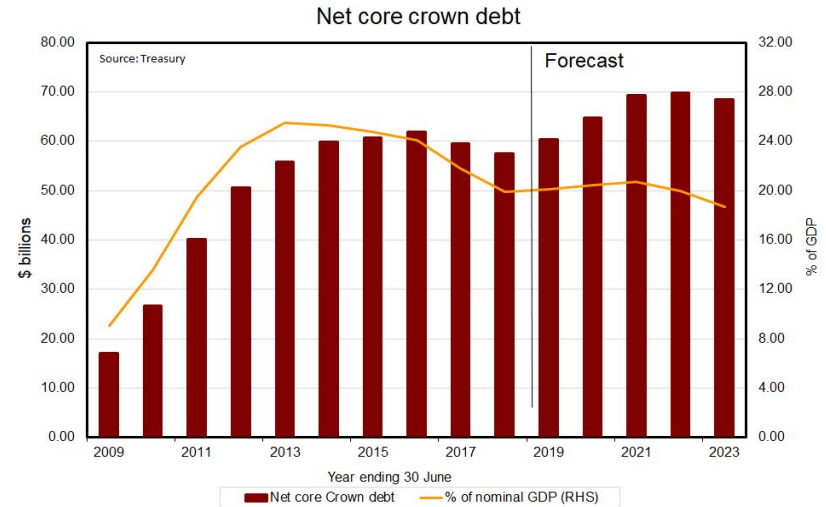
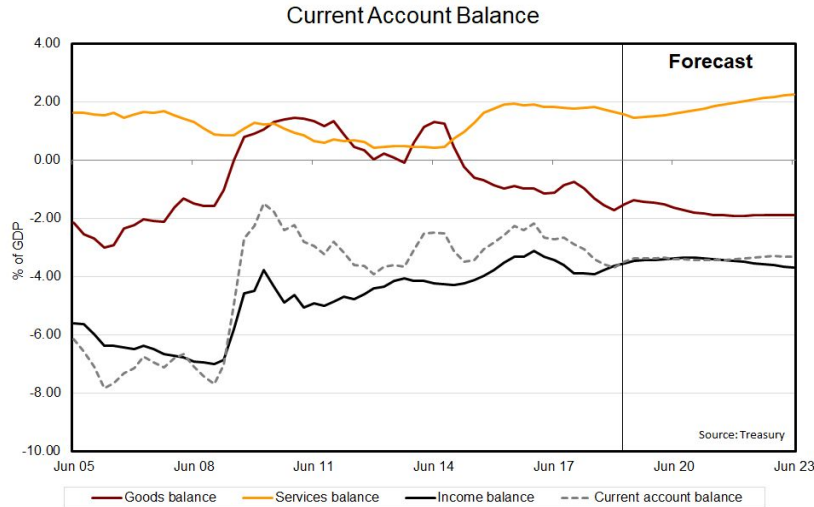
Lower deposit rates could constrain household credit growth

Lower term deposit rates are starting to drive retail money from banks in search of higher yields elsewhere. As household borrowing also rises on the back of lower rates, a funding gap is beginning to emerge. When such a gap opens up, either the price of credit needs to rise (enticing household deposits back into the banking system and lowering demand for credit), or credit availability deteriorates. This situation becomes a headwind for economic activity with interest rate cuts not having the desired effect (limited pass through) retail deposit and mortgage rates not falling to the same extent as the OCR. There are signs of this already occurring (also impacted by proposed RBNZ Capital Requirements Review); coming quarters will be more telling.



Strong financial position for NZ inc.

The government recently unveiled a \$7.5bn surplus (partly due to revaluation of assets), the widest since the financial crisis, as well as the lowest debt levels over the same period of time (net core crown debt at 19.2 percent of GDP). The current account deficit has also been more contained this business cycle, in part due to solid services exports. This has put the government in a strong financial position to spend more on infrastructure to help stimulate a weakening economy. At 19.2 percent, the Government is well short of its self-imposed Budget Responsibility Rules to keep debt as a percentage of GDP at less than 20 per cent. Those rules also state the Government needs to keep its spending below 30 percent of GDP (currently 29 per cent). This means the Government has an extra \$3 billion it is able to spend before it hits the self-imposed limit.



Market trends

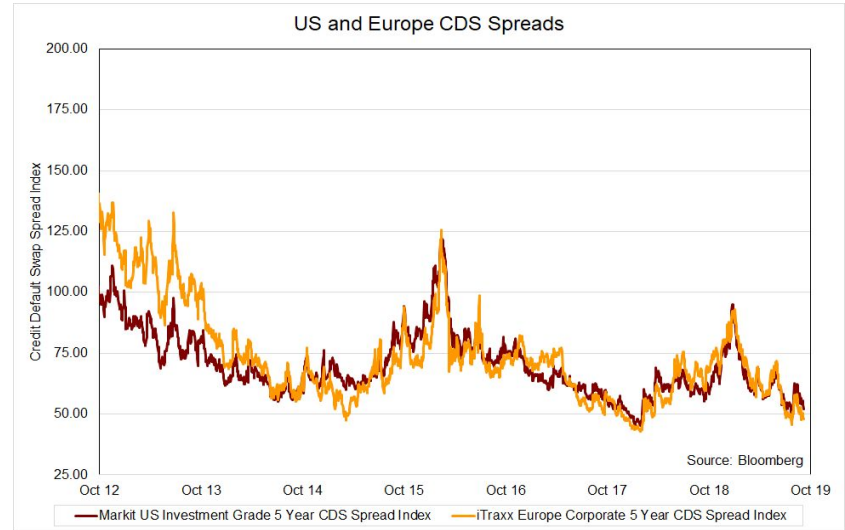
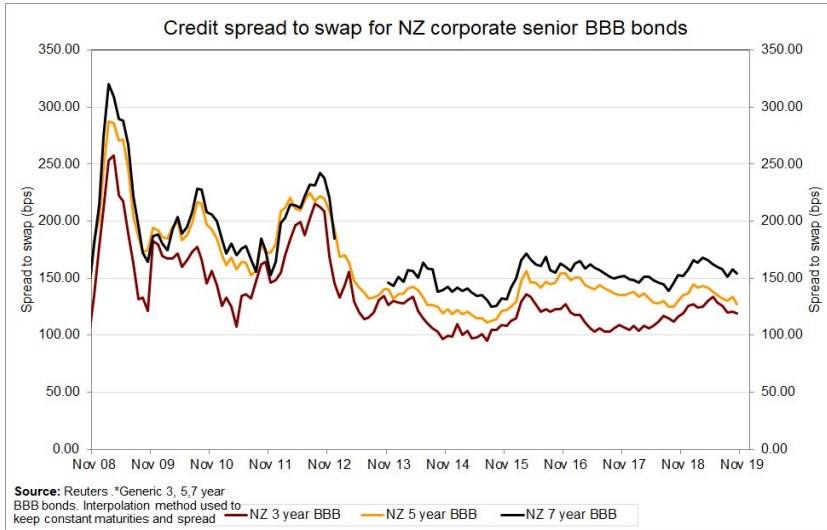
09. Credit outlook

Key takeaways: credit spreads are relatively low and stable at present but have spiked during periods of increased economic and political uncertainty. Large quantum of money searching for positive yields has assisted in driving down these spreads. Risks for widening including from banks' increased cost of capital. Constrained credit availability remains a key risk which appears to be starting to materialise (weaker outlook for credit growth and real GDP growth).



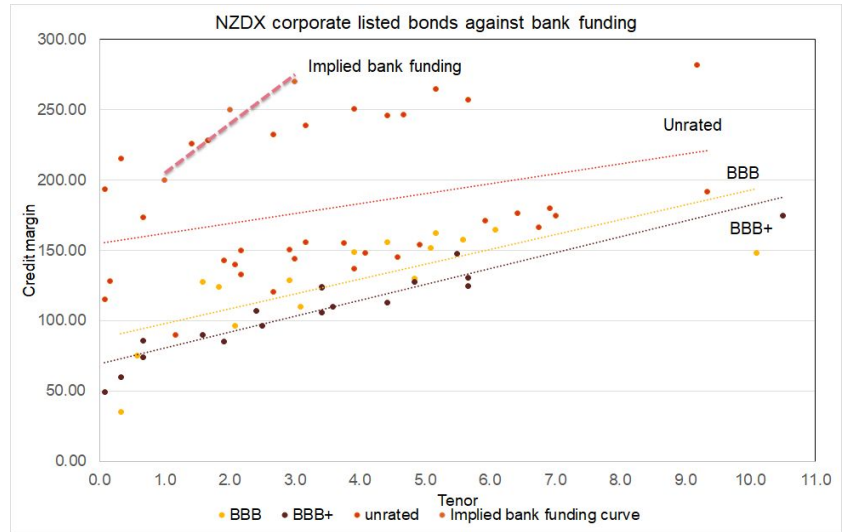
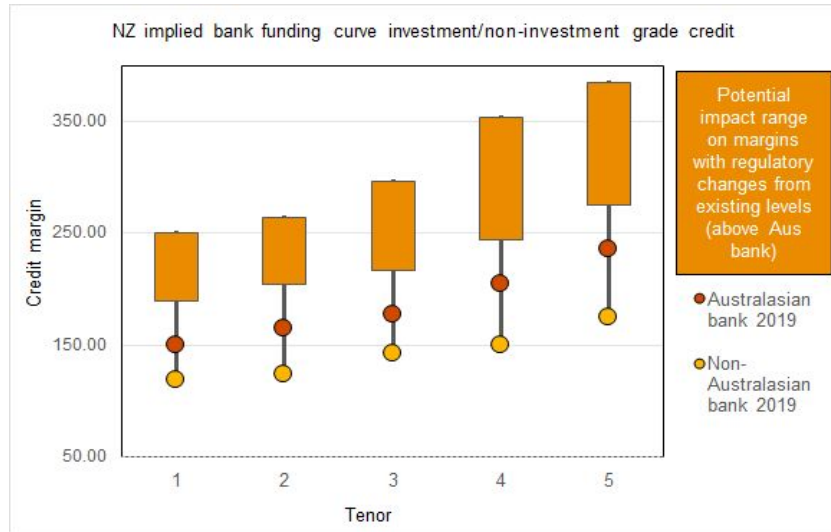
Credit spreads relatively low and stable, but domestic to move higher?

NZ and global credit spreads remain at relatively low and stable levels, assisted by the global economic expansion over the past decade. The large quantum of money in search of a positive yielding home has also been a factor in driving down credit spreads. Recent political and economic uncertainty over the past couple of years has seen credit spreads increase at times, but these increases have only been temporary in nature. At present, credit spreads aren't signalling any major risks on the horizon globally.



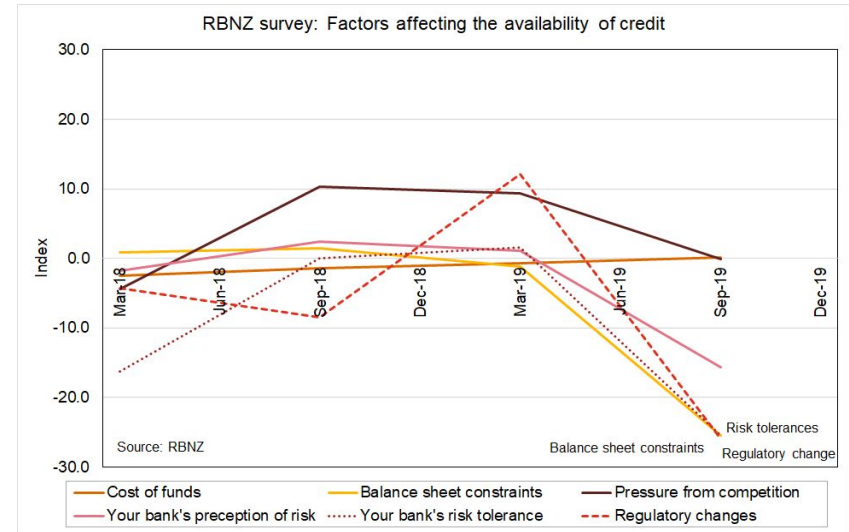
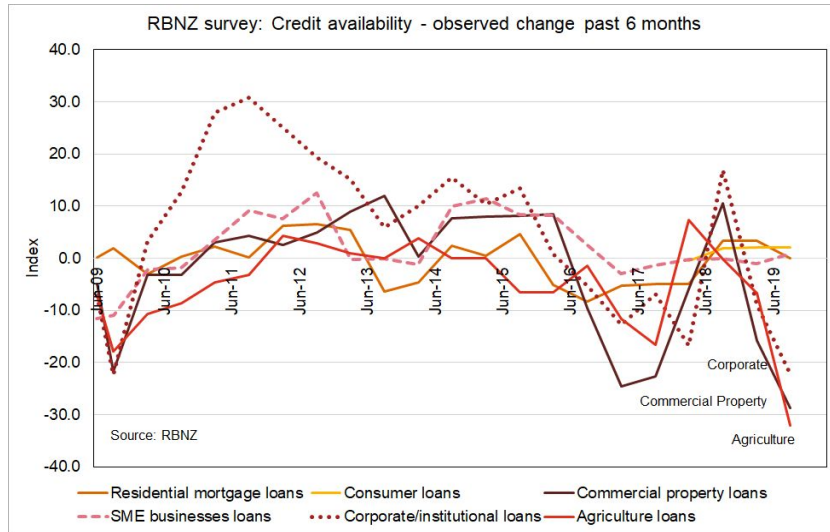
Constrained lending to certain sectors likely to act as a handbrake

Domestically, the impact of proposed RBNZ regulatory capital increases (bank cost of capital) passed through to borrowers remains a key risk. We are observing a widening in bank funding margins to corporate borrowers. Particular risks are single bank lending and/or where the bank's risk grading of the borrower resides at sub-investment grade level (below an implied BBB rating). With credit as the differentiator, high grade corporates are benefiting in the current environment. Broader risks to the economy resonate at SME, dairy, and sectors/industries where banks ROE is considered misaligned with the risk weighted exposure causing a retraction in lending (amount/tenor) and/or significant cost increases.



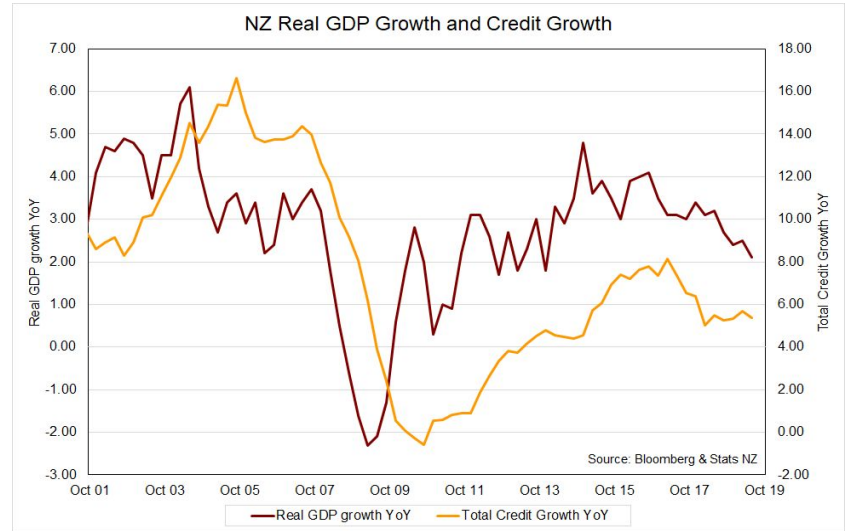
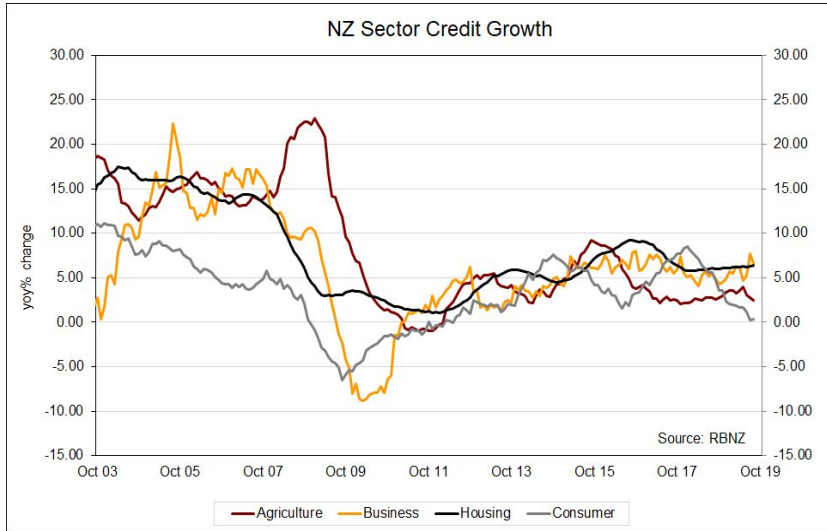
RBNZ credit conditions survey a spotlight on sector lending

The RBNZ credit conditions survey is conducted across a selection of banks. Credit availability reflects the bank lenders' willingness and ability to supply funding, while holding demand constant. This is impacted by various non-price and price factors such as (but not limited to); lending standards, risk appetite, limits, risk pricing, margins. An index outcome of zero is defined as "broadly unchanged", -50 "tightened somewhat", -100 "tightened significantly". As observed available credit to Agri, Commercial Property, and Corporate lending has deteriorated towards having "tightened somewhat". Bank responses on drivers of changes in credit conditions show balance sheet constraints, risk tolerance, and regulatory change as the lead causes. These are unlikely to be alleviated in both the near and medium term, remaining a key risk to the pace of economic growth.



Credit growth starting to moderate alongside GDP

Credit growth has historically tracked GDP growth with a reasonably strong degree of correlation as shown in the bottom right hand chart. Given this strong link, and what is appearing the likelihood of constrained credit growth/availability as the banks are required to hold more capital, then an expected slowing in the wider economy is anticipated to occur. On a sector basis, credit growth has been the most sluggish in Consumer and Agriculture, while Business and Housing have been the most robust.



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