New Zealand Economic Outlook

2019 Audit New Zealand Conferences
Key messages

• The economy is expected to expand at a pace that is close to trend, supported by migration-led population growth, government spending, accommodative monetary policy.

• OBEGAL surpluses expected to rise over the forecast period

• There are risks to the outlook:
  – The international outlook is softening
  – And the domestic demand looks to be cooling
Economic outlook – overview (HYEFU)

- The economy continues to expand at a pace that is close to trend, supported by migration-led population growth, government spending, accommodative monetary policy and solid growth abroad.
- Nominal GDP growth is supported by a rising terms of trade, inflation around 2%, and government labour market policies.
- Wage growth is forecast to accelerate owing to a tight labour market, higher inflation compared with recent years and a range of labour market policies.
- Inflation is close to the mid-point of the Reserve Bank’s target but interest rates are expected to remain on hold for some time.
- Economic data and developments since finalisation of the Half Year Economic and Fiscal Update point to higher growth in recent history but weaker short term momentum in the economy.
- International risks remain skewed to the downside but domestic risks are more balanced.
**Domestic developments**

**Solid but not spectacular…**

December 2018 quarter real production GDP growth of 0.6% was slightly weaker than forecast (0.7%) but in line with broader mkt expectations.

December quarter followed a weak September quarter (+0.3%).

- Production in ten of the sixteen industries increased. Retail trade and accommodation made the largest contribution
- Activity in the primary industries eased
- On the expenditure measure, growth was broad-based (up 0.5%), consumption (+1.3%) and construction activity (+2.1%) underpinned growth
- Annual (average) growth has been easing since 2017 and is now 2.8%

**Weaker TOT hit nominal expenditure GDP…**

TOT declined 2.7% in the quarter, with the overall (both goods and services) terms of trade declining 2.2%,

Overall this decline was slightly greater than we had been anticipating, with growth in nominal GDP, at 0.3%, a little weaker than incorporated in the preliminary BEFU forecasts.
Domestic developments cont’d

Labour Market
• Unemployment rate rose to 4.3% in the December 2018 quarter.
• QSBO reports that firms are facing difficulty finding both skilled and unskilled workers – the most difficult since 2005.
• Lower migration possibly a contributing factor.

Trade developments
• Continued growth in capital goods imports (an indicator of domestic investment).
• Dairy exports volumes growth reflects strong production, but prices softer.
• Increased exports to China accounted for almost half the increase in exports over the past year.

Higher petrol prices in 2018Q3 have contributed to a pick up in inflation to 1.9% (will drop out) but early signs of slightly stronger non-tradables inflation.
• Market pricing has shifted from approximately a 50% chance of a rate rise by the end of 2019, to a 50% chance of a rate cut by the end of 2019.
Population growth is high but declining

- High net inwards migration has boosted population growth and supported aggregate demand
- Migration is expected to continue to fall, which will weigh on aggregate growth
- A new method for estimating migration suggests there have been fewer migrants than previously thought
Rising incomes support consumption

- The economy has absorbed a large increase in the labour force
- The labour market is expected to remain tight, with unemployment hovering around 4%
- The tight labour market, together with government labour market policies, underpins an acceleration in wage inflation
- Solid household income growth underpins consumption growth
- Over the longer term slowing population growth and rising interest rates weigh on growth

[Graph showing Unemployment and Wage Growth]
Government spending supports demand (HYEFU)

- Government spending is expected to support demand, particularly in the shorter term
- Budget operating allowances are set at $2.4 billion per annum
Investment grows steadily

- Growth in residential investment is expected to be subdued in the short term owing to capacity constraints.
- Over time, KiwiBuild, and broader Govt investment in housing is expected to support faster growth, supported by policies that alleviate capacity pressures.
- Non-residential investment grows steadily, underpinned by the high terms of trade, low interest rates and rates of capacity utilisation.
- Non-residential investment includes the Governments $13.1 billion multi-year capital envelope.
Global growth outlook remains solid but risks of weaker growth have increased

• The forecasts assume a fairly stable outlook for world growth, with growth in our top 16 trading partners in the 3.4% to 3.6% range.

• Risks to the international outlook remain prevalent and are skewed to the downside. Key risks include
  – Trade tensions
  – Brexit
  – China debt levels
  – Australia housing market
Global growth is slowing with softer trading partner growth expected

- 2018Q3 growth slowed more than expected with softer momentum expected to carry over into Q4 and 2019.
- Weakening market sentiment and trade policy uncertainty appear to be affecting world activity.
- IMF and consensus forecasts have been reduced (Fig 1).
- Australian business confidence sharply lower and house price falls continue (towards -20%) as supply adjusts to lower demand (Fig 2).
- China growth transition continues but trade has slowed markedly, impacting other Asian trading partners including Japan.
- US Federal government shutdown and tighter financial conditions point to slower US growth.
- Euro area challenges continue as “yellow vests” slow French services and German manufacturing confronts slower global demand.
- Brexit uncertainty continues to hinder UK growth.
- Positives include ongoing US-China trade talks, increased policy stimulus in China, ongoing talks to avoid “no-deal” Brexit, and recovery in equities over January.
- In sum, growth is slowing more quickly than anticipated and risks of slower growth have increased.
- BEFU19 trading partner growth 0.2%-points lower in 2018 and 0.1%-points lower in 2019 and 2020 at 3.8%, 3.5% and 3.4% respectively.
- Weaker growth may reduce/delay monetary policy tightening, influencing exchange rates.
Solid demand supports exports and the terms of trade

- Growing conditions have been generally favourable, supporting agricultural exports, and tourism continues to grow strongly
- Import growth is also high, consistent with solid domestic demand
- Shorter term factors weigh on the terms of trade in the near term but overall the terms of trade remain at relatively high levels
- The current account deficit is expected to remain broadly stable at about 3.6% of GDP

Note: Goods and services, SNA basis
Tax developments

Stronger than forecast tax revenue may provide a partial offset to weaker growth

- There have been two months of actual tax data subsequent to the 2018 HYEFU forecast.
- In total, core Crown tax revenue for the 6 months to December was close to forecast (0.4% above).
- GST revenue was $300 million above forecast. Inland Revenue advises that December GST returns lodged up to 23 Jan were very strong.
- Corporate tax was $200 million below forecast. Most of this came from lower-than-forecast provisional tax. However, the two peak provisional tax months of the year, January and May, are yet to come.
The fiscal outlook continues to improve
Questions?