B.33

Monetary Policy Statement.

May 2024

Policy assessment.
OCR 5.50% - Official Cash Rate to Remain Restrictive

The Monetary Policy Committee today agreed to keep the Official Cash Rate at 5.50 percent.

Restrictive monetary policy has reduced capacity pressures in the New Zealand economy and lowered consumer price inflation. Annual consumer price inflation is expected to return to within the Committee's 1 to 3 percent target range by the end of 2024.

The welcome decline in inflation in part reflects lower inflation for goods and services imported into New Zealand. Globally, consumer price inflation has declined from 30-year highs in many advanced economies. However, services inflation is receding slowly, and expected policy interest rate cuts continue to be delayed.

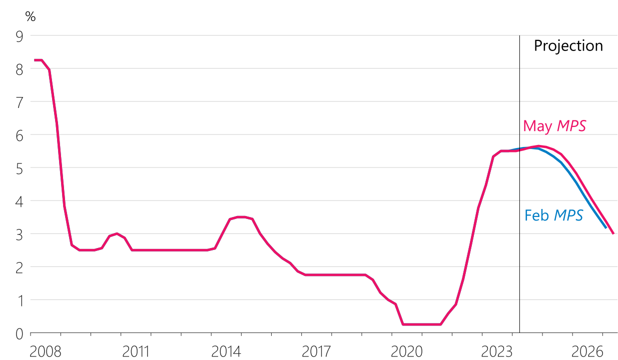
In New Zealand, pressures in the labour market have eased. Businesses are employing more cautiously in line with weak economic activity, while the number of people available to work has increased due to recent high net inward migration. Wage growth and domestic spending are easing to levels more consistent with the Committee's inflation target.

While weaker capacity pressures and an easing labour market are reducing domestic inflation, this decline is tempered by sectors of the economy that are less sensitive to interest rates. These near-term factors include, for example, higher dwelling rents, insurance costs, council rates, and other domestic services price inflation. A slow decline in domestic inflation poses a risk to inflation expectations.

Figure i.1

Official Cash Rate (OCR)

(quarterly average)



Source: RBNZ estimates.

Our economic projections include only officially available information on the Government's fiscal intentions to date, which includes the most recent fiscal update and 'mini budget'. The signalled lower government spending is currently and expected to continue contributing to weaker aggregate demand. Any impact of potential changes in the forthcoming *Budget* to government spending, or private spending due to tax cuts, remain to be assessed.

Annual consumer price inflation remains above the Committee's 1 to 3 percent target band, and components of domestic services inflation persist. The Committee agreed that monetary policy needs to remain restrictive to ensure inflation returns to target within a reasonable timeframe.

Meitaki, thanks.

Adrian Orr
Governor

Monetary Policy Framework

The Monetary Policy Committee operates and makes decisions under the monetary policy framework that comprises the following key components:

- the *Remit*;
- the *Charter*;
- the *Code of Conduct*; and
- the monetary policy strategy.

The corresponding documents to these components and additional information can be accessed on our website under the monetary policy framework.

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Thank you to RBNZ staff for photography in this report.

Cover: Aurora Australis viewed from Christchurch. Photo: Rebecca Williams

Monetary Policy Statement.
May 2024

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Chapter 01

Summary record of meeting

Mokohinau Islands. Photo: John Knowles

Chapter 1. Summary record of meeting

The Monetary Policy Committee discussed recent developments in the domestic and global economies and the implications for monetary policy in New Zealand. Restrictive monetary policy is contributing to an easing in capacity pressures. Headline inflation, core inflation, and most measures of inflation expectations are continuing to decline. However, domestic inflation has fallen more slowly than expected and headline Consumers Price Index (CPI) inflation remains above the Committee's target band. Members of the Committee agreed that monetary policy needs to remain restrictive to ensure inflation returns to target within the forecast timeframe.

Aggregate global economic growth was below trend last year and is expected to slow further in 2024. However, the economic outlook varies among New Zealand's trading partners. In the United States, monetary policy has contributed to an easing in capacity pressures and inflation, but economic growth remains stronger than in many other developed economies. In most other advanced economies, domestic demand remains weak. In China, economic activity strengthened in early 2024, although continued weakness in the property sector remains a significant downside risk to growth.

The Committee noted that headline and core inflation have continued to decline in many advanced economies. To date, the decline in headline inflation internationally has been due in large part to lower goods, energy, and food price inflation. Inflation in services has declined, but by less than anticipated at the start of the year. Nevertheless, inflation in New Zealand's trading partners is expected to continue to decline.

In discussing global financial conditions, the Committee noted that persistent inflation in some of New Zealand's key trading partners has led to fewer policy interest rate cuts being priced in by financial markets. Higher long-term wholesale interest rates globally have supported wholesale interest rates in New Zealand. Participants in global financial markets continue to exhibit confidence in the corporate earnings outlook, as reflected in equity prices and credit spreads.

The Committee discussed recent developments in financial conditions in New Zealand. Overall, credit growth remains weak. The average interest rate across the stock of mortgage borrowers continues to increase and is near its projected peak of 6.5 percent. Bank funding costs are expected to increase over the forecast period as funding sources normalise, with a reversion to higher cost wholesale and term deposit funding. Higher funding costs in turn are expected to maintain upward pressure on lending rates over the medium term.

The Committee received an update on the continued sales of New Zealand Government Bonds held in the Large Scale Asset Purchase Programme portfolio. Despite the high level of bond issuance over recent years, measures of secondary market liquidity generally remain in line with historical averages and demand for New Zealand Government Bonds in the primary market remains strong.

The Committee discussed recent domestic economic developments. A prolonged period of restrictive interest rates is reducing household spending and residential and business investment. Capacity pressures in the New Zealand economy have eased significantly over the past year and aggregate demand is now broadly in line with the supply capacity of the economy.

Members noted that labour market pressures are easing and that businesses are reporting it is much easier to find workers. Labour supply has continued to increase, due to strong population growth, and wage growth has continued to decline but remains elevated.

The Committee discussed New Zealand's current low rate of productivity growth and its implications for lower potential output growth and higher capacity pressures. The Committee noted that the revised smaller negative output gap in the published projections is more consistent with recent persistence in domestic inflation pressure.

The Committee discussed possible causes of the current low productivity rate and whether they were temporary or more persistent. For example, some labour hoarding by firms is likely to have occurred in response to the previous acute labour shortages once New Zealand's borders were reopened. This could prove to be temporary.

The Committee noted that the forecast for government expenditure in the projections is based on Treasury's *Half Year Economic and Fiscal Update (HYEFU)* 2023, adjusted to reflect the December 2023 quarter GDP data. Based on this information, the share of government expenditure in the economy is projected to decline. However, due to weaker potential output growth, government expenditure is higher as a proportion of potential output than projected in the February *Statement* and hence less disinflationary.

The Committee also discussed the implications of the publicly announced aspects of *Budget* 2024 for the economic outlook. If the decline in government revenue due to tax cuts is fully offset by lower government expenditure, then the net impact on aggregate spending is broadly neutral over an extended horizon.

However, the Committee discussed how differences in the timing between potential lower government spending and lower tax rates are relevant to monetary policy. The Committee noted that the signalled lower government spending is currently and expected to continue contributing to weaker aggregate demand. However, any likely changes to government spending or private spending due to proposed tax cuts are not in the May *Monetary Policy Statement* projections. This timing difference poses an upside risk to the forecast of aggregate demand, the relevance of which for monetary policy will be clearer over coming quarters.

The Committee noted that the estimate of the long-run nominal neutral OCR used in the projections has been increased by 25 basis points to 2.75 percent, consistent with the Reserve Bank's indicator suite. The long-run nominal neutral rate affects the central economic projection but has a larger impact in the latter part of the forecast horizon and beyond. Members agreed that the current level of the OCR remains contractionary.

The Committee discussed recent inflation outturns. An easing in capacity pressures in the New Zealand economy and falling inflation expectations over the past 12 months are working to bring domestic inflation down. Annual CPI inflation fell to 4.0 percent in the March 2024 quarter but remains above the Committee's 1 to 3 percent target band.

Both tradable and non-tradables inflation contributed to the decline in headline CPI inflation. However, annual non-tradables inflation declined only slightly to 5.8 percent, which was higher than the 5.3 percent forecast. This upside surprise was broad-based across non-tradables inflation components.

The Committee discussed the outlook for non-tradables inflation. So far, the decline in non-tradables inflation has primarily been due to housing and construction costs, which are typically more sensitive to monetary policy. Further near-term disinflation in non-tradables is likely to be due to falling inflation for some market services, as labour market conditions continue to soften. However, this is expected to be tempered by some relative prices increases, such as for insurance, local authority rates, and dwelling rents.

Members discussed risks to the inflation outlook. The Committee agreed that risks to tradable inflation were balanced but noted that price changes may continue to be volatile. Risks remain to near-term inflation outcomes given ongoing trade disruptions. To date, developments in the Middle East have not resulted in a large increase in oil prices, and goods inflation continues to decline across advanced economies.

Members agreed that persistence in non-tradable inflation remains a significant upside risk. The influence of recent inflation outcomes on setting future inflation expectations is critical to price setting, wage expectations, and the stance of monetary policy. In addition, slower potential output growth than currently assumed would reduce the pace at which spending can grow without putting upward pressure on inflation. Monetary policy may need to tighten and/or remain restrictive for longer if wage and price setters do not align with weaker productivity growth rates.

Members discussed downside risks to the projections. In China, strengthening manufacturing capacity, alongside subdued domestic demand, could lead to a sharper decline in New Zealand import prices than currently assumed. Some members also noted the risk of a decline in global equity prices, particularly in the US. This risk arises from elevated pricing based on expectations of a near-term easing in US monetary policy, ongoing strong earnings growth, and a low-risk premium. Members noted that domestic labour market conditions could deteriorate more quickly than anticipated, particularly if firms reduce their labour force rapidly in response to weak demand.

In the context of persistent domestic inflation, weaker productivity growth, and uncertainty regarding the pace of normalisation in wage and price-setting behaviour, the Committee discussed the possibility of increasing the OCR at this meeting. The Committee assessed that, while the near-term balance of risks around inflation are skewed to the upside, there is more confidence that inflation will decline to within the target range over the medium term. However, the Committee also agreed that interest rates may have to remain at a restrictive level for longer than anticipated in the February *Monetary Policy Statement* to ensure the inflation target is met.

The Committee discussed the reasons why inflation is outside of the target range and the expected time for inflation to return to target. The Committee noted that the high inflation experienced both domestically and internationally over recent years reflected the significant disruption to global supply, production, and potential output stemming from the pandemic; the impact on demand of the global easing in monetary policy and the rise in fiscal spending during the pandemic; an increase in commodity prices and shipping costs resulting from war and geopolitical tension; severe weather impacts on local food prices; and the persistence of domestic inflation in part reflecting low productivity.

The Committee noted that annual headline CPI inflation was expected to return to the target band in the December quarter of this year. The Committee agreed that in the current circumstances, there is no material trade-off between meeting their inflation objectives and maintaining the stability of the financial system. The Committee noted that borrowers have faced a significant increase in interest costs, but banks are well placed to support their customers through this difficult period. Restrictive monetary policy settings are necessary to reduce demand in the economy, while avoiding unnecessary instability in output, employment, interest rates and the exchange rate.

In discussing the appropriate stance of monetary policy, members agreed they remain confident that monetary policy is restricting demand. A further decline in capacity pressure is expected, supporting a continued decline in inflation. The Committee agreed that interest rates need to remain at a restrictive level for a sustained period to ensure annual headline CPI inflation returns to the 1 to 3 percent target range. On Wednesday 22 May, the Committee reached a consensus to keep the Official Cash Rate at 5.50 percent.

Attendees:

Reserve Bank members of MPC:

Adrian Orr, Christian Hawkesby, Karen Silk, Paul Conway

External MPC members:

Bob Buckle, Carl Hansen, Caroline Saunders

Treasury Observer:

Dominick Stephens

MPC Secretary:

Elliot Jones

Chapter 02

Recent economic developments and monetary policy outlook

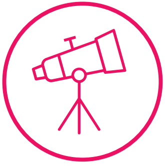
Diamond Lake. Photo: Hamish Fitchett

Chapter 2.
Recent economic developments and monetary policy outlook

Summary

- High interest rates have continued to reduce demand in the New Zealand economy. Weaker demand has contributed to lower domestic inflation. Subdued global growth and lower prices for goods and services that tend to have more volatile prices have led to lower tradables inflation over recent quarters. Annual Consumers Price Index (CPI) inflation has declined, but at 4.0 percent in the March 2024 quarter remains above the MPC's 1 to 3 percent target band.
- Gross domestic product (GDP) declined by 0.1 percent in the December 2023 quarter. Economic growth has now been negative for four of the past five quarters. High interest rates have reduced household spending, as well as residential and business investment, despite very strong population growth. Recent indicators of economic activity have been weak, as expected.
- Weaker economic activity has meant that businesses are employing fewer workers. At the same time, high net immigration over the past 18 months has increased the number of people available to work. As a result labour market conditions have softened, with labour demand and supply now broadly in balance. Businesses are reporting that it is easier to find workers. The unemployment rate increased to 4.3 percent in the March 2024 quarter. Other measures of capacity in the labour market, such as the underutilisation rate, have also increased. Labour Cost Index (LCI) wage inflation has declined, although it remains much higher than its pre-COVID-19 level.
- Global growth has been below trend and inflation has declined from 30-year highs in many advanced economies. However, there have been signs recently that global demand and inflation are somewhat stronger than anticipated. This is particularly the case in the US, where it has led to fewer policy interest rate cuts being expected and a higher US dollar exchange rate in recent months. A lower New Zealand dollar exchange rate than assumed at the time of the February *Statement* will lead to higher-than-otherwise prices for our imported goods and services.
- Domestic inflation has declined more slowly than anticipated. Annual non-tradables inflation – which measures price changes for goods and services less exposed to international competition – was 5.8 percent in the March 2024 quarter. This was only a small decline from the 5.9 percent in the previous quarter, and higher than the 5.3 percent anticipated at the time of the February *Statement*. The relative strength in non-tradables inflation was broad-based. Most measures of core inflation declined in the March 2024 quarter, but all remain above the MPC's target band.

- Higher than expected and broad-based domestic inflation is consistent with the output gap – the difference between actual economic activity and the 'potential' level of activity that the economy can sustain without generating more inflation – being higher in recent quarters than assumed at the time of the February *Statement*. Although actual economic growth was slightly lower than assumed at the end of 2023, very weak productivity growth, even by New Zealand standards, is likely to have contributed to lower potential GDP. This means that the output gap is assumed to be slightly less negative over 2024.
- A less negative output gap in 2024 and the higher starting point for non-tradables inflation imply that domestic inflationary pressures may be more persistent than previously assumed. The signs of lingering inflation in other parts of the world, higher expected global interest rates and the resulting depreciation of the New Zealand dollar exchange rate also imply that tradables inflation may be higher than previously assumed in the medium term. In addition, the neutral OCR has been revised higher, and this will create gradual upward pressure on the OCR over time.
- These factors are partly offset by an updated assumption that businesses' wage- and price-setting behaviour will normalise slightly more quickly once headline inflation is within the 1 to 3 percent target band. Conditional on the central economic projection, the OCR is expected to remain restrictive for longer than assumed in the February *Statement*, in order for inflation to return sustainably to the 2 percent target midpoint over the medium term.

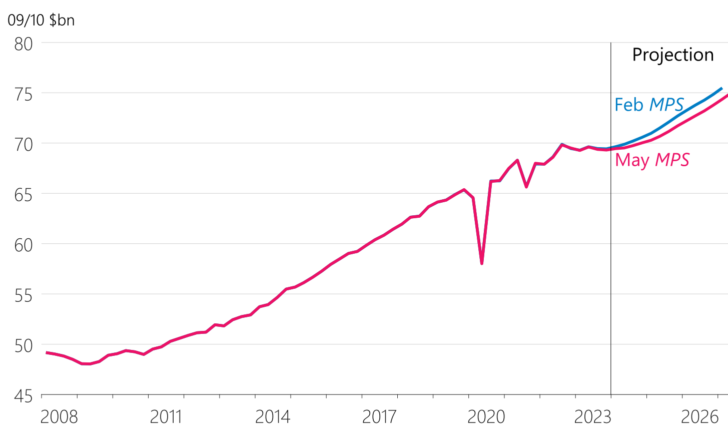


Current economic assessment

Restrictive interest rates have continued to reduce demand in the New Zealand economy

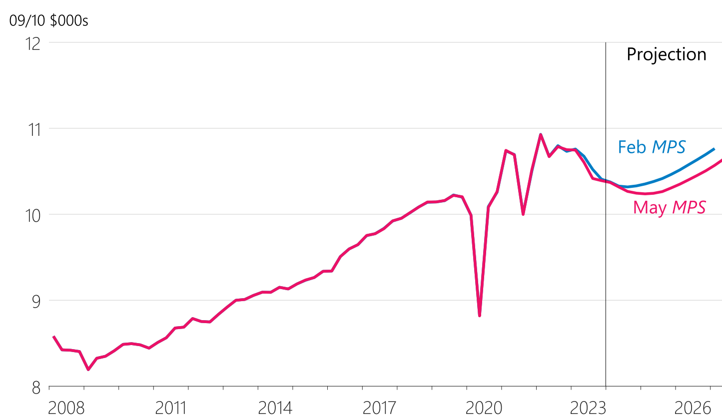
Economic activity in New Zealand, as measured by production GDP, declined by 0.1 percent in the December 2023 quarter. This was slightly weaker than the 0.0 percent assumed at the time of the February *Statement* (figure 2.1).

Figure 2.1
Production GDP
(seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Figure 2.2
Private consumption per capita
(seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Note: Per capita consumption is based on the working-age population.

The prolonged period of high interest rates is reducing household spending, and residential and business investment, despite very strong population growth over the past year. Subdued global growth has also reduced demand for New Zealand's exports. The New Zealand economy has now experienced negative growth in four of the past five quarters, meaning that the level of real GDP is still below its September 2022 quarter peak. While capacity pressures have declined, supply and demand are assumed to have been broadly in balance in the December 2023 quarter.

While the overall level of household consumption declined only slightly during 2023, it declined 3.3 percent in per capita terms (figure 2.2). Household consumption is assumed to decline further in per capita terms this year. High interest rates and a weakening labour market are expected to reduce income growth, while net immigration remains elevated relative to history. Residential investment is also expected to fall further, as a soft housing market and high interest rates more than offset additional demand from population growth. Below-trend global growth and high interest rates are assumed to continue to reduce business investment in 2024. Household consumption, residential and business investment are assumed to recover in the latter half of the three-year projection as interest rates eventually ease.

Recent economic activity indicators have been weak, as expected

Recent economic indicators have been weak, consistent with subdued economic growth as expected. Most survey measures of economic activity have declined. Firms' own domestic trading activity in the March 2024 Quarterly Survey of Business Opinion (QSBO) declined to a net 23 percent of firms reporting weaker activity, from a net 7 percent reporting an increase in the previous quarter. Around 60 percent of respondents in the QSBO claimed that orders are the factor most limiting production (figure 2.3). The Performance of Manufacturing and Services Indices are below their long-run averages. These more recent indicators have been broadly in line with our outlook in the February *Statement*.

Overall, economic growth is still expected to remain subdued over 2024, partly accounted for by weakness in household consumption, residential and business investment. While recovering international visitor numbers are supporting growth in services exports, growth in goods exports is expected to be weaker over the medium term (see chapter 4.2).

Government consumption and investment are assumed to evolve in line with the *Half-Year Economic and Fiscal Update (HYEFU)* 2023, adjusted for the December 2023 quarter GDP data, while we await the publication of the *Budget* on 30 May 2024. Based on *HYEFU* 2023, the share of government expenditure in the economy is projected to decline. However, due to weaker potential output growth, government consumption is higher as a proportion of potential output than projected in the February *Statement* and hence less disinflationary. Reductions in government spending to date have likely been captured in weaker high-frequency indicators for aggregate GDP in the March and June 2024 quarters. Our near-term GDP forecasts are based on these indicators.

Economic growth is assumed to recover from mid-2025, as the effects of high interest rates wane and global economic activity increases. However, the weaker outlook for potential GDP growth means that growth remains lower over the medium term than assumed at the time of the February *Statement*.

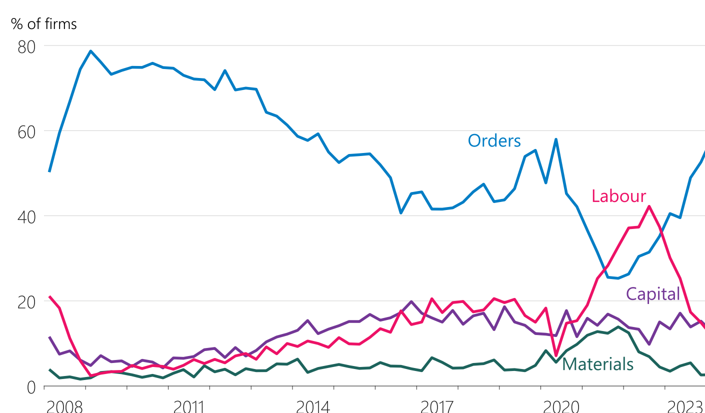
Immigration is adding to demand and supply

Economic activity has been supported to some extent by strong population growth, mainly from high net immigration. Net immigration has increased rapidly since the end of 2022, adding 2.2 percent to the working-age population in the year to March 2024 (figure 2.4). Migration is adding to demand in the economy, and increasing rents. Annual rent inflation is currently 4.7 percent, well above its 20-year average of 2.6 percent.

Figure 2.3

QSBO factor most limiting production

(seasonally adjusted)

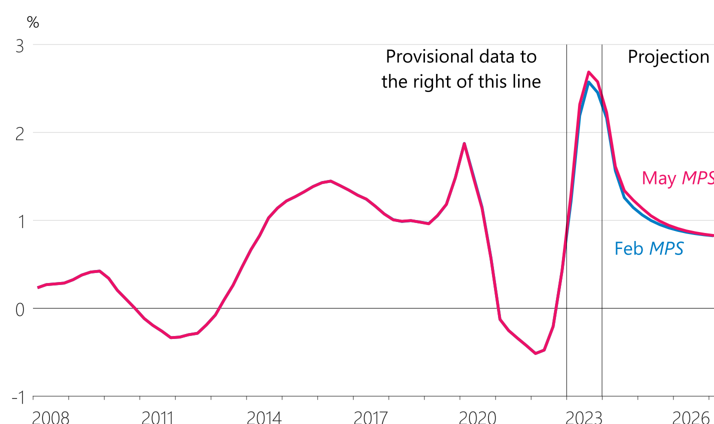


Source: NZIER, RBNZ estimates.

Figure 2.4

Net immigration

(annual, share of working-age population)

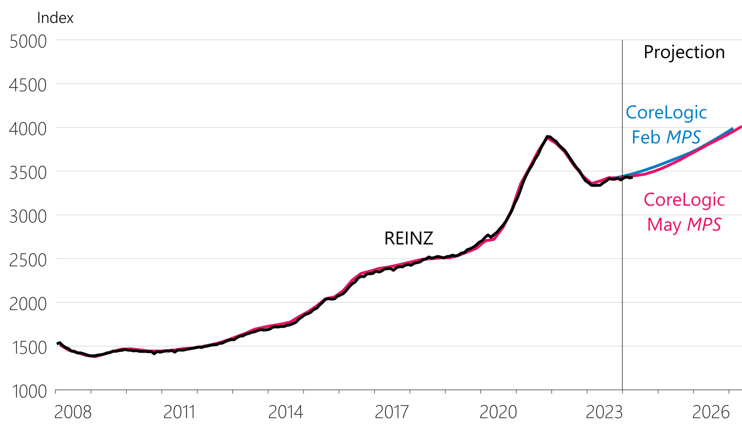


Source: Stats NZ, RBNZ estimates.

Apart from high rental inflation, demand in the housing market has remained subdued. Nationwide house prices have increased only modestly over the past year, after declining roughly 15 percent from their November 2021 peak. Listings have increased, but sales volumes have declined, resulting in a larger stock of houses on the market. Annual house price inflation is assumed to return gradually to its long-run average rate of around 5 percent (figure 2.5). However, the outlook for house prices is always highly uncertain.

While adding to demand, high immigration is also adding to the productive capacity of the economy by boosting the supply of labour. Businesses are reporting that it is much easier to find skilled and unskilled workers, as the acute labour shortages that emerged while the border was closed during the pandemic have subsided. The QSBO showed a sharp decline in respondents claiming labour is the factor most limiting production, after being reported as the factor most limiting output through 2022 (figure 2.3).

Figure 2.5
House prices
(nominal, seasonally adjusted)

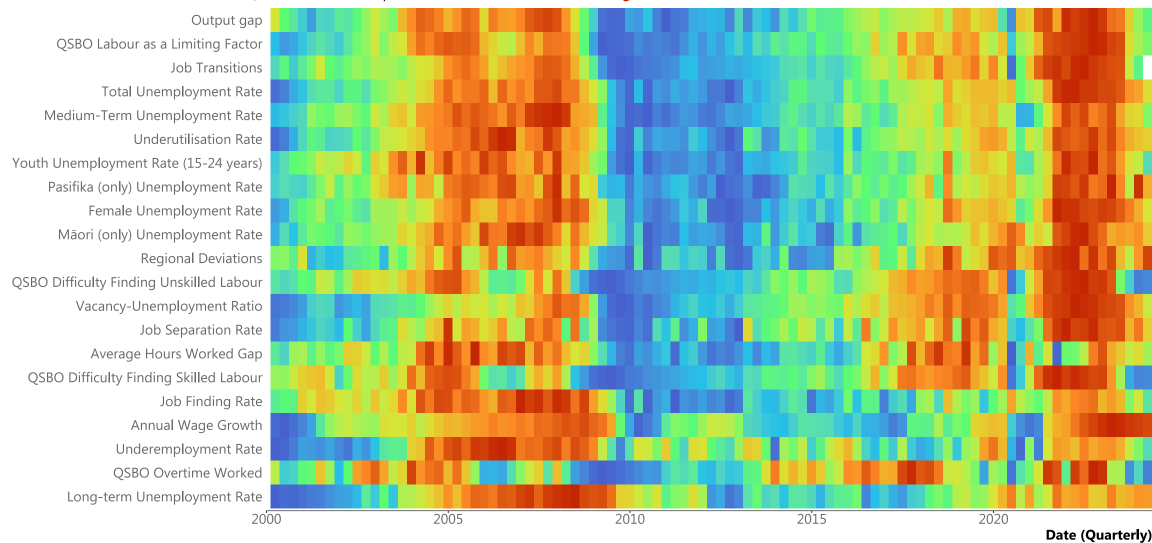


Source: CoreLogic, REINZ, RBNZ estimates.

Labour market conditions have softened

Declining worker shortages are due to both lower demand for labour and more workers being available. Various measures of labour market pressure eased further in the March 2024 quarter, with labour demand and supply now broadly in balance (figure 2.6). Employment declined by 0.2 percent. The unemployment and underutilisation rates increased to 4.3 percent and 11.2 percent respectively. Increases in unemployment were seen across most demographic groups. For example, the rate of youth unemployment – which tends to be highly cyclical – increased from 11.8 percent to 13.8 percent over the quarter.

Figure 2.6
Labour market indicator suite



Source: Stats NZ, NZIER, RBNZ estimates.

Note: See Ball (2024), 'Assessing and communicating labour market indicators of inflationary pressure'.

Participation in the labour force declined from 71.9 percent to 71.5 percent in the March 2024 quarter. While this is still high relative to history and to the rates of many other countries, it is about 1 percentage point lower than its peak in the June 2023 quarter. The decline in participation suggests that some people have stopped looking for work as job opportunities have waned. However, the decline in the participation rate was more than offset by growth in the working-age population, meaning that the overall size of the labour force increased in the March 2024 quarter.

An easing labour market and declining headline inflation have contributed to declines in nominal wage growth. Annual same-job wage growth, as measured by the LCI (ordinary and overtime, private sector) declined from 3.9 percent to 3.8 percent in the March 2024 quarter, as assumed in the February *Statement*. Annual growth in average hourly private sector earnings in the Quarterly Employment Survey (QES) fell from 6.6 percent to 4.8 percent. Since the QES earnings are a broader measure than same-job wages, the steeper fall may reflect the fact that there are fewer opportunities for workers to get larger pay increases by moving jobs or being promoted. This would be consistent with feedback from businesses that worker turnover has fallen quickly in recent quarters, as labour market conditions have eased.

Overall, the labour market is expected to continue to soften as economic activity remains subdued. Lower labour demand is expected to result in fewer job vacancies being listed, lower wage growth and rising unemployment over the medium term.

Global growth is below trend, but there are signs of resilience

Growth in our trading partners has been below trend, largely because central banks have raised interest rates in response to high inflation. Trading partner growth is expected to slow marginally on an annual basis in 2024.

However, activity and inflation data in recent months have led professional forecasters to increase their forecasts of growth, particularly in the US and China (see chapter 3). In the US, monetary policy has contributed to an easing in capacity pressures and inflation, but economic growth remains stronger than in many other developed economies. The US labour market has been robust, consumption growth has remained near its longer-term trend, and services inflation has stopped declining. Despite stress in the housing market, GDP growth in China was higher than expected in the March 2024 quarter, due to strong manufacturing investment and household spending.

Services inflation has declined by less than expected in many countries and is largely unchanged from a year ago in the US. As services inflation is a good gauge of domestically-generated inflation, the persistence in services inflation globally has contributed to expectations of policy interest rate cuts being reduced.

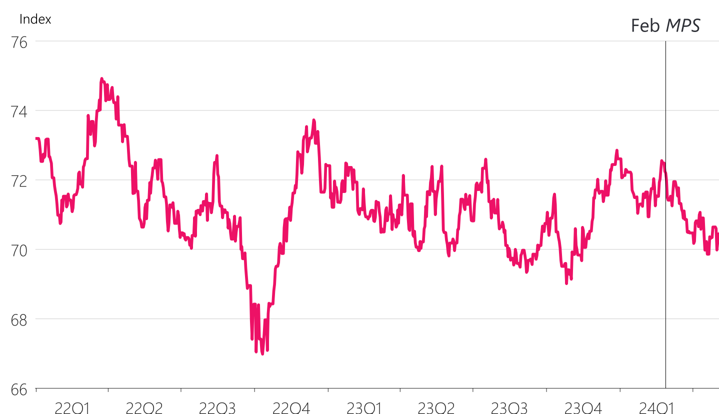
Global developments have led to a higher outlook for imported inflation

Higher interest rates globally, particularly in the US, have contributed to a slightly lower New Zealand dollar exchange rate than assumed at the time of the February *Statement* (figure 2.7). All else being equal, a lower New Zealand dollar exchange rate leads to higher import prices and increases in exporters' returns in New Zealand dollars. Higher global inflation also directly increases the prices of our imported goods and services. World prices for our imports were higher in the December 2023 quarter than assumed in the February *Statement*, and this is assumed to persist into the medium term. These factors mean tradables inflation in New Zealand is now assumed to be higher over the medium term than assumed in the February *Statement* (figure 2.8).

Global shipping costs increased sharply late last year in response to attacks on container ships in the Red Sea and disruptions in the Panama Canal. While they have since declined, they remain significantly higher than they were a year ago. The increases in shipping costs are assumed to pass through to New Zealand import prices with a lag (see chapter 4.1 of the February *Statement*).

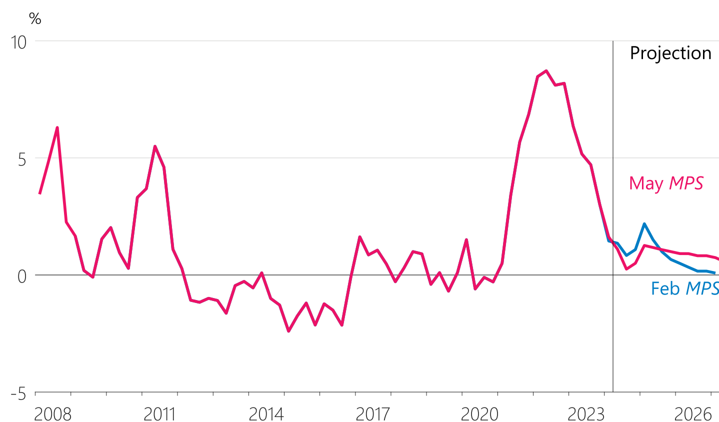
Export prices have declined substantially over the past two years, but a recovery in global dairy prices in recent months has contributed to higher prices for our export basket as a whole. Increased demand from many of our export destinations has supported the improvement in dairy prices, and is also being reflected in higher prices for seafood, forestry and horticulture. These have been partly offset by low lamb prices. Export prices are assumed to be supported by improved trading partner income over the medium term. However, the slightly higher outlook for export prices is more than offset by higher import prices over the medium term, and this results in a weaker outlook for New Zealand's terms of trade.

Figure 2.7
New Zealand dollar TWI
(nominal)



Source: RBNZ.

Figure 2.8
Tradables inflation
(annual)



Source: Stats NZ, RBNZ estimates.

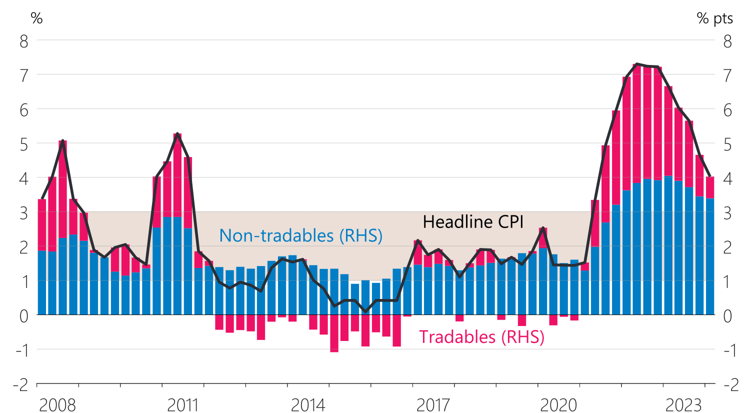
Headline inflation has declined, but domestic inflation has declined by less than expected

Annual CPI inflation declined to 4.0 percent in the March 2024 quarter. While this was much lower than the 4.7 percent in the previous quarter, it remained above the MPC's 1 to 3 percent target band and slightly higher than expected at the time of the February *Statement*. Although both tradables and non-tradables inflation contributed to the decline in headline CPI inflation, the decline was primarily accounted for by tradables (figure 2.9).

Annual tradables inflation declined to 1.6 percent in the March 2024 quarter, slightly higher than the 1.5 percent expected. However, annual non-tradables inflation declined only slightly to 5.8 percent, which was higher than the 5.3 percent expected. While inflation has broadly declined as expected over the past year, non-tradables inflation has generally remained higher than expected while tradables inflation has been slightly lower than expected (figure 2.10).

Higher-than-assumed non-tradables inflation in the March 2024 quarter was accounted for by individually small – but collectively significant – upside surprises across many parts of the CPI basket. The broad-based nature of this inflation is consistent with the declines in most measures of core inflation slowing or stalling in the March 2024 quarter (figure 2.11). Higher-than-assumed non-tradables inflation in an environment of weak economic activity, flat to falling productivity and declining inflation expectations has led us to review our assessment of capacity pressures in the economy, as discussed further in box A.

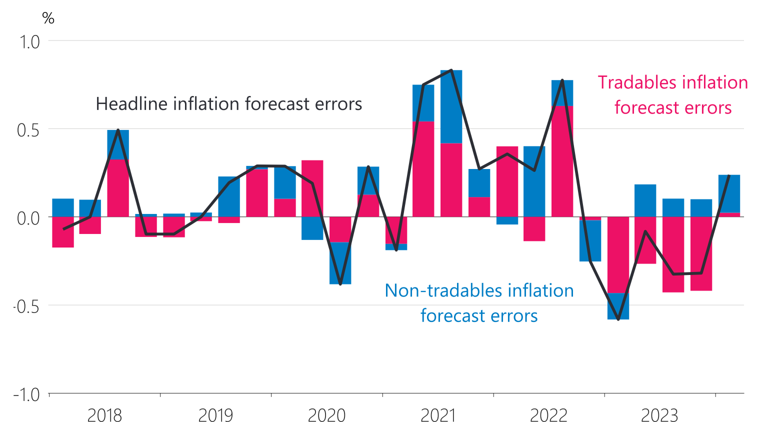
Figure 2.9
Contributions to CPI inflation
(annual)



Source: Stats NZ, RBNZ estimates.

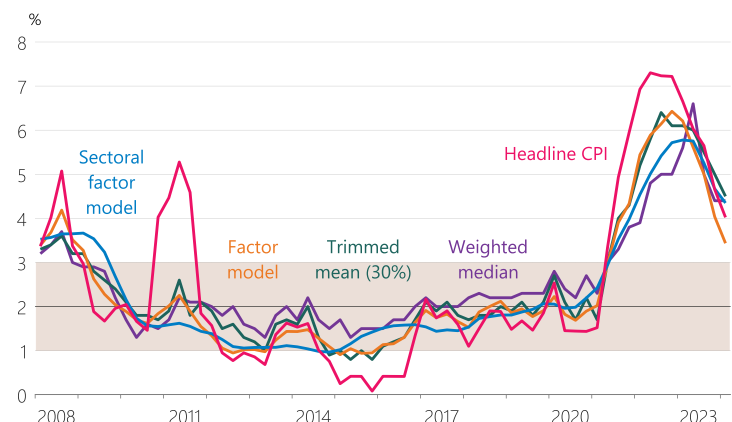
Note: The shaded area represents the MPC's 1 to 3 percent target range for inflation over the medium term.

Figure 2.10
Contributions to annual CPI forecast error
(one quarter ahead)



Source: Stats NZ, RBNZ estimates.

Figure 2.11
Headline and core inflation measures
(annual)



Source: Stats NZ, RBNZ estimates.

Note: The shaded area represents the MPC's 1 to 3 percent target range for inflation over the medium term.

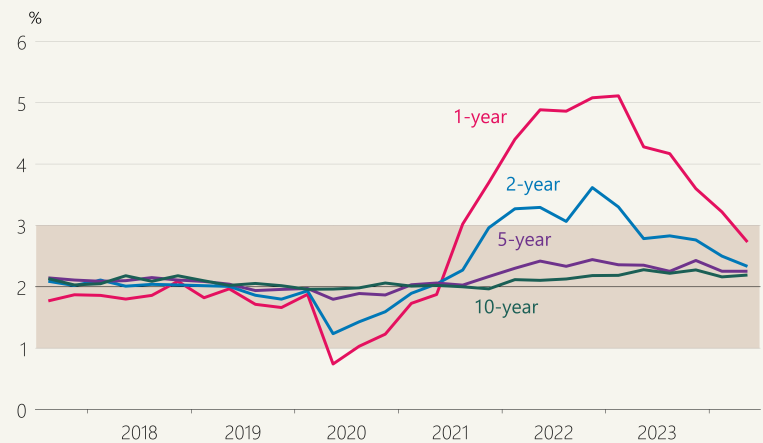
Box A: Assessing capacity pressures in the New Zealand economy

Non-tradables inflation captures changes in prices for goods and services that are less exposed to international competition, and more influenced by domestic factors. Although annual non-tradables inflation has declined over the past year, at 5.8 percent in the March 2024 quarter it remains elevated compared to history and higher than anticipated in previous *Statements*.

Figure A.1

Business inflation expectations

(annual, years ahead)



Source: RBNZ's *Survey of Expectations (Business).*

Note: The shaded area represents the MPC's 1 to 3 percent target range for inflation over the medium term.

Stronger domestic inflation could mean that capacity pressures have been higher in recent quarters than previously assumed

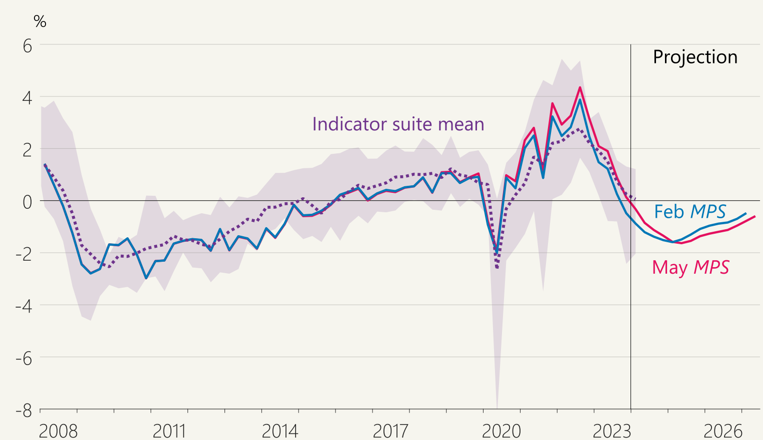
In our core forecasting model, non-tradables inflation is driven by three broad factors:

- the degree to which demand in the economy is putting pressure on available resources (known as the 'output gap' – the difference between actual output and what the economy can supply sustainably);
- pricing behaviour[1]; and
- other developments affecting specific sectors, such as insurance premiums after Cyclone Gabrielle.

Figure A.2

Output gap and indicator suite

(share of potential GDP, seasonally adjusted)



Source: Stats NZ, NZIER, MBIE, RBNZ estimates.

Various measures of inflation expectations have declined in recent quarters as headline CPI inflation has eased (figure A.1). As discussed in more detail in chapter 4.1, some specific components, such as insurance and local authority rates, have contributed to elevated non-tradables inflation over the past year. However, the broad-based resilience in non-tradables inflation in conjunction with falling inflation expectations suggest that the output gap may have been higher than assumed at the time of the February *Statement*. This is despite actual economic growth being slightly lower in the second half of 2023 than previously expected.

The output gap is unobservable, so we rely on a broad range of indicators to give us a steer on the degree of capacity pressures in the economy at any point in time (figure A.2). These indicators suggest that the output gap has declined from around 3 percent of potential output at the start of 2023 to around zero currently.

1 Pricing behaviour i.e. wage- and price-setting behaviour, which captures inflation expectations, wages and inflation persistence.

Another way in which we can estimate the degree of capacity pressures in the economy is by using our core forecasting model, New Zealand Structural Inflation Model (NZSIM), to assess the extent that non-tradables inflation can be explained by macroeconomic forces. Figure A.3 shows the modelled explanation of non-tradables inflation in the February *Statement*. The red bars show how much cannot be explained by the other variables in the model. If these red bars are consistently positive or negative for a period, this may indicate that our assumed output gap is too high or too low. Over the past three years, these bars had been consistently positive. While some of this can be explained by known idiosyncratic factors – such as the extreme under-supply of some building materials in New Zealand during the pandemic – they had remained elevated, suggesting our assumed output gap may have been too low.

Figure A.4 shows the same modelled explanation from the current central projection, where the output gap has been revised higher (from -0.9 percent to -0.3 percent of potential GDP in the March 2024 quarter). While a large part of the March 2024 non-tradables outturn remains unexplained by NZSIM, the 'unexplained' bars have been much smaller over recent years.

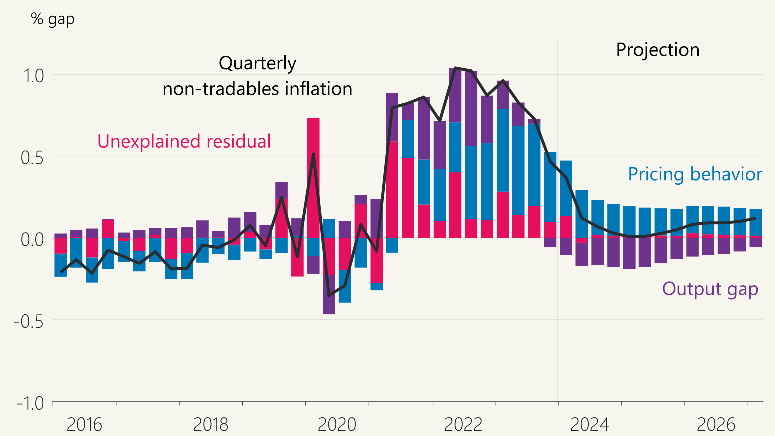
One reason that weak economic growth may not have translated into much lower capacity pressures is that declining productivity has reduced the speed at which the economy can grow without generating inflation (figure A.5). Very weak productivity growth in recent years likely reflects a range of factors, including the significant disruptions to the process of matching workers with jobs, and shifts in the composition of economic output experienced during the pandemic. While declining productivity has contributed to particularly subdued growth in potential output over the past year, productivity growth has been weak for many years.[2] Sustained lower productivity growth, or further deterioration, would contribute to lower growth in potential output over time, resulting in lower real incomes and wellbeing, and imposing a lower 'speed limit' on the economy.

2 See Treasury (2024), 'The productivity slowdown: implications for the Treasury's forecasts and projections' for discussion of New Zealand's poor productivity growth since the global financial crisis.

Figure A.3

Modelled explanation of non-tradables inflation in the February 2024 *Statement*

(quarterly, seasonally adjusted)

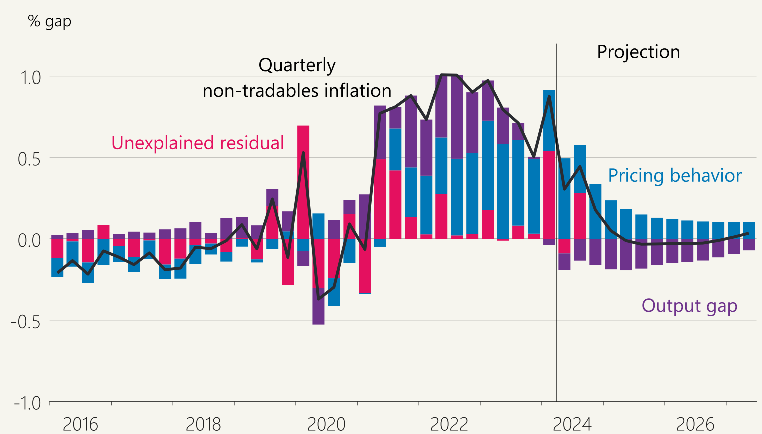


Source: RBNZ estimates.

Figure A.4

Modelled explanation of non-tradables inflation in the central projection

(quarterly, seasonally adjusted)

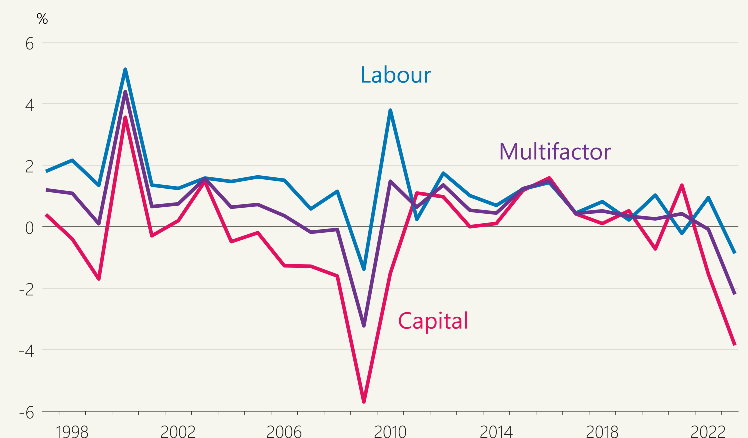


Source: RBNZ estimates.

Figure A.5

Productivity growth

(annual, March years)

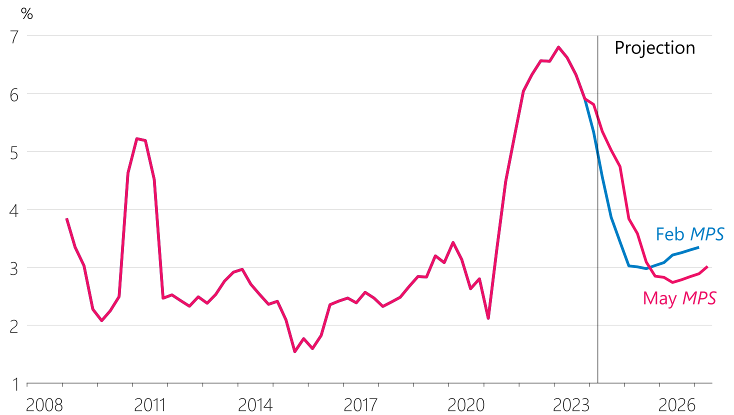


Source: Stats NZ.

Given that potential GDP and the output gap are unobservable, there is no single approach that can accurately estimate these variables at any given time. This is why we use a range of approaches, including models and our output gap indicator suite, to provide a steer on how capacity pressures have evolved. We also review our assumptions regularly.

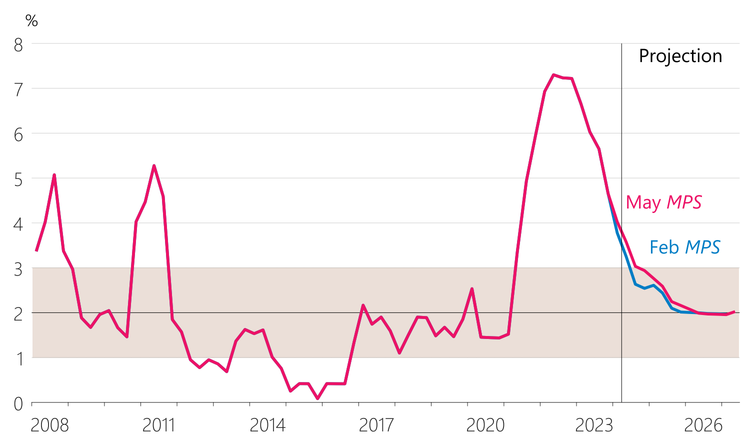
Overall, low growth in productivity and potential output mean greater capacity pressures in the economy and a slower decline in non-tradables inflation over 2024 than assumed in the February *Statement* (figure 2.12). Non-tradables inflation is lower in the latter part of the projection. This is because of a lower output gap due to higher interest rates, and the expectation that price- and wage-setting behaviour becomes consistent with a low inflationary environment slightly more quickly than previously assumed once headline inflation is within the 1 to 3 percent target band. When combined with the outlook for slightly higher tradables inflation, this means that the outlook for annual CPI inflation is a more gradual decline towards the midpoint of the target band (figure 2.13). Annual headline CPI inflation is assumed to return to within the MPC's 1 to 3 percent target band by the December 2024 quarter, and to the 2 percent target midpoint by the June 2026 quarter.

Figure 2.12
Non-tradables inflation
(annual)



Source: Stats NZ, RBNZ estimates.

Figure 2.13
CPI inflation
(annual)



Source: Stats NZ, RBNZ estimates.

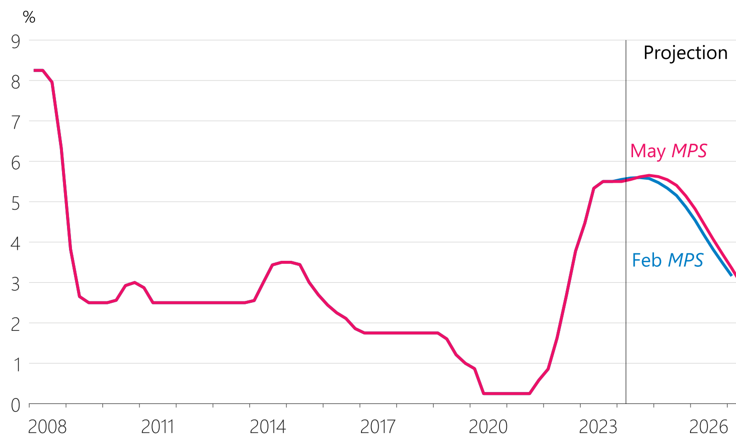
Note: The shaded area represents the MPC's 1 to 3 percent target range for inflation over the medium term.

Monetary policy outlook

Conditional on the central economic outlook, we expect that the OCR will need to remain at a restrictive level for longer than assumed in the February *Statement* (figure 2.14), in order for inflation to return to the 2 percent target midpoint in a similar timeframe to what was assumed in the February *Statement*.

The higher outlook for the OCR than in the February *Statement* reflects the higher starting point for non-tradables inflation and capacity pressures, as well as a higher medium-term outlook for tradables inflation based on higher import prices, higher global interest rates and the lower New Zealand dollar exchange rate. In addition, our assumption for the nominal long-run neutral interest rate has been revised from 2.50 to 2.75 percent, based on increases in the Reserve Bank's suite of neutral interest rate indicators. While the higher neutral rate is not assumed to require an immediate monetary policy response, it affects where the OCR is assumed to settle at the end of the projection. These factors are only partly offset by an assumption that businesses' wage- and price-setting behaviour normalises slightly more quickly once headline inflation is within the 1 to 3 percent target band.

Figure 2.14
Official Cash Rate
(quarterly average)



Source: RBNZ estimates.

Chapter 03

Global developments and outlook

Ōkārito, West Coast. Photo: Andre Castaing

Chapter 3. Global developments and outlook

This chapter outlines recent global developments as of 16 May 2024.

Growth across New Zealand's key trading partners remains below trend and is expected to slow slightly further over 2024 as restrictive monetary policy continues to moderate economic activity. However, economic activity in some economies, such as the US and China, has been stronger than expected so far this year. This has fed through to an increase in 2024 growth expectations.

Global headline and core inflation have continued to decline over recent months, although headline inflation remains above central bank inflation targets in most advanced economies. Services inflation continues to decline slowly across major economies but is expected to ease further over the rest of 2024. Labour markets remain robust, with unemployment rates still low compared to pre-COVID-19 averages, although labour demand continues to ease.

Major central banks have kept their policy rates unchanged in recent months. In response to some stronger-than-expected economic data, financial market participants now expect a more gradual pace in easing monetary policy settings. As a result, global sovereign yields have increased while global equity prices have changed little since the February *Statement* as global risk sentiment remains strong.

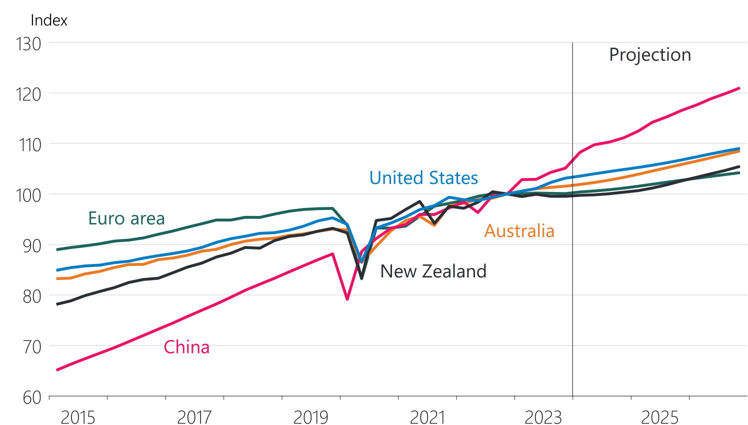
Global economic activity is below trend but remains resilient to high interest rates

Economic growth remains below trend for many of our trading partners (figure 3.1). However, some stronger-than-expected activity data since the beginning of the year have increased some near-term expectations for growth, particularly in the US and China. Growth in New Zealand's key trading partners is expected to be 2.8 percent in 2024, slightly below the 3.0 percent growth of 2023.

Figure 3.1

Key trading partner GDP forecasts

(index=100 in Q4 2022)



Source: Consensus Economics, Haver Analytics, RBNZ estimates.

Note: GDP forecasts are based on Consensus Economics estimates, except New Zealand's which is based on our current projection.

Economic growth in the US has remained strong, but is expected to moderate over the rest of this year. Real GDP increased by 3.0 percent in the year to the March 2024 quarter and is expected to increase by 2.3 percent over 2024. Recent economic activity in the US has been supported in part by households saving less to support consumption. More broadly, the US economy has been resilient to high interest rates given a combination of factors such as stimulatory fiscal policy, a sharper drawdown of excess savings and stronger productivity growth compared to other advanced economies.

Economic activity in China was stronger than expected at the start of this year. GDP increased by 5.3 percent in the year to the March 2024 quarter as robust investment growth in the manufacturing sector and improving household consumption offset continued weak activity in the property sector. The improvement in overall economic activity appears to have reduced the need for further material fiscal or monetary policy stimulus in the near term. However, a weak housing market, low levels of consumer confidence and elevated debt levels remain key challenges for China's growth outlook. China's economy is expected to expand 4.8 percent over 2024, slightly less than the Government's target of around 5.0 percent growth.

In Australia, annual GDP growth slowed to 2.1 percent in the December 2023 quarter, accounted for by slower growth in household consumption and government spending. The Australian economy is expected to grow 1.4 percent over 2024 as high interest rates continue to weigh on economic activity.

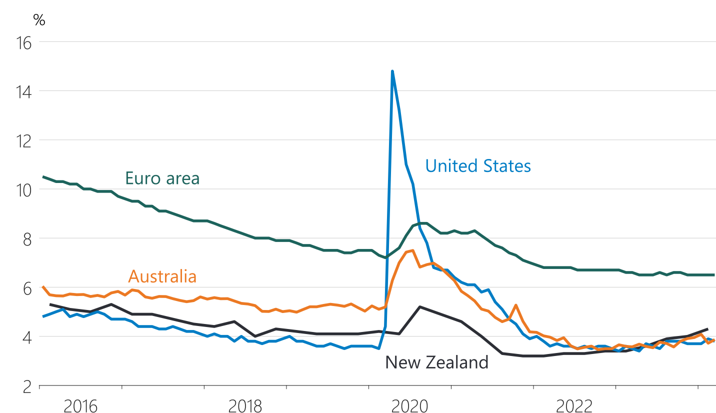
The euro area economy expanded 0.4 percent in the year to the March 2024 quarter. Although low, this was stronger than expected, suggesting that growth is starting to recover after contracting in the second half of 2023 in response to high inflation and tighter monetary policy. The euro area is expected to grow 0.5 percent in 2024.

Global labour markets continue to ease, but remain robust

Unemployment rates in advanced economies have increased from historical lows but are still below pre-COVID-19 averages (figure 3.2). Labour demand continues to decline, although the pace of this decline has slowed in some economies. Labour markets are expected to continue easing gradually over 2024.

The unemployment rates in the US, euro area and Australia have remained stable over recent months. High immigration rates across several of New Zealand's key trading partners have supported an increase in labour supply. As restrictive interest rates continue to feed through to a decline in aggregate demand, labour demand has also eased. Both factors have brought the labour market back to a better balance following labour shortages during the COVID-19 period. Easing labour market conditions are feeding through to slower wage growth across most advanced economies, although this moderation appears to be occurring faster in the US than elsewhere.

Figure 3.2
Key trading partner unemployment rates
(unemployed people as a share of the labour force, seasonally adjusted)



Source: Haver Analytics, Stats NZ.

Global inflation continues to decline

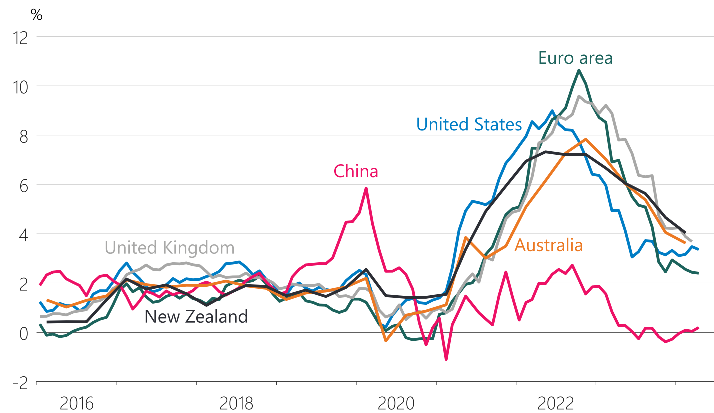
Headline inflation has continued to decline across advanced economies and is now between 2.0 and 4.0 percent in most of New Zealand's key trading partners. In China, headline inflation remains low at 0.3 percent (figure 3.3). Core inflation – inflation excluding food and energy – has also continued to decline but remains higher than headline inflation in most major economies, due to high services inflation (figure 3.4).

Disinflation to date has primarily been driven by lower goods, energy and food inflation. Services inflation, which tends to be a good gauge for domestically-generated inflation, has remained high across advanced economies. The slow disinflation of services has been driven by high wage growth and a shift in demand away from goods to services following the pandemic. In the US, annual services inflation has remained largely unchanged over 2024 at around 5.3 percent. Services inflation is declining slowly in New Zealand's other key trading partners.

Figure 3.3

Headline inflation for key trading partners

(annual)



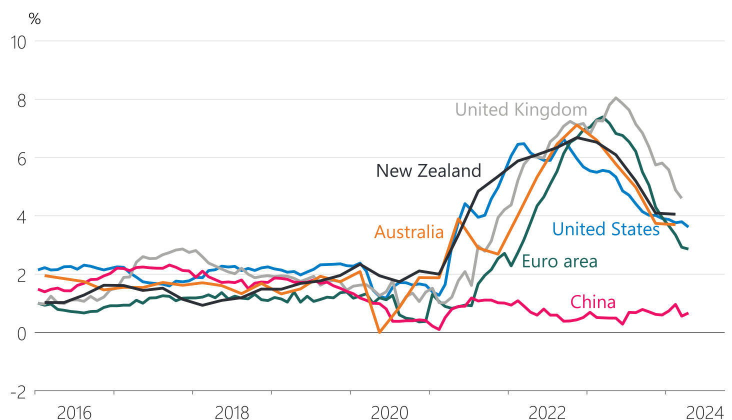
Source: Haver Analytics, Stats NZ.

Note: Data are monthly, except for Australia and New Zealand, which only publish official inflation data quarterly.

Figure 3.4

Inflation excluding food and energy for key trading partners

(annual)



Source: Haver Analytics, Stats NZ.

Note: Data are monthly, except for Australia and New Zealand, which only publish official inflation data quarterly.

Financial markets expect some central bank policy rates to decline more slowly

Most major central banks have left their policy rates unchanged since the February *Statement*. Many central banks continue to view their policy stances as restrictive and have communicated the importance of taking data-driven approaches to policy decisions. Some central banks have also said they will need to be confident that inflation is returning sustainably to target before easing policy rates.

Overall, financial market participants are expecting central banks to ease monetary policy more gradually than previously anticipated. This largely reflects the resilience in global economic activity and inflation so far this year. However, the pace and extent of monetary policy easing currently implied by market pricing differ across regions (figure 3.5). Market pricing currently suggests that market participants expect the European Central Bank (ECB) to lower its policy rate by 70 basis points this year, and a more moderate 45 basis point decline is expected from the Federal Reserve (Fed). This compares to the 90 and 70 basis points of cuts expected in 2024 from the ECB and the Fed, respectively, at the time of the February *Statement*. Further, in light of slower-than-expected disinflation in Australia in early 2024, market participants are no longer expecting the Reserve Bank of Australia (RBA) to ease its policy rates this year, compared to the 40 basis point reduction expected at the time of the February *Statement*.

In March, the Bank of Japan (BoJ) increased its policy rate for the first time since 2007 and announced an end to its Yield Curve Control Programme. The policy rate was increased by 10 basis points to a range of 0.0 to 0.1 percent. The move came after the Japanese spring wage negotiations resulted in higher-than-expected pay increases, providing confidence that inflation is more likely to remain close to target after several decades of very low inflation.

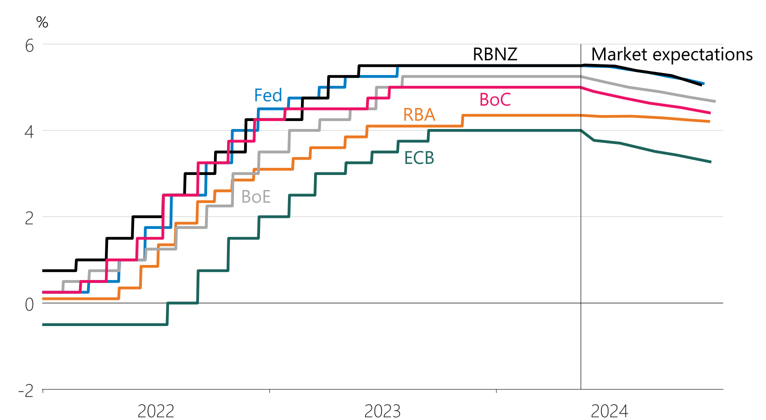
Global sovereign yields have increased

Expectations for fewer policy interest rate cuts have driven an increase in sovereign yields since the February *Statement*. Over this period, US 2-year and 10-year Treasury yields have increased by 20 and 30 basis points respectively (figure 3.6). This trend has been similar across advanced economies. Stronger-than-expected economic activity and inflation data have led to expectations that policy rates will decline more slowly over coming years, particularly in the US. The recent increase in US sovereign yields has fed through to higher yields in other advanced economies, despite some divergence in economic data and monetary policy expectations across regions.

Figure 3.5

Market-implied path of policy rates

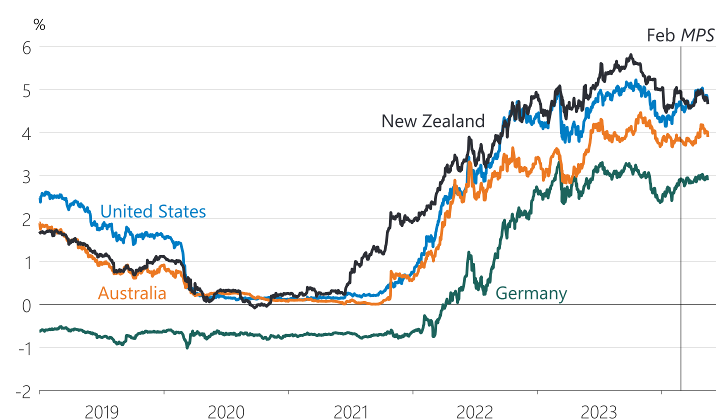
(annual)



Source: Bloomberg.

Figure 3.6

2-year sovereign yields



Source: Bloomberg.

Global risk sentiment remains strong

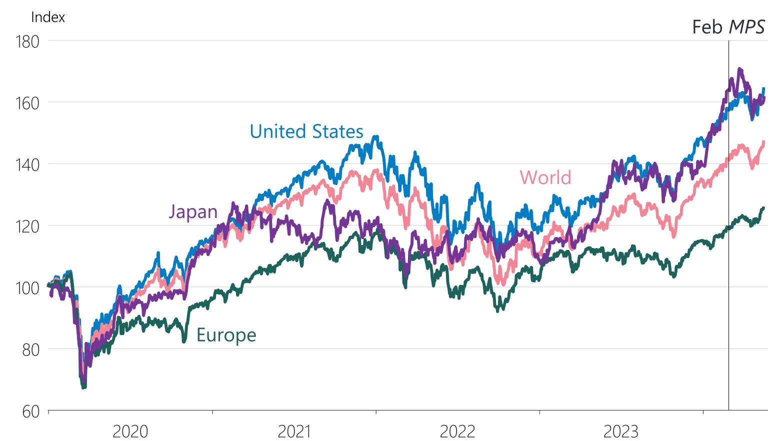
Global equity prices have broadly remained the same since the February *Statement* but remain higher than they were at the start of the year (figure 3.7). Strong earnings results, particularly in the technology sector in the US, have continued to support equity prices. However, this has largely been offset by the effects of higher expectations for central bank policy rates over recent months, which have placed downward pressure on global equity prices. Despite some volatility in global equity markets, equity risk premia remain low across advanced economies.[3] In addition, credit and funding market conditions remain favourable, particularly given the higher-interest-rate environment. Market pricing across a range of asset classes currently indicates that investors remain optimistic about the global economic outlook.

Oil prices increased in March in response to continued OPEC+ supply cuts and expectations of a tighter oil market in 2024 (figure 3.8). Since then, prices have declined to levels similar to those of the February *Statement*, indicating the limited impact of the ongoing geopolitical tensions in the Middle East. Despite increases in the number of crossings through the Panama Canal following a period of drought, shipping costs are still elevated compared to historical levels, reflecting the ongoing disruptions to travel in the Red Sea.

Figure 3.7

Global equity prices

(index=100 on 1 January 2020)



Source: Bloomberg.

Figure 3.8

Dubai oil price

Source: Bloomberg.

3 Equity risk premia is the compensation equity investors demand for risk compared to safer investments.

Chapter 04

Special topics

Aoraki. Photo: Nele McHattie

Chapter 4. Special topics

Before the publication of each *Statement*, the Monetary Policy Committee is provided with analyses of some topical issues.

Topics for the May *Statement* included:

1. Non-tradables inflation in New Zealand
2. Recent trends in New Zealand's exporting sector

Special topics in the past 12 months

Topic	Date/publication
The effect of higher shipping costs on inflation and the OCR	February 2024 *Statement* (Chapter 4)
The effect of the Government's proposed policies on monetary policy	February 2024 *Statement* (Chapter 4)
Monetary policy transmission lags	November 2023 *Statement* (Chapter 4)
The inflationary impact of recent migration	August 2023 *Statement* (Chapter 4)
Factors contributing to New Zealand's current account deficit and outlook	August 2023 *Statement* (Chapter 4)
The recovery in international tourism over the 2022/23 summer	May 2023 *Statement* (Chapter 4)
Have inflation expectations become more sensitive to higher inflation?	May 2023 *Statement* (Chapter 4)

1 Non-tradables inflation in New Zealand

Summary

- 'Non-tradables' goods and services are those that have low exposure to international competition. Non-tradables make up around 60 percent of the CPI basket.
- Non-tradables inflation is influenced primarily by domestic factors and tends to move relatively closely to core inflation. This makes it an important metric to monitor regarding the speed and sustainability with which the MPC is meeting its medium-term inflation target.
- Non-tradables inflation remained broad based in the March 2024 quarter and declines have slowed in recent quarters. Inflation remains high across all services subgroups.
- So far, monetary policy has reduced non-tradables inflation primarily through areas most responsive to monetary policy, especially housing and construction costs. In the near term, the main contributor to further declines in non-tradables inflation is expected to be a declining rate of market services inflation. This will likely be due to a weakening labour market and lower spending growth.
- The pace of disinflation will be tempered by some relative price increases in categories with slower responses to monetary policy. Subgroups with slower responses to monetary policy are now contributing more to inflation than other subgroups.

Non-tradables inflation is mainly affected by domestic capacity pressures and pricing behaviour

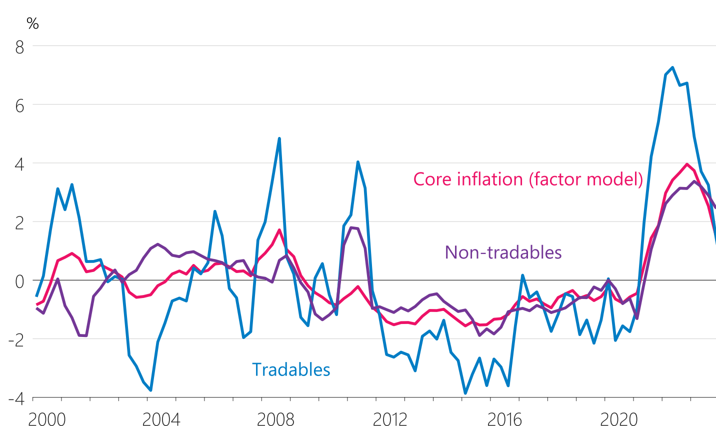
Headline inflation can be broken down into tradables and non-tradables inflation. While tradables inflation is often driven by changes in international prices and exchange rates, non-tradables inflation is mainly affected by domestic capacity pressure and price and wage setting behavior. As such, non-tradables inflation is largely driven by domestic demand and supply rather than global developments.

Non-tradables inflation moves closely in line with core inflation[4] (figure 4.1) and tends to be more persistent than tradables inflation. Moreover, non-tradables items account for around 60 percent of the CPI basket. Therefore, understanding the factors influencing non-tradables inflation is important for monetary policy decisions.

Figure 4.1

Inflation subgroups vs core inflation

(annual, deviation from post-2000 average)



Source: Stats NZ, RBNZ estimates.

4 Core inflation represents pricing pressures that are likely to persist once temporary shocks have unwound (Orr, 2024).

Non-tradables inflation has broadened

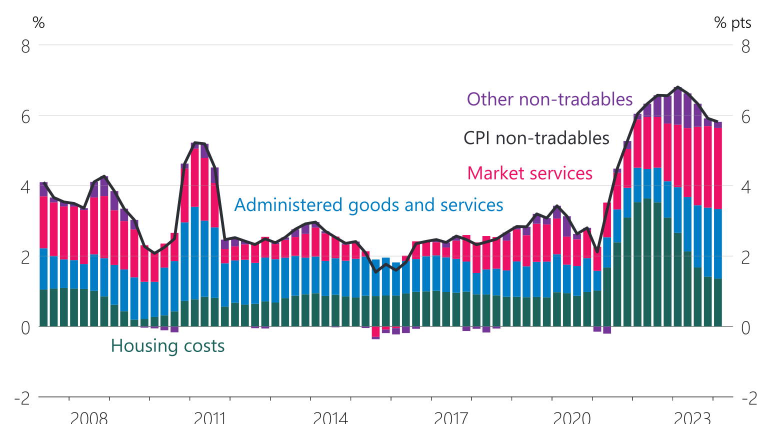
Sharp increases in non-tradables inflation over 2021 and early 2022 were largely due to housing-related price increases. Housing costs surged through this period as strong demand and constrained labour supply contributed to a rapid increase in home construction costs.

Excess demand and higher inflation expectations resulted in price increases broadening over 2022/23 to other non-tradables. These included administered goods and services and market services prices (figure 4.2).

Figure 4.2

Contributions to non-tradables inflation by category

(annual)



Source: Stats NZ, RBNZ estimates.

Note: We decompose non-tradables inflation into high-level groups. “Housing costs” includes actual rentals for housing, home ownership and property maintenance costs, “administered goods and services” includes property rates and related services, alcoholic beverages and tobacco, health services and other administered services, “market services” includes restaurant meals and ready-to-eat food, household energy, insurance and other market services, while “other non-tradables” include other subgroups that are not included in previous categories.

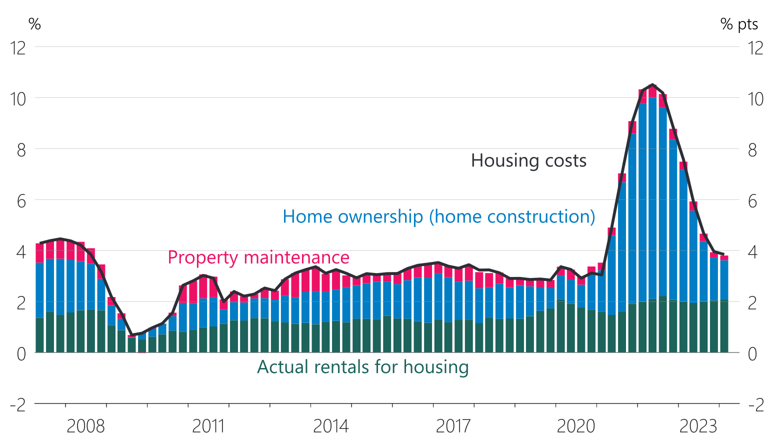
The decline in housing-related inflation is slowing

Construction bottlenecks began unwinding in the latter part of 2022. Residential investment activity also began slowing in late 2022 primarily in response to higher interest rates. As a result, slower price increases in construction accounted for much of the decline in the housing costs component of non-tradables inflation. Given the large weight for housing costs in the CPI basket (21 percent), this also accounted for most of the decline in overall non-tradables inflation. Even though housing-related inflation is getting closer to its pre-pandemic level, the rental component remained historically high in the March 2024 quarter (figure 4.3). Rent inflation is likely to remain high in the near term, as strong migration-led population growth adds to housing demand while new dwelling construction slows. However, over time, lower growth in nominal household incomes and slowing population growth are likely to contribute to slowing rental inflation.

Figure 4.3

Contributions to housing costs inflation

(annual)



Source: Stats NZ, RBNZ estimates.

Declines in market services inflation are likely to support a slowing in non-tradables inflation

Market services inflation is likely to slow over the coming year, with declines likely to be most material in subgroups that are relatively responsive to monetary policy tightening (box B). Broadly, these are areas more affected by cut-backs in discretionary spending as the labour market eases and income growth slows. However, the ongoing recovery in international tourism may prolong price growth in some categories related to hospitality.

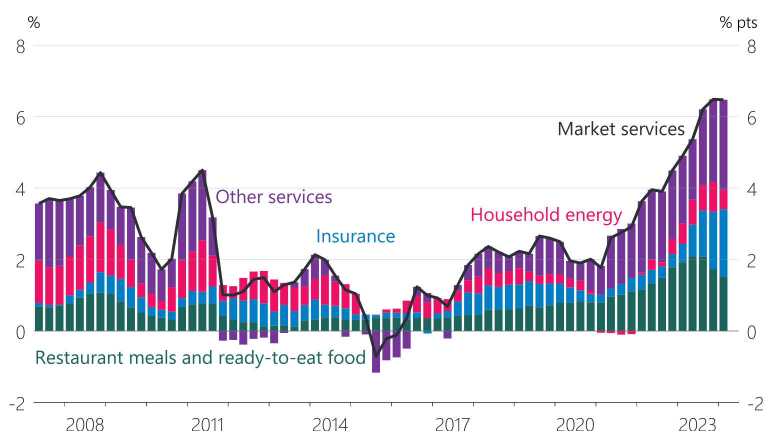
Dwelling, contents and vehicle insurance premiums have increased steeply in response to severe property damage from the Auckland anniversary floods and Cyclone Gabrielle in 2023 (figure 4.4). The cost of global reinsurance has also risen as the scale and frequency of severe weather events have increased. More frequent severe weather events due to climate change will present further upside risks to insurance costs in coming years.

Energy price increases are likely as electricity network revenue will be reset by the Commerce Commission in April 2025.[5] This will partly reflect the increased investment associated with a transition to more renewable power and a lower carbon economy, although this will be spread over some time.

Figure 4.4

Contributions to market services inflation

(annual)

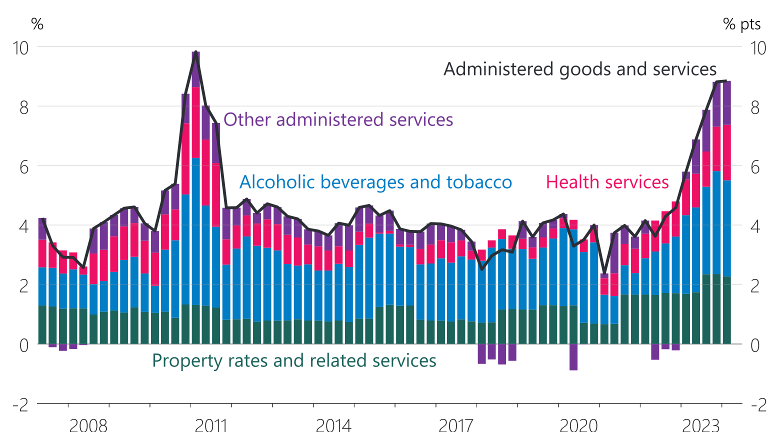


Source: Stats NZ, RBNZ estimates.

Figure 4.5

Contributions to administered goods and services

(annual)



Source: Stats NZ, RBNZ estimates.

5 Commerce Commission - 2025 reset of the electricity default price-quality path (comcom.govt.nz)

Administered goods and services inflation is likely to ease

Inflation rates for administered items are currently elevated (figure 4.5), but are expected to decline over the medium term. Tobacco and alcohol excise taxes are indexed to the CPI (excluding credit services), so inflation in these categories is likely to decline with a lag.

Property rates and related services inflation is an exception. Specifically, council rates have increased steeply over the past year and are likely to rise significantly this year. Local governments have recently proposed large increases to make up for shortfalls in revenue and an underinvestment in infrastructure spending in the past. Inflation has also meant that rate increases in recent years have been lower than expected in real terms. While lower general inflationary pressures should feed through into rate rises over time (e.g. via labour and material costs), relatively high inflation in council rates may persist if council expenditure requirements continue to grow or implementation delays increase costs.

The slow decline in administered goods and services inflation is consistent with our analysis that monetary policy has a relatively slow pass through to many of the components of this group (box B).

Conclusion

This analysis of non-tradables inflation suggests that while it will decrease, there are some factors that may slow the pace of decline. Relative price growth in some categories less responsive to monetary policy, in particular insurance, household energy and administered goods and services, is likely to temper the pace of overall non-tradables disinflation.

Monetary policy must remain restrictive to ensure that capacity pressures ease and price and wage setting behaviour normalise, to return inflation to the target midpoint in a reasonable timeframe.

Box B:
Monetary policy responsiveness of non-tradables subgroups

We recently conducted an analysis to understand the effects of OCR changes on different non-tradables subgroups. For this, we estimated the response across these subgroups to an unanticipated change of 100 basis points in the OCR over 12 quarters.[6] This exercise helped us to compare each subgroup by its responsiveness to OCR changes. Our sample consisted of 29 CPI non-tradables subgroups for the period 2006 to 2023.

We ranked subgroups by their monetary policy responsiveness and sorted them into three main groups: highly, medium and less responsive groups. This grouping was based on how statistically significant the reaction to the OCR change was. Table B.1 indicates some of the CPI components in each responsiveness group.

Table B.1
Non-tradables subgroups by their responsiveness to a monetary policy shock

Highly responsive	Medium responsive	Less responsive
Passenger transportation services	Restaurant meals and ready-to-eat food	Property rates and related services
Home ownership (home construction)	Actual rentals for housing	Recreational and cultural services
Other miscellaneous services		Insurance
Property maintenance		Household energy

6 It is challenging to isolate monetary policy's impact on inflation, because monetary policy is set in response to changes in the inflation outlook. We controlled for this in our analysis by estimating the effects of monetary policy 'shocks'. Shocks refer to changes in monetary policy that are independent of other changes to the inflation outlook (see chapter 4.1 in the November 2023 *Statement*).

2 Recent trends in New Zealand's exporting sector

Summary

- Exports are a key driver of economic growth and account for about a quarter of economic activity in New Zealand. Assumptions around trend export volumes as a share of potential output therefore have an important influence on our forecasts.
- In our forecasts, export volumes are affected by a range of temporary and cyclical factors, before returning to an assumed long-run percentage of potential GDP. Goods exports as a share of potential GDP have steadily declined over the past decade and are now well below our previous long-run trend assumption. In the following section, we focus on recent and future trends for goods exports only, while we assume trends for services exports are similar to those in the February *Statement*.
- Recent trends in goods exports suggest that supply constraints, such as tighter environmental restrictions, and uncertainty around securing beneficial trade agreements make it unlikely that New Zealand's goods exports will increase as much as previously assumed.
- In our projections, the weaker outlook for goods exports over the longer term does not materially change the amount of inflationary pressure in the economy. Resources that will not be used to produce exports – including labour and capital – are assumed to be deployed elsewhere in the economy. To the extent that this reallocation results in lower productivity growth, this contributes to lower potential GDP growth, but little change to anticipated capacity pressure.[7]
- Slow growth in goods export volumes contributes to a wider current account deficit in these projections. A wider current account deficit increases the risk of a depreciation of the real New Zealand dollar exchange rate over the medium term, although our net foreign liabilities are projected to remain at a low level compared to recent decades.

7 See Fabling and Sanderson (2013), Conway (2018) and the Productivity Hub (2018).

Our approach to forecasting goods exports

Goods and services exports comprise around 25 percent of New Zealand's GDP with about 70 percent goods and 30 percent services. Trends in exports influence aggregate demand, capacity pressures, external balances, incomes and employment. Consequently, exports are an important factor in our forecasts.

In our forecasts, export volumes are influenced by a range of temporary and cyclical factors, but return to an assumed long-run trend as a percentage of potential GDP. The long-run assumption as a percentage of potential GDP reflects the fact that we see the economy returning to its steady state. However, over the past decade goods exports as a share of potential GDP have steadily declined, and they are now significantly below our previous long-run assumption. While services exports have increased slightly during the same time, they offset only a small portion of the decline in goods exports.

We have assessed trends underpinning New Zealand's goods export performance to help inform an appropriate level for our long-run export assumptions. While services exports, including international tourism to New Zealand, declined sharply following border closures during the COVID-19 pandemic, they have recovered broadly in line with our expectations over the past year. In contrast, goods export volumes, on which we focus in this analysis, have been broadly unchanged since 2019, following several decades of relatively steady growth.

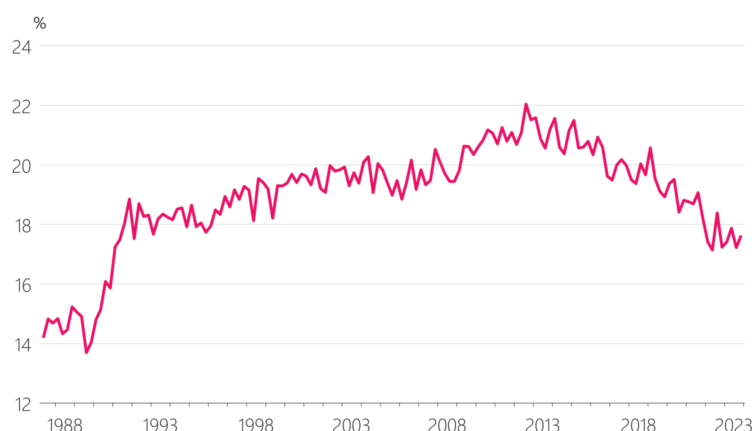
Goods export trends appear to have changed

New Zealand's goods exports as a share of potential GDP have been on a consistent downward trend over the past decade, from their 2013 peak of 22 percent to about 18 percent in the December 2023 quarter (figure 4.6). The average annual growth rate of New Zealand goods exports has fallen from 4 to 5 percent in the late 1990s and early 2000s, to 2.5 to 3.5 percent in the 2010s.

Figure 4.6

Real goods exports

(share of potential GDP)

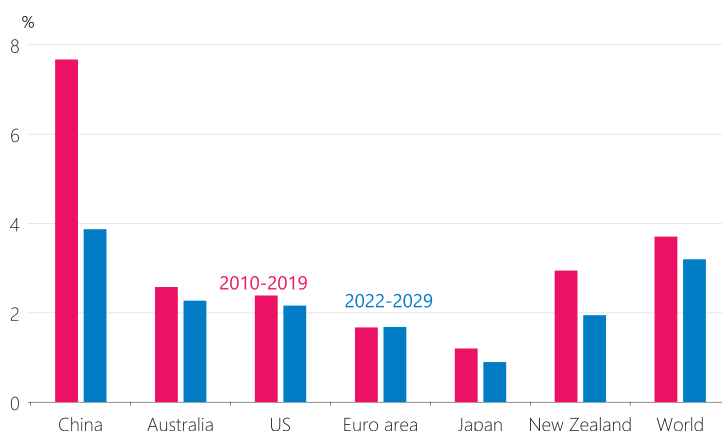


Source: Stats NZ, RBNZ estimates.

Growth of our trading partners is expected to slow

There are several reasons to think that we may not expect a significant reversal of the growth in goods exports and reversal of of the declining ratio of goods exports to potential GDP. The projected annual GDP growth of our trading partners is expected to be lower than it was prior to the COVID-19 pandemic. Most notably, China – our largest trading partner – has a lower growth outlook compared to recent decades. Lower projected growth is likely to reduce the growth in demand for New Zealand's exports over time (figure 4.7).

Figure 4.7
Projected average GDP growth
(annual)



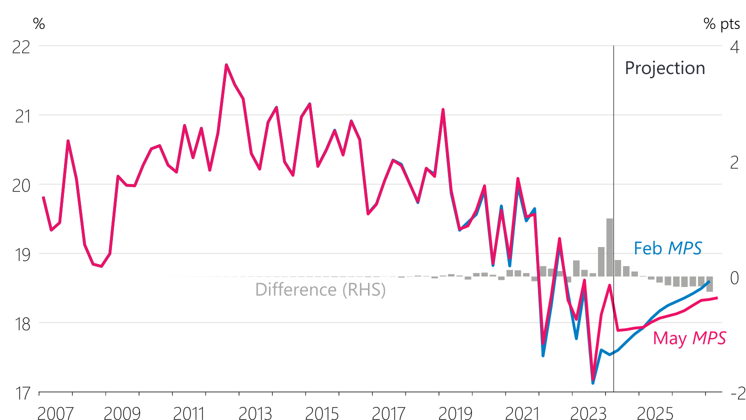
Source: Stats NZ, OECD, IMF *World Economic Outlook*.

Outlook for free trade agreements and environmental protections weigh on goods exports

As New Zealand is a small open economy, the removal of trade barriers is important in making its exports competitive in the global market and supporting the growth of our exports. However, the global pace of trade liberalisation has slowed since the global financial crisis as some countries have sought to protect local industries, particularly manufacturing. The outlook for the further removal of trade barriers for New Zealand in other markets, such as through free trade agreements (FTAs), is also uncertain.

The physical effects of climate change and our transition towards greater environmental protections to reduce them will likely continue to affect exporting industries. New Zealand's key export industries include agricultural goods, such as dairy and meat, which will face strong headwinds from climate change and have had to comply with tighter environmental regulations in recent years. We assume environmental regulations will not ease in the medium term and will therefore provide some constraint on goods exports. The disruption caused by the physical effects of climate change on these industries is also expected to weigh on production over the medium term, although adaptation and innovation may mitigate some of these risks over the longer term. New Zealand

Figure 4.8
Goods exports
(share of potential GDP)



Source: Stats NZ, RBNZ estimates.

goods export producers are also not alone in facing climate risks and environmental protection policies, with producers in most other countries facing similar constraints. This means that the overall impact of these factors on the global prices for these goods may mitigate some of the effects on overall exporter incomes over the longer term.

Overall, these trends suggest that medium-term export growth will likely be lower than has been assumed previously. Our analysis suggests it is unlikely that goods exports will grow at a materially faster rate than the rest of the economy over the medium term (figure 4.8).

Our findings support a lower goods export trend

The weaker outlook for goods exports over the longer term is not assumed to materially change the amount of inflationary pressure in the economy. This is because we have assumed that those resources that will not be used for goods export production will be largely reallocated elsewhere (for example, labour and capital could be moved into industries producing for domestic demand). To the extent that this reallocation results in lower productivity growth, it contributes to lower potential GDP growth.

Slow growth in export volumes contributes to a wider current account deficit in these projections. A wider current account deficit increases the risk of a depreciation of the real New Zealand dollar exchange rate over the medium term, although our net foreign liabilities are assumed to remain at a low level compared to recent decades in these projections.

Over longer-term horizons, we would expect economic adjustments to occur across a number of dimensions, including via the exchange rate and domestic relative price adjustments. These price adjustments will help with the reallocation of resources, such as a potential shift of resources to the provision of service exports.

Chapter

05

Domestic financial conditions

Smaills Beach. Photo: Rachael Grant

Chapter 5. Domestic financial conditions

Monetary policy affects economic activity and inflation by influencing financial conditions in New Zealand. These financial conditions include the interest rates at which households and businesses save and borrow, the exchange rate, and other factors such as credit availability. This chapter outlines recent developments in financial conditions in New Zealand as at 16 May 2024.

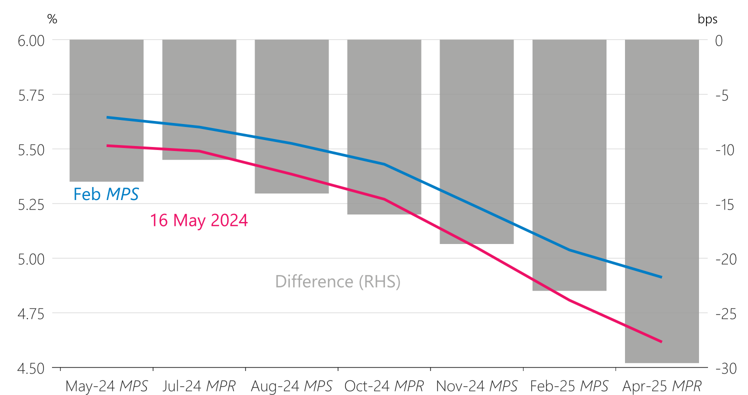
Financial conditions have loosened slightly since the February *Statement*. Mortgage rates and term deposit rates have fallen at all horizons. Wholesale interest rates such as swap rates, which have been volatile over recent months, have decreased at all terms compared to immediately before the February *Statement*.

One reason for the slightly loosened financial conditions is that market participants' expectations for upcoming OCR decisions are lower than they were immediately before the February *Statement* (figure 5.1). As of 16 May 2024, market pricing indicates that market participants expect the first 25-basis-point OCR cut to occur in November 2024 and a further two 25-basis-point cuts to occur by April 2025.

Domestic wholesale interest rates, such as those for interest rate swaps, have been volatile since the February *Statement*. They have decreased at all terms as market participants have reassessed the path of future OCR moves (figure 5.2). The 2-year swap rate has decreased by around 30 basis points, consistent with lower near-term OCR expectations, and the 10-year swap rate has decreased by around 20 basis points. Following these moves, the interest rate swap curve is less inverted than it was immediately before the February *Statement*.[8]

8 When interest rate curves are inverted, this means that longer-term interest rates are lower than shorter-term interest rates.

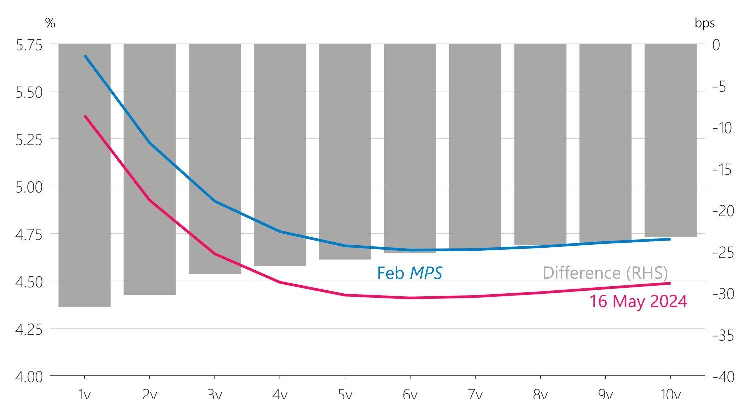
Figure 5.1
Market expectations for the OCR



Source: Bloomberg.

Note: The blue line shows market expectations for the OCR immediately before the February *Statement*. Each data point represents market expectations of the level of the OCR at a given point in the future, as measured by overnight indexed swap pricing.

Figure 5.2
New Zealand interest rate swap rates
(terms in years)



Source: Bloomberg.

Note: Interest rate swap rates are wholesale interest rates often used as a benchmark by financial institutions in setting other interest rates in the economy. They represent the fixed interest rate that one party to the swap agreement receives in exchange for paying a floating rate to the other party for the duration of the agreement.

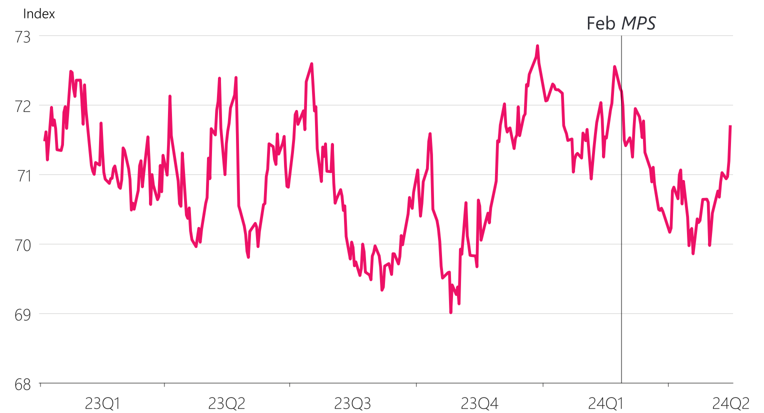
The New Zealand dollar exchange rate has moved lower on a trade-weighted basis since the February *Statement* (figure 5.3). Expected interest rates in New Zealand remain higher than those of some of our key trading partners. However, the continued strength of the US economy relative to the New Zealand economy has meant that the differences in expected interest rates between the US and New Zealand have decreased. The differences in expected interest rates between Australia and New Zealand have also decreased. This has reduced the attractiveness of New Zealand for overseas investors looking for the highest relative returns, putting downward pressure on the New Zealand dollar. More generally, the US dollar has been strong against a range of major global currencies over recent months.

Mortgage rates have declined slightly since the February *Statement* (figure 5.4). Decreases in wholesale rates have been larger than the decreases in mortgage rates. This means that spreads between mortgage rates and wholesale rates have increased since the February *Statement* (figure 5.5).

Figure 5.3

New Zealand dollar TWI

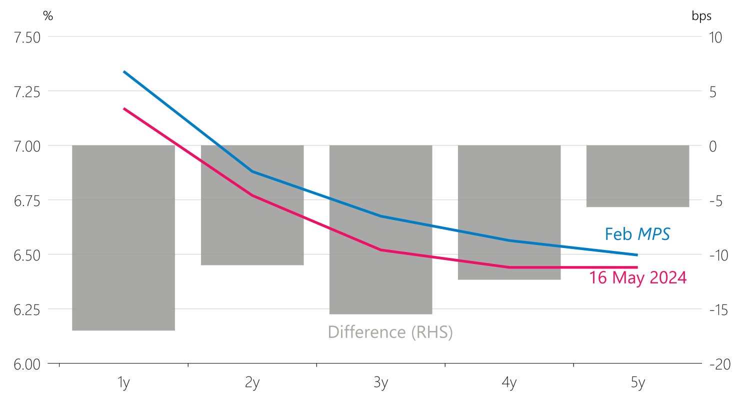
(nominal)



Source: RBNZ.

Figure 5.4

New Zealand mortgage rates

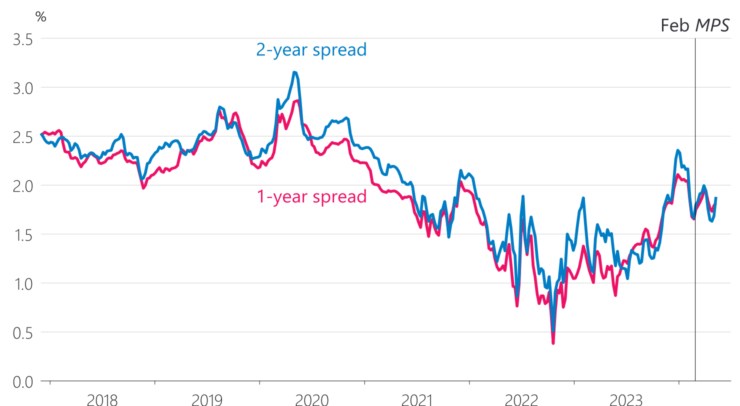


Source: interest.co.nz.

Note: The mortgage rates shown are the average of the latest advertised fixed-term rates on offer from ANZ, ASB, BNZ and Westpac for mortgages with a loan-to-value ratio of less than 80%.

Figure 5.5

New Zealand 1- and 2-year mortgage rates as a spread to equivalent swap rates

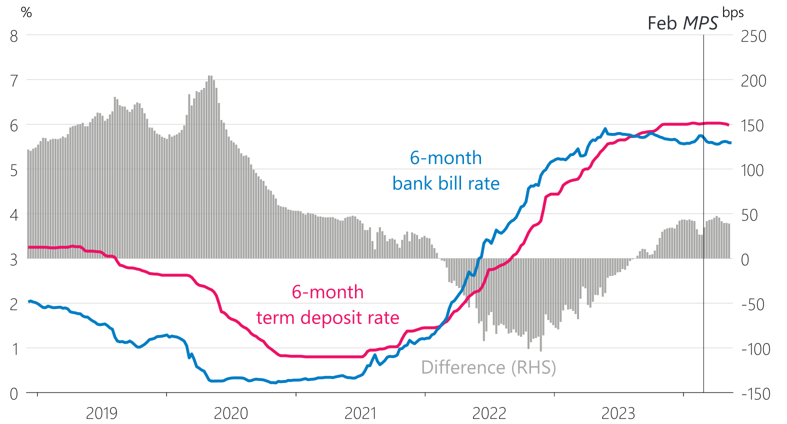


Source: interest.co.nz, Bloomberg.

Interest rates on term deposits, which make up a large share of banks' core funding, are slightly lower at all terms. The spread between the six-month term deposit rate and the equivalent wholesale rate is around the same level as at the start of 2024 (figure 5.6). This spread, which has been on a broad upward trend since the start of 2023, remains lower than its pre-pandemic average, holding down the cost of bank funding. Bank funding costs are likely to increase over the medium term, with banks expected to compete more aggressively for customer deposits as accommodative bank funding conditions continue to fade.

Figure 5.6

Spread between the 6-month term deposit rate and the 6-month bank bill rate



Source: interest.co.nz, Bloomberg.

Note: The term deposit rate shown is the average of the latest 6-month term rates on offer from ANZ, ASB, BNZ and Westpac. The 6-month Bank Bill rate represent the rates at which banks are willing to borrow from, or lend to, one another over a six month term.

Table 5.1

Developments in domestic financial conditions as of 16 May 2024

Wholesale interest rates	
Market pricing for the OCR	• The February *Statement* contributed to a downward shift in market participants' expectations for the OCR over 2024. This was influenced by the Reserve Bank's reduction in its near-term inflation forecast and a slight reduction in the OCR forecast, with the peak coming down to 5.6 percent from 5.7 percent in the November *Statement*. • Market pricing for the OCR is currently lower than at the time of the February *Statement*. In the weeks before the February *Statement*, market pricing indicated a moderate chance of a further OCR increase by May 2024. Immediately after the *Statement*, markets no longer priced further increases to the OCR. Markets are now pricing in around 45 basis points of cuts by November, which is around 20 basis points of additional easing compared to what was priced in at the time of the February *Statement*. • The current and expected OCR settings are contractionary, sitting above our estimates for the neutral OCR (see figure 7.4).
Interest rate swaps	• New Zealand swap rates have been volatile since the February *Statement*. Overall, swap rates are lower than they were just before the February *Statement*. The 2-year swap rate is around 30 basis points lower over this period and the 10-year swap rate is around 20 basis points lower. Consequently, the degree of swap curve inversion (when shorter-term rates are higher than longer-term rates) has decreased, with the difference between the 2- and 10-year swap rates narrowing from around minus 55 basis points at the time of the February *Statement* to around minus 40 basis points. • Domestic developments, including a reassessment of OCR expectations in response to the February *Statement* and slightly weaker-than-expected GDP data, led to declines in swap rates between the February *Statement* and the end of March. Subsequently, global factors, in particular expectations of future changes to US interest rates, were a key driver of swap rates as they gradually moved higher. • More recently, swap rates have declined as the US Federal Reserve signalled that US interest rates are unlikely to move higher during this cycle and after some weaker-than-expected US labour market data.
New Zealand government bonds (NZGB)	• NZGB yields are lower since the February *Statement*, influenced by similar factors to interest rate swaps (discussed above). • Bid-ask spreads, which measure how far apart buyers and sellers are from reaching an agreed price to trade, are broadly unchanged since the February *Statement*. Demand for NZGBs at New Zealand Debt Management tenders, as measured by bid-cover ratios, has improved at auctions since the February *Statement*, following a period of relatively weak demand at the start of 2024. • The difference between NZGB yields and swap rates is little changed from the February *Statement*. These spreads remain at high levels compared to historical values, reflecting an increased supply of NZGBs.
New Zealand dollar	
Interest rate differentials	• Interest rate differentials between New Zealand and both the US and Australia, our largest trading partners with floating exchange rates, have decreased since the February *Statement*. This has contributed to a depreciation in the New Zealand dollar against the US dollar and Australian dollar.
Risk sentiment	• Market risk sentiment has improved slightly since the February *Statement*. US equities are higher and equity market volatility (as measured by the VIX Index) is slightly lower. US bond market volatility is also slightly lower, than at the time of the February *Statement*. Overall, risk sentiment has likely had a slightly positive impact on New Zealand dollar movements since the February *Statement*.

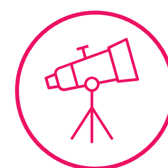
Commodity prices	• Decreases in New Zealand's key export commodity prices tend to be detrimental for the New Zealand dollar, while increases tend to be positive. • Prices of key export commodities in New Zealand have been broadly flat since the February *Statement*, and are likely to have had limited effects on New Zealand dollar movements.
Retail interest rates	
Mortgage rates	• Mortgage rates have decreased since the February *Statement*, following swap rates lower. • Mortgage rates at shorter terms have decreased by more than longer-term mortgage rates since the February *Statement*. Mortgages at terms of 1 and 2 years have decreased by around 10 to 20 basis points and 5-year mortgage rates have decreased around 5 basis points. • The spreads between mortgage rates and swap rates (mortgage-swap spreads) have been volatile since the February *Statement*. Overall, mortgage-swap spreads at 1- and 2-year terms are higher than they were just before the February *Statement*.
Deposit rates	• Term deposit rates have decreased at all terms since the February *Statement*. • Spreads between term deposits and swap rates (term deposit spreads) have been broadly unchanged since the start of 2024, having increased significantly during 2023. • Term deposit spreads are likely to increase towards pre-COVID-19 levels in coming years, as banks compete more aggressively for deposit funding. • Rates on other types of deposits, including bonus saver and transaction accounts, remain low compared to wholesale interest rates. This continues to hold down the overall cost of bank funding.
Bank funding conditions	
Funding composition	• Term deposit volumes have continued to increase over recent months, while on-call transaction and savings deposit volumes have fallen. Term deposit volumes grew by around $3 billion between January and March 2024, while on-call account volumes fell by around $4 billion. • Banks remain well funded and have strong liquidity buffers. Lower-cost deposit types, in particular transaction accounts, remain a larger share of bank funding compared to pre-COVID-19 averages. This has contributed to lower average bank funding costs. Bank core funding ratios remain high, sitting at around 90 percent in March. • Banks have paid back around 15 percent of loans that were taken out as part of the Funding for Lending Programme (FLP). The speed at which banks repay the remainder of the FLP borrowings will pick up during the second half of 2024 and 2025, with the final repayments made at the end of 2025. • As these loans are repaid, bank competition for other sources of funding, such as deposits, is expected to increase.
Credit spreads	• The cost of raising long-term wholesale bank funding relative to benchmark wholesale rates has decreased slightly since the February *Statement*. • Domestic bank credit spreads are lower than at the time of the February *Statement*. Broad wholesale funding conditions remain relatively favourable, particularly in the context of a higher interest rate environment.

Chapter 06

Economic projections

McKinnon Pass. Photo: Tyler Smith

Chapter 6. Economic projections



This chapter summarises the baseline economic projections that MPC members considered when making their policy assessment. The projections were finalised on 16 May 2024.

These projections rely on a set of key assumptions about the global and domestic factors influencing the New Zealand economy. These include:

- the level of potential GDP and the extent to which the output gap has declined in recent history;
- the degree of persistence in inflation expectations and price-setting behaviour following the recent high inflation period;
- the speed at which labour market and wage pressures ease, and the effects of these factors on household spending and core inflation;
- the extent to which high interest rates and house price declines from their peak in late 2021 contribute to lower residential construction activity and household spending;
- the extent to which business investment weakens as a result of declining capacity pressures in the economy;
- the outlook for net immigration, and the extent to which high net immigration contributes relatively more to aggregate demand or labour supply;
- the extent to which stronger activity and inflation in our key trading partners affects domestic financial conditions, demand for New Zealand's goods and services exports, and prices for imports;
- that government consumption and investment evolve in line with the macroeconomic and fiscal forecasts in the *Half Year Economic and Fiscal Update (HYEFU)* 2023. Reductions in government spending to date have likely been captured in weaker high-frequency indicators for aggregate GDP in the March and June 2024 quarters. Our near-term GDP forecasts are based on these indicators. The central projection does not include the effects of changes in fiscal policy related to the forthcoming *Budget* 2024. Any changes to real government consumption, or private consumption due to proposed tax cuts, are not captured in this projection. However, the projection does account for the direct effects of confirmed regulatory changes such as the annual minimum wage adjustment and the removal of the Auckland regional fuel tax.

There is significant uncertainty about these assumptions.

The projections take account of recent data, which show that domestic economic activity continued to decline slightly in the December 2023 quarter. The labour market has also eased further, with employment decreasing in the March 2024 quarter and unemployment rising.

However, CPI inflation in the March 2024 quarter was stronger than anticipated in the February *Statement*. In particular, non-tradables inflation was stronger than would have been explained by our February *Statement* assumptions for the output gap, and pricing behaviour.

Continued strong non-tradables inflation has supported a reassessment of the level of capacity pressure in the New Zealand economy over recent history (see box A, chapter 2). We have revised our estimate of the output gap higher and it now sits closer to the middle of our suite of output gap indicators (figure 6.1). This higher estimate of the output gap is better able to explain the inflation New Zealand has experienced in recent history, and lower potential GDP growth is more consistent with weak estimates of New Zealand's productivity growth over the past two years.

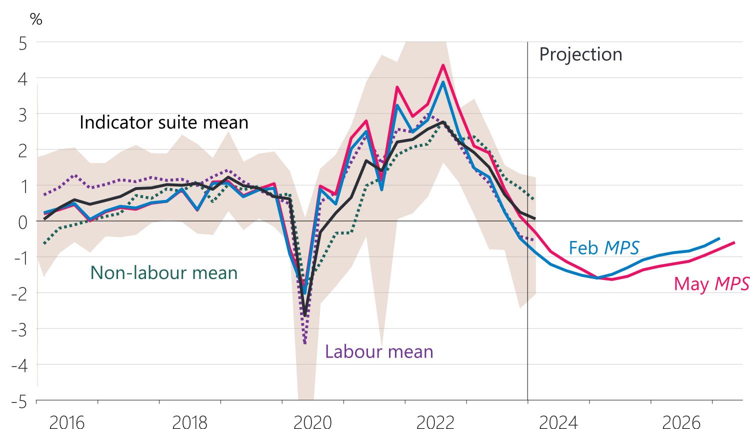
The higher starting point for the output gap means there has been more inflationary pressure in the domestic economy than previously assumed. As a result, interest rates will need to remain contractionary for longer than previously assumed, to reduce this inflationary pressure.

Given recent substantial declines in surveyed inflation expectations, we have revised our medium-term assumption for wage- and price-setting behaviour down slightly. This assumes that wage- and price-setting behavior by firms will normalise slightly more quickly once headline inflation has returned to within the 1 to 3 percent target range. However, we continue to assume that wage- and price-setting behaviour remains elevated relative to history by the end of the forecast period.

Figure 6.1

Output gap and indicator suite

(share of potential GDP, seasonally adjusted)



Source: Stats NZ, NZIER, MBIE, RBNZ estimates.

Note: The shaded area shows the range of the indicators in the suite. The vertical line shows the final quarter of published GDP data.

This reflects our expectation that wage- and price-setting behaviour adjusts slowly toward headline inflation. In addition, some lagging relative price adjustments have yet to occur following the recent inflationary period, and this source of inflationary pressure will take some time to normalise.

Over the medium term, we assume that restrictive interest rates in New Zealand will keep domestic demand growth subdued. Our outlook for economic activity is for a low rate of GDP growth over the next year. Non-tradables inflation is assumed to decline only slowly as aggregate demand slows and the labour market eases, reducing capacity pressure.

Annual tradables inflation is expected to continue to decline but remain slightly positive over the projection horizon. The delayed effects of recent shipping disruptions and higher freight costs, lingering inflationary pressure in our trading partners, and continued domestic cost pressures limit declines in tradables inflation.

Annual consumer price inflation is expected to return to its 2 percent target midpoint in the June 2026 quarter.

Table 6.1
Key projection assumptions

Key factors	
Global factors	• Inflation has been more persistent than expected in the US and Australia, supported by resilient labour markets. • This has caused expectations for world interest rates to rise, which all else being equal puts downward pressure on the New Zealand dollar and increases imported inflation in New Zealand. • The New Zealand dollar trade weighted index (TWI) is assumed to remain at 71.0 over the projection.
Domestic capacity pressures	• Persistent non-tradables inflation at the beginning of 2024 has added to the weight of evidence that capacity pressures have been higher than previously assumed in the domestic economy. Although our suite of output gap indicators continues to ease, this has occurred at a slightly slower pace than we had assumed the output gap would ease. • Output gap indicators based on labour market data have eased to a lesser extent than other indicators and indicate more capacity pressures in the economy than other indicators. This may be partly accounted for by a lag between the labour market and broader economic conditions. • Our updated output gap assumption sits closer to the mean of our indicator suite. It is better able to explain the non-tradables inflation experience in New Zealand over the past year, given our other assumptions for the drivers of non-tradables including inflation expectations, wages and persistence in price-setting.
Inflation expectations	• Inflation expectations are assumed to be adaptive and slow moving, because this approach has been able to better explain wage- and price-setting behaviour over history than survey-based measures of inflation expectations. However, we have revised our medium-term assumption for wage- and price-setting behaviour down slightly following recent substantial declines in surveyed inflation expectations. This assumes that wage- and price-setting behaviour by firms will normalise slightly more quickly once headline inflation has returned to within the 1 to 3 percent target range. • We continue to assume that wage- and price-setting behaviour remains elevated relative to history by the end of the forecast period. This reflects our expectation that wage- and price-setting behaviour adjusts slowly toward headline inflation. In addition, some lagging relative price adjustments have yet to occur following the recent inflationary period, and this source of inflationary pressure will take some time to normalise.
Economic growth	
Production	• We assume that the economy expanded by 0.2 percent in the March 2024 quarter, and will grow gradually over the following year. Growth is assumed to increase to be broadly in line with potential over the medium term. • Capacity pressures are assumed to be approximately neutral in the December 2023 quarter and spare capacity is expected to open up across the projection horizon. The supply potential of the economy is expected to continue to improve, supported by strong population growth through immigration that expands the productive capacity of the economy.
Consumption	• Consumption growth has been subdued over the past year, and is projected to remain subdued in the coming year. Given strong population growth, per-capita consumption is in the process of falling sharply. Per-capita consumption has fallen by 3.6 percent since its 2022 average, and this is about two thirds of the way through our projected decline. At the projected trough, per-capita consumption is similar to that at the end of 2019. • We project that per-capita consumption growth will start to recover in 2025 as the lagged impact of previous tightening fades, interest rates begin to fall, and house prices recover. • This projection makes no assumption about the effects of tax and transfer changes that may be contained in *Budget* 2024.

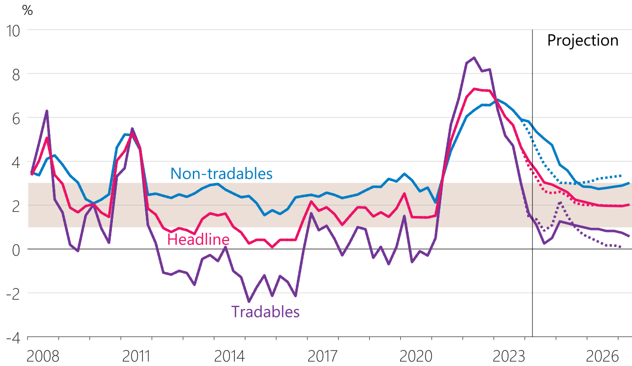
Investment	• Business investment has fallen over the past year and is projected to continue to decline in 2024 as previous falls in export prices and weaker demand reduce business profitability. Starting at the end of 2024, business investment is projected to increase as export prices recover slowly and interest rates eventually ease towards the end of the projection. • A substantial decline in residential investment is underway and is expected to continue until the beginning of 2025. High interest rates and subdued house price growth are causing a decline in residential construction activity, consistent with the decline in dwelling consents since mid-2022. In the second half of the projection, ongoing high net immigration and easing interest rates support a recovery in house prices and building activity. • The scale and speed of the residential investment slowdown are slightly more than in the February *Statement*, given higher interest rates in this forecast and the continued weakness seen in indicators like consents and ready-mix concrete.
Government	• Government spending forecasts are consistent with those in *HYEFU* 2023, but have been adjusted for the latest real government consumption and investment starting points in the December 2023 GDP data. The starting point for government consumption was higher and government investment was lower. On net, the starting point adjustment means real government spending is lower over the projection. • Real government consumption is projected to decline over the projection. However, due to weaker potential output growth, government expenditure is higher as a proportion of potential output than projected in the February *Statement* and hence less disinflationary.
Exports and imports	• We assume a steady recovery in export and import volumes in the medium term. The increase in import volumes in the medium term is consistent with the recovery in private consumption and business investment. • Total export volumes are expected to continue to increase their share of GDP in the medium term due to the continued recovery in international tourism. We have revised our projection for goods exports lower in the medium term following an in-depth look at the outlook for growth in our major goods export sectors (see chapter 4.2).
Labour market	
Employment and wages	• The New Zealand labour market has continued to ease. The unemployment rate increased further to 4.3 percent in the March 2024 quarter, while the number of people employed fell. • Same-job wage growth was close to expectations in the March 2024 quarter, and is expected to continue to ease. Over the past 18 months, we have consistently observed downside surprises to our wages forecasts. Our forecasts have previously assumed a rapid recovery in same-job wages relative to the CPI following declines in recent years. Our updated projections now assume that wage growth evolves more in line with historical relationships with labour market slack and recent inflation. These historical relationships imply considerably weaker wage growth over the forecast. • In addition, our near-term forecast has taken account of the increase in the minimum wage being smaller in 2024 than in recent years. • A range of indicators of pressure in the labour market show it has continued to ease from tight levels and suggests the labour market is broadly in balance. The labour market is expected to ease further over this year as economic growth remains below potential. • Employment fell in the March 2024 quarter, and employment growth is expected to remain subdued over the next year. • The unemployment rate is expected to continue to rise to a peak of 5.1 percent in mid-2025, in line with a declining output gap.

Immigration	• Net immigration has evolved similarly to our assumption in the February *Statement*. Net immigration has continued to decline from historically high levels. We assume net immigration will continue to decline from its current level, but will remain high relative to history during the forecast period.

Inflation	
Headline	• Annual headline CPI inflation is expected to continue to decline to within the 1 to 3 percent target band by the end of 2024, reaching the 2 percent target midpoint by the June 2026 quarter.
Tradables	• Annual tradables inflation is expected to decline slightly further, but remain above its pre-COVID-19 levels over the projection horizon. Stronger economic growth in our trading partners and the delayed effects of recent shipping disruptions are assumed to place upward pressure on import prices, while lingering domestic cost pressures also support tradables inflation.
Non-tradables	• Annual non-tradables inflation is expected to continue to decline, but to stay elevated for longer than previously assumed due to a higher starting point and our revised assumption for the output gap. • Falling capacity pressures are expected to continue to put downward pressure on non-tradables inflation, but this is expected to take some time in the context of elevated wage- and price-setting behaviour and other specific factors (see chapter 4.1).

Charts

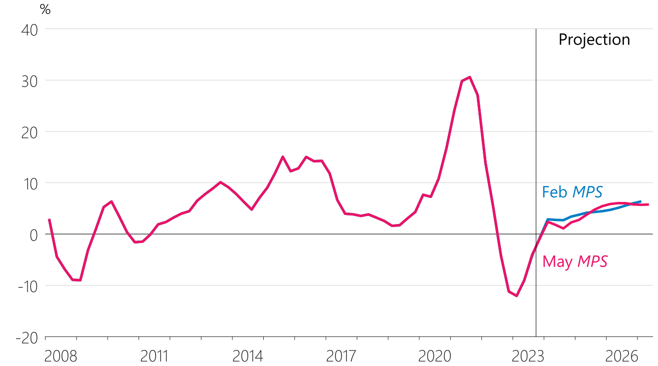
Figure 6.2
Inflation components
(annual)



Source: Stats NZ, RBNZ estimates.

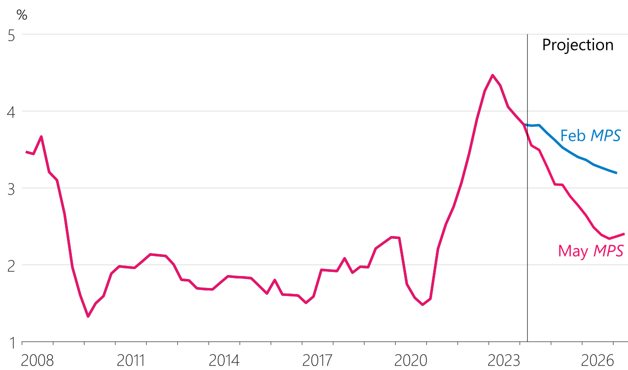
Note: Dotted lines show the projections from the February *Statement*. The shaded area represents the MPC's 1 to 3 percent target range for annual CPI inflation over the medium term.

Figure 6.5
House price growth
(annual)



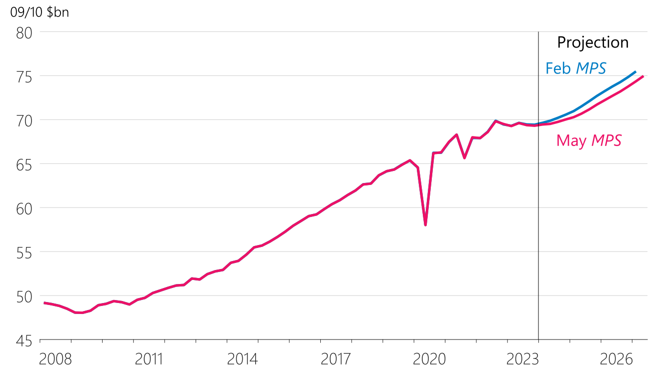
Source: CoreLogic, RBNZ estimates.

Figure 6.3
Private sector LCI wage inflation
(annual)



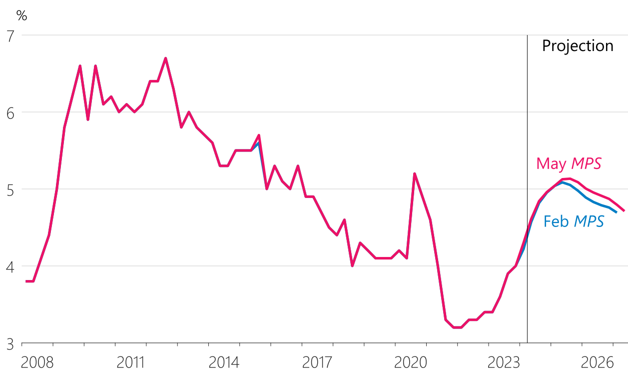
Source: Stats NZ, RBNZ estimates.

Figure 6.6
Production GDP
(quarterly, seasonally adjusted)



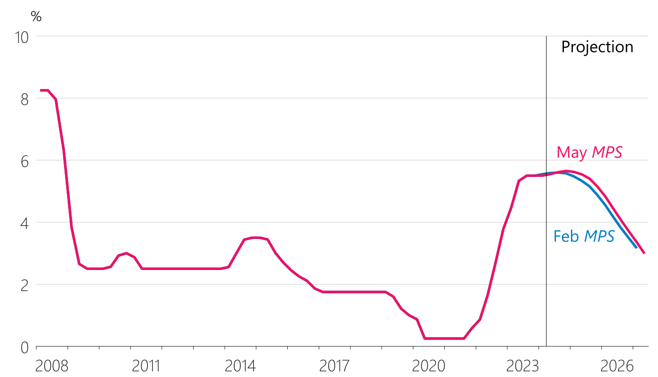
Source: Stats NZ, RBNZ estimates.

Figure 6.4
Unemployment rate
(unemployed people as a share of the labour force, seasonally adjusted)



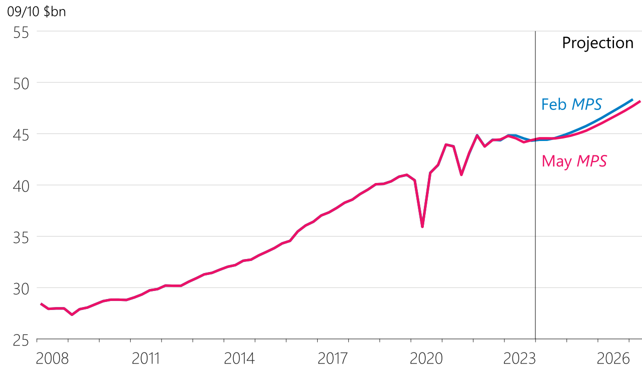
Source: Stats NZ, RBNZ estimates.

Figure 6.7
OCR
(quarterly average)



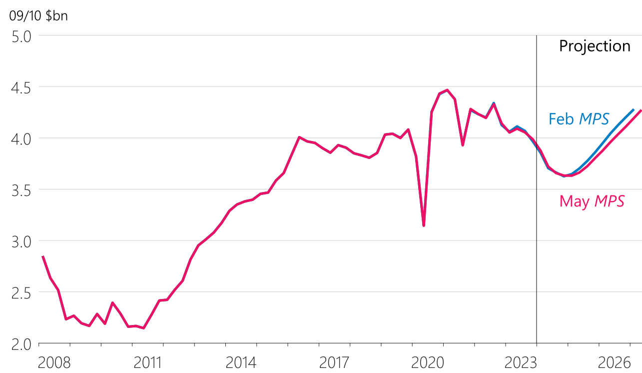
Source: RBNZ estimates.

Figure 6.8
Private consumption
(quarterly, seasonally adjusted)



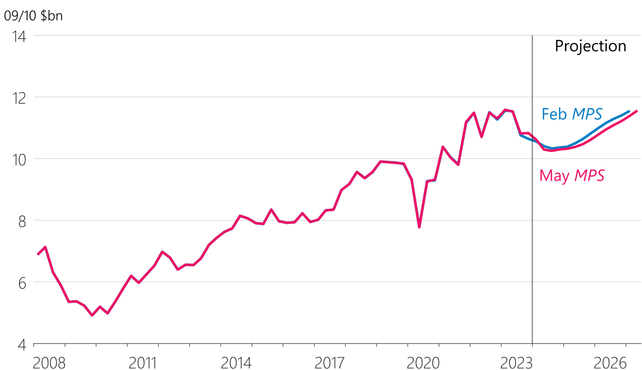
Source: Stats NZ, RBNZ estimates.

Figure 6.9
Residential investment
(quarterly, seasonally adjusted)



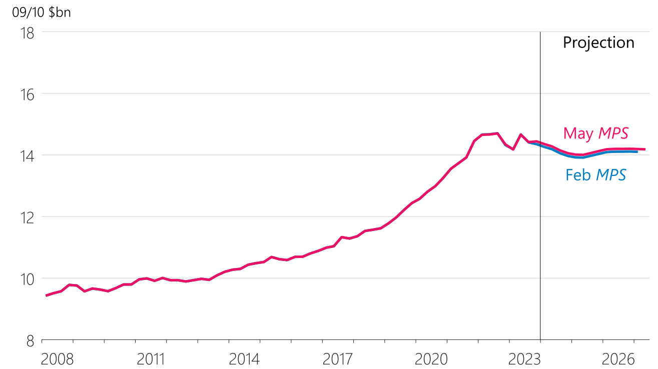
Source: Stats NZ, RBNZ estimates.

Figure 6.10
Business investment
(quarterly, seasonally adjusted)



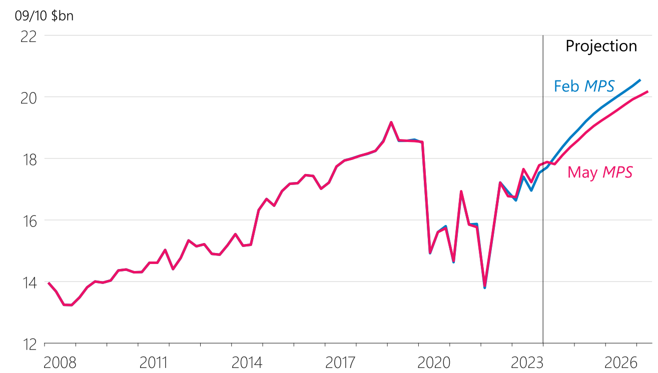
Source: Stats NZ, RBNZ estimates.

Figure 6.11
Government consumption
(quarterly, seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Figure 6.12
Total exports
(quarterly, seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Figure 6.13
Total imports
(quarterly, seasonally adjusted)

Source: Stats NZ, RBNZ estimates.

Chapter 07

Appendices

Lake Wānaka. Photo: India Power

Chapter 7. Appendices

Appendix 1: Statistical tables

Table 7.1

Key forecast variables

		GDP growth Quarterly	CPI inflation Quarterly	CPI inflation Annual	Unemployment rate	TWI	OCR
2022	Mar	-0.1	1.8	6.9	3.2	72.6	0.9
	Jun	1.0	1.7	7.3	3.3	72.1	1.6
	Sep	1.8	2.2	7.2	3.3	70.6	2.7
	Dec	-0.4	1.4	7.2	3.4	70.8	3.8
2023	Mar	-0.3	1.2	6.7	3.4	71.3	4.5
	Jun	0.5	1.1	6.0	3.6	71.0	5.3
	Sep	-0.3	1.8	5.6	3.9	70.6	5.5
	Dec	-0.1	0.5	4.7	4.0	70.8	5.5
2024	Mar	**0.2**	0.6	4.0	4.3	71.6	5.5
	Jun	**0.1**	**0.6**	**3.6**	**4.6**	**70.8**	**5.6**
	Sep	**0.3**	**1.3**	**3.0**	**4.8**	**71.0**	**5.6**
	Dec	**0.4**	**0.4**	**2.9**	**5.0**	**71.0**	**5.7**
2025	Mar	**0.4**	**0.5**	**2.8**	**5.0**	**71.0**	**5.6**
	Jun	**0.6**	**0.5**	**2.6**	**5.1**	**71.0**	**5.5**
	Sep	**0.7**	**0.9**	**2.2**	**5.1**	**71.0**	**5.4**
	Dec	**0.8**	**0.3**	**2.2**	**5.1**	**71.0**	**5.1**
2026	Mar	**0.7**	**0.4**	**2.1**	**5.0**	**71.0**	**4.8**
	Jun	**0.7**	**0.4**	**2.0**	**5.0**	**71.0**	**4.4**
	Sep	**0.7**	**0.9**	**2.0**	**4.9**	**71.0**	**4.1**
	Dec	**0.8**	**0.3**	**2.0**	**4.9**	**71.0**	**3.7**
2027	Mar	**0.8**	**0.4**	**2.0**	**4.8**	**71.0**	**3.4**
	Jun	**0.8**	**0.4**	**2.0**	**4.7**	**71.0**	**3.0**

Table 7.2

Measures of inflation, inflation expectations, and asset prices

	2022		2023				2024	
	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun
Inflation (annual rates)								
CPI	7.2	7.2	6.7	6.0	5.6	4.7	4.0	
CPI non-tradables	6.6	6.6	6.8	6.6	6.3	5.9	5.8	
CPI tradables	8.1	8.2	6.4	5.2	4.7	3.0	1.6	
Sectoral factor model estimate of core inflation	5.4	5.7	5.8	5.8	5.3	4.7	4.3	
CPI trimmed mean (30% measure)	6.4	6.1	6.1	6.0	5.5	5.0	4.5	
CPI weighted median	5.0	5.0	5.6	6.6	5.0	4.4	4.4	
GDP deflator (expenditure)	4.5	5.2	5.5	6.0	7.0	4.3		
Inflation expectations								
RBNZ Survey of Expectations – inflation 1 year ahead	4.9	5.1	5.1	4.3	4.2	3.6	3.2	2.7
RBNZ Survey of Expectations – inflation 2 years ahead	3.1	3.6	3.3	2.8	2.8	2.8	2.5	2.3
RBNZ Survey of Expectations – inflation 5 years ahead	2.3	2.4	2.4	2.4	2.3	2.4	2.3	2.3
RBNZ Survey of Expectations – inflation 10 years ahead	2.1	2.2	2.2	2.3	2.2	2.3	2.2	2.2
Asset prices (annual percent changes)								
Quarterly house price index (CoreLogic NZ)	-4.2	-11.2	-12.0	-9.0	-4.0	-0.8		
REINZ Farm Price Index (quarterly average to date)	12.2	5.0	-3.2	-5.7	-11.8	-10.9	-9.8	
NZX 50 (quarterly average to date)	-11.3	-12.8	-3.3	4.0	1.7	-0.4	-0.6	-0.1

Table 7.3

Measures of labour market conditions

(seasonally adjusted, changes expressed in annual percent terms, unless specified otherwise)

	2022		2023				2024
	Sep	Dec	Mar	Jun	Sep	Dec	Mar
Household Labour Force Survey							
Unemployment rate	3.3	3.4	3.4	3.6	3.9	4.0	4.3
Underutilisation rate	9.0	9.4	9.1	9.9	10.4	10.7	11.2
Labour force participation rate	71.6	71.8	72.1	72.4	72.0	71.9	71.5
Employment rate (% of working-age population)	69.3	69.4	69.6	69.8	69.2	69.0	68.4
Employment growth	1.1	1.7	3.0	4.3	2.9	2.7	1.3
Average weekly hours worked	33.9	34.0	33.6	33.4	33.6	33.7	33.9
Number unemployed (thousand people)	96	100	103	110	120	123	134
Number employed (million people)	2.85	2.87	2.90	2.93	2.93	2.95	2.94
Labour force (million people)	2.95	2.97	3.01	3.04	3.05	3.07	3.07
Extended labour force (million people)	3.02	3.05	3.09	3.14	3.14	3.16	3.18
Working-age population (million people, age 15 years+)	4.11	4.13	4.17	4.20	4.24	4.27	4.30
Quarterly Employment Survey – QES							
Filled jobs growth	1.3	1.5	2.3	6.4	6.0	4.3	3.6
Average hourly earnings growth (private sector, ordinary time)	8.6	8.1	8.3	7.7	7.0	6.6	4.8
Other data sources							
Labour Cost Index growth, private sector, adjusted	3.9	4.3	4.5	4.3	4.1	3.9	3.8
Labour Cost Index growth, private sector, unadjusted	5.6	6.1	6.1	6.1	5.7	5.7	5.2
Estimated net working-age immigration (thousands, quarterly)	7.8	20.3	29.3	40.1	24.3	16.3	
Change in All Vacancies Index	7.1	-4.1	-14.7	-21.9	-27.2	-27.2	-26.7

Note: The All Vacancies Index is produced by MBIE as part of the monthly Jobs Online report, which shows changes in job vacancies advertised by businesses on internet job boards. The unadjusted labour cost index (LCI) is an analytical index that reflects quality change in addition to price change (whereas the official LCI measures price changes only). For definitions of underutilisation, the extended labour force, and related concepts, see Stats NZ (2016) 'Introducing underutilisation in the labour market'. Estimated net working-age immigration is the Stats NZ outcomes-based measure.

Table 7.4

Composition of real GDP growth

(annual average percent change, seasonally adjusted, March years, unless specified otherwise)

	Actuals							Projection			
March year	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Final consumption expenditure											
Private	6.4	4.8	4.5	2.4	0.2	6.0	2.7	**0.2**	**0.5**	**1.9**	**3.4**
Public authority	1.9	3.8	3.3	5.8	6.9	7.9	2.0	**0.0**	**-2.4**	**-0.2**	**0.7**
Total	**5.4**	**4.6**	**4.3**	**3.2**	**1.8**	**6.4**	**2.5**	**0.1**	**-0.2**	**1.4**	**2.8**
Gross fixed capital formation											
Residential	8.8	-1.8	-0.1	2.7	2.2	3.2	-0.6	**-4.2**	**-8.5**	**2.9**	**8.2**
Other	0.1	10.0	7.1	2.7	-2.9	12.6	2.9	**-1.3**	**-2.6**	**3.3**	**4.9**
Total	**2.3**	**6.7**	**5.2**	**2.7**	**-1.7**	**10.2**	**2.1**	**-2.0**	**-3.9**	**3.2**	**5.6**
Final domestic expenditure	4.6	5.1	4.5	3.0	1.0	7.3	2.4	**-0.4**	**-1.1**	**1.8**	**3.4**
Stockbuilding*	0.1	0.2	-0.2	-0.2	-0.3	0.6	0.0	**-1.4**	**1.0**	**0.3**	**0.0**
Gross national expenditure	**4.8**	**5.6**	**4.3**	**2.7**	**-0.3**	**8.5**	**2.6**	**-2.0**	**0.1**	**2.1**	**3.5**
Exports of goods and services	2.0	3.8	3.3	0.2	-17.9	2.4	6.1	**6.5**	**3.3**	**5.0**	**3.6**
Imports of goods and services	5.1	7.8	4.8	1.3	-15.9	17.1	4.4	**-2.2**	**1.3**	**4.8**	**5.5**
Expenditure on GDP	**3.9**	**4.3**	**3.9**	**2.5**	**0.0**	**4.7**	**2.8**	**0.1**	**0.5**	**2.0**	**2.8**
GDP (production)	3.8	3.4	3.5	2.4	-0.5	4.6	2.7	**0.2**	**0.7**	**2.2**	**2.9**
GDP (production, March qtr to March qtr)	3.3	3.5	3.5	0.7	4.5	0.6	2.0	**0.3**	**1.2**	**2.8**	**3.0**

* Percentage point contribution to the growth rate of GDP.

Table 7.5

Summary of economic projections

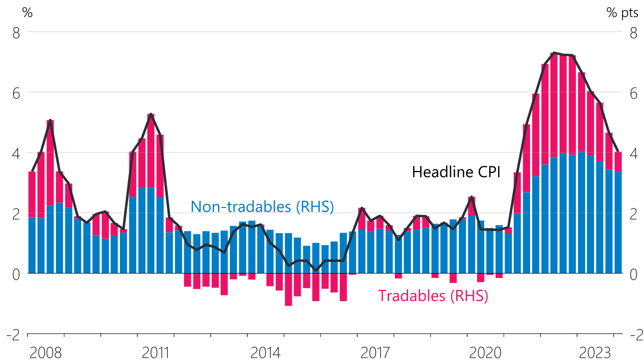
(annual percent change, March years, unless specified otherwise)

	Actuals								Projection		
March year	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Price measures											
CPI	2.2	1.1	1.5	2.5	1.5	6.9	6.7	4.0	**2.8**	**2.1**	**2.0**
Labour costs	1.5	1.9	2.0	2.4	1.6	3.1	4.5	3.8	**3.0**	**2.6**	**2.4**
Export prices (in New Zealand dollars)	4.1	3.2	1.1	6.7	-6.2	20.6	0.9	**-1.8**	**3.5**	**2.4**	**2.4**
Import prices (in New Zealand dollars)	1.2	1.6	4.0	2.4	-2.5	18.8	8.1	**-3.2**	**0.3**	**-0.4**	**0.0**
Monetary conditions											
OCR (year average)	2.0	1.8	1.8	1.2	0.3	0.5	3.1	5.5	**5.6**	**5.2**	**3.9**
TWI (year average)	76.5	75.6	73.4	71.7	72.4	74.0	71.2	71.0	**71.0**	**71.0**	**71.0**
Output											
GDP (production, annual average % change)	3.8	3.4	3.5	2.4	-0.5	4.6	2.7	**0.2**	**0.7**	**2.2**	**2.9**
Potential output (annual average % change)	3.2	3.2	3.1	2.7	-0.6	2.5	2.2	**2.8**	**2.6**	**2.4**	**2.4**
Output gap (% of potential GDP, year average)	0.3	0.4	0.8	0.5	0.5	2.6	3.2	**0.6**	**-1.2**	**-1.5**	**-1.0**
Labour market											
Total employment (seasonally adjusted)	5.9	2.9	1.5	2.6	0.2	2.5	3.0	1.3	**0.7**	**1.8**	**2.7**
Unemployment rate (March qtr, seasonally adjusted)	4.9	4.4	4.2	4.2	4.6	3.2	3.4	4.3	**5.0**	**5.0**	**4.8**
Trend labour productivity	0.6	0.6	0.6	0.6	0.5	0.2	-0.2	-0.3	**-0.1**	**0.2**	**0.6**
Key balances											
Government operating balance* (% of GDP, year to June)	1.5	1.9	2.4	-7.3	-1.3	-2.7	-2.5	**-2.6**	**-1.9**	**-1.1**	**-0.2**
Current account balance (% of GDP)	-2.5	-3.1	-3.8	-2.3	-2.5	-6.5	-8.2	**-6.5**	**-6.1**	**-5.2**	**-4.6**
Terms of trade (SNA measure, annual average % change)	2.1	4.5	-2.1	2.0	-1.0	0.4	-5.1	**-1.4**	**0.7**	**4.0**	**2.5**
Household saving rate (% of disposable income)	-1.8	-2.0	-1.3	1.4	7.6	2.7	2.0	**0.7**	**-1.3**	**-1.1**	**-1.0**
World economy											
Trading-partner GDP (annual average % change)	3.5	4.0	3.5	1.7	-0.5	6.2	2.7	**3.1**	**2.6**	**3.0**	**2.8**
Trading-partner CPI (TWI-weighted)	1.9	1.8	1.4	2.4	0.8	4.1	4.8	2.2	**2.4**	**2.1**	**2.2**

* Government operating balance is a model-based estimate of OBEGAL divided by nominal GDP in the projection. The estimate is partial because it relies on projections for some components from the *Half Year Economic and Fiscal Update* 2023.

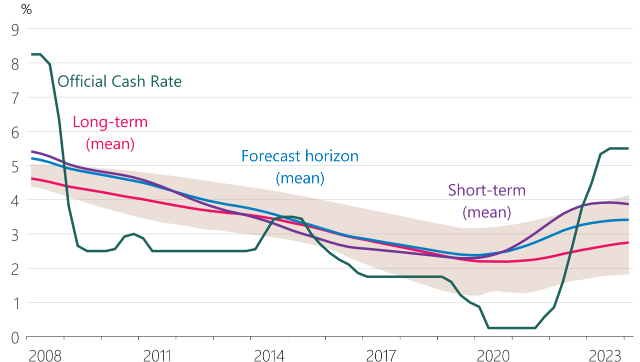
Appendix 2: Chart pack

Figure 7.1
Composition of CPI inflation
(annual)



Source: Stats NZ.

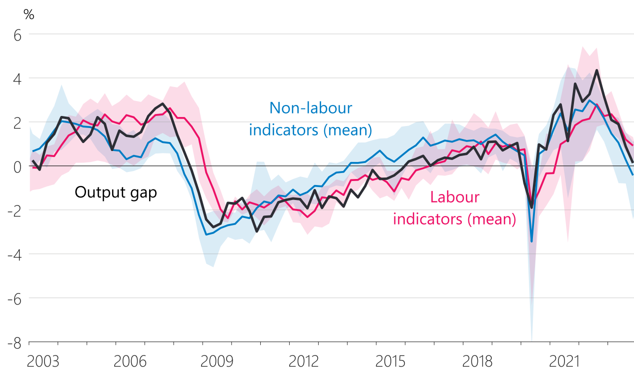
Figure 7.4
OCR and nominal neutral OCR indicator suite
(quarterly average)



Source: RBNZ estimates.

Note: The shaded area indicates the range between the maximum and minimum values from our suite of long-run nominal neutral OCR indicators. See Castaing et al. (2024) 'Estimates of New Zealand's nominal neutral interest rate'.

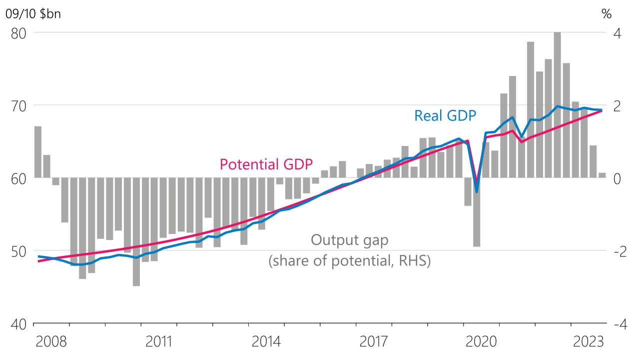
Figure 7.2
Output gap and output gap indicators
(share of potential GDP)



Source: NZIER, MBIE, Stats NZ, RBNZ estimates.

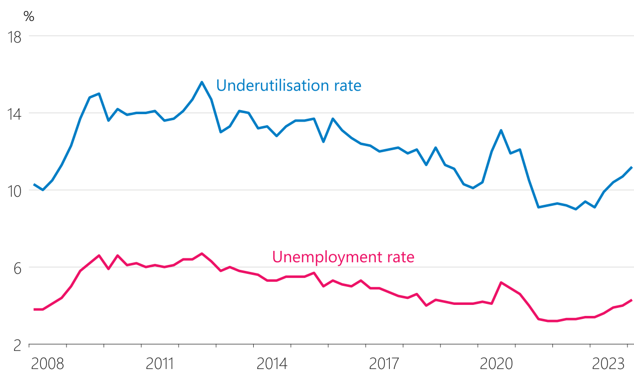
Note: The output gap indicators based on information from labour market surveys are shown separately from the other indicators. For each group of indicators, the shaded area shows the range of values and the line shows the mean value.

Figure 7.5
GDP and potential GDP
(seasonally adjusted)



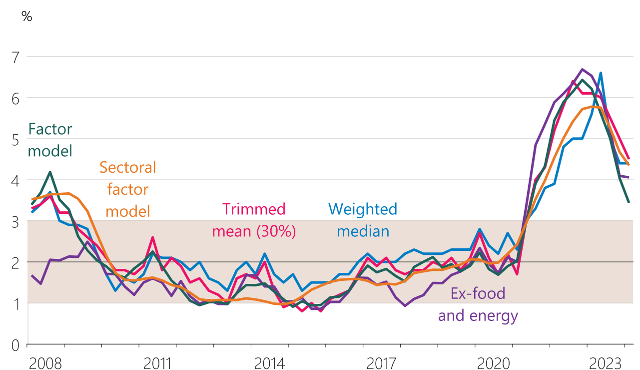
Source: Stats NZ, RBNZ estimates.

Figure 7.3
Unemployment and underutilisation rates
(seasonally adjusted)



Source: Stats NZ.

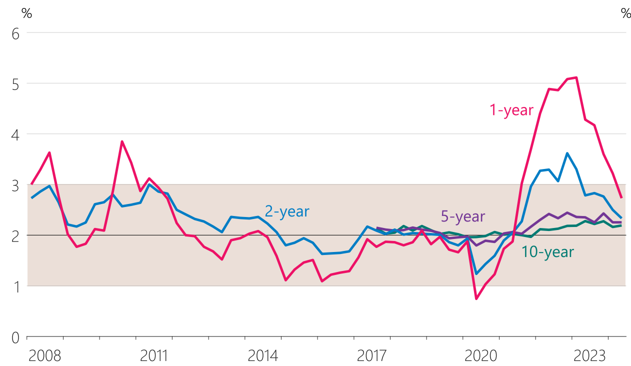
Figure 7.6
Measures of core inflation
(annual)



Source: Stats NZ, RBNZ estimates.

Note: Core inflation measures exclude the GST increase in 2010. The shaded area represents the MPC's 1 to 3 percent target range for annual CPI inflation over the medium term.

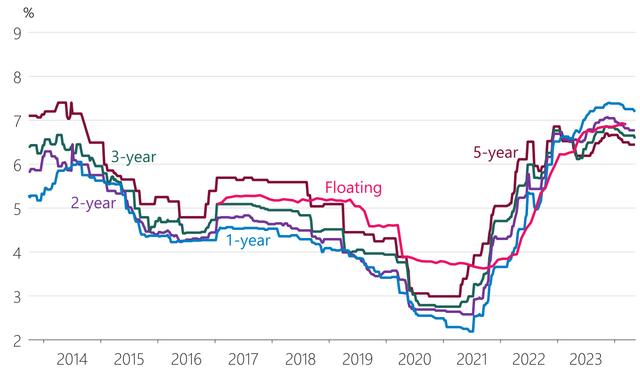
Figure 7.7
Inflation expectations
(annual, years ahead)



Source: RBNZ *Survey of Expectations (Business).*

Note: The shaded area represents the MPC's 1 to 3 percent target range for annual CPI inflation over the medium term.

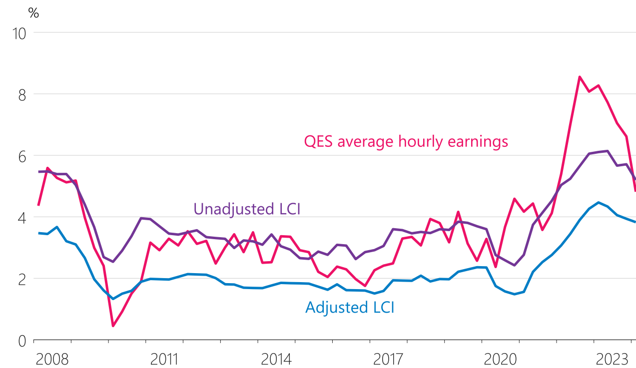
Figure 7.10
Mortgage interest rates



Source: interest.co.nz, RBNZ estimates.

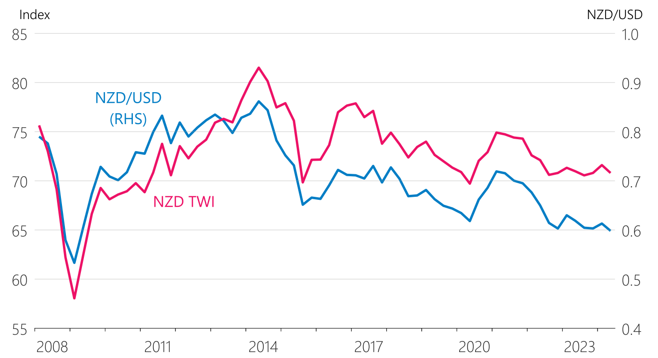
Note: The rates shown for the fixed terms are the average of the advertised rates from ANZ, ASB, BNZ, and Westpac, shown as weekly data. The floating rate represents the monthly yield on floating housing debt from the RBNZ *Income Statement* survey.

Figure 7.8
Private sector wage growth
(annual, nominal)



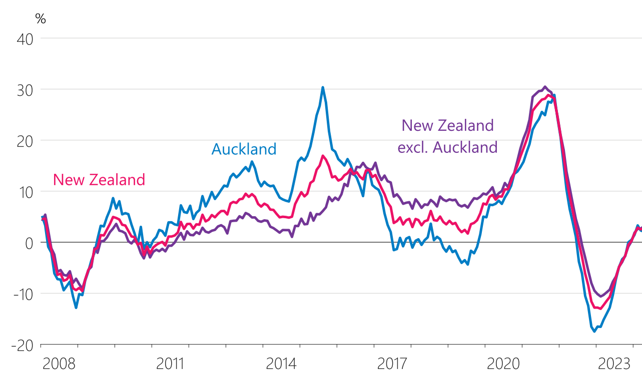
Source: Stats NZ.

Figure 7.11
New Zealand dollar exchange rates
(quarterly average)



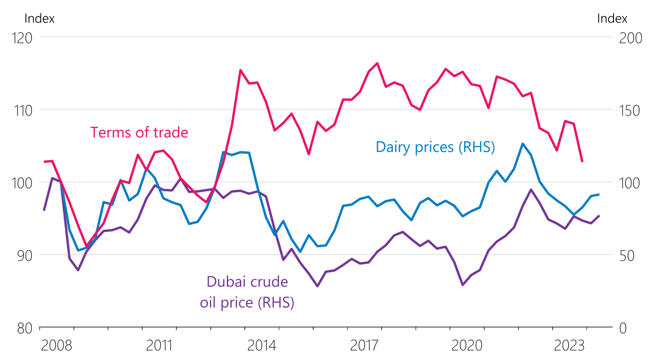
Source: NZFMA, RBNZ.

Figure 7.9
House price inflation
(annual, nominal)

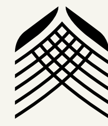


Source: REINZ.

Figure 7.12
Terms of trade, dairy and oil price indices
(index=100 in Q3 2008, quarterly average)



Source: Stats NZ, Global Dairy Trade, Refinitiv, RBNZ estimates.



Reserve Bank
of New Zealand
Te Pūtea Matua