

New Zealand Fixed Income Monthly June 2024

Economic struggles seen sending interest rates and inflation lower

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Lower interest rates looking increasingly likely amid economic weakness

Given the current weakness in New Zealand's economy, the key question regarding interest rates is not so much the direction they will take but when they are likely to be cut. The struggles seen in the economy span from GDP to employment and look set to persist for some time. New Zealand's GDP per capita has fallen for the last six straight quarters and its nominal GDP has declined for five of the last seven quarters. In the employment market, the number of job advertisements on SEEK, the online employment marketplace, decreased for the fourth straight month in May. Furthermore, the number was 5% lower than in April and down 30% from the level seen a year earlier. These are clear signs that New Zealand's restrictive monetary policy settings are constricting economic activity. The Reserve Bank of New Zealand (RBNZ) has kept the Official Cash Rate (OCR) unchanged since raising it to its current level of 5.5% in May 2023 with a quarter-point hike and the central bank sees its first rate cut occurring in mid-2025. Our view, however, is that New Zealand's monetary policy is sufficiently tight and may even be too restrictive given the impact it is having on the economy. This leads us to believe that there is a chance of a rate cut as early as November, when the RBNZ is scheduled to release its last Monetary Policy Statement for 2024. We feel that not cutting interest rates until mid-2025 would entrench the weaknesses that are already present in the economy, whereas earlier rate cuts would make the changes to the OCR less severe. Regardless of the timing of any cuts, however, interest rates will almost certainly be lower than their present level in a year to 18 months' time.

Inflation seen easing further in view of a sluggish economic environment

The likely direction of inflation in New Zealand also points to lower interest rates. Although the latest official figures show that the consumers price index (CPI) remained above the RBNZ's target range of 1-3% per annum in the March 2024 quarter with an annual rate of 4.0%, the data also show that the annual CPI has fallen for the past five quarters. Looking ahead, one of the key inflationary factors for New Zealand is higher shipping costs, which are being pushed up by the ongoing conflict in Gaza and low water levels in the Panama Canal. Although these costs generally drive inflation by pushing up import prices, their effect on New Zealand may not be as straightforward as they would usually be given the country's current economic weakness. After five straight quarters of decline in per-capita GDP, it may be challenging for companies to pass on higher costs to consumers through prices. Instead, the impact could be more apparent in the profit margins of importers and other businesses, leading to further sluggishness in the economy.

Some bright signs pointing to possible factors in future recovery

Amid the current negatives for New Zealand's economy, some signs of brightness point to possible factors in a future recovery. One of these is New Zealand's export sector, which is performing well overall. Forestry is rebounding, while the sheep and beef industries are also recovering to a certain extent. At the same time, tourism is continuing to benefit from a rebound in visitor numbers. For example, Chinese tourists are starting to visit New Zealand again, with strong increases in numbers expected in 2025 and 2026.

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