5 June 2025

Frequently Asked Questions

- **We lay out an economic FAQ of sorts, and take a stab at some answers**
- **Questions and concern about erratic US trade policy understandably commonplace**
- **As well as the sustainability and impacts of elevated export commodity prices**
- **Closer to home…regional differences, fiscal, and interest rates all areas of interest**

Getting around the country chatting to client groups always provides a valuable window into the key uncertainties, concerns, and opportunities the business community is grappling with.

So, for something different, we thought we'd share some of the more frequently asked questions from our recent travels in Auckland, Canterbury, Tauranga, the top-of-the-south, and Otago.

Our overall sense is that pessimism is continuing to slowly lift, consistent with what we're seeing in the numbers. But caution still abounds, particularly in the North Island. The South remains much less downbeat, and this inter-island divergence seems to be widening. There's concern about erratic US trade policy with the associated uncertainty particularly problematic. At the same time there was more of a sense of 'getting on with it' than we might have expected.

Tariffs, trade, and exports

Can high NZ commodity export prices be sustained in light of the global trade & tariff fiasco?

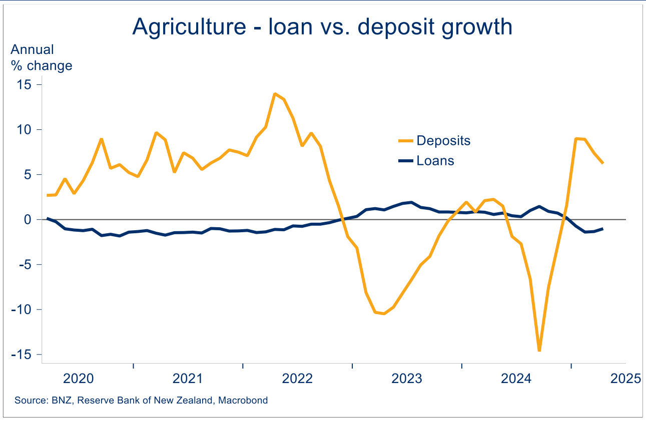
It will be a challenge. Disrupted global trade and slowing global growth are hardly supportive ingredients.

At the same time, there are some buffering factors to stir into the mix. The starting point is strong. Prices are currently skirting record highs in NZ dollar terms. Global supply in meat and dairy markets is also relatively tight, a steadying factor for prices even if demand tails off a bit. Overall, we expect some easing in prices for our major primary exports over the rest of the year, albeit to levels that would still be higher than a year ago.

Rural incomes are looking healthier than the past couple of years. Costs are also much higher, but where do you think any surplus cash flow will be directed?

A good chunk appears to be going towards debt reduction, or, more generally, parked at the bank. That's the thrust of the anecdote and it's in the numbers too. Total bank lending extended to the agriculture sector has been declining since January while deposit growth from the sector has jumped up.

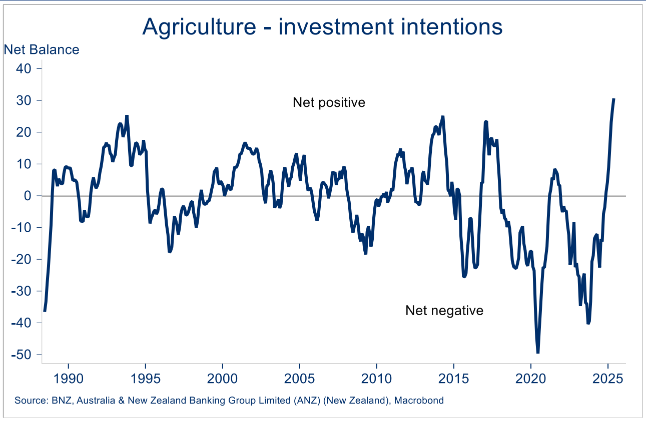
Farmers paying down debt



There are nevertheless some signs spending and investing appetites are thawing. For example, both farm sales and fertiliser imports are now clearly trending upwards, from admittedly low levels. Surveyed profitability and investment intentions, meanwhile, have climbed to multi-decade highs.

That's not to say those intentions will be acted on, but Fonterra's strong $10.00 opening 2025/26 season Milk Price forecast must increase the odds of such. Ditto the tax incentive from Budget 2025's "investment boost".

Strong intent



Will the policies of the White House spell the end of the US dollar?

The US dollar will very likely remain the world's reserve currency, mostly because TINA (**T**here **I**s **N**o **A**lternative). What's being hotly debated is the extent to which the long-term trend diversification out of the US dollar speeds up now that trust in the US is on the wane and prior economic exceptionalism has all but disappeared.

We agree that reduced capital inflows will pose a challenge for the greenback. Indeed, we see both structural and cyclical headwinds. The weakening USD has already pushed the NZD/USD back up to 0.6000 and we've recently lifted our year-end forecast to 0.6500, albeit with exceptionally wide error-bands around that forecast.

How will the US and Chinese economies cope with much-reduced trading activity?

It's too early to tell, not least because tariff rates are still far from settled. Interestingly, some high frequency indicators point to only a weak recovery in trade volumes in the wake of recent de-escalation moves (chart below).

For the US, the biggest impacts to date have been via shaken confidence, the curtailing of investment and employment plans, the front-loading of imports (driving the fall in Q1 US GDP) and increased inflation and inflation expectations. Chinese growth prospects have been less dented, in part thanks to some re-routing of exports. We note that consensus forecasts for Chinese GDP growth this year have recently been marked back *up* to where they were prior to 'liberation day', around 4.5%y/y.

Volatility in US-China trade activity

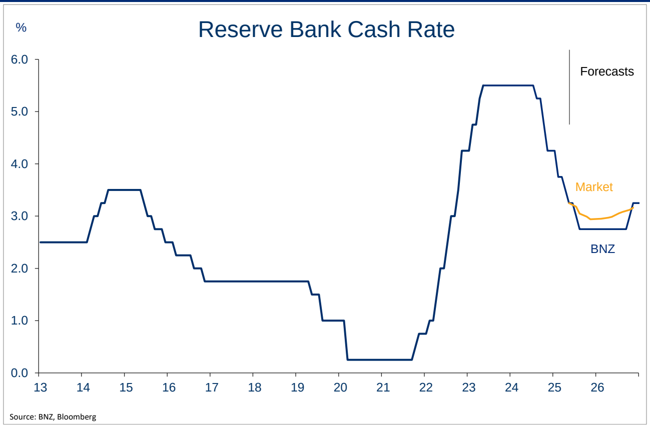
Interest rates

How much further will interest rates fall?

We're still forecasting the Reserve Bank (RBNZ) to deliver two more 25bps cuts to the cash rate, taking it to a cycle low of 2.75%. There was a slight 'less is more' tilt in the RBNZ's language last week though, which has lifted market pricing now to nearer a 3.00% low point. The evolution of global trade risks seems likely to have the final say here (the word "tariff" was mentioned in the RBNZ's Statement 176 times), and we're no more enlightened on that front than anyone else.

The broader point is that the rate cutting cycle appears to be entering its final stage. If that holds true, and unless another shock turns up, it suggests only floating and relatively short-term interest rates can be expected to fall much further from here. So that's the likes of six-month and one-year fixed mortgage rates which we still expect to dip into a 4.50-5.0% range over the second half of the year.

BNZ still forecasting 2.75% cash rate low



You're forecasting hikes in the cash rate from late 2026. What's the story there?

They're pencilled in, yes, mostly as a nod to the fact that the OCR cycle will turn at some point. In other words, a 'neutral' or below-neutral cash rate setting won't last forever. The timing is wildly uncertain. But by the end of next year, at least on our forecasts, we would have had around a year of respectable economic growth which will have soaked up some of the spare capacity that currently abounds.

How long does the Reserve Bank usually keep the cash rate at its cyclical low point, whatever that turns out to be?

Since the OCR was introduced in 1999, the cash rate cycle has troughed six times[1] and been held at the low point for an average of 18 months. That may not be particularly instructive for this cycle though. The tariff fog means the Reserve Bank is going to be feeling its way. Also bear in mind that the length of the lows in the cash rate over the last few decades have been extended by major shocks such as the GFC and the COVID pandemic. The big question is whether the trade war be as impactive as these previous shocks.

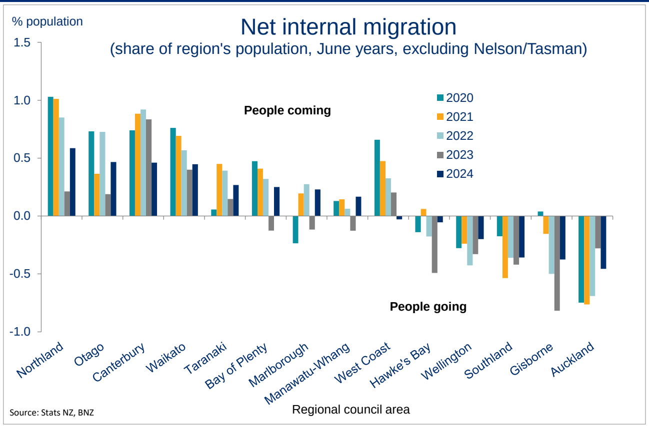
[1] On one occasion (2019) the "trough" gave way to another easing cycle

Population, housing, and construction

Are people still moving south?

Yep, internal migration patterns still have a 'head south' flavour to them. That's at least according to now slightly out-of-date Stats data (year to June 2024). And even if we don't have up-to-the-minute numbers, the ongoing economic outperformance of the South Island hints at a continued relative boost from people inflows (both short-term i.e. tourists, and longer-term movers).

Head south



The rates at which people are relocating have eased from the pandemic-era heights, but the general direction remains consistent: out of the Auckland, Wellington, Southland and Gisborne regions, and into Northland, Otago, Canterbury and Waikato.

How will the gap between the cost of building a new home and that of buying an existing one close?

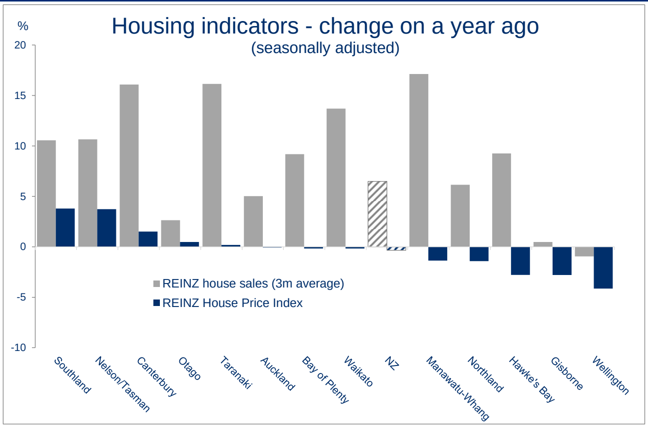
Build costs appear to have plateaued but not fallen, meaning there's still a wide gap to the cost of buying the average existing home. Our back-of-the-envelope estimates put the 'new build premium' for the average consented stand-alone house at 180-200k. That's down a touch from north of 200k last year, but still more than double the long-run average.

We could see some small falls in build costs from here but bear in mind labour costs are a major input and they're not going to come down. It brings us back to the view that more of the narrowing in the build vs. buy gap is likely to come via rising existing home prices. National house prices have lifted a cumulative 1.3% over the past six months, and we expect a slightly faster pace of gains over the coming six months.

Is the rising house sales/flattish house prices thematic the same right around the country?

Pretty much. There are some exceptions - Wellington and Gisborne most obviously. There's also been more of a price response in South Island regions. Growth in Otago sales activity is not as strong as elsewhere but that entirely reflects the fact house sales in Otago were more elevated to begin with.

Rising sales, flattish prices



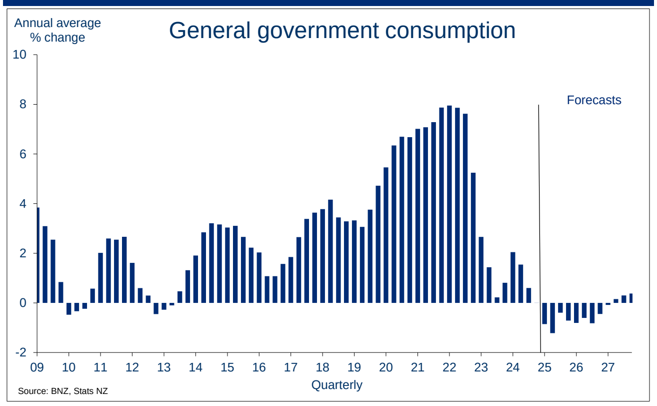
Others

How aggressively is the government cutting?

Budget 2025 revealed a bunch of reprioritisations but with overall core Crown expenses still growing. They're forecast to be up 2.3% in the 2025 fiscal year, after 9% growth last year. As a share of GDP, expenses are running at 32.7%, down from the 34.3% 2022 peak but still north of the 28% average in the five years prior to 2020.

Government consumption, in inflation adjusted terms, is expected to stay basically where it is now for the foreseeable future. In other words, general government activity won't be a massive drag but it won't be an active participant in the recovery either. It's a big growth gap to fill for the private sector.

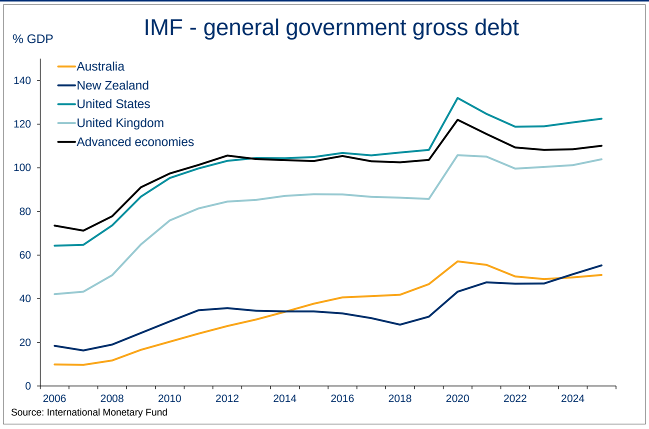
Government pulls back



But aren't we doing ok on government debt compared to some of the others?

Better than most, yes, although it's risen a lot. The issue is that we may need to maintain a lower debt position than many due to our significant disaster risk profile and the growing future burden of escalating health and superannuation expenses.

Rising trend

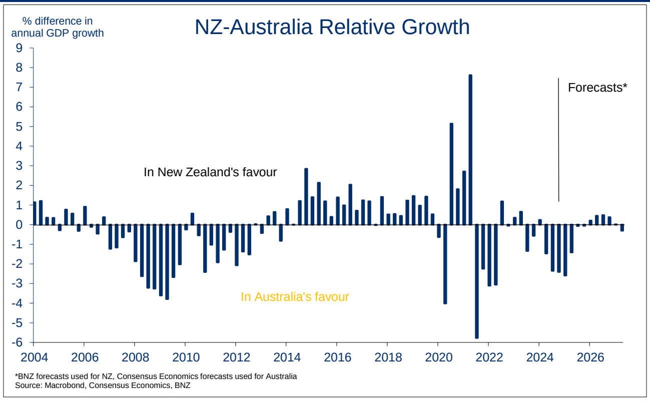


Why have the Aussies done so much better?

We dissected the performance of the antipodean economies in a note last year (find it here). Suffice to say, there wasn't a lot to cheer about from a NZ perspective.

But things might be changing. Our forecasts imply Australia's relative growth advantage may be peaking around now. Some NZ catch-up is expected over the next few years as NZ's economy climbs out of the mire and Australia slows up. Should that pan out, a reduction in the pace of Westward-bound migration outflows could be expected.

Peak 'Straya?



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