# **ECONOMIC OVERVIEW \_**

# **ANZ Research Agri-Focus April 2019**

**GLOBAL ECONOMY**

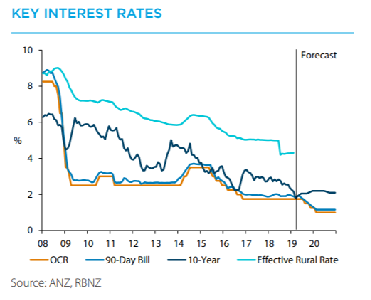
A reduction in global growth remains a key risk to New Zealand’s economy due to our reliance on our export sector. All of our main trading partners are experiencing challenges maintaining economic growth. The current slowing of global growth is expected to be a mid-cycle slowdown rather anything more sinister. However any slowing of growth could negatively impact demand for food products. The OECD forecasts a slight decline in prices of dairy and meat products over the next decade. It says demand growth from China is now decelerating while new sources of global demand are not sufficient to maintain growth. New Zealand is highly exposed to China, which is adjusting to structurally lower growth rates as the economy matures. China directly accounts for 24% of our exports, and we are also indirectly exposed to this market through our second largest trading partner, Australia. At present, China’s appetite remains strong for the products that New Zealand supplies. This demand has helped bolster returns across the primary sector. But economic uncertainty caused by political events such as the US-China trade war and the Brexit process, are adding to headwinds for global economic growth. Central banks are increasingly looking to adopt measures to stimulate growth. China plans to reduce the level of capital banks need to hold in order to stimulate lending to the private sector. Meanwhile, the US Federal Reserve now plans to hold interest rate at current levels through to 2021, while the European Central Bank also has its rates on hold and is providing extra stimulus though cheap loans to its banks. The RBA has also moved towards a more cautious stance.

**NEW ZEALAND ECONOMY**

GDP data for the final quarter of 2018, released last week, confirmed that economic growth has softened. The data showed annual growth slipping from 2.6% to 2.3% y/y, after growth in the final quarter of 2018 at 0.6% q/q. This rate of growth was aligned with our expectations but was lower than the Reserve RBNZ had been expecting. And downward revisions to previous quarters suggest that the slowing in growth has been more pronounced than previously thought. Our view is that the economy will struggle to accelerate from here and that growth will continue to run close to or a bit below 2.5% y/y over the next year. Drivers of growth such as the impetus from construction, tourism and net migration have waned. Meanwhile, the economy is coming up against constraints that limit how quickly it can grow. Most labour market indicators show the economy is operating at near full capacity, with employment close to its maximum sustainable level. However, recent data suggest that capacity pressures are starting to ebb and resource pressures are past their peak. Even with the economy running close to full capacity, there was little inflationary pressure. Inflation is tracking below the desired 2% medium-term target, and with capacity pressures expected to ease, it is unlikely this target will be met. However, there are some factors that are stimulating economic growth. The terms of trade remains strong – that is, the value of the goods we are exporting is strong relative to the value of the goods being imported. Put another way, when our terms of trade is strong, we can buy more smart phones with each tonne of milk powder sold. Monetary policy is also stimulatory at present. The OCR remains at 1.75%, having been at this low level since November 2016. We expect the next move in the OCR will be downward. The RBNZ has come around to this view, indicating at the March OCR Review that the next move in the OCR is more likely to be down. Government spending is also providing some boost to the economy and household spending remains strong.

**INTEREST RATES**

Effective rural interest rates flattened in the later part of 2018, while total borrowing from New Zealand’s rural sector increased. The dairy sector, which accounts for the majority of the debt, is becoming increasingly focused on debt repayment, with expansionary plans now more the domain of the horticultural and forestry sectors.



**EXCHANGE RATES**

The New Zealand dollar has traded at an average rate of US$0.6816 since the beginning of the year. The NZD generally appreciated during this time when central banks across the globe took a more dovish tone, indicating they would either cut interest rate or postpone planned rate hikes. The RBNZ announced last week that the next rate movement is likely to be down. The NZD reacted to this dovish statement by the RBNZ by rapidly depreciating. Prior to the announcement the NZD was priced above US$0.69 but has now stabilised near US$0.68. In the second half of 2019 further softening in the NZD is expected, with timing dependent on the expected OCR cuts and how other economies perform. The bank capital changes proposed by the RBNZ are expected to have a material impact on the cost and availability of credit in New Zealand. If implemented, this policy could put further downward pressure on the NZD in the later part of 2019.