Quarterly Economic Outlook

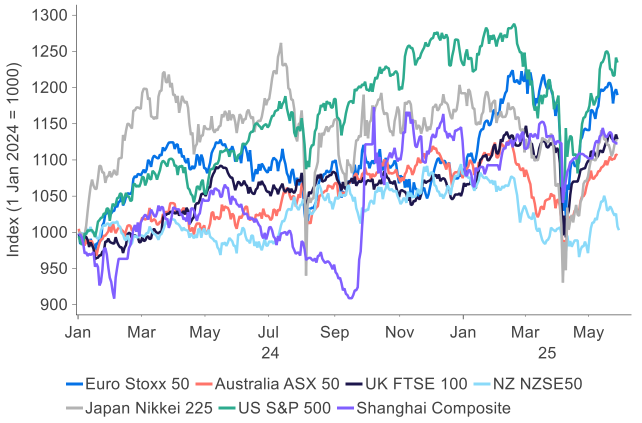
Walking a tightrope

May 2025

At a glance

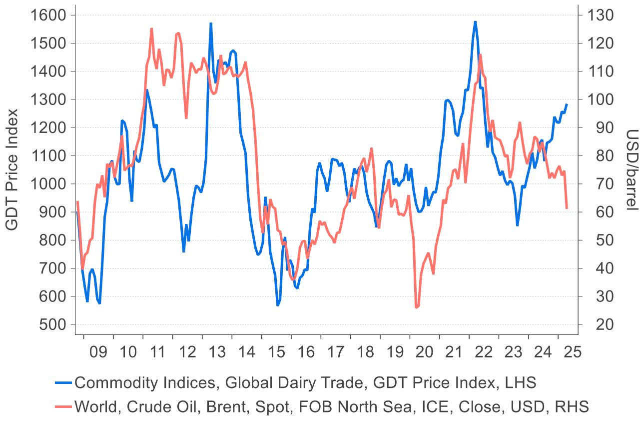
Global equities have largely recovered from their April wobble…

But US trade policy will remain a key source of uncertainty.



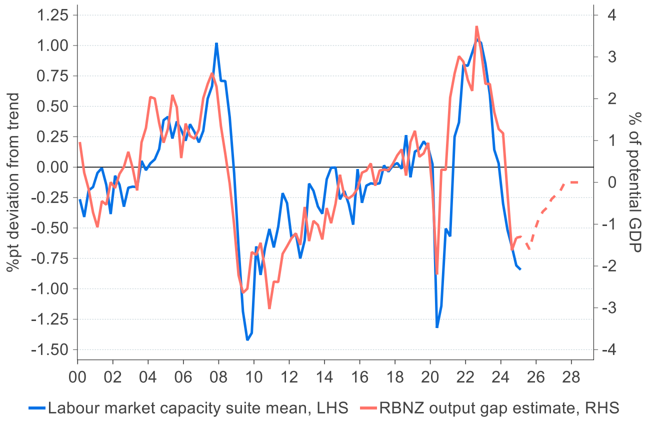
…while New Zealand export prices have held up

Breaking some of their usual correlations.



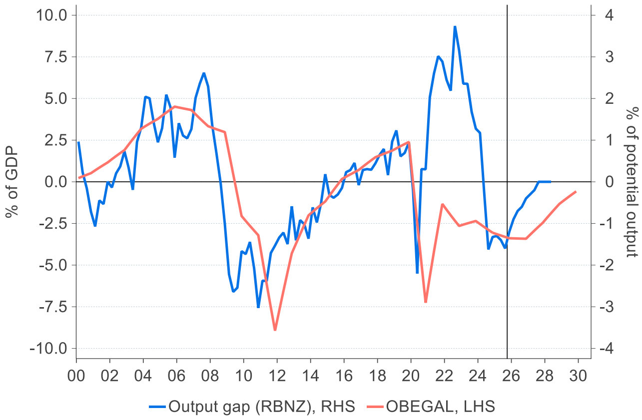
Labour market, activity, and survey data suggest there is plenty of spare capacity out there

Meaning further underlying disinflation to come.



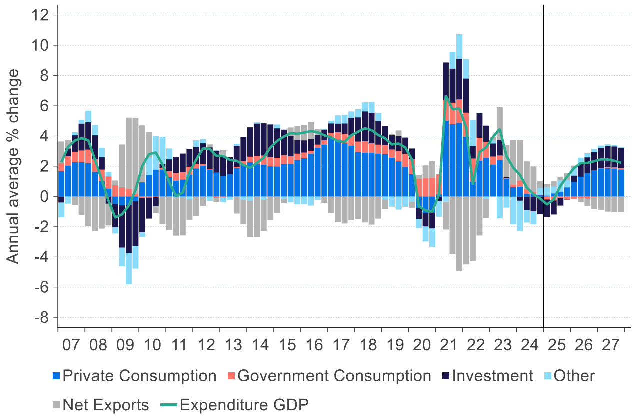
Fiscal deficits are forecast to persist…

New Zealand ran fiscal deficits following COVID, even as the economy ran hot.



…even as the economic recovery gathers pace

Net exports are expected to eventually hand the growth baton to domestic demand



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Source: Stats NZ, RBNZ, NZIER, Global Dairy Trade, ICE, NZ Treasury, Bloomberg, Macrobond, ANZ Research

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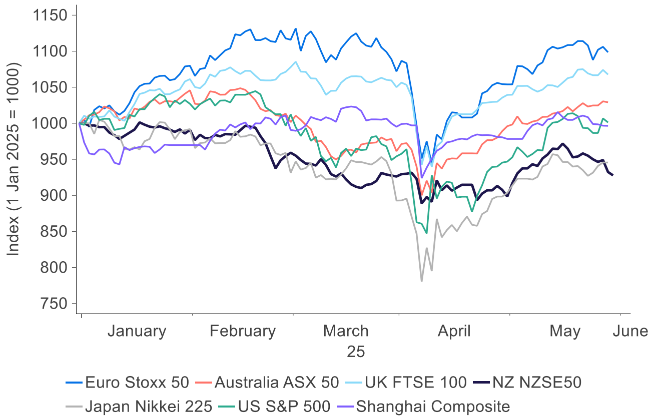
The big picture

Walking a tightrope

Global volatility has dominated the wires since our February edition, and while a lot of the initial panic following Trump's "Liberation Day" announcements has subsided, the world is still a different place: a 10% minimum tariff rate on all goods exported to the US seems like the new base case for all economies, with China likely to face something higher than that once the dust has settled.

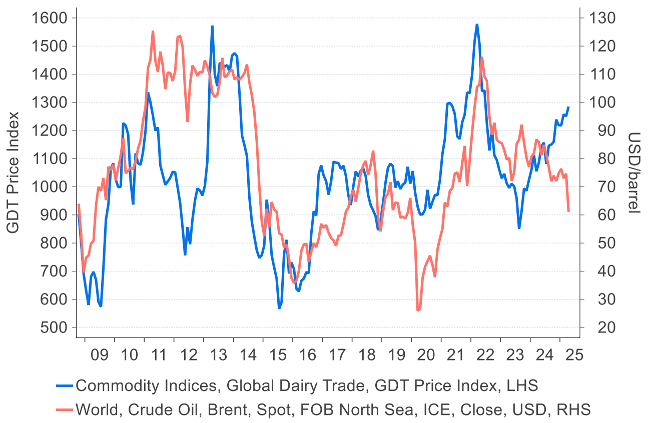
Figure 1. Global equities



Source: Bloomberg, Macrobond, ANZ Research

Confidence has taken a hit in the wake of global uncertainty, but prices for some of our key agricultural exports have remained robust (even surprising to the upside of late). We have therefore recently revised up our milk price forecast for the current and next season to \$10/kgMS. Meanwhile, global oil prices have been going the other way – a happy combo for our terms of trade and national incomes (all else equal). While the NZD Trade-Weighted Index has moved higher recently, it remains well below its 5-year average, and is still considered a support to the net exports recovery currently underway.

Figure 2. Dairy and oil prices

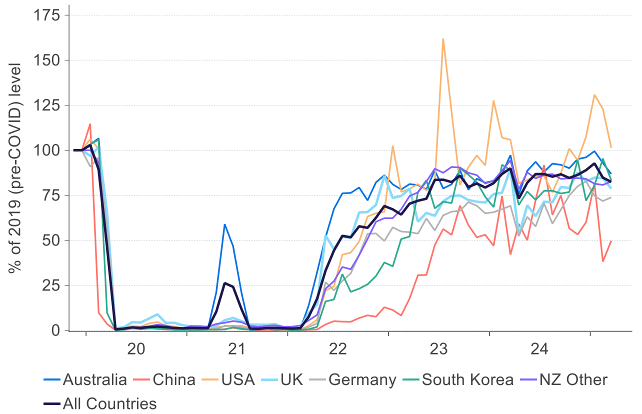


Source: Global Dairy Trade, ICE, Macrobond, ANZ Research

While trade in goods is so far proving robust in the face of global headwinds, the recovery in services exports (chiefly tourism) is a little less rosy. As at the end of last year, real services exports were still 0.5% below their pre-pandemic (Q4 2019) level. Services imports, on the other hand, were 1.4% higher. In nominal terms, services exports rose almost 20% over the same period (courtesy of higher prices), but services imports were up almost 40% (as higher world prices and the lower NZD added to the lift in volumes). Our expectation is that the services trade deficit will continue to narrow from here, but we are a little wary that it could be a very long time before we're recording surpluses anywhere near the ~1.5% of GDP level that we benefited from just ahead of the pandemic.

Running at just over 80% of their pre-pandemic level in March, short-term visitor arrivals are yet to recover to their pre-pandemic (2019) level. Of the top countries of origin, arrivals from the US have been the only one to top their 2019 level. Conversely, arrivals from China remain the weak spot.

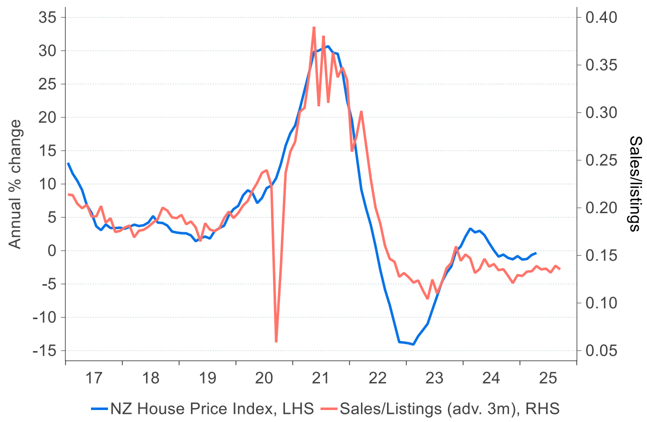
Figure 3. Short-term visitor arrivals



Source: Stats NZ, ABS, Macrobond, ANZ Research

Domestically, the recovery is still looking modest and a little patchy. Activity indicators are mixed, and while they are generally above their 2024 lows, not all are pointing to expansion (e.g. the PSI remains stuck sub-50). Meanwhile, housing market turnover has lifted on the back of lower mortgage rates, but pent-up supply dynamics have seen listings rise at a similar pace to house sales. In other words, supply has moved with demand, resulting in relatively subdued price pressure. We expect house prices to rise 4.5% in 2025, with price momentum picking up a little over the second half of the year as inventory is worked through (see our latest Property Focus for further details).

Figure 4. House prices vs sales-to-listings ratio

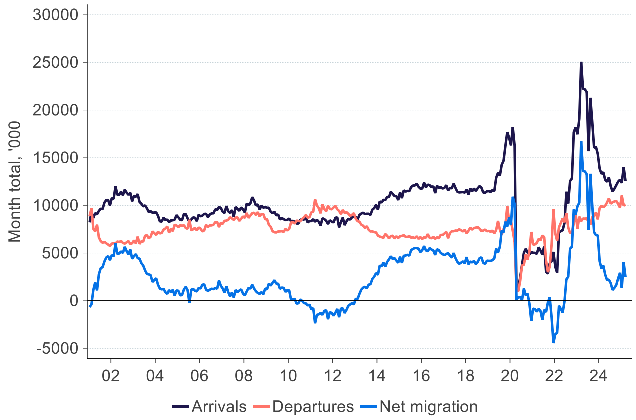


Source: REINZ, realestate.co.nz, Macrobond, ANZ Research

The big picture

Net migration inflows are tentatively turning higher, with departures stabilising at an elevated level and arrivals picking up. That could be a sign that opportunities in the labour market are growing), but it's important to highlight that these data are vulnerable to material revision.

Figure 5. Net migration



Source: Stats NZ, Macrobond, ANZ Research

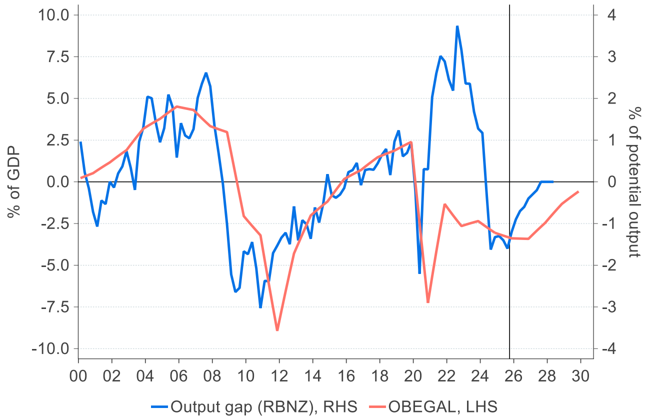
The Q1 rise in employment growth (just +0.1% q/q) tentatively suggests demand for labour has stopped contracting – although there is a risk that the Q2 figures come in weaker than our expectation, with some firms potentially putting their hiring plans on hold in response to the global trade and confidence shock. If we do see a bout of weakness in hiring and investment in the near term, forecasters and policy makers will still need to make a call regarding how much of that is likely to stick (i.e. because the world is perceived to have changed) and how much is temporary.

The outlook for fiscal policy settings is a smidgen different in the wake of May's Budget. Lower discretionary operational spending, a slightly more front-loaded capex outlook, and a few tweaks to tax settings have not been enough to move the dial on our headline GDP outlook. However, funding the Investment Boost initiative with government spending cuts will have some compositional effects. Government consumption as a share of GDP is likely to shrink faster than otherwise as the private sector share (and capital goods imports) expands. However, given the degree of uncertainty around the impacts of the post-Liberation Day global confidence shock, it could be difficult to differentiate the policy impacts.

Increasing the KiwiSaver contribution rate is also likely to have some minor economic impacts, with slower wage growth than otherwise (given firms are unlikely to wear the additional cost of labour), and potential changes to households' saving behaviour (as some rejig their finances in response). All in all, we think the impact on aggregate demand and non-tradable inflation will be negligible. We have made a minor tweak to our expectation for wage growth, but do not see this as having material implications for monetary policy.

In macroeconomic terms, the fiscal outlook presented at Budget was little changed from that in December's Half-Year Update. As figure 6 shows, prior to the pandemic, NZ had a track record of running counter-cyclical fiscal policy (deficits during times of economic weakness and spare economic capacity, and surpluses when the economy was running a bit hotter). That changed in the wake of the pandemic, with persistent deficits throughout all parts of the business cycle: during the hotter and inflationary times (when the output gap was positive), the weak period now (which is normal), and the more neutral times forecast ahead (when output gap closes). All up, there is very little room to achieve a sustainable fiscal path without continuing to run "tight" budgets or increasing revenues via tax policy changes.

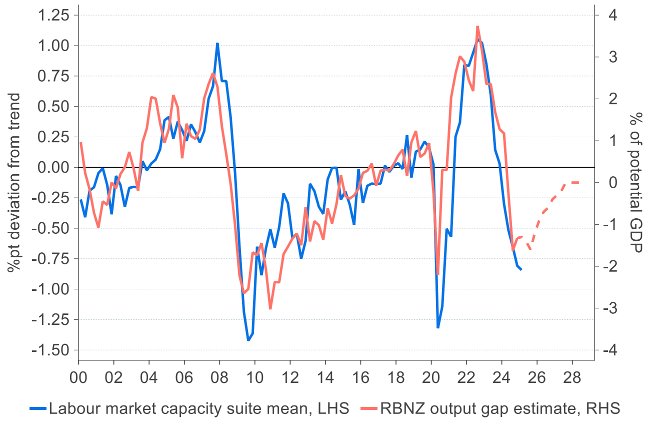
Figure 6. OBEGAL vs RBNZ output gap



Source: NZ Treasury, RBNZ, Macrobond, ANZ Research

Bringing it all together, capacity indicators (stemming from the labour market, activity, and survey data) continue to suggest there is plenty more underlying disinflation in the pipeline.

Figure 7. ANZ labour market capacity suite vs RBNZ output gap



Source: Stats NZ, RBNZ, NZIER, Macrobond, ANZ Research

The RBNZ is walking quite the tightrope as it withdraws monetary restriction while continuing to assess just how long and how variable the lags between monetary policy and inflation are likely to prove this cycle. That's BAU for central banks, but like all cycles that have come before this one, there are quirks. Pockets of strength in the CPI basket that are not sensitive to monetary conditions (e.g. property rates and electricity lines charges), combined with only a relatively gradual fiscal consolidation, and the fact that households and businesses have only just recently experienced high inflation (a threat to inflation expectations), suggest the RBNZ certainly can't stop worrying about upside inflation risks. But at the same time, many economic indicators, while off their lows, are still looking sluggish, and given the weak starting point, a pick-up in growth might not be much of a threat to inflation (i.e. the economy appears to still be a fair way from running into capacity constraints). Overlay all of this with lingering global uncertainty and it's fair to assume forecasters are likely to get a few things wrong this year.

For our part, we continue to pencil in 25bp OCR cuts all the way to 2.5%, but will be watching the data closely.

Table 1. Summary of key forecasts

Calendar Years	2020	2021	2022	2023	2024	2025f	2026f	2027f
Real GDP[1] (annual average % change)	-1.4	5.7	2.9	1.8	-0.5	1.0	2.6	2.6
Unemployment Rate (sa; Dec qtr)	4.9	3.2	3.4	4.0	5.1	5.1	4.5	4.2
CPI Inflation (annual % change; Dec qtr)	1.4	5.9	7.2	4.7	2.2	2.6	1.7	2.0
Official Cash Rate (Dec qtr end)	0.25	0.75	4.25	5.50	4.25	2.50	3.00	3.00

[1] Production based

Source: Statistics NZ, RBNZ, ANZ Research

Forecasts finalised 29 May 2025. See page 8 for detailed forecast charts and this link to download tables

Our forecasts

Sizing up the elephant

In mid-April, we downgraded our economic growth and OCR forecasts, taking signal from the high-frequency data (which was suggesting the recovery wasn't quite as robust as previously thought) and centralising some of the post-Liberation Day confidence impacts on domestic investment.

Since then, we have not made material changes to our forecasts. But we have made some minor tweaks, including:

- Swapping out a little public sector activity with private sector activity and capital goods imports in the wake of the Budget. This has had no impact on aggregate demand or headline GDP (as noted in the previous section).
- Trimming our near-term wage growth forecast, but not flowing this through to non-tradable inflation (also noted in previous section), and
- Increasing our Q2 CPI forecast, following the vehicle licencing fee omission in Q1 and taking a little bit of signal from the April Selected Price Indexes. This has had no implication for our medium-term outlook for inflation and therefore monetary policy.

Given lingering global uncertainties, it's fair to say that a lengthy discussion of the above forecast tweaks (particularly changes in fiscal settings) would very likely leave us splitting hairs over minor macroeconomic developments when it's still unclear whether the elephant in the room (the global trade and confidence shock) is about to stampede over our entire forecast or wander sedately past in the background, breaking the occasional tree but posing no real threat to our nation's economic wellbeing.

Fair to say, risks to the outlook are heightened. And as is always the case, while we've done our best to "centralise" what we see as being relatively high-probability, but low-impact risks, we (or the RBNZ) cannot centralise the relatively low-probability, but high-impact risks that have intensified with recent global economic fragility. That's important context for anyone digesting the forecast presented below.

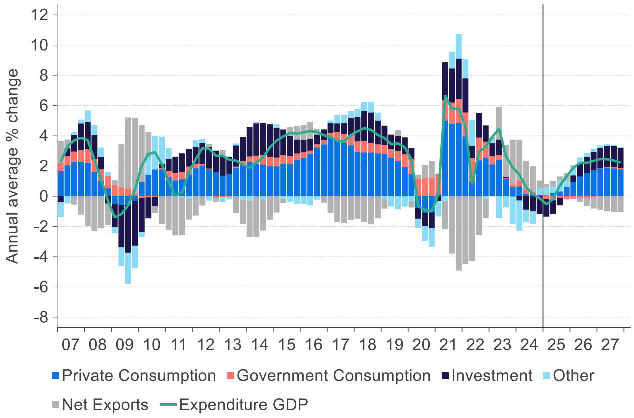
Net exports handing the growth baton to domestic demand…

It's likely to be a bumpier ride than we can reasonably forecast, but our expectation is that the recovery in GDP that started in the last three months of last year will steadily continue in 2025 and gather pace in 2026. We expect annual average growth to come in at 1.0% over 2025, accelerate to 2.6% in 2026, and maintain that pace in 2027.

As figure 8 shows, net exports have been a key offset to weak domestic demand over the past couple of years. That's been driven by a mix of factors, including weak domestic demand weighing on imports and favourable weather conditions supporting our agricultural exports.

But that dynamic is poised to change over the coming year or so as domestic demand (chiefly private consumption and investment) picks up the growth baton, causing imports to rise and the net exports contribution to flip from driver to drag.

Figure 8. Contributions to GDP growth



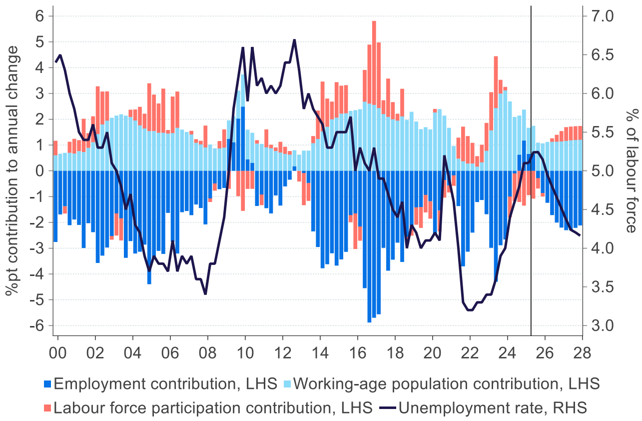
Source: Stats NZ, Macrobond, ANZ Research

While our GDP forecast suggests we're now past the worst of it, for many households it won't feel like things are getting better until after the labour market turns the corner, and given typical lags that's still likely to be a way off. Households' expectations that inflation is going to continue to run hotter than any economists are forecasting also won't do anything to reduce perceptions that the cost-of-living crisis continues unabated.

…as the labour market rounds the corner

The unemployment rate was unchanged at 5.1% in Q1, as growth in labour supply was broadly matched by labour demand. While employment growth has tentatively stopped contracting, we expect growth in labour supply will continue to outpace labour demand for a little while yet, meaning the unemployment rate is poised to drift a little higher. We expect the unemployment rate to lift to 5.2% in Q2 and maintain that level in Q3 before steadily dropping towards a level consistent with stable CPI inflation pressures.

Figure 9. Contributions to changes in the unemployment rate

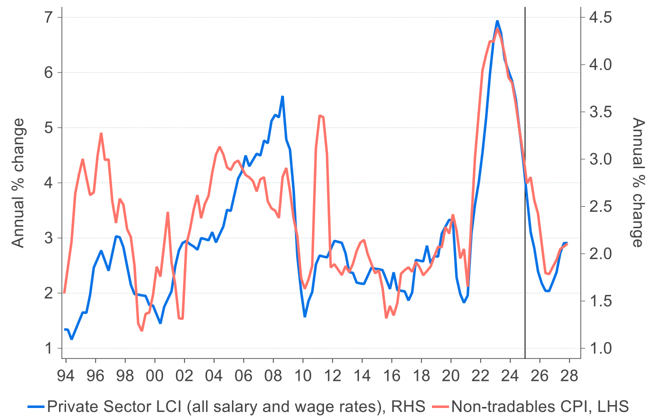


Source: Stats NZ, Macrobond, ANZ Research

Our forecasts

Annual private sector wage growth is expected to moderate in the near term, returning to levels consistent with inflation near the RBNZ's 2% target midpoint by the end of 2025. Firms' own wage expectations in our Business Outlook survey have been sub-3% for a year now.

Figure 10. Private sector labour costs vs non-tradable inflation



Source: Stats NZ, Macrobond, ANZ Research

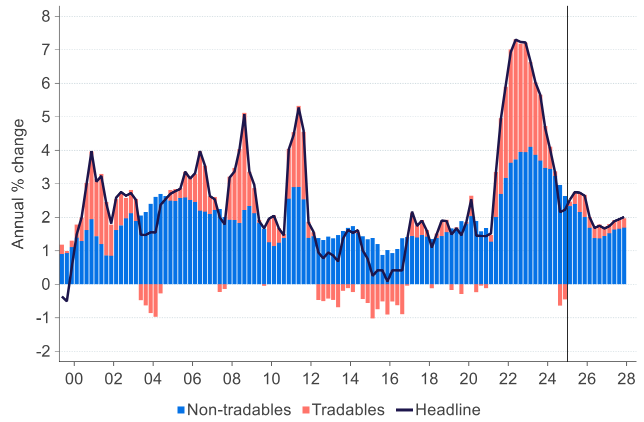
Further underlying disinflation to come

Despite annual headline inflation accelerating 0.3%pts to 2.5% in Q1, there was plenty of evidence in the CPI data to suggest the underlying disinflation trajectory remains intact:

- Annual non-tradable inflation slowed 0.5%pts to 4.0% y/y. While that was above our forecast of 3.8%, the surprise was driven by a change in fees-free eligibility and not a result of stronger underlying demand and inflation pressures.
- Core measures of inflation slowed, with all the main measures we keep a close eye on (trimmed mean, weighted median, ex food, fuel and energy, and the RBNZ's sectoral factor model) landing comfortably within the 1-3% target band.

As we noted previously, we have recently revised up our Q2 CPI inflation forecast, which if correct, would see annual inflation accelerate to 2.8% y/y. But as figure 11 portrays, that's a bump in the road rather than an expectation that underlying disinflation progress has run its course.

Figure 11. Contributions to inflation



Source: Stats NZ, Macrobond, ANZ Research

From its peak of 2.8% y/y in Q2 2025, our forecast is for inflation to slow to 1.7% y/y by mid-2026 before stabilising close to 2% over the medium term. After accelerating 0.1%pt to 4.1% in Q2, non-tradable inflation is expected to continue slowing as loose labour market conditions contain pressure on labour costs.

While the near-term acceleration in inflation could make the Monetary Policy Committee a little uncomfortable, provided they conclude (as we do) that this is a hiccup as opposed to a change in underlying price momentum, then it shouldn't prevent further – albeit cautious – OCR cuts over coming months. However, should inflation expectations continue to drift higher and/or capacity indicators start to turn more abruptly than anticipated, the RBNZ won't hesitate to hit the pause button and see where the dust is settling. Likewise, the Committee won't hesitate to cut more aggressively should economic conditions (and inflation pressure) deteriorate.

OCR expected to fall to 2.50%

Putting it all together, we have pencilled in 25bp cuts at each RBNZ meeting through to (and including) October, taking the OCR to a low of 2.50%; just below the 3% mark widely judged to be neutral (i.e. neither contractionary nor stimulatory), but the bottom of the 2.5-3.5% range of estimates of neutral that the RBNZ sometimes quotes, in order to highlight the inherent uncertainty of such estimates.

As per last quarter, we judge the risks around our forecasts to be broadly symmetrical. On the one hand, recent increases in surveyed inflation expectations, inflation uncertainty in the US owing to tariffs, and higher farmgate returns may mean fewer OCR cuts are needed. Lower mortgage rates are driving a modest bounce in the housing market, but it isn't tearing away. However, on the other hand, more stimulus may be needed if tariff uncertainty becomes more entrenched, weighing on sentiment, hiring and investment for longer, and import prices may fall if counties like China or manufacturers in product segments like EVs look for new markets for their goods. Oil prices and the stronger NZD/USD (discussed later) will also be worth watching.

It's worth noting that whereas we have centralised a softer outlook on account of global tariff uncertainty, we don't expect the RBNZ to do so just yet. Rather, we expect them to maintain a high degree of optionality, and to alter policy meeting-by-meeting, depending on how things unfold. For that reason, it may be some time before our forecasts and the RBNZ's are fully aligned.

Short-end rates to continue falling until around Q3

Flowing our OCR forecasts into our wider interest rate forecasts results in 90-day bill rates and 2-year swap rates bottoming out lower and later than we envisaged in our previous Quarterly. To enumerate, our forecasts envisage that the 90-day rate will fall to 2.65% by October and hold there through till mid-2026, after which it is expected to rise slowly in anticipation of eventual OCR hikes. Our profile for

Our forecasts

the bellwether 2-year swap rate is similar, but the prospect of eventual rate hikes on the horizon mean that it is expected to bottom out only a few basis points below 3%, rather than continuing towards 2.5%.

Long-end rates to remain elevated, delivering steeper yield curves

Whereas we have downgraded our short-end interest rate forecasts, we expect long-end rates to remain elevated, which will result in steeper yield curves. The two key drivers at play here are higher global bond yields as markets anticipate fewer US Federal Reserve cuts and higher near-term inflation as tariffs bite; and a higher term premium as bond markets factor in fiscal risks. The impact of the latter has been especially evident in the wider spread between US 10-year and US 30-year bonds, and in the spread between US government bond yields and same-maturity swap rates. This has happened as markets have baulked at President Trump's proposed "One Big Beautiful" tax bill (which the Congressional Budget Office has estimated could add up to USD 2.4 trillion to US government debt levels over the next decade).

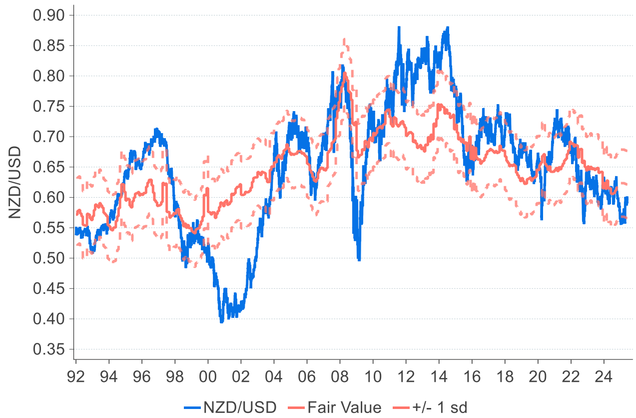
While New Zealand's fiscal outlook is far from perfect, with a balanced budget still several years off and government bond issuance still very high, the outlook here is better than in the US and many other places. Indeed, while 2024/25 government bond issuance was upgraded to $43bn at the Budget (which was just $2bn below where it peaked during COVID), issuance is at least forecast to fall over the next four years. Ordinarily, with the OCR going lower and New Zealand's fiscal outlook improving (albeit gradually), we'd be inclined to expect local long-end yields to fall. However, if US bond yields keep rising, it will be very difficult for New Zealand yields to fall, and that leaves us more neutral; hence our flat forecast from here for NZ 10-year bond yields. Clearly there are risks around that, particularly as markets ebb and flow, but our sense is that any relative positives in New Zealand's favour will be offset by unfavourable US and global fiscal developments.

NZD/USD already above our year-end forecast, but beware of volatility

Our forecasts envisage a resumption of NZD/USD strength as it returns to fair value (which we currently see at 0.62) over late 2025 and into 2026. However, with the Kiwi already above our 0.59 year-end forecast, we are mindful of downside risks as the OCR goes lower and markets work their way through US tariff policy uncertainty, especially with FX volatility still elevated.

However, we would caution that the risks are skewed to the possibility that the Kiwi does not correct lower, and instead continues to gradually appreciate from its current level towards our end-2026 forecast of 0.63. Such a move would certainly be consistent with the way markets traded over the month of May, shunning US assets including the US dollar, US bonds and US equities as traditional correlations between risk appetite, bond yields and currencies broke down.

Figure 12. ANZ estimate of NZD/USD fair value and standard deviation bands



Source: Bloomberg, Macrobond, ANZ Research

Table 1: Forecasts (end of quarter)

FX Rates	29-May	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
NZD/USD	0.597	0.550	0.570	0.590	0.600	0.610	0.620	0.630
NZD/AUD	0.929	0.902	0.905	0.922	0.923	0.924	0.925	0.926
NZD/EUR	0.529	0.491	0.500	0.509	0.517	0.517	0.525	0.525
NZD/JPY	86.5	79.8	79.8	81.4	81.6	81.7	81.8	81.9
NZD/GBP	0.444	0.423	0.432	0.440	0.441	0.449	0.449	0.457
NZ$ TWI	69.3	65.6	67.5	69.5	70.3	70.9	71.6	72.2
Interest Rates	**29-May**	**Jun-25**	**Sep-25**	**Dec-25**	**Mar-26**	**Jun-26**	**Sep-26**	**Dec-26**
NZ OCR	3.25	3.25	2.75	2.50	2.50	2.50	2.50	3.00
NZ 90-day bill	3.31	2.97	2.62	2.62	2.62	2.70	3.05	3.12
NZ 2-yr swap	3.34	3.15	3.04	2.96	3.07	3.18	3.27	3.32
NZ 10-yr bond	4.67	4.50	4.50	4.50	4.50	4.50	4.50	4.50

Source: Bloomberg, ANZ Research

Forecast charts

Figure 1. Production GDP level (headline vs per capita)

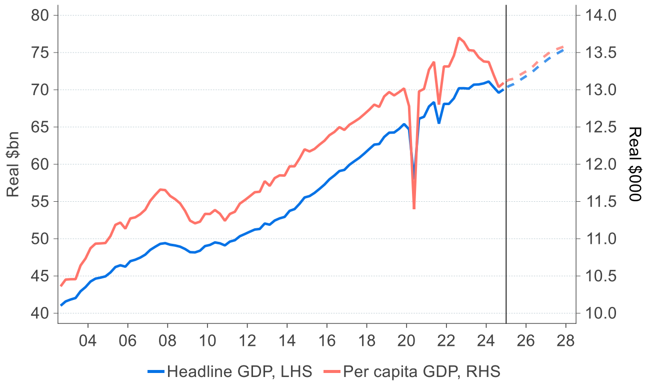


Figure 2. Production GDP growth

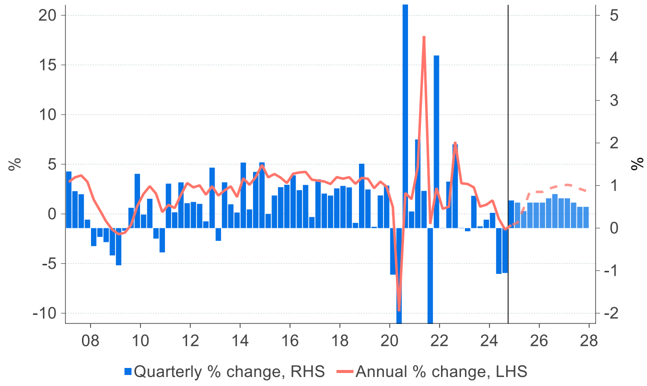
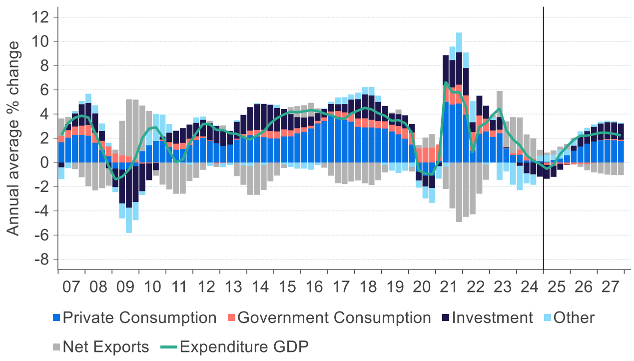


Figure 3. Contributions to GDP growth (detailed)



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Real investment

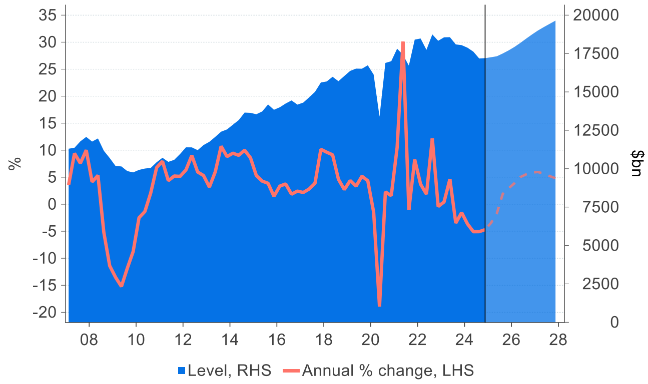


Figure 5. Real private consumption

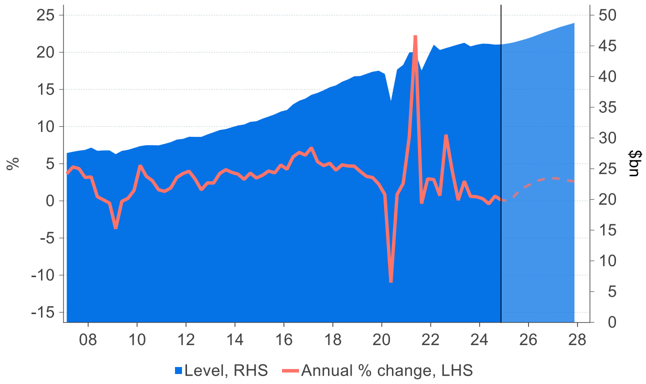


Figure 6. Real government consumption

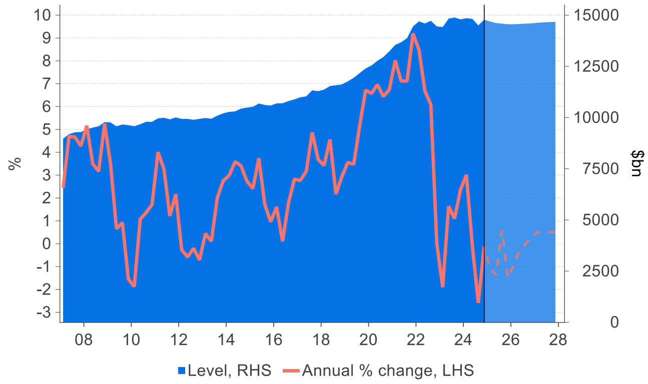


Figure 7. Real exports (goods and services)

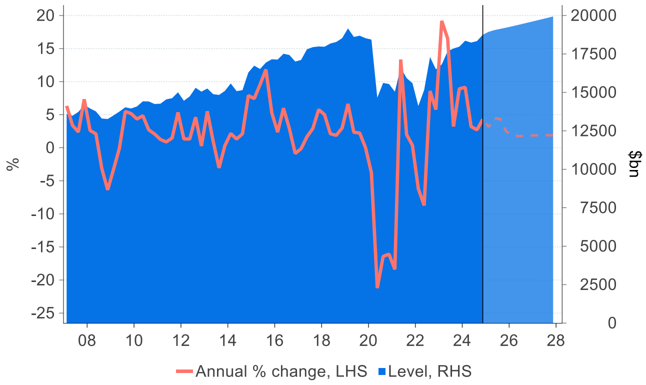
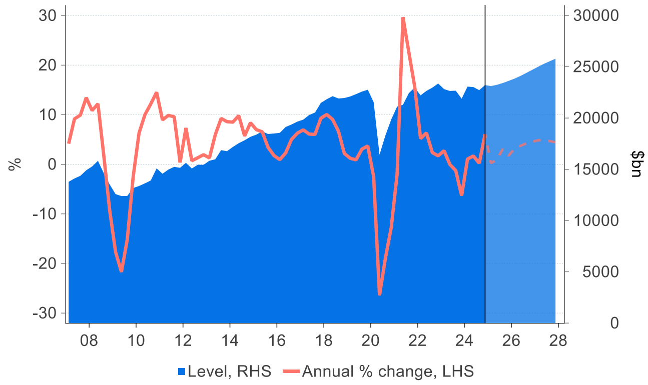


Figure 8. Real imports (goods and services)



Source: Stats NZ, Macrobond, ANZ Research

Forecast charts

Figure 9. Terms of trade

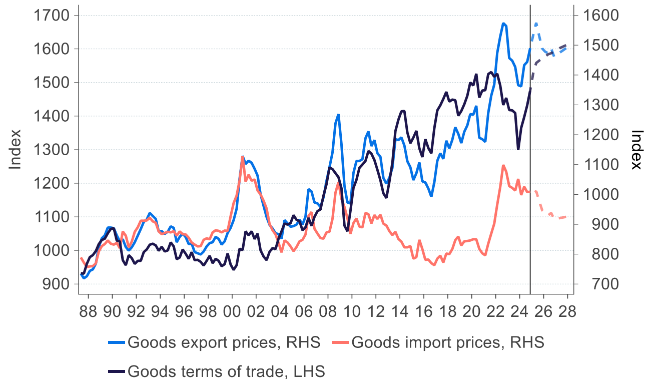


Figure 10. Current account balance

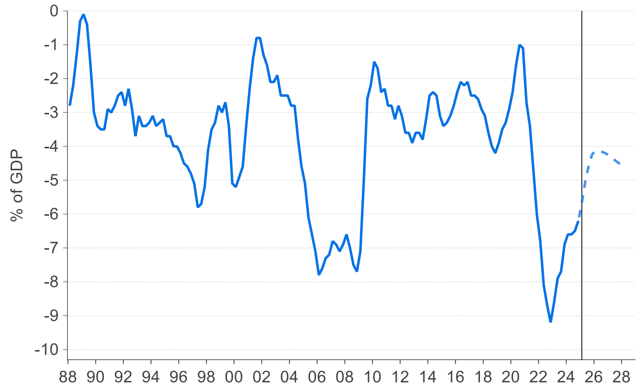


Figure 11. Output gap

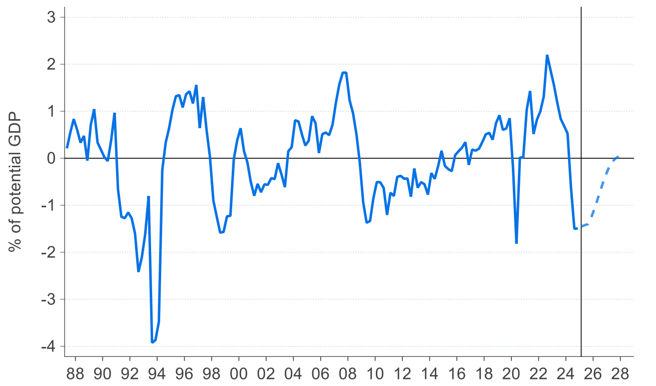


Figure 12. House prices (REINZ HPI)

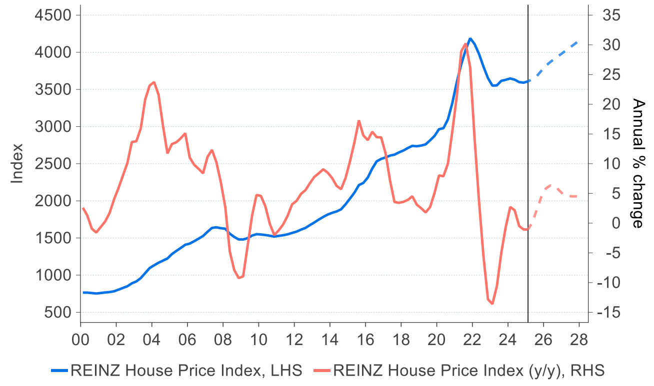


Figure 13. Annual migration

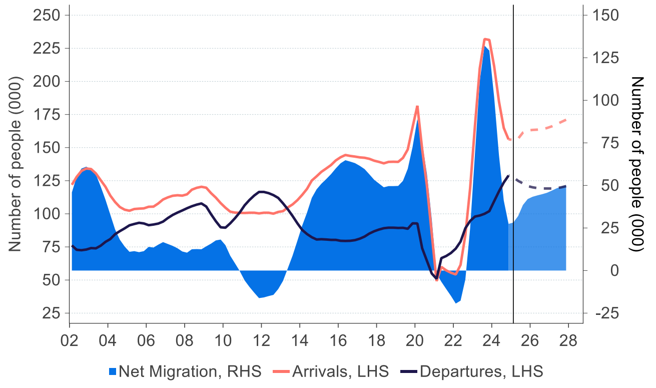


Figure 14. Resident population

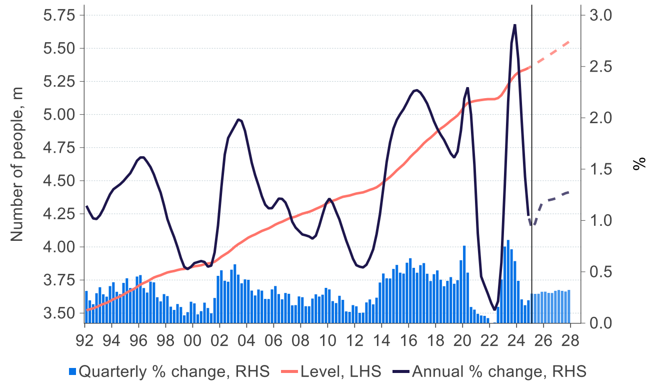


Figure 15. Participation and employment rate

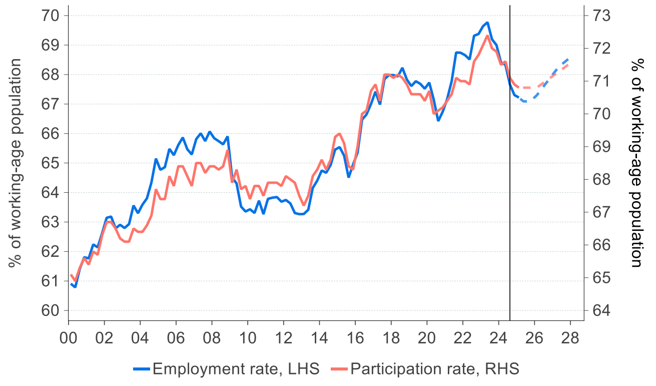
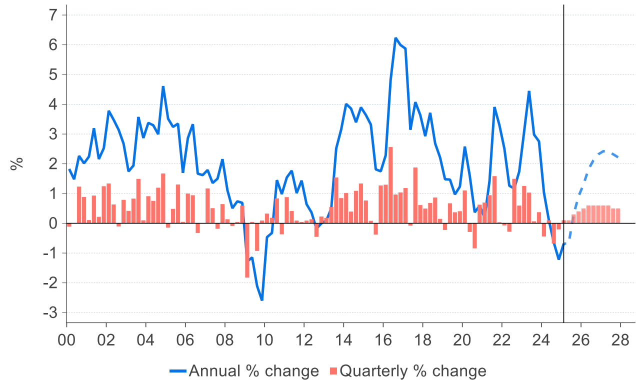


Figure 16. Employment



Source: Stats NZ, REINZ, Macrobond, ANZ Research

Forecast charts

Figure 17. Unemployment rate decomposition

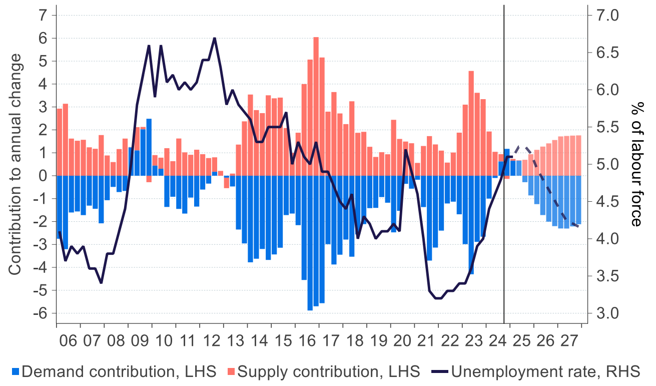


Figure 18. Wages and labour costs

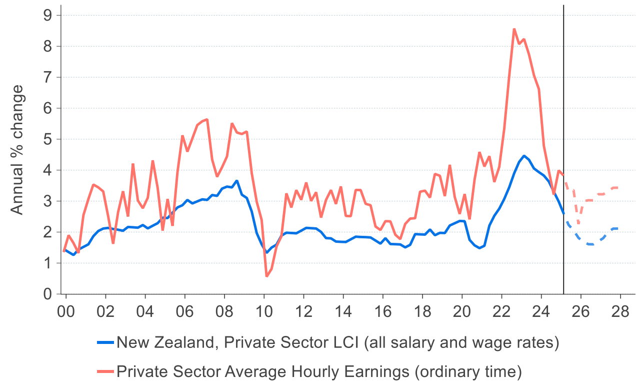


Figure 19. Inflation forecasts

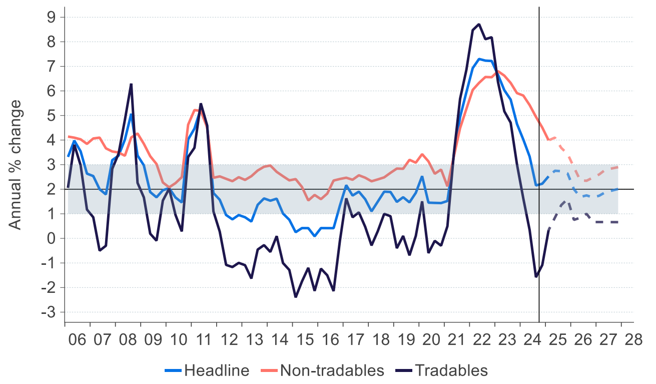


Figure 20. Headline inflation forecast decomposition

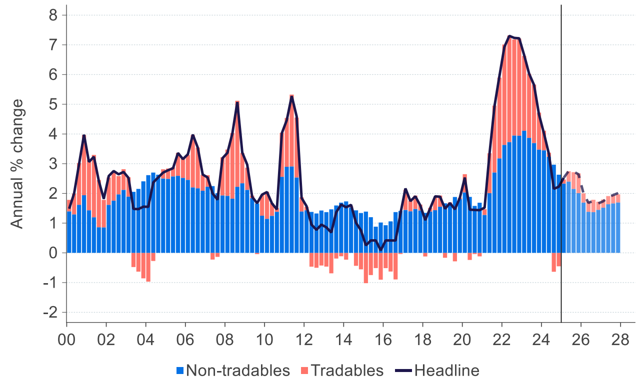


Figure 21. OCR and 90-day rate

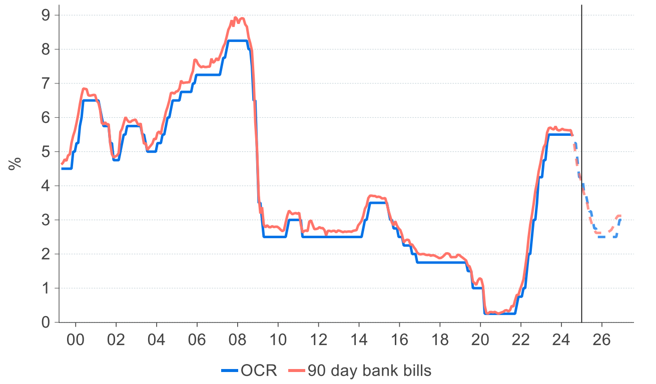


Figure 22. 2-year swap rate and 10-year bond yield

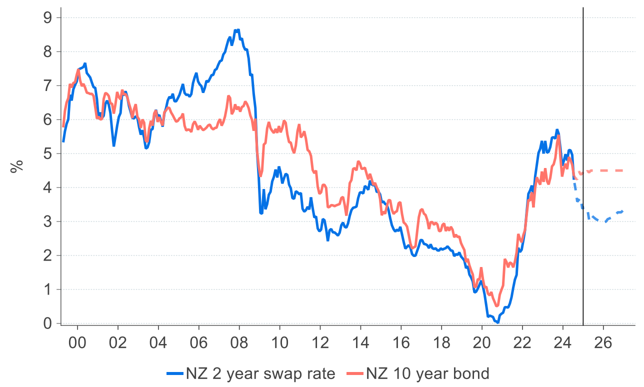


Figure 23. NZD against JPY and CNY, and TWI basis

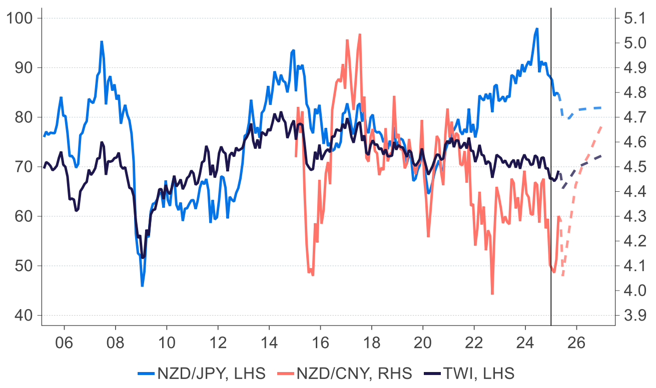
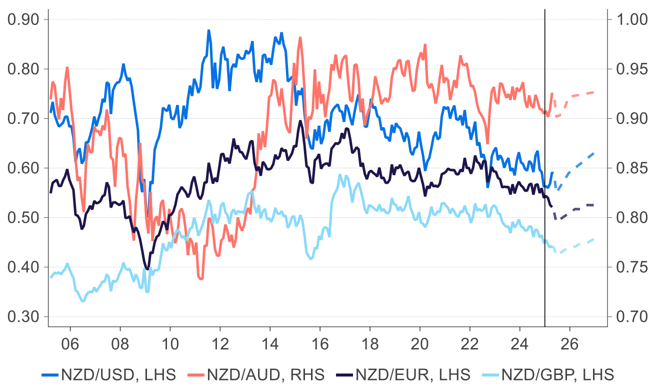


Figure 24. NZD against USD, AUD, EUR and GBP



Source: Stats NZ, Bloomberg, Macrobond, ANZ Research

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