

July 2019

## Executive Summary

- ▶ **Weak domestic business confidence and global concerns weigh on GDP growth prospects**
- ▶ **Household confidence remains resilient, supporting consumption outlook**
- ▶ **Fuel, food and rent drive consumer price inflation**
- ▶ **Ongoing trade uncertainty weighed on global business activity in the June quarter**
- ▶ **Global consumer spending holds up, supported by rising wages and solid labour markets**

Weak business confidence continues to weigh on the growth outlook, with the June Quarterly Survey of Business Opinion (QSBO) measure of general business sentiment falling to its lowest level since the March 2009 quarter, in the face of the deteriorating global environment. A net 31% of firms expected the economic outlook to deteriorate over the next six months, up from 27% the previous quarter. Firms' expectations about their own activity over the next three months also fell, with a net 4% of firms reporting that they expect weaker activity over the September quarter. Continued business pessimism has increased the downside risk to our near-term GDP growth forecasts.

Increases in food prices, fuel prices and housing costs drove CPI inflation of 0.6% in the June quarter, and lifted annual inflation to 1.7% from 1.5% in March. We expect fuel prices to ease, leading to a slightly weaker CPI inflation outlook with an annual headline inflation forecast of 1.6% in the September quarter.

Household demand remains resilient, with the ANZ-Roy Morgan Consumer Confidence index rising 3.3 points to 122.6 in June 2019, recovering most of last month's fall, to end up slightly above its historical average. In the housing market, sales volumes show signs of recovery in Auckland, and the Auckland region consented over 14,000 new homes in the year ended June 2019 (the most ever consented in a year). We continue to expect stable household consumption growth over the rest of the year, supported by income growth and low interest rates.

The quarterly overseas merchandise trade deficit narrowed to \$773 million in the June quarter from \$1.2 billion in the previous quarter. Exports remained strong in the June quarter, up 2.8% annually, with exports of logs and meat leading the way, although falling log prices and stockpiles of logs in China may act as a drag on log exports in the September quarter. Imports fell in the June quarter, as capital goods imports continued to soften, reflecting ongoing weakness in business confidence.

Internationally, falling exports and weak business investment continued to weigh on global growth in the June quarter, reflecting ongoing trade tensions and global uncertainties. Consumer spending remains resilient however, supported by rising wages and record low unemployment rates in many countries.

Global growth is expected to stabilise over the second half of 2019 and pick up in 2020, according to the IMF's July World Economic Outlook (WEO). The pick-up is contingent on stabilisation in developing economies (such as Argentina and Turkey), as well as progress towards resolving trade policy differences. The WEO also pointed to downside risks, including escalating trade and technology tensions, geopolitical tensions and a 'no-deal' Brexit.

This month's special topic looks at the increasing concentration of New Zealand's exports over the past decade.

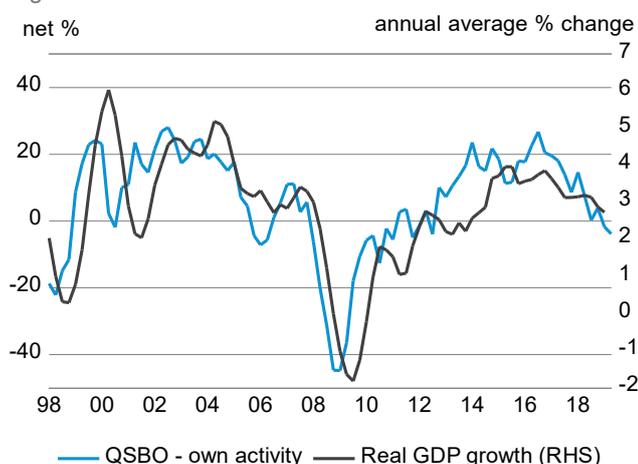
## Analysis

Business confidence weakened further in the June quarter according to the NZIER's latest Quarterly Survey of Business Opinion (QSBO) with firms expressing lower general business sentiment in the face of the deteriorating global environment. Firms' expectations of their own activity over the next three months also fell, providing increased downside risk to our *Budget Update* GDP forecast for September. Consumer confidence recovered in June and is slightly above its historical average and electronic card spending held up. June quarter inflation met expectations. Nationally, house prices remained flat but house sales rose in Auckland in June and the number of homes consented in Auckland reached a record high in the year to June. The monthly trade balance recorded the fourth consecutive surplus in actual terms but remains slightly in deficit in seasonally adjusted terms.

### Business confidence weakens further...

Business confidence weakened in the June quarter in the QSBO, likely due to both softening domestic demand and a slowing global economy. General business sentiment fell to its lowest level since the March 2009 quarter with a net 31% of firms expressing negative sentiment, up from 27% the previous quarter. A net 4% of firms experienced weaker trading activity over the past three months (Figure 1) and firms' expectations about their own activity over the next three months also fell, with a net 4% of firms reporting that they expect weaker activity over the September quarter. This is the lowest net percentage since the June 2009 quarter. Employment intentions, investment and profitability remained weak and are reflected in softening capital goods imports.

Figure 1: Business confidence and GDP

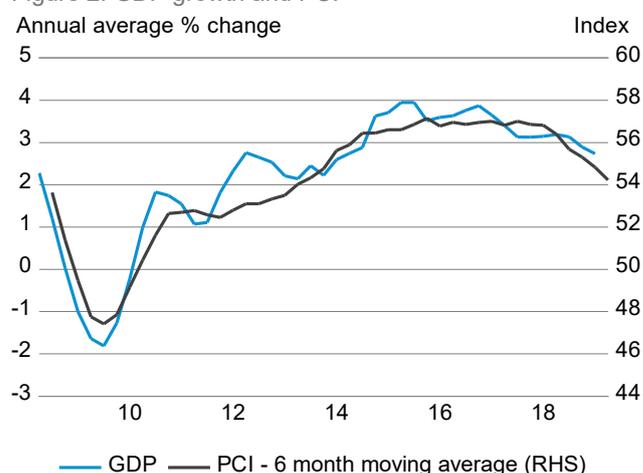


Source: StatsNZ, NZIER

The manufacturing sector provided much of the negative impetus in the June quarter QSBO, likely reflecting an increase in international risks, with export orders down sharply, reflecting the global decline in trade volumes. The deterioration of manufacturing sentiment was also seen in the BNZ-BusinessNZ Performance of Manufacturing Index (PMI), which at 51.3 remains below its historical average of 53.4, despite a 0.9 point rise in June.

The Performance of Services Index (PSI) also fell, down 0.8 points to 52.7 in June, taking the Performance of Composite Index (PCI) to 52.4, 0.7 points lower, despite the rise in the PMI. The PCI has been trending downwards this year, posing downside risk to our annual GDP growth forecast of 2.4% for the June 2019 year (Figure 2).

Figure 2: GDP growth and PCI



Source: BNZ-BusinessNZ, StatsNZ

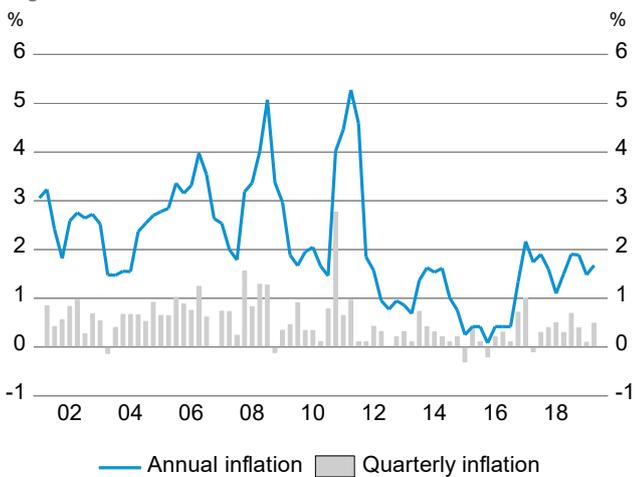
In the ANZ Business Outlook, headline business confidence fell 6 points in June to a net 38% of respondents reporting that they expect general business conditions to deteriorate in the year ahead. Firms' expectations of their own activity fell 1 point to a net 8% expecting a lift. Employment intentions, investment intentions and capacity utilisation were all unchanged while profit expectations fell 3 points to a net 13% expecting profit to decline.

Continued business pessimism has increased the downside risk that GDP growth undershoots our BEFU forecasts in coming quarters. The effects of higher government spending will provide some offset, however the timing and magnitude of these effects are uncertain. These outturns affirm financial market expectations that the Reserve Bank will cut the Official Cash Rate from 1.5% to 1.0% by the end of this year.

### ...and inflation met expectations

The Consumers Price Index rose 0.6% in the June quarter to be 1.7% higher than in June 2018 (Figure 3).

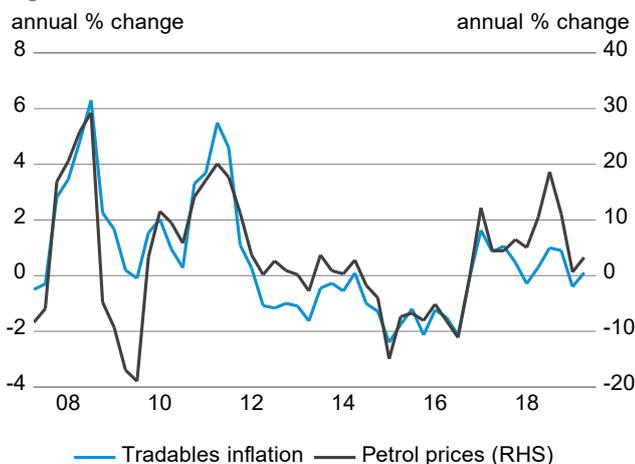
Figure 3: Headline inflation



Source: StatsNZ

Tradables prices rose by 0.9% in the quarter (up 0.1% annually) (Figure 4). Higher world oil prices drove petrol prices up by 5.8% in the quarter (up 3.3% annually), contributing 0.25 percentage points to quarterly inflation.

Figure 4: Tradables inflation



Source: StatsNZ

Food prices rose 0.6% in the June quarter while clothing and footwear prices increased by 0.8%. The lower exchange rate in the June quarter may have provided some upward pressure to traded goods prices.

Non-tradables prices rose by 0.3% in the quarter, supported by higher rent prices (up 0.7% in the quarter) and were up 2.8% in the year. Stats NZ has included a new housing rent measure in the CPI from the June 2019 quarter onwards. This produces higher rent inflation on average compared to the previous measure and is expected to contribute 0.1 percentage point on average to headline inflation going forwards.

Steady demand for rental properties and housing are expected to keep non-tradables inflation broadly stable over the rest of the year.

Fuel price growth is expected to ease over the September quarter as international uncertainty decreases and the effects of the recently stronger exchange rate flows through. We expect a slight easing in CPI inflation with annual headline inflation forecast to ease to 1.6% in the September quarter. However, lower future interest rates may provide support for higher inflation towards the end of the year. The Reserve Bank indicated at the June 2019 Official Cash Rate announcement that further cuts may be needed given the downside risks to their employment and inflation outlook.

### Consumer confidence recovers...

The ANZ-Roy Morgan Consumer Confidence index rose 3.3 points to 122.6 in June 2019, recovering most of last month's fall, to be slightly above its historical average. A strong labour market and lower interest rates may be drivers behind the improved outlook.

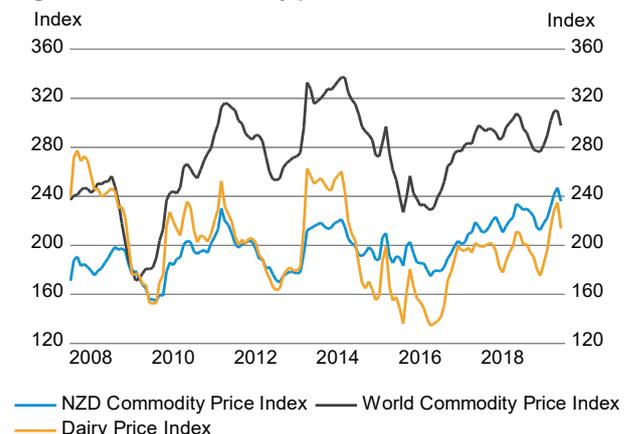
### ...and card spending was flat

Monthly total retail card sales were unchanged in June. Card transactions on fuel fell 4.3% as prices fell, offsetting increases in spending in other sectors. We continue to expect stable private consumption growth over the rest of the year, supported by consumer confidence and low interest rates.

### Dairy prices push down commodity prices

The ANZ World Commodity Price index fell 3.9% in June, driven by a fall in dairy prices, down 8.5% (Figure 5). Prices eased in most categories with the exception of meat and fibre which rose 1.7%, boosted by strong demand from China. China has overtaken the United States as our main market for beef exports. The NZD index fell 4.5% on the back of the weaker prices and a stronger NZD.

Figure 5: ANZ Commodity prices



Source: ANZ

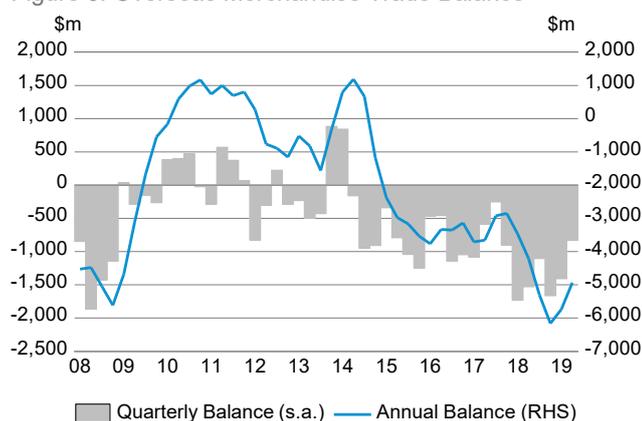
Merchandise Trade data showed that exports in the month of June were up 2.8% annually, with exports of logs and meat leading the way. Log export volumes rose 16% on June last year, while prices fell 4.6%, reflecting recent softness in log prices as a result of excess global supply to the China market. There is potential for subdued log exports in coming months as China draws down their existing stocks.

Meat exports to China have picked up, with the reduction in domestic supply of pork in China as a result of African Swine Fever bolstering their demand for alternative meat products and this should provide further support for beef prices going forward. Dairy volumes fell in the quarter, down 7.0%. This follows a strong March outturn following good growing conditions at the end of last year.

Imports fell in June, with petroleum imports down 39% on June 2018, however this reduction was largely the result of a temporary increase in imports in June 2018 to compensate for the planned maintenance at the Marsden Point oil refinery. Imports of vehicle parts also fell, down 16% on June last year. On an annual basis, import growth remains strong, up 7.8%, although import growth has been moderating across most import classes.

The monthly trade balance recorded the fourth consecutive surplus in actual terms but remains slightly in deficit in seasonally adjusted terms. The quarterly trade deficit was \$773 million in the June quarter, narrowing \$384 million from the March quarter (Figure 6).

Figure 6: Overseas Merchandise Trade Balance



Source: StatsNZ

### Migration has stabilised...

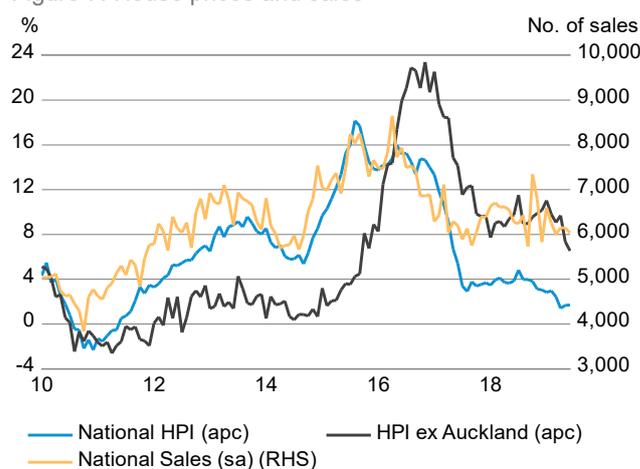
Annual net migration stabilised at around 50,000 over the second half of 2018. Estimated annual net migration was 50,200 in the year ended December 2018, compared with 52,600 in the previous year. The pace of visitor arrival growth has slowed in recent months, whereas NZ-resident visitor departures growth has picked up. This will likely weigh on the

services balance. More recent, and uncertain, provisional net migration data shows that annual net migration was 50,500 for the year ended May 2019. This potentially provides some support to aggregate growth relative to our BEFU forecasts, if it is maintained, which may partially offset weaker sentiment.

### House prices were flat...

The REINZ national house price index (HPI) rose 0.1% in June and 1.7% in the year. Prices in Auckland fell 3.5% annually while the national index excluding Auckland rose by 6.5% (Figure 7).

Figure 7: House prices and sales



Source: REINZ

National house sales fell 1.8% in June with lower sales in most regions. However, house sales in Auckland rose 8.2% in a historically weak sales month, possibly indicating a return of confidence in the market. We expect housing activity to stabilise over the rest of the year, supported by low mortgage rates and less uncertainty around tax policy changes.

### ...and building consents fell

The seasonally adjusted number of new homes consented in June 2019 fell 3.9%, following a 13.5% rise in May, to be 5.6% higher than the same time last year. Much of the weakness this month was driven by the volatile multi-unit dwelling category. Looking through the monthly volatility, consent issuance lifted 14.3% over the first half of the year, which should drive building activity over the second half of the year as forecast in BEFU.

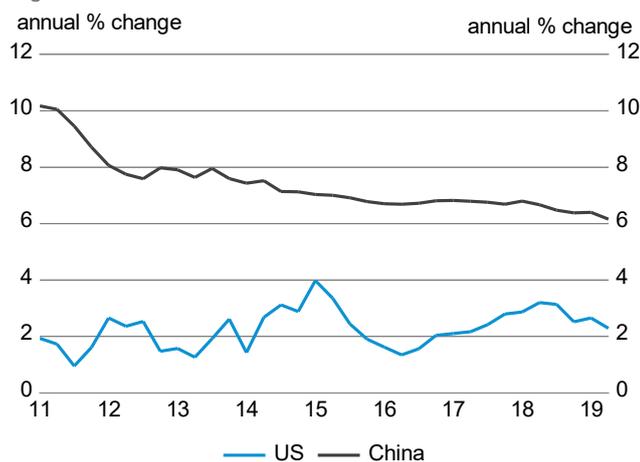
The Auckland region consented over 14,000 new homes (up 13%) in the year ended June 2019, the most ever consented in a year.

## Weak business activity weighs on growth...

In the US, annualised GDP growth eased from 3.1% in the March quarter to 2.1% in the June Quarter. The outturn was driven by personal consumption expenditure, which grew 4.3% (up from 1.1% growth in the March quarter). Business investment and export growth fell 0.6% and 5.2% respectively, reflecting ongoing trade tensions and global uncertainty.

Annual China GDP growth was 6.2% in the June quarter (Figure 8). As in the US, the weakness was driven by falling exports, reflecting ongoing trade tensions. However, growth stabilised in the month of June for industrial production, retail sales and fixed asset investment, suggesting that stimulus measures implemented by Chinese authorities are supporting domestic demand. It is likely that similar rates of growth will be achieved over the latter half of 2019, as stimulus continues to ensure growth is maintained at the official target of 6.0% - 6.5%.

Figure 8: Growth slows in China and the US



Source: Haver Analytics

Trade tensions are continuing to weigh on other economies. Annual GDP growth in Singapore fell to 0.1% in the June quarter, the weakest in a decade, and cementing the slowdown in growth since early 2018. The outturn was driven by weak manufacturing activity, down 3.8% on an annual basis, largely as a result of falling electronics and precision engineering output.

UK GDP growth rebounded to 0.3% in the three months to May, following a 0.4% fall in the three months to April. Manufacturing recovered, following temporary car factory closures related to Brexit uncertainty. However, GDP growth is still below the Bank of England's trend estimate of 1.5% annualised growth and is expected to be weak in the June quarter as temporary factors subside.

## ...reflecting ongoing trade uncertainty...

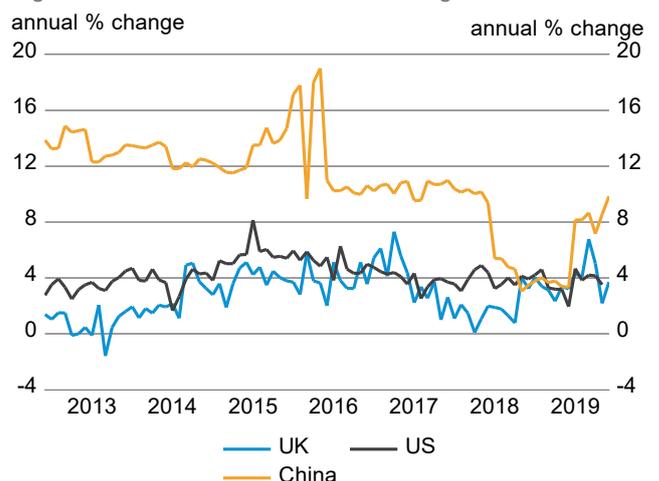
President Trump and President Xi Jinping agreed to pause any further tariff increases and restart trade negotiations at the G20 summit in Osaka, lessening fears of further escalations in trade tensions. The US Government also recently announced a significant relaxation of the restrictions on US firms selling goods to Huawei. US firms will now be able to apply for licences to trade with Huawei where there is deemed to be no threat to national security.

Despite easing tensions between US and China over this month, trade uncertainty increased between other nations. Japan imposed restrictions on exports of certain technological materials to South Korea. Japanese firms are now required to apply for licences to sell to Korean producers. Analysts expect South Korea to retaliate with similar measures. The US Government has also launched an investigation into France's digital services tax. Some analysts suggest the move could result in tariffs on French imports, such as wine and cars.

## ...however consumption holds up...

In contrast to weak business activity in many countries, consumer spending appears to be holding up. June quarter GDP growth in the US and China was supported by solid consumption growth. In the UK, retail sales volumes lifted 1.0% in June, to be up 3.7% on an annual basis (higher than the 2.2% recorded in May) (Figure 9).

Figure 9: UK, US and China retail sales growth



Source: Haver Analytics

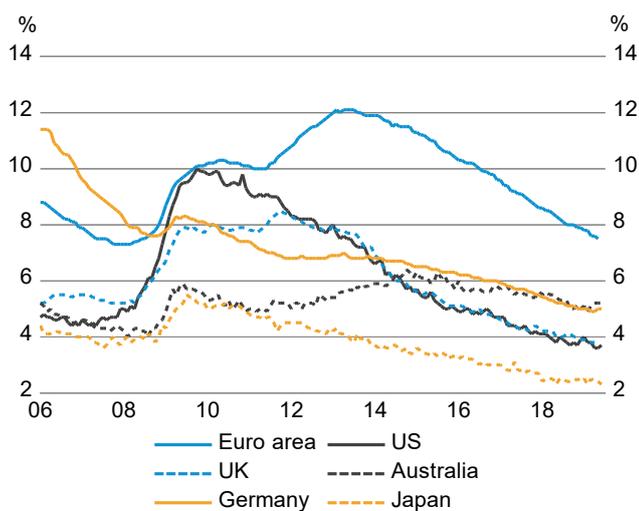
## ...supported by rising wages and solid labour markets

Growing consumption reflects solid labour markets in many economies (Figure 10). The US economy added 224,000 jobs in June, following a 72,000 gain in May. The unemployment rate ticked up slightly from 3.6% to 3.7%, reflecting a higher labour force participation rate. Annual hourly wage growth dipped slightly, from 3.2%, but remains solid at 3.1%.

In the UK, unemployment remained steady at 3.8% in May (a 44-year low) and annual wage growth rose to 3.9% (the highest rate in a decade), from 3.7% in April. Analysts note that the Bank of England would ordinarily have been raising interest rates in the absence of Brexit uncertainty.

In Australia, the unemployment rate remained steady at 5.2% in June, reflecting flat employment growth. The underemployment rate fell 0.4 percentage points, indicating slightly less spare capacity in the labour market. For the June quarter, hours worked rose just 0.2%, suggesting weak June quarter GDP growth.

Figure 10: Unemployment rates near record lows



Source: Haver Analytics

## Growth is expected to pick up...

Global growth is forecast to be 3.2% in 2019, according to the IMF's July World Economic Outlook (WEO). This is 0.1% lower than in the April WEO projections, reflecting weak momentum over the first half of the year (Table 1). Growth in advanced economies was revised up by 0.1% however, reflecting better than expected activity in the March quarter, particularly in the US and UK. World trade volumes were revised down significantly, driven by revisions to developing economies in Asia. Global growth is forecast to pick up to 3.5% in 2020.

Table 1: IMF July WEO projections

	Actual (apc)	Projections (apc)		Difference from April 2019 WEO	
		2018	2019	2019	2020
World	3.6	3.2	3.5	-0.1	-0.1
US	2.9	2.6	1.9	0.3	0.0
Euro Area	1.9	1.3	1.6	0.0	0.1
Japan	0.8	0.9	0.4	-0.1	-0.1
UK	1.4	1.3	1.4	0.1	0.0
China	6.6	6.2	6.0	-0.1	-0.1
ASEAN 5	5.2	5.0	5.1	-0.1	-0.1
Trade volumes	3.7	2.5	3.7	-0.9	-0.2

Source: IMF

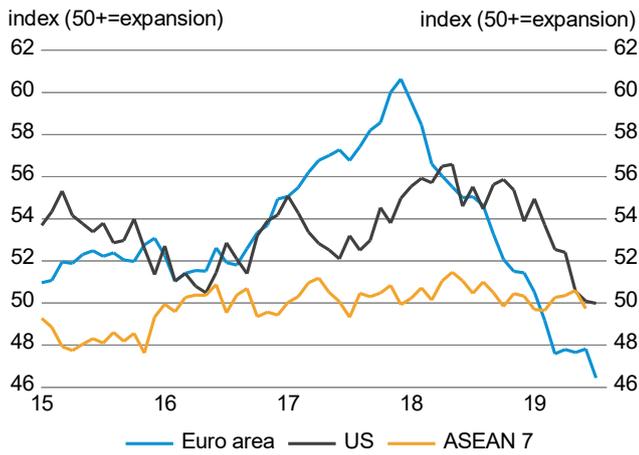
## ...although risks remain...

The pick-up in global growth is contingent on stabilisation in developing economies (such as Argentina and Turkey), as well as progress towards resolving trade policy differences.

The July WEO noted that while trade uncertainty is weighing directly on manufacturing, a range of geopolitical tensions are also driving weak business sentiment. Boris Johnson became Prime Minister of the UK, comfortably winning the Conservative leadership race and maintaining his stance that the UK will leave the EU on 31 October, with or without a Withdrawal Agreement. Meanwhile, tensions between Western nations and Iran increased further as Iranian forces seized a UK oil tanker in the Strait of Hormuz. The action comes after the UK seized an Iranian ship off Gibraltar.

Manufacturing remains a risk to growth stabilisation in the September quarter, as indicators of manufacturing activity continued to soften. The US and euro area manufacturing PMIs reached record lows in July. Services activity on the other hand remained elevated and expansionary. The ASEAN manufacturing PMI retreated in June to 49.7, from 50.6 in May (Figure 11).

Figure 11: Manufacturing continues to deteriorate



Source: IHS Markit

### ...and central banks prepare to cut rates

Since mid-June, a number of central banks have signalled more accommodative monetary policy, citing muted inflation and increased downside risks to growth. The US Federal Reserve is widely expected to cut interest rates by 25 basis points at their upcoming meeting. The cut will be the first since the

GFC easing cycle. Market pricing suggests the Fed will make three 25bps cuts by January next year. The European Central Bank (ECB) left its policy rate unchanged at -0.4% this month, but suggested that lower rates are likely through the first half of 2020. Citing weak inflation expectations, the Bank also said it would consider a range of stimulus options – including another quantitative easing package.

The Reserve Bank of Australia (RBA) lowered the cash rate by 25bp to a record low of 1.0% early this month. The statement by Governor Lowe suggested that the Bank would adjust monetary policy ‘if needed’, implying that the Bank may need to see further evidence of a deterioration in economic activity before cutting again. Market pricing suggests the RBA will cut interest rates at least once more by the end of the year.

Other central banks have also turned dovish or communicated a more cautious view on the outlook (including in Brazil, Chile, China, India, Malaysia, and the Philippines). Both the Bank of Korea, and Bank Indonesia lowered policy rates this month.

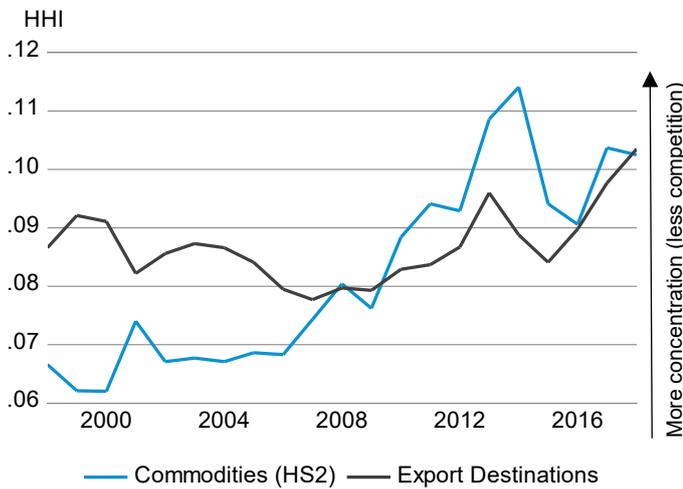
# Special Topic: New Zealand's Increasing Export Concentration

Real average growth in goods and services exports declined from 4.1% p.a. over the 1998-2008 period to 2.4% in the subsequent decade. Unprocessed primary products have grown at the fastest pace over this period, and account for 40% of the value of merchandise exports. Moreover, over the last decade, export concentration levels have increased. Dairy products accounted for a quarter of New Zealand's total merchandise exports in 2018, up from 17% in 1998. Over the same period, goods exports to China's have risen from just 3% of total exports to 25%. This puts New Zealand at risk from shocks emanating from either China or the global dairy sector. This Special Topic takes a closer look at the trends in New Zealand's export concentration levels over the past two decades, and briefly discusses the risks and mitigating factors associated with this.

## Export concentration levels have increased...

One way to assess concentration levels objectively is by looking at the Herfindahl-Hirschman Index (HHI).<sup>1</sup> The HHI ranges between zero and one, with a higher value indicating that exports are more concentrated. New Zealand's HHI scores have increased over the last decade from both a commodity and export destination perspective (Figure 12).

Figure 12: Herfindahl-Hirschman Index for New Zealand's trade exports

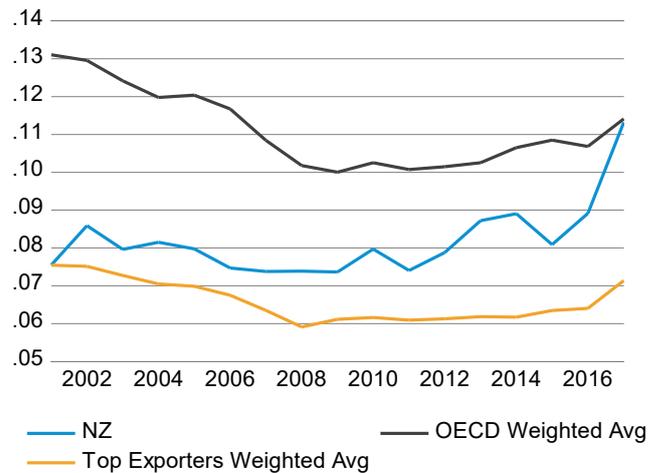


Source: Treasury calculations with StatsNZ data

## ...but are not significantly higher than comparable countries

Figure 13 shows the HHI concentration levels for New Zealand from an export destination perspective as well as the weighted averages for two groups of countries: the OECD and the top 10 exporters in the world in 2018.<sup>2</sup> New Zealand's market concentration level is not significantly higher than comparable countries, although the upward trend witnessed in New Zealand since 2014 is more pronounced than in the other two groups.

Figure 13: Herfindahl-Hirschman Index market concentration: international comparison



Source: World Integrated Trade Solution (WITS)

Note: Groups weighted by export share

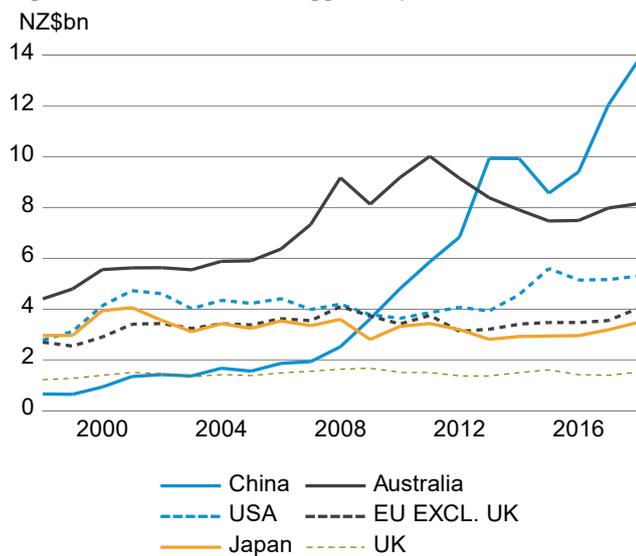
## Significant exposure to China...

China overtook Australia as New Zealand's largest export destination by value in 2013. Exports to Australia have declined in recent years, reaching \$8.2bn in 2018, compared to the 2011 peak of \$10bn (Figure 14).

<sup>1</sup> The HHI is calculated by taking the sum of the squares of market shares in an industry, and is usually applied to competition economics.

<sup>2</sup> The top 10 exporters in 2018 in descending order were China, USA, Germany, Japan, South Korea, Netherlands, Hong Kong, France, Italy, and the United Kingdom, according to data from the International Trade Centre.

Figure 14: New Zealand's biggest export markets



Source: StatsNZ

Meanwhile, during 1998-2018, export growth to China amounted to \$13.1bn, or 39% of New Zealand's total nominal export growth.

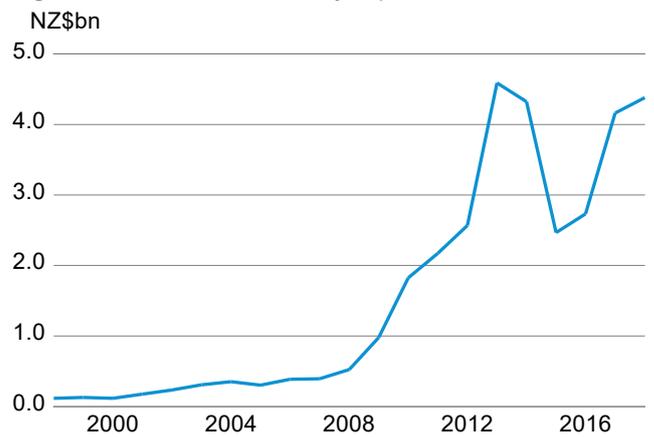
#### ...and to China's dairy sector in particular

Dairy products accounted for 32% of New Zealand's total exports to China in 2018. Interestingly, New Zealand's exports to China have in fact become less concentrated than 20 years ago. This is because wool accounted for more than half of exports to China in the 1990s. Wool's importance has since waned, with dairy, wood, and meat now accounting for two thirds of total exports to China.

#### As a result, dairy exports have become more concentrated

The composition of New Zealand's dairy exports by country has changed drastically over the past 20 years. In 2000, dairy export destinations were diverse, with the top 10 markets each accounting for just 3% to 7% of total exports, while China did not even feature on this list. China's demand for dairy grew rapidly in the 2000s (Figure 15), supported by an increase in incomes and urbanisation, with the latter being associated with a shift towards a more Westernised diet. New Zealand's dairy exporters arguably started benefiting disproportionately from this from 2008 onwards due to the Free Trade Agreement (FTA) with China coming into effect. At the same time, the 2008 China milk scandal (the presence of melamine in milk and infant formula) resulted in consumers preferring imported milk products.

Figure 15: New Zealand's dairy exports to China



Source: StatsNZ

With China now importing about a third of New Zealand's dairy products, the sector has become more concentrated. In fact, the HHI has increased from just 0.04 in 2000 to 0.11 in 2018.

#### Our increasing exposure to China and dairy holds risks...

Exposure to a single market, and moreover to a single sector in this market, holds risks that are somewhat mitigated for homogenous bulk commodities where overall supply and demand are the most important drivers over the medium to longer term. A single event in either China or the global dairy sector can lead to a substantial change in export revenues. Over the 2008-13 period, several factors resulted in a sharp increase in export revenues, but the reverse can also happen, as was the case in 2015-16. In 2013, Fonterra discovered botulism-causing bacteria in some of its whey products that had been sold to third parties to make infant formula, among other products. This resulted in a product recall and a temporary ban from China on the imports of some whey products from New Zealand. The botulism discovery in fact turned out to be a false positive test, which helped to resolve the crisis relatively quickly. The event initially caused a sharp increase in Chinese demand and prices, followed by an equally sharp decline in prices and export revenues as stocks were unwound.

#### ...but also opportunities

Although New Zealand's exposure to China carries some risk, it also presents opportunities. Table 2 shows the top dairy consuming countries in the world in per capita terms (all those with consumption above the world average), as well as China.

Table 2: Per capita dairy consumption by country

Top Dairy Consumers (kg/capita)	1998	2018	2018-27 Annual Growth (%)
Kazakhstan	206.8	264.1	1.4%
Pakistan	146.2	231.9	0.3%
Turkey	116.2	184.7	1.4%
Ukraine	225.7	174.2	2.0%
Australia	123.8	129.1	-0.1%
Colombia	124.4	127.3	0.6%
Russia	156.9	122.7	-0.2%
EU-28	95.7	113.7	0.0%
New Zealand	83.6	113.1	-0.1%
Norway	179.4	110.7	-1.2%
Israel	99.8	97.7	-0.5%
Canada	109.8	95.3	0.1%
United States	108.0	92.0	-0.8%
India	54.2	90.5	3.2%
Paraguay	88.3	82.1	1.9%
Brazil	71.0	81.4	1.6%
WORLD	50.5	61.8	1.1%
China	7.5	24.1	1.6%

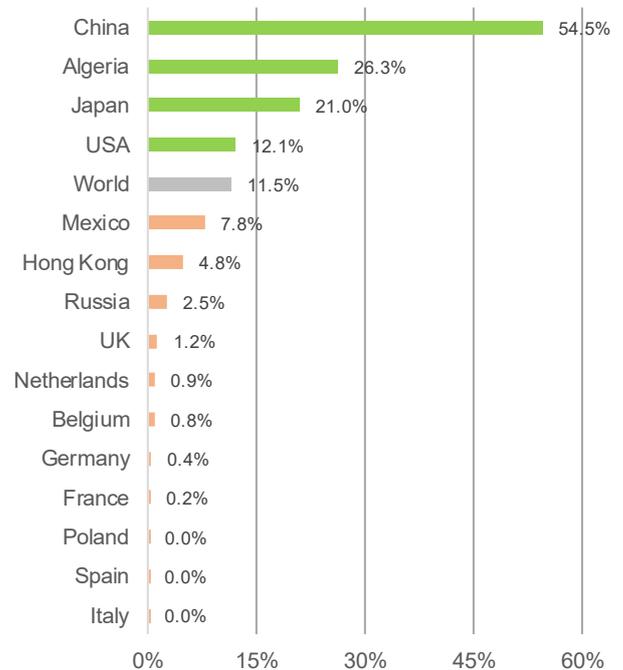
Source: OECD-FAO Agricultural Outlook (2018)

While dairy consumption levels have plateaued in the developed world, in the world's most populous country there is still significant room for growth. Per capita dairy consumption in China expanded very quickly between 1998 and 2008 (12% p.a.), before stalling over the subsequent decade (0.3% p.a.). The sharp increase in the demand for dairy in China, supported by publically-funded advertising on the health benefits of milk, comes despite the fact that lactose intolerance levels are much higher than in the Western world. Over the 2018-2027 period, the OECD projects that China's per capita dairy consumption levels will grow by an average of 1.6% p.a., which implies a noticeable increase in absolute terms given the country's massive population. Moreover, considering that consumers continue to be suspicious about local dairy products due to the 2008 scandal, foreign dairy products will continue to be in high demand.

Nevertheless, while continuing to maintain and grow our dairy market share in China, from a risk management perspective it would be prudent to expand exports to other markets in order to lessen the dependence on China. In particular, the New Zealand dairy sector should focus on countries where it is not yet well represented, while also considering whether these markets have a good appetite for dairy imports as well as strong growth potential. Figure 16 below shows New Zealand's share in the dairy imports of the top 15 dairy importers in the world. Globally, New Zealand

accounted for 11.5% of total global dairy exports, and remains under-represented in some of the world's largest dairy importers. In particular, there still appears to be significant untapped potential in European Union (EU) markets, although this would be contingent upon gaining market access.

Figure 16: New Zealand share in dairy imports for top 15 global dairy importers (2018)



Source: International Trade Centre

### Kiwifruit and wine offer possible sources of growth and diversification

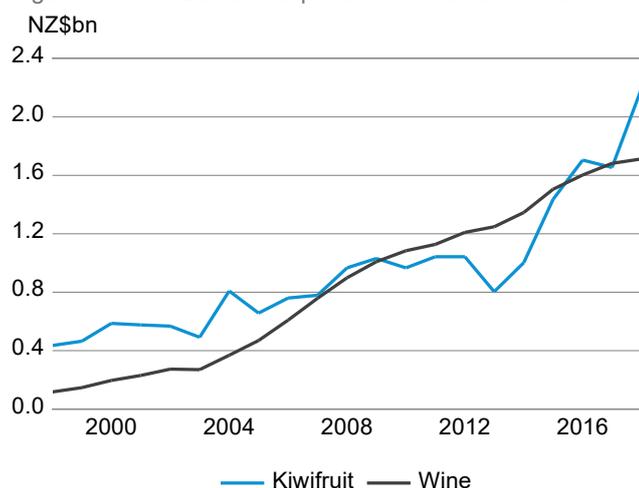
Wine grape production increased at a rate of 4.6% p.a. during 2002-2017, increasing its contribution to total horticultural production from 25% to 42%. In the 12 months ending June 2018, the value of New Zealand's wine exports grew for the 23<sup>rd</sup> year in a row. In addition to providing a growing amount of export receipts, the wine industry is also making a significant contribution to the tourism sector. According to New Zealand Winegrowers Inc., close to a third of all holiday visitors to New Zealand visit a winery; these visitors tend to stay longer in New Zealand, spend more money, and visit more regions.

Although wine exports have grown strongly, the sector is also quite concentrated, both in terms of varietal and market. Sauvignon Blanc accounted for 86% of New Zealand's total wine exports in 2018, compared to around half of the total in 2001. New Zealand has been successful in carving out a niche market in Sauvignon Blanc, which has supported export volume growth. Meanwhile, New Zealand's wine exports predominantly go to three countries, namely the US, the UK, and Australia. In 2018, these three countries accounted for 76% of

New Zealand's total wine exports in value terms. While exports to these countries dominate, there has also been robust growth in exports to Canada, the Netherlands, and China.

New Zealand's kiwifruit exports have been on an upward trajectory over the past two decades, with export values growing at an average rate of 8.4% p.a. over the 1998-2018 period (Figure 17). In 2017, kiwifruit once again overtook wine as New Zealand's largest horticultural export earner.

Figure 17: New Zealand exports of kiwifruit and wine



Source: StatsNZ

## FTAs may boost trade, but possibly also concentration levels

New Zealand currently has 10 active FTA's in place, with a further three that have been concluded but are not yet in force, and a number of others that are at varied stages of the negotiation process. While FTAs tend to boost trade levels, they may also have the by-product of an increase in concentration levels. That being said, reaching an agreement with India that will open up the country's dairy sector to New Zealand would serve to lessen our dependence on China. India's dairy market is the largest in the world in absolute terms and is projected to continue growing strongly. New Zealand's dairy exports to India are currently taxed at the most-favoured-nation (MFN) weighted average tariff rate of 43.1%. Talks on New Zealand's FTA with India are ongoing, as are negotiations on the Regional Comprehensive Economic Partnership (RCEP), which also includes India. These FTA's could be the key to improved access to the potentially lucrative Indian market. Furthermore, negotiations with the EU on an FTA's are also ongoing, which if successful would give New Zealand improved access to some of the world's biggest dairy importers, among other benefits.

**Monthly Economic Indicators** is a regular report prepared by the Forecasting team of the Treasury.

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# New Zealand Key Economic Data

## Quarterly Indicators

		2017Q4	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2
<b>Gross Domestic Product (GDP)</b>								
Real production GDP	qtr % chg <sup>1</sup>	0.9	0.5	0.9	0.4	0.6	0.6	...
	ann ave % chg	3.1	3.2	3.2	3.1	2.9	2.7	...
Real private consumption	qtr % chg <sup>1</sup>	1.0	0.3	0.9	1.0	1.0	0.4	...
	ann ave % chg	4.7	4.1	3.7	3.4	3.2	3.2	...
Real public consumption	qtr % chg <sup>1</sup>	-0.4	0.4	1.2	-0.7	0.8	0.9	...
	ann ave % chg	2.9	2.8	3.0	2.1	1.9	1.9	...
Real residential investment	qtr % chg <sup>1</sup>	0.7	-0.5	0.8	0.5	1.9	2.7	...
	ann ave % chg	0.9	1.0	2.6	2.5	2.6	3.5	...
Real non-residential investment	qtr % chg <sup>1</sup>	3.3	1.1	-0.5	-2.1	1.4	1.9	...
	ann ave % chg	4.7	6.4	7.1	6.2	4.0	2.1	...
Export volumes	qtr % chg <sup>1</sup>	0.7	-0.1	1.9	-0.3	1.3	2.8	...
	ann ave % chg	1.8	3.0	3.6	3.7	3.1	3.6	...
Import volumes	qtr % chg <sup>1</sup>	3.5	1.0	1.4	-0.8	-0.1	0.7	...
	ann ave % chg	6.9	7.1	7.9	7.7	5.7	4.1	...
Nominal GDP - expenditure basis	ann ave % chg	6.2	5.6	5.6	4.9	3.9	3.9	...
Real GDP per capita	ann ave % chg	1.0	1.0	1.1	1.1	1.0	0.9	...
Real Gross National Disposable Income	ann ave % chg	3.7	3.8	3.5	3.3	2.8	2.5	...
<b>External Trade</b>								
Current account balance (annual)	NZ\$ millions	-8,180	-8,540	-9,548	-10,565	-11,210	-10,623	...
	% of GDP	-2.9	-3.0	-3.3	-3.6	-3.8	-3.6	...
Investment income balance (annual)	NZ\$ millions	-10,221	-10,343	-10,815	-10,557	-10,173	-9,879	...
Merchandise terms of trade	qtr % chg	1.4	-2.0	0.4	-0.1	-3.2	0.9	...
	ann % chg	7.9	1.8	1.2	-0.3	-4.8	-2.0	...
<b>Prices</b>								
CPI inflation	qtr % chg	0.1	0.5	0.4	0.9	0.1	0.1	0.6
	ann % chg	1.6	1.1	1.5	1.9	1.9	1.5	1.7
Tradable inflation	ann % chg	0.5	-0.3	0.3	1.0	0.9	-0.4	0.1
Non-tradable inflation	ann % chg	2.5	2.3	2.4	2.5	2.7	2.8	2.8
GDP deflator	ann % chg	3.4	1.3	2.2	1.1	-0.2	1.4	...
Consumption deflator	ann % chg	1.6	0.7	1.2	1.9	1.5	1.5	...
<b>Labour Market</b>								
Employment (HLFS)	qtr % chg <sup>1</sup>	0.6	0.7	0.5	1.0	0.0	-0.2	...
	ann % chg <sup>1</sup>	3.7	3.1	3.7	2.8	2.3	1.5	...
Unemployment rate	% <sup>1</sup>	4.5	4.4	4.4	4.0	4.3	4.2	...
Participation rate	% <sup>1</sup>	70.9	70.9	70.9	71.0	70.9	70.4	...
LCI salary & wage rates - total (adjusted) <sup>5</sup>	qtr % chg	0.4	0.3	0.5	0.5	0.5	0.4	...
	ann % chg	1.8	1.8	1.9	1.8	1.9	2.0	...
QES average hourly earnings - total <sup>5</sup>	qtr % chg	0.8	0.9	0.1	1.1	0.9	1.2	...
	ann % chg	3.1	3.5	3.0	2.9	3.1	3.4	...
Labour productivity <sup>6</sup>	ann ave % chg	-0.4	0.1	-1.1	-0.6	0.2	-0.1	...
<b>Retail Sales</b>								
Core retail sales volume	qtr % chg <sup>1</sup>	1.4	0.7	1.2	0.6	2.0	0.7	...
	ann % chg	5.6	4.6	4.5	3.7	5.0	3.9	...
Total retail sales volume	qtr % chg <sup>1</sup>	1.1	0.2	0.9	0.3	1.7	0.7	...
	ann % chg	5.4	2.8	3.1	2.7	3.5	3.3	...
<b>Confidence Indicators/Surveys</b>								
WMM - consumer confidence <sup>3</sup>	Index	107	111	109	104	109	104	104
QSBO - general business situation <sup>4</sup>	net %	-11.8	-10.7	-20.0	-30.4	-17.3	-28.8	-33.7
QSBO - own activity outlook <sup>4</sup>	net %	18.7	10.9	6.9	18.9	19.4	0.4	-12.3

## Monthly Indicators

		2018M12	2019M01	2019M02	2019M03	2019M04	2019M05	2019M06
<b>External Sector</b>								
Merchandise trade - exports	mtth % chg <sup>1</sup>	4.0	-8.1	6.0	9.3	-8.4	3.6	0.6
	ann % chg	-4.0	1.6	5.9	16.7	10.7	7.4	2.8
Merchandise trade - imports	mtth % chg <sup>1</sup>	1.2	-1.0	0.3	-1.7	0.1	1.3	-4.0
	ann % chg	7.9	6.9	12.8	-3.5	7.4	8.1	-10.0
Merchandise trade balance (12 month total)	NZ\$ million	-6161	-6433	-6715	-5739	-5564	-5588	-4937
Visitor arrivals	number <sup>1</sup>	327,430	326,510	321,340	329,380	318,990	318,320	...
<b>Housing</b>								
Dwelling consents - residential	mtth % chg <sup>1</sup>	5.2	13.1	1.8	-7.2	-7.7	13.5	-3.9
	ann % chg	9.8	30.3	28.4	8.7	-4.5	8.2	3.2
House sales - dwellings	mtth % chg <sup>1</sup>	-14.0	13.1	-5.2	-4.0	2.5	-0.1	-1.8
	ann % chg	-8.5	-0.6	-6.6	-9.4	-7.2	-5.5	-3.8
REINZ - house price index	mtth % chg	0.4	0.1	0.7	-0.2	-0.9	0.3	0.1
	ann % chg	3.1	2.8	3.0	2.4	1.4	1.7	1.7
<b>Private Consumption</b>								
Electronic card transactions - total retail	mtth % chg <sup>1</sup>	-2.2	2.1	0.6	-0.1	0.5	-0.5	0.0
	ann % chg	0.6	3.5	3.4	0.7	4.5	3.2	1.1
New car registrations	mtth % chg <sup>1</sup>	-5.0	5.5	1.2	-3.1	1.6	-1.6	-2.8
	ann % chg	-15.8	-12.1	-3.9	-2.9	-0.5	-12.6	-11.0
<b>Migration</b>								
Migrant arrivals	number <sup>1</sup>	14,010	12,580	11,830	11,420	11,530	12,050	...
Migrant departures	number <sup>1</sup>	8,170	8,130	7,430	7,700	7,630	7,810	...
Net migration (12 month total)	number	50,184	50,434	51,133	50,833	50,659	50,541	...
<b>Commodity Prices</b>								
Brent oil price	US\$/Barrel	57.36	59.41	63.96	66.14	71.26	71.29	64.22
WTI oil price	US\$/Barrel	48.95	51.45	54.96	58.14	63.86	60.85	54.65
ANZ NZ commodity price index	mtth % chg	-0.7	2.6	2.0	4.1	4.3	2.3	-4.5
	ann % chg	-2.0	3.6	3.2	5.3	8.5	5.7	1.9
ANZ world commodity price index	mtth % chg	-0.2	2.0	2.8	4.1	2.6	0.1	-3.9
	ann % chg	-3.4	-2.2	-2.2	0.6	2.2	0.7	-2.4
<b>Financial Markets</b>								
NZD/USD	\$ <sup>2</sup>	0.6829	0.6776	0.6835	0.6832	0.6730	0.6563	0.6597
NZD/AUD	\$ <sup>2</sup>	0.9503	0.9479	0.9571	0.9651	0.9463	0.9445	0.9501
Trade weighted index (TWI)	June 1979 = 100 <sup>2</sup>	74.73	73.59	74.14	74.24	73.23	72.26	72.51
Official cash rate (OCR)	%	1.75	1.75	1.75	1.75	1.75	1.50	1.50
90 day bank bill rate	% <sup>2</sup>	1.98	1.91	1.90	1.88	1.81	1.72	1.60
10 year govt bond rate	% <sup>2</sup>	2.45	2.33	2.18	2.02	1.96	1.80	1.63
<b>Confidence Indicators/Surveys</b>								
ANZ - business confidence	net %	-24.1	...	-30.9	-38.0	-37.5	-32.0	-38.1
ANZ - activity outlook	net %	13.6	...	10.5	6.3	7.1	8.5	8.0
ANZ-Roy Morgan - consumer confidence	net %	121.9	121.7	120.8	121.8	123.2	119.3	122.6
Performance of Manufacturing Index	Index	54.7	52.8	53.4	51.7	52.8	50.4	51.3
Performance of Services Index	Index	53.0	56.4	53.6	52.5	52.0	53.5	52.7

1 Seasonally adjusted

2 Average (11am)

3 Westpac McDermott Miller

4 NZIER Quarterly Survey of Business Opinion

5 Ordinary Time

6 Production GDP divided by HLFS hours worked

Sources: Stats NZ; Reserve Bank of NZ; NZIER; ANZ; Haver; Westpac McDermott Miller; ANZ-Roy Morgan; REINZ; BNZ-Buisness NZ