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ONE STEP›AHEAD

What to Look Out For in 2025

Mark Smith, Senior Economist
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Recap: How have the five key risks for 2024 panned out?

At the start of the year, we highlighted five key risks for the NZ economy. The view was that the NZ economy could experience a period of heightened volatility with unexpected twists and turns. How have these risks panned out?

1 **Inflation persistence:** Will global and NZ inflation continue to ease back to historically low levels or hold up for longer?
Outcome: Job partly done for the RBNZ with NZ headline inflation close to 2%. Some work to do to ensure that domestic inflation settles under 3%.

2 **NZ fiscal policy:** Will NZ fiscal policy objectives be met without igniting inflation, further delaying the return to surplus, or keeping the account deficit elevated?
Outcome: NZ's fiscal position looks worse given the weaker economic backdrop, structural fiscal deficit and large future public investment needs. Cost overruns and public expectations could test fiscal discipline and NZ's reputation.

3 **NZ population growth:** Will record net immigration rates continue and what will be the economic, labour market, and housing market impacts?
Outcome: Slowing resident population growth driven by cooling net immigration. A record number of NZ citizens are currently leaving NZ, with the risk of net immigration outflows over 2025.

4 **NZ housing market:** Will strong population tailwinds or stretched affordability and debt servicing/rising unemployment headwinds dominate?
Outcome: Listless year, with house prices little changed over 2024 and well below the 7-10% gains earlier expected. Debt servicing, unemployment, and slowing net immigration headwinds dominating.

5 **Geopolitics:** Risk of Trump victory in 2024 US presidential elections, heightening geopolitical and trade tensions, fraying social cohesion.
Outcome: Republican clean sweep of the Presidential and Congressional races, with new US trade tariffs on the 2025 horizon. Trump trade of the stronger USD, higher yields/steeper yield curves, rising equities has gained momentum. What gets put in place and how other countries respond is still a major unknown.

2025 Watchlist

It's amazing what a difference a year makes. Pessimism at the start of this year is being replaced by guarded optimism and while there are challenges ahead, the scene overall is looking brighter for 2025.

Here, we highlight five key things to look out for in 2025:

1	**NZ Interest Rate Outlook**	Will falls be modest or substantial?
2	**The Return to Low and Stable Inflation**	Is global and NZ inflation on track to settle at historically-low levels, or could we see a resurgence in CPI inflation?
3	**Consumer Spending and the Housing Market**	Cost of living headwinds are abating, and mortgage interest rates are declining, but will this be sufficient to drive a consumer spending and housing market rebound at a time of rising unemployment?
4	**NZ Economic Rebalancing**	One of the bright lights for 2024 has been the commodity export sector. Will the gains here be extended throughout the wider export sector and support nationwide incomes? Is the economy starting the transition to a more economically sustainable model?
5	**Trump 2.0**	Will the delivery of the Trump agenda be the same as that proposed? What will be the impacts, and how will the rest of the world respond?

1 Lower NZ interest rates

1 **NZ and global interest rates have experienced pronounced volatility in recent years,** moving from record lows in the early stages of the COVID-19 pandemic to multi-decade highs a year to two later as economies proved to be more resilient, the policy stimulus deployed to be more potent than envisaged, and as supply-side disruptions added to inflationary pressures.

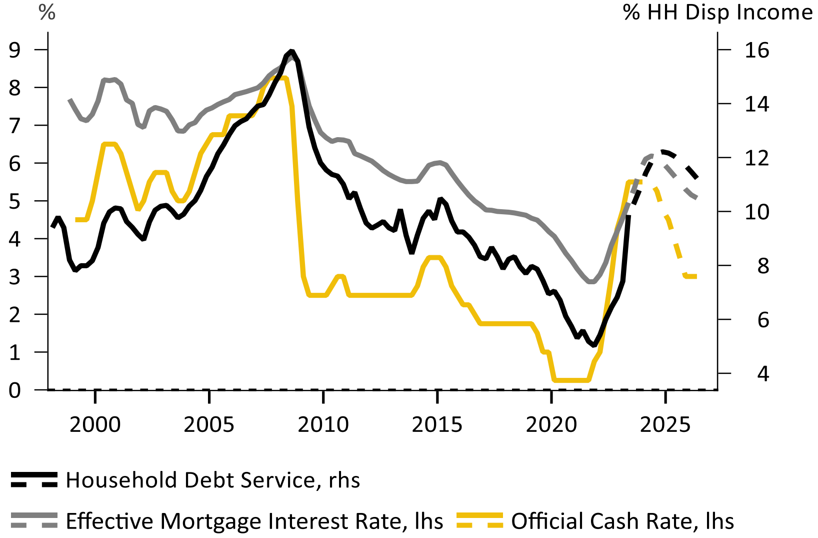
2 **Global and NZ interest rates are now on their way down as inflationary pressures subside.** Over 2024 we have seen central banks start to normalise monetary settings, although at different speeds. Usually, the higher the policy interest rate and the extent of earlier tightening, the bigger the subsequent fall. The RBNZ delivered 125bps of OCR cuts in 2024, but this followed 525bps of hikes up to May 2023 (5.50% OCR peak). This is at the higher end of the 50-175bps of cuts delivered by the FOMC, ECB, BoE and BoC. The RBA has held the 4.35% cash rate since late 2023 but have signalled rate cuts in 2025. The BoJ has actually hiked policy rates over 2024, although at 0.25% the main policy interest rate is still very, very low.

3 **How far will NZ interest rates fall?** We expect a further 100bps of OCR cuts by the RBNZ (including a 50bp cut in February) taking the OCR to 3.25%. Equivalent borrowing rates for households are likely to be in a 5% to 6% range by the end of next year. The average interest rate on mortgage borrowing is assumed to end 2025 about 100bps lower than its 6.4% Q3 2024 peak. Kiwis are net debtors on average with the value of household deposits about $130bn below mortgage and consumer loans. Lower mortgage interest rates will deliver a cash injection to the household sector, although savers will not be cheering as loudly.

4 **At 3.25% this will leave the OCR well within the 2.75-3.75% "Goldilocks" or neutral OCR zone.** Sticky domestic inflation means that the OCR is unlikely to move below 3%, but a lot can happen in the next 12 months, and we can see instances requiring the RBNZ to switch from the policy brake to the accelerator. Conversely, a burst of inflation could see the RBNZ pare back monetary easing over 2025.

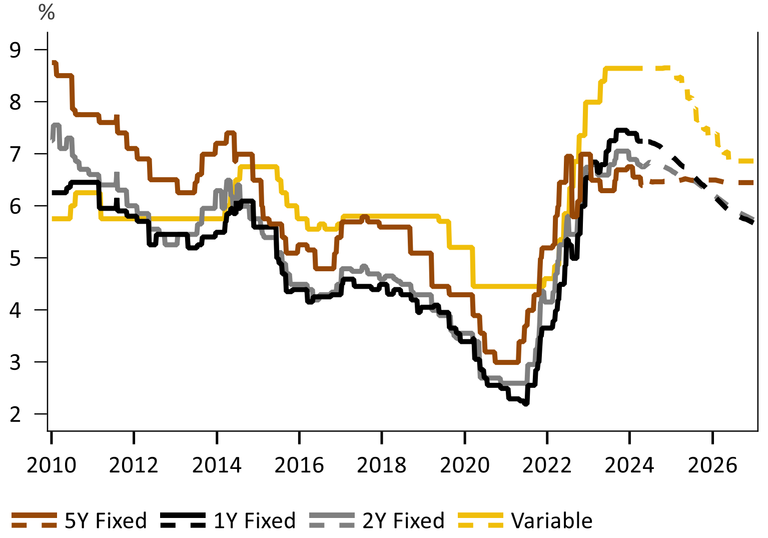
5 Neutral interest rates are a key nominal anchor and are a better guide to the trend direction of interest rates but are unobserved. **We expect neutral nominal interest rates will eventually resume their downward trend after been temporarily pushed higher with the COVID-19 burst of inflation.** This assumption could be tested if inflationary pressures quickly resurface.

OCR, Effective Mortgage Rate and Household Debt Service



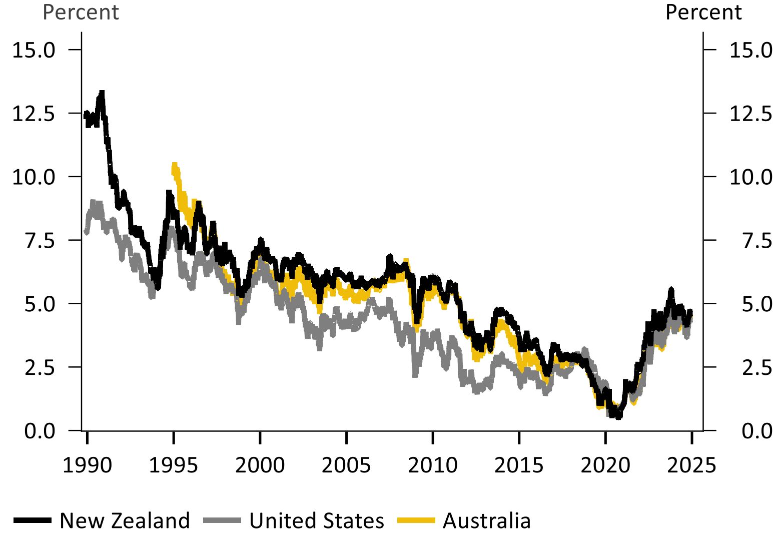
Source: Macrobond, ASB

ASB new Mortgage Interest Rates



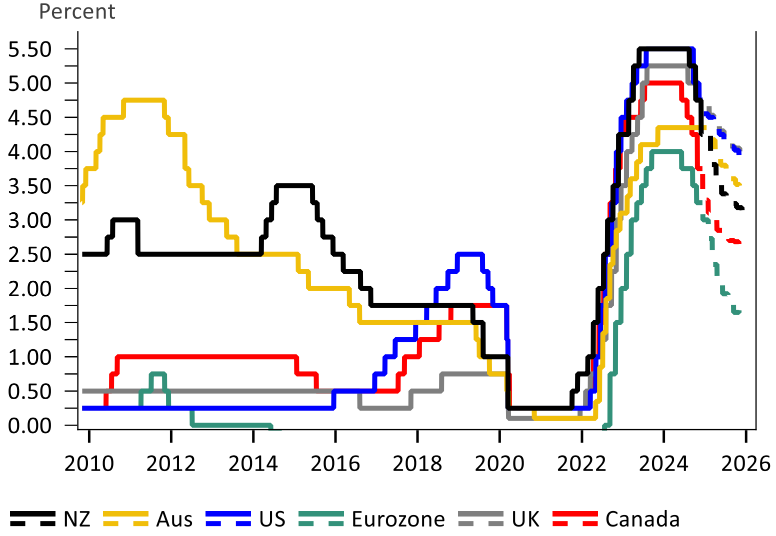
Source: Macrobond, ASB

Goverment 10-Year Bond Yields



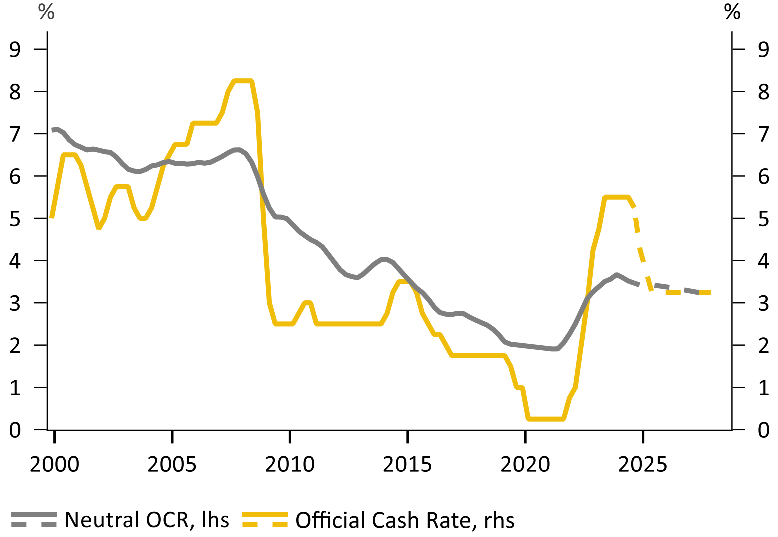
Source: Macrobond, ASB

Central Bank Policy Rates Around the World



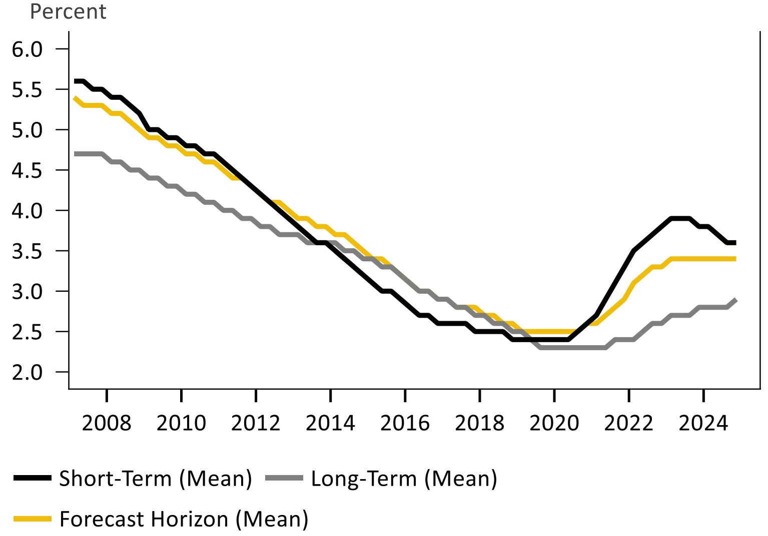
Source: Macrobond, ASB

OCR and Neutral OCR



Source: Macrobond, ASB

RBNZ OCR & Nominal Neutral OCR Indicator Suite, Estimate



Source: Macrobond, ASB

2 The return to low and stable inflation

1 **High and variable inflation is social and economic poison that has impeded economic efficiency, make us poorer.** It has also been politically damaging to incumbent governments. Cost of living crises have been experienced, both here and abroad. The world has been through a turbulent time in which inflation hit multi-decade highs during 2022 and 2023.

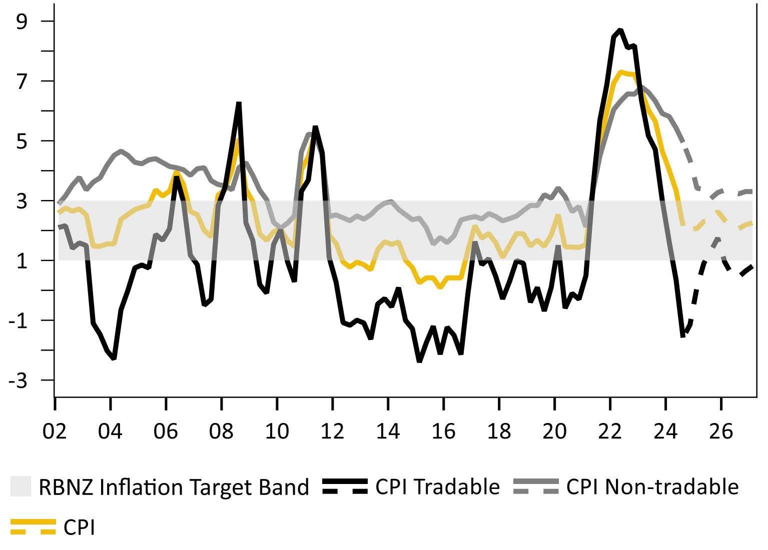
2 **Brighter signs have emerged over 2024** as inflation in NZ and abroad dropped sharply as earlier price premiums built up during the COVID pandemic have started to dissipate, and as central bank driven slowdowns have impacted. More of the cooling has been evident for external inflation influences, with domestic inflation tending to be slower to moderate.

3 **We estimate that NZ CPI inflation ended 2024 at around 2.0%, at the midpoint of the 1-3% RBNZ inflation target.** Tradable CPI prices fell about 1.5% over 2024. Annual non-tradable inflation will end 2024 at circa 4.7% (around 3.5% excluding local authority rates and insurance).

4 **Annual CPI inflation is expected to modestly tick up to 2.6% by the end of 2025.** Deflation in tradable prices is expected to be replaced by a mildly inflationary impulse. The global inflationary backdrop is looking less benign, and the NZD is lower. Global developments will be closely watched. Abundant spare capacity should see non-tradable inflation continue to recede despite the economy recovering. We expect annual non-tradable inflation to cool towards 3% by the end of 2025 but remain wary of sticky services inflation and cost driven increases for local authority rates and insurance.

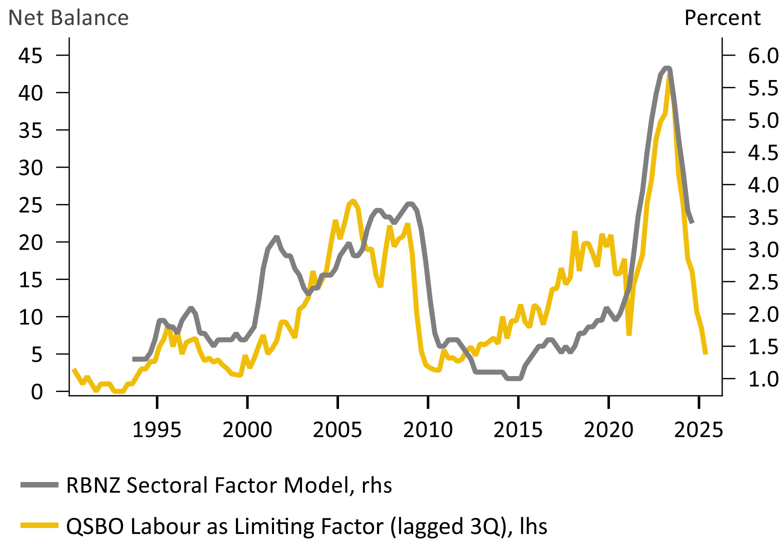
5 **The return to low and stable inflation will make it easier for firms, household and government to plan and invest, helping to grow the economy.** For households it will also take considerable pressure off household budgets. During peak COVID-19, households were facing annual increases of more than $100 on weekly living costs. In 2024 this had slowed to an extra $30 per week. **Courtesy of low inflation and falling interest rates, weekly increases for 2025 will shrink to less than an extra $10pw. That's great news for cash strapped households, many of which are living paycheck to paycheck.**

Annual NZ CPI Inflation



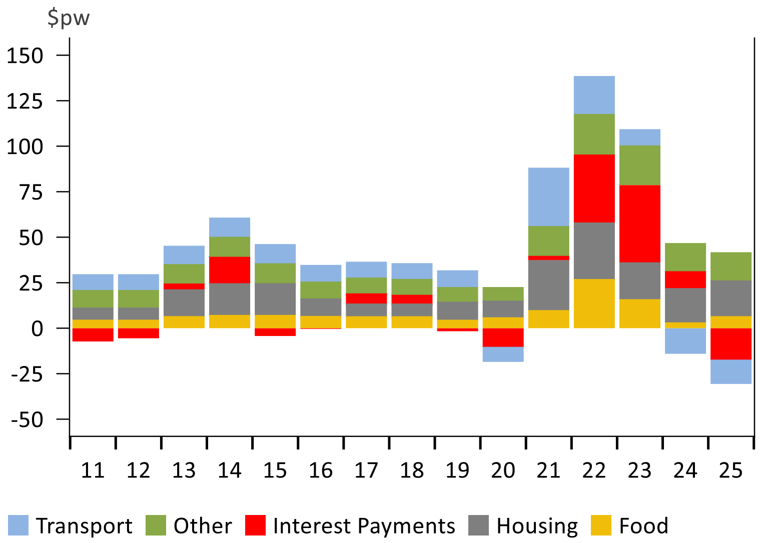
Source: Macrobond, ASB

NZ Core Inflation and Labour Utilisation



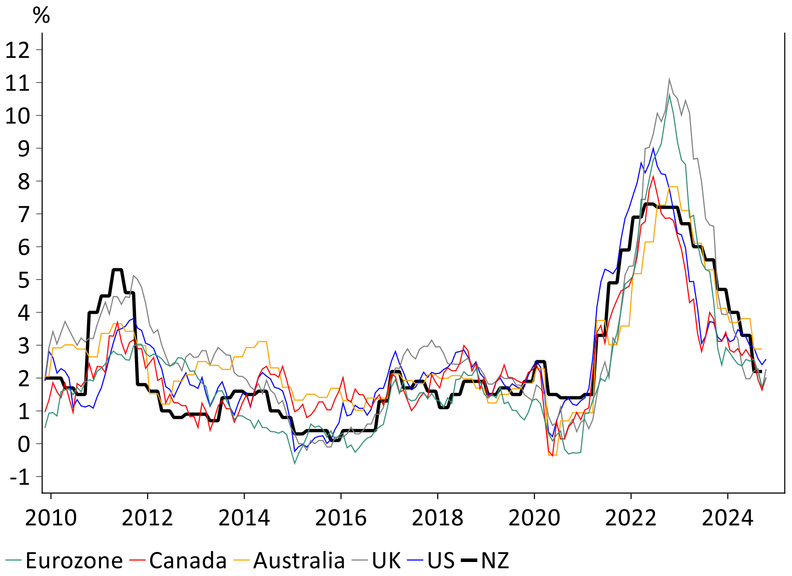
Source: Macrobond, ASB

Weekly Change in NZ Household Living Costs by year



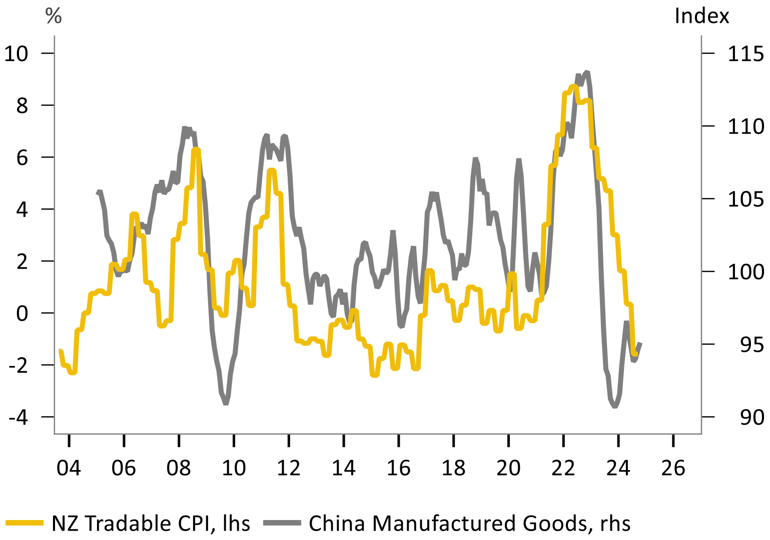
Source: Macrobond, ASB

Annual CPI Inflation



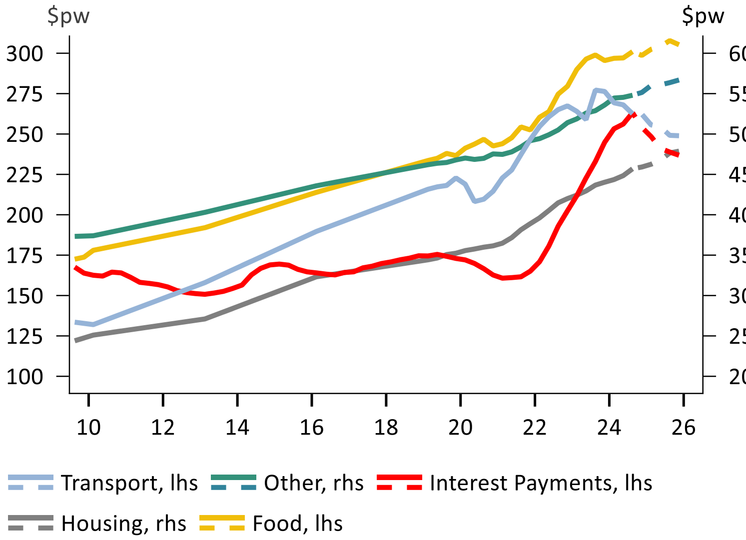
Source: Macrobond, ASB

Chinese Export Prices and NZ Tradable CPI Inflation



Source: Macrobond, ASB

NZ Weekly Household Living Costs



Source: Macrobond, ASB

3 The comeback for consumer spending and the housing market

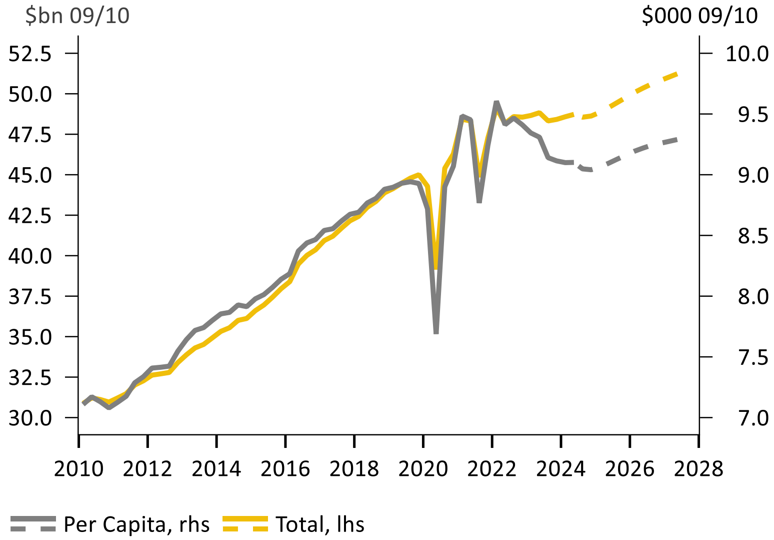
1 **2024 was generally a lacklustre year for NZ household spending,** with the hangover from the earlier COVID-induced binge setting in and the consumer bearing the brunt of monetary tightening. Household spending volumes are expected to end 2024 about 6% below early 2022 peaks on a per-capita basis (forthcoming data revisions could reduce this somewhat), with NZ household net worth and house prices to end 2024 about 20% below late 2021 peaks in inflation-adjusted terms.

2 **We are more hopeful about 2025.** It's much easier to rebound from a cyclical low than extend from cyclical highs. Households have been tidying up their balance sheets and deleveraging with household debt at just over 90% of nominal GDP (closer to 100% of GDP in 2021/22). **The moderation in NZ inflation will take considerable pressure off household budgets and business costs. Lower interest rates should kick-start interest rate sensitive and employment-rich pockets** including retail, wider services and construction. **This should help to support labour incomes and limit increases in the unemployment rate, which we expect to peak under 5½% by mid-2025 and then subsequently ease. Prospects for NZ export returns are looking brighter,** although we remain wary of the global outlook (see Themes 4 and 5). NZ households still have $18bn of savings amassed during 2020/21 that have yet to be spent.

3 **Lower interest rates should also provide a welcome boost to the housing market.** We expect house prices to rise 5-10% over 2025, although it will take until 2026 to surpass 2021 record peaks. It will take much, much longer to reach new inflation-adjusted peaks. There will be marked differences by region.

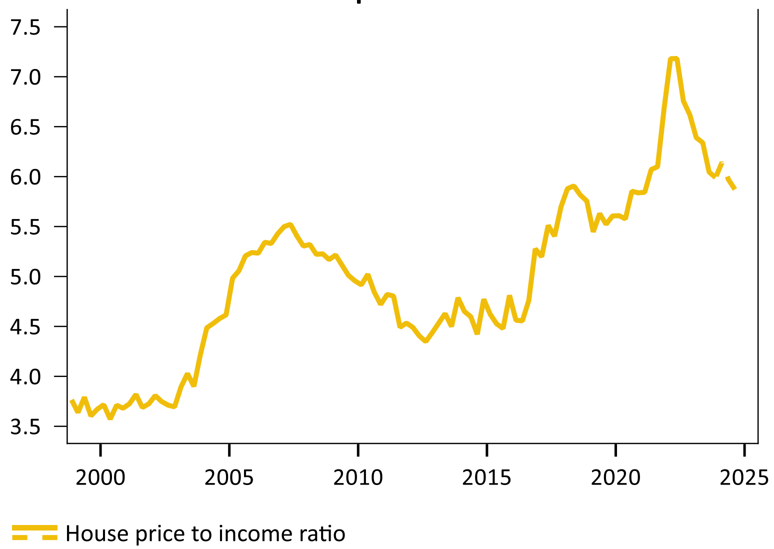
4 **There are still reasons for caution.** The global outlook is still clouded in uncertainty. NZ is past peak net immigration, and while net migration outflows over 2025 are a possibility, it is not our core view. The labour market lags the cycle and the climb in unemployment has some way to go. Pressures on corporate profitability will need to quickly subside so that firms can pivot from cost-cutting mode to hiring and investing. Housing affordability has improved but housing is expensive, with housing rental yields still below the cost of funding.

Household Spending Volumes



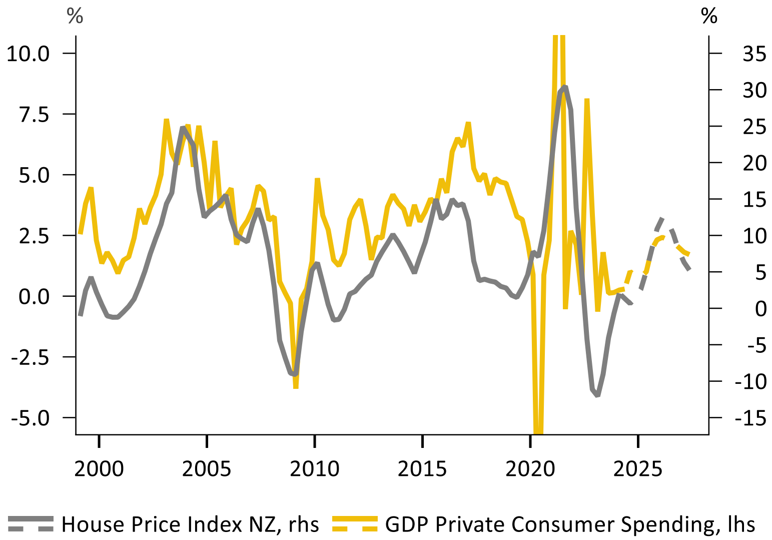
Source: Macrobond, ASB

Median House price to income ratio



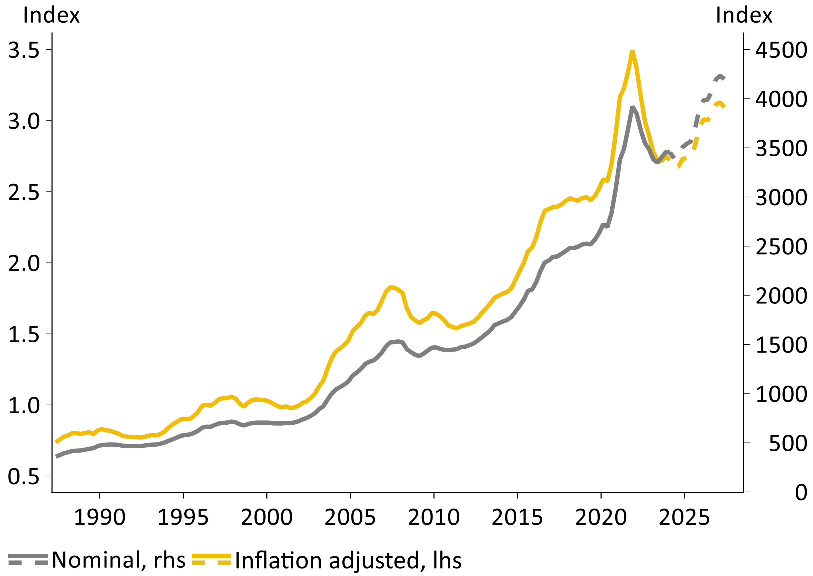
Source: Macrobond, ASB

NZ Consumer Spending and House Price Growth



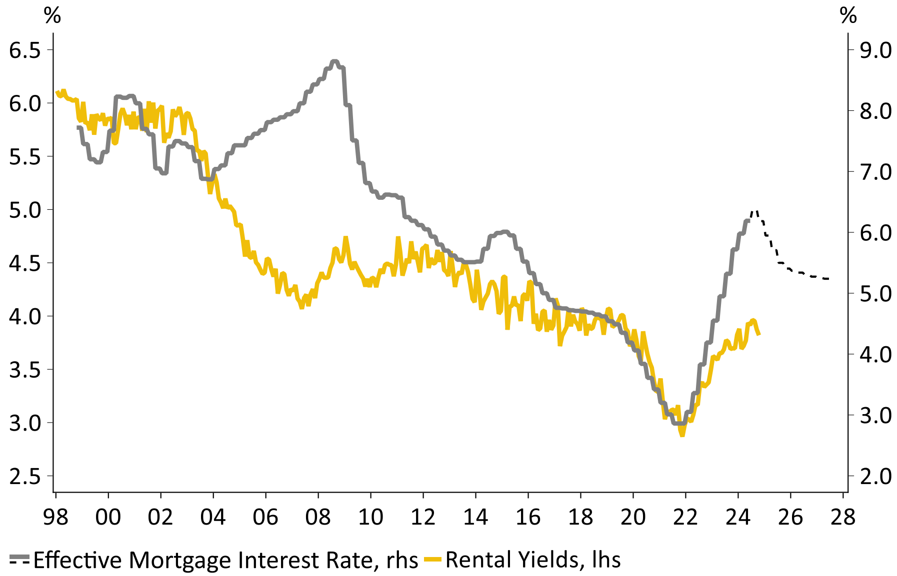
Source: Macrobond, ASB

NZ House Price Index



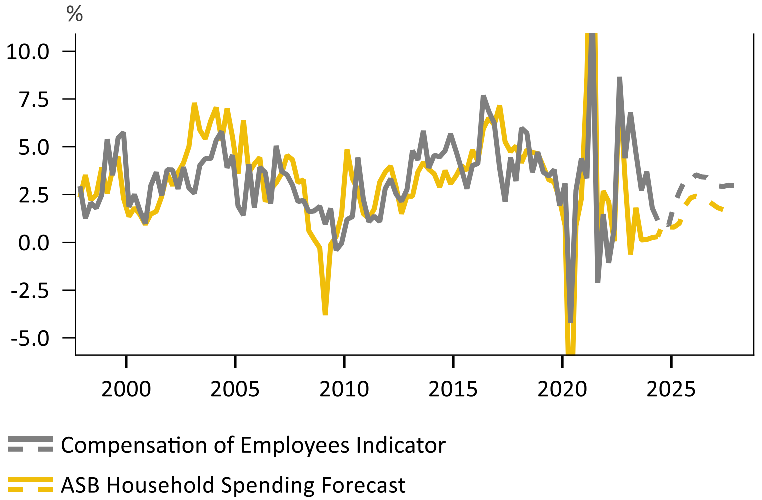
Source: Macrobond, ASB

Rental Yields and mortgage interest rates



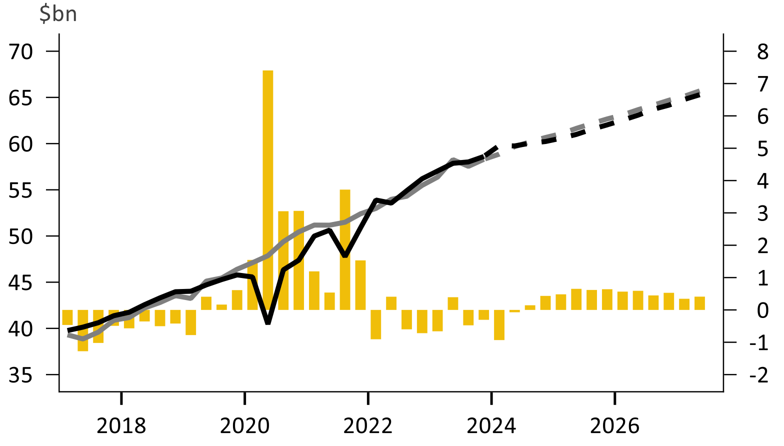
Source: Macrobond, ASB

ASB Household Spending Forecast vs Real Compensation of Employees Indicator



Source: Macrobond, ASB

NZ Household Saving

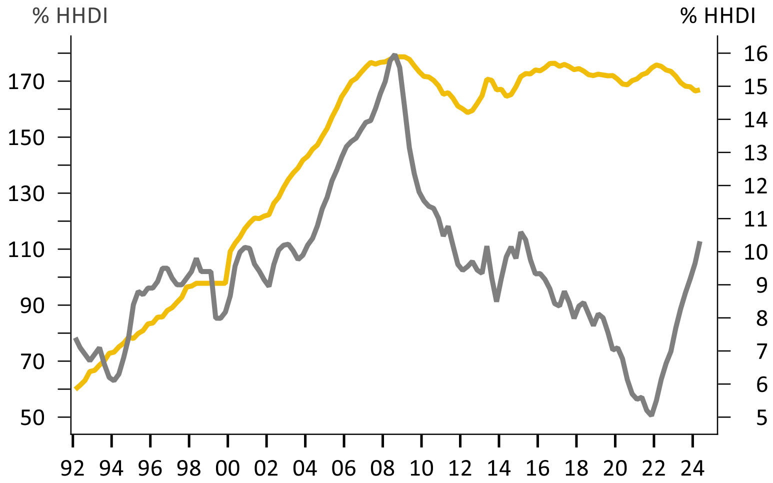


HH expenditure, lhs HH disposablle income, lhs

HH saving, rhs

Source: Macrobond, ASB

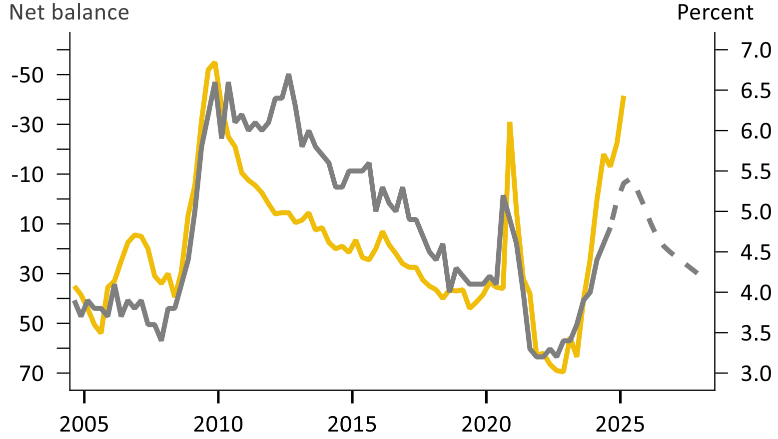
NZ Household Debt and Debt Servicing



Servicing, rhs, rhs Debt, lhs, lhs

Source: Macrobond, ASB

Difficulty Finding Labour & The Unemployment Rate

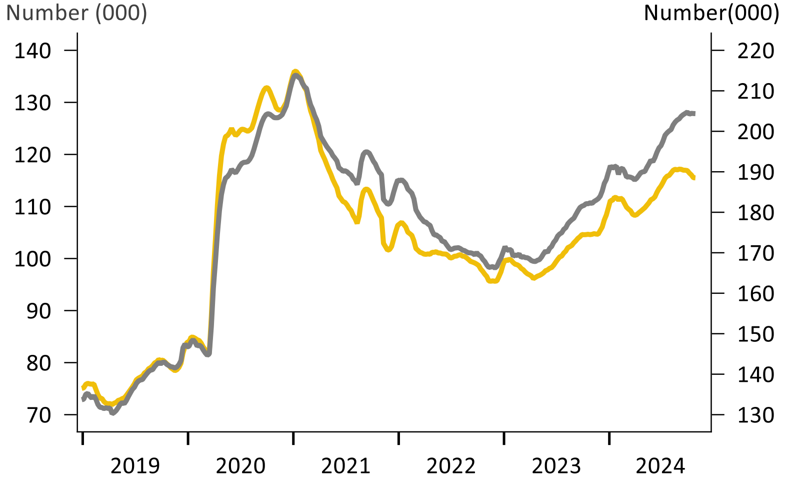


NZ Unemployment Rate, rhs

QSBO, Difficulty in Finding Labour (Advanced 2 qtrs), lhs

Source: Macrobond, ASB

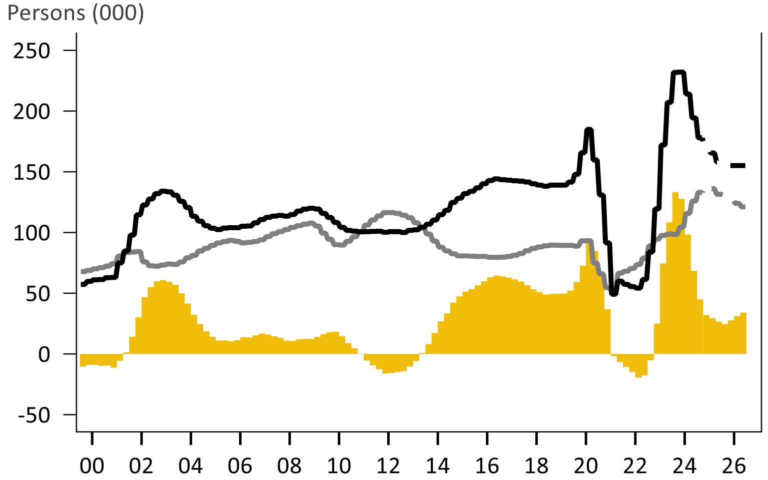
Jobseeker Support



Jobseeker Support, Total, rhs Jobseeker Support, Work Ready, lhs

Source: Macrobond, ASB

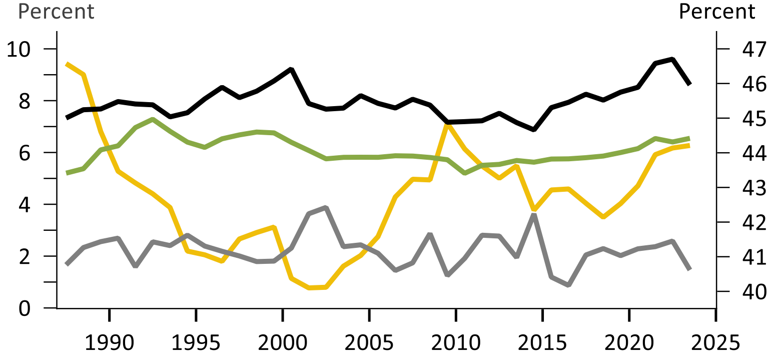
NZ PLT Migration - Annual totals



PLT arrivals PLT Departures Net PLT Immigration

Source: Macrobond, ASB

NZ Household Incomes



Gross Operating Surplus & Gross Mixed Income, lhs

Entrepreneurial Income, Non-Farm, lhs

Entrepreneurial Income, Farm, lhs

Compensation Of Employees, rhs

Source: Macrobond, ASB

4 The start of NZ's economic rebalancing

1 **One of the bright lights for 2024 has been the commodity export sector which constitutes about half of NZ exports.** NZ commodity export prices are about 25% above August 2023 lulls in USD terms. **This, and the combination of strengthening offshore demand, production constraints for overseas competitors and favourable domestic climatic conditions should help to bolster NZ primary sector incomes in 2025**. Incomes in the dairy sector alone are expected to be at least $4bn higher in 2024/25 versus the previous season. **Higher prices for commodity-based exports are expected to lift the NZ terms of trade, a key economic support.**

2 Fortunes for manufacturing exports (25% of total) have differed, but with some very strong performers. **Services exports have recovered much of their COVID-19 dip** and now constitute about 30% of exports, after falling as low as around 15% in 2021. **The lower NZD should help**, and the AI revolution could be a fertile breeding ground for NZ technology firms.

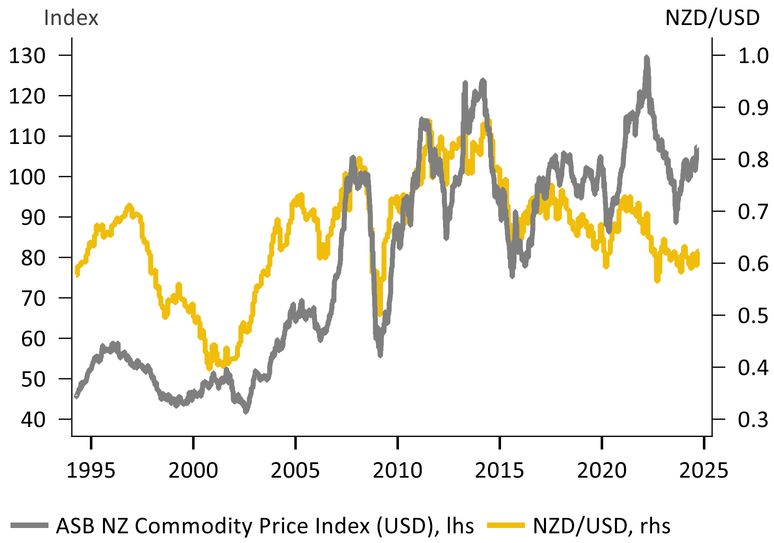
3 **Developments on the cost side are also becoming more favourable.** Cost pressures are slowing, with rapidly cooling input costs for agriculture and a generalised slowing in input costs. Shipping costs are also on the retreat and well below COVID-19 peaks.

4 However, there are limits to how much export volumes can be increased given biological, land, capital and labour constraints. **At about 25% of GDP, NZ's export intensity is below the of OECD average of 30% and is the lowest of 24 OECD small countries** (sub-20 million population). **Lifting NZ's export intensity looks to be the key to boosting NZ's lacklustre productivity performance and helping to close the 25-30% income shortfall with the OECD average.**

5 **A more outward and export focus will boost productivity and domestic incomes.** It will help to turn around the continuing trend deterioration in NZ's net export position and to narrow NZ's extremely large current account deficit and reduce NZ's large external debt. **It is unrealistic to expect the NZ economy to become an export powerhouse overnight but sacrificing some current spending in favour of building up saving and investment should help boost the NZ capital stock and our productive potential.**

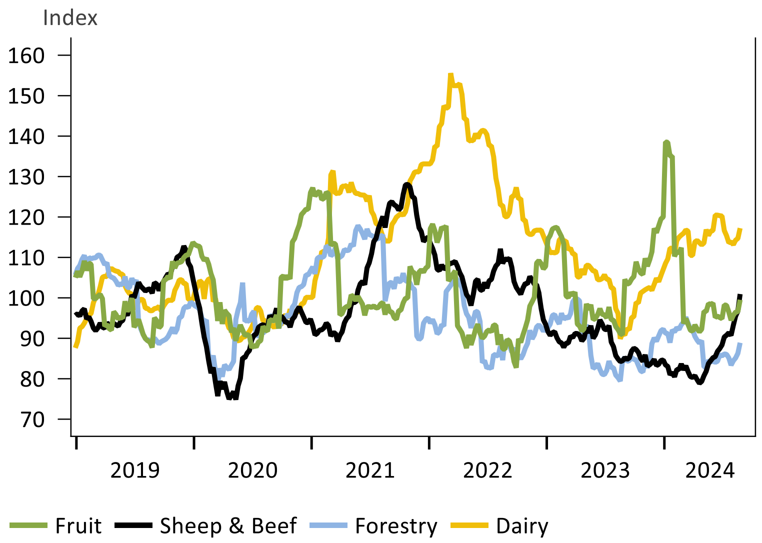
6 **Firms, households and government all have a role to play.** Fiscal settings need to be tightened, but the capital pipeline maintained. There is the need to restore fiscal buffers given future challenges. Tax policies may need to be tweaked to promote more nationwide saving and productive investment. NZ has made a start with KiwiSaver and the Superannuation Fund, but more needs to be done. Firms and households also need to be more future focused. **We will provide more detail in a forthcoming note in 2025.**

Commodity Export Prices and the NZD



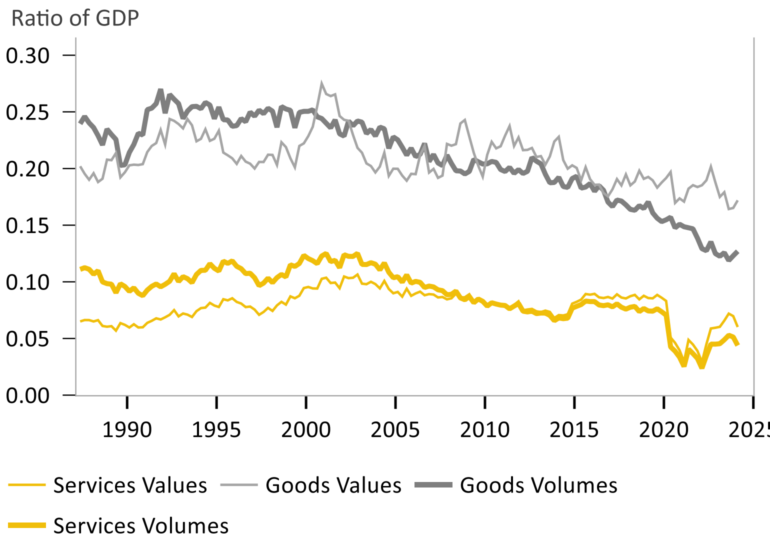
Source: Macrobond, ASB

New Zealand USD Commodity Prices



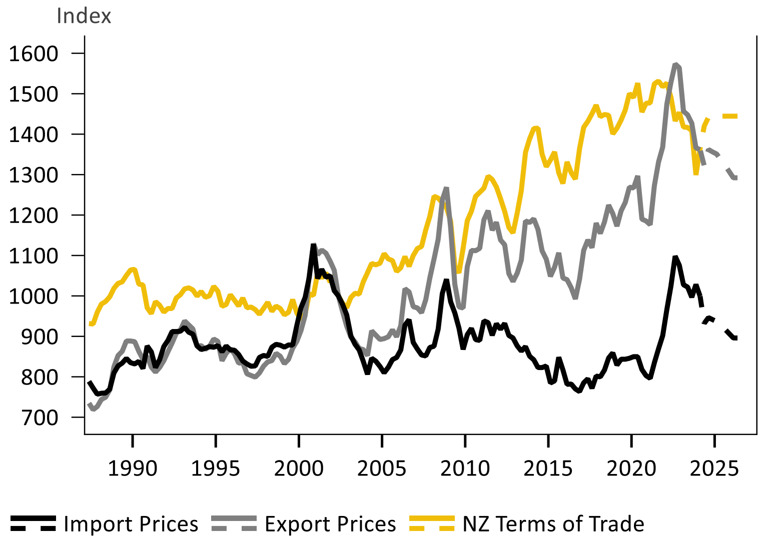
Source: Macrobond, ASB

NZ Exports to GDP



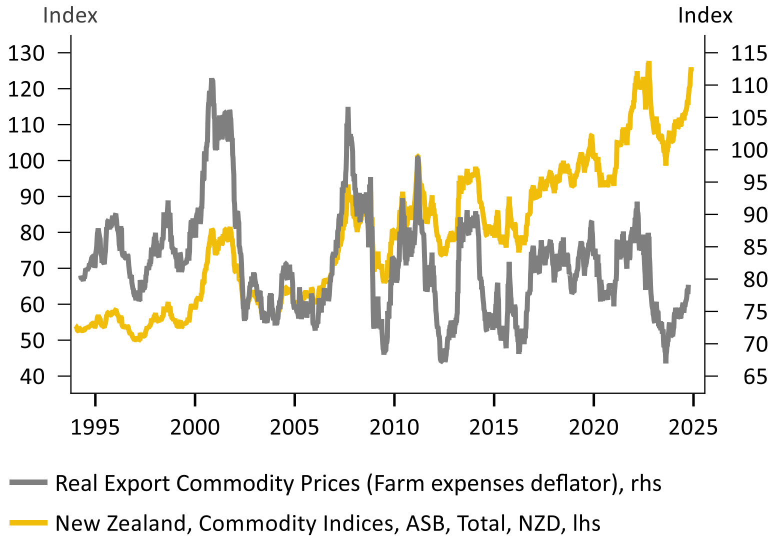
Source: Macrobond, ASB

Trade Prices and Terms of Trade



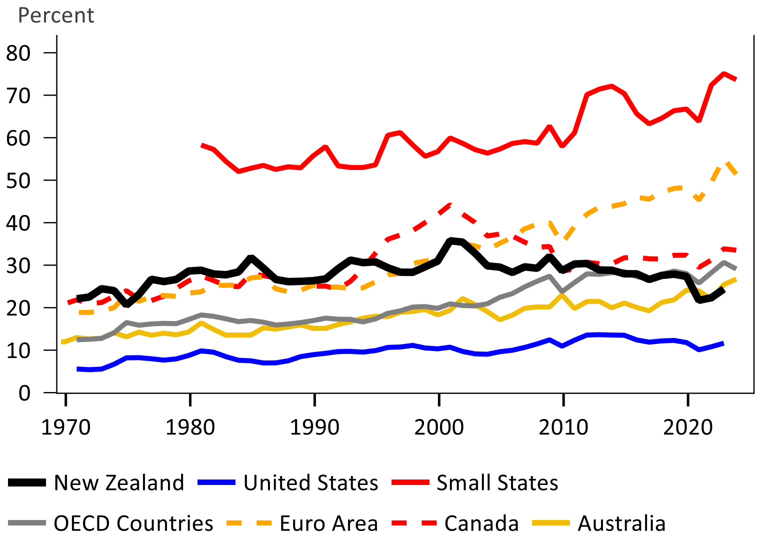
Source: Macrobond, ASB

NZ Export Commodity Prices



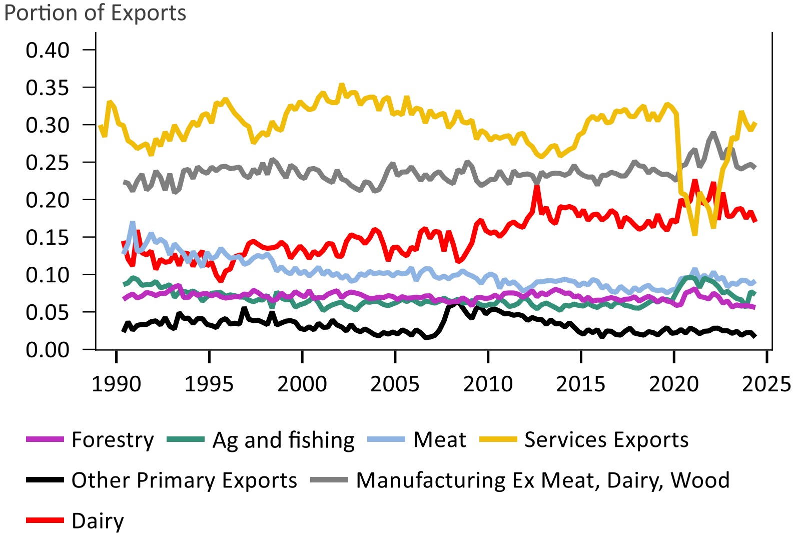
Source: Macrobond, ASB

Export Shares of GDP (World Bank estimates)



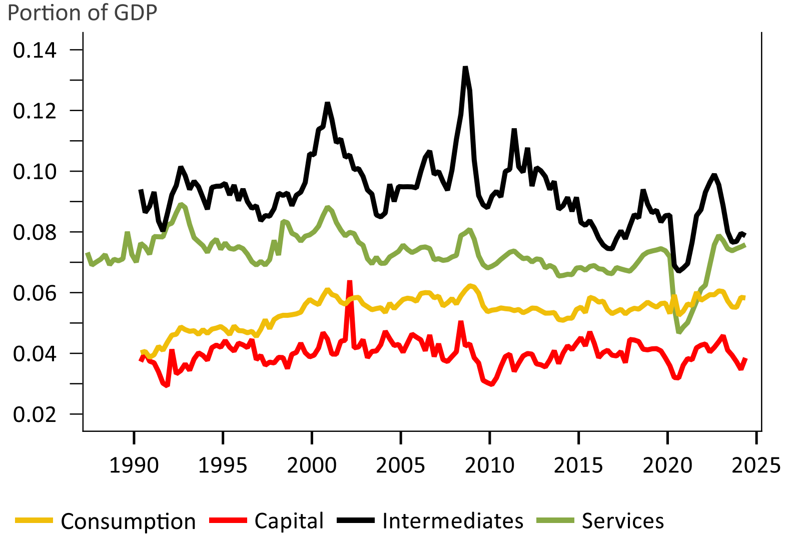
Source: Macrobond, World Bank, ASB

Share of total export volumes



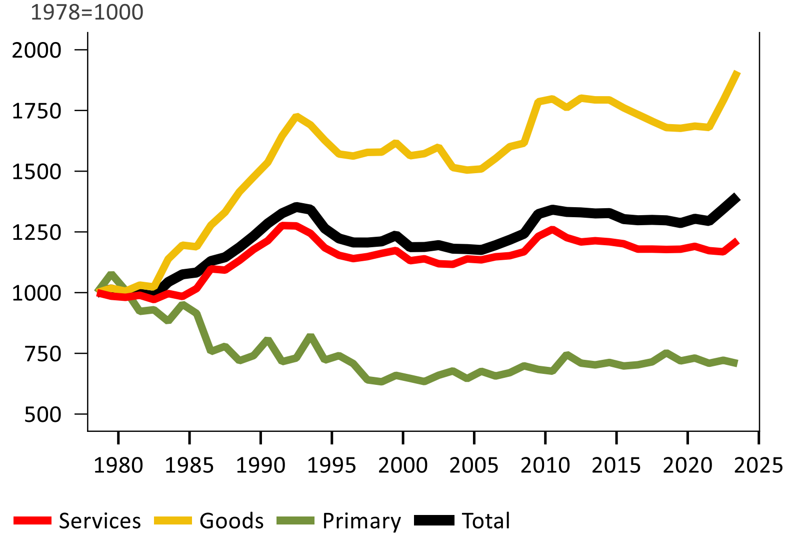
Source: Macrobond, ASB

NZ Import Values



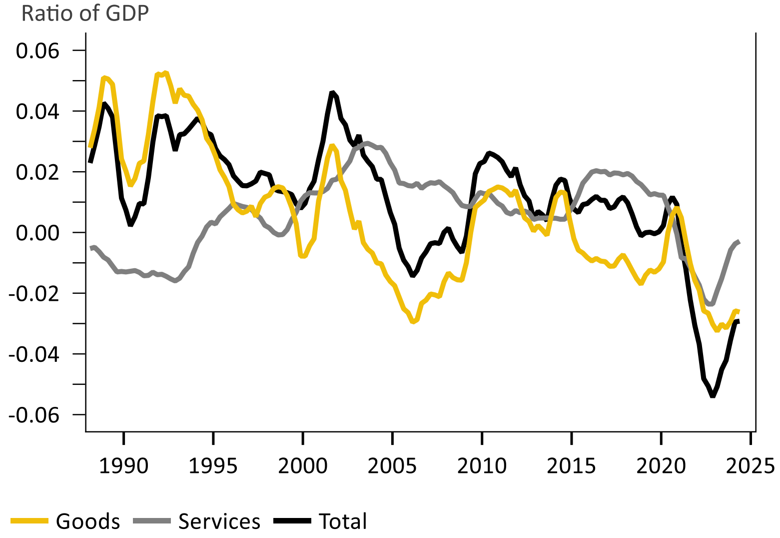
Source: Macrobond, ASB

NZ Capital/Output Ratios by Broad Sector



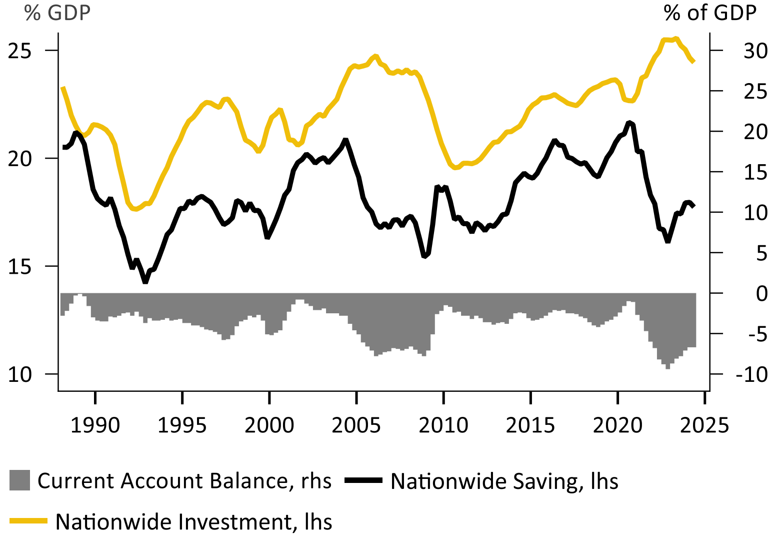
Source: Macrobond, ASB

Net Trade Values



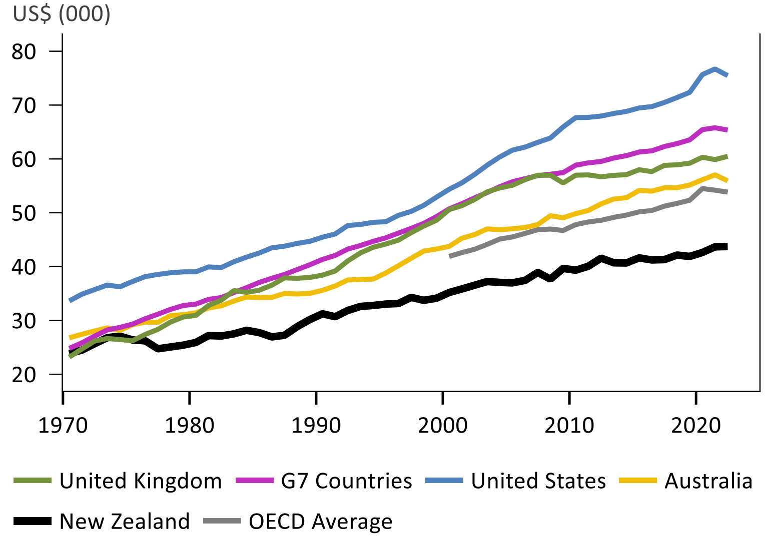
Source: Macrobond, ASB

NZ Saving and Investment



Source: Macrobond, ASB

OECD Comparison: Real GDP per Hour Worked, PPPs, USD



Source: Macrobond, OECD, ASB

5 Trump 2.0

1 In 2024 about half of the global population voted in nationwide elections, but the focus was on the US. **Donald Trump won the popular vote as well as the electoral college and was elected 47th US President. A majority in both houses of Congress should embolden the Republicans until at least the 2026 mid-term elections.**

2 **Financial market sentiment has so far remained constructive,** with expectations of a strong US economy and deregulation under a second Trump administration. US equities are around record highs. The USD and global yields have lifted. Cryptocurrencies have had a field day.

3 After the January 20 inauguration in 2025, the Trump policy package is likely to be quickly rolled out and we expect a flurry of executive orders issued. An America First policy position is to be expected, with a scaling back of economic and military assistance overseas, leaky border issues fixed, and a more protectionist and less environmentally friendly policy stance followed.

4 **Extending the 2017 Trump tax cuts (which are due to expire by the end of 2025) could significantly add to US fiscal deficits and federal debt.** Various non-partisan studies place the costs in the region of US$4-5 trillion over the next 10 years (Federal spending is about USD$8.5 trillion annually and nationwide US GDP roughly US$30 trillion). If these tax cuts are not offset by savings made elsewhere or by higher revenues, expect much higher US Federal debt and US Treasury issuance. This will lift US Treasury yields, pressuring NZ longer-term yields higher.

5 **The trade policies are of most concern for a small open economy like NZ.** The US imports roughly US$4 trillion per annum, about US$3.2 trillion of which are goods. The US typically runs goods trade deficits (around US$1 trillion annually) and services surpluses (about $300bn) with the rest of the world. Countries that run large trade surpluses with the US – China, Mexico, the Eurozone, Canada, South Korea and countries in the ASEAN block – could be targeted irrespective of whether or not they have a Free Trade Agreement with the US (YES - Canada, Mexico, Australia, South Korea, NO – NZ, China, Europe).

6 **The US is NZ's 3rd largest trading partner** (behind China and Australia), with 2-way trade approaching $30bn. NZ exports to the US are above imports by about $5bn, with NZ running both goods and services trade surpluses with the US. Hopefully, NZ is too small to attract unwelcome attention.

5 Trump 2.0 (cont'd)

7 **What will the impacts be? We will have to wait and see.** Trump is famously unpredictable, having already changed his tariff view, with the possibility that the threat of tariffs are just a negotiating tactic.

8 **If tariffs are announced, the impact will depend on the size of tariff, how long they are imposed for, and how targeted they are (general or country/good & service specific). The response of other countries will also be key.** The reaction of China will be pivotal.

9 **For markets it is very much a waiting game.** There is the potential for the USD and US yields to move higher still. The risk is that the honeymoon period ends, and market sentiment turns sour if President Trump's tariff threats turn into reality, a trade war ensues, and uncertainty about the global growth outlook increases.

10 **Tariffs will lead to higher import costs for US firms and consumers**. It will likely raise US inflation and weigh on US demand. The US economy has been a key engine for global growth post-COVID and the impacts will filter throughout the global economy.

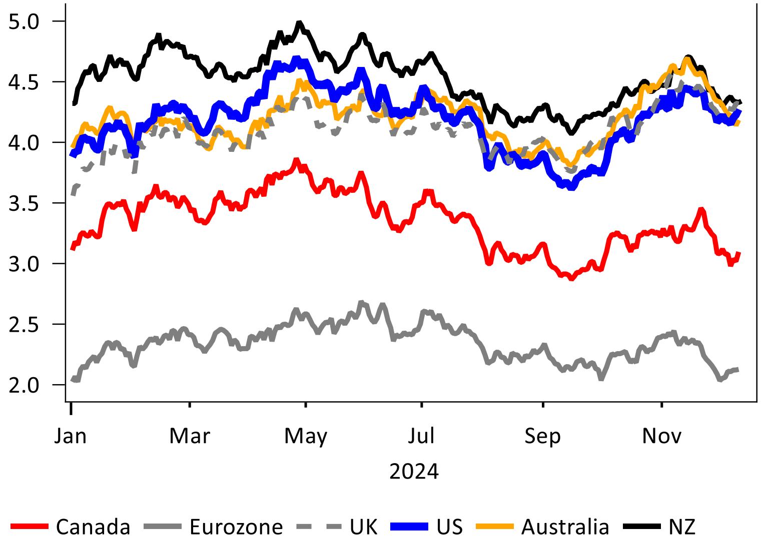
11 **The global impact could be more significant if there is a retaliatory response,** with tariff increases imposed on US exports by other countries. Global growth would take a bigger hit. An increasingly volatile and more protectionist global backdrop could create significant headaches for NZ. **NZ exporters will need to be nimble, particularly for those selling into US markets.**

12 **It may not be all bad news, however.** Context is key. The NZD will act as a shock absorber to mitigate the fallout to the NZ export sector but will raise the costs into NZ. **A US-led trade war may not be inflationary for NZ** even if it results in a lower NZD. Products destined for the US could be directed to NZ. The diversion of Chinese exports to non-US markets could dampen NZ inflation.

13 **Increasing policy support may also be rolled out both here and abroad to compensate for the trade war hit.** The Chinese global growth locomotive has run out of puff and is struggling to regain pre-COVID-19 momentum, with demographic challenges, a moribund real estate sector, investment and export centric growth mix, and rising central and local government debt. Increased Chinese policy stimulus could bolster demand for more NZ exports. Let's not forget there are other markets that NZ can tap into.

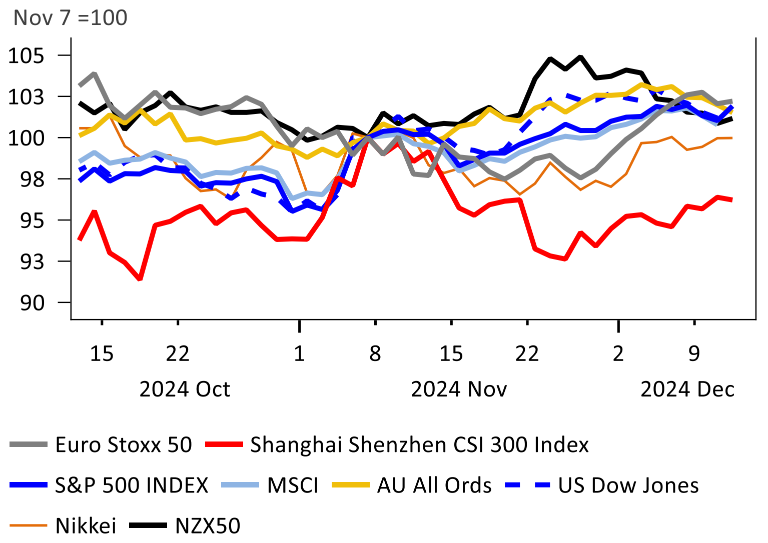
14 **The lesson for 2025 will be to expect the unexpected.** The prospect of increased financial market and broader economic volatility will likely be the base case scenario for most of us, but we will have to wait and see.

10-Year Government Bond Rates



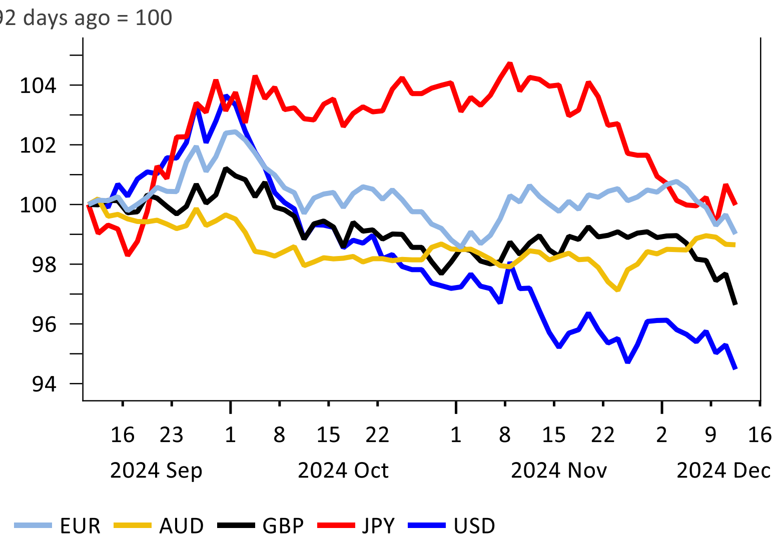
Source: Macrobond, ASB

Equity Indices



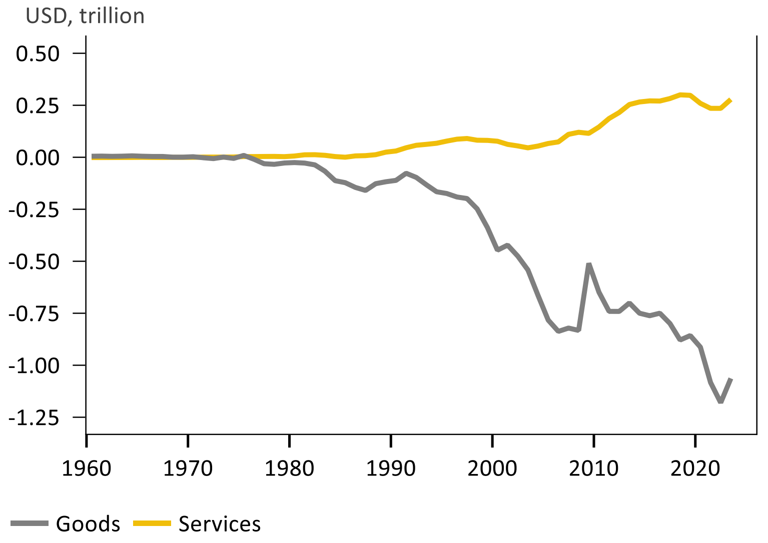
Source: Macrobond, ASB

NZD Crosses



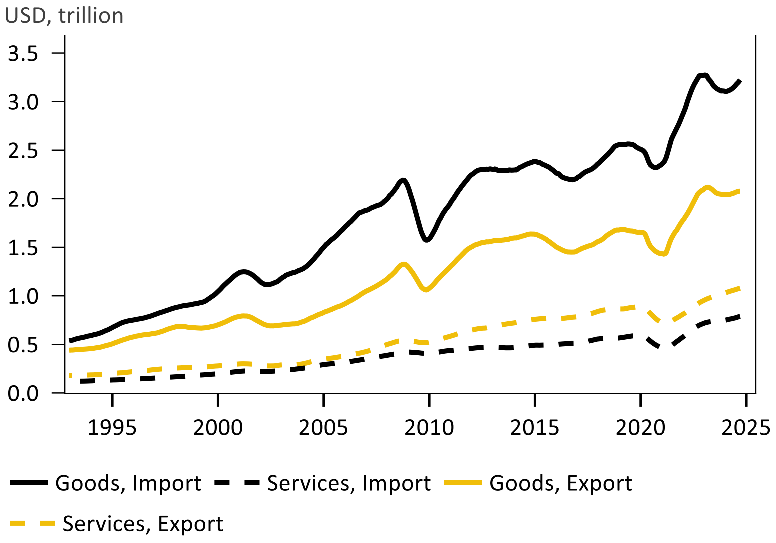
Source: Macrobond, ASB

US Trade Balance



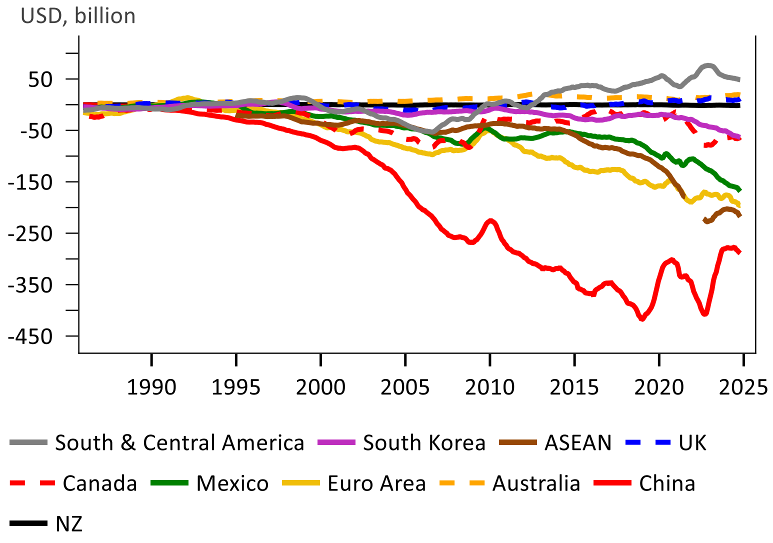
Source: Macrobond, ASB

US Foreign Trade Values



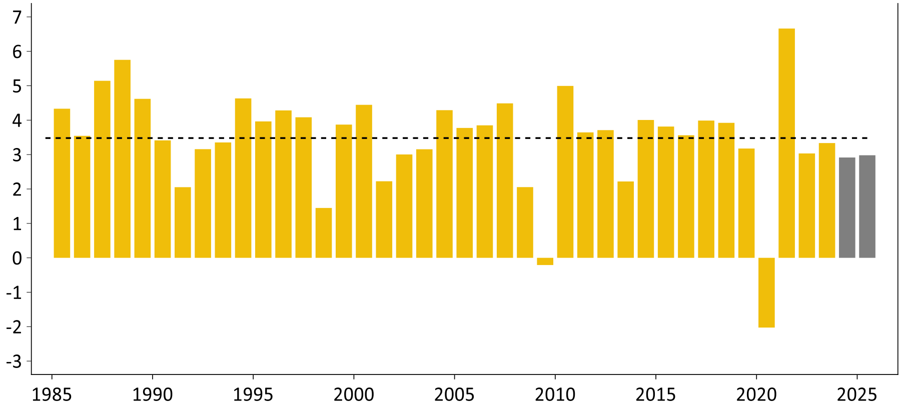
Source: Macrobond, ASB

Annual Goods Trade Balance with the US



Source: Macrobond, ASB

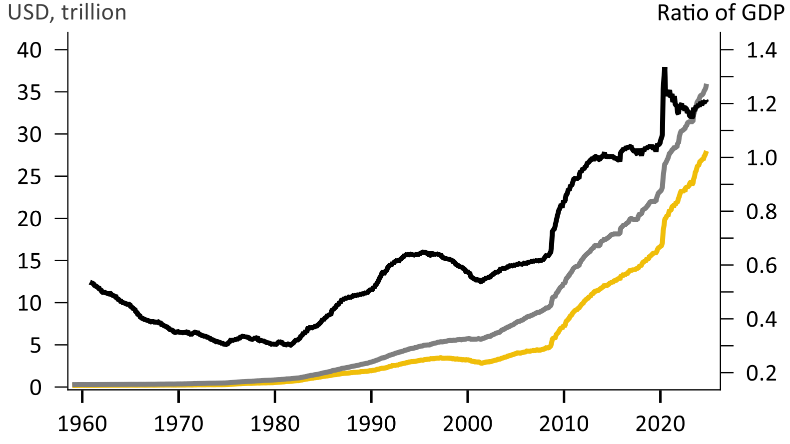
NZ Trading Partner GDP (top 16)
Annual Average Growth



Average Growth (post 1995) New Zealand, NZ trading partner GDP forecast

Source: Macrobond, ASB

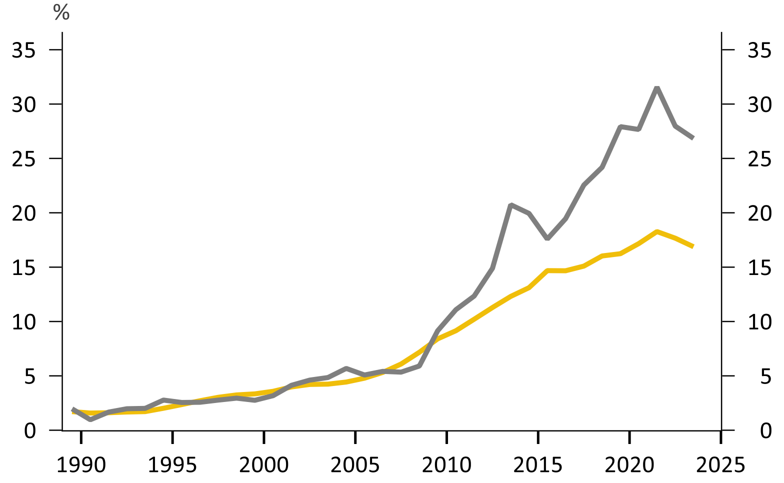
US Gross Public Debt and Treasury Issuance



Gross Federal Debt to GDP, rhs Gross Federal Debt, lhs
Marketable Treasury Debt, lhs

Source: Macrobond, ASB

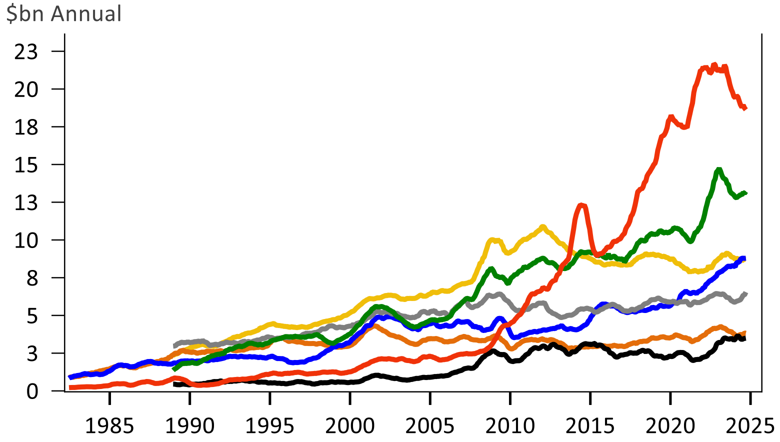
China's Influence Waning?



China share of NZ exports, lhs China share of Global GDP, rhs

Source: Macrobond, ASB

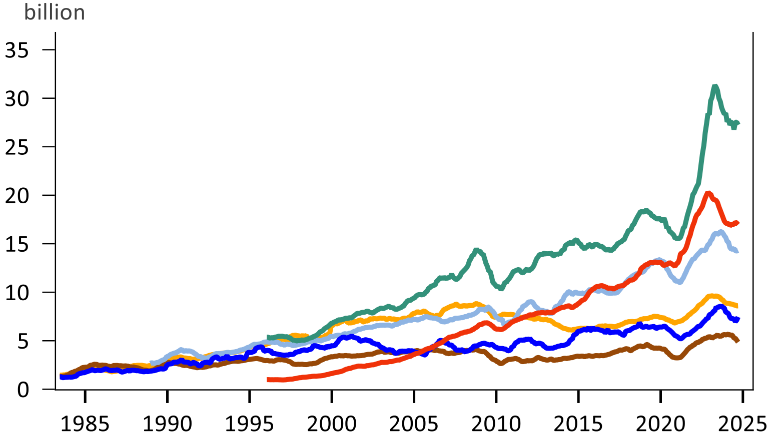
NZ Merchandise Exports



China ansd HK Asia ex China and Japan Europe, Europe
OPEC US Japan Australia

Source: Macrobond, ASB

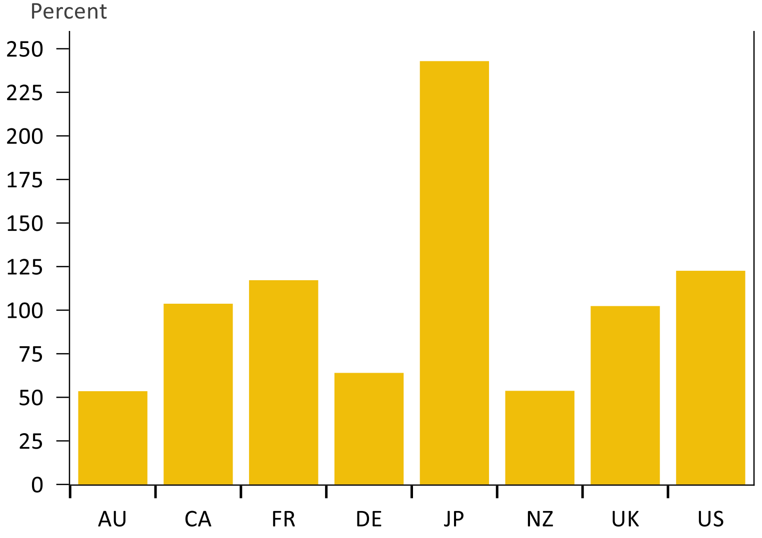
Merchadise Imports into NZ



Asia ex China and Japan China and HK US Europe
Japan Australia

Source: Macrobond, ASB

Government Gross Debt as a % of GDP



Source: Macrobond, ASB

Contact details

Mark Smith

Senior Economist

Email: mark.smith4@asb.co.nz

Mobile: 027 578 5635

ASB Economics & Research			Phone	Fax
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659	(649) 302 0992
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657	
Senior Economist	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5853	
Senior Economist	Kim Mundy	kim.mundy@asb.co.nz		
Economist	Yen Nguyen	yen.nguyen@asb.co.nz		
Administration Manager	Caro Phillips	caro.phillips@asb.co.nz		