TRADING PLACES

Comparing economic conditions in New Zealand and Australia.

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CONTENTS AND AUTHOR

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OVERVIEW

Trading places.

When we last peeked over the Tasman in late 2024, the Australian economy was enjoying more robust economic conditions than New Zealand, with firmer GDP growth and a stronger labour market.

Jump forward a year and we are now moving into a new phase of the economic cycle, with economic growth in New Zealand set to outpace Australia over the next few years.

These diverging economic trends in New Zealand and Australia in large part reflect differences in monetary policy. The Reserve Bank of New Zealand's earlier aggressive tightening of policy meant that we experienced a sharper downturn in growth in recent years. However, now that inflation has dropped back, the RBNZ has also been able to cut rates faster, with a 250bp reduction in the Official Cash Rate to date and a likely 50bps more to come before the end of 2025. Over time, that will help to boost both domestic demand and employment.

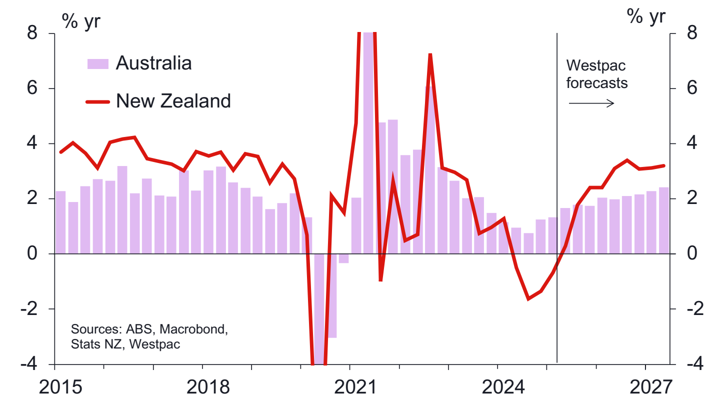
In contrast, the Reserve Bank of Australia took a more gradual approach to tightening policy which helped to support growth and the labour market in previous years. However, its easing cycle has also been more gradual—with Australia's cash rate having only been cut by 75bps since the start of this year, interest rates across the Tasman remain at mildly restrictive levels.

But despite the slower pace of monetary easing and cooling economic growth, Australia's economy and labour market have remained firmer than in New Zealand, and that's set to continue for some time yet.

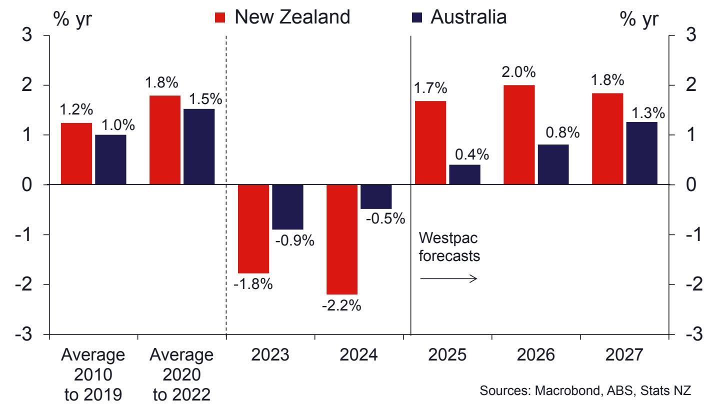
ECONOMIC GROWTH

- GDP growth in both New Zealand and Australia has slowed over the past year, with New Zealand seeing a sharper slowdown through mid-2024.
- While economic growth in Australia is expected to remain modest over the year ahead, growth in New Zealand is expected to pick back up to more normal levels. New Zealand is also expected to see stronger per capita GDP growth over the next few years.
- GDP growth in **New Zealand** is forecast to accelerate to 2.4% by the end of 2025 and 3.1% in 2026, underpinned by the large cuts in the OCR. Increases in commodity export prices are also boosting incomes and spending.
- The **Australian** economy is expected to grow 2.0% in 2025 and 2.2% in 2026. Public sector spending, which boosted demand over the past year, is slowing with fiscal pressures constraining public sector investment plans. The handover of growth from public demand to the private sector as interest rates decline has been gradual to date.
- New Zealand's sharper downturn over the past year means that our economy has a much greater degree of spare capacity than Australia. That difference is set to persist for some time, even with the forecast recovery in growth. That difference in the underlying strength of economic conditions is most clearly evident in the labour market, with New Zealand's unemployment rate well above average, while unemployment in Australia remains relatively low.

GDP growth



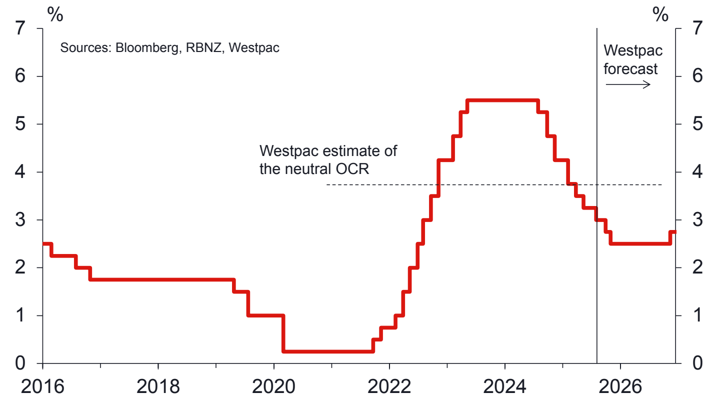
Per capita GDP growth (December years, constant prices)



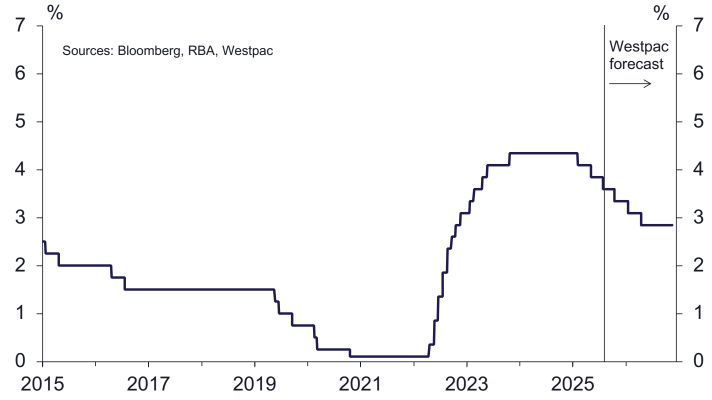
MONETARY POLICY

- Both the Reserve Bank of New Zealand (RBNZ) and Reserve Bank of Australia (RBA) cut their policy rates 25bps at their most recent policy meetings in August. Further rate cuts are expected on both sides of the Tasman over the next few months, with New Zealand heading deeper into stimulatory territory.
- Following an aggressive tightening cycle in the wake of the pandemic, **New Zealand's** Reserve Bank has cut the OCR by 250bps over the past year, taking it to 3.00%. Westpac estimates that the neutral level of the OCR is around 3.75%, and cuts over the past year have taken the cash rate into mildly stimulatory territory. **We expect two more 25bp rate cuts before the end of this year**. Around 90% of mortgage lending in New Zealand is on fixed rates, so interest rate changes take around 12 to 24 months to pass through to the economy (In comparison, only around 10 to 15% of Australian mortgage lending is on fixed rates).
- In **Australia**, the RBA's tightening cycle in recent years was less pronounced than the approach taken by the RBNZ. That reflected Australia's higher inflation target (2.5% midpoint vs 2% in NZ), a higher proportion of floating rate lending, and an increased focus on preserving employment in the Australian case.
- The pace of interest rate cuts in Australia has also been more gradual, with the RBA having only cut the cash rate 75bps since the start of this year. At 3.60%, Australia's cash rate remains a little above the estimated neutral level of 3.50%. We expect a further 75bps of easing over the coming year.

RBNZ Official Cash Rate



RBA cash rate



INFLATION

After dropping back over 2024, headline inflation on both sides of the Tasman is set to pick up again over the coming year. Under the surface, core inflation is easing in both countries, but is expected to be softer in Australia.

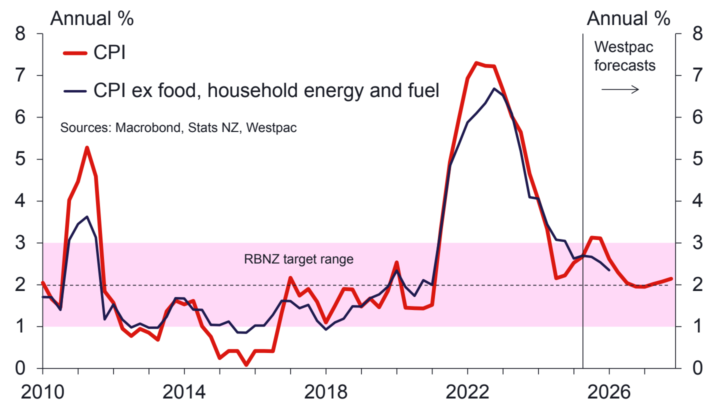
New Zealand.

- After dropping to 2.2% last year, inflation in New Zealand picked back up to 2.7% in the year to June. And over the coming months, higher food prices will push overall inflation back up above 3%.
- While the various measures of core inflation have been easing, they are set to linger above the 2% midpoint of the RBNZ's target band. Domestic inflation has been cooling only gradually, with continued large increases in administered charges like local council rates. At the same time, while tradables inflation remains low, prices are no longer falling like they did last year.

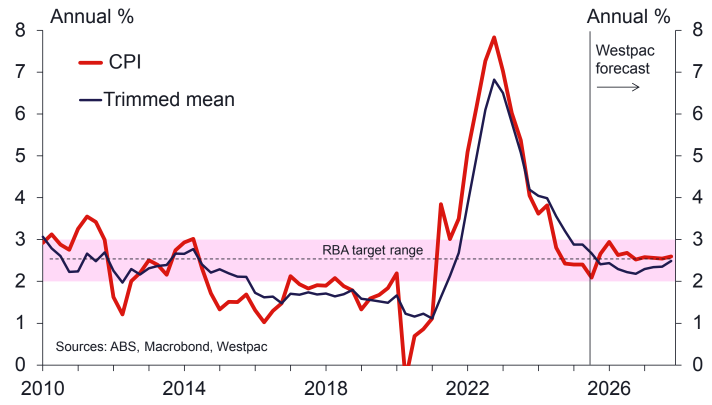
Australia.

- Headline inflation in Australia was pulled lower over the past year by policy measures which temporarily reduced household energy costs.
- But while headline inflation will pick up again as these earlier support measures expire, core inflation is set to continue cooling and is forecast to drop into the lower part of the RBA's 2-3% target band over 2026.

New Zealand headline and core inflation



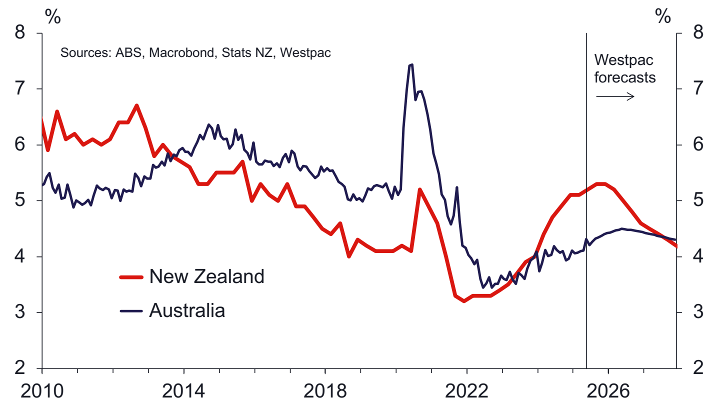
Australia headline and core inflation



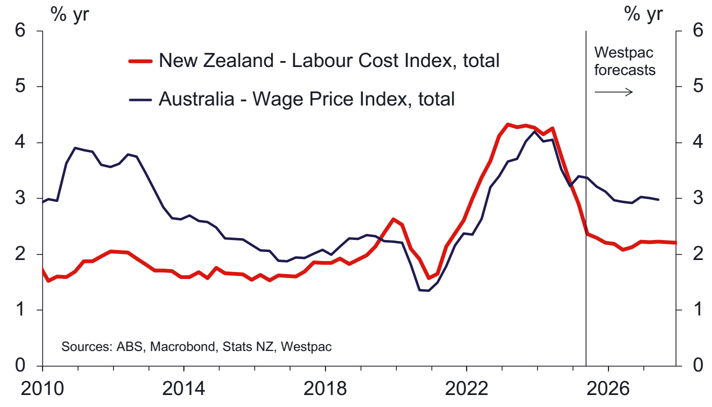
LABOUR MARKET

- Australia's labour market has held up better than New Zealand's over the past year, with stronger growth in both jobs and wages. That's consistent with the less aggressive tightening of interest rates in Australia in recent years and the related resilience in demand.
- While economic growth is forecast to be stronger in New Zealand than in Australia, our labour market is expected to remain softer for some time. That reflects the firmer economic conditions in Australia, which are continuing to support the labour market even as growth cools.
- Employment in **New Zealand** fell by 0.9% over the past year and unemployment has risen to 5.2% – above the long-run trend of around 4.5%. A further rise in unemployment to around 5.3% is expected over the coming months. Jobs growth is expected to pick up over 2026 as economic growth lifts. New Zealand has also seen a stark slowdown in wage growth over the past year, with only modest wage growth of around 2% expected over 2026.
- **Australia's** labour market has generally remained resilient over the past year, with employment levels rising by 2.3%. The labour market is expected to soften over the coming year, with unemployment forecast to rise from 4.2% to 4.5% – a little above trend levels. Wage growth has dropped back from its earlier highs, with some further moderation expected over the coming year. Even so, wage gains in Australia are expected to continue outpacing those in New Zealand.

Unemployment



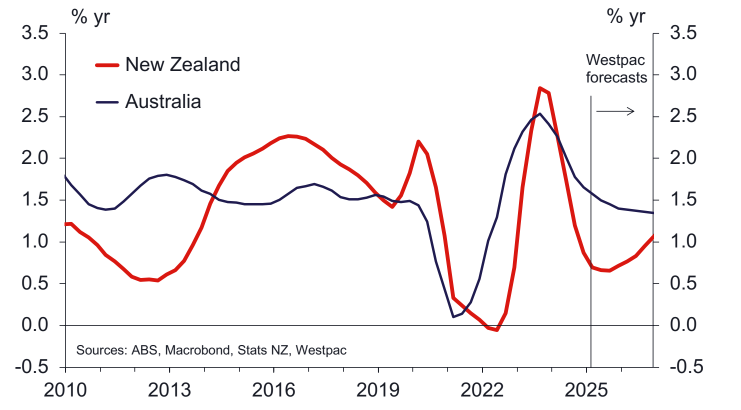
Wage growth



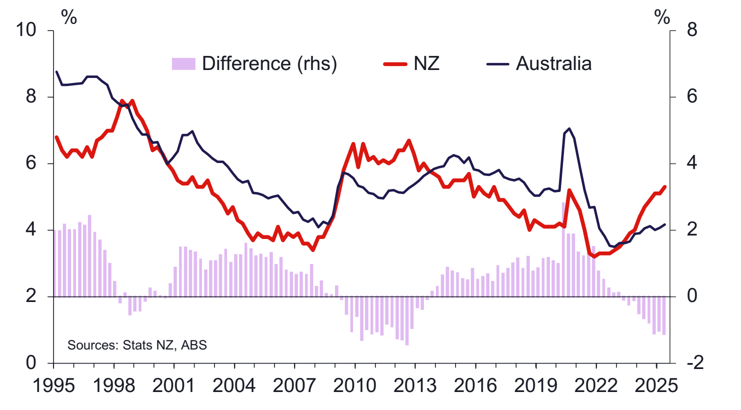
POPULATION GROWTH

- In the past year, both net migration and population growth in New Zealand have fallen to low levels, whereas Australian population growth has slowed less markedly.
- Recent low population growth in New Zealand largely reflects the trends in economic growth and the labour market. With less favourable employment opportunities, New Zealand has been less attractive for migrants and increasing numbers of New Zealand residents have moved abroad.
- Many of those who have departed our shores in recent years have headed to Australia. That reflects Australia's stronger labour market and the relatively unrestricted ability to move between our countries.
- Much of the increase in outflows from New Zealand, including the increase in outflows to Australia, is the flipside of the large increase in migrant arrivals in previous years. Many of them entered New Zealand on temporary work visas, and they are now returning home or seeking employment opportunities elsewhere.
- Net outflows to Australia have stabilised in recent months, and they are expected to revert to more normal levels over the coming year as economic activity in New Zealand gradually recovers.

Population growth



Relative unemployment rates currently in Australia's favour



HOUSEHOLDS AND BUSINESSES

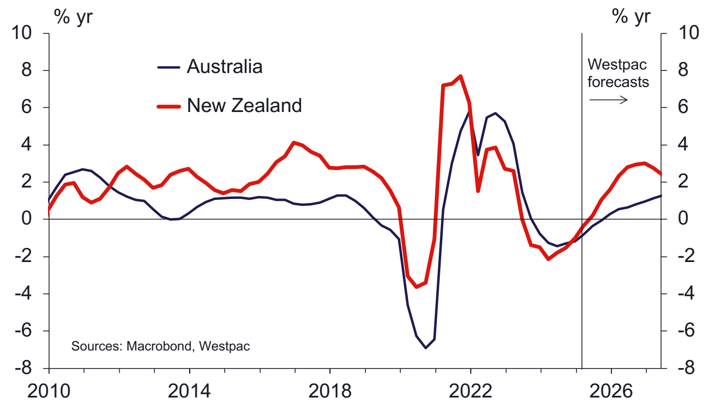
Households.

- In both Australia and New Zealand, household spending has slowed sharply over the past year. Households on both sides of the Tasman have been confronted by continued cost of living increases, as well as other financial headwinds.
- Over the coming year, spending growth is expected to lift in both countries. However, New Zealand is expected to see stronger growth, consistent with the more pronounced easing in interest rates and likely faster recovery in economic growth.

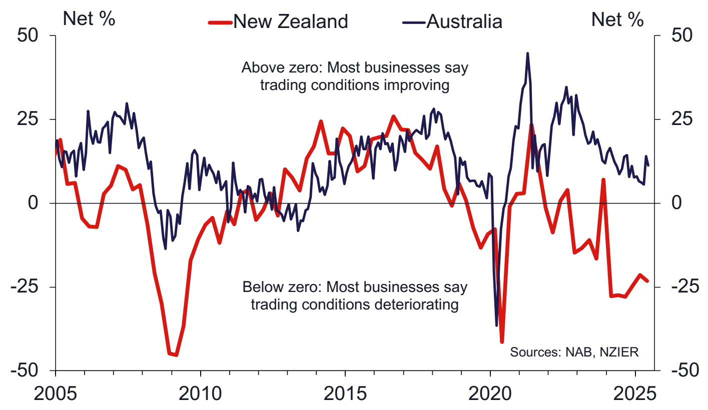
Businesses.

- Recent business surveys have shown a downturn in trading conditions in both New Zealand and Australia. Conditions have been weaker in New Zealand. That's been reflected in weaker investment spending and hiring.
- Business confidence is higher in New Zealand than in Australia, with interest rate reductions adding to expectations for a recovery in activity over the coming year.

Per capita household spending growth



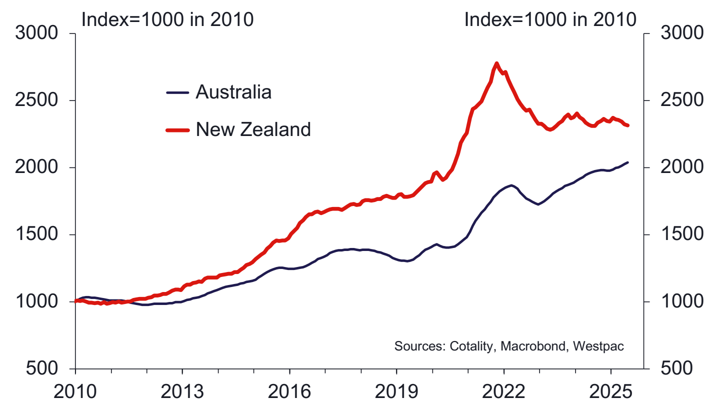
Business conditions



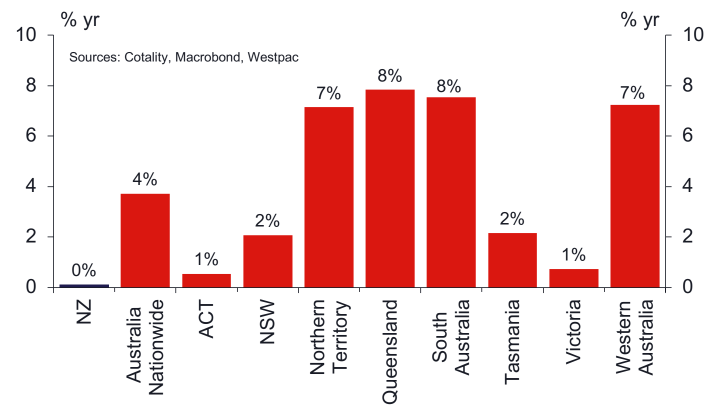
HOUSING MARKET

- Over 2020 and 2021, house prices in New Zealand rose by an average of 40%, while in Australia average prices rose by around 30%. However, since that time, there have been significant differences in the housing markets on each side of the Tasman.
- In **New Zealand**, prices fell around 17% from their peak as interest rates rose, and for the past few years prices have been tracking sideways. While lower interest rates have boosted affordability and sales, there has also been an increase in the number of properties available for sales. Existing owners who had been on the sidelines in recent years have been bringing properties to market. At the same time, despite the current slowdown, new home building has remained at a relatively high level compared to history. The downturns in the labour market and population growth will also have weighed on prices.
- **Australia's** housing market has been more resilient than New Zealand's, with more modest falls in prices in the wake of the pandemic and firmer growth over the past year (though there have been differences across states). Australia also saw a more moderate run-up in prices in the decade leading up to the pandemic.
- While firmer than in New Zealand, recent housing market momentum in Australia has been modest compared to historic trends. The high starting point for prices and gradual pace of interest rate easing to date means that affordability remains constrained for many potential buyers.

Nationwide house prices



House price growth - past 12 months



FISCAL POLICY

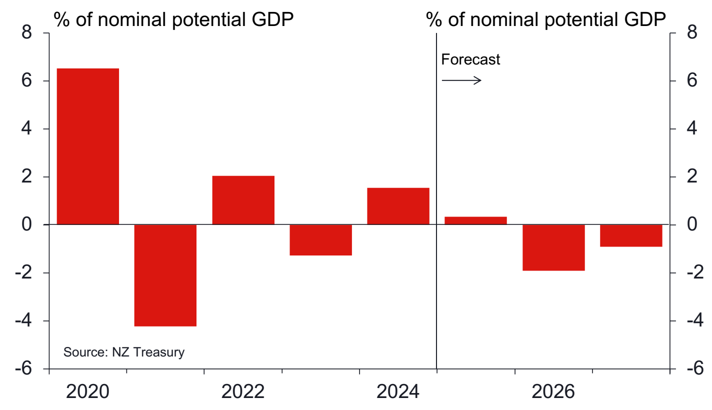
New Zealand.

- Ongoing restraint in spending means that fiscal policy in New Zealand will shift from being the modest boost to growth that it was in recent years, to a drag over 2026 and 2027. Even with that restraint, however, net debt is set to remain above the Government's long run target range of 20% to 40%.

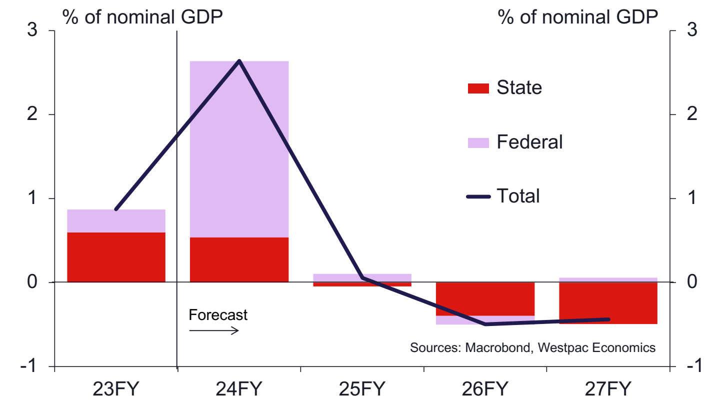
Australia.

- Large increases in spending by the Federal and state governments provided a significant boost to demand in Australia over the past few years. That included increases in spending on public services and infrastructure, as well as cost of living support measures. However, much of that spending was financed through debt.
- Fiscal policy is set to become a drag on growth. Increases in spending are expected to be much more modest over the coming years, and cost of living support measures are being wound back. In addition, states' growing interest bills are limiting the scope for increases in new spending.

New Zealand Government fiscal impulse



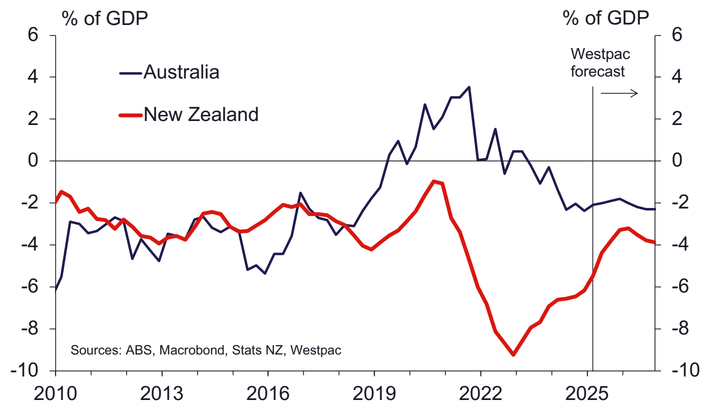
Australian Federal and State fiscal impulse



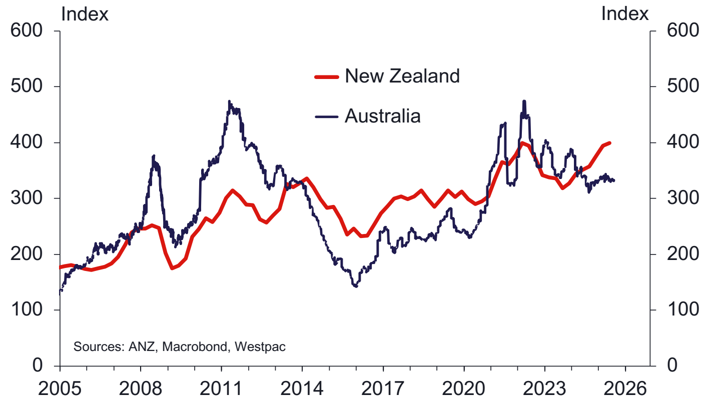
TRADE

- Both New Zealand and Australia are export-oriented economies. Australia's focus on hard commodities (in contrast to New Zealand's focus on food and consumer exports) has helped to underpin stronger growth in its export earnings in recent years. But while Australia continues to enjoy a stronger trade position than New Zealand, that advantage has reduced and is set to narrow further over the next few years, with demand for hard commodities easing while global demand for dairy and other food products remains firm.
- **Australia** recorded a trade deficit of around 2% of GDP in the year to March. That's a reversal of the improvement seen in recent years, when increases in hard commodity prices saw Australia's trade balance rising to a surplus between 2019 and 2021. Over the next few years, Australia is expected to continue recording trade deficits as cooling global demand, especially from China, weighs on hard commodity prices.
- **New Zealand's** current account deficit narrowed to 6% of GDP in the March quarter (compared to a peak of 9% in 2022). New Zealand's trade deficit is expected to continue shrinking to around 4% of GDP over the coming year, underpinned by firm demand and prices for our key commodity exports, including dairy products. The continuing recovery in international tourist numbers will also boost export earnings.

Current account balance



Commodity price indices (USD)



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