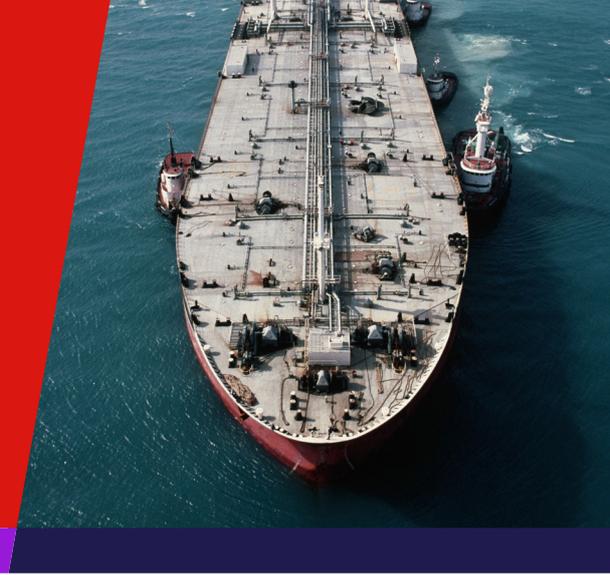




ECONOMIC BULLETIN

Forecast update, March 2026.



25 Mar 2026 | Kelly Eckhold, Chief Economist | +64 9 348 9382 | +64 21 786 758 | kelly.eckhold@westpac.co.nz

Inflation up, growth down, OCR on hold.

- We are updating our forecasts to reflect the growing impacts of the Iran war on the New Zealand economy.
- We have increased our assumptions of where oil and especially refined product prices will peak. But we still (optimistically) assume that oil market disruptions ease in around a month's time and prices fall gradually from there.
- We now see a hole in economic growth in the middle of 2026, with a recovery from the second half of the year. Growth for 2026 is revised down to 1.9%.
- The labour market will again be weak through the middle of the year, with unemployment peaking at 5.6% and ending 2026 at 5.4%. This will crimp the recovery in household spending and the housing market.
- House prices are now expected to fall by around 0.9% over 2026. Sharply weaker confidence, employment and GDP growth will drive that weakness.
- Higher energy prices imply another significant upward revision to our inflation forecast, which is now expected to peak at 4.1%. Inflation is set to linger well above the levels the RBNZ had previously assumed for all of 2026.
- We continue to see the Official Cash Rate as on hold until late this year. While inflation will lift in 2026, it will reverse course in 2027. In the interim, excess capacity in the economy will grow.

The Iran war is expected to significantly crimp the previously expected recovery.

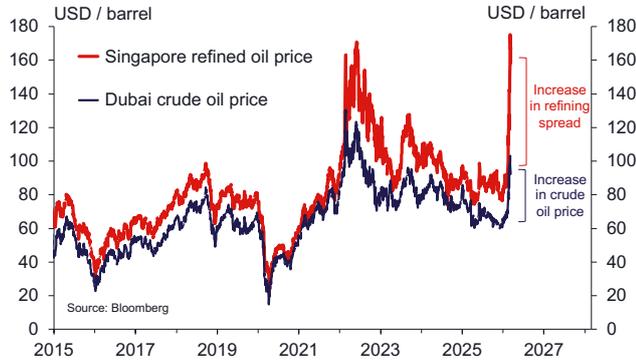
The Iran war has not moderated in the last couple of weeks and in some sense the pressure on the New Zealand economy has intensified as early hopes of a fast resolution and quick return to global economic normality have waned. We can't say with any certainty when the conflict will end. But we now think it will be at least another month until we see tangible signs of an end to the war with the possibility of more normal service to the global oil markets returning.

Crude oil prices have remained volatile but refined fuels markets have continued to tighten as the flow of crude oil around the world has now been constrained for more than three weeks. Damage to infrastructure in the Persian Gulf has accumulated which means that even if the war ended tomorrow, the path to normality will take some time. At the time of writing crude oil prices are modestly higher than where they sat last week when we made a first cut at impounding the Iran war shock into our forecasts. But refined fuels spreads are wider and capacity at the Asian refineries where we and our trading partners access fuel has declined. Hence pressure has built on the economic outlook from the tightening in refined fuels markets.

We continue to assume that the Iran war eases in around a month and that crude oil and refined fuels prices will gradually ease over the rest of 2026. Crude oil prices are expected to drop back to around pre-war levels by the start of 2027. However, refined fuels prices remain elevated compared to levels seen a few months ago as we expect some element of a war risk premium to remain, and damage to infrastructure may take time to repair. That means inflation in New Zealand will likely linger at elevated levels for much of this year.

Crucially for the domestic and global economy, the Iran War will have damaged confidence in the household and business sectors and will be prompting changes in spending and investment plans given people have no real idea on when conditions will improve. Hence output losses are likely globally, and New Zealand will not be left out of that.

Oil prices



GDP growth.

We've pulled down our forecast for GDP growth over 2026 to 1.9% (from 2.8% previously).

In the very near term, we've pencilled in a fall in quarterly GDP of 0.4% in the June quarter. That's mainly due to an expected drop in household spending in response to increases in living costs and related falls in consumer confidence. Those headwinds will not be significantly offset by the Government's support package targeting lower income households.

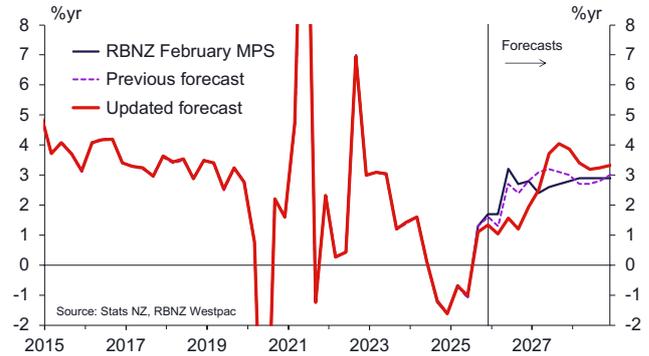
We also expect weakness in investment spending over the coming year, with some businesses likely to delay major capital spending in response to the increased uncertainty about the outlook for economic growth and the near-term downturn in demand that may be experienced in some industries.

The most direct impact of the shock on exports will be felt in the tourism sector, with the recent strong growth in international arrivals likely to be reversed for a period due to a combination of flight disruptions, much higher airfares and perhaps consumer reluctance to travel long distances. The economic impact will be partly mitigated by fewer New Zealanders choosing to holiday abroad. At this stage we have made no major changes to our forecasts for the volume of merchandise trade. As is usually the case in New Zealand, weaker global growth is likely to manifest mostly through lower prices, rather than lower volumes.

Growth is expected to pick up again next year as the eventual fall in oil prices boosts households' disposable incomes. However, the recovery in investment spending is expected to be more gradual, with businesses likely to

remain cautious about major capital expenditure until they are confident that the recovery is entrenched.

GDP growth forecasts

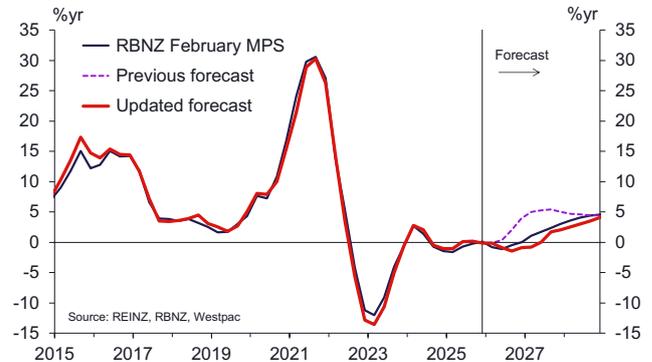


Housing.

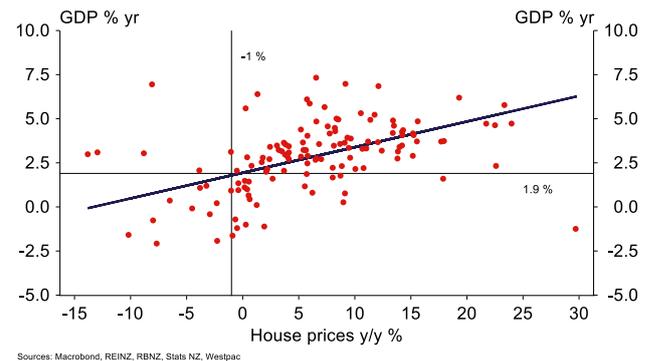
We now expect house prices to fall around 1% over 2026. House price growth has already been muted in recent months. And in the wake of the Middle East conflict, recent weeks have seen a lift in global bond rates, along with related upward pressure on local mortgage rates. Combined with a downturn in economic growth and a weaker labour market, that's likely to see buyers stepping back from the market.

Further ahead, we expect a return to more moderate rates of house price growth.

House prices



House prices growth versus GDP growth

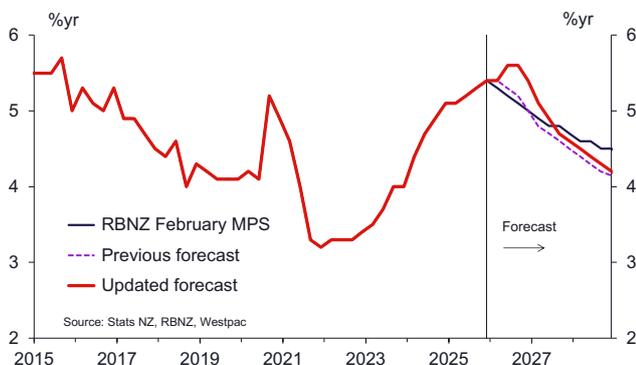


Labour market.

We now expect unemployment will rise from 5.4% currently to 5.6% in the middle of this year, before easing back gradually (previously, we expected that 5.4% would be the peak in unemployment in this cycle). With a softer outlook for economic growth, businesses are likely to remain cautious about taking on new staff, and some firms may shed workers.

With weakness in activity and the jobs market, the overall level of wage inflation is expected to remain moderate in the near term (though some workers with specialised skills may be able to negotiate larger pay increases in response to the rise in living costs). Longer term, as the economy recovers, we may see demands for larger cost-of-living adjustments to wages as workers try to claw back the loss in their purchasing power.

Unemployment

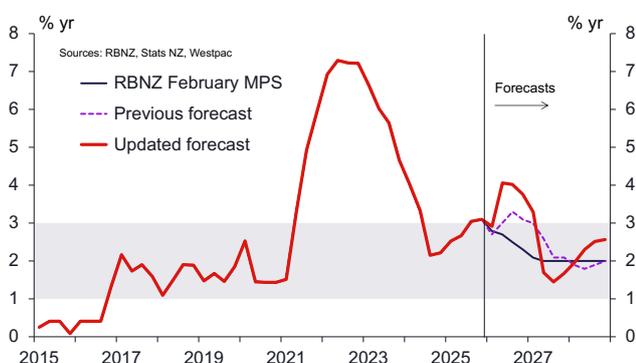


Inflation.

We now expect that inflation will peak at 4.1% in mid-2026, and that it will remain above 3% through the first quarter of 2027. That is up sharply from our previous forecasts, which assumed a peak in inflation of around 3.2%.

Importantly, inflation is set to linger well above the levels the RBNZ had previously assumed for all of 2026.

Inflation forecasts



Underpinning the lift in our inflation forecast has been the dramatic rise in crude oil prices since the start of the war, along with the related lift in refining spreads. Those

developments have pushed domestic petrol and diesel prices sharply higher in recent weeks.

Higher oil prices will also add to the cost of many other goods and services. That includes higher costs for passenger transport services, like airfares and ride-share charges. However, the impacts of higher oil prices and the related disruptions to transport will be felt across a range of sectors, including groceries and construction. In some cases, such as higher costs for fertilizer, the impact of those disruptions could extend over several quarters.

When oil prices do eventually drop back, inflation is expected to fall to levels that are lower than we previously assumed (a pattern that is often seen in the wake of oil price spikes). In our updated projections, inflation is expected to briefly dip below 2% in late-2027, before rising back up to around 2.3% further ahead.

The extent of the current uplift in inflation signals upside risk for inflation expectations and business price setting behaviour. In the near term, any uplift in output prices will be moderated by the softness in activity. However, when activity recovers, we expect some firms will attempt to rebuild margins, while workers are likely to ask for larger wage increases to offset the erosion of their purchasing power.

Should oil prices fall back more rapidly than we've assumed, we're still likely to see inflation lingering above 3% this year. That's due to the lift in fuel prices that have already occurred and related impacts on cost of production. The impact of some disruptions to supply chains will take several months to resolve even if oil prices drop faster than we've assumed.

Fiscal position.

Our revised economic outlook also has implications for the Government's fiscal position.

On the revenue side, the outlook for growth in real activity is weaker than forecast previously. However, tax revenue is driven by nominal activity. So, while tax revenues in 2026/27 are likely to be lower than we forecast previously, a combination of higher inflation and a non-inflation-indexed tax system means that tax revenues from 2027/28 onwards are likely to be in line with or even slightly higher than the forecasts we had made in our February Economic Overview.

On the spending side, transfer costs will rise due to the wage indexation of NZ superannuation and CPI indexation of other main benefits (for a period, beneficiary numbers will also be higher than we had expected in February due to a higher unemployment rate forecast). We continue to forecast higher debt financing costs than the Treasury due to our higher forecast for interest rates. This is now compounded by the need to fund higher deficits in the near-term. For now, we continue to assume that the Government will manage within the previously

announced \$2.4bn per year operating allowances for new discretionary spending.

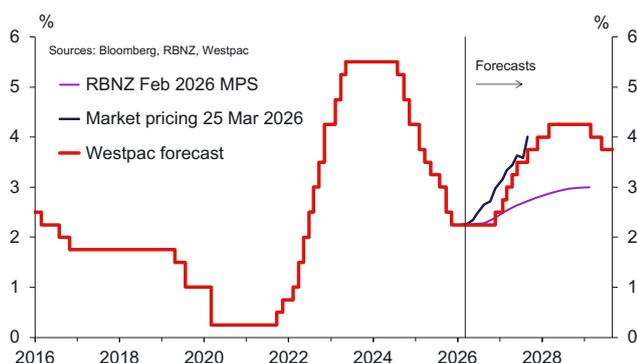
The bottom line is that the OBEGALx deficit in 2026/27 is now likely to be around \$4bn larger than we had forecast previously. The deterioration in subsequent years is much less, reflecting the forecast bounce back in the economic growth and the impact of a higher path for the level of wages and prices on tax revenue. A surplus would still be achievable in 2029/30, but the cumulative deficit over the forecast period would be around \$7-8bn higher than forecast previously, with net core Crown debt peaking at around 46% of GDP.

It is worth noting that our February forecasts were more optimistic than the Treasury forecasts that underpinned the Half-Year Economic and Fiscal Update (HYEFU). As a result, our revised forecast for the OBEGALx deficit in 2026/27 is only around \$1bn larger than the HYEFU forecast. However, we think it is likely that the Treasury will revise down its HYEFU forecast – and possibly remain relatively pessimistic – so that Budget 2026 could show an OBEGALx deficit in 2026/27 that is around \$2-3bn larger than forecast previously. This will flow through to the forecast bond programme.

Monetary policy.

Even with a significant near-term rise in inflation, we expect the RBNZ will remain on hold until the end of this year. That's in contrast to market pricing, which is consistent with rate hikes beginning in July, and at least two hikes before year's end.

Official Cash Rate forecasts



RBNZ Governor Breman noted in her recent speech that the RBNZ is likely to look through the immediate uplift in inflation resulting from the oil price spike. Higher interest rates cannot offset an uplift in oil prices that has already occurred. Furthermore, given the long lags between interest rate changes and changes in inflation (usually around 12 to 18 months), tightening policy now could dampen growth at the same time as inflation will be coming down.

The economy's starting point is also important here. In contrast to some of our peers, such as Australia,

New Zealand has seen weak GDP growth over the past year and already has high levels of unemployment. Those conditions will limit any near-term lift in other prices and wages in the face of the oil price shock.

However, there are larger questions around the longer-term outlook for policy, and we do expect that the RBNZ will begin to hike the OCR from the December quarter. When the shock passes and spare capacity begins to be eroded, we do see a risk that businesses will attempt to rebuild margins. There could also be demands for larger cost-of-living adjustments to wages if petrol and other prices settle noticeably above pre-shock levels. That upside risk for longer term inflation expectations and price setting behaviour is a key risk that Governor Breman highlighted in her speech. As a result, surveys and other evidence of pricing behaviour will warrant close attention over the coming months.

We need to remember that with an OCR of 2.25%, the real OCR will be negative for the next year or so. Reasonable people will differ on how much inflation expectations might shift in this shock. But the balance of risks lies firmly towards a need to normalise the OCR once the shock has passed. Global interest rates may also rise in coming years if inflation does remain entrenched around the world. Hence there are risks to the New Zealand dollar should real interest rates remain too low for too long in absolute terms and relative to our global peers. Disinflation could prove hard to sustain through 2027 if the exchange rate does weaken.

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March 2026 revised forecasts

Economic indicators	Quarterly % change				Annual % change			
	Mar-26	Jun-26	Sep-26	Dec-26	2024	2025	2026	2027
GDP	0.8	-0.4	0.5	1.0	-1.6	1.3	1.9	3.9
GDP (annual average)	-	-	-	-	-0.3	0.2	1.5	3.5
Consumer price index	0.8	1.6	1.0	0.4	2.2	3.1	3.8	1.7
Employment change	0.2	0.0	0.3	0.7	-1.3	0.2	1.2	3.1
Unemployment rate	5.4	5.6	5.6	5.4	5.1	5.4	5.4	4.6
Labour cost index (all sectors)	0.5	0.6	0.7	0.6	3.3	2.0	2.3	2.2
Current account balance (% of GDP)	-3.7	-3.8	-3.8	-3.5	-4.7	-3.7	-3.5	-3.4
Terms of trade	-0.3	-0.5	3.7	1.5	8.9	3.5	4.4	3.4
House price index	0.4	-0.3	-1.3	0.2	-1.0	-0.1	-0.9	2.0

Financial forecasts	End of quarter				End of year			
	Mar-26	Jun-26	Sep-26	Dec-26	2024	2025	2026	2027
Official Cash Rate	2.25	2.25	2.25	2.50	4.25	2.25	2.50	4.00
90 day bank bill	2.45	2.45	2.50	2.90	4.45	2.52	2.90	4.25
2 year swap	3.30	3.60	3.85	4.10	3.64	2.71	4.10	4.40
5 year swap	3.90	4.10	4.20	4.30	3.73	3.27	4.30	4.45
10 year bond	4.75	4.80	4.95	4.95	4.50	4.27	4.95	5.10
TWI	66.9	66.5	67.8	68.9	69.5	66.4	68.9	72.5
NZD/USD	0.59	0.59	0.61	0.62	0.59	0.57	0.62	0.67
NZD/AUD	0.82	0.82	0.84	0.85	0.91	0.87	0.85	0.91
NZD/EUR	0.51	0.50	0.51	0.52	0.55	0.49	0.52	0.55
NZD/GBP	0.44	0.44	0.44	0.45	0.46	0.43	0.45	0.48

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