WEEKLY ECONOMIC COMMENTARY

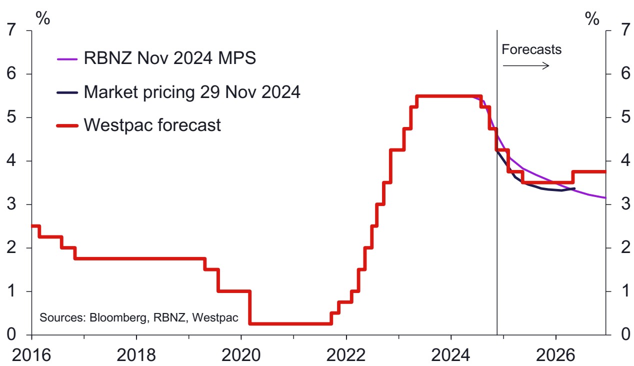
2 Dec 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Frontloading

The RBNZ cut the OCR by 50bps in November to 4.25%, as was widely expected. The Governor and his team have indicated this decision was made without a need to seriously consider alternatives, reflecting a strong consensus within the Monetary Policy Committee (MPC).

As **discussed in our review of the meeting**, the RBNZ's short-term OCR profile was revised downwards as expected. The RBNZ now projects the OCR to end 2025 at 3.55%, which was broadly in line with our pre-meeting expectation. The longer-term OCR profile has been adjusted upwards by around 10bp such that the OCR is now expected to bottom out closer to 3.1%. This adjustment reflects an upward revision to the RBNZ's estimate of the long-run neutral interest rate to 2.9% (other neutral rate estimates in the RBNZ's indicator suite were unchanged).

Official Cash Rate forecasts

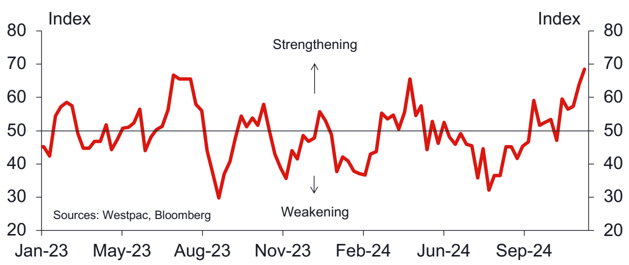


The RBNZ's very short-term OCR projection for the February meeting was lower than expected and implies a greater-than-even chance that it will cut the OCR by 50bp at the February 2025 meeting – an implication that the Governor (and other MPC members) have confirmed in their post-meeting interviews. Given the RBNZ expects to cut the OCR by a total of 75bp over all of 2025, this

Key views

	Last 3 months	Next 3 months	Next year
Global economy	→	→	↗
NZ economy	↘	→	↑
Inflation	↘	→	→
2 year swap	→	→	↗
10 year swap	→	→	↗
NZD/USD	↘	→	→
NZD/AUD	↘	↘	↘

Westpac New Zealand Data Pulse Index



Key data and event outlook

Date	Event
5 Dec 24	Govt financial statements, 4 months to October
10 Dec 24	RBA Monetary Policy Decision
16 Dec 24	NZ Selected price indexes, November
17 Dec 24	Half-Year Economic and Fiscal Update
18 Dec 24	FOMC Meeting (Announced 19 Dec NZT)
19 Dec 24	NZ GDP, September quarter
14 Jan 25 (tbc)	QSBO business survey, December quarter
16 Jan 25	NZ Selected price indexes, December
22 Jan 25	NZ CPI, December quarter
29 Jan 25	FOMC Meeting (Announced 30 Jan NZT)
5 Feb 25	Labour market statistics, December quarter
13 Feb 25	RBNZ Survey of Expectations, December quarter
14 Feb 25	NZ Selected price indexes, January
18 Feb 25	RBA Monetary Policy Decision

represents an unusual degree of front-loading of the remaining easing cycle.

The RBNZ's near-term macro forecasts for key variables such as non-tradable inflation, GDP, and the unemployment rate have been adjusted as expected and map closely to our own projections.

The RBNZ has significantly revised down its estimates of potential output by increasing emphasis on recent weaker trends in population and productivity growth. Consequently, the output gap has been revised upwards by more than what would be implied by the starting point error on Q2 GDP. Hence the RBNZ sees less spare capacity in the economy than previously, which supports their view that non-tradable inflation will be stickier and the terminal OCR somewhat higher than thought in August.

RBNZ's monetary policy strategy.

Beyond 2025, further cuts in the OCR to 3-3.25% are implied for 2026/27, but these are further out and reflect technical assumptions on the evolution of inflation expectations. In practice, the easing cycle effectively ends by mid-2025.

The MPC justifies the front-loading strategy as it has confidence that pricing behaviour will quickly normalise, and hence the MPC wants to push the OCR towards the neutral rate relatively quickly now that inflation is around 2%.

Communications.

The RBNZ has been unusually explicit about the size of the next move and seems to be setting a high bar for any deviation from the expected 50bps cut in February.

The Governor indicated he saw the neutral OCR as likely in a 2.5-3.5% range, although the range implied by the RBNZ's indicator suite suggests a range of 2.9-3.6%. We suspect there are a range of views within the MPC on where the neutral OCR lies and the performance of the economy from here will be the deciding factor. Nevertheless, by indicating that after February the OCR will be cut more slowly, they are acknowledging that the neutral rate may be close.

Risks and issues to watch.

We see three key issues as relevant in determining the degree of front-loading of RBNZ easing in 2025. A key issue will be evidence on how quickly pricing behaviour is normalising. Relevant to this will be the Q4 CPI (22 January), pricing indicators in the QSBO (around 14 January), and wage data (5 February). A second issue will be the strength of the response of the economy to OCR cuts. Relevant here will be the QSBO and monthly housing, credit and consumer spending data. A third issue will be the performance of the labour market as this will give the cleanest read on the extent of spare capacity in the economy. Relevant data include monthly filled jobs, Q4 labour market reports (5 February), and the QSBO and ANZBO business surveys.

Kelly's take.

I think the RBNZ's assessment of the neutral rate is too low and hence little further easing will be required after early 2025. I see significant downside risk to the exchange rate which will likely limit the scope for the RBNZ to ease too far in 2025 while global interest rates remain elevated. Nevertheless, the RBNZ has a strong presumption of a 50bps cut in February which makes this the most likely outcome. Currently I assess the odds of a 25bp cut vs a 50bp cut as a 40:60 proposition. Cuts of 75bps are off the table in the absence of a new negative shock. I expect the easing cycle to conclude by mid-2025, assuming no new economic shocks. If the RBNZ has underestimated the level of the neutral OCR significantly then there is a risk the RBNZ over-eases in 2025, potentially setting up the next tightening cycle in 2026.

Recent economic news.

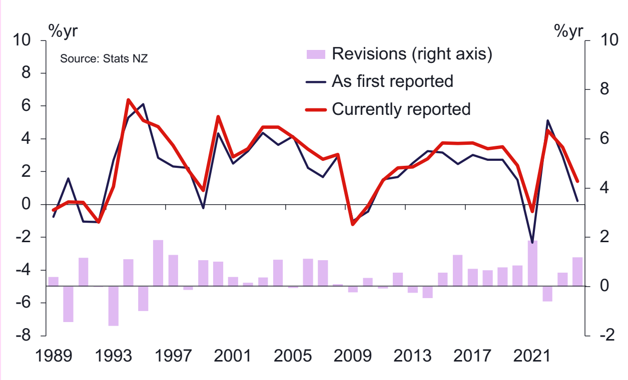
Economic news over the past week pointed to continued softness in economic growth through the back half of 2024. Notably, the latest retail sales report showed that, excluding spending on fuel and vehicles, the volume of goods sold fell 0.8% in the three months to September. In addition, the number of filled jobs fell by 0.1% in October, following similar sized declines in the past two months. But while we have seen continued softness in activity in recent months, there are signs that the economy is bottoming. For instance, a net 10% of firms in the November ANZBO survey reported that their activity was down on the same time last year – still soft, but the gap is closing compared to the net 24% who were behind the pace in July. That chimes with the feedback we heard during our recent travels around the country. Looking forward, confidence in the economic outlook is continuing to firm on the back of falls in interest rates. In the business sector, the number of businesses who expect trading activity will firm over the coming year has risen to around a 10-year high. Consumer confidence has also been climbing, with households expecting better economic conditions over the year ahead. Overall, the balance of recent data is consistent with our expectations for soft growth over the remainder of 2024, giving way to a gradual recovery over 2025.

Kelly Eckhold, Chief Economist

Chart of the week.

Last week Stats NZ provided a preview of its revisions to the recent history of GDP growth, which will be published along with the September quarter GDP release later this month. The pace of growth has been revised up substantially for both the March 2023 and March 2024 years, indicating a more moderate slowdown in the economy and a higher level of labour productivity than previously believed. In fact there has been a long-running tendency for GDP to be revised higher over time – going back to the start of the current GDP series in 1987, the annual growth rate has been revised up by 0.5%yr on average, relative to its initial release. What's more, larger upward revisions tend to occur after periods of strong net migration and vice versa, suggesting that the GDP figures are initially slow to pick up on changing trends in population growth.

Annual GDP growth has been revised higher again

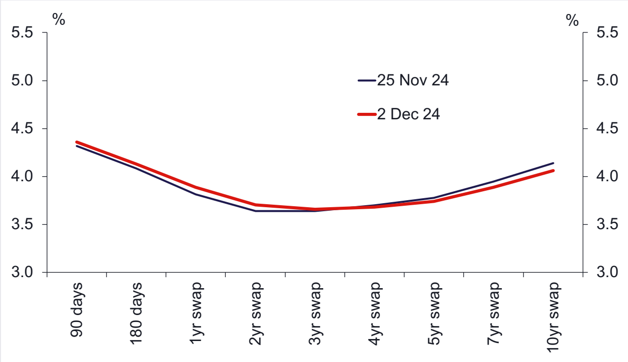


Fixed versus floating for mortgages.

The RBNZ followed up August's 25bp cut in the OCR with a supersized 50bp cut at its October policy review. We expect another 50bp cut at the November review, with further, but more gradual, cuts in 2025.

A significant amount of OCR easing is already factored into longer-term mortgage rates. This suggests that it's now more attractive to fix for longer periods than it has been for a while – perhaps even for terms as long as two to three years. Mortgage rates for shorter terms of up to a year are substantially higher now but are likely to fall in the coming months towards current longer term fixed rates.

NZ interest rates



Global wrap

U.S.

The FOMC's November minutes noted recent data were "consistent with inflation returning sustainably to 2%." However, they stressed that policy was not on a predetermined course and that the easing cycle could be paused if inflation remained elevated or accelerated if the labour market turned down. Several FOMC members noted that uncertainties concerning the neutral level of interest rates meant it was appropriate to ease policy gradually. On the data front, the core PCE deflator remained firm in October at 2.8%yr. There was also a solid rise in incomes, though real spending growth was soft. Turning to politics, President-elect Trump announced plans to add a 25% tariff on all imports from Canada and Mexico and an extra 10% on goods from China, though such measures are likely to be a bargaining chip in trade negotiations. The highlight of this week's data calendar will be Friday's payrolls report which is expected to show a 180k rise following last month's weather-affected weakness. We'll also get a range of survey measures of business conditions and hear from several Fed speakers.

Europe.

Eurozone inflation rose to 2.3% in the year to November, with core inflation remaining at 2.7% for a third month. Although inflation remains above 2%, recent comments from ECB members have been supportive of further rate cuts. In particular, Chief Economist Lane noted that, while policy is not on a predetermined path, it should gradually ease over time to support growth and avoid an undershoot of the inflation target.

Asia-Pacific.

In a speech last week RBA Governor Bullock reiterated that inflation remained too high for the Board to consider near-term policy cuts, that the labour market remains tighter than consistent with inflation meeting the target, and that policy in Australia is significantly less restrictive than in other major advanced economies. Consistent with the concerns raised in that speech, October's inflation update pointed to firm underlying price pressures. While headline inflation remained at 2.1% for the year to October, annual trimmed mean inflation rose to 3.5% from 3.2% previously. Over in China, October's industrial profits data remain soft, but pointed to a stabilising (rather than deepening) downturn. Similarly, the November's PMIs indicated that growth remained subdued. This week's calendar includes updates on Australian retail sales (Monday), the current account (Tuesday) and GDP (Wednesday) which we expect will show a 0.5% rise over the quarter. PMIs for economies in Asia are also out this week.

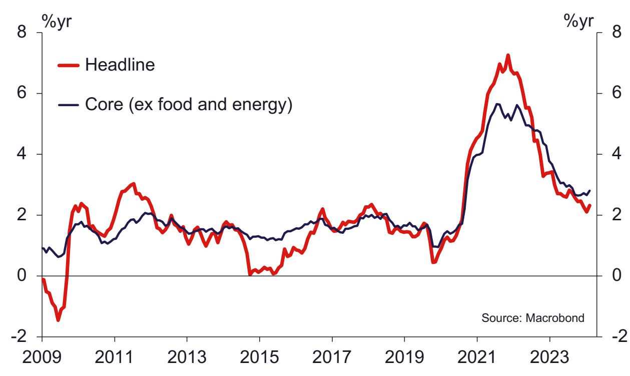
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.0	1.3	2.2	2.4
China	5.2	5.0	4.8	4.5
United States	2.9	2.7	2.3	2.0
Japan	1.9	0.1	1.1	0.9
East Asia ex China	3.3	4.2	4.1	4.1
India	7.8	7.0	6.8	6.5
Euro Zone	0.4	0.6	1.5	1.5
United Kingdom	0.1	1.0	1.4	1.5
NZ trading partners	3.3	3.2	3.4	3.2
World	3.2	3.3	3.3	3.3

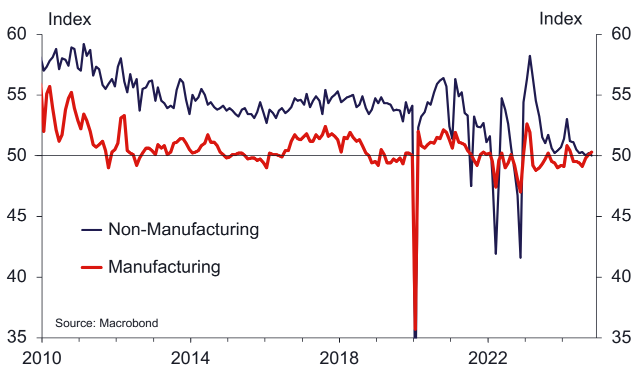
Australian & US interest rate outlook

	29 Nov	Dec-24	Mar-25	Dec-25
Australia				
Cash	4.35	4.35	4.35	3.35
90 Day BBSW	4.43	4.43	4.43	3.50
3 Year Swap	3.92	4.00	3.90	3.80
3 Year Bond	3.94	3.95	3.80	3.65
10 Year Bond	4.36	4.50	4.45	4.55
10 Year Spread to US (bps)	12	20	15	5
US				
Fed Funds	4.625	4.375	3.875	3.375
US 10 Year Bond	4.24	4.30	4.30	4.50

US PCE deflator



Chinese PMIs



Financial markets wrap

Interest rates.

NZ swap rates remain in consolidation mode, the 2yr between 3.50% and 3.95% during the past two months and likely to remain so during the month ahead.

Markets have fully priced the whole RBNZ easing cycle, assuming no negative news surprises, implying it will end around mid-2025 with an OCR at 3.25% (slightly below Westpac's forecast of 3.50%).

The RBNZ last week did explicitly signal a 50bp for February, which markets have priced as a 75% chance, suggesting potential for very short maturities (0 to 1yr) to fall further, but term swap rates would be little moved by a shift in market pricing to a 100% chance. The 2yr and 5yr swap rates have probably made cycle lows at 3.50%.

The main event risk for rates markets this week will be offshore, with little of note in the NZ calendar. Global markets will be watching the US payrolls release closely because it could influence market pricing for a Fed rate cut later this month. Any movement in US rates will likely spill over to NZ rates.

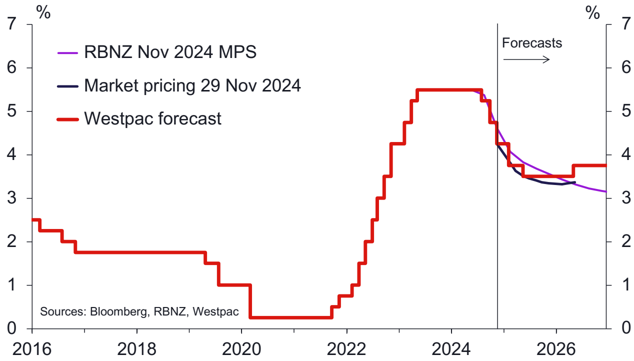
Foreign exchange

The NZD/USD rally during the past week appears to be a minor correction of the 6c decline which preceded it. We don't expect it to run much higher than 0.6050, and for it to eventually give way to a resumption of the decline. A break below 0.5775 would signal a move to 0.5500.

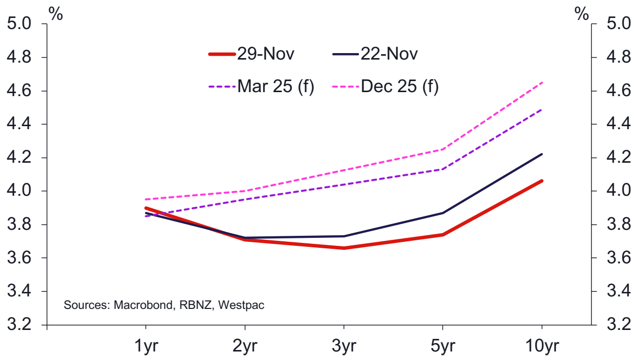
The US dollar had a strong run during October and November, in part fuelled by expectations a Trump administration would be US dollar supportive. More recently, his nominated Treasury Secretary is seen as moderating some of his proposals. In addition, the US dollar became technically overbought and needed a correction to return to a more balanced state. Looking ahead, even if some of the Trump administration's trade policies are less extreme, the US economy is expected to remain an outperformer among major economies, and that will be US dollar supportive over the medium term. In addition, short-maturity NZ-US yield spreads are likely to remain negative during the next few months, with the RBNZ likely to deliver another 50bp cut while the Fed could pause following a 25bp cut in December.

For NZD/AUD, yield spreads are likely to remain negative too, weighing on NZD/AUD. The RBA is not expected to start cutting until Q2 2025 at the earliest, by which time the RBNZ's easing cycle may be complete. We expect the cross to test 0.89 during the next few months, although there will remain much uncertainty regarding the Trump administration's impact on world trade.

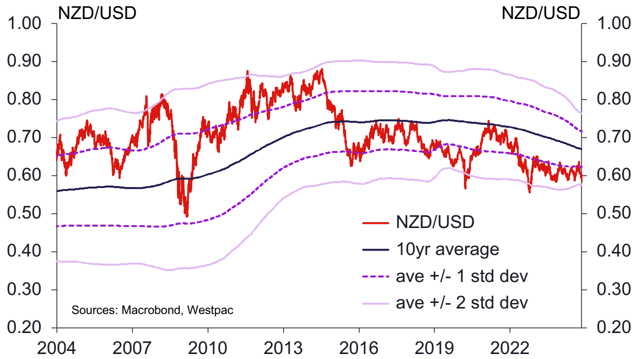
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-24
USD	0.592	0.581-0.636	0.555-0.743	0.644	0.59
AUD	0.908	0.895-0.925	0.873-0.992	0.928	0.89
EUR	0.559	0.548-0.569	0.517-0.637	0.580	0.55
GBP	0.464	0.458-0.476	0.456-0.535	0.501	0.46
JPY	88.6	86.5-92.1	61.3-98.6	81.3	90.3

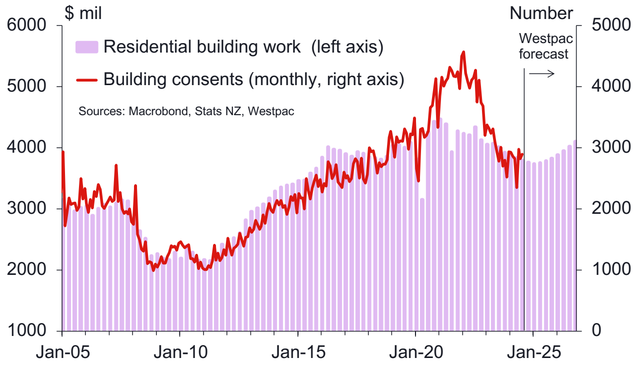
The week ahead

Oct building consents

Dec 2, Last: 2.6%, Westpac f/c: Flat

We're forecasting that residential building consent numbers will remain broadly flat in October. While consent issuance is still well down from its post-pandemic highs, since the start of this year, monthly issuance has been tracking around 2,800 to 2,900 per month. We expect that consents will remain around current levels for the remainder of this year, with a pick-up likely from mid-2025 as the impact of lower interest rates ripple through the housing market. In the non-residential space, weak economic activity is expected to continue weighing on new developments.

Residential building and consent numbers

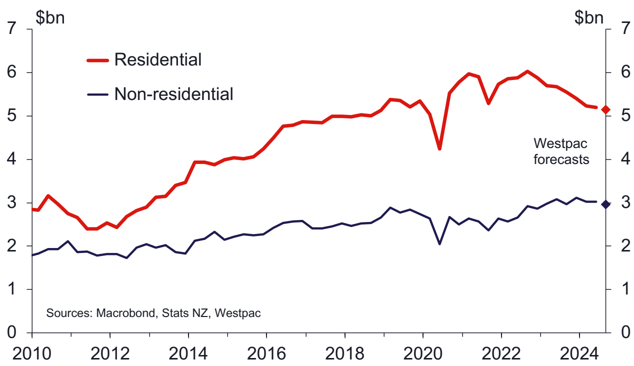


Q3 Building work put in place

Dec 5, Last: -0.2%, Westpac f/c: -1.2%

Construction activity fell 0.2% in the June quarter, with small declines in both residential and commercial activity. We expect further declines in both areas in the September quarter. High interest rates, subdued economic activity and low confidence over the past few years have dampened development activity. The key area of uncertainty is non-residential construction which can be volatile on a quarter-to-quarter basis. But smoothing through such quarterly noise, the direction for building activity remains down for now.

Real building work put in place

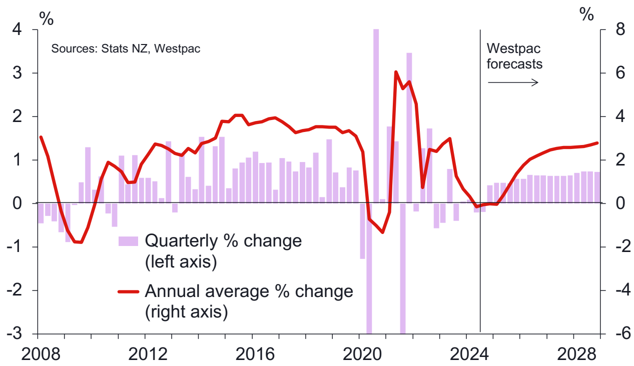


Economic and financial forecasts

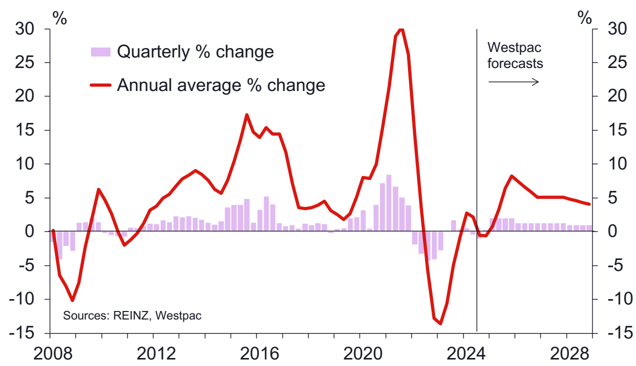
Economic indicators	Quarterly % change				Annual % change			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
GDP (production)	-0.2	-0.2	0.3	0.4	0.7	0.0	1.5	2.8
Consumer price index	0.4	0.6	0.4	0.5	4.7	2.1	2.0	2.1
Employment change	0.2	-0.5	-0.3	-0.1	2.8	-1.0	0.2	2.1
Unemployment rate	4.6	4.8	5.1	5.3	4.0	5.1	5.4	4.6
Labour cost index (all sectors)	1.2	0.6	0.7	0.5	4.3	3.5	2.0	1.8
Current account balance (% of GDP)	-6.7	-6.3	-5.7	-5.0	-7.1	-5.7	-3.9	-4.5
Terms of trade	2.0	2.0	4.9	1.4	-10.7	14.8	0.8	1.1
House price index	-0.4	-1.0	0.2	2.0	-0.6	-0.6	8.2	5.1

Financial forecasts	End of quarter				End of year			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
OCR	5.50	5.25	4.25	3.75	5.50	4.25	3.50	3.75
90 day bank bill	5.63	5.31	4.15	3.75	5.65	4.15	3.60	3.85
2 year swap	5.01	4.06	3.75	3.80	5.28	3.75	3.95	4.00
5 year swap	4.53	3.81	3.85	3.90	4.85	3.85	4.15	4.25
10 year bond	4.74	4.31	4.55	4.50	5.09	4.55	4.70	4.85
TWI	71.4	70.9	69.0	68.1	70.8	69.0	66.7	67.6
NZD/USD	0.61	0.61	0.59	0.59	0.60	0.59	0.59	0.61
NZD/AUD	0.92	0.91	0.89	0.88	0.93	0.89	0.85	0.85
NZD/EUR	0.56	0.56	0.55	0.54	0.56	0.55	0.54	0.55
NZD/GBP	0.48	0.47	0.46	0.45	0.49	0.46	0.45	0.46

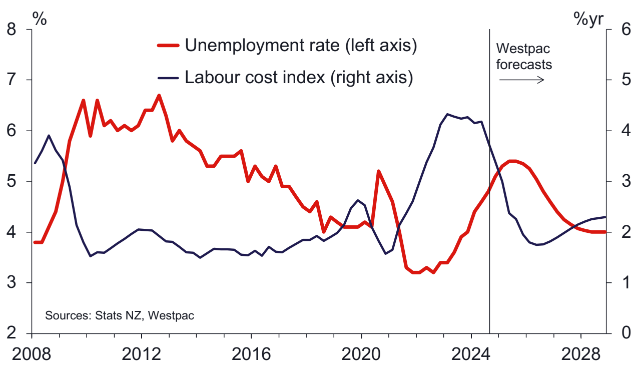
GDP growth



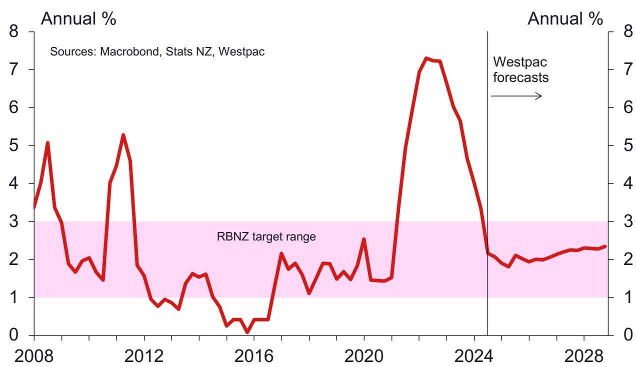
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 02					
NZ	Oct Building Permits, %mth	2.6	–	flat	Residential consents look like they've found a base.
Aus	Nov CoreLogic Home Value Index, %mth	0.2	–	0.1	Price slowdown starting to spread across capitals.
	Nov MI Inflation Gauge, %ann	3	–	–	Provides a general view on risks to official gauge.
	Nov ANZ-Indeed Job Ads, %mth	0.3	–	–	Labour demand remains robust, easing only marginally.
	Q3 Inventories, %qtr	0.1	–0.1	–0.5	Inventory run-down expected to persist.
	Q3 Company Profits, %qtr	–5.3	0.8	0.7	Mining to remain a drag on gross profits.
	Oct Dwelling Approvals, %mth	4.4	1.5	2.0	Signs of a modest uptrend starting to form.
	Oct Retail Sales, %mth	0.1	0.4	0.5	Starting to lift as consumer sentiment rises to over a 2-year high.
	RBA Head of Domestic Markets	–	–	–	Jacobs speaking at Australian Securitisation Conference.
Chn	Nov Caixin Manufacturing PMI, index	50.3	50.6	–	Policy driven improvement may not be long-lasting.
Eur	Oct Unemployment Rate, %	6.3	–	–	Upside risks failing to materialise keeping unemployment low.
US	Oct Construction Spending, %mth	0.1	0.2	–	Weather effects to be offset by impetus from rate cuts.
	Nov ISM Manufacturing, index	46.5	47.6	–	Regional surveys pointing to improved manufacturing conditions.
	Fedspeak	–	–	–	Waller, Williams.
World	Nov S&P Global Manufacturing PMI, index	–	–	–	Final estimate for Japan, Europe, UK and US.
Tue 03					
NZ	Q3 Terms Of Trade, %qtr	2.0	1.3	2.0	Boosted by firmer export commodity prices.
Aus	Q3 Net Exports (Cont'n), ppts	0.2	0.2	0.1	Net exports to contribute marginally to GDP growth.
	Q3 Current Account Balance, $bn	–10.7	–10.8	–11.5	Deficit expected to widen, in line with monthly goods trade.
US	Oct JOLTS Job Openings, 000s	7443	7510	–	Job openings likely to tick-up despite growing downside risks.
Wed 04					
NZ	Nov ANZ Commodity Prices, %mth	1.4	–	2	Strong lift in world dairy prices.
	RBNZ Gov Adrian Orr interview	–	–	–	Interview on 'Q+A', expected to be out around 5am.
Aus	Q3 GDP, %qtr	0.2	0.5	0.5	Public sepdning to remain an outsized contribution to growth...
	Q3 GDP, %ann	1.0	1.1	1.1	... private demand set to lift on household and business spending.
Chn	Nov Caixin Services PMI, index	52	52.5	–	Momentum may fail to build on the policy-induced bounce in Oct.
US	Oct Factory Orders, %mth	–0.5	0.3	–	A slight recovery following the prior month's decline.
	Nov ISM Non-Manufacturing, index	56	55.5	–	Services sector firmly within expansionary territory.
	Dec Federal Reserve's Beige Book	–	–	–	An update on conditions across the regions.
	Fedspeak	–	–	–	Musalem.
World	Nov S&P Global Services PMI, index	–	–	–	Final estimate for Japan, Europe, UK and US.
Thu 05					
NZ	Q3 Building Work Put in Place, %qtr	–0.2	–0.5	–1.2	Residential and commercial activity likely to ease.
Aus	Oct Goods Trade Balance, $bn	4.6	4.5	4.4	Surplus narrows as commodity prices ease.
	Oct Household Spending Indicator, %mth	–0.1	0.3	–0.1	Historical estimates to be revised following re-benchmarking.
Eur	Oct Retail Sales, %mth	0.5	–	–	Lift in consumer mood flowing through to spending.
US	Oct Trade Balance, $bn	–84.4	–75.0	–	Trade deficit expected to narrow.
	Initial Jobless Claims	213	–	–	Holding steady.
Fri 06					
Jpn	Oct Household Spending, %ann	–1.1	–2.5	–	Households pull-back as high prices deter consumption.
Eur	Q3 GDP, %qtr	0.4	0.4	–	Final estimate.
US	Nov Non-Farm Payrolls, 000s	12	200	180	A rebound in non-farm payrolls is anticipated...
	Nov Unemployment Rate, %	4.1	4.2	–	... though insufficient to curb a rise in the unemployment rate...
	Nov Average Hourly Earnings, %mth	0.4	0.3	–	... placing downward pressure on earnings.
	Dec Uni. Of Michigan Sentiment, index	71.8	73	–	A fifth consecutive rise expected, but a political divide is evident.
	Fedspeak	–	–	–	Goolsbee, Hammack.

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