WEEKLY ECONOMIC COMMENTARY

3 Feb 2025 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

The year is heating up!

The Reserve Bank's first policy review of the year is approaching, after an almost three-month gap since the November *Monetary Policy Statement*. The last major piece of data before then is the Q4 labour market surveys, released this Wednesday, though we're not expecting anything that would decisively change the RBNZ's thinking. Meanwhile, a speech by the RBNZ's Chief Economist mused about the country's longer-term productivity challenges but provided little guidance on current conditions. Finally, the first shots in the trade war have been fired – with the calibre of the shots being more of the big gun variety.

The December quarter labour market surveys are likely to show a continuation of the steady softening in New Zealand's jobs market. We expect the unemployment rate to rise to 5.0%, compared to 4.8% in the September quarter. That's a touch less than the 5.1% that both we and the RBNZ had previously forecast, reflecting the fact that recent jobs data has been slightly better than expected.

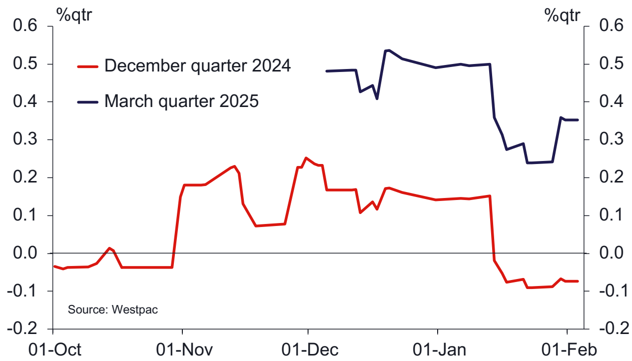
Our key indicator here is the Monthly Employment Indicator (MEI). While there are some conceptual differences between this measure and the Household Labour Force Survey (HLFS), the most likely cause of any divergence between the two is that the HLFS is subject to sampling error. In contrast, the MEI is taken from income tax data, making it a more or less complete record of paid employment.

The MEI showed a 0.1% rise in the number of filled jobs in December, following a 0.2% rise in November. These gains, while modest, point to some emerging stabilisation in the labour market, after a cumulative 1.8% fall in jobs between March and October. However, for the quarter as a whole, they were still down 0.2% compared to the September quarter.

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	→	↘	↘

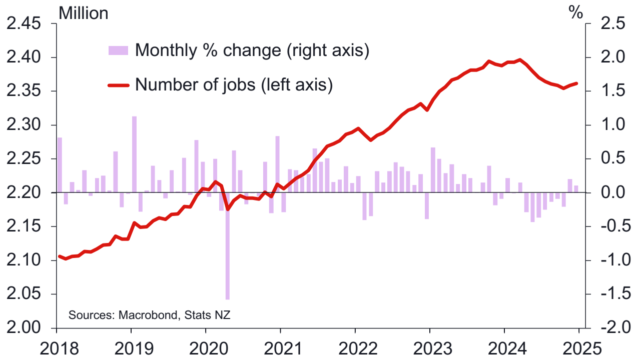
Westpac GDP nowcasts



Key data and event outlook

Date	Event
5 Feb 25	Labour market statistics, December quarter
13 Feb 25	RBNZ Survey of Expectations, December quarter
13 Feb 25	Govt Financial Statements, 6 mths to December
14 Feb 25	NZ Selected price indexes, January
18 Feb 25	RBA Monetary Policy Decision
19 Feb 25	RBNZ OCR Review & Monetary Policy Statement
6 Mar 25	Govt Financial Statements, 7 mths to January
14 Mar 25	NZ Selected price indexes, February
19 Mar 25	FOMC Meeting (Announced 20 Mar NZT)
20 Mar 25	NZ GDP, December quarter
1 Apr 25	RBA Monetary Policy Decision

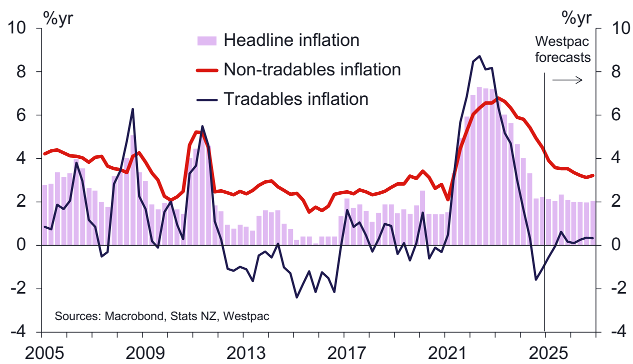
Monthly Employment Indicator filled jobs



We expect the drop in employment to be accompanied by a fall in the participation rate from 71.2% to 71.0%. Participation has played a significant buffering role over the last few years. In particular, young people were drawn into the workforce in 2021-22 when the labour market was tight and migrant workers weren't available; as those conditions have reversed, many of them are ending up back at school rather than continuing to look for work. The result is that the measured unemployment rate has risen at a slower pace than many of us (including the RBNZ) were expecting, and forecasts of where it will peak this year have been gradually revised down.

The softening jobs market, along with the easing in inflation, mean that we should also see a further slowdown in wage growth. We're expecting a 0.6% rise in the Labour Cost Index (LCI) for the private sector. The public sector measure may prove to be stronger – there was a 3.9% pay increase for teachers that took effect in December, the last stage of the collective pay agreements that were set by the previous government. However, it's not clear whether this will be captured in the Q4 or the Q1 figures, as the LCI is generally surveyed mid-quarter.

CPI inflation and components



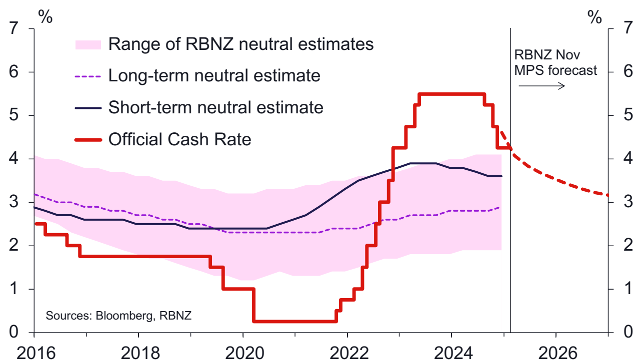
On an annual basis, we expect the private sector LCI to slow to 3.0%, which would be the lowest in three years. Slowing wage growth is not exactly something to celebrate, but it's an unfortunately necessary step in breaking the cycle of domestically-generated inflation while productivity growth remains anaemic. The RBNZ is going to need that in order to keep overall inflation on target, because tradables prices – the more globally-driven part – are likely to be less helpful going forward than they were over the last year.

Our forecasts for both employment and wages are slightly stronger than what the RBNZ expected in its November forecasts, though not meaningfully so. The RBNZ has been unusually explicit that the base case for its 19 February policy meeting will be a 50bp cut, so presumably it would take a substantial amount of accumulated evidence in one direction or the other to move them off that view. Given the generally mixed tone of the recent economic data, it would take a major surprise for the labour market surveys to tip the balance on their own.

The RBNZ's first comments for the new year came from a speech by Chief Economist Paul Conway, titled "Beyond the cycle: Growth and interest rates in the long run". As the name suggests, it was not intended to provide any guidance as to the policy committee's current thinking, though there were a few general points worth noting.

Conway noted that the 'neutral' level of interest rates has been falling over time, much of which appears to reflect New Zealand's relatively poor performance on productivity growth. One implication of this is that the economy's speed limit is relatively low, and that a period of recession was required to exert sufficient downward pressure on inflation (unlike in the US for instance). Certainly, it didn't seem to be the case that the RBNZ was repentant on contributing to the sharp fall in output seen in mid-2024.

Official Cash Rate and RBNZ estimates of neutral



More recently, the RBNZ has been lifting its estimate of the longer-term neutral policy rate. Conway noted that it looks like the trend in the neutral rate is flattening off and currently lies in the range of 2.5-3.5%. This is the same range communicated by the RBNZ in its November *Monetary Policy Statement*. Conway also noted that as the OCR gets closer to the middle of the neutral range, it will be appropriate to move more incrementally. That doesn't preclude another sizeable OCR cut at this month's review but moves beyond that are likely to be on a meeting-by-meeting basis.

Over the weekend, there was a flurry of activity in the trade restrictions space as the Trump administration announced broad tariffs on Canadian and Mexican imports. It is very much a case of "what you see is what you get" as Trump is delivering on promises made in his re-election campaign. Early signs are that the tariffed will not take the moves lying down as the Canadian, Mexican and European authorities indicated an intention to retaliate to US tariffs.

Right now, the impact on NZ is indirect and being mainly felt through the exchange rate and long-term interest rates. An overwhelming consensus is tariffs will boost US inflation and interest rates (and it was notable that the Federal Reserve went on hold and indicated a more neutral outlook in their meeting last week).

Research indicates that tariffs on average see weaker exchange rates for the tariffed – perhaps around half of the tariff is offset by FX depreciation of the tariffed currencies. Hence the risks for future NZD depreciation seem clear – especially as the RBNZ continues to push NZ interest rates down towards their quite low neutral rate estimate of 3%.

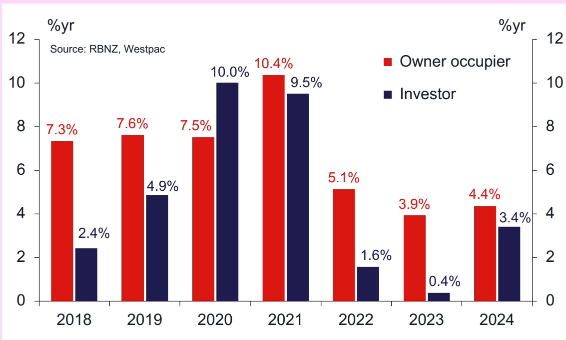
For the RBNZ, most of this isn't likely to shift views on the appropriateness of a 50bp cut this month – this was well signalled, and the weaker GDP data late last year probably cemented that in. But the weaker exchange rate and potential for more may make them a bit less equivocal on how quickly the OCR moves towards 3% after February. The low ratio of knowns to unknowns probably points in the direction of caution until the fog of war clears a bit.

Michael Gordon, Senior Economist

Chart of the week.

With interest rates dropping in recent months, New Zealand's housing market is starting to emerge from its slumber. The latest data from the RBNZ shows that lending to owner-occupiers has been turning higher, with lending growth rising to 4.4% over the past year. That chimes with anecdotes of a growing number of people at open homes in recent weeks. We've also seen investors starting to dip their toes in the water again after they stepped back from the market over the past couple of years. That lift in investor demand may have been boosted by changes in policies affecting the tax treatment of investor housing, as well as the fall in borrowing costs. For now, the level of sales to both owner occupiers and investors remains low. However, with mortgage rates now down from their recent highs, we expect to see sales trending higher over the coming year, with house prices to rise by around 8% this year and 5% in 2026.

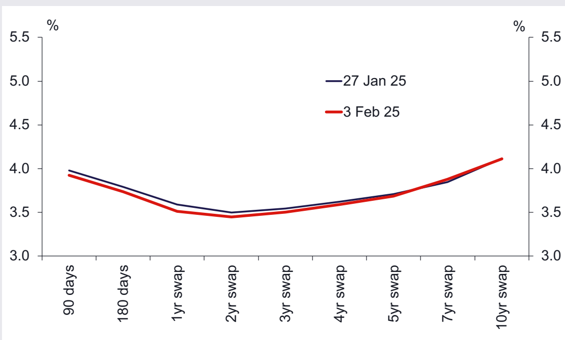
New home loans by borrower type, annual growth



Fixed versus floating for mortgages.

We're forecasting another 50bp cut at the 19 February OCR review, and we expect the cash rate will bottom at 3.25% in mid-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

North America.

President Trump has announced a tariff of 25% on goods imported from Mexico and Canada and a 10% tariff on goods imported from China, beginning from Tuesday. Canada and Mexico have already announced retaliatory measures, and any further developments in this space will be a key focus over the week ahead. On the data front, the FOMC delivered the expected on-hold decision at its first meeting of the year. The accompanying statement was hawkish, highlighting firmness in the labour market and that the economy continues to expand at a "solid pace," while also noting that inflation remains elevated. Markets are currently pricing in 47pts of cuts from the Fed by the end of this year. Other economic news this week pointed to resilience in the economy, with GDP growth coming in at 2.3% in the December quarter, including strong growth in consumption spending and exports. December also saw the PCE deflator rising 0.3% over the month as expected. This week's calendar includes January's non-farm payrolls report, which could be affected by the recent fires in California. There will also be a range of business sector updates throughout the week. Across in Canada, the BOC cut its policy rate 25bps as expected, following 50bp cuts at the previous two meetings. The BOC dropped its forward guidance, noting greater than expected uncertainty about the outlook, especially with regards to potential US tariffs.

Europe.

The ECB cut its policy rate by 25bps at their January meeting, noting that the disinflation process remains on track and that financial conditions remain tight. The decision follows disappointing growth in some of the region's largest economies. The ECB noted that further policy decisions will be data-dependent on a meeting-by-meeting basis. We expect two more cuts this year. The Swedish Riksbank also cut rates 25bp as expected. The Bank of England meets on Thursday and is also expected to cut its policy rate by 25bps.

Asia.

Australia's December quarter CPI came in lower than expected, with the headline rate rising 0.2% (2.4%yr). The details of the release pointed to softening price pressures across sectors, with trimmed mean inflation falling to 3.2% from 3.6% previously. With that cooling in inflation pressures, our Australian team have pulled forward their expectations for the start of rate cuts from May to February. We now expect the RBA will deliver 25bps of cuts per quarter through to a terminal rate of 3.35% in December. This week's calendar includes updates on Australian household spending, along with the Caixin PMIs in China.

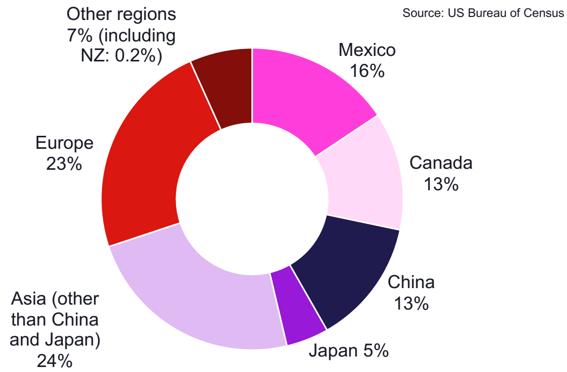
Trading partner real GDP (calendar years)

	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	2.8	2.4	2.0
Japan	1.9	-0.1	1.2	1.0
East Asia ex China	3.3	4.3	4.1	4.1
India	7.8	6.8	6.8	6.5
Euro Zone	0.4	0.8	1.3	1.5
United Kingdom	0.1	1.0	1.4	1.5
NZ trading partners	3.3	3.3	3.4	3.3
World	3.2	3.3	3.3	3.3

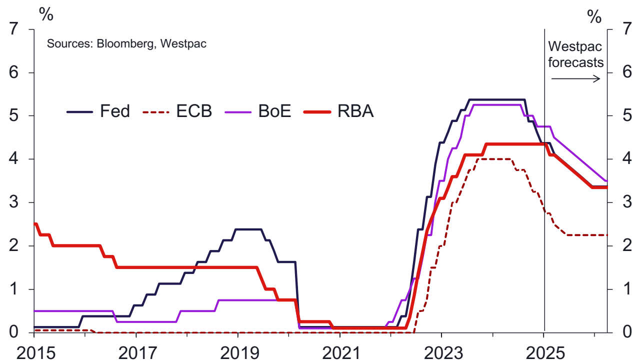
Australian & US interest rate outlook

	31 Jan	Mar-25	Dec-25	Dec-26
Australia				
Cash	4.35	4.10	3.35	3.35
90 Day BBSW	4.25	4.43	3.50	3.55
3 Year Swap	3.79	3.75	3.80	4.00
3 Year Bond	3.82	3.70	3.70	3.80
10 Year Bond	4.42	4.35	4.55	4.85
10 Year Spread to US (bps)	-12	5	5	5
US				
Fed Funds	4.375	4.125	3.375	3.875
US 10 Year Bond	4.54	4.30	4.50	4.80

US import markets



Global central bank policy rates



Financial markets wrap

Interest rates.

The NZ 2yr swap rate has been driven by a moderate receiving bias over the past few weeks, falling 25bps to 3.42%. The move could stall this week as market participants take stock of the latest tariff news. US tariff developments present complex risks to NZ's economic growth and inflation outlook and there will be other factors for the RBNZ to consider too. We expect January's range of 3.38%-3.65% to hold this week.

OIS pricing has been fairly stable this month, implying a 90% chance of a 50bp cut at the 19 February RBNZ MPS. The terminal rate is seen as around 3.00%. This week's Q4 labour data (5 February) will be important and could shift OIS pricing.

Over the next few months, NZ swap rates could increasingly find some support from expectations that a large mortgage fixing wave could start soon, if households acknowledge the easing cycle is nearing completion. That mortgage wave, on its own, would also likely flatten the swap curve.

Foreign exchange.

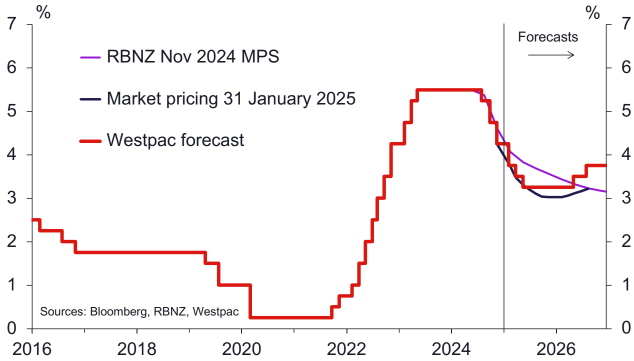
NZD/USD has broken sharply lower this morning, in response to the weekend's news of US tariffs on Canada, Mexico and China. The tariff rates and timing (25% on Canada and Mexico, start from 1 Feb) were more severe than the markets had expected and priced, so the US dollar has risen against most currencies.

NZD/USD has potential to test support at 0.5540, and then 0.5470, this week. If the latter gives way, we'll be targeting much lower, around 0.5000 over the next few months. This has been our view for some time, but tariff developments may hasten it.

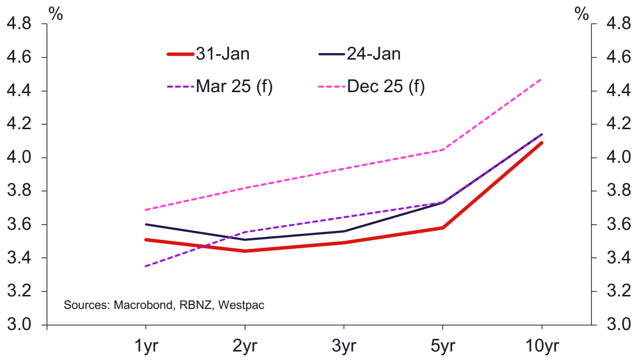
The next few months are likely to see heightened volatility in global financial markets. There will be further tariff developments from the US administration, and there will be responses from other countries. Exchange rates will be particularly sensitive to the above, and we expect volatility – both actual and option-implied – to rise. The US dollar will likely outperform all major currencies.

Regarding event risk this week, aside from tariff news, the monthly US payrolls data on Friday will be the global highlight, while in NZ it will be the Q4 labour data on Wednesday. This latter will be of much interest to the RBNZ given CPI inflation is close to the 2.0% target.

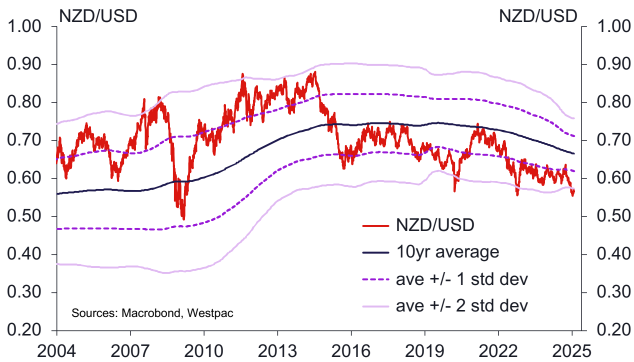
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-25
USD	0.563	0.556-0.602	0.555-0.743	0.641	0.57
AUD	0.907	0.895-0.912	0.873-0.992	0.927	0.86
EUR	0.548	0.539-0.560	0.517-0.637	0.579	0.52
GBP	0.455	0.447-0.466	0.447-0.535	0.500	0.44
JPY	86.9	86.9-92.1	61.3-98.6	81.9	84.4

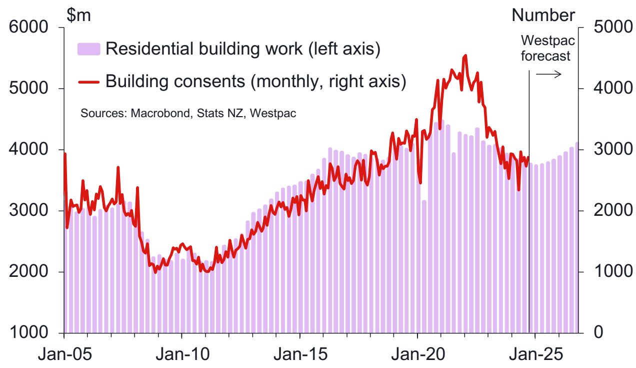
The week ahead

Dec building consents

Feb 4, Last: +5.3%, Westpac f/c: -5.0%

We're forecasting that residential building consent numbers will fall modestly in December following a sharp rise in some of the 'lumpier' multi-unit categories last month. However, more important than the month-to-month swings, the longer-term trend looks like it has found a floor after earlier sharp declines. Annual consent issuance has been running at a little over 33,000 for several months now. We expect that consent issuance will remain around current levels for the next few months before beginning to turn higher through the latter part of year as the impact of lower interest rates ripples 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



Q4 labour market surveys

Feb 5, Unemployment rate – Last: 4.8%, Westpac f/c: 5.0%
Labour Cost Index, private sector – Last: +0.6, Westpac f/c: +0.6%

The December quarter labour market surveys are expected to show that the unemployment rate has risen to 5.0%, compared to 4.8% in the September quarter. Monthly jobs figures were starting to tick up again at the end of the year, but they were down slightly for the quarter as a whole. The softening jobs market, along with the easing in inflation, mean that we should also see a further slowdown in wage growth. We expect a 0.6% rise in the Labour Cost Index for the private sector, taking the annual rate down to 3.0% (public sector wage growth may hold up for a bit longer). Our forecasts are only marginally better than what the RBNZ assumed – not enough to shake its strong conviction for another 50bp OCR cut in February.

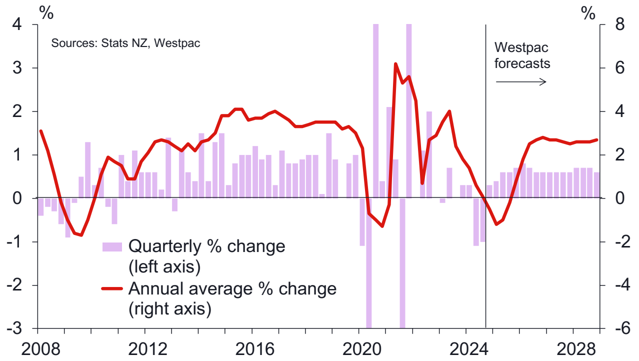
Labour market indicators

Economic and financial forecasts

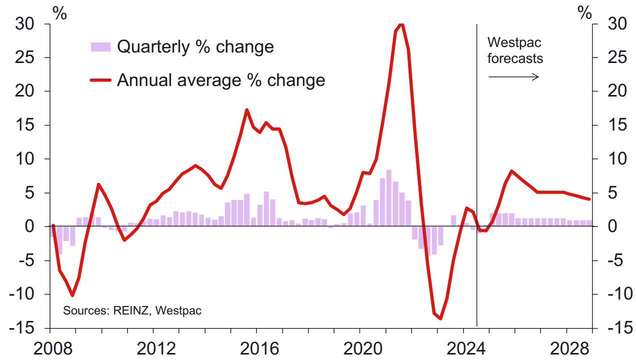
Economic indicators	Quarterly % change				Annual % change			
	Sep-24	Dec-24	Mar-25	Jun-25	2024	2025	2026	2027
GDP (production)	-1.0	0.3	0.4	0.6	-0.5	0.8	2.8	2.5
Consumer price index	0.6	0.5	0.5	0.3	2.2	2.1	2.1	2.2
Employment change	-0.5	-0.3	-0.1	0.0	-1.0	0.2	2.1	2.1
Unemployment rate	4.8	5.0	5.3	5.4	5.1	5.4	4.6	4.1
Labour cost index (all sectors)	0.6	0.7	0.5	0.5	3.5	2.0	1.8	2.1
Current account balance (% of GDP)	-6.4	-5.9	-5.1	-4.3	-5.9	-3.7	-4.5	-4.8
Terms of trade	2.5	6.7	3.4	-0.2	17.4	2.8	0.7	1.7
House price index	-0.9	0.3	2.0	2.0	-0.6	8.2	5.1	5.1

Financial forecasts	End of quarter				End of year			
	Sep-24	Dec-24	Mar-25	Jun-25	2024	2025	2026	2027
OCR	5.25	4.25	3.75	3.25	4.25	3.25	3.75	3.75
90 day bank bill	5.31	4.45	3.55	3.35	4.45	3.35	3.85	3.85
2 year swap	4.06	3.64	3.55	3.60	3.64	3.80	4.00	4.00
5 year swap	3.81	3.73	3.75	3.85	3.73	4.05	4.25	4.25
10 year bond	4.31	4.51	4.40	4.50	4.51	4.65	4.85	4.85
TWI	70.9	69.5	68.1	67.3	69.5	65.7	66.6	68.1
NZD/USD	0.61	0.59	0.58	0.58	0.59	0.57	0.60	0.63
NZD/AUD	0.91	0.91	0.89	0.88	0.91	0.86	0.86	0.86
NZD/EUR	0.56	0.55	0.54	0.54	0.55	0.52	0.54	0.56
NZD/GBP	0.47	0.46	0.45	0.44	0.46	0.44	0.45	0.47

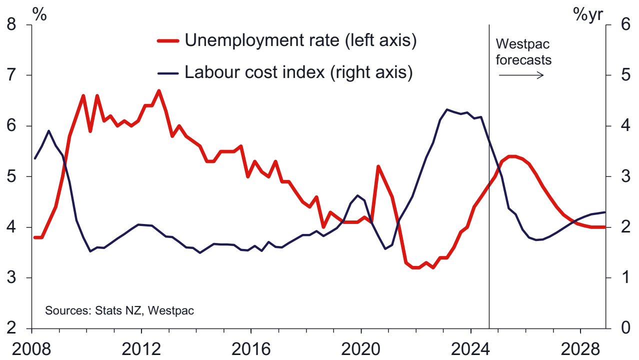
GDP growth



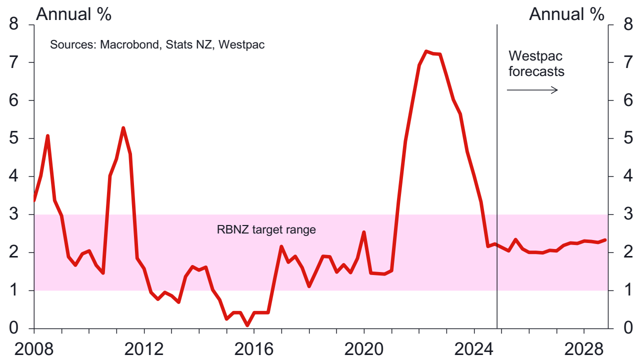
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 03					
Aus	Jan Corelogic Home Value Index, %mth	-0.2	–	-0.2	Falls in Syd and Melb extend, other major capitals soften.
	Jan MI Inflation Gauge, %ann	2.6	–	–	December saw the strongest monthly increase in a year.
	Jan ANZ Job Ads, %mth	0.3	–	–	Job ads finished 2024 16.5% lower than 2023.
	Dec Retail Sales, %mth	0.8	–0.8	0.5	A decent Dec showing driven by non-food retail.
	Q4 Real Retail Sales, %qtr	0.5	0.8	1.1	Recovery in retail volumes continues.
	Dec Dwelling Approvals, %mth	-3.6	1	1	Underlying up-trend to remain broadly on course.
World	Jan S&P Global Manufacturing PMIs, index	48.8	–	–	Final estimate for US, UK, Europe and Japan.
Chn	Jan Caixin Manufacturing PMI, index	50.5	50.6	–	Should remain consistent with modest growth in the sector.
Eur	Jan Final HICP Inflation, %ann	2.4	–	–	Higher energy prices should lift headline inflation rate again.
US	Dec Construction Spending, %mth	0	0.2	–	WIll be watched for signs of recovery in the housing sector.
	Jan ISM Manufacturing PMI, index	49.2	49.3	–	Signals ongoing contraction in manufacturing production.
	Fedspeak	–	–	–	Fed's Bostic Speaks on Economic Outlook.
Tue 04					
NZ	Dec Building Permits, %mth	5.3	–	-5	Trend in consent issuance has stabilised.
Aus	Dec Household Spending Indicator, %mth	0.4	0.3	0.6	Spending to strengthen amid late Black Friday and vehicle sales.
US	Dec JOLTS Job Openings, 000s	8098	–	–	Likely return to a gradual downward trend.
	Dec Factory Orders, %mth	-0.4	0.5	–	Bounce back expected after November weakness.
	Dec Final Durable Goods Orders, %mth	-2.2	–	–	Final estimate likely to confirm firm underlying growth in orders.
	Fedspeak	–	–	–	Fed's Bostic Speaks in Moderated Conversation on Housing.
Wed 05					
NZ	Q4 Unemployment Rate, %	4.8	5.1	5.0	The labour market is continuing to soften...
	Q4 Employment, %qtr	-0.5	-0.2	-0.2	... with a softening in jobs growth...
	Q4 LCI Wages (Pvte, Ord. Time), %qtr	0.6	0.6	0.6	... and a cooling in annual wage growth.
	Jan ANZ Commodity Prices, %mth	0.2	–	–	Month-to-month movements quite volatile.
Jpn	Dec Labour Cash Earnings, %ann	3.9	3.9	–	Signs of increasing wage pressures.
Chn	Jan Caixin China PMI Composite, index	51.4	–	–	Consistent with stronger momentum continuing in early 2025.
	Jan Caixin China PMI Services, index	52.2	52.5	–	Suggest that services continues outperforming manufacturing.
World	Jan S&P Composite Global PMIs, index	–	–	–	Final estimate for US, UK, Europe and Japan.
US	Jan ADP Employment Change, 000s	122	153	–	A noisy indicator of a monthly change in non-farm payrolls.
	Dec Trade Balance, US$bn	-78.2	-80.4	–	A short term boost to imports set to drive deficit higher.
	Jan ISM Services PMI, index	54.1	54.5	–	Will provide further evidence of services sector growth in Jan.
	Fedspeak	–	–	–	Fed's Goolsbee Gives Remarks at Auto Conference.
Thu 06					
NZ	Waitangi Day	–	–	–	Public holiday, markets closed.
Aus	Dec Trade Balance , $bn	7.1	6.7	6.3	Weaker AUD and higher trade flows in China to help exports.
Eur	Dec Retail Sales, %mth	0.1	0	–	Positive albeit modest growth to continue.
UK	BoE Policy Decision	4.75	4.5	4.5	25bp cut to Bank Rate is fully priced in.
US	Q4 Productivity, %ann	2.2	1.9	–	Productivity growth set to remain broadly stable around 2%yr.
	Initial Jobless Claims	207k	–	–	To remain at benign levels.
Fri 07					
Jpn	Dec Household Spending, %mth	-0.4	0.5	–	Growth has been below zero for the majority of 2024.
Chn	Jan Foreign Reserves, US$bn	3.2	–	–	To remain elevated for now.
US	Jan Non-Farm Payrolls, 000s	256	150	170	Volatility is high at the turn of the year but...
	Jan Unemployment Rate, %	4.1	4.1	4.1	... labour supply and demand is coming into better balance...
	Jan Average Hourly Earnings, %mth	0.3	0.3	–	... causing wage growth to slowly return to average rates.
	Feb Uni. Of Michigan Sentiment, index	71.1	–	–	Signs of consumer reactions to new policy announcements.

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