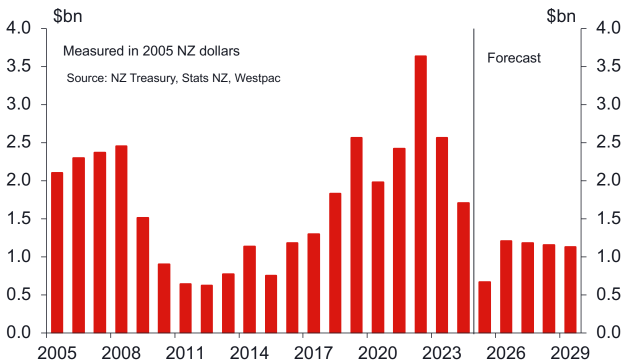
WEEKLY ECONOMIC COMMENTARY

5 May 2025 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Finance Minister signals a tight Budget

With Budget 2025 now coming into view, a key focus in New Zealand last week was a pre-Budget speech given by the Finance Minister, Nicola Willis. Most importantly for the bond market, the Minister indicated that the Government's fiscal strategy remains unchanged from that communicated late last year in the Half-Year Economic and Fiscal Update (HYEFU). A key component of that strategy is to achieve an operating surplus – measured on an OBEGALx basis – in 2027/28 if possible, although the HYEFU pointed to surplus most probably being achieved a year later in 2028/29.

Real operating allowance

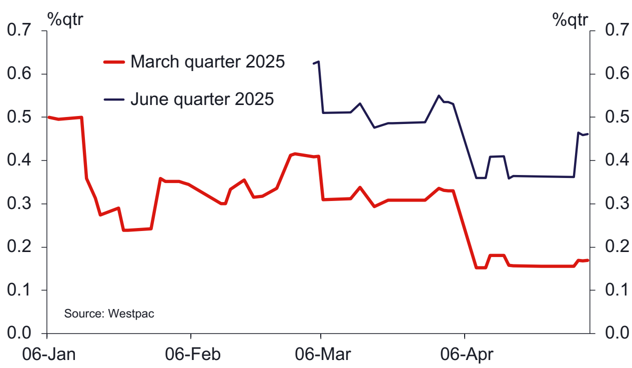


Prior to the Minister's speech, there had been some possibility the return to surplus would be delayed further in Budget 2025. This is because of downward revisions to the economic outlook associated with the global turmoil created by President Trump's tariff policy. And the Minister stated that the Treasury forecasts in Budget 2025 will indeed project weaker real economic growth in 2025 and 2026 than expected at the time of the HYEFU, reducing tax revenue and so – in the absence of a policy response – delaying the return to surplus. However, rather than accepting that outcome, the Minister announced that she has decided to reduce the size of

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
7 May 25	Labour market statistics, March quarter
7 May 25	RBNZ Financial Stability Report
7 May 25	FOMC Meeting (Announced 8 May NZT)
8 May 25	Govt financial statements, 9 months to March
15 May 25	NZ Selected price indexes, April
20 May 25	RBA Monetary Policy Decision
22 May 25	Government releases Budget 2025
28 May 25	RBNZ OCR Review & Monetary Policy Statement
5 Jun 25	Govt financial statements, 10 months to April
17 Jun 25	NZ Selected price indexes, May
18 Jun 25	FOMC Meeting (Announced 19 Jun NZT)

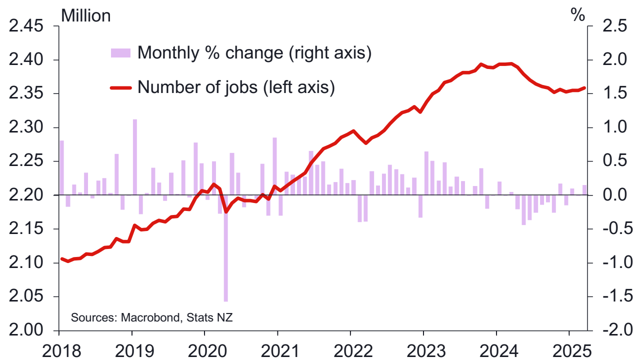
the Budget 2025 operating allowance – the allowance for new spending or revenue initiatives – to just $1.3bn from the $2.4bn set previously. This will save $4.4bn across the 4-year horizon of the forecasts. According to the Minister, near-final Treasury Budget forecasts indicate that this – in concert with other savings – will preserve a return to surplus in 2028/29.

Working within a $1.3bn operating allowance will not be easy. Indeed, this is the smallest allowance set since 2015, and the smallest since 2012 in real terms. To achieve this, the Minister indicated that new spending initiatives would be strictly limited to the Government's most important priorities: health, education, law and order, defence, and a small number of social investments. She also said that she had found room for modest measures to support business growth and to provide some targeted cost of living relief. Importantly, beyond a small number of exceptions, government departments are not receiving additional funding in the Budget. Meanwhile, following a line-by-line review of previous funding commitments, she indicated that further savings had been found that will also be used to fund the Government's priorities.

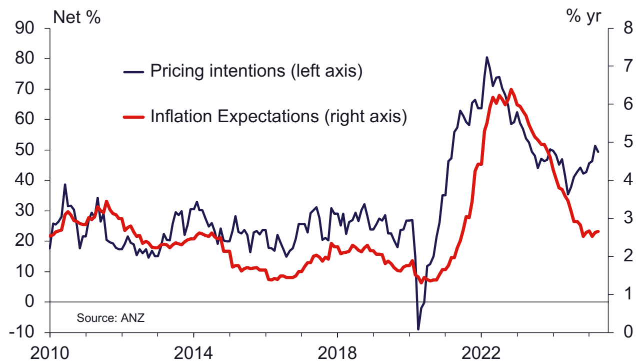
Later this week we will publish our preview of Budget 2025, to be presented by the Minister on 22 May. The preview will take account of the release of upcoming Government financial data for the 9 months to March. But at face value – and in contrast to recent fiscal updates – the Minister's speech suggests that changes to the forecast for the operating balance are unlikely to be a major driver of changes to the bond programme at Budget 2025. This leaves open the possibility of small changes to the forecast cash requirement related to the Government's capital investment programme. That said, the Minister spent some time in her speech bemoaning the sharp increase in debt financing costs seen in recent years – now greater than annual core Crown expenses for the Police, Corrections, the Ministry of Justice, Customs and the Defence Force combined. And she reasserted the Government's goal of reducing net Core Crown debt below 40% of GDP and then keeping it below that percentage. This suggests that revisions to the bond programme are most likely to be minor. While the Minister indicated a preference to show intentions to allocate very small operating allowances over the long term, we should note there are mainly upside risks to that spending. This is because the real value of those allowances is quite small, and they will apply to the next two governments at least. Those government's may not share the same spending preferences as the current one.

Turning to last week's other local economic news, the Monthly Employment Indicator pointed to a 0.2%m/m lift in filled jobs in March and around a 0.25% lift from 3 months earlier. There remains an urban – rural divide where jobs growth is more evident in the regions where the primary sector and tourism have a bigger impact. But as has become common place, downward revisions to estimates for previous months meant that filled jobs were still down 1.5%y/y. Downward revisions to the March estimate will likely show filled jobs were likely flattish in Q1 for NZ overall. This data has not changed our view regarding the outlook for next week's key Q1 labour market surveys. As my colleague Michael Gordon writes in his preview, given ongoing growth in the working age population and assuming broadly unchanged labour force participation, **the unemployment rate will likely rise to 5.3% in Q1**, from 5.1% last quarter – a notch higher than the RBNZ forecast in the February Monetary Policy Statement but unchanged from our forecasts. He also expects these surveys to report a further moderation in labour cost growth, which should help drive a further moderation of non-tradables inflation.

Monthly Employment Indicator filled jobs



Inflation expectations and pricing intentions



The latest ANZ Business Outlook Survey for April showed us that the business sector remained upbeat ahead of the tariff announcements in April. But we got less insight into the impact of developments in US tariff policy as many of the survey responses were received early in the month. While headline business confidence fell a comparatively modest 8.2pts to a still very healthy 49.3, own activity indicators remained steady and encouragingly, a net 11% of firms said that activity had lifted from a year ago, representing a strong lift from the March reading (this measure had also fallen sharply last April). Survey responses taken later in the month suggested that business optimism had significantly reduced, so we will await the May survey to see where confidence has settled. The inflation picture was little changed, with year-ahead inflation expectations sitting at 2.65% and the net proportion of firms intending to lift their prices nudging only slightly lower to a still elevated 49.4%. The latter continues to point to considerably greater inflation pressure than the equivalent indicators in the closely followed QSBO survey.

The news from the construction sector was more positive last week, with dwelling consents rising almost 10%m/m in March. However, much of the growth was in the very bumpy apartment category, where consents increased more than fourfold compared with February. Consents for townhouses also lifted following three soft months. Consents for houses increased a more moderate 4.5%m/m following a 6.3%m/m decline in February, with the March reading almost identical to the average reading over the past 12 months. Looking through the month-to-month volatility, consents are probably still best described as bumping along the bottom. However, as the economic recovery broadens, we expect to see more evidence of an uptrend developing later this year. Meanwhile, consents for non-residential buildings maintained a softer trend, declining 17% in the March quarter compared with a year earlier.

Finally, it also is worth noting that last week Statistics New Zealand announced that it had made an error in the Q1 CPI, by omitting to include the impact of a $25 increase in the annual motor vehicle licensing fee. Had this been included, the CPI would have increased 1.0%q/q/2.6%y/y, rather than the 0.9%q/q/2.5%y/y movement that was reported. Rather than revise the CPI, Statistics New Zealand has decided that the impact of this price change will be included when the Q2 index is released in July. This will slightly lift our near-term inflation outlook, although index-number rounding means that this may not be evident until the second half of this year.

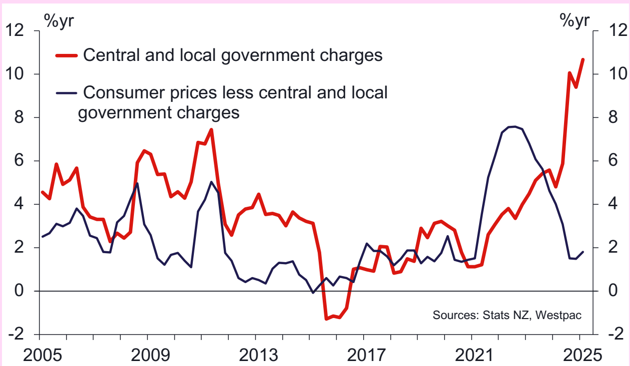
Darren Gibbs, Senior Economist

Chart of the week.

Late last week Stats NZ announced that a $25 increase in the annual motor vehicle licensing fee had been accidentally omitted from the March quarter CPI figures. Had that increase been included, inflation in the year to March would have been 2.6% (instead of the published rate of 2.5%). However, vehicle licencing fees aren't the only area where we've seen increases in government charges. In fact, over the past year central and local government charges have risen by 10.7%, while the other components of the CPI rose by just 1.8%.

Looking back over the past couple of decades, government charges have typically risen faster than other consumer prices (with the notable exception of the years immediately following the pandemic). Much of that has been due to increases in local council rates, which recorded an especially large 12% increase last year. While we don't expect rates to continue rising at the same pace they did last year, we're still likely to see some sizeable increases. That will limit the downside for overall domestic inflation over the next few years. The Government's preference to shift costs from the operating budget to households directly only increases those upside risks.

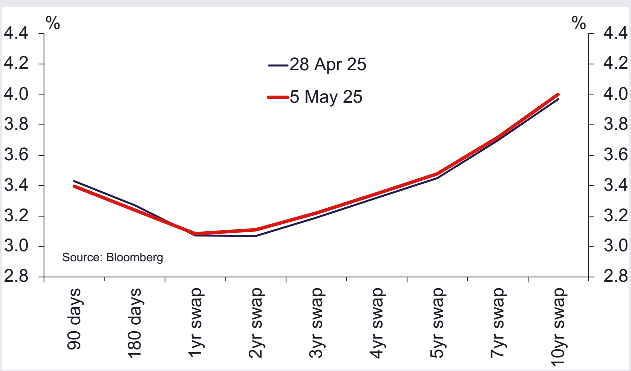
Government charges continuing to rise faster than the consumer prices more generally



Fixed versus floating for mortgages.

We're forecasting the cash rate to bottom at 3.25% in mid-2025 but with downside risks to that forecast given global events. Markets now factor in an OCR that bottoms closer to 2.75%. Mortgage rates now uniformly sit just under 5% reflecting the recent fall in wholesale rates, and even longer-term mortgage rates have fallen a touch. There could be some further scope for mortgage rates to fall further should wholesale rates settle around current levels. But fixing for longer periods still looks attractive now mortgage rates are either below or close to 5%. Very short-term mortgage rates are likely to fall in the near term as the RBNZ delivers further OCR cuts but they may remain above current longer term fixed rates. Fixing shorter than a year is a bet that the OCR bottoms somewhat lower than 2.75%.

NZ interest rates



Global wrap

North America.

US March quarter GDP was as disappointing as expected, falling 0.3% on an annualised basis. The details were distorted by a pull-forward of imports to get ahead of the tariff changes, resulting in a sharp rise in both imports and inventories. But the telling detail was a slowdown in household consumption growth, from a 4.0% annualised pace in Q4 to 1.8% in Q1. Consumer sentiment has fallen further since then, with respondents noting concern over near-term inflation, but also noting that tariffs were likely to impact the jobs market. To date, labour market data has been consistent with a deceleration in employment growth rather than an outright decline. Non-farm payrolls rose 177k in April, above market forecasts, though with downward revisions to previous months. The unemployment rate was steady at 4.2%, as were average hourly earnings at 3.8%y/y. The ISM manufacturing survey remained below 50 in April, though wasn't as weak as markets expected. The FOMC is expected to leave the Fed funds rate unchanged at its first post-tariff meeting on Thursday. No formal update to forecasts will be provided, but qualitative guidance is likely to imply that rate cuts are off the agenda until at least the second half of this year, with inflation concerns coming to the fore.

Asia-Pacific.

Australia's March quarter CPI was slightly above consensus, with the headline measure rising 0.9%qtr (2.4%yr) and the underlying trimmed mean measure 0.7%qtr (2.9%yr). That included a deceleration in market services inflation to 3.3%yr after being stuck at 4.2%yr throughout 2024 (this group has been regularly cited by the RBA when discussing the upside risks to inflation). The March overseas trade report showed a significant rebound in the goods surplus to $6.9bn. Australian goods exporters look to have benefited from tariff front-running by US importers. Over the weekend, the federal election saw the Labor Party returned to government with an increased majority. The Bank of Japan met last week and, unsurprisingly given current US policy uncertainty, left policy unchanged. The BoJ's focus remains on slowly normalising policy, targeting a policy rate of 1.0%.

Europe.

Euro area GDP surprised to the upside, rising 0.4% in Q1 to remain 1.2% higher over the year. European Commission economic sentiment and recent labour market data point to resilience across the region. However, this is unlikely to stand in the way of further interest rate cuts this year. The Bank of England is universally expected to cut the Bank Rate by 25bps to 4.25% this week, with growth concerns outweighing firmer near-term inflation.

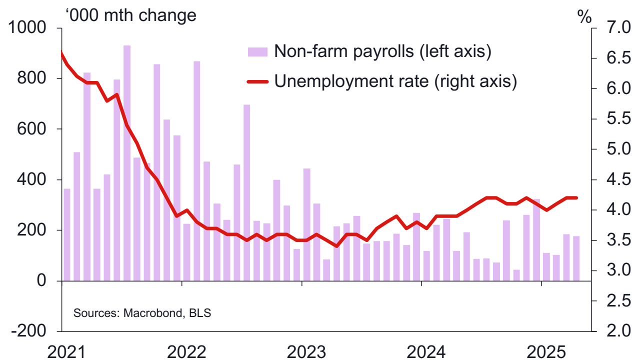
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.1	1.0	2.0	2.2
China	5.2	5.0	5.0	4.7
United States	2.5	2.8	1.1	0.9
Japan	1.9	-0.1	1.0	0.8
East Asia ex China	3.3	4.3	3.7	3.8
India	7.8	6.6	6.2	6.2
Euro Zone	0.4	0.7	0.7	1.2
United Kingdom	0.1	0.7	0.6	1.1
NZ trading partners	3.2	3.2	3.0	3.0
World	3.2	3.3	2.9	3.0

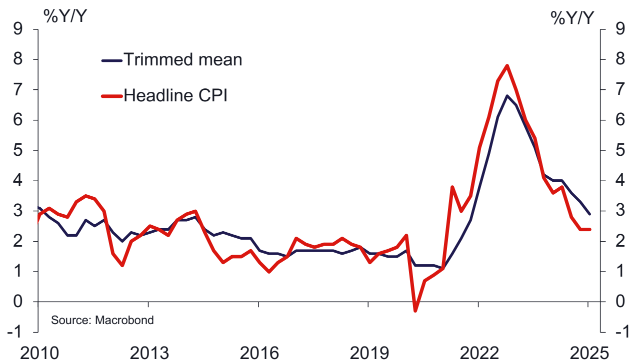
Australian & US interest rate outlook

	2 May	Jun-25	Dec-25	Dec-26
Australia				
Cash	4.10	3.85	3.35	3.35
90 Day BBSW	3.86	3.90	3.45	3.55
3 Year Swap	3.25	3.35	3.50	3.90
3 Year Bond	3.34	3.40	3.55	3.95
10 Year Bond	4.23	4.35	4.45	4.70
10 Year Spread to US (bps)	0	5	5	0
US				
Fed Funds	4.375	4.375	3.875	3.875
US 10 Year Bond	4.23	4.30	4.40	4.70

US non-farm payrolls and unemployment rate



Australian CPI inflation



Financial markets wrap

Foreign exchange.

NZD/USD remains in consolidation mode, in a 0.5900-0.6000 range, which could persist during the week ahead. We would attach a slight upward bias to our near-term outlook.

Global risk sentiment has risen over the past two weeks, as some de-escalation in the US trade wars has been evident. Most recently, on Friday, China's Commerce Ministry expressed conditional willingness to negotiate with the US. Further conciliatory gestures would lift sentiment further, and in turn, currencies such as the NZD. That said, it's too early to conclude the eventual shape of the global trade landscape, and it's likely that more surprises are in store – in both directions.

There's a major NZ event this week - the Q1 labour data on Wednesday, which we estimate will show unemployment rising to 5.3%, but only slightly above the RBNZ's 5.2% forecast. In the US, the Fed will likely remain sidelined amid tariff uncertainty, but there will be Chair Powell's press conference to watch – it often elicits a market reaction.

The NZD/AUD cross fell to 0.92 last week, and has potential to extend the decline to 0.91 this week. Further positive news on US-China tariff negotiations would enable this (AUD is more sensitive to China developments than NZD). Data-wise, there's little of note from Australia, so that any surprise from the NZ jobs data could be significant for the cross.

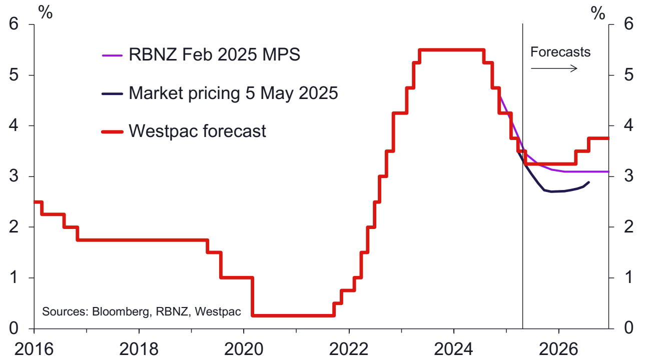
Interest rates.

The NZ 2yr swap rate has hovered above tentative support at 3.03% during the past few weeks, continuing to follow US and AU rates. Local fundamental drivers haven't added much to the mix, NZ economic data momentum largely matching expectations.

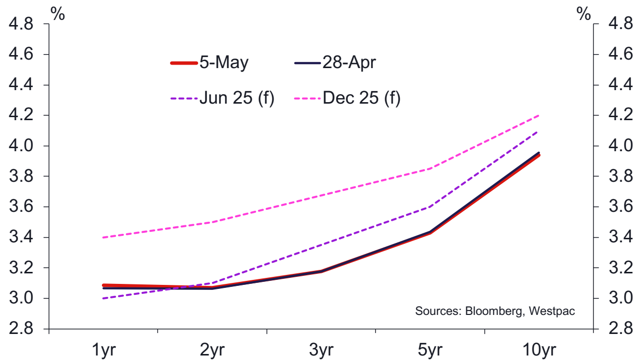
OIS pricing has stabilised during the past few weeks, stuck on three more 25bp cuts in this cycle (while ruling out any chance of a larger 50bp cut in this cycle). Westpac continues to forecast only one more 25bp cut, while the RBNZ's OCR forecast from the February MPS implies one more with a chance of two.

The NZ yield curve, which in April steepened significantly as US long-maturity yields jumped on fears US treasury bonds would lose their safe-haven identity, has calmed and flattened by around 15bp. Further slight flattening is possible during the next few weeks if the US backdrop becomes less risk-averse, but major flattening – led by expectations of the next RBNZ tightening cycle – is now a year-end story at the earliest.

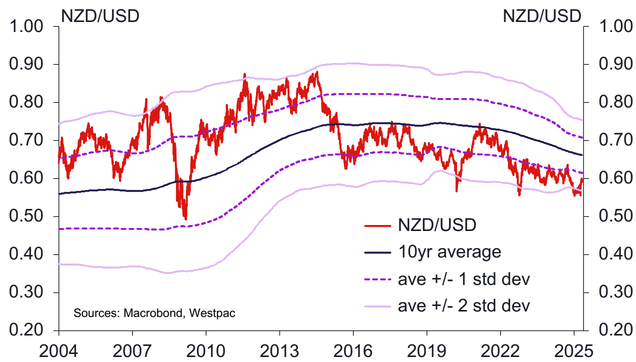
Official Cash Rate forecasts



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	0.594	0.553-0.599	0.553-0.743	0.639	0.57
AUD	0.922	0.897-0.936	0.873-0.971	0.924	0.87
EUR	0.526	0.502-0.549	0.502-0.637	0.577	0.51
GBP	0.448	0.431-0.456	0.431-0.535	0.498	0.44
JPY	86.0	80.5-87.6	63.7-98.6	82.8	79.9

The week ahead

Q1 labour market surveys

May 7,
Unemployment rate – Last: 5.1%, Westpac f/c: 5.3%
Labour Cost Index, private sector – Last: +0.6, Westpac f/c: +0.4%

We expect a further rise in the unemployment rate to 5.3% in the March quarter, which would be the highest level since 2016. Employment appears to have stabilised in recent months, but this is insufficient to keep up with the growth in the working-age population.

The ongoing slack in the labour market suggests that we should also see a further slowdown in wage growth. We expect a 0.4% rise in the Labour Cost Index for the private sector, with the public sector seeing a somewhat larger increase due to a pay agreement for teachers.

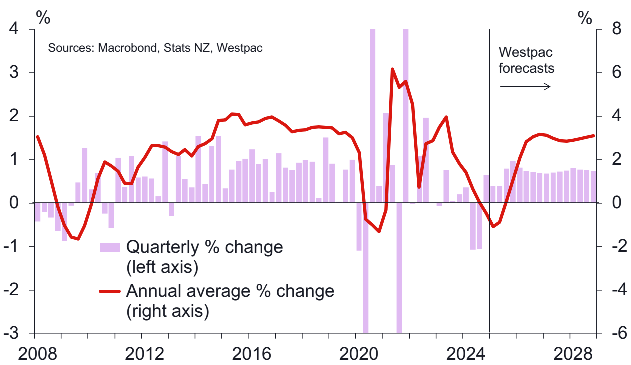
Labour market indicators

Economic and financial forecasts

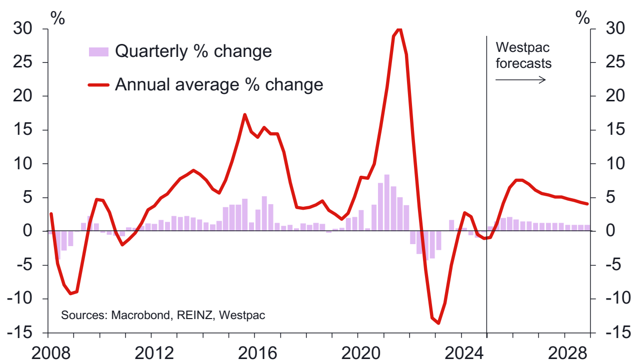
Economic indicators	Quarterly % change				Annual % change			
	Dec-24	Mar-25	Jun-25	Sep-25	2024	2025	2026	2027
GDP (production)	0.7	0.4	0.4	0.8	-0.5	1.0	3.2	2.8
Consumer price index	0.5	0.9	0.2	0.9	2.2	2.8	2.0	2.1
Employment change	-0.1	-0.1	0.1	0.1	-1.1	0.5	2.1	2.0
Unemployment rate	5.1	5.3	5.4	5.4	5.1	5.3	4.6	4.1
Labour cost index (all sectors)	0.6	0.6	0.5	0.5	3.3	2.2	1.8	2.1
Current account balance (% of GDP)	-6.2	-5.5	-4.6	-4.3	-6.2	-4.0	-4.5	-4.4
Terms of trade	3.1	7.1	2.6	-1.1	13.6	8.0	1.4	2.3
House price index	-0.2	0.8	1.5	2.0	-1.1	6.5	6.1	5.1

Financial forecasts	End of quarter				End of year			
	Dec-24	Mar-25	Jun-25	Sep-25	2024	2025	2026	2027
OCR	4.25	3.75	3.25	3.25	4.25	3.25	3.75	3.75
90 day bank bill	4.45	3.86	3.35	3.35	4.45	3.35	3.85	3.85
2 year swap	3.64	3.46	3.10	3.25	3.64	3.50	4.00	4.00
5 year swap	3.73	3.71	3.60	3.70	3.73	3.85	4.25	4.25
10 year bond	4.51	4.63	4.60	4.65	4.51	4.70	4.90	4.95
TWI	69.5	67.8	66.7	66.2	69.5	66.2	67.3	68.1
NZD/USD	0.59	0.57	0.56	0.56	0.59	0.57	0.60	0.62
NZD/AUD	0.91	0.90	0.90	0.89	0.91	0.87	0.87	0.87
NZD/EUR	0.55	0.54	0.51	0.51	0.55	0.51	0.52	0.54
NZD/GBP	0.46	0.45	0.44	0.43	0.46	0.44	0.45	0.46

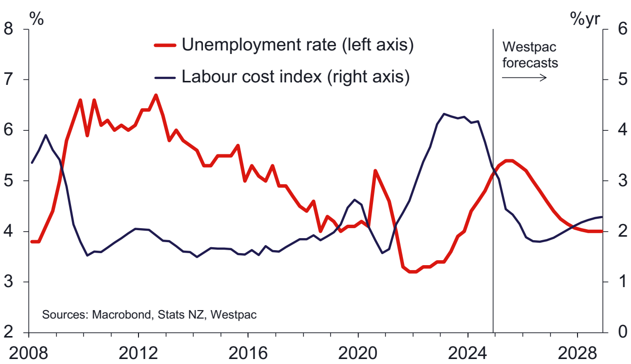
GDP growth



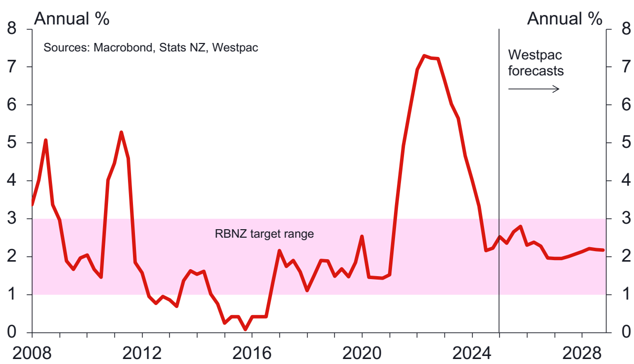
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 05					
Aus	Apr MI Inflation Gauge, %yr	2.8	–	–	Easing domestic price growth to balance global concerns.
	Apr ANZ-Indeed Job Ads, %mth	0.4	–	–	In a stable 114-117pt range over the past seven months.
Eur	May Sentix Investor Confidence, index	–19.5	–15.0	–	Expectations index back in the negative.
US	Apr ISM Services PMI, index	50.8	50.2	–	Edging towards contractionary levels.
Tue 06					
NZ	Apr ANZ Commodity Prices, %mth	-0.4	–	–	Further gains in meat and dairy prices.
Aus	Mar Dwelling Approvals, %mth	-0.3	–0.6	-1.5	Have been on an upward trajectory since early-2024.
	Mar Household Spending Indicator, %mth	0.2	0.3	0.5	Feb marked the fifth consecutive monthly rise.
Chn	Apr Caixin Services PMI, index	51.9	51.8	–	Holding firm at above 50 levels.
Eur	Mar PPI, %yr	3	2.6	–	PPI inflation has further strengthened since late-24.
US	Mar Trade Balance, US$bn	-122.7	-122	–	Monthly deficit since Dec averaging twice its 10yr average.
Wed 07					
NZ	RBNZ Financial Stability Report	–	–	–	Six-monthly update, unlikely to be market moving.
	Q1 Unemployment Rate, %	5.1	5.3	5.3	Unemployment rate is expected to tick higher…
	Q1 Employment, %qtr	-0.1	0.1	0.1	…with jobs steady but population still growing.
	Q1 LCI Wage Inflation (Pvte, Ordinary Time), %qtr	0.6	0.5	0.4	Slack in labour market is easing wage growth.
Chn	Apr Foreign Reserves, US$bn	3241	–	–	Moving higher reflecting growing trade surplus.
Eur	Mar Retail Sales, %mth	0.3	–0.1	–	Slowly regaining momentum despite monthly fluctuations.
US	FOMC Policy Decision	4.375	4.375	4.375	No policy change as the FOMC assesses the tariff impac.
Thu 08					
UK	BoE Policy Decision	4.5	4.25	–	Growth jitters to clash with firmer near-term inflation.
US	Mar Consumer Credit, $bn	–0.8	10	–	To recover following an unexpected pull-back in Feb.
	Q1 Productivity, %yr	1.5	-0.5	–	Productivity set to record first decline since 2022.
	Apr NY Fed 1-Yr Inflation Expectations, %yr	3.58	–	–	Medium term inflation expectations remain more stable.
	Wkly Initial Jobless Claims, 000s	241	–	–	Increased slightly last week.
Fri 09					
Jpn	Mar Household Spending, %mth	–0.5	0.5	–	Spending is improving, just not impressively.
Chn	Apr Trade Balance, US$bn	102.6	88.8	–	Reaction to the escallation of the trade war with the US.
UK	BoE's Bailey Speaks	–	–	–	BoE Governor gives the keynote address in Reykjavik.
US	Fedspeak	–	–	–	Fed's Williams, Kugler and Barr speak in Reykjavik.
	Fedspeak	–	–	–	Different Fed speakers at the monetary policy conferece.
Sat 10					
Chin	Apr PPI, %mth	-2.5	–	–	Have been broadly stable; negative since 2022.
	Apr CPI, %yr	–0.1	–	–	Core inflation back in the positive as headline wallows.

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