WEEKLY ECONOMIC COMMENTARY

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

Commercial property in focus

Since peaking in 2021, the value of commercial property assets in New Zealand has fallen by around 10%.[1] That sharp decline followed the rise in interest rates and related weak economic activity in recent years. The number of commercial property transactions has also fallen to low levels, with the value of sales dropping below $6b over the 12 months to June 2024. That's the lowest in more than a decade and well down from the levels of around $10b per annum that we saw in the years prior to the pandemic.[2]

Conditions in the commercial property sector are expected to firm again over the coming years, with investor confidence already turning higher in recent months. Interest rates are now dropping, and GDP growth is expected to accelerate to 2.3% in 2025 and 2.7% in 2026. That strengthening in economic activity is likely to fuel increased occupier demand for space, and it will also boost investor appetites. However, with the recovery in economic growth to be gradual, the demand for commercial property is likely to remain subdued in the near term. We're also likely to see conditions remaining varied across market segments, as well as more space becoming available over the coming year. Those conditions will be reflected in rents and yields.

Office.

Recent years have seen significant changes in businesses operating models that have impacted the demand for office space. Even before the pandemic, many businesses were reassessing the amount of space they needed and reducing their footprints. That trend accelerated significantly over the past few years with the increasing prevalence of work-from-home and flexible working

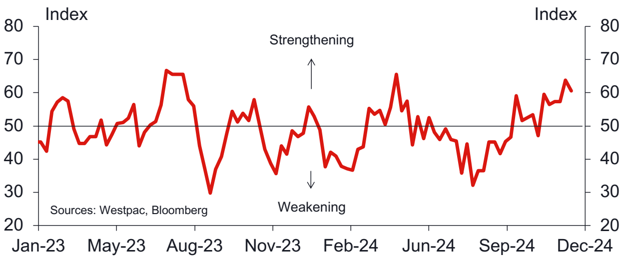
1 RBNZ Financial Stability Report Special topic August 2024, "Commercial Property in New Zealand".

2 **colliers.co.nz/en-nz/real-estate-research/new-zealand-research-report-november-2024**

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
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
19 Feb 25	RBNZ OCR Review & Monetary Policy Statement

models. Data from Seek show that around 9% of advertised jobs can now be done from home (up from only around 1% prior to the pandemic)[3] and a recent report from CBRE showed that office attendance for the average worker is now just over three days each week.[4] Working from home has been especially popular in Wellington, where around 13% of job ads include work from home options. It's also popular in Auckland.

Although there has been some reversal of work-from-home practices recently, the shift toward more flexible working policies means that many businesses now need less space. At the same time, the types of spaces occupiers are demanding have been changing. Occupiers are increasingly seeking higher quality premises that are close to amenities to help attract staff back into the workplace. They are also opting for premises that meet environmental and seismic concerns.

In response to those shifting preferences, there continues to be a significant amount of development and refurbishment work occurring, especially in Auckland. However, this is also resulting in a two-tier market, with strong demand for premium and A-grade space, and less demand for lower grade offerings. That split in occupier preference has resulted in a growing wedge in rents between higher grade properties (which are able to command higher rents) and lower grade ones. It's also resulted in increased vacancy rates among lower grade properties.

Retail.

Occupier demand for retail space has fallen in recent years. In part, that's been because of tough economic conditions. Sharp rises in living costs and related increases in interest rates saw retail spending levels fall by close to 3% in the year to September. On top of that, the pandemic accelerated the shift to online purchases, with a related downturn in spending in traditional brick-and-mortar stores. There have been similar trends in the hospitality sector, with households winding back their spending in bars, cafes and restaurants in response to the squeeze on their finances.

In some areas, that downturn in both retail and hospitality spending has been compounded by changes in how and where we are working. The shift to work-from-home and hybrid working models has seen reduced foot traffic in city centres in metropolitan areas like Auckland and Wellington, and there have been related falls in spending in those areas. However, some of the spending lost from city centres has actually shifted to suburban areas. In addition, online delivery services have captured some of the spending that previously occurred in takeaway or sit-down restaurants.

We've also seen differing demand trends across store types. While strip-retail and central city locations have been out of favour, we've seen firmer sales and demand for space from big-box / large-format retailers. Similarly, demand in shopping malls has tended to be more resilient, with operators able to combine retail, dining and entertainment activities in one location to attract customers.

In the face of weaker consumer spending and shifts in spending patterns, here's been a sharp decline in the amount of new retail and hospitality space being developed. As with other segments, rental growth has also slowed over the past year.

We expect that retail spending growth will remain limited over the next few months. A more material lift is expected to take shape through the first half of next year as the effects of lower interest rates ripple through the economy.

Industrial space.

A corollary of the shift away from traditional physical stores and towards online spending has been increased demand for warehouse and storage buildings. That demand for space has also been supported by a focus on more efficient inventory management by retailers.

While we're continuing to see firm occupier demand, some of the tightness in the industrial property space is now easing. While vacancy rates remain low in both Auckland and Christchurch, they have been nudging higher. And there is also a large amount of space currently in development. We've also seen rental growth slowing again over the past year.

Rents.

With a downturn in economic growth, the past year saw the growth in commercial rents slowing across all segments.

Rental growth is expected to lift over the coming years as economic activity picks up again and fuels the demand for space. Even so, rental growth is likely to remain gradual for some time yet. That's because the recovery in activity is likely to remain gradual in the near term. In addition, inflation is expected to track close to 2% over the year ahead, meaning smaller CPI Indexation adjustments to rents than we saw over the past few years.

Increases in supply could also be a brake on rental growth. Vacancy rates have been rising (albeit from low levels in some cases), and there is a large amount of industrial and office space in development.

3 seek.co.nz/about/news/article/economist-insight-jan24
4 cbre.co.nz/insights/books/new-zealand-office-occupier-survey-2024/hybrid-working

Yields.

Commercial property yields firmed over the past couple of years as interest rates pushed higher and economic growth stalled. That reversed the declines seen in the preceding years, with yields now back around the levels we last saw in 2015/16.

For prime grade properties, average gross yields on industrial assets are now around 5.5%, office around 6% to 7%, and yields on retail properties have averaged around 7% to 7.5% (though there are sizeable differences across regions and asset classes).

Commercial property yields have flattened off in recent months. And with interest rates now dropping, some modest declines are expected over the coming year.

As a comparison:

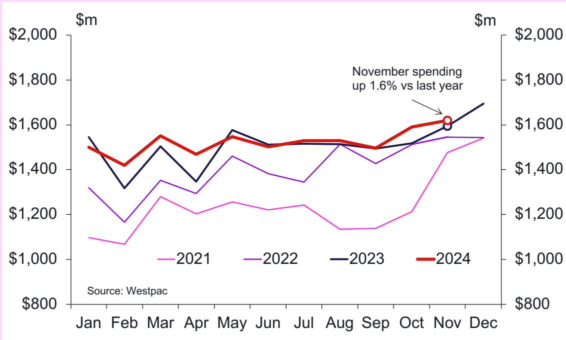
- The Official Cash Rate has fallen to 4.25% and is expected to reach a low of 3.5% in mid-2025.
- Two-year swap rates have fallen to around 3.63% and are expected to rise to 3.95% over 2025.
- Term deposit rates have fallen to around 5% or lower depending on the term.

Satish Ranchhod, Senior Economist

Chart of the week.

We're heading into the holiday shopping season and New Zealanders are starting to open their wallets again. Spending on Westpac issued credit and debit cards was up 1.6% in November compared to the same time last year. That lift in spending appetites has been supported by tax cuts and other income support measures that were introduced in late-July. Mortgage rates have also started to drop, and though the full impact of those reductions is yet to flow through to households' back pockets, consumer confidence is on the rise and petrol prices have declined. But while spending is starting to lift, it's still a mixed picture across sectors. Spending in the hospitality sector is on the rise. However, spending on apparel and durables (like household furnishings) has been softer, suggesting only a limited boost from the Black Friday / Cyber Monday sales events. We expect further modest gains in spending over the Christmas period, with a more pronounced lift next year as more households roll onto lower mortgage rates.

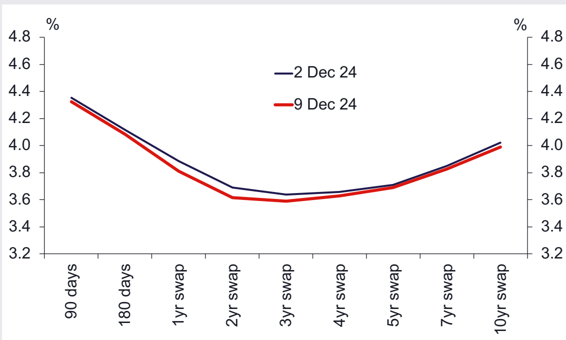
Retail spending continuing to gradually grind higher



Fixed versus floating for mortgages.

The RBNZ delivered a second 50bp cut in the OCR in November. We're forecasting another 50bp cut in February and expect the cash rate will bottom at 3.50% 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

U.S.

Non-farm payrolls rose 227K in November, which was slightly firmer than expected and wage growth remained solid. However, the unemployment rate rose to 4.25% which left markets comfortable with their expected 25bp rate cut in December. Fed Chairman Powell's remarks on Wednesday stated that "the US economy is in very good shape, and there's no reason for that not to continue". However, he also commented that the Fed "can afford to be a little more cautious" about decisions on rate moves. Other Fed speakers including Bowman and Daly were supportive of more gradual rate adjustments. The highlight on the data front this week is the US CPI data on Wednesday.

Asia-Pacific.

Australian GDP rose by 0.3% in Q3, less than expected. The shortfall was largely in household consumption, which was flat for the quarter. Tax cuts spurred a 0.8% rise in real household incomes, but this appears to have been saved rather than spent during the quarter. Subsequent data has pointed to a solid lift in spending in October, though this may be distorted by shifting seasonal patterns around end-of-year discounting. Government spending made the biggest contribution to GDP growth, partly due to a 'reallocation' of electricity spending by households to the government through energy rebates. However, this marks a continuation of recent trends where government spending as a share of the economy has continued to set new record highs.

Looking to the week ahead, we expect the RBA to leave rates unchanged at its review on Tuesday. Despite the soft GDP result, the RBA will want to see evidence of a sustained deceleration in inflation over the coming months. We expect the November labour market report to show a continued gradual rebalancing, with modest growth in jobs and a small uptick in the unemployment rate to 4.2%.

Europe.

Turmoil at the top continued in the region, with the French government failing a no-confidence vote after a standoff with the opposition over a draft 'austerity budget'. French government bonds are now trading at yields close to those of Greece. There were no surprises from the regional economic data, with Q3 GDP growth being confirmed at 0.4% on the final estimate, and the unemployment rate holding steady at 6.3% in October. The ECB is widely expected to deliver another 25bp cut at its meeting on Thursday night.

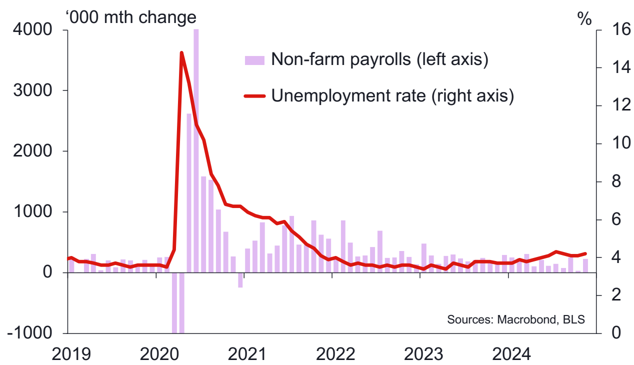
Trading partner real GDP (calendar years)

	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

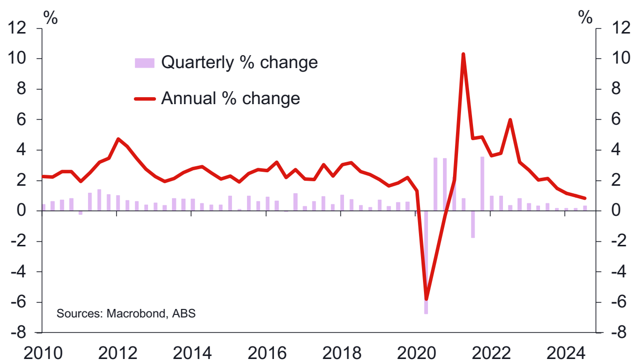
Australian & US interest rate outlook

	6 Dec	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	3.82	4.00	3.90	3.80
3 Year Bond	3.82	3.95	3.80	3.65
10 Year Bond	4.23	4.50	4.45	4.55
10 Year Spread to US (bps)	6	20	15	5
US				
Fed Funds	4.625	4.375	3.875	3.375
US 10 Year Bond	4.17	4.30	4.30	4.50

US non-farm payrolls and unemployment rate



Australian GDP growth



Financial markets wrap

Interest rates.

NZ swap rates fell back towards the bottom of their recent range last week, with the 2yr closing at 3.615%. The NZ market has opened little changed this morning following Friday's payrolls report.

Markets have fully priced the whole RBNZ easing cycle, implying it will end later next year with an OCR at around 3.15% (below Westpac's forecast of 3.50%). The RBNZ has explicitly signalled a likely 50bp for February, which markets have priced as a 75% chance, suggesting potential for very short maturities (0 to 1yr) to fall further. However, the 2yr and 5yr swap rates will probably remain above their cycle lows of 3.50%.

The main event risk for rates markets this week will likely come from offshore. Wednesday's US CPI will influence market pricing for a Fed rate cut the following week, with any movement in US rates likely to spill over to NZ rates. Other key events include central bank meetings in Australia (Tuesday), Canada (Wednesday) and the euro zone (Thursday), with both the BoC and ECB expected to continue their easing cycles. The Swiss National Bank is also expected to ease policy on Thursday.

Domestically, this week we will receive Q3 GDP partial indicators and consumer spending and housing data for November.

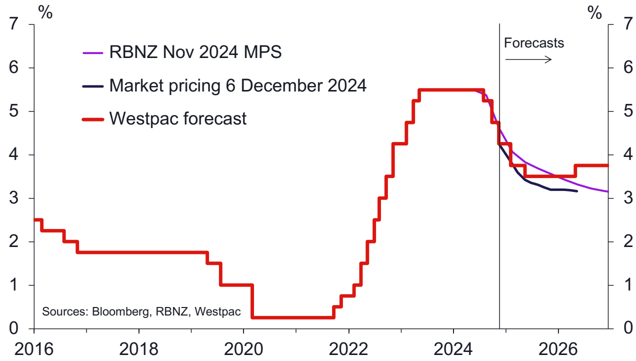
Foreign exchange.

After falling 8% from early October to a low of 0.5797, the NZD/USD had enjoyed a modest corrective rally to 0.5927. However, that rally lost its legs last week, with the Kiwi trading back down to 0.5830 in the wake of the US payrolls data. Looking ahead, major support lies at 0.5775 (October 2023 low), which if broken would signal a move to around 0.5500.

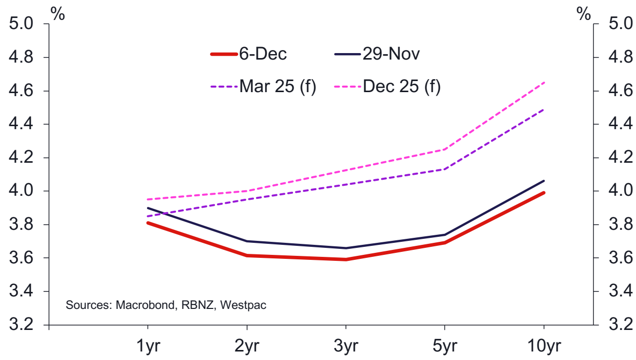
Our fair value model estimates that fair value is currently around 0.61. The implied 2c undervaluation is moderate in the context of the model's history and is a result of the US dollar's influence on NZD/USD becoming stronger. Our expectation is that the US dollar will remain in an uptrend, fuelled by expectations the US economy will outperform most G10 economies. In addition, the risk of global trade frictions is supportive of the US dollar.

NZD/AUD moved higher last week, with a weaker than expected Australian GDP report for Q3 rekindling the market's enthusiasm for pricing RBA rate cuts over the first half of next year (a rate cut is fully priced by April). We continue to expect the cross to test 0.89 during the next few months. That said, there will remain much uncertainty regarding the Trump administration's trade policy, which could have different impacts on the NZD and the AUD.

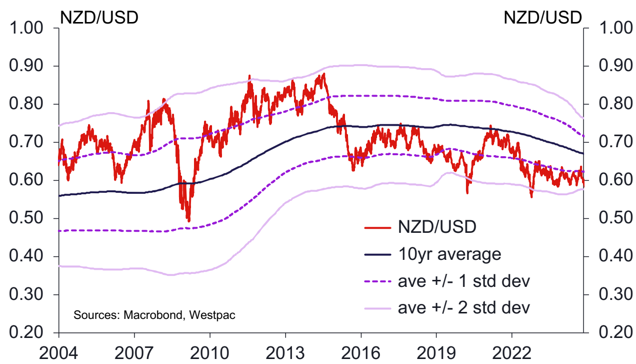
Official Cash Rate forecasts



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	0.584	0.581-0.636	0.555-0.743	0.644	0.59
AUD	0.914	0.895-0.924	0.873-0.992	0.928	0.89
EUR	0.553	0.548-0.569	0.517-0.637	0.580	0.55
GBP	0.458	0.458-0.475	0.456-0.535	0.501	0.46
JPY	87.6	86.5-92.1	61.3-98.6	81.4	90.3

The week ahead

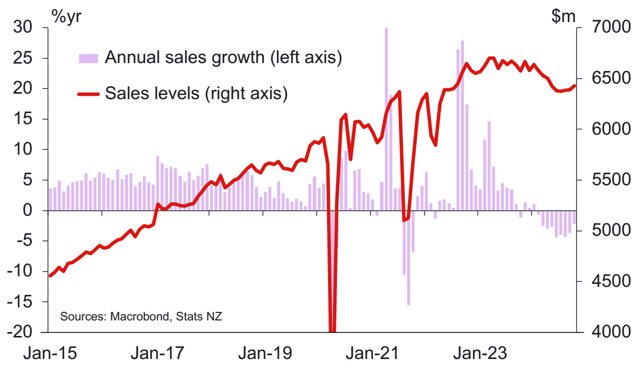
Nov retail card spending

Dec 12, Last: +0.6%, Westpac f/c: +0.5%

Retail spending levels rose 0.6% in October. That was the third increase in a row and comes on the back of tax cuts in late July, as well as the start of the RBNZ's rate cutting cycle in August. Gains have been centred on the hospitality sector.

We're forecasting another moderate rise of 0.5% in November. In addition to easing borrowing costs, spending is likely to be boosted by sales events like 'Black Friday' promotions. However, a rise in petrol prices will limit any increases in spending in other areas.

Monthly retail card spending



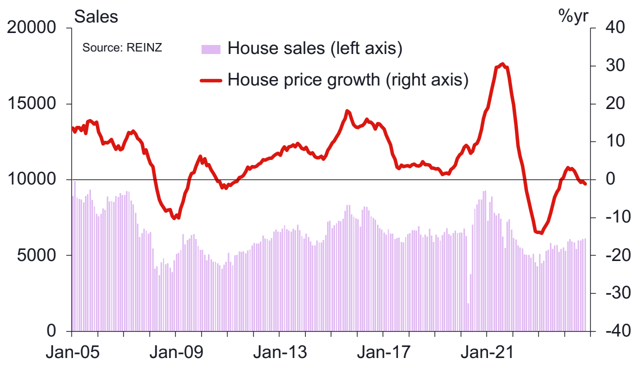
Nov REINZ house prices and sales

Dec 13 (TBC), Prices Last: –1.1%yr; Sales Last: +20%yr

As mortgage rates have fallen, we've seen clear signs of a revival in interest among potential buyers, with home loan applications well up on last year. However, that has yet to translate into a lift in activity – house sales have risen only modestly in recent months, and sale prices have remained subdued.

The large number of listings on the market suggests that buyers are not under pressure to act. As this backlog is worked through, we would expect to see a more meaningful lift in prices next year.

REINZ house prices and sales

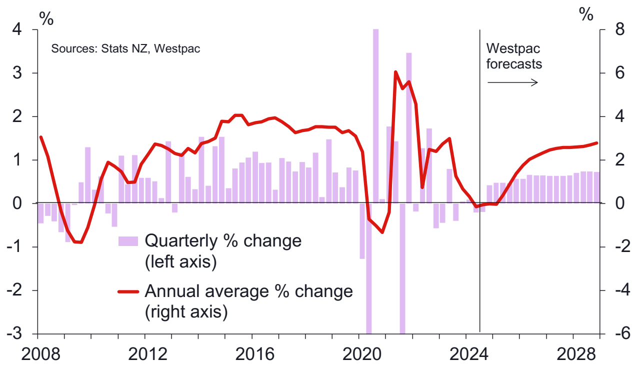


Economic and financial forecasts

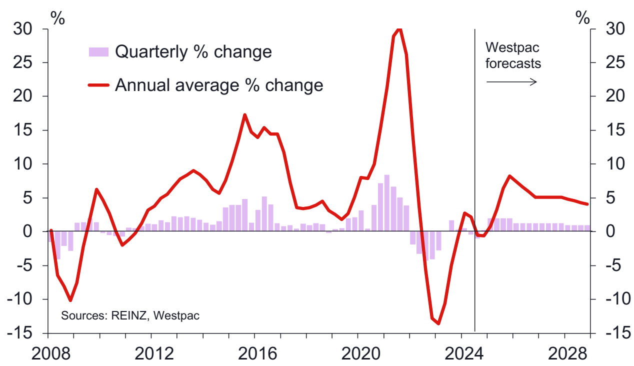
Economic indicators	Quarterly % change				Annual % change			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
GDP (production)	-0.2	-0.2	0.3	0.4	0.7	0.0	1.5	2.8
Consumer price index	0.4	0.6	0.4	0.5	4.7	2.1	2.0	2.1
Employment change	0.2	-0.5	-0.3	-0.1	2.8	-1.0	0.2	2.1
Unemployment rate	4.6	4.8	5.1	5.3	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

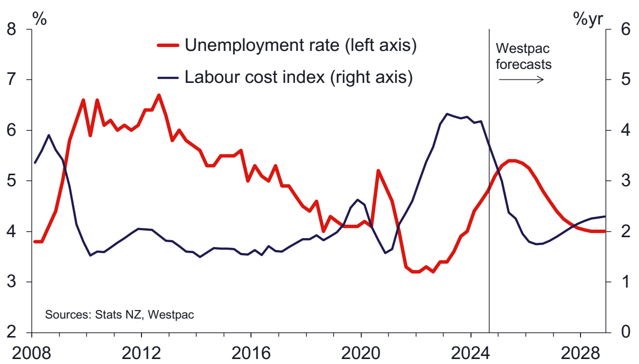
GDP growth



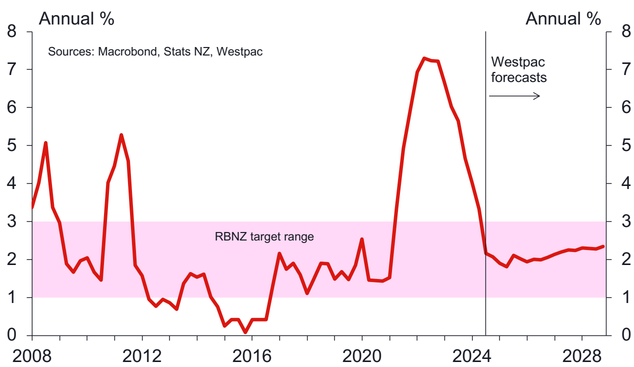
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 09					
Jpn	Oct Current Account Balance (SA), ¥trn	1.3	2.2	–	Stronger Yen points to a wider current account surplus in Oct.
	Q3 GDP, %qtr	0.2	0.3	–	Final estimate might show an upward revision to Q3 GDP.
Chn	Nov CPI, %ann	0.3	0.4	–	Little or no recovery in Chinese inflation….
	Nov PPI, %ann	–2.9	–2.9	–	…as producer price inflation remains well below zero.
	Nov M2 Money Supply, %ann	7.5	7.5	–	Looser monetary conditions support money supply…
	Nov New CNY Loans YTD, trn	16.5	17.5	–	… and lending growth. Note this data is due December 9-15.
Eur	Dec Sentix Investor Confidence, index	–12.8	–13.2	–	Signs of higher uncertainty impacting confidence.
US	Oct Wholesale Inventories, %mth	0.2	–	–	Final estimate.
Tue 10					
Aus	Nov NAB Business Conditions, index	7	–	–	Stable business conditions and higher business confidence.
	Dec RBA Policy Decision, %	4.35	4.35	4.35	Reaction to Q3 GDP will be the focus.
Chn	Nov Trade Balance, US$bn	95.7	92	–	Sep surplus close to record highs of June 2024.
US	Nov NFIB Small Business Optimism, index	93.7	94.1	–	Small businesses feeling more confident after the US election.
	Q3 Labour Productivity, %qtr	2.2	2.2	–	Final estimate likely to confirm above-2%yr increase.
Wed 11					
Aus	RBA Deputy Governor	–	–	–	Hauser speaking at ABE Annual Dinner.
US	Nov CPI, %mth	0.2	0.3	0.3	Goods inflation trend critical through 2025 given tariffs.
Can	Bank of Canada Policy Decision	3.75	3.25	–	25bp or 50bp interest rate cut in Canada.
Thu 12					
NZ	Nov Retail Card Spending, %mth	0.6	–	0.5	Spending levels starting to push higher again.
Aus	RBA Assist' Governor (Fin Syst)	–	–	–	Jones speaking at AusPayNet Summit 2024.
	Nov Employment Change, 000s	15.9	25	20	Black Friday remains a potential wildcard, but on a multi-month…
	Nov Unemployment Rate, %	4.1	4.2	4.2	… basis, the labour market remains solid, easing only gradually.
Eur	Dec ECB Policy Decision (Deposit Rate), %	3.25	3	3	25bp interest rate cut is fully priced in.
US	Nov PPI, %mth	0.2	0.3	–	Underlying inflationary pressures remain quite stable.
	Initial Jobless Claims	224	–	–	Historically low, likely to remain so in coming months.
Fri 13					
NZ	Nov REINZ House Sales, %yr	20	–	–	Lower mortgage rates are reviving buyer interest…
	Nov REINZ House Prices, %yr	–1.1	–	–	… but sale prices have remained subdued.
	Nov Manufacturing PMI, index	45.8	–	–	Current conditions remain soft.
	Oct Net Migration, no.	2310	–	–	Net inflows easing as job prospects weaken.
Aus	RBA Assist' Governor (Economic)	–	–	–	Hunter speaking at University of Adelaide.
Jpn	Q4 Tankan Large Manufacturers, index	13	13	–	Major business confidence survey from the BoJ.
	Oct Industrial Production, %mth	3	–	–	Final estimate to confirm a steep increase in October.
Eur	Oct Industrial Production, %mth	–2.0	0	–	Weakness in manufacturing to continue.
UK	Dec GfK Consumer Sentiment, index	–18	–	–	Mood of UK consumers ahead of the holiday season.
	Oct Monthly GDP, %mth	–0.1	–	–	Output growth at the start of Q4.
US	Nov Import Price Index, %mth	0.3	-0.3	–	Likely to signal that imported inflation remained low.

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