WEEKLY ECONOMIC COMMENTARY

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

Steady as she goes into the storm

Domestic labour market data took a backseat to the global events last week. The as-expected weakening in the labour market cements in the next 50bp cut in the OCR to 3.75%. But stormy seas lie ahead as global trade frictions heat up.

Most of the week was focused on the market reaction to fluctuating news on the evolution of global trade policies. We are not surprised at the events so far - the new US president is merely delivering on promises made during his campaign. We don't know just how far-reaching the change in the global trading environment will be. Nonetheless, it seems clear that trade will be more fettered than it has been – and that will have implications for trading countries like New Zealand.

While the magnitude of the eventual change in the trade environment is up in the air, the implications in terms of direction are clear. US tariffs will result in slower trading partner growth, even if they are not directed at NZ exporters specifically. Hence this is a negative shock for NZ. The magnitude of that shock will be determined by whether tariffs directly affect NZ and the extent to which tariffed nations retaliate. The end size and extent of coverage of tariffs globally will also be important.

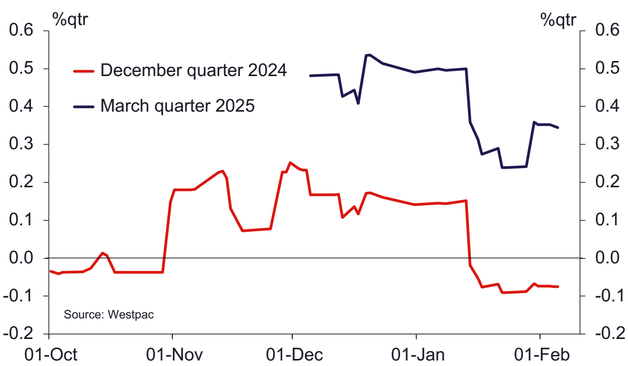
And one thing we should keep in mind is that 'tariff' is no longer a dirty word on the global stage. Countries will likely be more emboldened to deploy protectionist policies in the future now that the US, Canada, Mexico, and Europe are using these tools more earnestly. None of this is good for NZ's goal of breaking down trade barriers to facilitate a better environment for our exporters.

US tariffs are more likely than not to add to global inflation pressures – at least for a while. For countries that impose tariffs the linkage is obvious; for those that don't, the impact will be from weaker exchange rates as the

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
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
9 Apr 25	RBNZ OCR Review

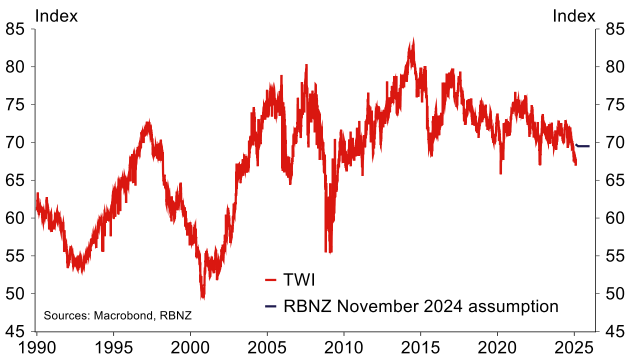
USD remains strong. While there could be some unders and overs in terms of inflation across different categories of imported goods (some manufactured goods prices might be depressed if they can't be profitably sold in markets now subject to tariffs), these may be more likely to change relative prices, as opposed to overall inflation. The impact of changing prices and excess demand on inflation expectations will be of most interest to central banks. Interest rates globally are likely to be higher for a while as the tariff price shock flows through.

The bigger impacts will be on those countries with a heavier trading relationship with those countries imposing tariffs. NZ's exposure is sizeable in that regard as the US is our second-largest market for goods exports, and exports account for a large share of our GDP.

All of this has clear but complex implications for the NZ outlook. The hit to global demand makes a case for weaker incomes and demand in New Zealand. But there will be important mitigating factors before we can determine the implications for NZ interest rates.

The key factor is the extent to which the exchange rate buffers this shock. We can clearly see the impact of this buffer in action – the TWI is down 6% since early October when it became clear that Trump had a good shot of implementing his anti-trade agenda. Research generally indicates about half of the impact of tariff introduction is offset by the exchange rate. That's why the USD is strong, and the NZD is not.

NZD trade-weighted index

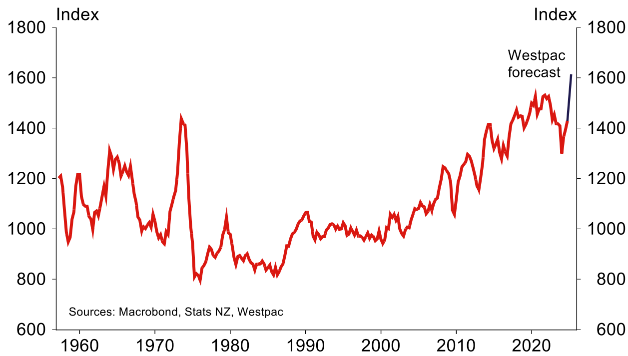


The weaker exchange rate/weaker incomes combination will change the composition and level of inflation. The depreciation so far will have a significant impact on tradable inflation in the year ahead and will likely keep headline inflation in the top half of the RBNZ's 1% to 3% target band. Some of this extra inflation may be offset if the income hit delays the economic recovery. But absent calamity, there seems room to play with before a sub-1% inflation rate is in prospect.

We also need to remember we are not facing a single shock. Tariffs are not the only thing on Trump's mind. A significant expansion of US fiscal policy is in the offing as Trump's 2017 tax cuts are extended, even if the DOGE can cut a few Politico subscriptions here and there. US exceptionalism could continue for a while.

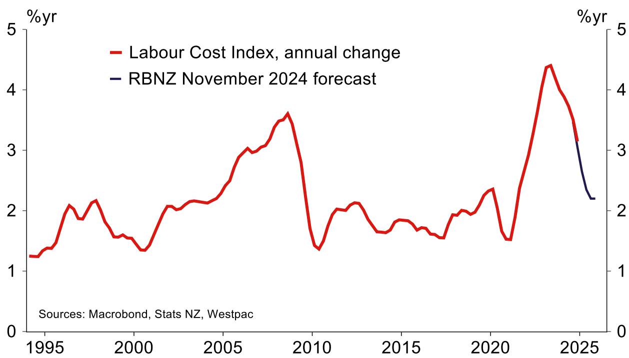
Perhaps more importantly, the new negative trade shock is being overlaid on top of much more positive news from higher New Zealand commodity prices. Last year NZ's terms of trade rose 18% as dairy and horticulture prices surged and even the much-maligned meat markets regained their footing. Last week saw another very strong GDT dairy auction where prices rose 3.7%. It's now likely this season's milk price will exceed our current estimate of $10/kg. In addition, next season's return could also be very high if the exchange rate remains weak and world demand remains firm. That's a big if, but a key possibility lurking under the radar.

Merchandise Terms of Trade



In the end, the direction for interest rates will take its tone from the fortunes of the labour market. Last week's data was boringly in line with expectations. The 5.1% unemployment rate was close to forecast and wage growth continued to drop. Where the unemployment rate peaks, and how quickly wage growth declines from here, will be key. The RBNZ will plough on with rate cuts if the labour market remains weak but will stop when it's clearer the peak in the unemployment rate is in sight. Last week's data gave no sense of implosion in either unemployment or wages – indeed wage growth still looks a bit high.

Labour Cost Index, private sector



We retain our view the RBNZ will cut 50bp this month but will signal a likely slowing of the pace and make no promises from there. There are just too many uncertainties – and they are not all to the downside.

Updated outlook for the NZ dollar and currencies.

Given the potential inflationary consequences of tariffs for the US, along with capacity constraints evident in the economy, we no longer expect rate cuts from the Fed this year. Instead, we now expect the FOMC to remain on hold over 2025 with two 25bp rate cuts expected in the first half of 2026. A gradual rise in US term premium will offer additional support for the currency, particularly if, as we expect, inflation remains benign elsewhere. However, this strength in the US dollar and inflation will inevitably come at the cost of weaker growth for the US.

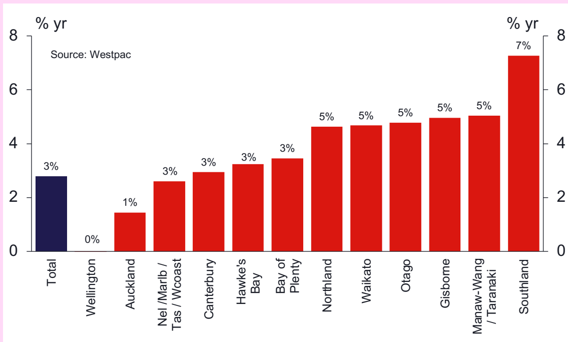
Given those conditions, we expect the NZ dollar will track around US 54 cents this year, before rising to 59 cents over 2026. The AUD/USD is expected to fall to 60 cents through the first half of the year, before rising to 62 cents by the end of 2025. The NZD/AUD cross is forecast to fall to 90 cents through the first half of 2025, before dropping back to 87 cents through the back part of the year.

Kelly Eckhold, Chief Economist

Chart of the week.

With financial pressures in the economy easing, retail spending levels have been rising again in recent months. However, the recovery to date has been gradual, with spending in the three months to January up just 2.8% compared to the same time last year. Spending trends have also been mixed across the country. We've continued to see restrained spending growth in Auckland (up 1.4% over the past year), while spending in Wellington has stalled. In contrast, areas with strong agricultural backbones – like Southland, Otago, Gisborne and Taranaki/Whanganui/ Manawatu – have seen larger lifts in spending. That likely reflects the recent gains in commodity prices and a related boost to rural incomes. Importantly, with continued a firming in export commodity prices and a fall in the NZ dollar, spending in New Zealand's regional centres is likely to continue outpacing urban areas.

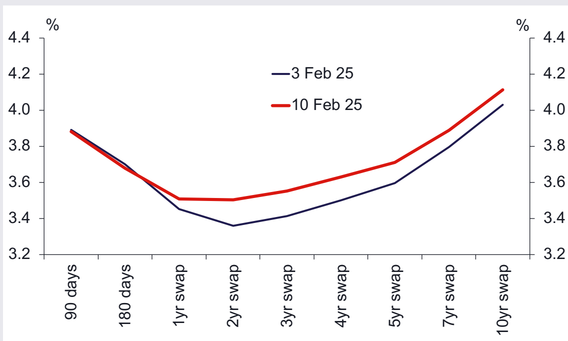
New Zealand spending growth by region (Three months to January vs same time last year)



Fixed versus floating for mortgages.

We're forecasting the cash rate to bottom at 3.25% in mid-2025 and see balanced risks around that forecast. Markets have factored in more easing than this into mortgage rates and suggest the OCR will bottom closer to 3%. Longer term mortgage rates have fallen – in some cases significantly – and now look attractive to fix for longer periods, particularly in the two- to three-year space. Shorter term mortgage rates are likely to fall in the near term once the RBNZ cuts 50bp this month but would still likely remain above current longer term fixed rates. Fixing shorter than a year is a bet that the OCR bottoms somewhat lower than 3%.

NZ interest rates



Global wrap

North America.

The US agreed to a one month pause on the imposition of tariffs with both Canada and Mexico in exchange for strengthening protections along the border. At the same time, China has responded to the increase in US tariffs with its own targeted increase in tariffs on selected US imports. Negotiations between the countries are continuing, while President Trump has flagged plans to also impose tariffs on European imports. On the data front, the January labour report suggested a still solid labour market. Jobs growth was lower than expected at 143k but may have been affected by the wildfires in California. Job growth in the previous two months was revised up, the unemployment rate slipped to 4.0% and wages were strong. Other US data painted a mixed picture of US business sector conditions, with stronger than expected gains in construction activity and the manufacturing ISM, but unexpected softness in the Services PMI. In the household sector, consumer confidence has fallen, while expectations for inflation have taken a sizable step higher. The week ahead includes updates on CPI on Wednesday, and both retail and industrial production on Friday. In addition, Fed Chair Powell will be testifying before the house on Wednesday.

Europe.

The BOE cut the bank rate 25bps last week in a 7 to 2 vote (the dissenters supported a larger 50bp cut) and growth forecasts reduced. Governor Bailey indicated that he expects to be able to cut rates further, but elevated domestic inflation and potential US tariffs means the BOE will take a "gradual and careful" approach. The ECB also released estimates of their neutral rate which is in the range of 1.5-2.25% suggesting room for further interest rate cuts in Europe.

Asia-Pacific.

Recent data have pointed to firmness in Australian household spending. Nominal retail sales were up 1.4% over the December quarter. We also saw a 0.4% rise in the ABS' measure of household spending. However, the latest update from CoreLogic did highlight a broadening slowdown in price growth across the major capital cities. Across in China, consumer prices rose 0.5% in January, boosted by higher food prices, as well as a Lunar New Year related lift in services spending. Even so, the PPI fell 0.2% over the month (-2.3% yr), underscoring the continued weakness in the manufacturing sector. This week's data calendar includes updates on Australian consumer and business sentiment (both out on Tuesday), along with the Chinese current account (Friday).

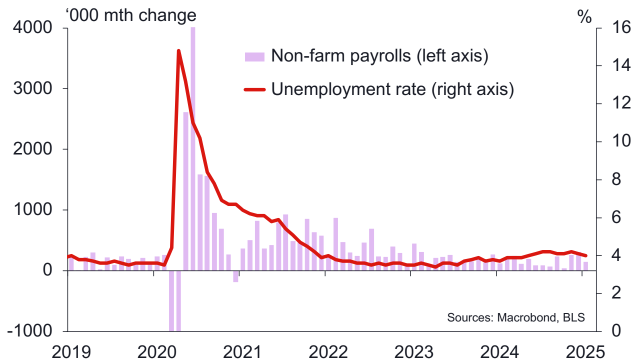
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	**2024**	**2025**	**2026**
Australia	2.1	1.1	2.0	2.2
China	5.2	5.0	4.8	4.5
United States	2.5	2.8	2.6	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	6.6	6.6	6.5
Euro Zone	0.4	0.7	0.9	1.0
United Kingdom	0.1	0.7	0.6	1.2
NZ trading partners	3.3	3.3	3.3	3.2
World	3.2	3.3	3.3	3.2

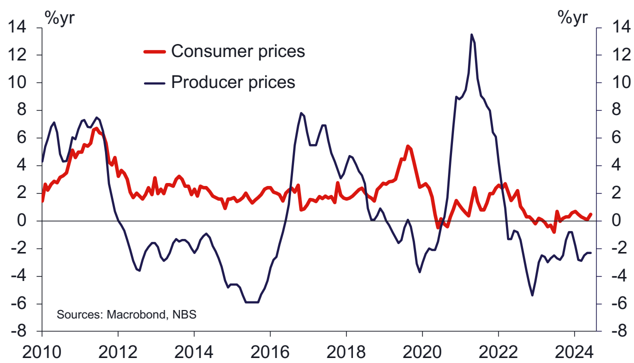
Australian & US interest rate outlook

	7 Feb	Mar-25	Dec-25	Dec-26
Australia				
Cash	4.35	4.10	3.35	3.35
90 Day BBSW	4.21	4.20	3.50	3.55
3 Year Swap	3.72	3.75	3.80	4.00
3 Year Bond	3.75	3.75	3.75	3.85
10 Year Bond	4.33	4.45	4.70	4.65
10 Year Spread to US (bps)	-10	-15	-25	-15
US				
Fed Funds	4.375	4.375	4.375	3.875
US 10 Year Bond	4.43	4.60	4.95	4.80

US non-farm payrolls and unemployment rate



Chinese inflation



Financial markets wrap

Interest rates.

The NZ 2yr swap rate, which had been driven by a moderate receiving bias over the past few weeks, has rebounded from 3.33% - possibly a cycle low - to 3.50%, led by US and AU rates. We expect the 2yr to remain inside a range of 3.33%-3.65% this week.

While the US tariff regime's impact on RBNZ monetary policy is complex and unclear, an extended Fed pause in its easing cycle (Westpac forecasts no more cuts at all in 2025) will impact globally and lift NZ swap rates. There's also an expected large NZ mortgage fixing wave which could start after the RBNZ MPS on 19 February. if households perceive the easing cycle to be nearing completion.

OIS pricing continues to imply a 100% chance of a 50bp cut at the 19 February RBNZ MPS and a terminal rate around 3.00%.

Event risk for NZ rates markets this week will be as noted in the FX section below.

Foreign exchange.

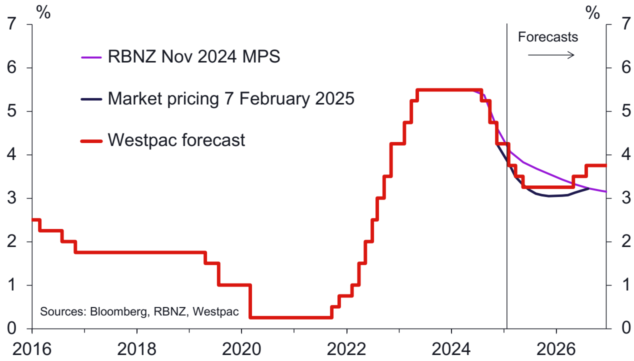
NZD/USD last week recovered from the surprising announcement the previous weekend on US tariff imposition, becoming increasingly desensitised to the stream of tariff-related announcements. But on Friday, stronger than expected US economic data (payrolls and inflation expectations) caused the US dollar to rise again, and NZD/USD to fall.

That has left NZD/USD around the middle of a month-old range of 0.5540-0.5725, with no strong directional bias for the week ahead. But over the next few months, we remain bearish, expecting it to test the lower bound at 0.5540, and then key support at 0.5470. If the latter gave way, we would target 0.5000.

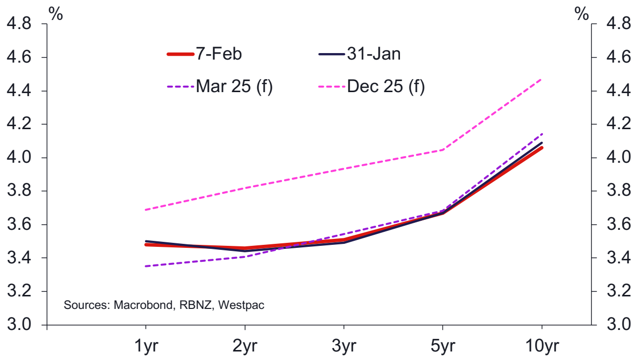
The main driver for a significant multi-month fall in NZD/USD would be a resumption of the US dollar's uptrend. US economic data has been solid and will likely cause the Fed to pause its easing cycle for some time. Tariff developments will remain influential, albeit in both directions in the near term.

Event risk this week comes primarily from US CPI and PPI data, as well as retail sales. In NZ, we have the RBNZ's inflation expectations survey, manufacturing PMI and monthly price data to watch.

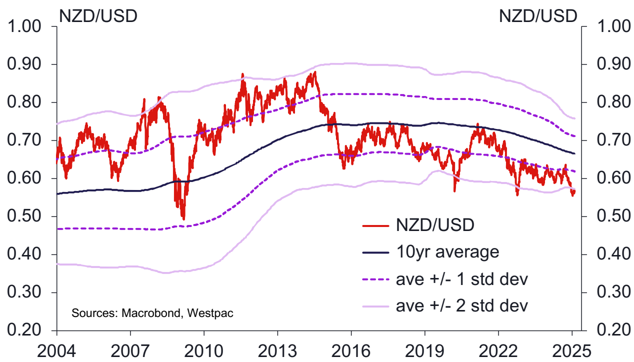
Official Cash Rate forecasts



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	0.566	0.554-0.602	0.554-0.743	0.641	0.54
AUD	0.903	0.895-0.912	0.873-0.992	0.926	0.87
EUR	0.548	0.539-0.560	0.517-0.637	0.579	0.53
GBP	0.457	0.447-0.466	0.447-0.535	0.499	0.44
JPY	85.7	85.8-92.1	61.3-98.6	82.0	82.1

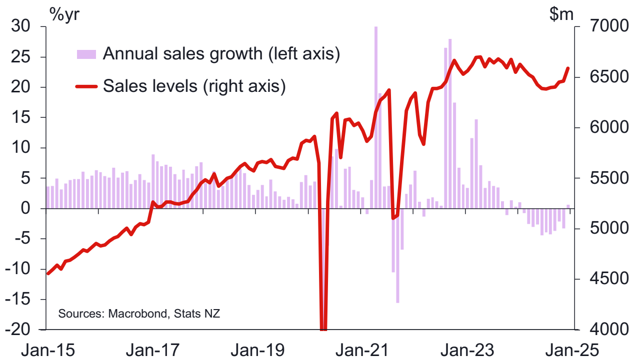
The week ahead

Jan retail card spending

13 Feb, last: +2.0%, Westpac f/c: -0.1%

Retail sales were much stronger than expected in December, rising 2%. December saw a particularly large increase in spending on household durables like furnishings, though gains were widespread. We're forecasting a modest 0.1% fall in spending January. In part that's due to a partial reversal of some of December's large increases in lumpy categories, like durables spending. January also saw a large increase in petrol prices that is likely to have crowded out some discretionary spending. That would still leave us with an upwards trend in spending levels in recent months.

Monthly retail card spending

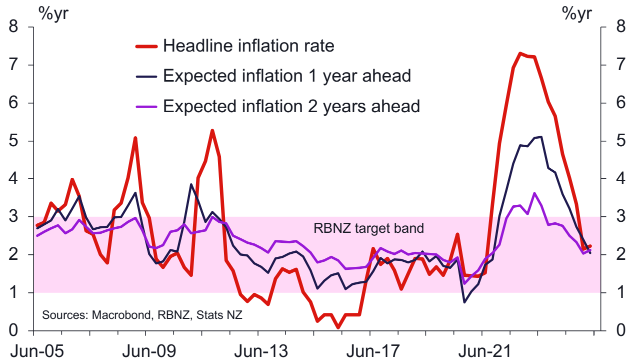


Q1 RBNZ Survey of Expectations

13 Feb, Expected inflation two years ahead, last: 2.12%

While there were a few swings in the previous Survey of Expectations, the results still pointed to inflation expectations remaining comfortably close to the 2% midpoint of the RBNZ's target band. Since the last survey, inflation has remained steady at 2.2%. However, concerns about the global outlook have increased and the NZ dollar has dropped sharply, meaning the risks for inflation have tilted to the upside. We'll be watching to see how big of an impact that has had on longer-term expectations, which will be an important consideration in the RBNZ's upcoming policy deliberations.

RBNZ Survey of Expectations

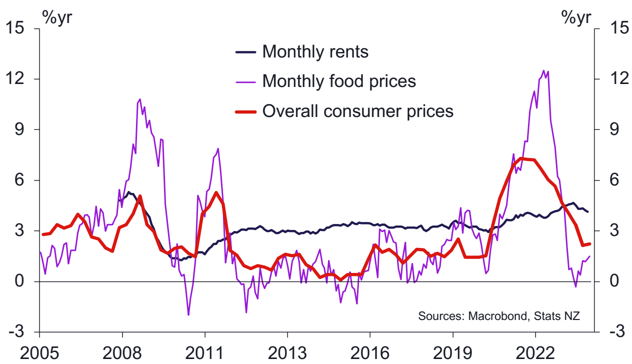


Jan Selected Price Indices

14 Feb

Stats NZ's monthly price data covers around 45% of the CPI. We'll be watching for signs of further softness in discretionary spending areas, like hospitality. It will also be worth watching what happens to rents, which are one of the largest components of domestic inflation. We're picking a seasonal 0.3% rise in rents, however it looks like the pressures on this front are easing. We're also expecting a 0.9% rise in food prices related to seasonal increases in the prices of fresh fruit and groceries.

Selected consumer prices

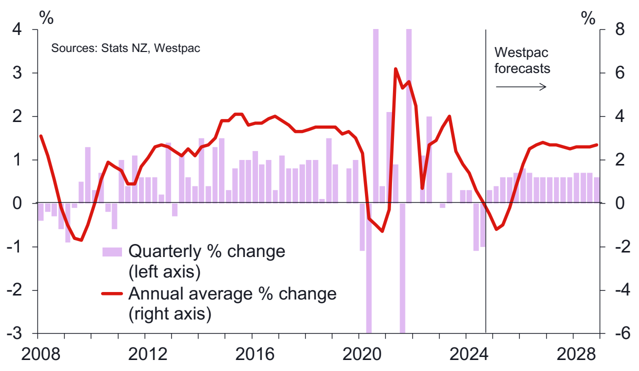


Economic and financial forecasts

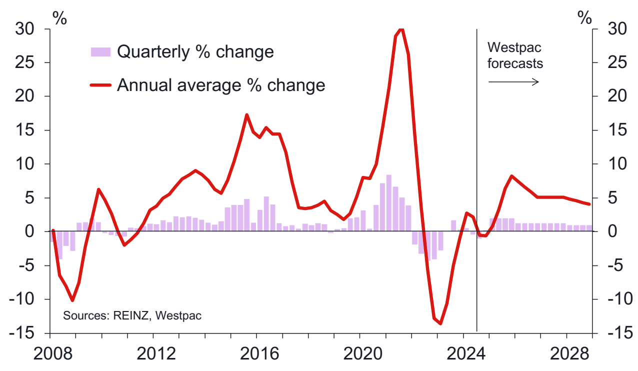
Economic indicators	Quarterly % change				Annual % change			
	Sep-24	Dec-24	Mar-25	Jun-25	2024	2025	2026	2027
GDP (production)	-1.0	0.3	0.4	0.6	-0.5	0.8	2.8	2.5
Consumer price index	0.6	0.5	0.5	0.3	2.2	2.1	2.1	2.2
Employment change	-0.5	-0.3	-0.1	0.0	-1.0	0.2	2.1	2.1
Unemployment rate	4.8	5.1	5.3	5.4	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	3.40	3.50	3.64	3.80	4.00	4.00
5 year swap	3.81	3.73	3.70	3.80	3.73	4.05	4.25	4.25
10 year bond	4.31	4.51	4.60	4.70	4.51	4.90	4.95	4.95
TWI	70.9	69.5	65.6	65.5	69.5	64.5	67.4	68.7
NZD/USD	0.61	0.59	0.54	0.54	0.59	0.54	0.59	0.62
NZD/AUD	0.91	0.91	0.90	0.90	0.91	0.87	0.87	0.87
NZD/EUR	0.56	0.55	0.54	0.54	0.55	0.53	0.56	0.56
NZD/GBP	0.47	0.46	0.44	0.44	0.46	0.44	0.46	0.47

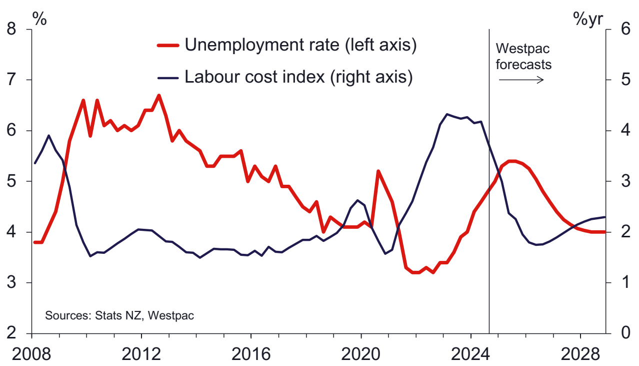
GDP growth



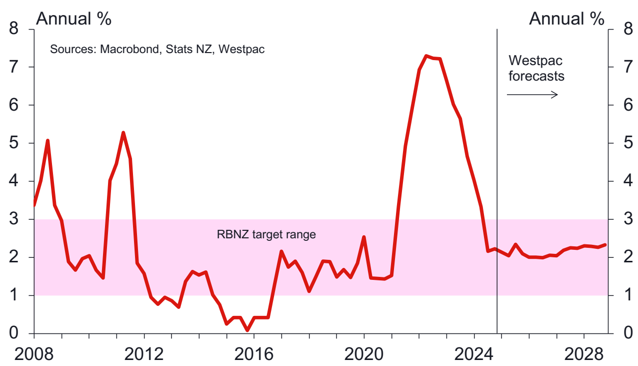
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Sun 09					
Chn	Jan CPI, %yr	0.1	0.4	–	Lunar New Year anticipated to drive consumer demand.
	Jan PPI, %yr	–2.3	–2.2	–	Producer prices are due to fall for a 28th consecutive month.
	Jan New Loans YTD, CNYtrn	18.1	4.5	–	New loans fell in 2024 for the first time in over a decade...
	Jan M2 Money Supply, %yr	7.3	7.3	–	...we'll see if 2025 gets off to a better start, due 9-15 February.
Mon 10					
Jpn	Dec Current Account Balance, ¥trn	3.4	1.4	–	Widening trade surplus not enough to increase CA balance.
Eur	Feb Sentix Investor Confidence, index	–17.7	–18.0	–	Economic pessimism holding since March 2022.
Tue 11					
Aus	Feb Westpac-MI Cons. Sentiment, index	92.1	–	–	Headwinds from increased global uncertainty.
	Jan NAB Business Conditions, index	6	–	–	Business conditions to remain subdued.
UK	BoE Speak	–	–	–	Governor Bailey speaking on financial markets.
US	Jan NFIB Small Business Optimism, index	105.1	104.7	–	Surged to 6yr high, led by expectations not current conditions.
	Jan NY Fed 1–Yr Inflation Expectations, %yr	3	–	–	Signs for upward pressure on inflation expectations.
	Fedspeak	–	–	–	Hammack and Williams are scheduled to speak.
Wed 12					
Aus	Q4 Housing Finance Approvals, %qtr	4.7	–	1	Expected to signal a moderation in growth...
	Q4 Owner–Occupier Loans, %qtr	3.2	–	flat	... as house prices dipped...
	Q4 Investor Loans, %qtr	7.1	–	3	... and market activity numbers pulled back in Q4.
US	Jan CPI, %mth	0.4	0.3	0.3	Gradual disinflationary trend to continue.
	FOMC Chair Powell	–	–	–	Testifying before House Financial Services Committee.
Thu 13					
NZ	Jan Retail Card Spending, %mth	2	–	–0.1	Partial reversal of last month's strong gain.
	Q1 RBNZ Inflation Expectations, %ann	2.12	–	–	Upside risk from trade developments and fall in NZD.
Aus	Feb MI Inflation Expectations, %yr	4	–	–	Down from a mid-2022 peak of 6.7%.
Eur	Dec Industrial Production, %mth	0.2	–0.2	–	Rising manufacturing PMI hints at industrial recovery.
UK	Q4 GDP, %qtr	0	–	–	Likely to show that GDP failed to increase in H2 2024.
US	Jan PPI, %mth	0.2	0.2	–	Tariffs may begin to squeeze producer margins going forward.
	Weekly Jobless Claims	219	–	–	Claims remain at benign levels.
Fri 14					
NZ	Jan Manufacturing PMI, index	45.9	–	–	Continued weakness.
	Jan Food Price Index, %mth	0.1	–	0.9	Seasonal lift in groceries and fresh fruit prices.
Chn	Q4 Current Account Balance, US$bn	147.6	–	–	Sharp improvement reported in Q3.
Eur	Q4 GDP, %qtr	0	0	–	Second estimate set to confirm the preliminary reading.
US	Jan Retail Sales, %mth	0.4	0	–	Flat start to 2025, after a solid end to spending in 2024.
	Jan Import Price Index, %mth	0.1	0.4	–	A pivotal indicator to monitor in the months ahead.
	Jan Industrial Production, %mth	0.9	0.3	–	Expected to lift in 2025; weak investment to date a headwind.
	Dec Business Inventories, %mth	0.1	0.1	–	Growth has eased since mid-2024.

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