



WEEKLY ECONOMIC COMMENTARY



18 May 2026 | Westpac Economics Team | westpac.co.nz/economics | economics@westpac.co.nz

Under the pump

The New Zealand economy has entered a far more challenging phase than expected earlier in the year. Momentum that had been building through late 2025 and early 2026 has been disrupted by the Iran conflict, which has delivered a sharp energy price shock, lifted inflation pressures and renewed uncertainty for households, businesses and policymakers alike. While a recession is not our central expectation, the outlook now points to another year of subdued growth, elevated inflation and a delicate balancing act for monetary and fiscal policy.

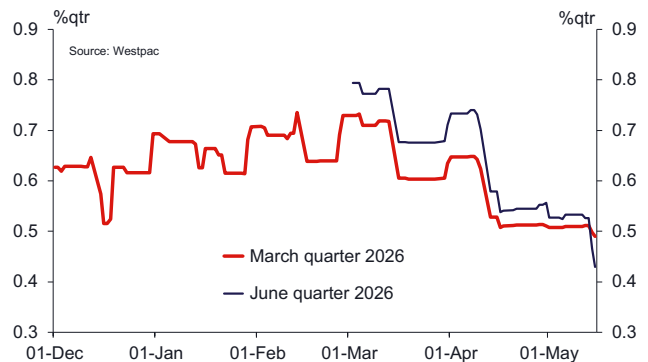
At the heart of the shift in outlook is the surge in global oil and refined fuel prices following the prolonged disruption in the Middle East. Real petrol and diesel prices in New Zealand are at multi-decade highs. Even if the conflict were to ease suddenly, damage to infrastructure and strained refinery capacity mean fuel costs are likely to remain elevated for some time. The result is a broad-based cost shock that is filtering through transport, production and distribution channels, weighing on spending power and lifting inflation well above comfortable levels. That said, last week's selected prices data for April showed weaker inflation pressures than we had pencilled in. Hence there is some modest downside risks to our June quarter CPI pick of 4.4% y/y.

Economic growth has slowed as these pressures intensify. We now expect GDP growth of around 1.5% over 2026, a disappointing outcome given the more optimistic view we held in early 2026. Higher living costs are eroding real household incomes, while uncertainty is encouraging both households and firms to delay discretionary spending and investment decisions. The services sector, retail trade and hospitality are bearing the brunt of this adjustment, reflecting their sensitivity to household budgets. Tourism, which had been recovering strongly, is also expected to pause as higher airfares and global uncertainty dampen long-haul travel demand.

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	↘	→	↗

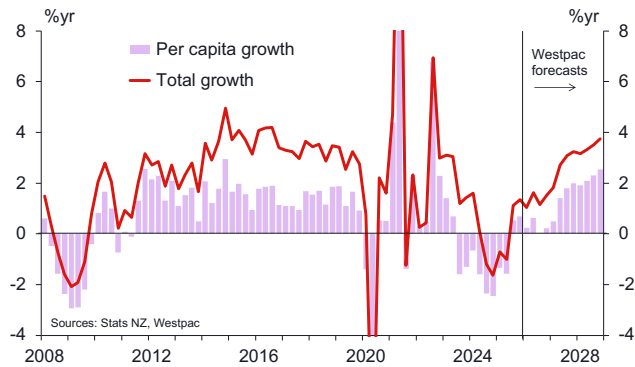
Westpac GDP nowcasts



Key data and event outlook

Date	Event
27 May 26	RBNZ OCR Review & Monetary Policy Statement
28 May 26	NZ Government Budget
4 Jun 26	Govt accounts for 10 months to April
16 Jun 26	NZ Selected price indexes, May
16 Jun 26	RBA Monetary Policy Decision
17 Jun 26	FOMC meeting (18 Jun NZT)
18 Jun 26	NZ GDP, March quarter
2 Jul 26	Govt accounts for 11 months to May
8 Jul 26	RBNZ OCR Review
14 Jul 26	NZIER QSBO Survey, June quarter

Total and per capita GDP growth



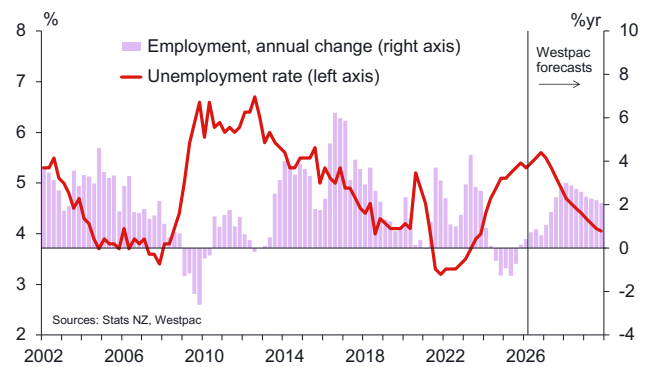
Last week's manufacturing PMI survey showed a modest pullback of the aggregate index to 50.5 and a sharper decline in the new orders component to 48.2. On balance, these results look broadly consistent with our view that we will see a small decline in GDP in the June quarter. Early days on that assessment though.

Households are facing a renewed squeeze on finances. Fuel prices have risen by more than 30% since the conflict began, compounding earlier increases in essentials such as food, electricity and insurance. At the same time, the labour market remains soft. Unemployment, while dipping marginally in early 2026, is expected to rise again to around 5.6% as firms respond cautiously to weaker demand and higher costs. Wage growth will hopefully remain muted relative to inflation but will limit households' ability to absorb the shock.

Interest rate dynamics add another layer of strain. Over the past two years many borrowers benefited from falling mortgage rates, but that easing phase is ending. Mortgage rates have begun to edge higher again, meaning households refinancing loans will see smaller reductions in repayments, and eventually gradual increases. Together, higher living costs, a soft jobs market and less interest-rate relief point to a sharp slowdown in household spending through the remainder of this year, before conditions gradually improve as cost pressures ease.

The labour market story is one of fragility rather than collapse. Prior to the Iran conflict, signs were emerging that employment growth was stabilising. However, hiring intentions have since weakened as firms grapple with higher input costs and uncertain demand. We now expect to see little employment growth in 2026, with unemployment peaking later this year. While there may be isolated pockets of skill shortages, overall labour market slack will restrain wage bargaining power, preventing a rapid acceleration in wage inflation despite rising living costs. Right now, we see few signs of a discontinuous labour market reaction to the war. Weekly filled jobs trends are tracking typical seasonal patterns while job advertisements for April fell just 1.7%.

Unemployment rate and annual employment growth



Housing, which had shown tentative signs of recovery early in the year, has been knocked off course. Low interest rates, improving confidence and a stabilising labour market had supported modest house price gains in the first quarter. These supports have largely evaporated. We now expect flat to slightly declining house prices over 2026 as confidence weakens and the prospect of higher interest rates re-emerges. Strong net migration will provide some underlying demand, but it is unlikely to offset the broader drag from weaker incomes and sentiment. Data last week confirmed that view with a 0.4% fall in house prices in April – albeit with a small fall in the average time to sell a home.

In the construction sector, recent momentum is unlikely to be sustained. Residential building activity is set to lift modestly in the near term as earlier consent approvals translate into work on the ground. However, rising fuel and materials costs, higher financing costs and elevated uncertainty are expected to curb new project initiation as we move into 2027. Commercial construction remains subdued, with office and industrial projects holding steady but little evidence of renewed expansion, particularly in retail and hospitality-related developments.

Business investment decisions are being deferred rather than abandoned. Surveys suggest firms have become more cautious, scaling back near-term capital expenditure plans while uncertainty around the conflict persists. Encouragingly, capital imports were strong in early 2026, indicating that momentum had been building prior to the shock. Over time, postponed investment – particularly in areas such as IT and software linked to the AI investment cycle – is likely to resume once conditions stabilise and confidence returns.

As we set out in more detail in [our preview of Budget 2026](#), the fiscal outlook has also been impacted by the Middle East conflict. Higher inflation and interest rates are set to place upward pressure on government spending, particularly on social assistance and debt servicing, while weaker economic activity is weighing on revenue growth. As a result, the Treasury is likely to forecast a further lift the Government's borrowing

requirement in Budget 2026 (perhaps \$7-9bn across the four-year forecast horizon). While an operating surplus in the final year of the forecast period remains possible, achieving it will require sustained fiscal discipline. Even greater discipline will be required if the Government is to achieve its goal of a surplus a year earlier in 2028/29. And credible progress towards fiscal consolidation will be required if Moody's and Fitch are to remove the negative outlook that they have placed on New Zealand's sovereign credit rating.

The primary sector remains a relative bright spot. Export commodity prices are expected to stay elevated, supported by strong global protein demand and a supportive exchange rate. Higher energy, fertiliser and feed costs will squeeze margins in the near term, but prolonged price pressures offshore increase the likelihood of these costs being passed through to export prices. Dairy incomes are expected to remain resilient, helping to support rural regions and partially offset weakness elsewhere in the economy.

New Zealand's balance of payments looks set to deteriorate temporarily as higher fuel prices lift the import bill. At the same time, services exports – especially tourism – are set to slow. We expect the current account deficit to widen in the near term before narrowing again in 2027 as energy prices ease and tourism activity recovers.

Inflation is the central challenge. Headline inflation is expected to rise into the mid-4% range and remain above 3% until mid-2027. The energy price shock has spilled into a much broader range of costs, and ongoing increases in administered prices are reinforcing underlying inflation pressures. While economic slack should limit the extent of second-round effects, the risk remains that businesses begin to embed higher inflation expectations into pricing behaviour.

For monetary policy, this environment presents an uncomfortable trade-off. The 2.25% OCR was set assuming a much more benign inflation outlook. The OCR now looks too low given the scale of the coming cost and inflation shock. We expect the Reserve Bank to begin lifting the OCR to 3% and more neutral levels, most likely from September, but with the potential for a start as early as this month given it seems clear the key question is when not if the OCR needs to rise. How far and how fast the OCR ultimately rises will depend critically on the duration of the conflict and the persistence of inflation pressures.

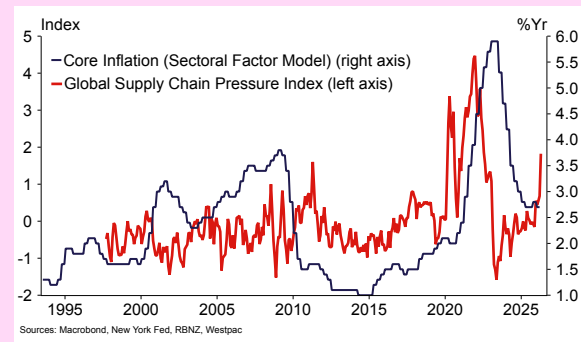
Overall, the economy is navigating rocky waters. Growth is subdued, inflation is uncomfortably high, and confidence has taken a hit. However, there are grounds for cautious optimism once energy prices ease and uncertainty recede.

Kelly Eckhold, Chief Economist

Chart of the week.

The New York Fed's Global Supply Chain Index is a widely used measure of supply chain stress, combining information on such factors as shipping costs and airfreight rates, and measures of delivery times and backlogs from major economy PMI surveys. Unsurprisingly, the index spiked higher in April, although at this stage it remains well below the levels seen during the pandemic. Historically, there has not been a close relationship between this index and core inflation, as most of New Zealand's inflation cycles have been driven by demand-side influences – such as the pre-GFC credit boom – rather than supply side influences. The sharp rise in core inflation that followed the pandemic reflected a combination of the pandemic-driven supply shock and the ultra-easy monetary and fiscal policy settings that were employed to support the economy. The current macro policy environment suggests less risk of a repeat of that inflation cycle.

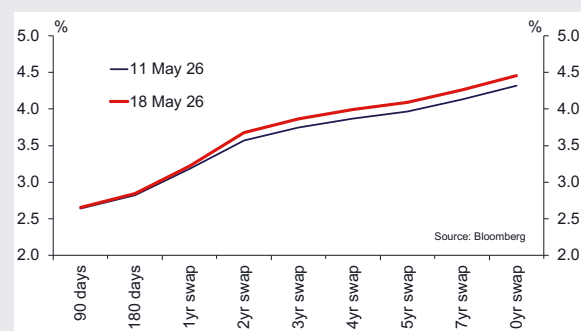
Global supply chain and inflation



Fixed versus floating for mortgages.

Recent weeks have seen a broadening in inflation pressures in the wake of the Middle East conflict and the RBNZ has revised its near-term inflation outlook sharply higher. In response to those developments, the RBNZ's latest policy statement noted related concerns about the longer-term inflation outlook. We've pulled forward our expectations for OCR hikes, which are now expected to begin in September (previously, we expected the first hike in December). Once the tightening cycle does get under way we expect to see a series of rate hikes to return the OCR to more neutral levels. Fixed-term mortgage rates between two and five years now lie above 5%, but fixing for one of these longer periods still appears attractive as it would insulate borrowers from a trend higher in the OCR over the next couple of years.

NZ interest rates



Global wrap

Middle East.

The stalemate has continued in the Middle East, leaving the Strait of Hormuz closed to most traffic. Brent crude rose \$8/bbl to \$109/bbl last week. And with global crude oil inventories continuing to fall, prices will continue to drift higher if no progress towards reopening the Strait is achieved.

North America.

The impact of the surge in energy prices was on display last week, with CPI inflation rising to 3.8%yr in April from 3.3%yr in March. Core inflation also moved higher, rising to 2.8%yr from 2.6%yr. The surge in prices was even greater at the producer level, with PPI inflation rising to 6.0%yr. In other news, Kevin Warsh was confirmed by Congress for a 4-year term as Fed Chair and a 14-year term on the Board of Governors. With Jerome Powell remaining on the Board for now, Stephen Miran has left the Board. The coming week will bring the release of the preliminary PMIs for May, together with a range of housing-related data and the minutes from last month's FOMC meeting.

Europe.

The preliminary PMIs for May are the focus in the euro area this week, while the UK will also print key inflation, retail spending and labour market reports. At present, the market is pricing a 90% chance of an ECB policy tightening next month, and a 35% chance of the BoE tightening policy.

Asia-Pacific.

The highlight in Australia last week was the Federal Budget. Compared to previous projections, the budget bottom line has improved owing to commodity price windfalls, with the deficit now expected to hold steady around 1.0% of GDP. Larger improvements in the Government's finances are anticipated in the outer years as major saving measures begin to deliver. On the data front, the NAB survey indicated that business sentiment remained heavily negative in April, albeit not quite as weak as in March. Meanwhile, wage growth nudged down to 3.3%yr in Q1. The coming week will bring an update on consumer confidence, the release of the minutes from this month's RBA meeting and the Labour Force report for April (Westpac expects a steady unemployment rate of 4.3%). In China, President Trump's official visit to Beijing saw cooperation on Iran and oil flows discussed, but no major breakthroughs emerged, and tensions over Taiwan and trade remained unresolved. Today will see the release of China's key domestic activity and house price data for April.

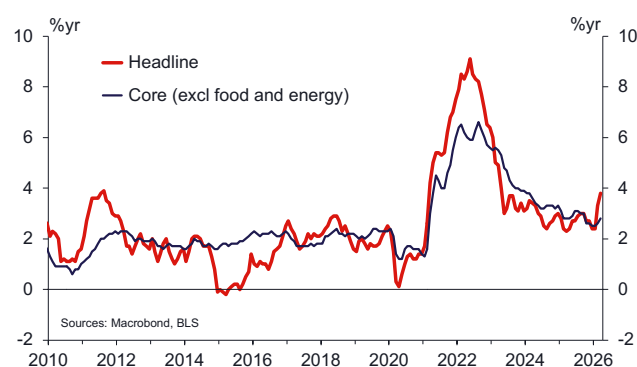
Trading partner real GDP (calendar years)

	Annual average % change			
	2024	2025	2026	2027
Australia	1.0	2.0	1.8	1.2
China	5.0	5.0	4.7	4.6
United States	2.8	2.1	2.0	1.8
Japan	-0.2	1.2	0.6	0.8
East Asia ex China	4.5	4.7	4.3	4.2
India	7.1	7.6	6.5	6.7
Euro Zone	0.9	1.5	0.7	1.1
United Kingdom	1.1	1.4	0.8	1.1
NZ trading partners	3.0	3.2	2.8	2.7
World	3.4	3.4	3.2	3.3

Australian & US interest rate outlook

	15 May	Jun-26	Dec-26	Dec-27
Australia				
Cash	4.35	4.35	4.85	4.85
90 Day BBSW	4.44	4.55	4.90	4.80
3 Year Swap	4.64	4.75	4.70	4.40
3 Year Bond	4.63	4.75	4.70	4.40
10 Year Bond	4.96	5.00	5.05	4.95
10 Year Spread to US (bps)	57	65	60	30
US				
Fed Funds	3.625	3.625	3.625	3.625
US 10 Year Bond	4.39	4.35	4.45	4.65

US CPI inflation



Australian wage price index



Financial markets wrap

Foreign exchange.

NZD/USD last week broke below the 0.5930-0.5990 range prevailing in early May. This week, a test of 0.5800 is possible.

Earlier expectations of a possible de-escalation in the Iran war have given way to concerns that a stalemate could persist for some time, in turn inflicting economic damage via higher oil prices and supply chain disruption. In addition, NZ economic data last week was consistent with a slowdown ahead. This week's local data highlights will be the services PMI, April retail spending and two RBNZ surveys of expectations.

For the quarter ahead, we retain a neutral bias, pending resolution of the Iran war. An escalation would likely cause a break below 0.5700, towards 0.5500, while a positive resolution would likely ignite a rally towards the 0.6100 area.

NZD/AUD's trend decline extended slightly last week, making a fresh 13-year low at 0.8165. While further weakness is possible this week, the risk of an upward correction towards 0.84 during the month ahead is growing - it's technically oversold, and yield spreads have been rising slightly (the RBA's hiking cycle is maturing, while the RBNZ's has yet to start). Further ahead, though, for H2 we retain a bearish bias, based on expected relative economic performance which should continue to favour the AUD. Australia is likely more resilient than NZ to a prolonged war and oil shock.

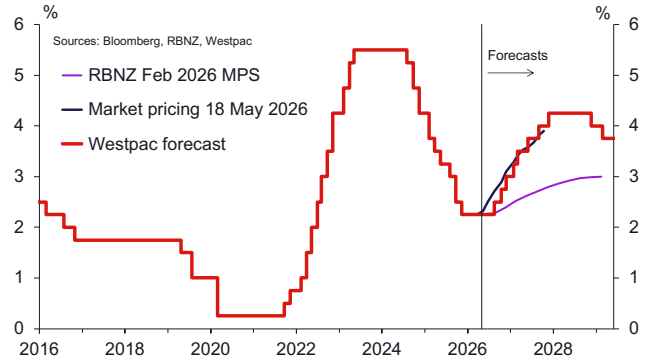
Interest rates.

The NZ 2yr swap rate last week broke above the 3.20%-3.60% range prevailing since March and risks a move higher to 3.80% during the months ahead. The RBNZ's tightening cycle looms, and war-related inflation could persist for longer than expected, threatening inflation expectations.

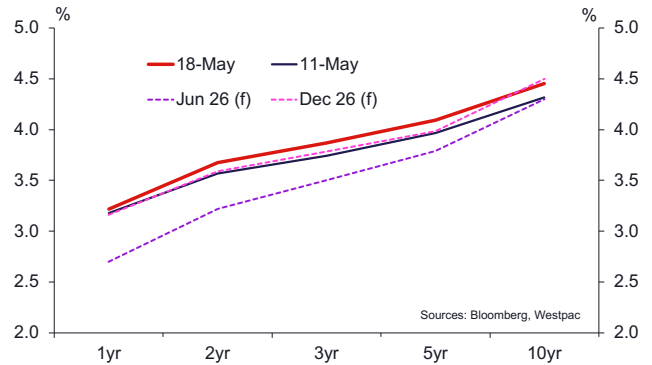
Market pricing for OCR hikes in 2026 was volatile last week, but closed little changed, with OIS rates implying a 30% chance of a hike in May, and a 100% chance of one by July. There are slightly more than three hikes in total priced by year end, not too dissimilar to our forecast of hikes in September, October and December.

The yield curve's flattening trend since the peak in late December remains intact, the 2-10yr swap at 77bp vs December's cycle peak at 120bp. We expect further flattening during the year ahead as we approach the RBNZ's tightening cycle, the 2-10yr swap with potential to reach 50bp.

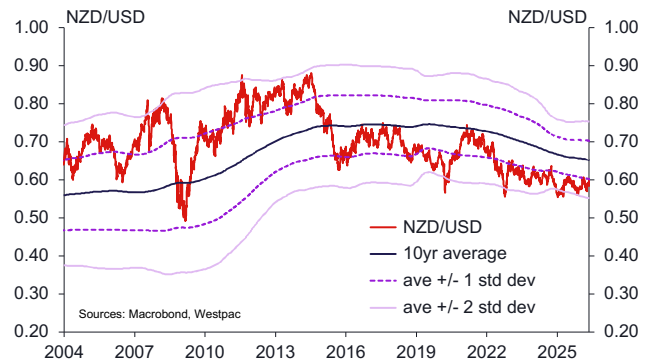
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-26
USD	0.594	0.569-0.605	0.553-0.728	0.620	0.62
AUD	0.820	0.818-0.857	0.818-0.971	0.913	0.85
EUR	0.506	0.493-0.511	0.484-0.637	0.562	0.52
GBP	0.438	0.430-0.444	0.426-0.531	0.482	0.45
JPY	93.0	91.0-94.4	74.7-98.6	86.3	95.5

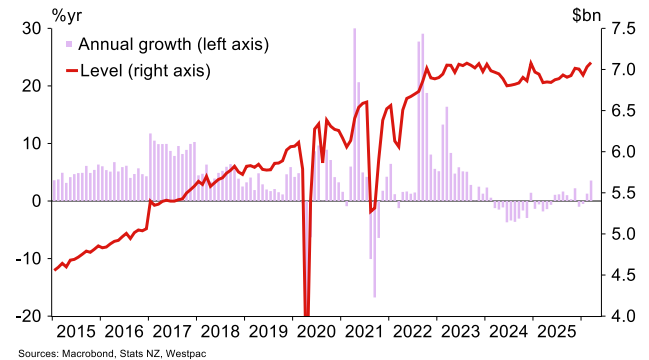
The week ahead

Apr Retail Card Spending

May 19, Last: +0.7%, Westpac f/c: +1.2%

We expect the April spending update will show that nominal retail spending was up 1.2% over the past month. That's mainly due to the 15% rise in fuel costs over the past month, along with increased spending on groceries. However, spending in discretionary areas like apparel and hospitality is expected to be more muted. The fuel price spike is squeezing households' purchasing power, and households are winding back their discretionary spending. Of note, travel related spending (like airfares) has fallen sharply. However, much of that spending is not included in 'retail' spending categories. It is, however, captured in the 'total' spending category, which we expect will be down around 2% this month.

Monthly retail card spending

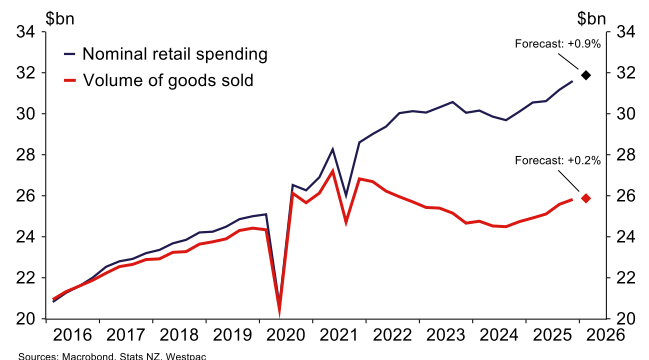


Q1 Retail Trade Survey

May 22, Volumes last: +0.9%, Westpac f/c: +0.2%

The March quarter is expected to see a muted 0.2% rise in real retail sales. The latter part of March saw fuel prices rising sharply, and that has been a drag on spending. But we've also seen price rises in other areas like food. As a result, we expect a firmer 0.9% rise in nominal spending. One key area of uncertainty is vehicle spending, which can be lumpy on a quarter-to-quarter basis. Distributors reported a lift in sales of EVs late in the month, though we expect that will be balanced out by lower sales for combustion engine vehicles.

Retail sales

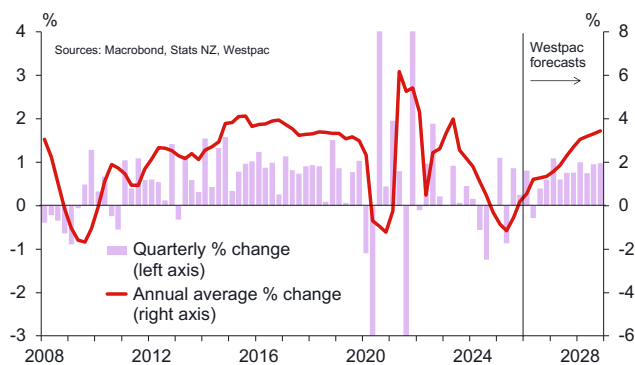


Economic and financial forecasts

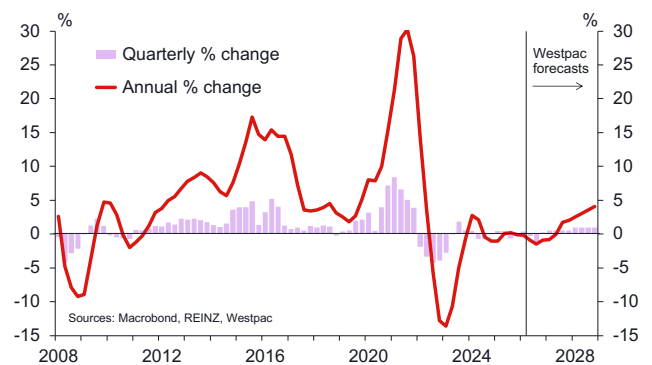
Economic indicators	Quarterly % change				Annual % change			
	Dec-25	Mar-26	Jun-26	Sep-26	2024	2025	2026	2027
GDP (production)	0.2	0.8	-0.3	0.4	-1.6	1.3	1.5	3.2
Consumer price index	0.6	0.9	1.8	1.2	2.2	3.1	4.4	1.6
Employment change	0.5	0.1	0.1	0.1	-1.3	0.2	0.6	2.9
Unemployment rate	5.4	5.3	5.4	5.5	5.1	5.4	5.6	4.9
Labour cost index (all sectors)	0.4	0.5	0.6	0.7	3.3	2.0	2.5	2.3
Current account balance (% of GDP)	-3.7	-3.8	-4.0	-4.1	-4.7	-3.7	-4.1	-4.2
Terms of trade	0.3	-1.9	0.6	2.6	8.9	3.5	1.0	3.3
House price index	-0.4	0.4	-0.3	-1.3	-1.0	-0.1	-0.9	2.0

Financial forecasts	End of quarter				End of year			
	Dec-25	Mar-26	Jun-26	Sep-26	2024	2025	2026	2027
OCR	2.25	2.25	2.25	2.50	4.25	2.25	3.00	4.25
90 day bank bill	2.52	2.51	2.50	2.95	4.45	2.52	3.40	4.45
2 year swap	2.71	3.12	3.75	4.05	3.64	2.71	4.30	4.35
5 year swap	3.27	3.71	4.10	4.30	3.73	3.27	4.35	4.45
10 year bond	4.27	4.54	4.85	4.95	4.50	4.27	5.00	5.10
TWI	66.4	67.2	66.5	66.2	69.5	66.4	69.1	72.7
NZD/USD	0.57	0.59	0.59	0.59	0.59	0.57	0.62	0.67
NZD/AUD	0.87	0.85	0.82	0.82	0.91	0.87	0.85	0.91
NZD/EUR	0.49	0.50	0.50	0.50	0.55	0.49	0.52	0.55
NZD/GBP	0.43	0.44	0.44	0.43	0.46	0.43	0.45	0.48

GDP growth



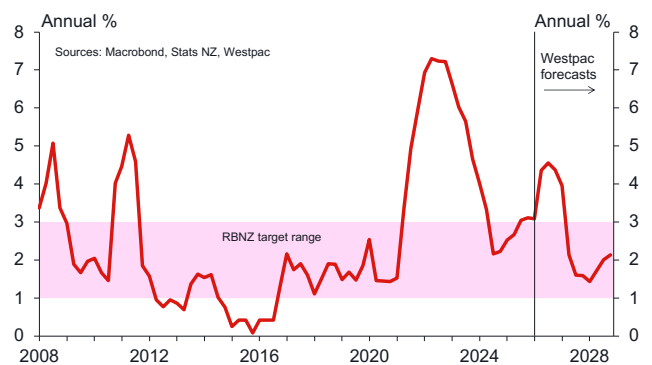
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Apr BusinessNZ PSI, index	46	-	-	Has been soft, even prior to the Iran conflict.
Chn	Apr Retail Sales, ytd %yr	2.4	-	-	Tentative signs of a stabilisation in consumer demand but...
	Apr Industrial Production, ytd %yr	6.1	-	-	... trade's contribution to growth has further to run as...
	Apr Fixed Asset Investment, ytd %yr	1.7	1.7	-	... green technology demand accelerates in light of US-Iran.
Tue 19					
NZ	Apr Retail Card Spending, %mth	0.7	-	1.2	Increased spending on essentials.
Aus	RBA Assist' Governor (Economic)	-	-	-	Hunter speaking at Bloomberg Forum.
	May RBA Minutes	-	-	-	To provide more colour on the Board's deliberations.
	May Westpac-MI Cons. Sentiment, index	80.1	-	-	Will provide a read post Federal budget and 25bp rate hike.
Jpn	Q1 GDP, %qtr	0.3	0.4	-	Heading into the global energy shock with GDP near-stagnant.
UK	Mar ILO Unemployment Rate, %	4.9	4.9	-	Dip in unemployment rate may prove short-lived.
US	Apr Pending Home Sales, %mth	1.5	1.6	-	Early guide to established home sales, which is low and stable.
Wed 20					
Eur	Apr CPI, %ann	3	3	-	Final estimate to provide full component detail.
UK	Apr CPI, %ann	3.3	3	-	Inflation centred on fuel; core inflation broadly stable, for now.
US	Apr FOMC Meeting Minutes	-	-	-	More colour on the balanced baseline and risk outlook.
	Fedspeak	-	-	-	Paulson.
Thu 21					
NZ	Apr Trade Balance, \$mn	698	-	845	A seasonal surplus, weighed down by higher fuel imports.
Aus	Apr Employment Change, 000s	17.9	17.5	10	Still too early to see weakness from Middle East or recent...
	Apr Unemployment Rate, %	4.3	4.3	4.3	... rate rises, but April 'abnormal seasonality' could surprise.
Jpn	May S&P Global Manufacturing PMI, index	55.1	-	-	Pull-forward of output and new orders before conflict impacts...
	May S&P Global Services PMI, index	51	-	-	... services activity is delicately positioned.
Eur	May S&P Global Manufacturing PMI, index	52.2	51.5	-	European manufacturing resilient for similar reasons...
	May S&P Global Services PMI, index	47.6	48	-	... but the gap lower in services is a concerning signal.
	May Consumer Confidence, index	-20.6	-20.0	-	Starting to probe pandemic-era lows as inflation lifts.
UK	May S&P Global Manufacturing PMI, index	53.7	53.1	-	Orders brought forward to get ahead of price lifts...
	May S&P Global Services PMI, index	52.7	51.8	-	... but firmer services activity certainly a welcome sign.
US	Initial Jobless Claims	211	-	-	Still at a very low level versus history.
	May Philly Fed Manufacturing, index	26.7	15	-	Phily's momentum is enviable, but is at clear risk of easing...
	May Kansas City Fed Manufacturing, index	10	-	-	... as headwinds start to materialise across the nation.
	Apr Housing Starts, %mth	10.8	-5.5	-	Sense of caution underlies the monthly volatile data as...
	Apr Building Permits, %mth	-11.4	2.7	-	... permit issuance slows amid high new home inventory.
	May S&P Global Manufacturing PMI, index	54.5	53.6	-	Industry remains on a solid footing, like the ISM, but...
	May S&P Global Services PMI, index	51	51.3	-	... momentum in services at risk if consumer weakens.
Fri 22					
NZ	Q1 Real Retail Sales, %qtr	0.9	0.5	0.2	Price rises weighing on volumes growth.
Aus	Q1 Westpac-Now, %qtr	0.6	-	0.6	Final estimate will provide a near complete read on Q1 activity.
Jpn	Apr CPI, %ann	1.5	1.6	-	Focus is on trend excl. food and energy for now.
Ger	May IFO Business Climate Survey, index	84.4	84.6	-	Will souring expectations bleed into current situation view?
UK	May GfK Consumer Sentiment, index	-25	-27	-	Falling, but not 'collapsing' like in some other countries...
	Apr Retail Sales, %mth	0.7	-	-	... aiding growth in retail sales, even after excluding petrol.
US	May Uni. Of Michigan Sentiment, index	48.2	48.2	-	Final estimate will provide full reaction to recent updates.

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