WEEKLY ECONOMIC COMMENTARY

24 Jan 2025 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Not your usual Friday read.

We're bringing this edition of the Weekly Economic Commentary to you a little earlier than usual before our team, along with the rest of Auckland, enjoys the Anniversary long weekend.

Westpac Economics Team

Year of the Snake to see lower inflation, but economic activity remains mixed for now.

The latest updates on the New Zealand economy were a green light for a further rate cut from the RBNZ in February, with inflation pressures well contained. We're forecasting another 50bp cut at the RBNZ's February meeting. That will support a recovery in economic activity over the year ahead, though for now conditions remain mixed.

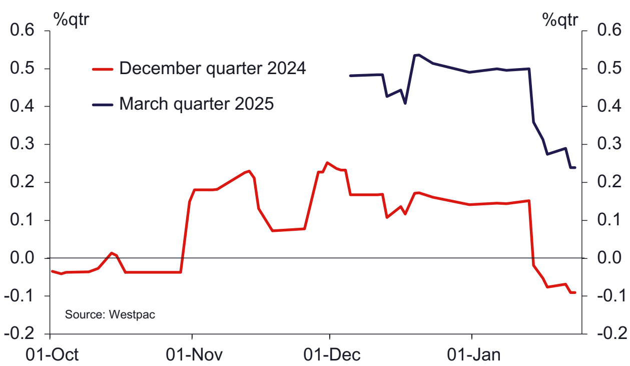
New Zealand **consumer prices rose 0.5% over the December quarter**. That saw the annual inflation rate remaining unchanged at 2.2%.

December's inflation result was in line with our forecast and just slightly above the RBNZ's last published forecast. However, the RBNZ's forecast was finalised back in November, and the past few months saw some sharp moves in the prices for items like international airfares that they might not have anticipated. Those sorts of quarter-to-quarter swings in volatile items are not the focus for monetary policy, and we think the overall tone of the December inflation report will have been in line with the RBNZ's thinking. The key issue now is whether inflation dynamics will lead to inflation expectations stabilising around 2% - and this week's outcomes won't likely threaten that.

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	→	↘	↘

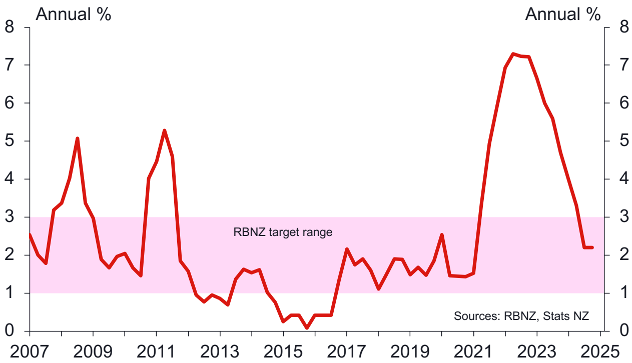
Westpac GDP nowcasts



Key data and event outlook

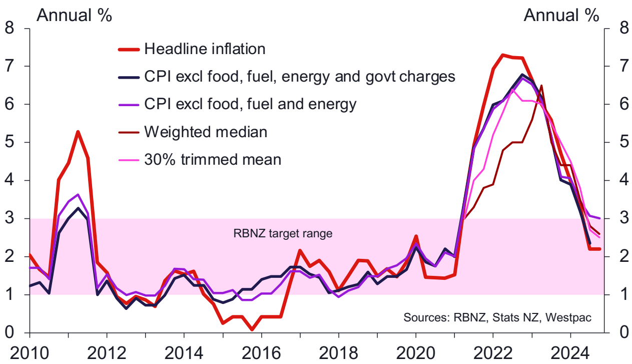
Date	Event
29 Jan 25	FOMC Meeting (Announced 30 Jan NZT)
5 Feb 25	Labour market statistics, December quarter
13 Feb 25	RBNZ Survey of Expectations, December quarter
13 Feb 25	Govt Financial Statements, 6 mths to December
14 Feb 25	NZ Selected price indexes, January
18 Feb 25	RBA Monetary Policy Decision
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

Annual inflation



Smoothing through the quarter-to-quarter volatility, inflation is now much better contained than it has been for a long time. Not only is headline inflation close to 2%, but measures of core inflation have also been trending down and are back inside the RBNZ's target band. For instance, trimmed mean inflation has fallen to 2.4% in the year to December (down from 2.5% previously) and weighted median inflation fell to 2.6% (down from 2.8%).

Core inflation



That downtrend in overall inflation over the past year is in large part due to falls in tradables prices (mainly imported retail goods) which fell 1.1% over the past year. The decline in tradables inflation has been related to the reversal of the tight global supply conditions that saw import prices rise sharply in recent years, partially amplified by the pressures on household budgets and weak discretionary spending.

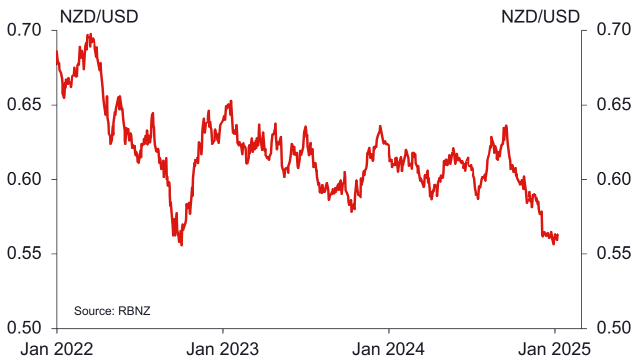
Of more importance for the RBNZ, the domestic components of inflation have also been easing back, though at 4.5% non-tradables inflation remains relatively high. However, that strength is masking some important detail under the surface. We're still seeing solid increases in costs such as local council rates and insurance premiums, which tend to be less sensitive to the level of interest rates. Services sector inflation remains relatively high albeit easing. Hence overall domestic inflation is moderating gradually, as opposed to quickly.

We can see some areas where tight financial conditions have had more bite. For instance, weak demand over the past year has contributed to a slowdown in construction cost inflation and has restrained price increases in the hospitality sector.

Looking ahead, inflation looks set to remain close to 2% over 2025, with soft activity and a cooling labour market helping to further dampen domestic inflation pressure.

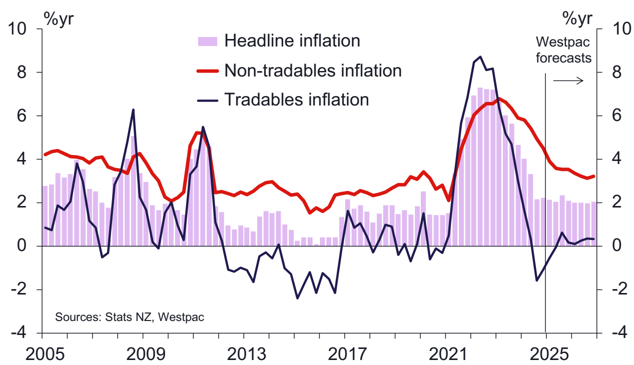
But even with domestic inflation continuing to ease, we don't think there is a risk of a material or protracted period of sub-2% inflation. In part, that's because domestically generated inflation is only gradually easing. But it's also because the sharp downturn in imported inflation over the past year looks like it is now coming to an end. The earlier tightness in global supply conditions has now eased and going forward we won't see the same sort of falls in import prices that we did over the past year. On top of that, oil prices have been pushing higher. We've also seen the NZ dollar dropping to its lowest level since 2022, and that could push up the prices of many imported goods.

NZ dollar



Putting that altogether means that we see aggregate inflation remaining around 2% in 2025. The mix of inflation should change as domestic inflation continues to normalise while tradables sector disinflation abates and rises to more normal levels.

Inflation looks likely to track close to 2% over the year ahead



We expect the easing in inflation and interest rates will see economic activity gradually firming over the coming year. That follows some mixed economic conditions in recent months.

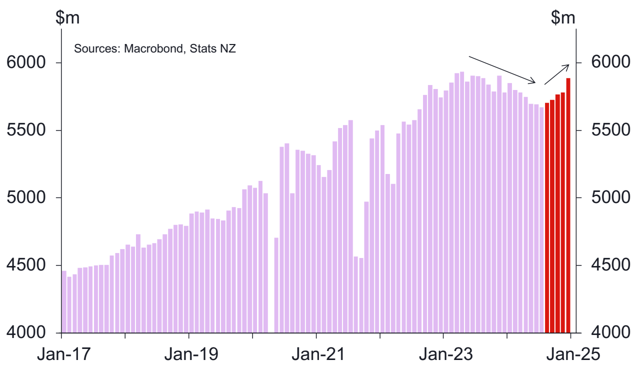
The latest BusinessNZ PSI added to the list of recent business surveys highlighting softness in activity through the final months of 2024, with sluggish sales and demand for new staff remaining limited. Consistent with those trends, we estimate that the economy grew by just 0.3% in the December quarter and that the unemployment rate will have risen to 5.1%.

While economic activity was soft over the past year, some more positive signs for the economy are emerging as we enter the Year of the Snake. In the household sector, we've already seen consumer confidence start to turn higher as inflation and borrowing costs have fallen. And it looks like that is flowing through to a lift in households' spending appetites. Retail sales rose by 2% in December. That was the largest monthly rise since early 2022 when Covid-related activity restrictions were eased. December's rise in spending was underpinned by a large increase in spending on household durables like furnishings.

While some of the strength in the December spending figures might prove to be temporary, it still points to a firming in households' spending appetites. Taking a longer-term perspective, the more general trend in retail spending over the past few months is to the upside, with spending levels having risen for the past five months.

We're expecting spending will continue to trend higher over 2025. The financial pressures that households have been wrestling with are easing, with inflation dropping back and interest rates falling.

Monthly retail spending



We're also starting to see some more positive signs in the housing market, with prices up 0.2% in December. That small lift in prices came on the back of some particularly light activity in the housing market over the end of the year. However, adjusting for the normal monthly volatility, that was the third rise in the past four months. Setting aside the holiday period, lower mortgage rates have helped to revive interest among potential buyers in recent months, with evidence of a lift in loan applications and increasing open home attendance. We expect this to translate to more support for prices over 2025.

It's also important to remember that conditions are better in the regions compared to urban centres because 2024's strong rise in the terms of trade is being felt there first. We got a further reminder of this this week as dairy prices lifted again in the GDT auction as Chinese buyers returned to the auction. 2025 may well be one where the improvement begins on the farm and takes a while to reach the café dwellers of Lambton Quay and Queen St.

Lastly, while borrowing costs are dropping, they look set to return to average levels, rather than the very low ones that we saw in the wake of the pandemic. And while those reductions will help to support both economic activity and house prices, we expect the recovery to be gradual and will lead to a return to trend rates of growth (rather than very elevated levels).

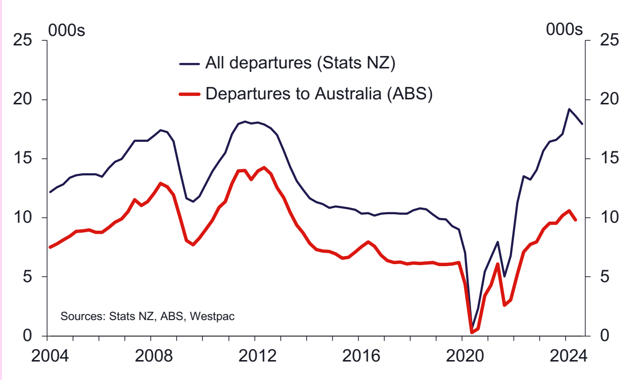
Satish Ranchhod, Senior Economist

Chart of the week.

Compared to migrant arrivals, we don't have as much detail about the people who are leaving the country – not least because departure cards were eliminated in 2018. In the case of departing New Zealanders, since a large share of them traditionally head to Australia, we can use data provided by the Australian Bureau of Statistics as a cross-check on current trends.

Outflows of Kiwis have been substantially higher over the last couple of years, partly due to a catch-up on travel plans that were delayed during Covid, and partly due to the relatively softer jobs market in New Zealand. However, the Australian data suggests that the outflow has not been as historically large as what the New Zealand figures would suggest – and indeed, the latter has tended to be revised down from what was initially reported. Both countries' data suggest that the outflow of Kiwis has passed its peak on a quarterly basis (though the more widely-reported annual balance is still rising).

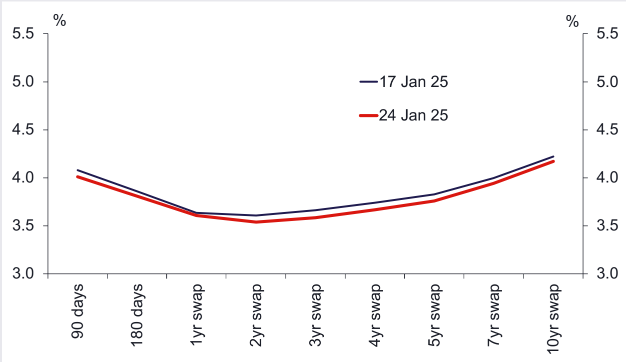
New Zealand citizen departures, quarterly



Fixed versus floating for mortgages.

We're forecasting another 50bp cut in February and expect the cash rate will bottom at 3.25% in mid-2025. A significant amount of OCR easing is already factored into longer-term mortgage rates. This suggests that it's now more attractive to fix for longer periods than it has been for a while – perhaps even for terms as long as two to three years. Mortgage rates for shorter terms of up to a year are substantially higher now but are likely to fall in the coming months towards current longer term fixed rates.

NZ interest rates



Global wrap

North America.

Amidst a light data flow the focus in the US this week has been on President Trump's inauguration. While Trump has issued a plethora of executive orders impacting immigration, energy and climate policy, he is yet to impose the broad-based tariffs mooted during his campaign (he has stated that he aims to introduce 25% tariffs on imports from Canada and Mexico, starting next month). As a result, at least for now, sentiment has improved somewhat in markets, lending some support to risk-sensitive assets and currencies. Looking ahead, following today's flash PMI and existing home sales reports, the focus in the US next week will turn to the first FOMC meeting for this year (Thursday NZT) and several key economic reports. The Fed has already signalled that it is unlikely to move its policy rate and new forecasts will not be published until March, so the focus for markets will be mainly on any nuances that come from Chair Powell's press conference. Following the Fed meeting, attention will turn to the release of the advance Q4 GDP report, the core PCE deflator for December and the Q4 Employment Cost Index.

Europe.

A relatively quiet week saw ECB President Lagarde argue that Europe needed to prepare for US tariffs that would be "more selective, focused". In the UK, growth in earnings remained elevated even as the unemployment rate rose to a 6-month high of 4.4%. The flash January PMI reports for the euro area and the UK will be released later today. Looking to the coming week, initially the focus will be on the release of further national business surveys together with the flash Q4 GDP report. With the latter likely to point to ongoing weakness in the euro area economy, the ECB is widely expected to cut its key policy rates by a further 25bps on Thursday. Following the ECB meeting, flash January CPI reports will be released in France and Germany. The UK dataflow is light next week.

Asia-Pacific.

In Japan, CPI inflation lifted to a more than 1-year high of 3.6% in December. Given growing confidence that positive inflation will be sustained, the BoJ today took a further small step towards normalising policy, with the overnight rate lifted by 25bps to 0.5%. Next week, following the release of the official PMI reports on Monday, China will begin its 8-day long New Year holiday break. In Australia, the focus will be Wednesday's Q4 CPI report. We expect headline inflation to ease to 2.5%y/y (thanks to government rebates), but key core measures such as the trimmed mean are expected to remain above the RBA's 2-3% target band.

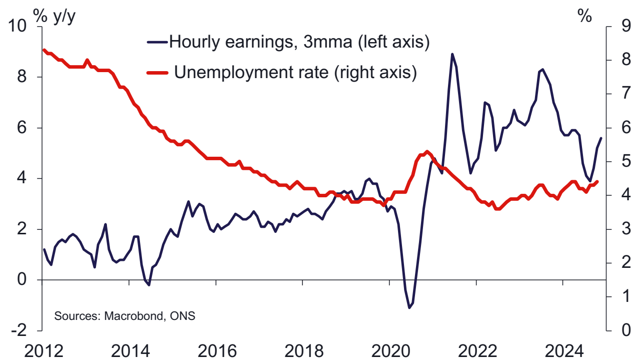
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	**2024**	**2025**	**2026**
Australia	2.0	1.3	2.2	2.4
China	5.2	5.0	4.8	4.5
United States	2.9	2.8	2.4	2.0
Japan	1.9	-0.1	1.2	1.0
East Asia ex China	3.3	4.3	4.1	4.1
India	7.8	6.8	6.8	6.5
Euro Zone	0.4	0.8	1.3	1.5
United Kingdom	0.1	1.0	1.4	1.5
NZ trading partners	3.3	3.3	3.4	3.3
World	3.2	3.3	3.3	3.3

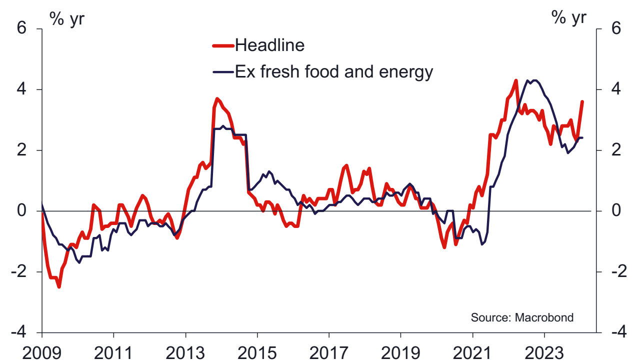
Australian & US interest rate outlook

	24 Jan	**Mar-25**	**Dec-25**	**Dec-26**
Australia				
Cash	4.35	4.35	3.35	3.35
90 Day BBSW	4.32	4.43	3.50	3.55
3 Year Swap	3.88	3.75	3.80	4.00
3 Year Bond	3.93	3.70	3.70	3.80
10 Year Bond	4.49	4.35	4.55	3.85
10 Year Spread to US (bps)	-15	5	5	5
US				
Fed Funds	4.375	4.125	3.375	3.875
US 10 Year Bond	4.64	4.30	4.50	4.80

UK hourly earnings and unemployment rate



Japan CPI inflation



Financial markets wrap

Interest rates.

The NZ 2yr swap rate has pulled back slightly to around 3.50% this week, a moderate receiving bias persisting ahead of the RBNZ's 19 Feb MPS, where a 50bp cut has been signalled. We expect the recent 3.38%-3.65% range to hold next week, barring offshore surprises. Yield support is provided by expectations a large mortgage fixing wave could start after the Feb MPS, as households acknowledge most of the easing cycle is complete and credit growth accelerates as activity picks up. That mortgage wave could flatten the 2-5yr swap curve, from 22bp currently to around zero.

OIS is pricing a 90% chance of a 50bp cut at the Feb RBNZ meeting, and terminal is around 3.15%. A key NZ data event which could shift pricing ahead of the MPS will be the Q4 labour data (5 Feb), the labour market assuming more importance now that CPI inflation is close to the RBNZ's midpoint target of 2%.

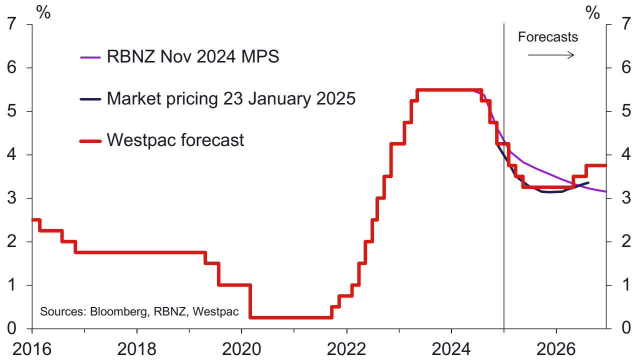
Foreign exchange.

NZD/USD support at 0.5540 has held in January and could be the launchpad for a bounce to around 0.5800 during the week ahead. Short NZD positioning and technicals have been stretched, warning of a bullish reversal, and the NZ economic data pulse has improved of late. Similarly, the USD has been stretched to the upside, warning of a reversal lower. A bounce in NZD/USD would provide opportunities for importers to hedge.

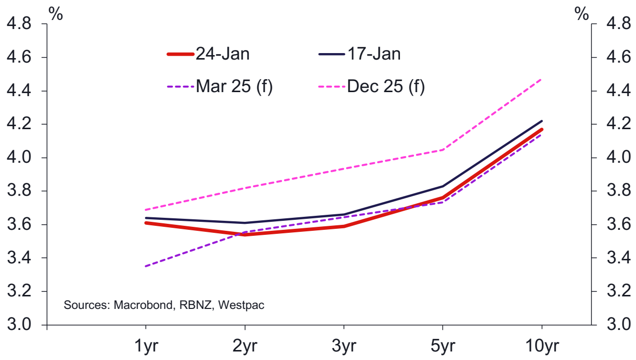
The USD has been volatile this month, mostly relating to the new Trump administration. The stream of eye-catching headlines will likely continue for some time. Since the inauguration these have been net-negative for the US dollar (e.g. Trump's preference for lower interest rates), but two-way risks lie ahead. The main risk event for USD markets next week will be the Fed's rate decision – an on-hold outcome is widely expected, but guidance has the scope to surprise.

This week's NZ CPI outturn was as many had expected, and the RBNZ will be comfortable with headline inflation near 2%. Their attention, and the NZD market's, will now shift to the labour data update on 5 Feb. Beyond the next few weeks, our outlook remains bearish, expecting the strong USD trend since September to eventually resume, in part due to US economic growth exceptionalism. A break below the 0.5470 low formed in March 2020 would signal a move towards 0.5000. NZD/AUD retains a slight downward drift, and we continue to expect an eventual break below the month-old range at 0.9000, and then a test of 0.8900 during the next few months. NZ-AU yield spreads remain negative and near decade lows, while medium term drivers such as current and fiscal accounts will continue to favour the AUD.

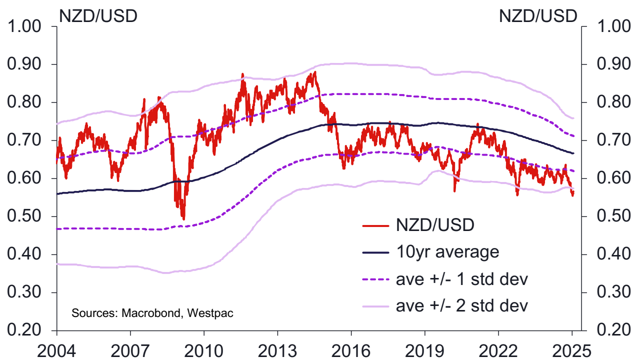
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-25
USD	0.568	0.556-0.603	0.555-0.743	0.641	0.57
AUD	0.903	0.895-0.912	0.873-0.992	0.927	0.86
EUR	0.545	0.539-0.560	0.517-0.637	0.579	0.52
GBP	0.460	0.447-0.466	0.447-0.535	0.500	0.44
JPY	88.6	87.0-92.1	61.3-98.6	81.8	84.4

The week ahead

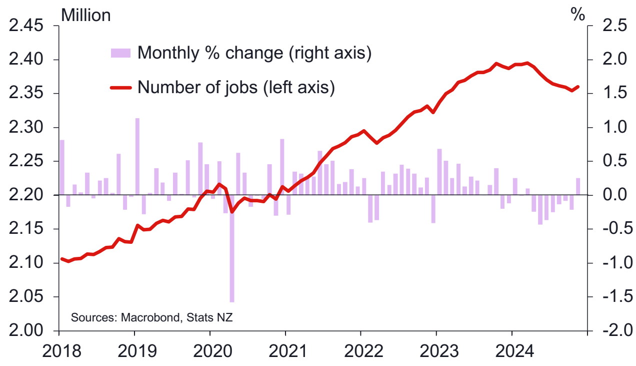
Dec Monthly Employment Indicator

Jan 28, Last: +0.3%, Westpac f/c: flat

The Monthly Employment Indicator (MEI) rose by 0.3% in November, its first increase since March. While this series tends to be revised down from its initial release, we think it's unlikely to turn into a minus.

The weekly snapshots provided by Stats NZ suggest a broadly flat result for December in seasonally adjusted terms – the lift in hiring ahead of the Christmas period was similar to the previous year. An emerging pickup in tourism-related sectors is balanced against ongoing weakness in areas such as manufacturing and construction.

Monthly Employment Indicator filled jobs



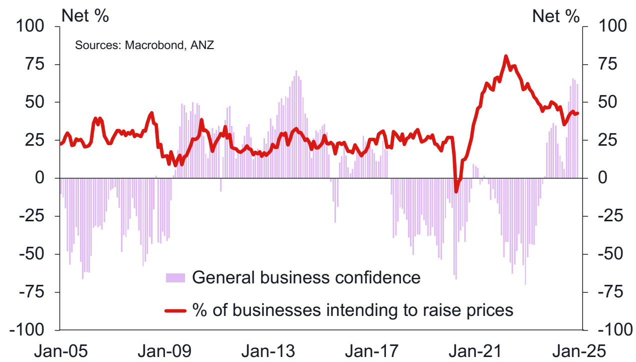
Jan ANZ Business Confidence

Jan 30, Last: 62.3

Business confidence surged over the second half of last year as the RBNZ began to ease interest rates. That optimism generally hasn't been matched by their performance to date, although there were some signs of stabilisation in the December survey.

The January survey comes after the reporting of a sharp fall in GDP in the last two quarters, which may have dented confidence in the forward outlook. Against this, the prospect of further OCR cuts in the coming months remains firmly on the cards.

Business confidence and pricing intentions

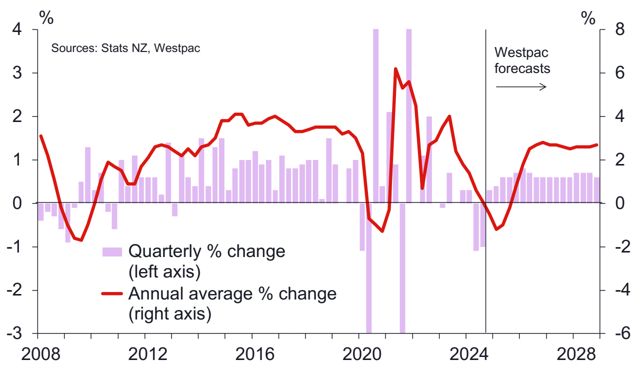


Economic and financial forecasts

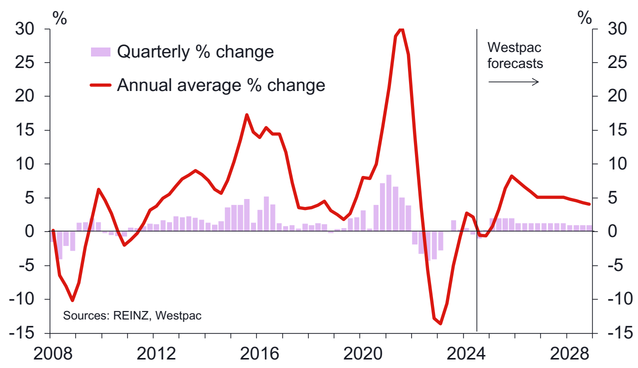
Economic indicators	Quarterly % change				Annual % change			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
GDP (production)	-1.1	-1.0	0.3	0.4	1.8	-0.5	0.8	2.8
Consumer price index	0.4	0.6	0.5	0.5	4.7	2.2	2.1	2.1
Employment change	0.2	-0.5	-0.3	-0.1	2.8	-1.0	0.2	2.1
Unemployment rate	4.6	4.8	5.1	5.3	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)	-6.6	-6.4	-5.9	-5.1	-6.9	-5.9	-3.7	-4.5
Terms of trade	2.1	2.5	6.7	3.4	-10.7	17.4	2.8	0.7
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	5.25	4.25	3.75	3.25	5.50	4.25	3.25	3.75
90 day bank bill	5.31	4.45	3.55	3.35	5.65	4.45	3.35	3.85
2 year swap	4.06	3.64	3.55	3.60	5.28	3.64	3.80	4.00
5 year swap	3.81	3.73	3.75	3.85	4.85	3.73	4.05	4.25
10 year bond	4.31	4.51	4.40	4.50	5.09	4.51	4.65	4.85
TWI	70.9	69.5	68.1	67.3	70.8	69.5	65.7	66.6
NZD/USD	0.61	0.59	0.58	0.58	0.60	0.59	0.57	0.60
NZD/AUD	0.91	0.91	0.89	0.88	0.93	0.91	0.86	0.86
NZD/EUR	0.56	0.55	0.54	0.54	0.56	0.55	0.52	0.54
NZD/GBP	0.47	0.46	0.45	0.44	0.49	0.46	0.44	0.45

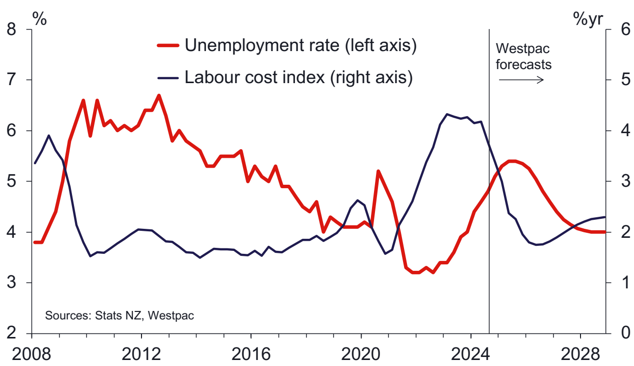
GDP growth



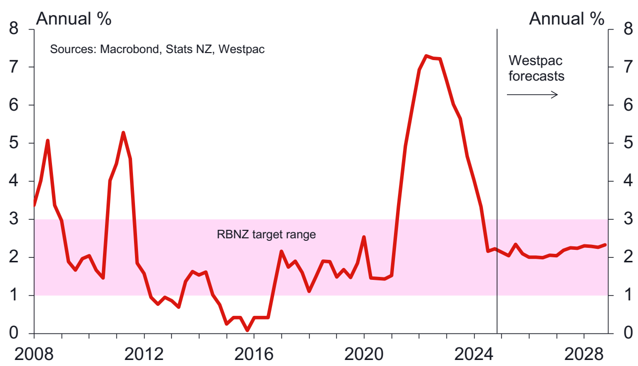
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
Aus	Australia Day Public Holiday	–	–	–	Markets closed.
Chn	Jan NBS Manufacturing PMI, index	50.1	–	–	Lunar New Year to leave manufacturing marking time...
	Jan NBS Non-Manufacturing PMI, index	52.2	–	–	... while tourism-related services receives a boost in activity.
Ger	Jan IFO Business Climate Survey, index	84.7	–	–	Expectations shaky amid tariff and election uncertainty.
US	Dec New Home Sales, %mth	5.9	6.6	–	Supply is gradually coming on line, but pressures linger.
	Jan Dallas Fed, index	3.4	–	–	Broadly consistent with ISM around break-even territory.
Tue 28					
NZ	Dec Employment Indicator, %mth	0.3	–	0	Jobs may be flattening out after declines in mid-2024.
Aus	Dec NAB Business Conditions, index	2	–	–	Conditions are at its lowest level since August 2020.
US	Dec Durable Goods Orders, %mth	–1.2	0.8	–	Evolution of orders to provide a clue on business sentiment.
	Jan CB Consumer Confidence, index	104.7	105.6	–	Politics to remain a key driver near-term.
	Jan Richmond Fed, index	–10	–	–	Broadly consistent with ISM around break-even territory.
Wed 29					
NZ	RBNZ Chief Economist Speech	–	–	–	"Beyond the Cycle: Growth and Interest Rates in the Long Run".
Aus	Q4 Headline CPI, %qtr	0.2	0.4	0.3	Cost-of-living assistance shaving 0.3ppt off the CPI in Q4...
	Q4 Headline CPI, %ann	2.8	2.5	2.5	... and 0.7ppt off the annual pace.
	Q4 Trimmed Mean CPI, %qtr	0.8	0.6	0.6	At most cost of living assistance only shaves 0.1ppt off the...
	Q4 Trimmed Mean CPI, %ann	3.5	3.3	3.3	... annual pace of core inflation. Falling dwellings more important.
	Dec Monthly CPI Indicator, %ann	2.3	2.5	2.5	Holiday travel, fuel and garments behind the outsized rise.
Chn	Lunar New Year	–	–	–	Stock markets closed until February 4th in HK and Shanghai.
US	Jan FOMC Policy Decision, %	4.375	4.375	4.375	FOMC taking a patient approach to policy normalisation.
Can	Jan BoC Policy Decision, %	3.25	3	–	Despite a lumpy print, inflation data supports another rate cut.
Thu 30					
NZ	Dec Trade Balance , $mn	–437	–	340	Seasonal lift in exports to drive first surplus since June.
	Jan ANZ Business Confidence, index	62.3	–	–	Activity and confidence indicators firming.
Aus	Q4 Import Price Index, %qtr	–1.4	1.5	1.5	Weaker currency is set to have lifted import prices...
	Q4 Export Price Index, %qtr	–4.3	2.5	4	... while higher commodity prices suggest higher export prices.
	RBA Assist' Gov (Financial Systems)	–	–	–	Jones fireside chat at superannuation forum.
Eur	Q4 GDP, %qtr	0.4	1.1	–	Activity at risk of finishing the year on a soft note...
	Dec Unemployment Rate, %	6.3	6.3	–	... and despite labour market remaining historically tight...
	Jan ECB Policy Decision (Deposit Rate), %	3	2.75	2.75	... moderating inflation paves the way for a 25bp cut in Jan.
US	Q4 GDP, %ann'd	3.1	2.6	2.8	Growth holding at a modestly above-trend pace.
	Initial Jobless Claims	223	–	–	To remain at a relatively low level.
	Dec Pending Home Sales, %mth	2.2	–1.0	–	Marginal buyers taking advantage of early emerging supply.
Fri 31					
NZ	Jan ANZ Consumer Confidence, index	100.2	–	–	Confidence trending higher as financial pressure ease.
Aus	Q4 PPI, %qtr	1	–	–	Rising energy prices set to boost the PPI in Q4.
	Dec Private Sector Credit, %mth	0.5	0.5	0.5	Follows a stable trend, but with downside risks.
Jpn	Dec Jobless Rate, %	2.5	2.5	–	Prospects for policy adjustment remains constructive given...
	Jan Tokyo CPI, %ann	3	3	–	... backdrop of tight labour market and sustainable inflation.
	Dec Industrial Production, %mth	–2.2	–	–	Hovering more-or-less around flat on an annual basis.
Chn	Jan Caixin Manufacturing PMI, index	50.5	–	–	Production to remain soft heading into Lunar New Year.
US	Q4 Employment Cost Index, %qtr	0.8	1	0.9	Labour income growth has eased somewhat over the past...
	Dec Personal Income, %mth	0.3	0.4	0.4	... twelve months but remains relatively robust overall.
	Dec Personal Spending, %mth	0.4	0.5	0.4	End-of-year discounting provided some support to spending...
	Dec PCE Deflator, %mth	0.1	0.3	0.3	... but does not signal a material upside risk to inflation.
	Jan Chicago PMI, index	36.9	39.7	–	Manufacturing particularly fragile in local region.

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