WEEKLY ECONOMIC COMMENTARY

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

RBNZ delivers no surprises

The focus for New Zealand financial markets last week was the outcome of the RBNZ's first policy review for 2025. As it happens, the RBNZ delivered the 50bps easing that it had clearly signalled at the previous meeting in November, taking the OCR to 3.75%. And the Bank's revised economic and financial projections were in many respects unchanged from those published in the November Monetary Policy Statement (MPS). Therefore unsurprisingly, wholesale interest rates and the NZ dollar closed the day close to pre-meeting levels.

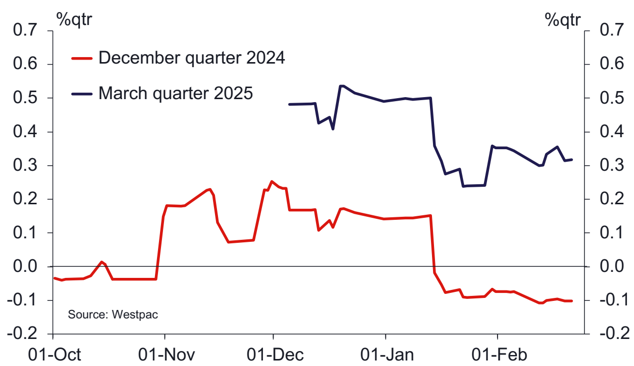
One notable change to the projections – but one that we had fully anticipated – is that the forecast pace of additional rate cuts would slow to 25bp increments and that future forecast cuts would be front-loaded. During the post-meeting press conference, Governor Orr noted explicitly that the new projections were consistent with 25bp easings at both the upcoming April and May meetings, taking the OCR down to 3.25%. This brings the RBNZ's projection into line with Westpac's own forecast up to mid-2025. Given that guidance and our forecasts for the upcoming data flow, we think that a 25bp easing at the next meeting on 9 April must be regarded as very likely, with a high hurdle to be crossed for the RBNZ to ease by 50bps or pause.

Beyond the near term, the RBNZ's revised projections show a year-end OCR forecast of 3.14%, down from 3.55% previously. This implies some chance of a further 25bp rate cut by year end – a possibility that was alluded to by the Governor in his press conference. That said, we regard this part of the projection as a placeholder. There is a lot of water to flow under the bridge between now and then and economic and financial developments will determine whether additional policy easing is required. As set out in **our recent Economic Overview**, we expect that a weaker exchange rate will provide additional support to the economy this year. Indeed, over the coming year our forecast for the trade-weighted exchange rate (TWI)

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



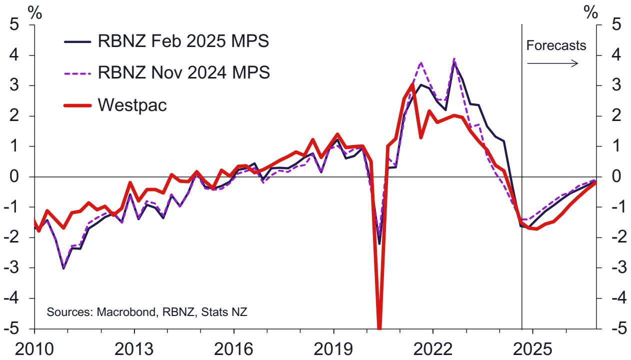
Key data and event outlook

Date	Event
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
8 Apr 25	NZIER QSBO Business Survey, March quarter
9 Apr 25	RBNZ OCR Review
15 Apr 25	NZ Selected price indexes, March
17 Apr 25	NZ CPI, March quarter
7 May 25	Labour market statistics, March quarter
7 May 25	RBNZ Financial Stability Report

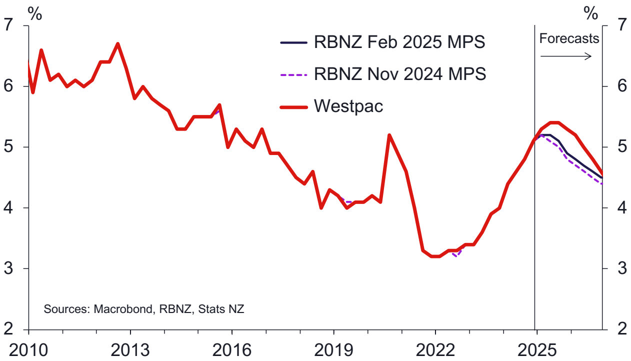
is noticeably lower than the 67.5 track assumed by the RBNZ in its updated forecasts. Therefore, we remain comfortable with our forecast that the easing cycle will conclude when the RBNZ lowers the OCR to 3.25% at the May meeting.

As we had anticipated, the GDP report released in December has caused the RBNZ to estimate a more positive output gap in 2022 and 2023 – helping to better explain the strong domestic inflation seen over that period – but a slightly more negative output gap at the end of last year. From that starting point, the outlook for growth is much as forecast in November. The unemployment rate is still forecast to peak at 5.2% – a little lower than we think is likely, given that it has already reached 5.1% – but is now expected to begin declining a quarter later than forecast previously. Given a more negative output gap, the RBNZ's near-term forecasts for non-tradables inflation are a little lower than forecast in November.

Output gap forecasts

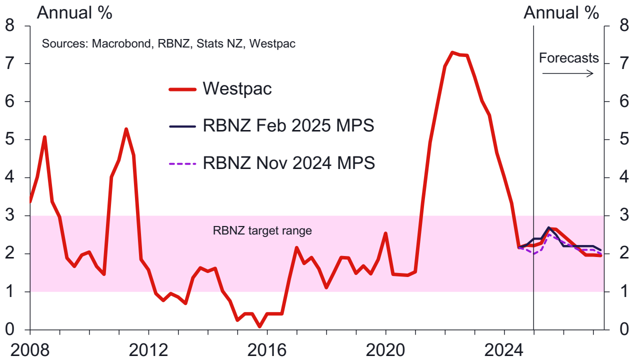


Unemployment forecasts

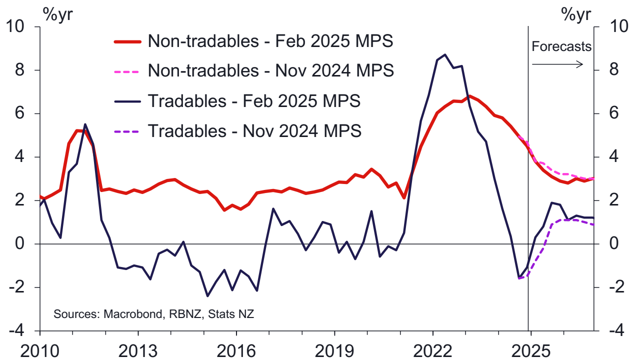


Also of note, the RBNZ has significantly cut its forecast of house price inflation this year to 3.8% from 7.1% previously (we see upside risk to this new forecast). This may have caused the RBNZ to lower its forecasts of inflation in housing-related items (e.g. construction costs). Even so, the RBNZ has revised up its forecast of near-term headline inflation, which is now seen as rising to a peak of 2.7%y/y this year before declining back to 2%y/y thereafter. The higher near-term peak – which matches our own forecast – reflects a stronger profile for tradables inflation, in part due to the recent depreciation of the exchange rate. The RBNZ will pay close attention to how measures of inflation expectations evolve this year to see whether the near-term lift in headline inflation risks gaining some persistence.

Consumer price inflation



Inflation component forecasts



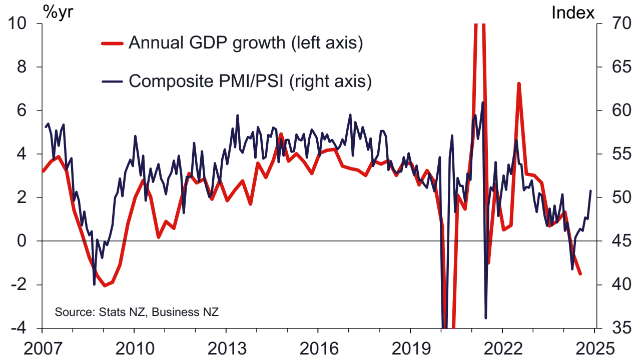
A key focus of the MPS was how global tariff policy might impact the New Zealand economy, with a special topic devoted to this issue. Given the various uncertainties about the final form of the policies that will emerge, the RBNZ's commentary was necessarily hypothetical. Uncontroversially, the RBNZ argues that higher global tariffs may result in lower global economic growth; increased inflationary pressure in tariff-imposing countries; a decrease in export prices in tariff-targeted countries; and trade diversion towards non-tariffed countries. New Zealand would be directly affected if higher tariffs are imposed on our exports and indirectly affected via the effects of tariffs on our trading partners. In accordance with our own thinking, the RBNZ expects that the indirect effects for New Zealand are likely to be larger than the direct effects. Overall, increased uncertainty and any future trade policy shocks are viewed as likely to reduce growth in New Zealand. However, given that this uncertainty and tariffs are likely to put downward pressures on the exchange rate, the RBNZ notes that the effect on inflation in New Zealand is ambiguous. From a monetary policy standpoint, the RBNZ seems comfortable that the impact of such shocks is likely to take time to materialise, giving it flexibility to react as necessary once the impacts on medium-term inflation pressures become clear.

Looking ahead to the RBNZ's next meeting on 9 April, the two key domestic data releases between now and then are the December quarter GDP report (due 20 March) and the March quarter QSBO business survey (due 8 April). We presently estimate that the economy expanded 0.3%q/q in the December quarter – identical to the RBNZ's updated estimate – and so we don't expect the GDP report will impact the policy trajectory. In any case, given the large revisions and surprises seen in this data of late, both we and the RBNZ will be very cautious in interpreting any deviations from expectations. The QSBO will provide important information on how activity and inflation pressures evolved over the first quarter of this year and what firms anticipate for the second quarter. This report will probably have more bearing on what the RBNZ's signals when it next updates its formal projections in the May MPS. Unfortunately, the March quarter CPI report will not be released until 17 April. However, the February Selected Price Indexes (due 14 March) will provide some indication of what the CPI report might reveal.

Key high frequency indicators such as the BusinessNZ indexes and the ANZ Business Outlook survey will be of interest, as will developments in retail spending and housing indicators (the latter could be especially instructive as we move into what is typically the busiest time of the year for housing market activity). Outside of New Zealand, interest will centre on any clarity that emerges regarding the implications of the Trump presidency for New Zealand's export sector. On that score, we note that President Trump has signalled an intention to apply 'reciprocal' tariffs to countries that apply value-added taxes (which would presumably include New Zealand's GST) from as soon as early April. Associated developments in financial conditions – longer-term interest rates and the exchange rate – will also factor into the next OCR review.

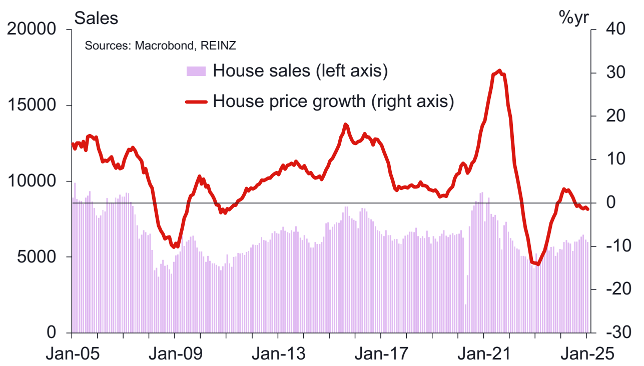
Turning to the rest of last week's key economic news, the BusinessNZ Performance of Services Index reported a welcome rebound in January, rising 2.3pts to 50.4 – the first reading above 50 since February last year. This follows last week's improvement in the Performance of Manufacturing Index, which also moved into expansionary territory. Signs of increased activity were also evident in the merchandise trade data for January, with imports of consumption goods and plant and machinery tracking well above year-earlier levels. Exports were also firm, with higher prices contributing to a very good month for dairy shipments. As a result, the seasonally adjusted trade balance moved into a rare surplus.

Business NZ composite PMI & GDP growth



By contrast, housing market data remained subdued, with sales declining around 3%m/m in January following a 5%m/m decline in December. That said, sales tend to be underestimated on first release, so we are not reading much into the further decline in January. Forward indicators, such as mortgage applications, clearly point to a trend improvement in housing activity over coming months, as one should expect given the large decline in mortgage interest rates over recent months. After adjusting for seasonal effects, we estimate that house prices nudged up 0.1%m/m in January. Prices remain at about the same level as when the RBNZ pivoted its policy stance back in July. However, we expect that house prices will pick up in coming months as activity trends higher.

REINZ house prices and sales



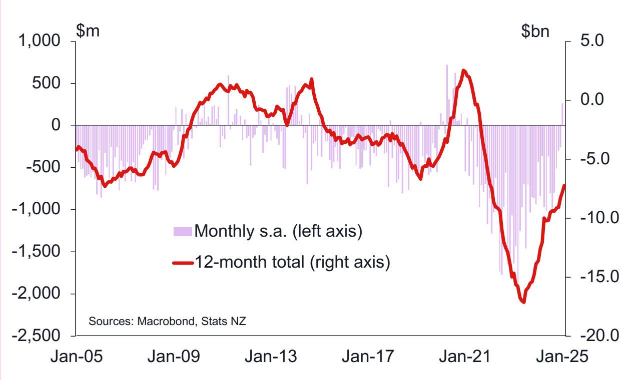
Today brings the release of the December quarter retail sales report, beginning the run of key partial indicators ahead of next month's GDP data. Later in the week the ANZ's monthly business and consumer confidence surveys will cast light on both activity and pricing trends, while a read on how the labour market has entered the new year will be provided by the Monthly Employment Indicator.

Darren Gibbs, Senior Economist

Chart of the week.

Last week's merchandise trade report indicated that New Zealand recorded a rare seasonally adjusted trade surplus of $266m in January, with the annual trade deficit declining to $7.2bn from $12.6bn a year earlier. Exports rose just over 28%y/y in January. Growth was propelled by a 44%y/y lift in exports of milk powder, butter and cheese. Most of the growth reflects the strong lift in commodity prices seen in recent months, as volumes exported increased by a much smaller 7%y/y. While imports are also now beginning to grow as the economy recovers, the feedthrough of stronger commodity prices – including in the meat sector – means that monthly trade surpluses should become more commonplace in coming months. As a result, the annual trade deficit should continue to trend lower, contributing to a narrowing of the current account deficit to below 4% of GDP by the end of this year.

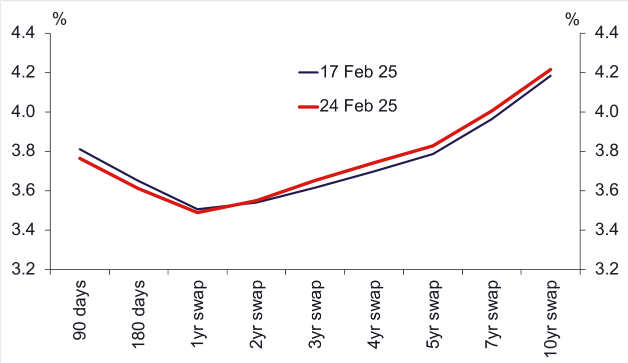
Merchandise trade balance



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

Asia-Pacific.

As expected, the RBA reduced its cash rate by 25bps by 4.10%, its first cut since 2020. However, the tone of its messaging was surprisingly hawkish. While the Board cited "welcome progress on inflation," it expressed concern over easing policy "too much too soon". Governor Bullock also described market pricing for another three rate cuts as "far too confident" and "unrealistic", projecting that this would see core inflation hold above the mid-point of the target range through to June 2027. The key to this view will be whether the continued strength in the labour market proves to be as much of an inflationary force as the RBA expects. The January labour force survey was again stronger than forecast, with jobs up 44k and the unemployment rate up only slightly to 4.1%. However, wage inflation is easing faster than the RBA's forecast, with wages up 0.7%qtr (3.2%yr) in Q4.

North America.

The US and Russia began negotiations on a ceasefire in Ukraine, while President Trump announced tariffs on imports of automobiles, pharmaceuticals and semiconductors, and warned of tariffs on countries that apply a digital services tax. The minutes of the January FOMC meeting, along with various Fed speakers, emphasised the high degree of uncertainty around the inflation outlook, warranting a more cautious approach to future policy adjustments. Economic data ended the week on a sour note: the S&P services PMI fell to 49.7, a two-year low, although the manufacturing index rose slightly. The University of Michigan consumer sentiment survey fell to 64.7, a 15-month low, and inflation expectations for the year ahead rose sharply, suggesting that households are increasingly aware of the impact of tariffs. This week brings the January PCE deflator, the Fed's preferred inflation gauge, which is expected to be more subdued than the CPI release earlier this month.

Europe.

Germany's conservative CDU/CSU bloc fared well in Sunday's federal election, with 29% of the vote. This is seen as increasing the chances of a relatively stable two-party coalition government, and all but ensures that the far-right Alternative for Germany party will be shut out. The next government's policy mix is also expected to be more pro-growth than the previous one. UK data pointed to inflation risks remaining present, justifying the BOE's gradual approach to monetary easing. Wage growth accelerated to 5.9%yr for December, in line with expectations. The January CPI was down 0.1% for the month, but base effects lifted the annual inflation rate to 3.0%.

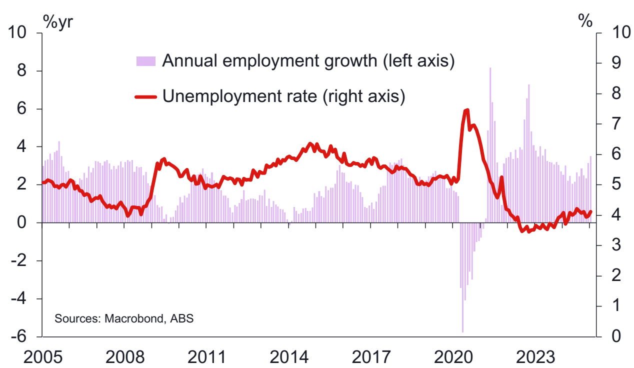
Trading partner real GDP (calendar years)

	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

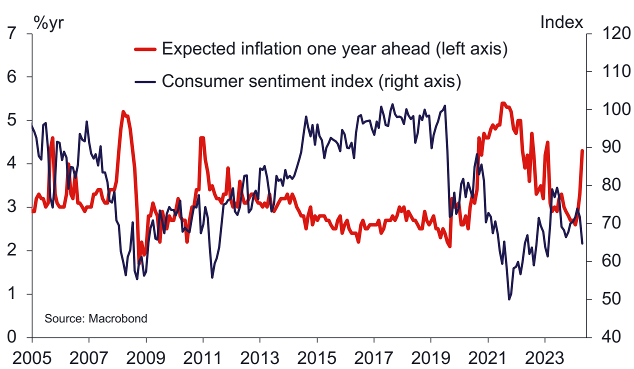
Australian & US interest rate outlook

	21 Feb	Mar-25	Dec-25	Dec-26
Australia				
Cash	4.10	4.10	3.35	3.35
90 Day BBSW	4.14	4.20	3.50	3.55
3 Year Swap	3.90	3.75	3.80	4.00
3 Year Bond	3.93	3.75	3.75	3.85
10 Year Bond	4.51	4.45	4.70	4.65
10 Year Spread to US (bps)	2	-15	-25	-15
US				
Fed Funds	4.375	4.375	4.375	3.875
US 10 Year Bond	4.49	4.60	4.95	4.80

Australian labour market



US University of Michigan consumer sentiment



Financial markets wrap

Interest rates.

NZD/USD retains bullish potential near term. Last week's break higher was sustained and took it to 0.5773. There's potential for that level to be retested this week, with a plausible upside target of 0.5860. Multi-month, though, we remain bearish, targeting 0.5500 or lower.

The main factor supporting a near term rally is positioning – speculative short positions in NZD/USD futures remain extreme and are thus vulnerable to a reversal. This extreme positioning is not unique to the NZD. Markets have bet heavily on the US dollar continuing to rise against most currencies, and while we wouldn't disagree with that sentiment over the medium term, it does look overdone near term.

In addition, in the wake of the RBNZ MPS last week, where it clearly signalled 25bp OCR cuts for April and May, and a third and final one sometime later, NZ-US yield spreads have risen. Interest rate markets had already priced in this RBNZ projection, and are now starting to look ahead to the next cycle.

Our medium-term bearish view is based on the expectation that the US dollar will eventually resume its October-January uptrend, supported by the performance of the US economy, a lengthy pause in the Fed's easing cycle, and clarity on US import tariffs by April.

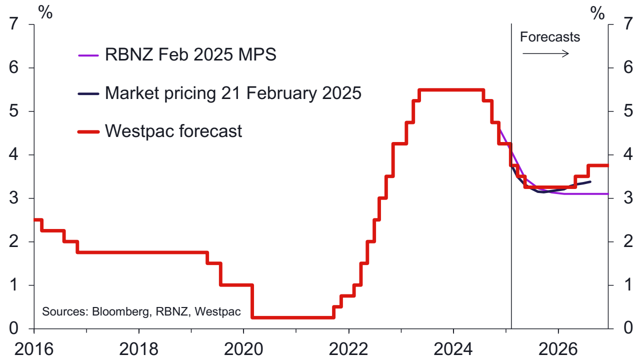
Interest rates.

The NZ 2yr swap rate has been stuck in a range of 3.33%-3.65% over the past two months, but that is vulnerable to breaking to the upside during the weeks ahead.

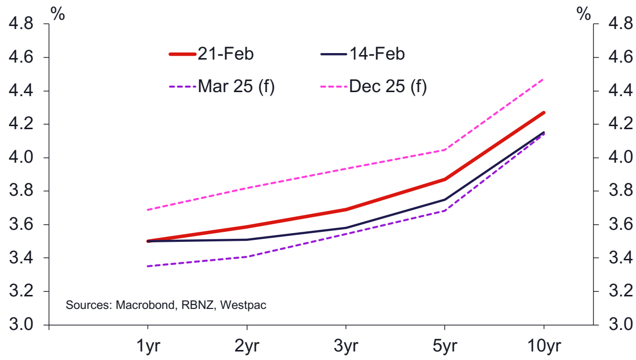
The RBNZ MPS last week clearly signalled the trajectory of the remainder of the easing cycle, and it was no lower than markets had already priced in. While there is plenty of opportunity for economic surprises over the next nine months, markets have priced the OCR to be cut by 25bp in April, May and October, to bottom at 3.0%, and to start rising in 2026 (Westpac's forecast also has 25bp cuts in April and May, but the cycle to end there at 3.25%).

Also supportive of higher swap rates is the pipeline of mortgages due to refixing. Banks lowered some of their term mortgage rates following the RBNZ MPS, and we will be watching closely for signs of a pickup in fixing, which we expect will target terms in the 18mth-3yr area.

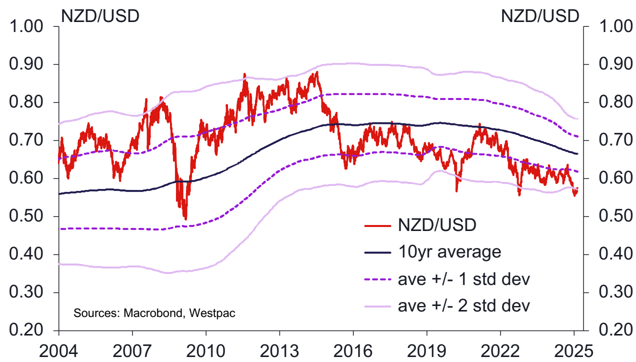
Official Cash Rate forecasts



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	0.574	0.554-0.590	0.554-0.743	0.640	0.54
AUD	0.902	0.895-0.912	0.873-0.992	0.926	0.87
EUR	0.548	0.539-0.560	0.517-0.637	0.578	0.53
GBP	0.454	0.447-0.465	0.447-0.535	0.499	0.44
JPY	85.7	85.5-91.1	61.3-98.6	82.1	82.1

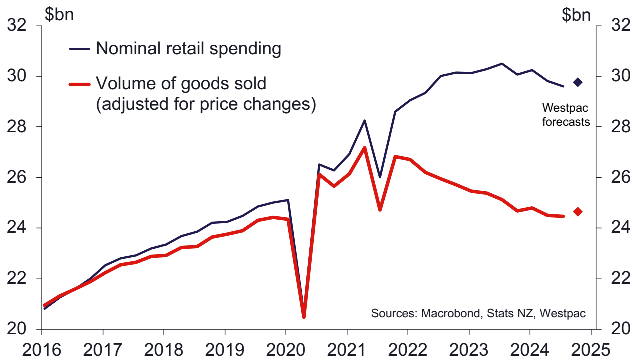
The week ahead

Q4 retail trade

Feb 24, Last: -0.1%, Westpac forecast: +0.7%

Retail spending was weak over most of the past year with high inflation, high interest rates and a softening labour market all weighing on spending appetites. However, some of those headwinds are now easing, with inflation back close to 2% and interest rates dropping. That's given confidence a boost, and monthly retail sales have started to push higher again. We're forecasting a 0.7% rise in spending over the December quarter, including a 1.1% rise in core categories.

Retail trade survey



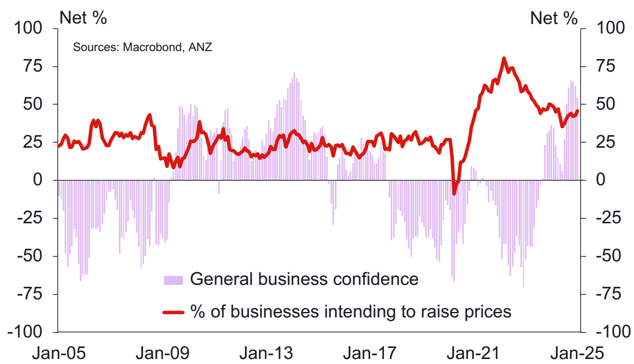
Feb ANZ business confidence

Feb 27, Last: 54.4

Business confidence pulled back in January but remained close to a 10-year high. Firms' expectations have surged higher since the RBNZ began its easing cycle – running well ahead of their assessment of current conditions, though there are also some signs of improvement on this front.

Notably, the pricing indicators in the survey have also been picking up in recent months. The weakening in the NZ dollar since the US presidential election is likely to add to concerns about inflation in the near term.

Business confidence and pricing intentions



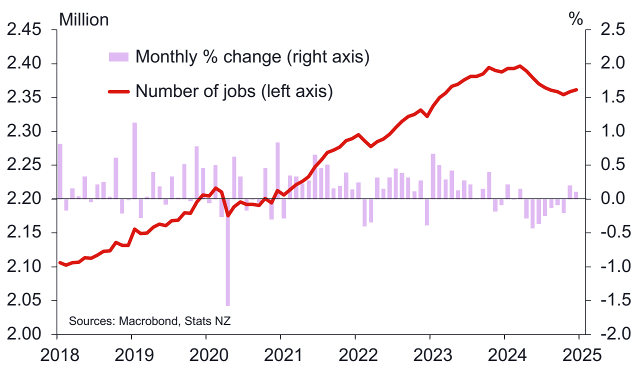
Jan Monthly Employment Indicator

Feb 28, Last: +0.2%, Westpac f/c: flat

The Monthly Employment Indicator (MEI) rose by 0.2% in December, making it two months of modest gains. This measure tends to be revised down from its initial release, though we think it's unlikely to turn into a minus.

The weekly snapshots provided by Stats NZ suggest a broadly flat result for January in seasonally adjusted terms. An emerging pickup in tourism-related sectors is balanced against ongoing weakness in areas such as manufacturing and construction.

Monthly Employment Indicator filled jobs

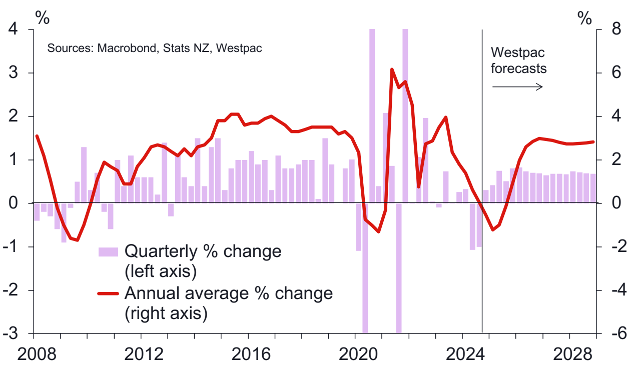


Economic and financial forecasts

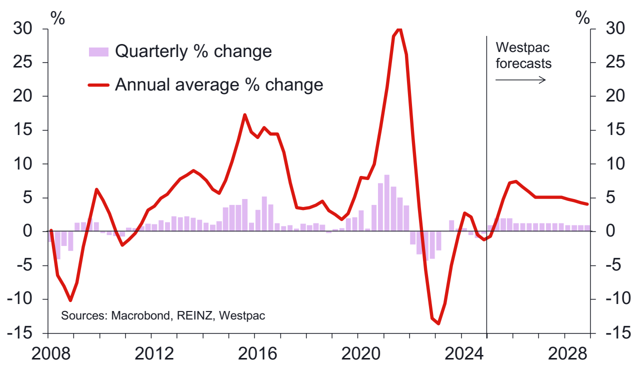
Economic indicators	Quarterly % change				Annual % change			
	Sep-24	Dec-24	Mar-25	Jun-25	2023	2024	2025	2026
GDP (production)	-1.0	0.3	0.4	0.8	1.8	-0.5	0.9	3.0
Consumer price index	0.6	0.5	0.6	0.5	4.7	2.2	2.6	2.0
Employment change	-0.6	-0.1	-0.1	0.0	2.8	-1.1	0.4	1.9
Unemployment rate	4.8	5.1	5.3	5.4	4.0	5.1	5.3	4.6
Labour cost index (all sectors)	0.6	0.6	0.6	0.5	4.3	3.3	2.2	1.8
Current account balance (% of GDP)	-6.4	-5.9	-5.0	-4.1	-6.9	-5.9	-3.5	-4.3
Terms of trade	2.5	6.5	5.9	0.7	-10.7	17.2	4.2	2.1
House price index	-0.9	-0.2	1.0	2.0	-0.6	-1.2	7.2	5.1

Financial forecasts	End of quarter				End of year			
	Sep-24	Dec-24	Mar-25	Jun-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	3.40	3.50	5.28	3.64	3.80	4.00
5 year swap	3.81	3.73	3.70	3.80	4.85	3.73	4.05	4.25
10 year bond	4.31	4.51	4.60	4.70	5.09	4.51	4.90	4.95
TWI	70.9	69.5	65.7	65.5	70.8	69.5	64.5	67.4
NZD/USD	0.61	0.59	0.54	0.54	0.60	0.59	0.54	0.59
NZD/AUD	0.91	0.91	0.90	0.90	0.93	0.91	0.87	0.87
NZD/EUR	0.56	0.55	0.54	0.54	0.56	0.55	0.53	0.56
NZD/GBP	0.47	0.46	0.44	0.44	0.49	0.46	0.44	0.46

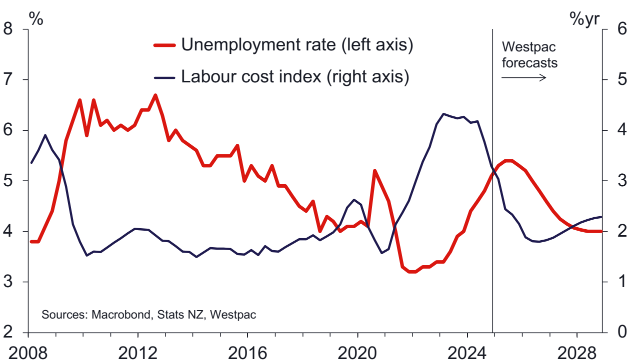
GDP growth



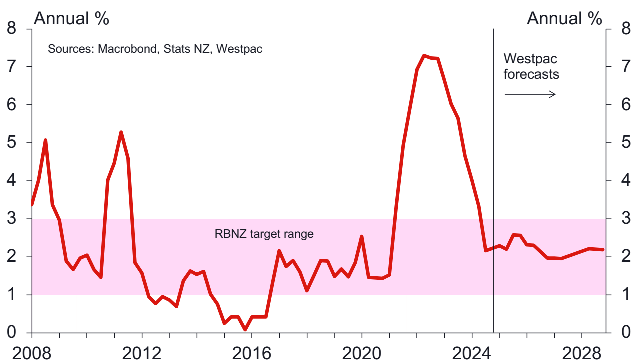
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 24					
NZ	Q4 Real Retail Sales, %qtr	–0.1	0.5	0.7	Easing financial pressures boosting spending.
Eur	Jan CPI, %ann	2.5	–	–	Final estimate to provide more colour on component detail.
Ger	Feb IFO Business Climate Survey, index	85.1	85.8	–	Focus to return to broader issues facing economy post-election.
US	Jan Chicago Fed Activity Index, %mth	0.15	–	–	On an average basis, consistent with growth moving to trend.
	Feb Dallas Fed, index	14.1	–	–	Manufacturing mixed across US, but Texas a clear stand-out.
Tue 25					
Aus	RBA Assist' Governor (Fin Systems)	–	–	–	Jones, fireside chat at DLT-Enabled.
US	Dec S&P/CS Home Price Index, %mth	0.41	–	–	Affordability constraints capping any upside momentum.
	Feb CB Consumer Confidence, index	104.1	103	–	To provide a first look into reactions to Trump's policies.
	Feb Richmond Fed, index	–4	–	–	Points to a more gradual recovery unfolding over 2025.
	Fedspeak	–	–	–	Logan, Barr, Barkin.
Wed 26					
Aus	Jan Monthly CPI Indicator, %ann	2.5	2.6	2.4	January is seasonally a soft month plus energy rebates.
	Q4 Construction Work Done, %qtr	1.6	1	1	Engineering and resi construction work expected to grow.
US	Jan New Home Sales, %mth	3.6	–2.9	–	Sales trending higher as supply continues to come online.
	Fedspeak	–	–	–	Bostic on economic outlook and housing.
Thu 27					
NZ	Feb ANZ Business Confidence, index	54.3	–	–	Hopes are running high as interest rates fall.
Aus	RBA Head of Economic Analysis	–	–	–	Speaking on the importance of productivity at ABE Conference.
	Q4 Private New Capital Expenditure, %qtr	1.1	0.5	0.8	A touch slower growth and broadly unchanged spend plans.
Eur	Feb Economic Confidence, index	95.2	–	–	Broader sentiment little-changed amid uncertain outlook.
US	Q4 GDP, %ann'd	2.3	2.3	–	No revisions anticipated in the second estimate.
	Jan Durable Goods Orders, %mth	–2.2	1.8	–	Modest trend growth in core orders a positive for investment.
	Initial Jobless Claims	219k	–	–	To remain low, for now.
	Jan Pending Home Sales, %mth	–5.5	–1.2	–	Pointing to weak turnover for existing homes.
	Feb Kansas City Fed, index	–5	–	–	Points to a more gradual recovery unfolding over 2025.
	Fedspeak	–	–	–	Schmid, Barr, Bowman, Hammack, Harker.
Fri 28					
NZ	Feb ANZ Consumer Confidence, index	96	–	–	Confidence is trending higher.
	Jan Employment Indicator, %mth	0.1	–	0	Jobs are flattening out after declines in mid-2024.
Aus	Jan Private Sector Credit, %mth	0.6	0.5	0.5	Weaker house price growth might start to slow housing credit.
Jpn	Feb Tokyo CPI, %ann	3.4	3.2	–	Core inflation stabilising near target, a welcome sign for BoJ.
	Jan Industrial Production, %mth	–0.2	–1.1	–	Japanese industry on weak footing ahead of tariff risks.
US	Jan Personal Income, %mth	0.4	0.3	–	Income growth easing but relatively robust overall.
	Jan Personal Spending, %mth	0.7	0.2	–	Set to pull–back after a seasonal bump in December...
	Jan PCE Deflator, %mth	0.3	0.3	–	... and therefore unlikely to knock disinflation off track.
	Jan Wholesale Inventories, %mth	–0.5	–	–	Flat annual growth points to sound inventory management.
	Feb Chicago PMI, index	39.5	–	–	Points to downside risk for manufacturing.
	Fedspeak	–	–	–	Goolsbee in Q&A.
Sat 01					
Chn	Feb NBS Manufacturing PMI, index	49.1	50	–	Seasonal impacts from Lunar New Year muddying the read...
	Feb NBS Non–Manufacturing PMI, index	50.2	50.3	–	... authorities looking for a sustained lift in underlying growth.

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