WEEKLY ECONOMIC COMMENTARY

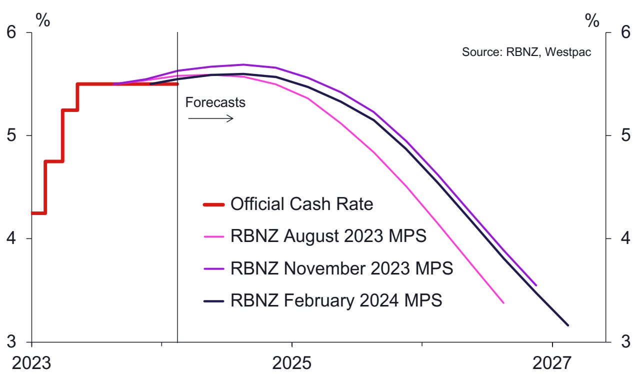
4 Mar 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Steady as she goes

The key event in New Zealand last week was the RBNZ's OCR decision and accompanying *Monetary Policy Statement* (MPS). The RBNZ indicated that the economy and inflation is continuing to evolve broadly as it had expected. The Bank's policy approach remains one of "staying the course" – the theme of **our recent Economic Overview**. That is, inflation is expected to return to 2% later next year provided that the OCR remains at its current rate of 5.5% until at least early next year.

As we and most commentators had expected, the RBNZ left the OCR at 5.5%. The overall tone of the *Statement* remained somewhat hawkish in absolute terms but was much less hawkish than markets had feared. The RBNZ still sees a risk that the OCR might need to rise later this year. However, this risk is now lower than seen in the November 2023 *MPS*, with the updated OCR track implying around a 40% chance of a further 25bps hike – down from around 75% previously. As a result, the RBNZ's forecast for the OCR over the next year now looks much like that published in the August 2023 *MPS*.

Official Cash Rate forecasts

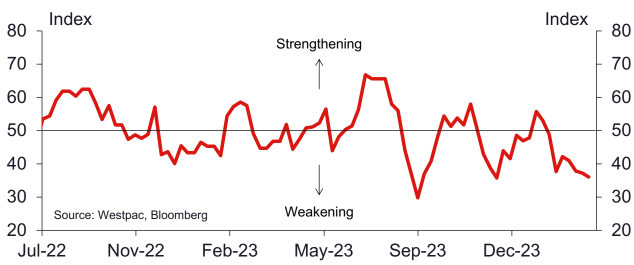


As we wrote in our *MPS* preview, a straight interpretation of recent economic data suggested that the OCR track could be lowered. But we saw material risks of either an OCR increase or upgraded risks of one in the future, if

Key views

	Last 3 months	Next 3 months	Next year
Global economy	→	→	↗
NZ economy	→	→	↗
Inflation	↘	↘	↓
Short-term interest rates	→	→	↘
Long-term interest rates	↘	→	↘
NZD/USD	→	↗	↗
NZD/AUD	↗	→	↘

Westpac New Zealand Data Pulse Index



Key data and event outlook

Date	Event
13 Mar 24	NZ selected price indexes, February
19 Mar 24	RBA Monetary Policy Decision and SMP
20 Mar 24	FOMC Meeting (Announced 21 Mar NZT)
21 Mar 24	GDP, December quarter
27 Mar 24	Govt to release Budget Policy Statement
9 Apr 24	QSBO business survey, March quarter
10 Apr 24	RBNZ Monetary Policy Review
12 Apr 24	NZ Selected price indexes, March
1 May 24	NZ Labour market statistics, March quarter
1 May 24	RBNZ to release Financial Stability Report
1 May 24	FOMC Meeting (Announced 2 May NZT)
7 May 24	RBA Monetary Policy Decision and SMP
13 May 24	NZ Selected price indexes, April

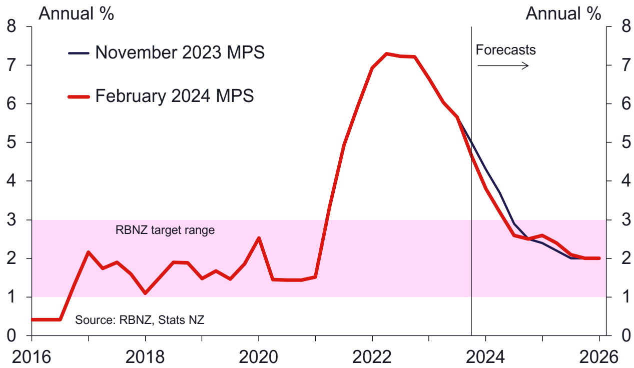
the RBNZ were to focus on the more worrying aspects of the data (e.g., the stickiness of non-tradable inflation). As it turns out, the RBNZ played a straight bat, giving significant weight to both the weak Q3 GDP outcome, the larger than expected decline in headline inflation in Q4 and the significant decline in business inflation expectations reported in its own survey.

A key excerpt from the latest *MPS* summarises the drivers of the RBNZ's updated view:

"Conditional on our central economic outlook, the Official Cash Rate (OCR) is expected to remain around current levels for an extended period in order for the MPC to meet its inflation target. The outlook for the OCR is slightly lower than in the November 2023 Statement. This reflects that the slightly lower outlooks for capacity pressures, import prices and house price inflation more than offset the higher outlook for export prices."

Importantly, the record of the meeting noted that members viewed that "overall, risks to the outlook for inflation were more balanced than at the time of the November 2023 *Statement*. However, from a monetary policy perspective, there remains less capacity to absorb upside inflation surprises, relative to downside surprises." In the press conference, Governor Orr emphasised that while the risks to inflation are now more balanced, the policy reaction function to any realisation of these risks remains asymmetric given the current level of inflation. Governor Orr also indicated that while the possibility of a hike was discussed at the meeting, no vote was required indicating a strong consensus that the current OCR remains appropriate.

Consumer price inflation forecasts



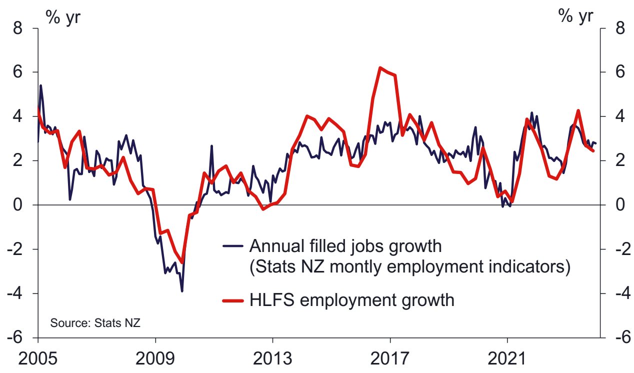
We remain comfortable with our view that the OCR remains on hold at 5.5% over 2024, before a gradual easing cycle begins in early 2025. That said, we do see a more gradual easing in domestic inflation pressures than the RBNZ.

Looking out over the next month or so, key economic data points to watch ahead of the next OCR review on 10 April will be:

- The Q4 GDP report (21 March). We presently estimate that the economy grew just 0.1% - not materially different to the flat outcome estimated by the RBNZ in the *MPS*.
- The selected price indexes released on 13 March, which will provide some further information about the outlook for the Q1 CPI report released on 17 April.
- Incoming migration and housing-related data, as well as indicators of consumer spending.
- Inflation indicators from the ANZ Business Outlook survey (27 March) and the NZIER's QSBO survey (9 April).

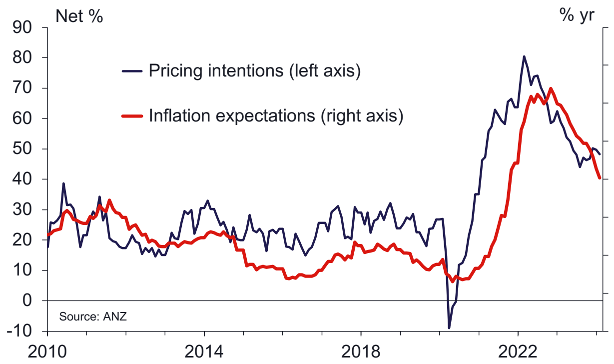
As far as last week's key data was concerned, the main points of note were the Monthly Employment Indicator (MEI) for January and the ANZ's Business Outlook survey for February. The MEI, which is drawn from tax data, reported a surprising 0.6% lift in filled jobs, whereas the weekly snapshots of this data had suggested a flat result. This data has been choppy over the Christmas / New Year period and there seems to be some variation in the timing of when teachers are hired – it's not consistent from year to year so the seasonal adjustment doesn't capture it fully. With filled jobs flat in December, the average of 0.3% over the past two months probably gives a better sense of the underlying trend (although there has been a marked tendency for recent outcomes to be revised downward in subsequent releases). This is still a solid result; it's slightly ahead of the growth in the working-age population, which grew 3% last year on the back of record net migration. We will continue to track this data closely in coming months.

Employment indicators



The ANZ's survey indicated that business confidence held at firm levels in February. The number of businesses who expect trading conditions to improve over the coming year did nudge higher. But while firms are optimistic about the outlook, a net 5% of businesses continued to report a decline in trading activity over the past year, with weakness noted in the retail and construction sectors. On the prices front, we did see expectations for inflation over the coming year continuing to ease, dropping from 4.3% previously to 4.0% now. That continues the downtrend seen over the past year and follows the easing in actual inflation. But while expectations for inflation are dropping back, the number of businesses who are planning on raising their prices remains high, especially in the retail and services sectors. That's consistent with our expectations that inflation will return to the RBNZ's 2% target only gradually and might be consistent with inflation getting "stuck" about 3% at some point.

Inflation expectations and pricing intentions



The coming week is somewhat quieter on the data front. While not usually market-moving, most interest will be on the release of a few partial activity indicators that will cast light on the likely outcome of the Q4 GDP report. That aside, the outcome of the latest GDT dairy auction will also be of interest, especially with some indicators suggesting the possibility of a further pull-back in the price of the key whole milk powder product.

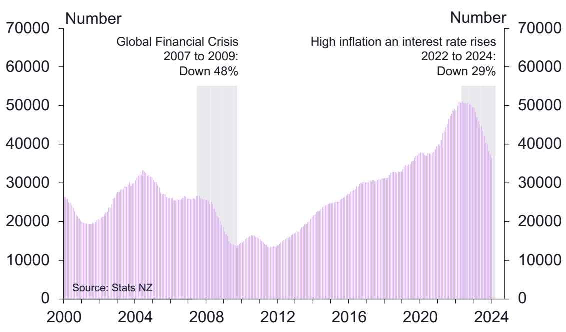
Kelly Eckhold, Chief Economist

Chart of the week.

The downturn in the residential construction sector is deepening. Dwelling consent issuance fell 9% in January and consent numbers are now down nearly 30% from the peak we saw in 2022. That downturn has been widespread across the nation. Notably, there has been a sharp fall in medium-density developments, like townhouses, with developers reluctant to bring new projects to market given high financing costs and a slow market for sales.

While fewer new projects are coming to market, the downturn in actual building activity has been more gradual to date. That's because over the past few years, shortages of staff and materials meant that building activity did not keep pace with the rapid rise planned projects. As the existing pipeline of projects is completed, we expect home residential building activity will drop to levels that are 15% below the peak we saw in 2022.

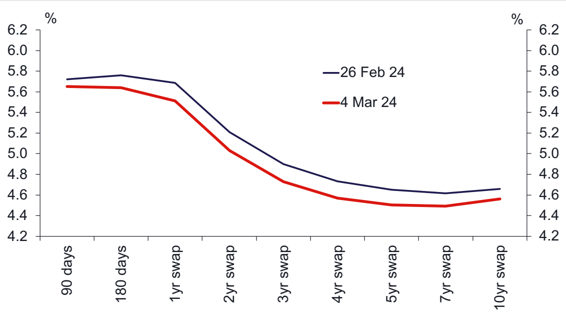
Annual dwelling consent issuance



Fixed versus floating for mortgages.

The RBNZ left of the OCR on hold in February. While further OCR hikes don't look likely, easings are still some way off. Fixing for a shorter term would provide borrowers with greater flexibility if mortgage rates fall later this year. However, for borrowers who favour certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

As expected, the PCE deflator eased 0.2ppts to 2.4% in January with core inflation slowing to 2.8% - the lowest rates since early 2021. While Fed officials have welcomed the fall in inflation, the latest semi-annual Monetary Policy Report (MPR) noted that inflation remains high and that the labour market remains tight. Consistent with that, officials remain cautious with regards to the pace of policy easing. US data over the past week were mixed. Despite strong household income growth of 1%, spending growth was up only 0.2%. In the business sector, the manufacturing ISM unexpectedly dipped to 47.8. The various regional surveys were mixed, but generally pointed to softness in activity. This week the focus will be on Friday non-farm payrolls report (Westpac is forecasting jobs growth of 170k). Fed Chair Powell will also testify on the MPR before the House and Senate.

Asia-Pacific.

Australia's Q4 GDP report will be out on Wednesday. Following last week's partials, we've revised down our forecast for Q4 growth to a flat result. That would see annual growth slow from 2.1% to 1.2%. Tight financial conditions continue to weigh on demand, especially in the household sector. And in the business sector there's been a slowdown in labour hours and capex. Those pressures have continued in the new year, with retail sales up just 1.4% in the year to January – well below inflation or population growth. On the prices front, the Monthly CPI Indicator fell 0.3% in January, weighed down by falls in holiday travel costs and Government rebates. Across in China, activity indicators remain patchy but generally point to soft activity. February saw the manufacturing PMI slipping to 49.1 with softness in employment, orders and pricing. Services sector conditions have been firmer with the non-manufacturing index rising to 51.4, likely boosted by Lunar New Year celebrations. These signs of sluggish activity come just before this week's National People's Congress. The Government will announce its growth target for this year (last year's target was "around 5%"), and perhaps further policy support to help achieve this goal.

Other regions.

In the eurozone, February's headline CPI came in at 2.6%, with core inflation running at 3.1%. While down on the December result, the moderation in inflation was less than expected, reflecting stickiness in services prices. That's likely to reinforce the ECB's cautious 'wait-and-see' approach at this week's meeting, where policy is expected to be left unchanged. Over the course of the week, markets will also be watching for news of a potential ceasefire in Gaza ahead of the Ramadan period.

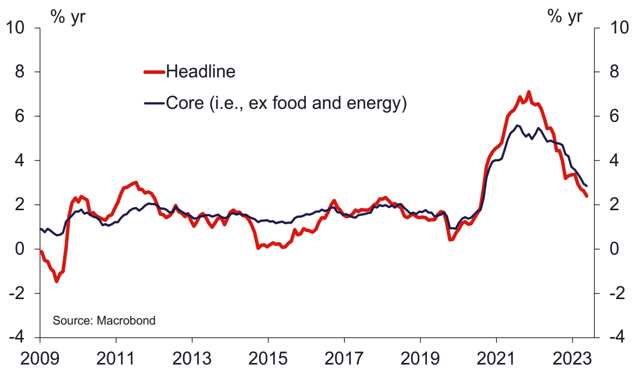
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	**2023**	**2024**	**2025**
Australia	3.8	2.0	1.3	2.2
China	3.0	5.2	5.2	5.0
United States	2.1	2.5	2.6	1.3
Japan	1.0	2.0	0.9	0.9
East Asia ex China	4.5	3.4	4.1	4.2
India	7.2	7.0	6.3	6.5
Euro Zone	3.3	0.5	0.6	1.5
United Kingdom	4.1	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.4	3.4
World	3.5	3.3	3.3	3.1

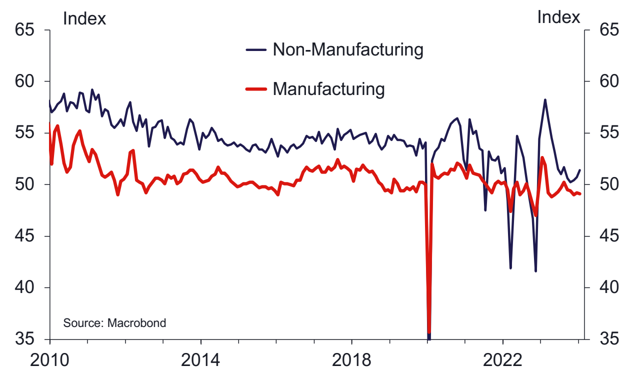
Australian & US interest rate outlook

	1-Mar	**Jun-24**	**Dec-24**	**Dec-25**
Australia				
Cash	4.35	4.35	3.85	3.10
90 Day BBSW	4.34	4.37	3.92	3.30
3 Year Swap	3.91	3.95	3.75	3.50
3 Year Bond	3.70	3.75	3.55	3.30
10 Year Bond	4.11	4.05	3.85	4.00
10 Year Spread to US (bps)	-13	5	5	0
US				
Fed Funds	5.375	5.125	4.375	3.375
US 10 Year Bond	4.24	4.00	3.80	4.00

US PCE deflator



Chinese PMIs



Financial markets wrap

Interest rates.

NZ swap rates fell sharply last week, with most of the move due to a dovish surprise from the RBNZ – it shifted its OCR forecast track lower, indicating it now sees less than a 50/50 chance of another rate hike in this cycle. Markets have priced a zero chance of any further rate hikes, but a 100% chance of a cut by October. The 2yr swap rate fell 30bp last week, to around 5.00%, and is more likely to test the mid 4s than the mid 5s over the next few months.

That said, while swap rates should trend lower, the path will likely be bumpy. Our economists' forecast the first rate cut to be in Feb 2025, before which there is likely to be a range of data surprises to buffet markets. Notable, Q1 CPI inflation data released in April is expected to be stronger than the RBNZ has forecast, raising potential for one such bump.

The week ahead is low key regarding NZ events, but any surprises from AU GDP and US payrolls data would likely ripple to NZ markets.

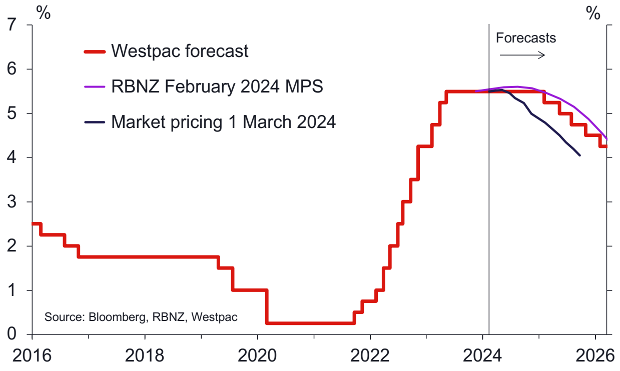
Foreign exchange.

The past week's decline in NZD/USD stalled at 0.6075 but it remains vulnerable to a test of the early-Feb low of 0.6040 during the next few days. The pair has been confined to a 0.6040-0.6175 range over the past six weeks, but markets will now be more inclined to probe the downside than the upside following last week's dovish RBNZ surprise. Fresh catalysts this week are more likely to be from the US, though, with payrolls data on Friday, and Fed chair Powell speaking to Congress on Wednesday.

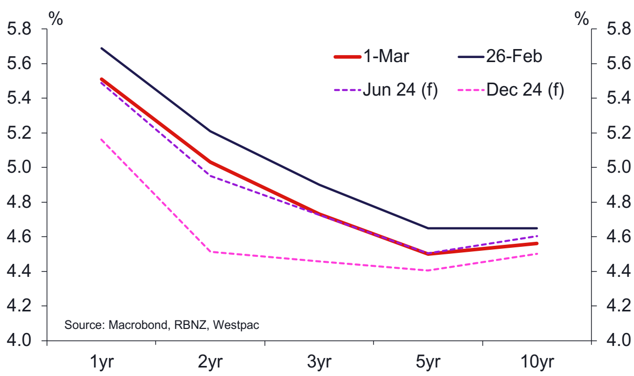
Multi-month, we remain bullish, seeing potential for 0.6300. That is based on expectations that the RBNZ's next easing cycle will start much later than the US Federal Reserve's (our economists forecast June 2024 and February 2025, respectively). Our bearish near term and bullish longer term outlooks could present opportunities for both exporters and importers, respectively, over those horizons.

NZD/AUD reversed lower last week following the RBNZ, and it looks bearish near term, with potential to break back inside its year-old contracting range at 0.9335. NZ-AU yield spreads are likely to be particularly influential during the weeks ahead.

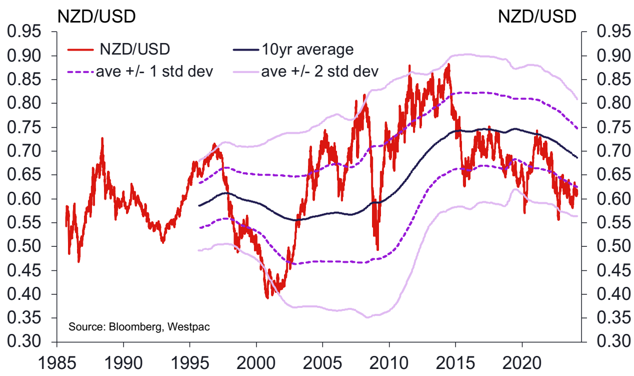
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-24
USD	0.611	0.605-0.635	0.555-0.743	0.651	0.64
AUD	0.936	0.923-0.944	0.873-0.992	0.933	0.91
EUR	0.563	0.558-0.572	0.517-0.637	0.584	0.56
GBP	0.482	0.478-0.497	0.464-0.544	0.508	0.50
JPY	91.7	88.1-93.1	61.3-93.1	78.2	88.3

The week ahead

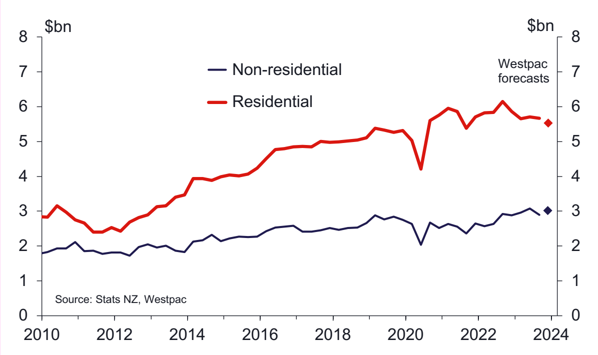
NZ Q4 building work put in place

Mar 6, Last: –2.4%, Westpac f/c: –0.3%

Building activity fell by 2.4% in the September quarter. That was due to a sharp 5.9% fall in non-residential activity, with residential work dropping by a more modest 0.6%.

We're forecasting a 0.3% fall in total construction activity in the December quarter. Underlying that, non-residential building activity is expected to retrace some of last quarter's sharper than expected fall. However, the downturn in residential building activity is expected to deepen with financial headwinds and the soft housing market putting the brakes on new development.

NZ real building work put in place

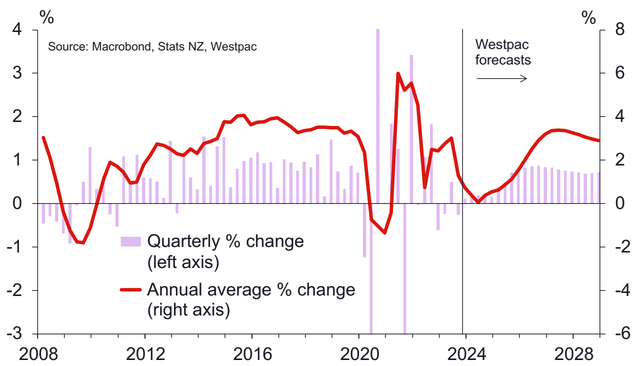


Economic and financial forecasts

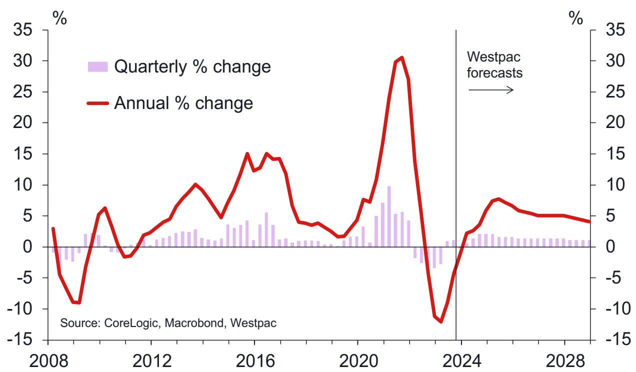
Economic indicators	Quarterly % change				Annual % change			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
GDP (production)	-0.3	0.1	0.2	0.2	2.4	0.7	0.5	1.6
Consumer price index	1.8	0.5	0.7	0.6	7.2	4.7	2.7	2.3
Employment change	-0.1	0.4	0.0	0.2	1.7	2.4	0.3	1.0
Unemployment rate	3.9	4.0	4.3	4.6	3.4	4.0	5.1	5.2
Labour cost index (all sectors)	1.1	1.0	0.8	0.8	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-7.6	-7.0	-6.4	-5.8	-8.8	-7.0	-4.4	-3.6
Terms of trade	-0.6	0.3	2.0	2.0	-4.2	-1.5	6.1	3.4
House price index	1.0	-0.2	0.5	1.3	-11.2	-1.1	5.9	6.7

Financial forecasts	End of quarter				End of year			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.66	5.65	5.60	5.60	4.26	5.65	5.50	4.50
2 year swap	5.53	5.28	5.10	4.95	5.10	5.28	4.50	4.00
5 year swap	4.90	4.84	4.60	4.50	4.67	4.84	4.40	4.10
10 year bond	4.87	5.09	4.85	4.70	4.31	5.09	4.60	4.25
TWI	70.6	70.8	72.2	72.3	70.8	70.8	71.7	70.0
NZD/USD	0.61	0.60	0.62	0.63	0.60	0.60	0.64	0.65
NZD/AUD	0.92	0.93	0.94	0.93	0.92	0.93	0.91	0.89
NZD/EUR	0.56	0.56	0.57	0.57	0.59	0.56	0.56	0.56
NZD/GBP	0.48	0.49	0.49	0.50	0.51	0.49	0.50	0.50

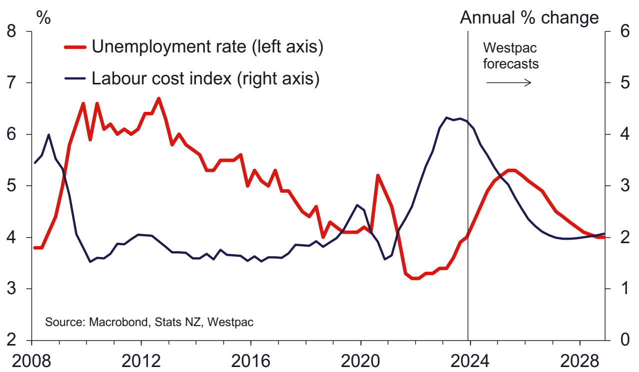
GDP growth



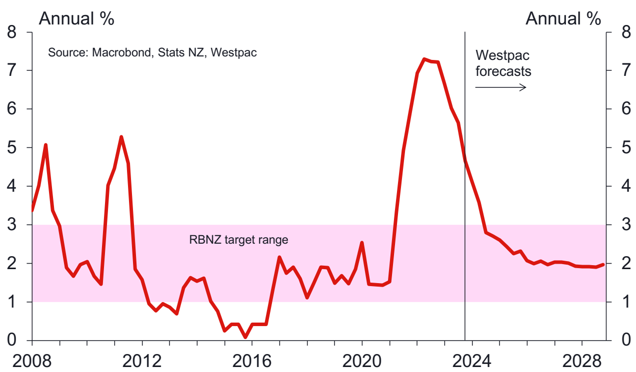
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
NZ	Q4 terms of trade	–0.6%	–0.1%	0.3%	Modest falls in both export and import prices.
Aus	Jan dwelling approvals	–9.5%	4.0%	3.0%	Partial rebound from big Dec fall. Bumping along the bottom.
	Q4 inventories	1.2%	0.1%	–0.3%	Q3 up on mining. Q4 to slip on soft sales. Impact –0.5ppts.
	Q4 company profits	–1.3%	1.0%	4.2%	Up on mining profits & "double upward bias".
	Feb ANZ job ads	1.7%	–	–	Easing gradually, pockets of strong labour demand linger.
	Feb MI inflation gauge %yr	4.6%	–	–	Provides a general view on risks.
US	Fedspeak	–	–	–	Harker.
Tue 05					
NZ	Feb ANZ commodity prices	2.2%	–	3.0%	Solid gains in dairy and meat prices.
Aus	Q4 current account balance, $bn	–0.2	4.9	4.0	Higher export prices, lower goods imports.
	Q4 net exports, ppts cont'n	–0.6	+0.2	+0.1	Imports & exports both lower, –1.8% & –0.9%, led by goods.
	Q4 public demand	1.4%	–	0.4%	Q3 inflated by "price relief" assistance for households.
Jpn	Feb Tokyo CPI %yr	1.8%	2.5%	–	Base effects to drive a temporary lift in Feb.
Chn	Feb Caixin services PMI	52.7	52.9	–	Sluggish demand for services remains.
US	Feb ISM non–manufacturing	53.4	52.9	–	Headwinds emerging for services.
	Jan factory orders	0.2%	–2.2%	–	Decline in durable goods will post a drag on factory orders.
	Fedspeak	–	–	–	Barr.
Wed 06					
NZ	GlobalDairyTrade auction (WMP)	–1.8%	–	–	GDT Pulse –3%, futures –4% compared to last auction.
	Q4 building work	–2.4%	–1.8%	–0.3%	Residential decline continuing, non–res to bounce.
Aus	Q4 GDP	0.2%	0.2%	flat	Challenging backdrop, domestic demand pulse weakly positive.
Eur	Jan retail sales	–1.1%	–	–	Rates hikes are factoring into demand.
US	Jan JOLTS job openings	9026k	–	–	Labour market coming into balance, some downside risks.
	Federal Reserve's Beige Book	–	–	–	An update on conditions across the regions.
	FOMC Chair Powell	–	–	–	Testifying before the House Financial Services Committee.
	Fedspeak	–	–	–	Daly, Kashkari.
Thu 07					
Aus	Jan goods trade balance, $bn	11.0	11.5	12.0	Surplus to widen. Higher commodity prices boost exports.
	Jan housing finance	–4.1%	2.0%	1.0%	Upturn moderating as turnover declines, price gains slow.
	Jan owner occupier finance	–5.6%	–	1.0%	More sensitive to affordability but policy–related boost in Qld.
	Jan investor finance	–1.3%	–	1.0%	Starting to outperform slightly?
Chn	Feb foreign reserves US$bn	3219	–	–	Sustainability on a TWI basis in focus, not USD/CNY.
Eur	ECB policy decision, deposit rate	4.00%	–	4.00%	Setting the tone for the year.
US	Jan trade balance $bn	–62.2	–62.5	–	Consumer demand supporting imports.
	Jan consumer credit $bn	1.6	10	–	Credit demand to continue weakening in 2024.
	Initial jobless claims	215k	–	–	To remain low for now.
	FOMC Chair Powell	–	–	–	Testifying before the Senate Banking Committee.
	Fedspeak	–	–	–	Mester.
Fri 08					
Jpn	Jan household spending %yr	–2.5%	–4.2%	–	Price growth weighing on real consumption.
Eur	Q4 GDP	0.0%	0.0%	–	Final estimate.
US	Feb non–farm payrolls	353k	190k	170k	Jan's strength likely to partly reverse; watchout for revisions.
	Feb unemployment rate	3.7%	3.7%	3.8%	Household employment weak. Participation key for U/E.
	Feb average hourly earnings %mth	0.6%	0.3%	0.3%	Changing composition a problem for this wage indicator.
	Fedspeak	–	–	–	Williams.
Sat 09					
Chn	Feb CPI %yr	–0.8%	0.1%	–	A lack of demand alongside excess capacity...
	Feb PPI %yr	–2.5%	–2.6%	–	... are leading to deflation in China.

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