



WEEKLY ECONOMIC COMMENTARY



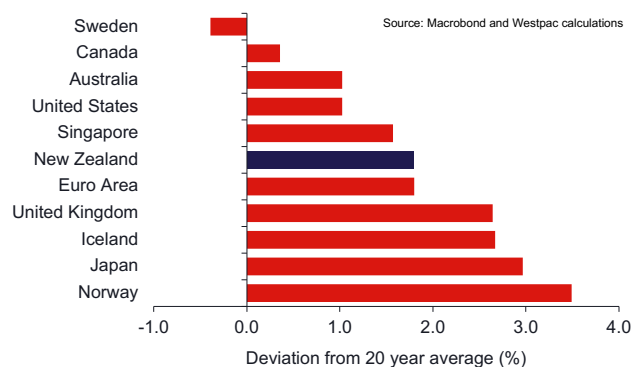
5 Feb 2024 | Westpac Economics Team | westpac.co.nz/economics | economics@westpac.co.nz

Horses for courses

Recent weeks have seen markets become challenged on their very strong view that now central bank policy rates have peaked, there should be a sudden significant reduction in policy interest rates. Markets have generally held the view that the central bank policy rate cycle will continue to be synchronised. Hence policy easing is expected to come from most jurisdictions at around the same time and be delivered by a similar magnitude. The challenge to these views is coming on two fronts: firstly, on the timing of the first policy rate cut; and secondly on the extent of policy easing in 2024 and beyond.

Central banks have tended to push back on the idea of near-term policy easing and in the case of Japan, expectations are growing of an increase in the policy rate (finally!) out of negative territory. In most jurisdictions, inflation remains relatively high or has fallen due to factors that might prove transitory. The central banks of the US, Canada and the UK have all recently indicated caution on reducing rates too soon even though in some cases (especially the US and Canada) core inflation has dropped off more significantly than other advanced economy jurisdictions.

Core inflation relative to 20 year average, advanced economies



New Zealand fits into the category of advanced economies where core inflation remains stubbornly

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

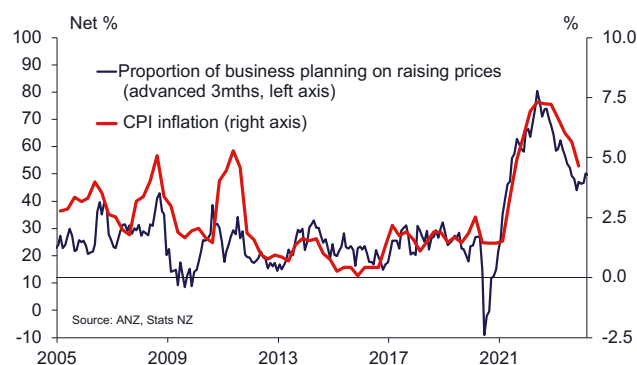


Key data and event outlook

Date	Event
6 Feb 24	RBA Monetary Policy Decision and SMP
7 Feb 24	NZ labour market statistics, December quarter
14 Feb 24	NZ selected price indexes, January
16 Feb 24	RBNZ Governor Orr to speak on inflation remit
28 Feb 24	RBNZ Monetary Policy Statement and OCR
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
9 Apr 24	QSBO business survey, March quarter
10 Apr 24	RBNZ Monetary Policy Review
12 Apr 24	NZ Selected price indexes, Mar
1 May 24	NZ labour market statistics, March quarter
1 May 24	FOMC Meeting (Announced 2 May NZT)

high. The RBNZ noted this when their Chief Economist updated markets on the RBNZ's thinking last week. He emphasised that non-tradables inflation still hovers around 6% and is falling only very slowly. We also saw evidence of core inflation stickiness in recent business surveys – for example the ANZ Business Outlook measure of pricing intentions in January continued its very recent rising trend and might suggest inflation could get stuck around the 4% level for a while. Other business surveys such as the long running Quarterly Survey of Business Opinion paint a similar picture. Hence, despite market expectations that the RBNZ will move to reduce rates at around the same time as other major economies, we continue to see it more likely that NZ will need to endure the current 5.5% OCR for all of 2024 based on what we see right now. We think the world has graduated from the time where every country gets a similar interest rate. Looking forward it will be horse for courses and individual country circumstances will determine the timing and magnitude of policy adjustment.

Consumer prices vs business pricing intentions

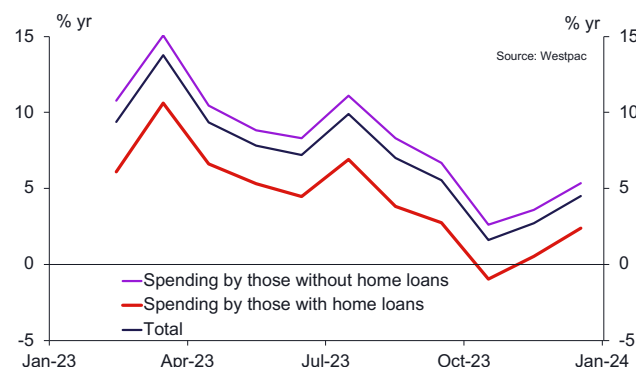


We remain alert to signs that the inflation dam might break as we head through the year. It is certainly the case that economic momentum in New Zealand remains weak. This should generate lower inflation outcomes in the period ahead – although we have been waiting a while for this to happen. The housing market still is not showing signs of a summer bounce – although the population pressures continue and should increasingly be felt as we head through the year. The government is yet to definitively chart its course for fiscal policy and the taxation policies to be applied to housing investors. Hence investors remain on the sidelines and real estate activity remains more than seasonally weak.

We got some data on household living costs this week that confirm the story that especially mortgaged households remain under the pump. While consumer price inflation slowed to 4.7% in the year to December, household living costs rose by 7% – much higher than the 5% growth in disposable incomes over 2023 (see our chart of the week). High and rising mortgage rates explain much of the difference – especially as borrowers have transitioned onto higher rates in the last year.

We see the impact of higher mortgage rates quite clearly in Westpac New Zealand's new tracker of spending on Westpac issued cards. Spending in the final quarter of 2023 was up just 4% on a year earlier for all households. But there is a clear divergence between the spending trends of unmortgaged households was up by 5% whereas it was only 2% by those with mortgages. The mortgaged households will remain under pressure for the foreseeable future. While we are a fair way through the mortgage repricing cycle there is still perhaps another 80 basis points or so to run (depending on what happens to mortgage rates over the balance of 2024).

Annual spending growth



This week will see the release of the Q4 Labour market data which will be another important indicator of the future resiliency (or lack thereof) of the New Zealand household. We anticipate another tick higher in the unemployment rate to 4.3% (slightly above the RBNZ's estimate).

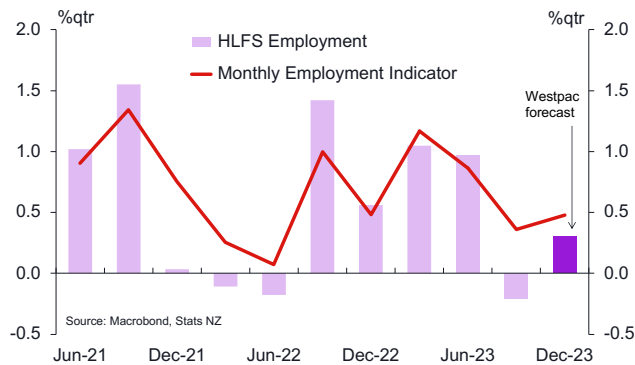
Current job opportunities vs unemployment rate



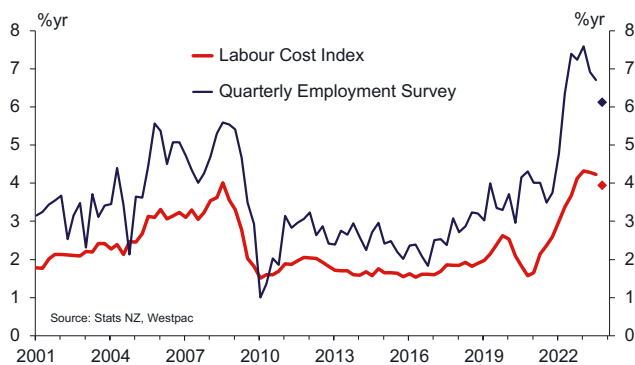
Employment growth should tick up given indicators of ongoing demand for labour in the context of a significant increase in the working age population in turn driven by strong net migration inflows. But it looks like labour supply is strong than demand – hence the rising unemployment rate. Wage growth has passed its peak and should move a bit lower, as both skill shortages and cost-of-living pressures have eased. The unemployment rate will be a key focus for the RBNZ this year as it assesses the sustainability of the move lower in core inflation pressures that we hope for (and expect). Without

an ongoing and significant rise in the unemployment rate and reduction in wages growth it will be hard for core inflation pressures to fall as much as required.

Quarterly employment growth



Wage growth, all sectors ordinary time



Kelly Eckhold, Chief Economist

Chart of the week.

The current multi-decade high in population growth is adding to the pressure on housing supply. That's been seen most clearly in rents, which have been rising rapidly in areas like Auckland. However, at the same time as population growth has surged, the number of new building projects coming to market has been dropping fast – residential consent issuance has fallen by 25% over the past year in response to large increases in build costs and interest rates. There is still a large amount of work currently in train, but with fewer new projects coming to market, a slow down in home building is coming. In terms of population pressures, Auckland has made a lot of progress in addressing the housing shortages that developed in the years prior to the pandemic, but still needs to keep building at a brisk pace to keep up with the current population inflows. However, in many other parts of the country, home building has not kept up with population growth. And with building activity now turning down, the resulting pressure on housing supply is set to continue for several years.

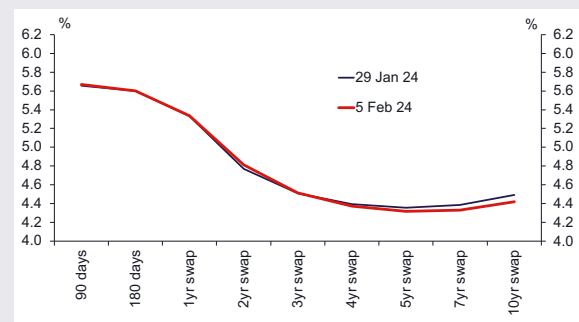
Regional consent issuance



Fixed versus floating for mortgages.

With inflation dropping back, we don't expect that the RBNZ will take the OCR higher and markets are pricing in rate cuts. 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.

The FOMC left the funds rate on hold at its first meeting of the year, and the forward guidance was softened, with the removal of the previous reference to the potential for further policy tightening. Nevertheless, the FOMC was still more hawkish than analysts expected, with the statement and comments from Chair Powell indicating that they did not expect that they would have enough confidence in the inflation outlook to begin reducing the funds rate by the time of the March meeting. That saw analysts pushing back the expected start of the easing cycle from March to May. The shift in market pricing was endorsed by January's payrolls report which revealed much stronger than expected jobs growth of 353k over the month, along with large upwards revisions to history. With only limited data on the calendar this week, the focus will be on comments from the large number of Fed speakers.

Asia-Pacific.

Inflation in Australia has slowed more rapidly than expected, slipping to 4.1% in the year to December – below the RBA's forecast and the lowest rate since 2021. The cooling in inflation is expected to continue over the year ahead. Looking at domestic demand, the latest retail sales report was soft, with nominal spending rising by only 0.5% in the December quarter. With inflation and demand cooling, we expect the RBA will keep rates on hold at Tuesday's policy meeting. However, they are unlikely to completely rule out any further tightening. In China, the latest PMIs pointed to a sluggish start to the year. Despite lifting slightly, the manufacturing index remained in contractionary territory with softness in domestic spending offsetting a modest rise in external demand. Conditions are a little firmer outside of the manufacturing sector, but they are still soft (especially in sectors like construction). Overall, weakness in the PMIs reinforces that further stimulus will be needed.

Other.

The Bank of England left the bank rate unchanged at its February meeting in a split decision, with two members voting for another hike and one voting for a cut. The BOE's previous tightening bias was dropped, with the statement instead signalling an extended period of restrictive policy. Over in the eurozone, the December quarter GDP report showed that the region has only just skirted recession – economic output was flat over the quarter, and rose by only 0.1% over the past year. On the prices front, headline inflation has slowed to 2.8% with core dropping to 3.3%. The situation in the Middle East remains volatile, with the US and UK launching further strikes on Houthi targets. Even so, oil prices have remained capped at this stage.

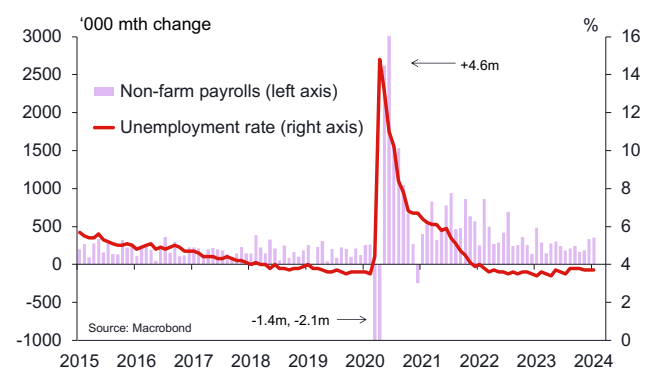
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	2023	2024	2025
Australia	3.8	2.0	1.3	2.2
China	3.0	5.3	5.3	5.0
United States	2.1	2.4	1.4	1.3
Japan	1.1	1.7	0.9	0.9
East Asia ex China	4.5	3.4	4.2	4.3
India	6.8	6.4	6.4	6.4
Euro Zone	3.5	0.6	1.1	1.1
United Kingdom	4.0	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.3	3.4
World	3.4	3.2	3.0	2.9

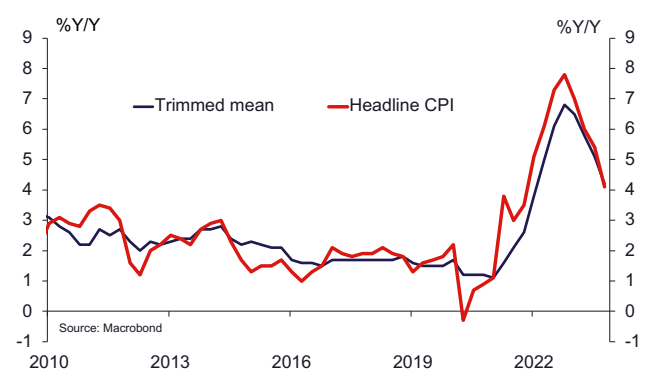
Australian & US interest rate outlook

	2-Feb	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	3.85	3.10
90 Day BBSW	4.32	4.47	3.97	3.30
3 Year Swap	3.74	4.10	4.00	3.50
3 Year Bond	3.56	3.90	3.80	3.30
10 Year Bond	3.98	4.30	4.15	4.00
10 Year Spread to US (bps)	9	10	5	0
US				
Fed Funds	5.375	4.875	4.375	3.375
US 10 Year Bond	3.89	4.20	4.10	4.00

US non-farm payrolls and unemployment rate



Australian CPI inflation



Financial markets wrap

Interest rates.

NZ swap rates will start this week with upward momentum, following a large positive surprise from the monthly US jobs data on Friday night. That caused US swap rates to jump 10-15bp, and NZ rates are likely to follow suit today, albeit in dampened fashion. That will still leave the NZ 2yr swap stuck in the narrow sideways range which has prevailed since early January, between 4.67% and 4.86%, but will add a glimmer of upside risk for the week ahead. For the month ahead, we see 5.00% as a reasonable ceiling.

Markets are giving no chance to an RBNZ OCR easing on 28 February, and the 40% chance assigned to the May meeting will probably be reduced today. Our economists forecast the first cut to be in February 2025.

While NZ economic data over the past few months has been softer (inflation, labour, GDP), RBNZ Chief Economist Conway downplayed some of that and emphasised vigilance on upside inflation risks in a recent speech. We are looking forward to RBNZ Governor Orr's speech on 16 February. Ahead of that, there's event risk from NZ Q4 labour data on Wednesday, and offshore, the RBA on Tuesday will almost surely remain on hold but could ruffle markets via its commentary.

Foreign exchange.

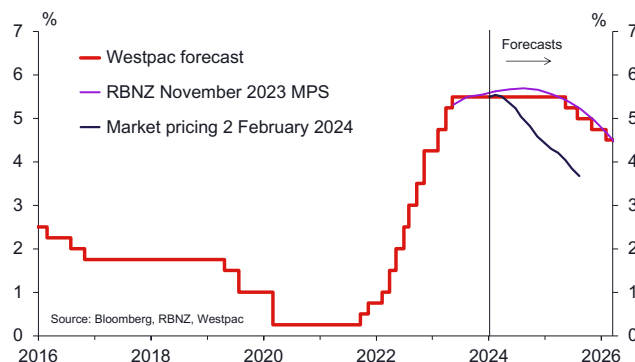
NZD/USD reversed sharply lower on Friday following the US jobs data which boosted the US dollar. It is now sitting at the bottom of a two-week old range at 0.6060, and vulnerable to falling further to around 0.6000 during the week ahead.

Apart from the strong USD, there's NZ labour data for Q4 this week which could ruffle NZD/USD. Markets are expecting an unemployment rate of 4.3% - any higher would see the NZD fall in response, while Westpac's pick of 4.2% would probably do the opposite.

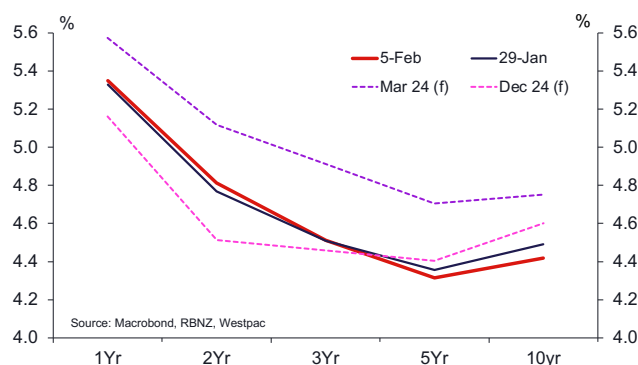
Further ahead, we are more upbeat about the NZD's prospects. If the Fed starts easing before the RBNZ (which our economists forecast), interest rate differentials should favour NZD/USD, a recovery back above 0.6300 by Q2 is plausible. In the meantime, any dips to the 0.6000 area would be worthy of consideration by exporters looking to hedge receipts.

NZD/AUD has been rangebound since June, inside 0.9150-0.9400, although that range has tightened since early December to 0.9250-0.9350. It is currently mid-range at 0.9310, and we will be watching for a breakout to guide our medium-term directional view. NZ jobs data and the RBA this week, the RBNZ at month end, and ongoing developments in China will be important determinants.

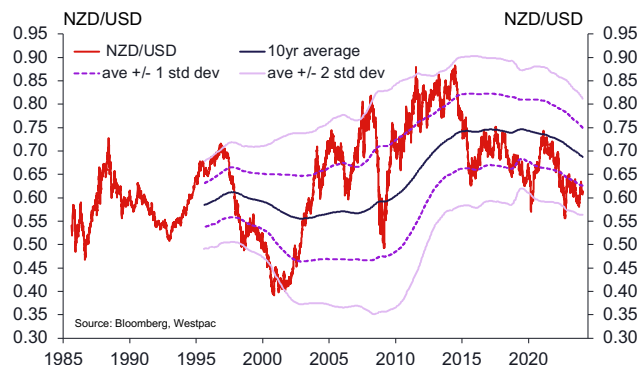
Official Cash Rate forecasts



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	0.606	0.588-0.635	0.555-0.743	0.652	0.63
AUD	0.931	0.915-0.937	0.873-0.992	0.933	0.90
EUR	0.561	0.549-0.572	0.517-0.637	0.585	0.55
GBP	0.480	0.478-0.497	0.464-0.544	0.508	0.49
JPY	89.9	88.1-91.2	61.3-91.2	78.0	86.5

The week ahead

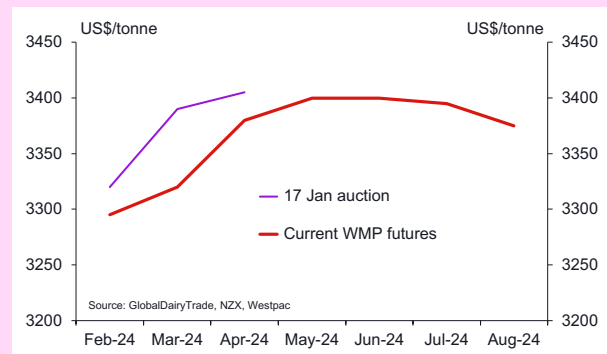
NZ GlobalDairyTrade auction, whole milk powder prices

Feb 7, Last: +1.7%, Westpac f/c: -1%

We expect a small drop in whole milk powder prices (WMP) at the upcoming auction. Our pick reflects both the results of the last mini (GDT Pulse) auction and the prices indicated by the futures market.

Milk production in New Zealand has so far been up on last season, which will have eased concerns that the El Niño weather pattern would lead to a shortfall of supply on the world market. The strength of demand from China remains uncertain, but the Lunar New Year means that this month's auctions may not be representative anyway.

Whole milk powder prices



NZ Q4 labour market surveys

Feb 7, Unemployment rate, Last: 3.9%, Westpac f/c: 4.2%

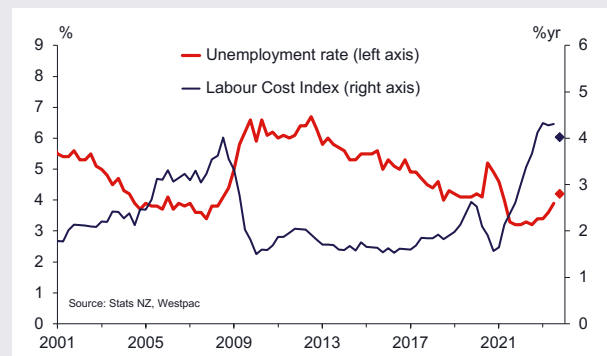
Feb 7, Labour Cost Index, Last: 0.8%, Westpac f/c: 0.8%

We expect a further rise in the unemployment rate for the December quarter, from 3.9% to 4.2%. Labour shortages are now clearly easing, as higher interest rates have contributed to a softening in demand. Strong net migration is driving a rise in both employment and the labour force, but the former is not keeping pace with the latter.

Similarly, wage growth now looks to have passed its peak, as both skill shortages and cost-of-living pressures have eased.

Our forecasts are in line with the Reserve Bank's most recent projections, so they don't alter our near-term outlook for monetary policy. Although employment is no longer directly in the RBNZ's mandate, it still provides a useful guide as to how hot the economy is running, and in turn the degree of future inflation pressures.

NZ labour market indicators

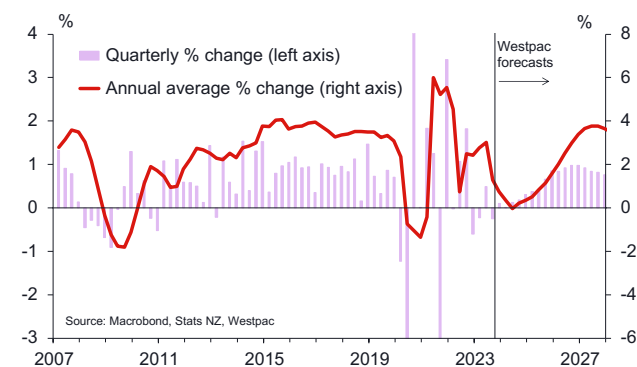


Economic and financial forecasts

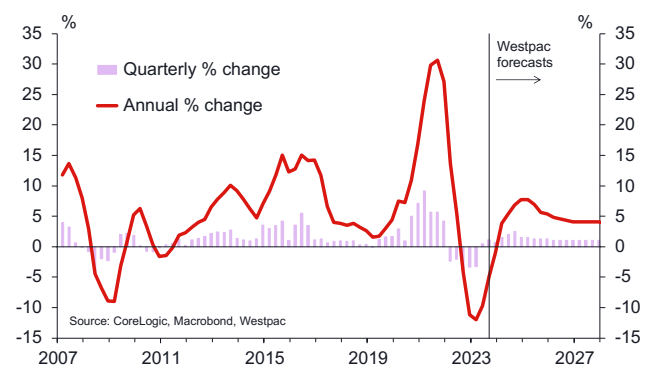
Economic indicators	Quarterly % change				Annual % change			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
GDP (production)	-0.3	0.1	0.0	0.1	2.4	0.7	0.3	1.6
Consumer price index	1.8	0.5	0.9	0.6	7.2	4.7	3.1	2.5
Employment change	-0.2	0.2	-0.1	0.0	1.7	2.1	-0.2	1.2
Unemployment rate	3.9	4.2	4.6	5.0	3.4	4.2	5.5	5.1
Labour cost index (all sectors)	1.1	0.8	0.8	0.7	4.1	4.0	3.2	2.6
Current account balance (% of GDP)	-7.6	-7.1	-6.5	-6.2	-8.8	-7.1	-5.2	-4.0
Terms of trade	-0.6	-1.7	2.6	2.2	-4.2	-3.5	9.6	5.8
House price index	2.1	1.0	1.5	2.0	-11.2	1.0	8.0	6.4

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	4.70	4.60	4.67	4.84	4.40	4.10
10 year bond	4.87	5.09	4.85	4.80	4.31	5.09	4.70	4.35
TWI	70.6	70.8	71.0	70.4	70.8	70.8	69.6	68.1
NZD/USD	0.61	0.60	0.62	0.62	0.60	0.60	0.63	0.64
NZD/AUD	0.92	0.93	0.92	0.91	0.92	0.93	0.90	0.87
NZD/EUR	0.56	0.56	0.57	0.56	0.59	0.56	0.55	0.54
NZD/GBP	0.48	0.49	0.50	0.50	0.51	0.49	0.49	0.49

GDP growth



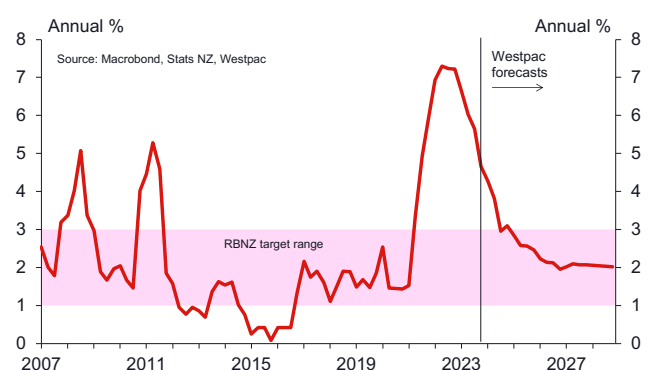
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 05					
NZ	Jan ANZ commodity prices	2.4%	–	2.0%	Further rebound in dairy prices in January.
Aus	Dec trade in goods balance, \$bn	11.4	10.5	10.5	Imports likely to normalise, +4%, after sharp Nov fall, –7.9%.
	Jan ANZ job ads	0.1%	–	–	Downtrend well established, more declines to come this year.
	Jan MI inflation gauge %yr	5.2%	–	–	Meaningfully above official gauges, Q4 CPI at 4.1%yr.
Chn	Jan Caixin services PMI	52.9	53.0	–	Capturing optimistic views, somewhat at odds with NBS.
Eur	Feb Sentix investor confidence	–15.8	–	–	Sentiment in a fragile state as global uncertainties persist.
	Dec PPI %yr	–8.8%	–	–	Moving past its nadir at a measured pace.
US	Jan ISM non-manufacturing	50.5	52.1	–	Employment and price gauge will be of particular interest.
	Senior Loan Officer Opinion Survey	–	–	–	Loan demand is crimping as standards tighten.
Tue 06					
NZ	Waitangi Day	–	–	–	Public holiday; markets closed.
Aus	Q4 real retail sales	0.2%	0.1%	flat	Poor finish to a weak year.
	RBA Policy Decision	4.35%	4.35%	4.35%	Disinflation encouraging, but further progress is needed...
	RBA Statement on Monetary Policy	–	–	–	... before RBA can be confident in inflation's return to target.
Jpn	Dec household spending %yr	–2.9%	–2.0%	–	Notably weak, as real cash earnings remain negative.
Eur	Dec retail sales	–0.3%	–	–	Struggling to make any headway as pressures linger.
US	Fedspeak	–	–	–	Mester, Kashkari, Collins.
Wed 07					
NZ	GlobalDairyTrade auction (WMP)	1.7%	–	–1.0%	Futures prices have dipped; El Niño fears may be easing.
	Q4 unemployment rate	3.9%	4.3%	4.2%	Unemployment continuing to rise from its historic lows...
	Q4 employment	–0.2%	0.3%	0.3%	... with job creation falling behind population growth.
	Q4 LCI wage inflation (pvt, ord. time)	0.8%	0.8%	0.8%	Labour shortages are easing and inflation is cooling.
Chn	Jan foreign reserves US\$bn	3238	–	–	Authorities focused on sustainability of TWI, not USD/CNY.
US	Dec trade balance \$bn	–63.2	–62.3	–	Deficit continues to narrow, supported by services exports.
	Fedspeak	–	–	–	Harker, Kugler, Collins Barkin, Bowman.
Thu 08					
Jpn	Dec current account balance ¥bn	1925.6	1007.7	–	Surplus remains at an elevated level.
Chn	Jan PPI %yr	–2.7%	–2.6%	–	Excess capacity putting downward pressure on upstream...
	Jan CPI %yr	–0.3%	–0.5%	–	... prices, while consumer demand remains weak.
US	Dec consumer credit \$bn	23.8	16.5	–	Short-term bounce in credit card debt during year-end.
	Initial jobless claims	224k	–	–	To remain at a relatively low level, for now.
	Dec wholesale inventories	0.4%	–	–	Final estimate.
	Fedspeak	–	–	–	Barkin.
Fri 09					
Aus	RBA Governor Bullock	–	–	–	Appearing before House of Representatives.
Chn	Jan new loans, CNYbn	1170.9	4500.0	–	Due between Feb 9–15. Year opening bounce anticipated...
	Jan M2 money supply %yr	9.7%	9.2%	–	... as policy seeks to build confidence.

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