WEEKLY ECONOMIC COMMENTARY

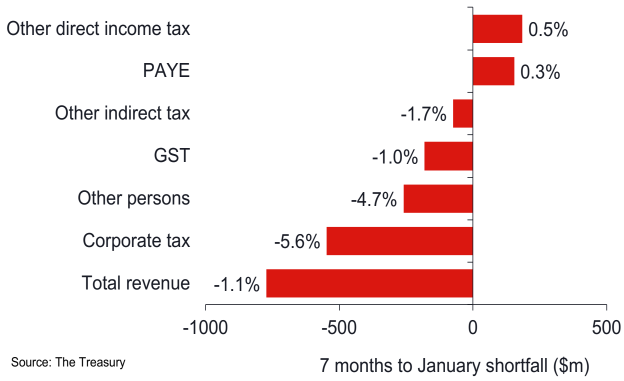
11 Mar 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Fiscal pressures and construction crunch

This week's data on the tax take and construction highlighted the economy's weak momentum. In addition, a pullback in dairy prices after a strong run illustrates the ongoing downside risks to global demand.

First up, the Treasury's latest update highlighted the weakness of the economy and ongoing pressure on the fiscal purse strings. Tax revenue for the seven months to January was $800m below forecast. Corporate tax and taxes paid by the self-employed were down $500m and $300m respectively due to weak profits, while GST was down $200m due to weaker consumption spending. These falls were partially offset by a lift in PAYE tax, reflecting the resilience in the labour market. At this stage, fiscal expenditure is also running behind forecast, so the Government's operating balance remains close to the half-year economic forecasts (for now).

7 months to January tax outcomes versus Treasury forecasts

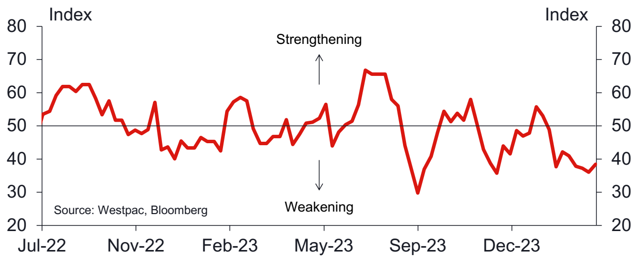


We'll be watching the Treasury's next few updates to see if January's outcome was the start of a trend. The Government is aiming to get the operating balance back into surplus in the 2026/2027 fiscal year. But with economic activity still weak and ongoing pressures on spending reflecting population growth and cost

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

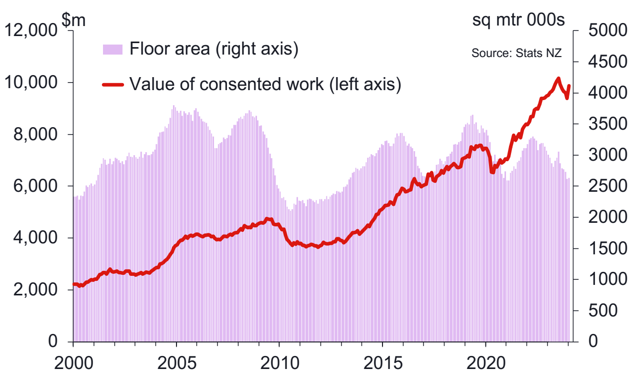
pressures, the Minister of Finance has indicated that achieving this will be challenging. We agree.

Next, the latest GlobalDairyTrade auction saw total prices falling 2.3% with the key whole milk powder (WMP) price down 2.8%. This was the first fall in overall dairy prices since November 2023 and the second decline in WMP prices in a row. We are still happy with our forecast for a $7.90 payout this season and a $8.40 payout next season. The outlook for the current season is fairly locked in at this late stage of the season, but next year's milk price will be importantly determined by prices in coming months and will especially be influenced by the performance of Chinese consumer spending which still looks weak.

Lastly, the latest building work survey showed that construction activity remained steady through the December quarter, with building activity easing just 0.1%. But while that resilience is encouraging, under the surface there are clear signs of softness, and we expect activity to turn down over 2024.

Much of the resilience in construction activity over the December quarter was due to a 4.6% rise in non-residential construction. However, work on non-residential projects can be 'lumpy' on a quarter-to-quarter basis, and December's rise followed a similar decline in September. Taking a longer-term perspective, non-residential construction activity has flattened off over the past year. In addition, with economic conditions softening, fewer new projects are coming to market, with the amount of floor space consented over the past year down 12.5%.

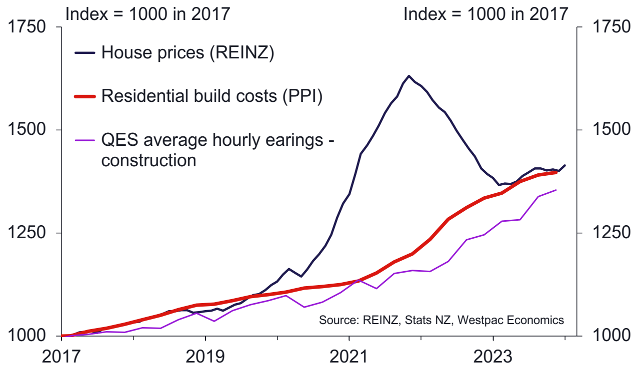
Non-residential consents



On the residential front, building levels were down 2.4% in the December quarter, and they've fallen 9% over the past year. Over the coming year, we're forecasting a further 10% decline in residential building which will be the sharpest slowdown since the Global Financial Crisis when residential construction activity fell by 30%.

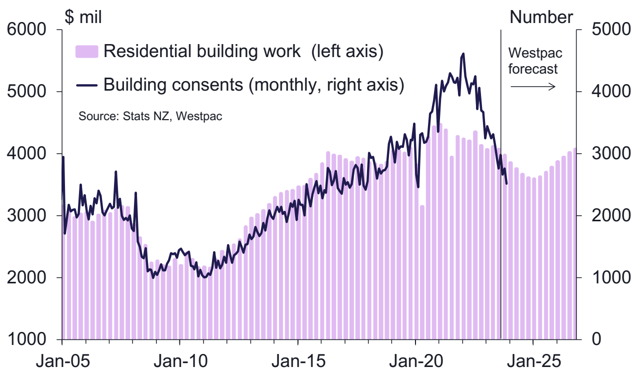
Tougher financial conditions in the building sector, high materials costs and crucially the weaker housing market since the 2021 peak is driving the decline in construction we see today. Developers remain reluctant to bring new projects to market and hence new dwelling consents have fallen nearly 30% over the past year. We also expect that a higher-than-usual proportion of planned projects will be cancelled.

House prices and residential building costs



We don't expect that actual home building will fall as sharply as consent issuance. That's because earlier shortages of materials and staff, as well as stretched capacity more generally, acted as a brake on how much work could be completed in recent years. As a result, although consent issuance rocketed higher in recent years, building activity rose more modestly. Although forward orders are now declining, many firms are still working through existing pipelines of planned work. Even so, New Zealand is still likely to see a sizeable slowdown in home building activity over the next few years.

Residential building and consent numbers



That slowdown in building is occurring at the same time as population growth is booming. Over the past year, New Zealand's population grew by a massive 145,000 people implying a need for around 55,000 additional houses. However, we estimate that the number of homes in New Zealand only increased by around 30,000 over the last year.

We expect population growth will slow over the coming year. Even so, New Zealand is going to need a lot more houses. On top of the existing housing shortfall, we'll need to build around 110,000 new homes over the next five years to keep up with population growth.

The past few years have shown that we can achieve the necessary pace in home building activity. However, with net migration still running at near record levels for now and home building turning down, many parts of the country are likely to face ongoing pressure on housing supply for some time yet. In addition, with an extended period of rapid home building needed to address supply shortages, we're likely to see continued pressure on build costs.

Finally, we learned late in the week that the Government is moving ahead with reinstating the tax deductibility of mortgage interest for residential property investors from April 1, 2024. Both new and existing investors will be able to deduct up to 80% of interest costs in the upcoming tax year and 100% thereafter. This will improve the fortunes of property investors and will help encourage them back into a market they have been largely absent from for some time. We see house prices remaining fairly flat for the immediate future given slow sales volumes and auction clearance rates but a pickup later in the year as population growth pressures (and perhaps the expectation of future interest rate cuts) assert themselves.

The economic data flow will pick-up over the coming week. First up is the February update on the housing market from REINZ, which is likely to show that housing market turnover has remained subdued in the face of high interest rates. Similarly, February's update on retail card spending (out Tuesday) is expected to again highlight weakness in spending appetites with financial pressures continuing to squeeze households' budgets. On Wednesday we'll get Stats NZ's monthly price indicators for February, which will be a key focus for the RBNZ. Lastly, we'll be watching Thursday's update on net migration to see if the recent rise in departures has continued.

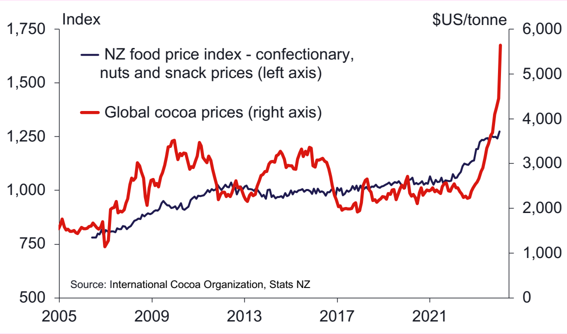
Satish Ranchhod, Senior Economist

Chart of the week.

Bad news for those of us with a sweet tooth. The global price of cocoa – the key ingredient in chocolate – has more than doubled in recent months, rising to its highest level in more than 50 years. That follows dry weather in parts of West Africa which has resulted in crop failures. And there are concerns that the resulting production short-falls could continue for several months more.

Here in New Zealand, we've already seen the price of a block of chocolate rising by 5% over the past year, while the average price of chocolate bars was up a staggering 13%! With the price of cocoa rocketing higher, we could see further price increases over the coming months, meaning this year's Easter treats could be a lot more expensive. Alternatively, we could see 'shrinkflation,' with the retail prices for chocolate blocks and bars remaining steady but serving sizes contracting. This could be the time to switch to healthier snacks.

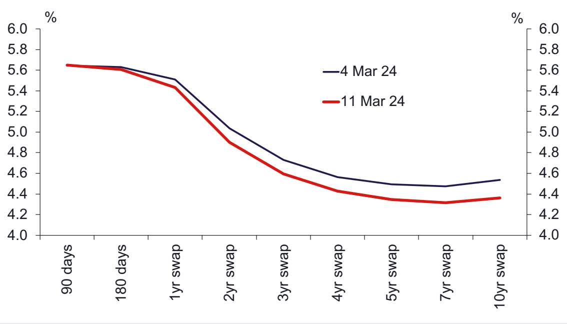
Cocoa prices – Risk of an Easter chocolate spike?



Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in February. While further OCR hikes don't look likely, easings are still some way off. Borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

US non-farm payrolls rose a solid 275k in February, albeit coming after a sizeable 167k of downward revisions to the prior two months. However, the unemployment rate rose to a 25-month high of 3.9% and annual wage growth slowed to 4.3%. Speaking to Congress, Fed Chair Powell indicated that the FOMC were "not far" from having the confidence required to begin an easing cycle. This week the February CPI report (Tuesday) will take centre stage, especially after last month's upside surprise. PPI, retail sales, consumer sentiment and industrial production reports will follow later in the week, helping to set the scene ahead of next week's FOMC meeting and updated policy projections. In Canada, the BoC left its policy settings unchanged last week, but noted that it continues to harbour concerns that inflation might get stuck materially above the target midpoint.

Europe.

The ECB left its policy settings unchanged last week, as widely expected. But with the Bank lowering its growth and inflation forecasts, President Lagarde indicated that rate cuts could be on the table for discussion in June. The coming week is quiet on the data front, with final February CPI readings of greatest note. In the UK, last week's spring Budget provided no great surprises. This week will bring an update on the labour market and GDP data for January.

Asia-Pacific.

In China, the Government set a GDP growth target for this year of "around 5%", matching last year's target. The Work Report indicated that China plans to "transform" its growth model and take steps to curb overcapacity and risks associated with the property sector, although details on how it plans to do this were thin on the ground. With the favourable base effect from the pandemic fading, hitting the growth target will be a tougher task this year.

In Japan, expectations are building that the BoJ might soon abandon its negative policy rate policy. This follows firmer than expected January wage data and a report from the country's largest trade union, which indicated that the average wage hike claim this spring will exceed 5% for the first time in 30 years. A quiet week ahead in Japan will bring the release of updated Q4 GDP data (today) and the MoF's business survey (Tuesday).

Australia's GDP grew just 0.2% in Q4, lowering annual growth to 1.5%. Domestic demand was especially soft, rising just 0.1% in the quarter. An improving inflation outlook should allow the RBA to begin easing policy from September. The NAB business survey is the only significant report ahead this week.

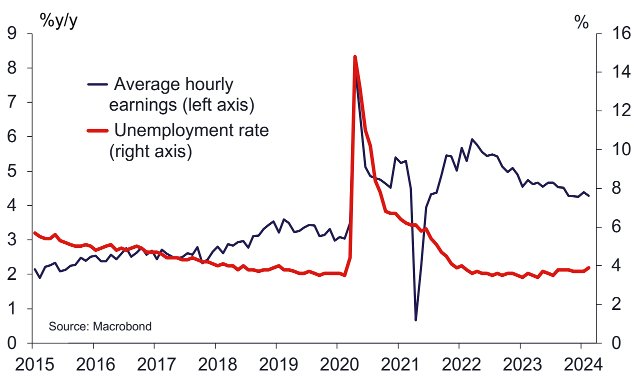
Trading partner real GDP (calendar years)

	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

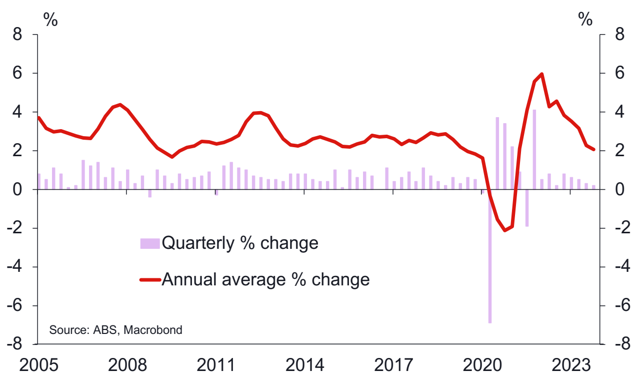
Australian & US interest rate outlook

	8-Mar	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	3.85	3.10
90 Day BBSW	4.35	4.37	3.92	3.30
3 Year Swap	3.83	3.95	3.75	3.50
3 Year Bond	3.61	3.75	3.55	3.30
10 Year Bond	3.98	4.05	3.85	4.00
10 Year Spread to US (bps)	-10	5	5	0
US				
Fed Funds	5.375	5.125	4.375	3.375
US 10 Year Bond	4.08	4.00	3.80	4.00

US average hourly earnings and unemployment rate



Australian GDP growth



Financial markets wrap

Interest rates.

NZ swap rates fell further last week, led by US yields which responded to Fed Chair Powell's testimony reiterating rate cuts were likely this year. That update compounded the dovish surprise from the RBNZ the previous week and helped push the 2yr swap down another 10bp to 4.90%.

There is potential for swap rates to fall further over the next month, but probably not as quickly as they have done of late. That is because markets have already priced in plenty of easing compared to our economists' forecast of the first cut in February 2025. Markets continue to price 100% chance of OCR cuts at the next three meetings in October, November and February. There will also be plenty of volatility, given this RBNZ pre-cut on-hold period will be the longest in OCR history.

The week ahead is relatively lowkey regarding NZ events, but in the US February CPI inflation data poses major event risk for interest rate markets globally.

Foreign exchange.

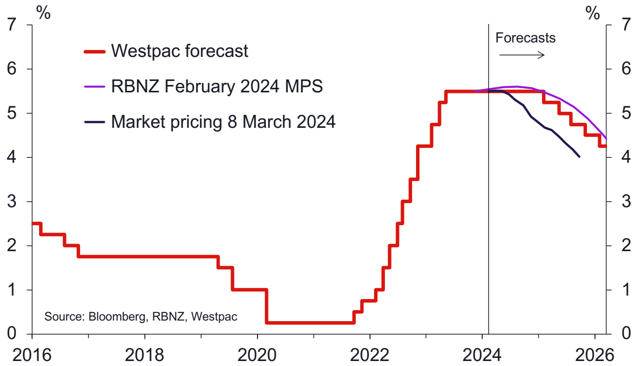
The 0.6040-0.6220 range in NZD/USD since mid-January is now at risk of breaking upwards. A break would then target 0.6370 multi-week.

Recent US events (mainly Fed Chair Powell's reiteration of rate cuts, but also some data moving in the "right" direction for the Fed) have caused the US dollar to weaken, boosting all G10 currencies. The best performer over the past week was the yen, helped by signals from BoJ officials that a rate hike was likely within the next few months. The week ahead is low key regarding NZ events, but in the US, February CPI inflation data poses major event risk for foreign exchange markets globally.

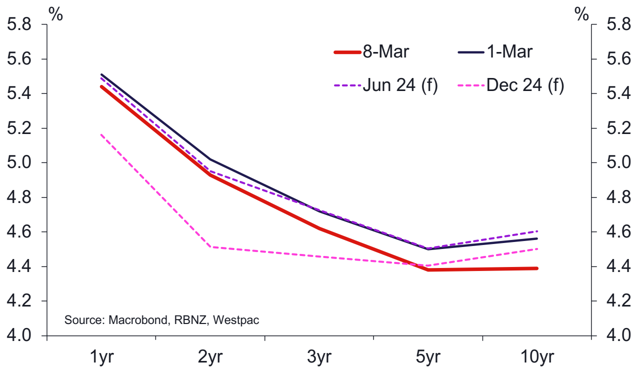
Multi-month, we remain bullish, seeing potential for the NZD to push above US 0.6300. That is based on expectations that the RBNZ's next easing cycle will start much later than the US Federal Reserve's (our economists forecast June 2024 and February 2025, respectively). If that proves correct, there will likely be attractive opportunities for importers to hedge payments.

NZD/AUD has continued to decline since the dovish RBNZ MPS surprise and could extend to the 0.9200 area during the weeks ahead. NZ-AU yield spreads are likely to remain influential.

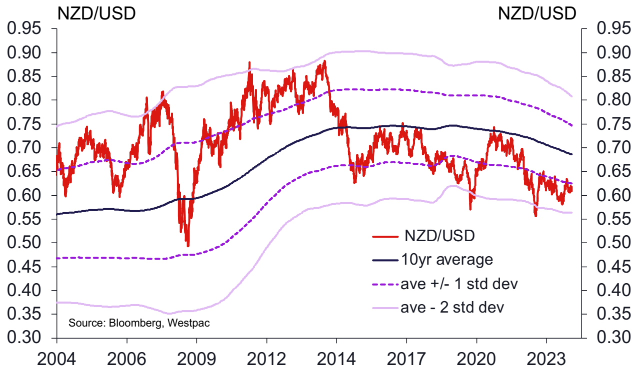
Official Cash Rate forecasts



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	0.619	0.605-0.635	0.555-0.743	0.651	0.64
AUD	0.933	0.923-0.944	0.873-0.992	0.933	0.91
EUR	0.565	0.558-0.572	0.517-0.637	0.584	0.56
GBP	0.481	0.478-0.497	0.464-0.544	0.508	0.50
JPY	1.0	88.1-93.1	61.3-93.1	78.3	88.3

The week ahead

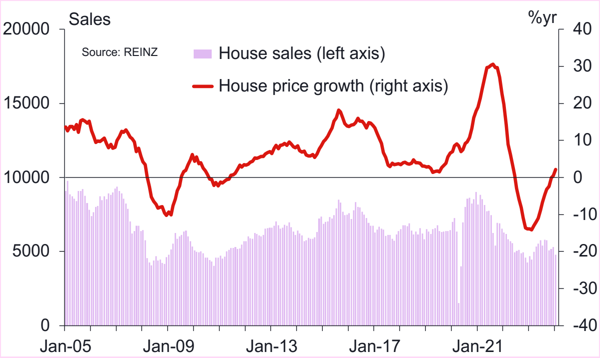
NZ Feb REINZ house sales and prices

Mar 11-14 (TBC), Sales* – Last: -9.2% mth, +4.9% annual
Mar 11-14 (TBC), Prices* – Last: +1.0% mth, +2.2% annual
*** Monthly figures based on Westpac seasonal adjustment**

New Zealand's housing market remained subdued in January. Sales were down 9% in seasonally adjusted terms, with Auckland in particular hitting its lowest level on record barring the 2020 COVID lockdown. The REINZ house price index saw a surprise 1% increase, although the low level of turnover suggests a greater margin of error than usual around this measure.

Listings roared back to life in February, which is likely to have boosted sales for the month. However, auction clearance rates remain low, which points to further downward pressure on prices in order for the market to clear. While we expect population growth and Government policy changes to lift house prices over the medium term, high mortgage rates remain a barrier to recovery for now.

REINZ house prices and sales



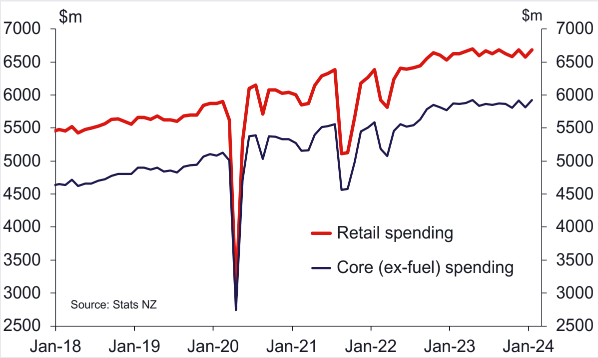
NZ Feb retail card spending

Mar 12, Last: +1.7%, Westpac f/c: -0.3%

Retail spending levels rose by 1.7% in January, reversing the fall that we saw in December. However, the longer-term trend in spending remained weak. Despite rapid population growth of over 2% and the continued rise in consumer prices, overall spending levels have effectively been tracking sideways over the past year.

We expect that February's spending report will highlight continued weakness in demand. We're forecasting a 0.3% drop in retail spending. Underlying that result, we expect a modest gain in groceries spending (underpinned by continued rapid population growth) but falls in most other categories. The softness reflects the continued pressure on households' finances and related weakness in sentiment.

Monthly retail card spending



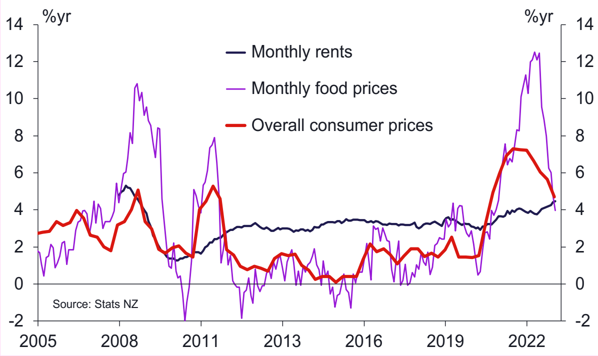
NZ Feb monthly selected price indices

Mar 13

Stats NZ's suite of monthly price data covers around 45% of the CPI. Much of this relates to volatile non-core items (like petrol), which drive a large proportion of the quarter-to-quarter swings in inflation. We expect that the February update will show a 4% rise in fuel prices, alongside a 0.6% seasonal rise in food prices. In addition, a key focus for the RBNZ will be rents. In line with recent trends, we are expecting a 0.4% rise over the month, which would leave rents up a solid 4.5% over the past year.

We'll also be keeping a close eye on airfares. In particular, international airfares fell 21% in January and are likely to have been a key contributor to the RBNZ's low forecast for March quarter inflation. In contrast, we think softness in airfares (and tradables prices more generally) will be less pronounced.

Consumer prices



The week ahead

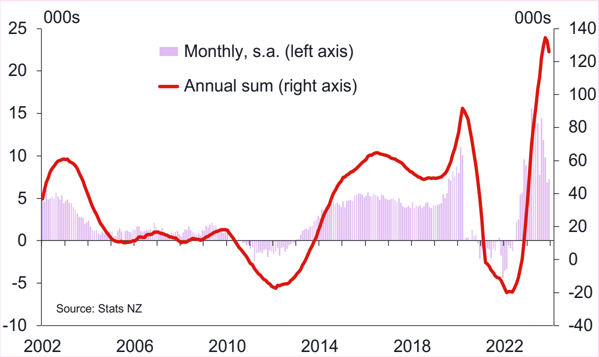
NZ Jan net migration

Mar 14, Last: +7,260 (s.a.)

The November and December migration figures showed a startling jump in departures (although the November rise has been revised down from the initial release). We suspect there are issues with modelling the movements of holidaymakers and international students over the Christmas / New Year period – these movements were largely absent in the previous few years, when COVID restrictions were in place. If that is the case, it may not be fully resolved until the February release.

Notwithstanding these issues, we think it's likely that net inflows have passed their peak. Foreign arrivals remain strong, but below last year's highs, and departures are rising as a relatively stronger Australian economy attracts more New Zealanders.

Net migration

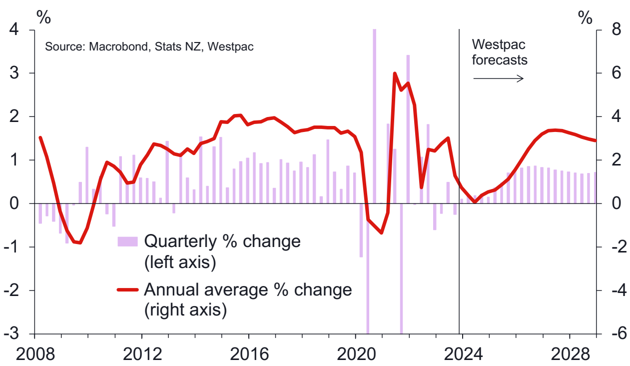


Economic and financial forecasts

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

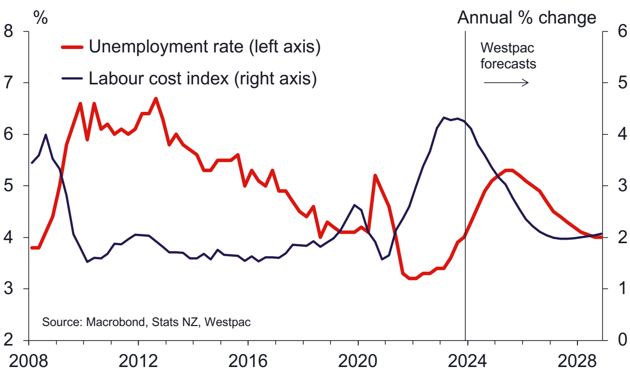
Financial forecasts	End of quarter				End of year			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.66	5.65	5.60	5.60	4.26	5.65	5.50	4.50
2 year swap	5.53	5.28	5.10	4.95	5.10	5.28	4.50	4.00
5 year swap	4.90	4.84	4.60	4.50	4.67	4.84	4.40	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

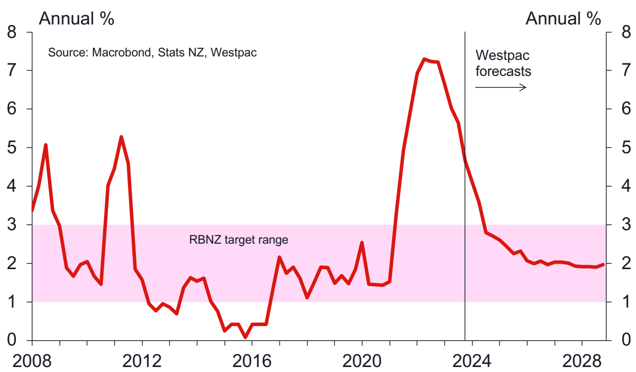


House prices

Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 11					
Jpn	Q4 GDP	–0.1%	0.3%	–	Final estimate.
Chn	Feb new loans, CNYbn	4920	1550	–	Due between Mar 9-15. Policy has eased downside risks...
	Feb M2 money supply, %yr	8.7%	8.8%	–	... but is yet to instil confidence.
Tue 12					
NZ	Feb REINZ house sales %yr (TBC)	4.9%	–	–	A surge in listings may have boosted sales…
	Feb REINZ house prices %yr (TBC)	2.2%	–	–	… while keeping a lid on prices.
	Feb retail card spending	1.7%	–	–0.3%	Financial pressures weighing on discretionary spending.
Aus	Feb NAB business survey	6	–	–	Conditions slowed to below par, confidence at low levels.
	RBA Assistant Governor (Economics)	–	–	–	Speaking at the AFR Business Summit.
UK	Jan average weekly earnings %yr	5.8%	–	–	Rapidly decelerating from peak of 8.5%yr at July 2023.
	BoE speak	–	–	–	Catherine Mann on productivity and investment.
US	Feb CPI	0.3%	0.4%	0.3%	Disinflation in 'last mile': shelter and insurance 'hot spots'.
	Feb NFIB small business optimism	89.9	–	–	Impetus for job creation fading amid economic uncertainty.
Wed 13					
NZ	Feb selected price indices	–	–	–	Updates on 45% of the CPI – see this week's preview box.
Eur	Jan industrial production	2.6%	-2.0%	–	Retracement from outsized year-end bounce likely.
UK	Jan monthly GDP	–0.2%	–	–	Economy buckling under the weight of high interest rates.
Thu 14					
NZ	Jan net migration	7260	–	–	Distortions from Christmas/NY travel may continue.
US	Feb retail sales	–0.8%	0.8%	–	Growth to decelerate to a below-trend pace this year.
	Feb PPI	0.3%	0.3%	–	Upstream price pressures contained.
	Jan business inventories	0.4%	0.3%	–	Run-down centred on wholesale; industrial to a lesser extent.
	Initial jobless claims	217k	–	–	Few signs of widespread job-shedding thus far.
Fri 15					
NZ	Feb manufacturing PMI	47.3	–	–	Less weak in Jan, but has been below 50 for the last year.
US	Feb industrial production	–0.1%	0.0%	–	Growth tracking a broadly flat to slightly negative trend...
	Mar Fed Empire state index	-2.4	-8.0	–	... as manufacturers experience weak conditions.
	Feb import price index	0.8%	0.2%	–	Imported inflation not a major concern.
	Mar Uni. of Michigan sentiment	76.9	77.0	–	Attention will be on inflation expectations.

CONTACT

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