WEEKLY ECONOMIC COMMENTARY

22 Jan 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Key factors to watch in 2024

Happy New Year! Given the holiday break, we didn't see much news of note in New Zealand since Christmas. Rather market trends have been dominated by global events and fluctuating expectations for monetary policy. Markets have tended to take an aggressive view on the timing and extent of policy interest rate cuts in most jurisdictions and this has flowed through into expectations for the RBNZ in 2024.

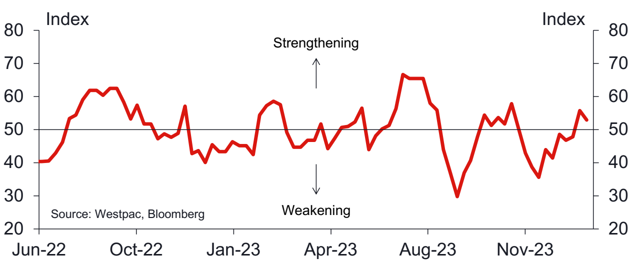
The RBNZ finished 2023 with a hawkish perspective on the interest rate outlook. That reflected their frustration with the apparently slow pace of deceleration in core inflation pressures. The RBNZ also likely has concerns that conditions in some sectors of the economy (for example housing and the labour market) might make it harder to bring inflation sustainably back to the middle of the 1-3% target range by the second half of 2025. The new government only increased the pressure on the RBNZ to perform in their core role when they refocused the RBNZ's mandate to a sole focus on inflation control in December, as they campaigned on during the 2023 election.

Since then, the situation has shifted as data showed stagnant economic growth since the middle of 2022 despite historic levels of inward migration and population growth. It is remarkable that, despite this apparently weak economy, core inflation pressures have remained so robust. This might be telling us that potential growth has not been as strong as we thought through the post Covid period – which could be a concern looking forward in terms of the level of growth we can expect and in relation to the speed with which we might anticipate inflation to sustainably decline. But, more likely, we suspect that the RBNZ will continue to think that potential growth, while perhaps a bit weaker than earlier appreciated, will have been moving ahead in the last year as the population has grown, and hence the level of excess capacity will have been building in recent quarters. As a result, we suspect they will be more comfortable that core inflation pressures will moderate sooner than they worried about

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
24 Jan 24	NZ CPI, December quarter
31 Jan 24	FOMC Meeting (Announced 1 Feb NZT)
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
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
10 Apr 24	RBNZ Monetary Policy Review
12 Apr 24	NZ Selected price indexes, Mar
1 May 24	FOMC Meeting (Announced 2 Mayr NZT)

in late 2023, and consequently the case for a further OCR increase will have dissipated and that rate cuts may eventually come into view.

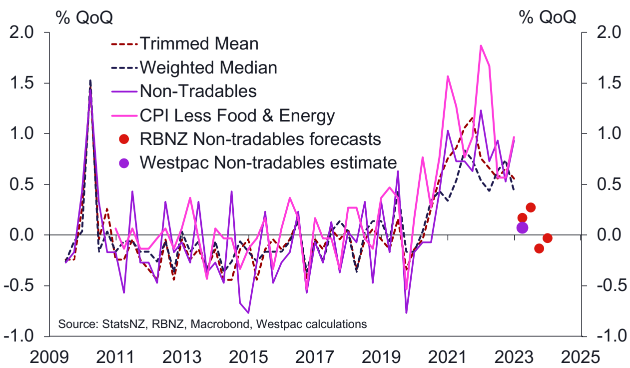
Recent inflation data will have given the RBNZ more comfort that inflation expectations are well in check. The new monthly selected price indices confirm rapid disinflation in tradable goods and food prices. We think headline inflation will have moved back below 5% for the first time since mid-2021. The RBNZ will hence likely have greater confidence that overall inflation will be at 3% or lower by the end of 2024. Such confidence will be a critical plank in the case for a reduction in the OCR in 2024. We see the headline CPI at 4.7% for the year to December when the CPI is released next week.

Looking ahead for 2024 then, what are the key issues to keep an eye on to gauge what happens next? We remain much more cautious on the potential for near term and significant rate cuts than markets. We continue to see as a base case the OCR remaining at 5.5% through 2024 as we think inflation will continue to prove sticky, and we don't think the RBNZ will have much scope for taking risks of not reaching 2% CPI inflation in the second half of 2025. Given the policy lags, the work done with interest rates over the next few quarters will be most relevant to those H2 2025 outcomes.

We see four key issues to focus on in determining the timing of any OCR cuts in 2024:

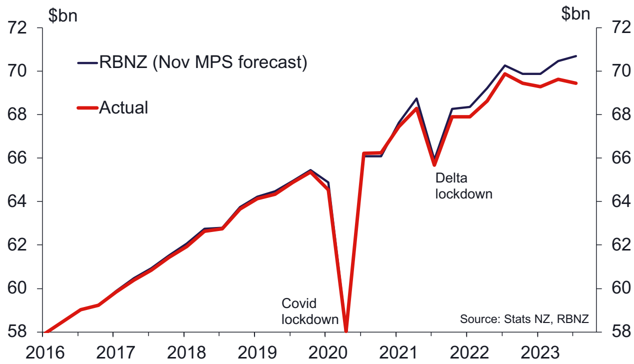
- **Significant deceleration in core inflation indicators.** An enduring feature of 2023 (at least before Q4) was the stickiness of core inflation indicators such as non-tradables inflation. These indicators need to sustainably decline to make the case for OCR cuts. We suspect we won't see such evidence until the middle of the year at the earliest – although this week's data will provide a critical starting point.

Quarterly core inflation indicators relative to 1995-2019 average



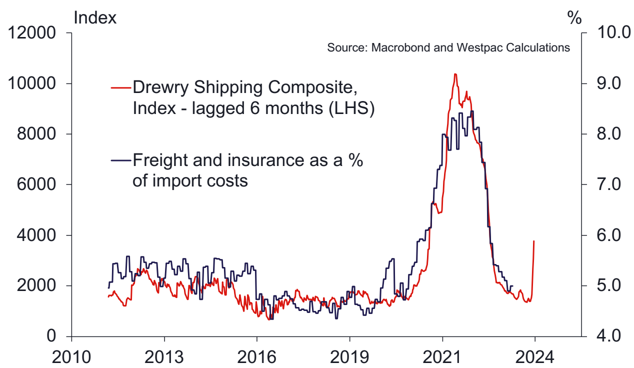
- **Ongoing economic momentum.** Growth went backwards in 2023. The year seems to have been bookended with a technical recession at the start and potentially one at the end. Growth likely ended the year weak and might have picked up a bit right at the end. The extent of any growth pickup (or not) in 2024 will be critical in providing confidence that the RBNZ's inflation goal will be met. The housing market will be key - it will be interesting to see how housing responds to lower mortgage rates through 2024.

Production-based GDP



- **The strength of the labour market.** Even though growth apparently went backwards the labour market continued to move forward in 2023. The extent to which this continues through 2024 will be key to the assessment of wage and inflation pressures.
- **Global geopolitical issues and their domestic influence.** 2023 was a year of serendipitous disinflation. We saw the full benefit of eased supply chains and lower energy and food prices reflected in tradables inflation (and a couple of core inflation elements such as construction costs and domestic airfares). 2024 looks set to be a much more turbulent year given the US presidential election (and the impact on already tense Chinese relations), the ongoing Russian war, and now significant trade disruptions from tensions in the Middle East. Disinflationary tailwinds could turn into headwinds and frustrate the RBNZ even if growth remains weak. The performance of the weak Chinese economy will be a key factor to watch.

Global container shipping costs and NZ import costs



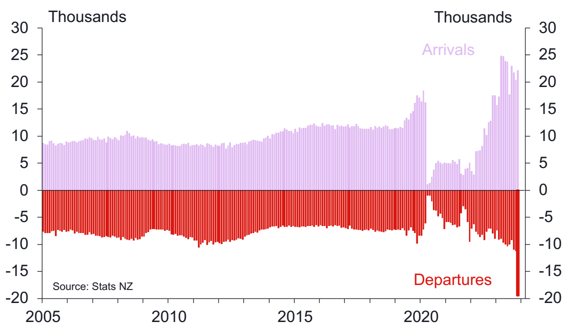
Kelly Eckhold, Chief Economist

Chart of the week.

Migrant inflows have remained strong, with 22,000 people arriving on our shores in November. However, the latest figures showed an unusual jump in the estimated number of people who departed on a long-term basis, indicating monthly departures have risen to around 19,000. That's almost double the pace of recent months and way beyond anything we've seen in history. We're taking this result with a large grain of salt. Migration estimates can be volatile and are often revised. It may turn out to have been holidaymakers spending more time out of the country than usual.

Setting the November figures aside and taking a look at the longer-term trend, it's likely that the annual net inflow is nearing its peak with arrivals having flattened off at high levels. The big question is how long net migration will remain around the current multi-decade highs? GDP growth has slowed (and has actually gone backwards in per-capita terms), unemployment is rising, and job vacancies have fallen below pre-pandemic levels. With economic conditions to continue cooling, we expect the coming year will see inflows starting to ease back and departures pushing higher.

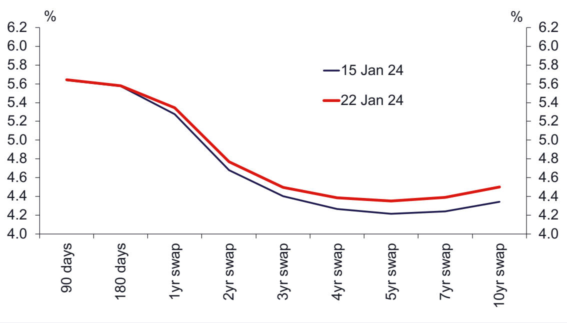
Migration flows



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.

US Treasury yields took a step higher over the past week. While Fed speakers have this week noted the possibility of rate cuts, they have stressed that the FOMC's stance will depend on the evolution of data. Notably, San Francisco Fed Governor Waller noted that policy changes should "be carefully calibrated and not rushed." Waller noted that the strength of the labour market meant that the Fed has scope to move gradually and ensure the downtrend in inflation will be sustained. Recent US data has been mixed. Retail spending remained firm in December, rising 0.6%. We also saw the Michigan consumer confidence survey rising sharply in January, while jobless claims have remained low. However, recent surveys of business activity have been subdued.

Asia-Pacific.

China's GDP increased by 5.2% over the past year. While that was ahead of the 5% increase policy makers had been targeting, China's economy continues to face some important challenges. Notably, prices are continuing to decline, with the GDP deflator falling through most of the past year. There has also been an increase in the jobless rate from 5% to 5.1%, along with ongoing falls in property prices. Given such challenges, further stimulus is likely. That's expected to be in form of expansionary fiscal policy rather than monetary stimulus, with the PBOC leaving the benchmark lending rates on hold in January. In Australia the number of people in employment fell by 65k in December (though some of that softness likely reflects changes in seasonal hiring trends). Looking through the monthly volatility, Australia's labour market is moving into a softer period. Monthly employment growth averaged 0.7% through the back part of the year, down from rates of around 0.9% earlier in the year. The unemployment rate has also begun to drift upwards. Consistent with the cooling in the labour market, consumer confidence has softened in early 2024.

Other.

ECB speakers, including Lagarde, have noted the possibility of rate cuts this year, but pushed back on market expectations about how soon any cuts may occur. ECB members have stressed that the stance of policy remains data dependent and, at least for now, there are lingering concerns about the strength of inflation (consumer prices rose by 2.9% in the year to December, with core up 3.4%). Across the Channel, UK inflation was stronger than expected in December with prices up 4% over the past year. Elsewhere, attacks in the Red Sea continue to disrupt global supply chains and have seen shipping costs pushing higher.

Trading partner real GDP (calendar years)

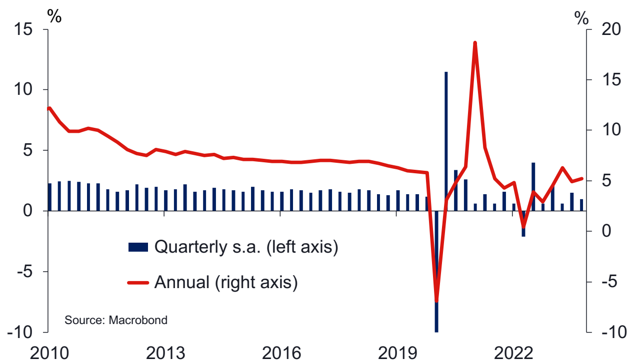
	Annual average % change			
	2022	2023	2024	2025
Australia	3.8	2.0	1.3	2.2
China	3.0	5.3	5.3	5.0
United States	2.1	2.4	1.4	1.3
Japan	1.1	1.7	0.9	0.9
East Asia ex China	4.5	3.4	4.2	4.3
India	6.8	6.4	6.4	6.4
Euro Zone	3.5	0.6	1.1	1.1
United Kingdom	4.0	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.3	3.4
World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

Australian & US interest rate outlook

	15-Dec	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	3.85	3.10
90 Day BBSW	4.34	4.47	3.97	3.30
3 Year Swap	4.03	4.10	4.00	3.50
3 Year Bond	3.86	3.90	3.80	3.30
10 Year Bond	4.29	4.30	4.15	4.00
10 Year Spread to US (bps)	13	10	5	0
US				
Fed Funds	5.375	4.875	4.375	3.375
US 10 Year Bond	4.16	4.20	4.10	4.00

US and NZ 10 year government bond yields

China GDP growth



Financial markets wrap

Interest rates.

The last quarter of 2023 saw wholesale interest rates fall sharply as markets sensed central banks would start cutting their policy rates in 2024. In NZ, the 2yr swap fell 120bp to 4.60%, and markets fully priced an OCR cut in May. Such pricing was arguably overdone, and this month the 2yr has rebounded by around 20bp, and a May cut is now priced as a 60% chance, although July is priced as a 100% chance.

The main driver of the rate fall in NZ has been a softer run of economic data (inflation, labour, GDP), while overseas, most countries have seen inflation receding. Central bankers have welcomed these developments, but have declared it too early to start easing, and will continue to assess incoming data.

The key NZ events for interest rates markets during the remainder of January are the Q4 CPI data release (this Wednesday) and a speech from RBNZ Chief Economist Conway (30th). Overseas, there will be plenty of central bank decisions announced but none expected to result in a change of policy rate. If central bankers continue to declare market pricing for rates cuts too aggressive, rates could rise slightly further globally. NZ 2yr swap rates would follow such moves, but should be capped by around 5.0% during the month ahead.

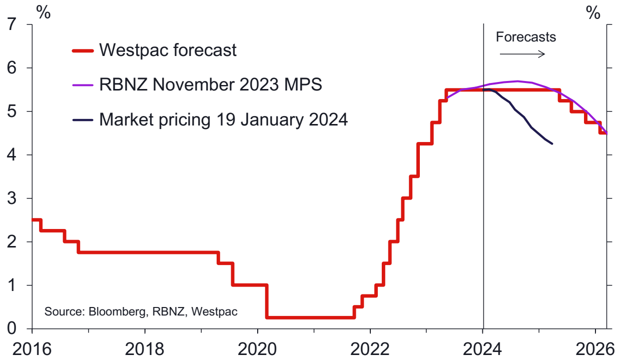
Foreign exchange.

NZD/USD had a strong finish to 2023, rising by 6c in November and December to 0.6369. A falling US dollar was the mean reason, in turn driven by expectations the Fed would cut rates early in 2024. Those expectations have cooled, allowing the US dollar to partly recover. As a result, NZD/USD has fallen to 0.6088.

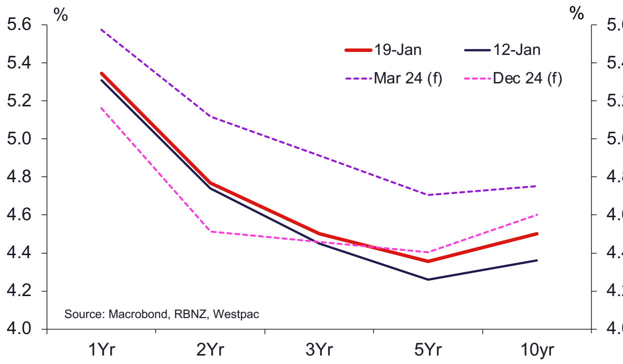
While there is scope for this fall to extend to 0.6000 during the month ahead, we are upbeat about the NZD's prospects longer term. If the Fed starts easing before the RBNZ, interest rate differentials should favour NZD/USD, and a recovery back above 0.6300 is plausible. In the meantime, any dips to 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. It is currently mid-range, but momentum suggest a move lower during the weeks ahead. Yield spreads support that view, but key will be developments in China.

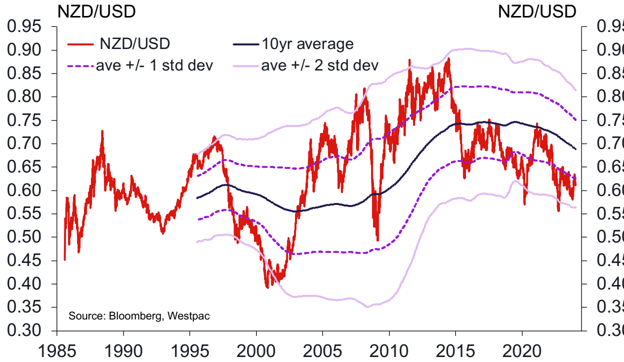
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mnth range	5yr range	5yr avg	Dec-24
USD	0.621	0.578-0.621	0.555-0.743	0.654	0.63
AUD	0.927	0.915-0.939	0.873-0.992	0.934	0.90
EUR	0.569	0.547-0.571	0.517-0.637	0.586	0.55
GBP	0.489	0.474-0.492	0.464-0.544	0.509	0.49
JPY	87.9	86.8-91.2	61.3-91.2	77.5	86.5

The week ahead

NZ Q4 Consumer Price Inflation

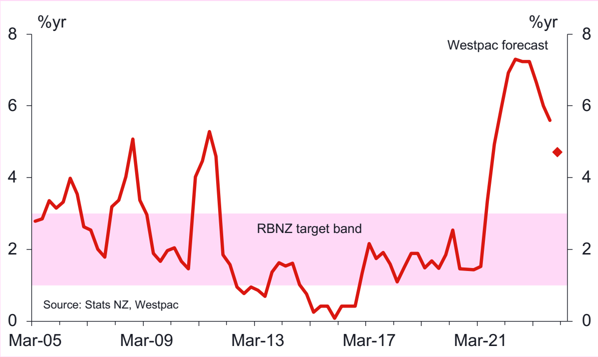
Jan 24:
Quarterly – Last: +1.8%, Westpac: +0.5%, Market: +0.5%
Annual – Last: +5.6%, Westpac: +4.7%, Market: +4.7%

We estimate that New Zealand consumer prices rose by 0.5% in the December quarter. That would see annual inflation dropping to 4.7%, down from 5.6% in the year to September.

Inflation is being pulled down by softness in import prices, including the price for food, fuel and airfares. However, domestic inflation pressures remain strong and are easing more gradually.

Our forecast is lower than the RBNZ's projection (published back in November) with most of that difference due to prices of volatile imported items. The key focus for the RBNZ will be the measures of core inflation which are easing, but remain uncomfortably high.

Consumers Price Index

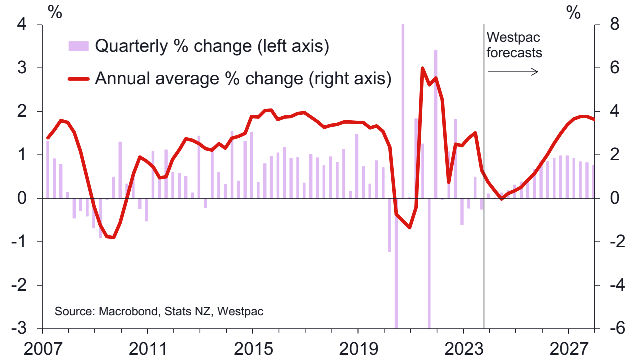


Economic and financial forecasts

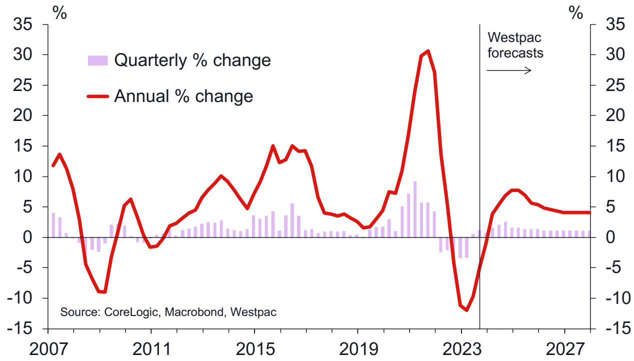
Economic indicators	Quarterly % change				Annual % change			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
GDP (production)	-0.3	0.1	0.0	0.1	5.5	2.4	0.7	0.3
Consumer price index	1.8	0.5	0.9	0.6	5.9	7.2	4.7	3.1
Employment change	-0.2	0.2	-0.1	0.0	3.3	1.7	2.1	-0.2
Unemployment rate	3.9	4.2	4.6	5.0	3.2	3.4	4.2	5.5
Labour cost index (all sectors)	1.1	0.9	0.8	0.9	2.6	4.1	4.2	3.4
Current account balance (% of GDP)	-7.6	-7.1	-6.5	-6.2	-5.8	-8.8	-7.1	-5.2
Terms of trade	-0.6	-1.7	2.6	2.2	2.8	-4.2	-3.5	9.6
House price index	2.1	1.0	1.5	2.0	27.0	-11.2	1.0	8.0

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

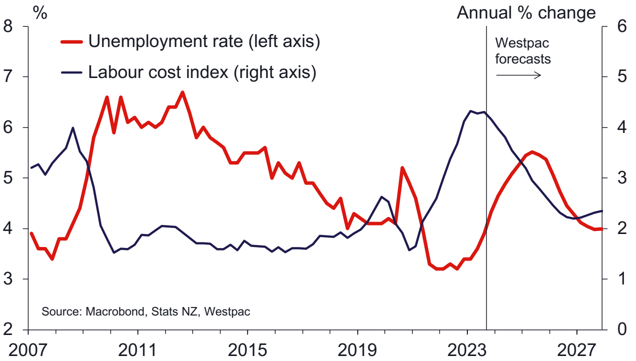
GDP growth



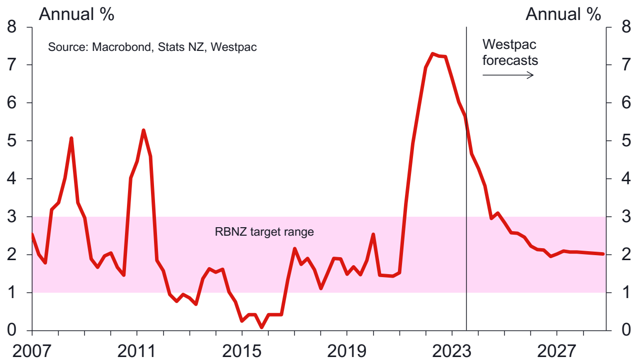
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 22					
US	Dec leading index	−0.5%	−0.3%	–	Rain clouds are forming.
Tue 23					
NZ	Dec BusinessNZ PSI	51.2	–	–	Economic activity cooling, but services more resilient.
Aus	Dec NAB business survey	+9	–	–	Conditions have cooled, mood deeply pessimistic at –9.
Jpn	BoJ policy decision	−0.10%	–	−0.10%	Lack of demand–side inflation will keep rates steady.
Eur	Jan consumer confidence	–15	–14	–	Rate hikes and high prices weighing on consumers.
US	Jan Richmond Fed index	–11	–	–	Manufacturing activity coming under pressure.
Wed 24					
NZ	Q4 CPI %qtr	1.8%	0.5%	0.5%	Inflation is dropping due to weaker import prices…
	Q4 CPI %yr	5.6%	4.7%	4.7%	… but domestic price pressures remain elevated.
Aus	Dec Westpac–MI Leading Index	0.30%	–	–	Looks to be stabilising rather than turning up.
Jpn	Jan Jibun Bank manufacturing PMI	47.9	–	–	Car manufacturing a bright spot.
	Jan Jibun Bank services PMI	51.5	–	–	Tourism is keeping services spending strong.
Eur	Jan HCOB manufacturing PMI	44.4	–	–	Weakness expected as demand dries up for European goods.
	Jan HCOB services PMI	48.8	–	–	Tepid consumption warrants a downbeat view.
UK	Jan S&P Global manufacturing PMI	46.2	–	–	Weakness to persist…
	Jan S&P Global services PMI	53.4	–	–	… throughout most of the economy.
US	Jan S&P Global manufacturing PMI	47.9	48.0	–	Higher costs are weighing on manufacturers minds.
	Jan S&P Global services PMI	51.4	51.0	–	Uncertainty on how much long consumer resilience will last.
Thu 25					
Aus	RBA Bulletin	–	–	–	Quarterly bulletin containing research articles.
Eur	ECB policy decision (deposit rate)	4.00%	4.00%	–	Cuts still some time away; services inflation remains strong
US	Q4 GDP, annualised	4.9%	1.9%	2.0%	Q4 likely to prove transition quarter, above to below trend.
	Dec durable goods orders	5.4%	1.0%	–	Weaker demand to show through in orders.
	Dec Chicago Fed activity index	0.03	–	–	Economy is slowly building capacity.
	Dec wholesale inventories	−0.2%	−0.2%	–	Firms drew down on inventories over holidays.
	Dec new home sales	–12.2%	10.1%	–	Post–holiday rebound.
	Jan Kansas City Fed index	–1	–	–	Manufacturing activity is weak.
	Initial jobless claims	187k	–	–	To remain low for now.
Fri 26					
Aus	Australia Day	–	–	–	Public holiday; markets closed.
Jpn	Jan Tokyo CPI %yr	2.4%	2.0%	–	Further deceleration expected as import prices ease.
UK	Jan GfK consumer sentiment	–22	–	–	Weakness persists as rate cuts remain distant.
US	Dec personal income	0.4%	0.3%	0.4%	Wage growth is moderating…
	Dec personal spending	0.3%	0.4%	0.4%	… but consumer spending has remained surprisingly resilient.
	Dec PCE deflator	−0.1%	0.2%	0.2%	Rents lower weight and alternative inputs to keep below CPI.
	Dec pending home sales	0.0%	–	–	Supply constraints keeping sales low.
Sat 27					
Chn	Dec industrial profits ytd %yr	−4.4%	–	–	Profit growth will gradually improve this year.

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