WEEKLY ECONOMIC COMMENTARY

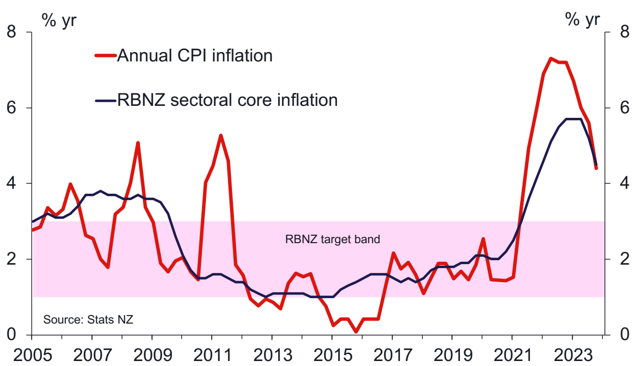
30 Jan 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

The inflation dragon hasn't been slain (yet).

December's update on consumer prices showed that inflation in New Zealand is continuing to cool. Consumer prices rose by 0.5% in the December quarter and 4.7% for the year –the lowest annual rate in over two years.

December's inflation result was in line with our own estimate but lower than the RBNZ's last published forecast for a 0.8% rise. Inflation has fallen short of the RBNZ's forecasts for most of the past year.

Headline and core inflation



Lower import and food prices (tradables inflation) were the key driver. These prices are more volatile, less reflective of domestic economic conditions, and of less focus for the RBNZ when setting monetary policy.

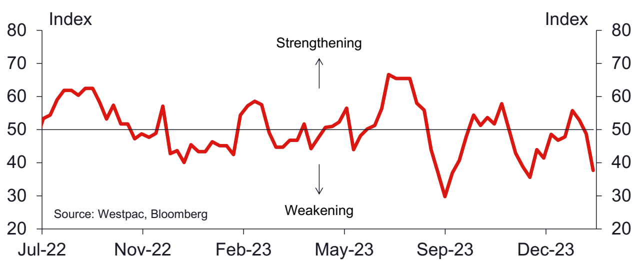
The RBNZ is more concerned with core inflation trends. Core inflation indicators are gradually moderating from very strong levels and are now running at annual rates of around 4% to 5%, and hence remain uncomfortably high. The RBNZ's own sectoral model of core inflation fell from 5.2% to 4.5% – still well above the 1% to 3% target band.

Domestic inflation continues to sizzle. Non-tradable prices were up 1.1% over the quarter – more than we or the RBNZ expected. And on an annual basis, non-

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

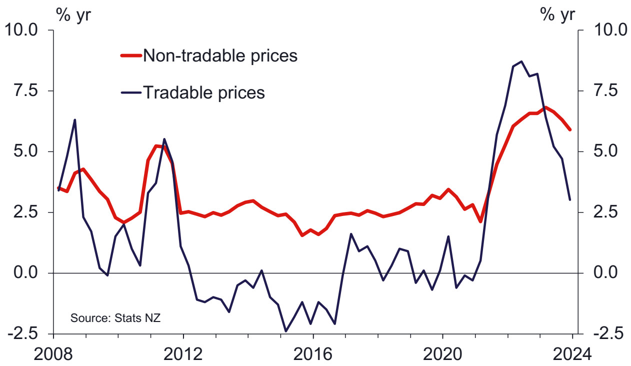


Key data and event outlook

Date	Event
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
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)

tradables inflation is running at a still-strong rate of 5.9% and remains particularly strong outside the construction sector. Those lingering domestic price pressures mean that it will still be some time before overall inflation returns to levels consistent with the RBNZ's target.

Tradables and non-tradables inflation



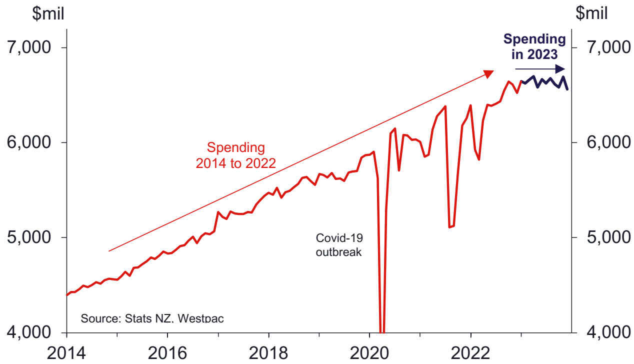
The RBNZ will likely feel more confident that inflation expectations will remain in check as headline inflation is coming down faster than they had forecast. However, this still leaves us with a picture of 'lower' inflation, not low inflation. The lingering strength in domestic and core inflation means that the Monetary Policy Committee won't be comfortable taking its foot off the brake just yet and we continue to expect the OCR to remain unchanged over 2024. We think the RBNZ will need to see a further easing in core inflation before adjusting the OCR lower. The RBNZ will also be keeping a close eye on the global stage, with recent disruptions to global shipping likely to slow the fall in imported inflation.

Consistent with our expectations for continued caution from the RBNZ were comments from RBNZ Chief Economist Conway in a speech on Tuesday morning. While noting that the economy is slowing and inflation is falling, Conway's comments seemed to push back on market expectations for any policy easing in the near term. When discussing the recent downside surprises to the RBNZ activity forecasts, he noted much of this was due to methodological changes related to areas like government expenditure and education. In contrast, estimates of private demand and business investment had been revised higher. He also went on to reiterate the RBNZ's earlier comments about how record net migration was adding to demand and inflation. Finally, he noted that while inflation has eased and monetary policy was working, domestic inflation remained elevated and there was still a way to go to get inflation back to the target midpoint. That focus on the midpoint is consistent with the recent change to the RBNZ remit, and also reinforces that it won't be sufficient for the RBNZ to just get inflation below the 3% upper bound of the RBNZ's target range.

A key concern for the RBNZ is whether interest rate reductions could reignite inflation pressures, and central to that assessment is the strength of household demand.

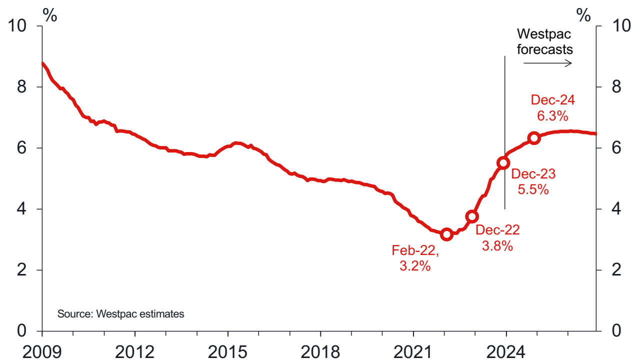
On this front, recent economic news has pointed to flagging momentum in spending appetites. Over the past year, spending levels have effectively been tracking sideways. Compared to the same time in 2022, card spending in December 2023 was down 0.6% despite population growth of around 2% and around 5% inflation.

New Zealand retail spending growth has stalled



We expect that household spending will remain under pressure this year. Household finances will continue to be constrained by high mortgage rates and the ongoing movement of borrowers from the lower mortgage interest rates available in recent years to higher rates. Over the next 12 months around 60% of all fixed rate mortgages will come up for repricing which will occur at a higher rate. The average mortgage rate that borrowers are paying has already risen by around 230bp since 2022, and it will rise by a further 80bps on average in 2024.

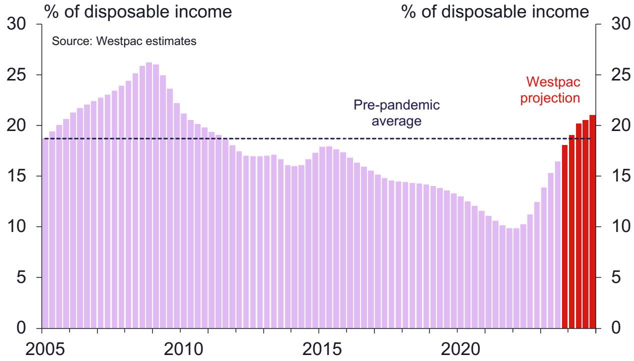
'Effective' average mortgage rate*



* The 'Effective mortgage rate' is an estimate of the average interest rate borrowers are currently paying. It accounts for the fact that most borrowers fix their mortgages, rather than paying the interest rates that are currently on offer.

The continued rise in debt servicing costs will suck a lot of money out of households' wallets. We estimate that for households with mortgages, their spending on debt servicing costs has already risen from just under 10% in 2021 to around 16% now, and it's set to rise to over 20% over the coming year. (Note: We are basing this on current mortgage rates and are not assuming any changes in the interest rates that are on offer from lenders.)

Spending on interest costs (households with mortgages)



The other key area that will be crucial for determining the strength of domestic spending appetites is the state of the labour market. While economic growth has slowed sharply over the past year, unemployment has remained low and currently sits at just 3.9%. We've also seen strong growth in disposable incomes of around 5% over the past year. That strength in the labour market has helped support household spending in the face of mounting financial pressures.

However, we think the job market will cool over 2024. Employment growth has slowed and there's also been a sharp fall in employee turnover as economic growth has slowed. We expect the unemployment rate will rise to 5% by the end of this year with a related easing in wage growth. That will reinforce the downward pressure on spending.

There are some factors that will help to support household spending in the face of those pressures. First is that many households took advantage of the low borrowing costs in recent years to get ahead on their repayments. That's giving them a buffer from the recent rise in interest rates.

Second, the decline in household wealth levels over the past few years has been arrested. The value of financial assets, like KiwiSaver balances, have been rising. In addition, the housing market has found a base – prices are no longer falling and some regions have seen modest price rises. We expect that household wealth levels will push higher over the coming year, underpinned by a pickup in house prices. And with New Zealanders holding a large portion of their wealth in owner-occupied or investor housing, that will provide some boost to spending appetites. But that will only offset a portion of the other headwinds that households will face over the coming year. We continue to expect that 2024 will see weakness in household demand and overall GDP growth.

This week we'll receive updates on business confidence on Wednesday and building consents on Friday. Both of those reports will be worth watching to gauge how much momentum there is in the economy at the start of the new year. The main event globally will be the FOMC's policy decision, released on Thursday morning NZ time.

While no change in the Fed Funds rate is expected, the statement will be closely watched for signals on the Fed's policy stance for the year ahead.

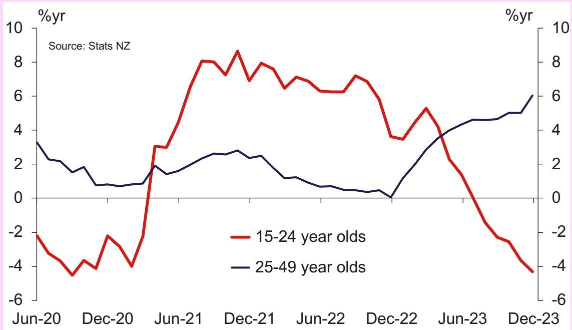
Satish Ranchhod, Senior Economist

Chart of the week.

The employment figures split by age tell a stark story about the impact of migration. By 2021 the economy was running hot, but with the migrant tap turned off, some severe labour shortages were developing. Employers found themselves resorting to one of the few areas where there was scope to bring more people into the workforce: the young. Youth employment surged over 2021 and 2022, especially in the school-age bracket.

Once the border was reopened, this trend went swiftly into reverse. All of the job growth since then has been in the 25-49 age group, which is the age range of most of the arriving migrants. With no need for employers to rely on schoolkids anymore, youth employment has fallen sharply over the last year.

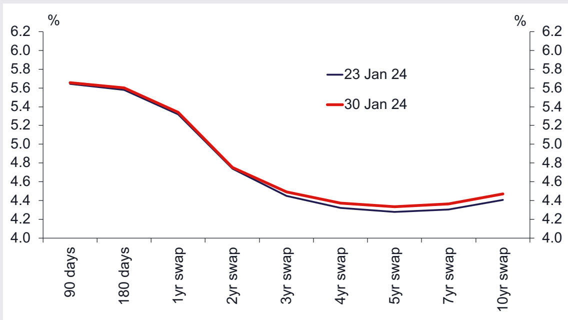
Filled jobs growth, by age group



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 US economy grew 3.3% in Q4 – well above market forecasts. Even so, inflation continued to move lower in December, with annual core PCE inflation – the Fed's preferred inflation metric – declining to 0.3ppts to a 31-month low of 2.9%. The focus this week will be Wednesday's FOMC meeting (Thursday morning NZT) and Friday's payrolls report for January. While no rate change is expected, investors will analyse the Fed's commentary to see how the policy outlook has evolved. We expect non-farm payrolls to have increased 150k in January and the unemployment rate to have nudged up 0.1ppts to 3.8%. The Employment Cost Index and JOLTs jobs data will also attract interest this week, together with the ISM manufacturing survey. In Canada, the BoC left its policy rate at 5% last week, as expected. While not entirely ruling out a further hike, the Bank's Governor noted that the internal discussion is shifting from whether policy is restrictive enough, to how long it needs to stay at the current level.

Europe

Last week the ECB left its policy rate steady, as expected. While President Lagarde stated that it was premature to discuss rate cuts, markets took note of her more downbeat comments on the euro area economy. Earlier in the week the composite PMI improved only marginally to 47.9 in January, thus remaining in contractionary territory for a 9th consecutive month. This week's flash Q4 GDP report will likely confirm that the euro area remains flat, while flash inflation data will likely show a further decline in January. In the UK, the PMIs improved slightly in January, with the composite index rising to 52.5. The CBI's survey also pointed to a decline in business pessimism. This week the BoE will likely again leave its policy rate on hold as it continues to monitor progress in reducing inflation.

Asia-Pacific.

Chinese equities halted their slump last week after the PBoC announced it would cut reserve ratio requirements for banks by 50bps from 5 February. The focus in China this week will be Wednesday's official PMI readings, especially after a disappointing print in December. In Japan, the BoJ left its policy settings unchanged as expected. However, Governor Ueda hinted that the Bank would look at exiting its current ultra-easy stance if the upcoming shunto wage negotiations provide further evidence that a favourable wage-inflation cycle is in place. Labour market and IP data take centre stage in Japan this week. In Australia, we expect Wednesday's Q4 CPI report to show a 0.8% lift in prices, lowering annual inflation to 4.3% - 0.2ppts below the RBA's forecast.

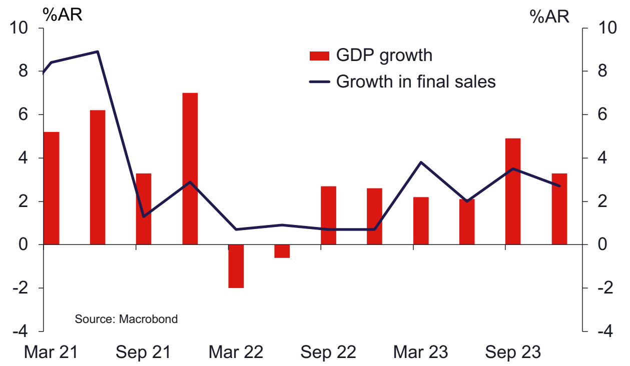
Trading partner real GDP (calendar years)

	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

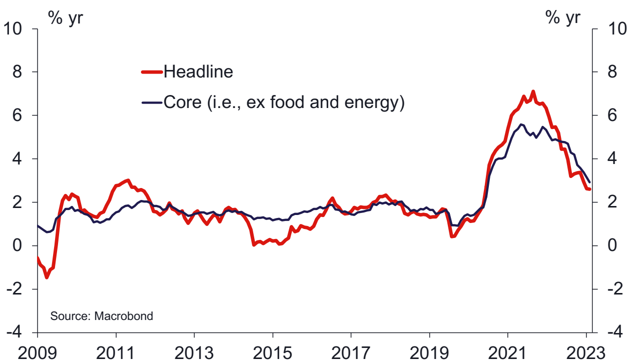
Australian & US interest rate outlook

	25-Jan	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	3.98	4.10	4.00	3.50
3 Year Bond	3.82	3.90	3.80	3.30
10 Year Bond	4.25	4.30	4.15	4.00
10 Year Spread to US (bps)	12	10	5	0
US				
Fed Funds	5.375	4.875	4.375	3.375
US 10 Year Bond	4.13	4.20	4.10	4.00

US GDP growth



US PCE deflator



Financial markets wrap

Interest rates.

Interest rate markets in January have been relatively stable, compared to the last quarter of 2023 when wholesale rates in most countries fell sharply as markets sensed central banks would start cutting their policy rates sometime in 2024. NZ 2yr swap rates, which fell 120bp to 4.60%, rebounded to 4.84% in January as markets acknowledged too much easing was priced in. An OCR cut in May is now priced as a 50% chance, which is still much more optimistic than our economists' forecast of February 2025.

NZ economic data over the past few months has been softer (inflation, labour, GDP), and overseas most countries have seen inflation receding. Central bankers have welcomed these developments, but most have declared it too early to start easing, preferring to continue to assess incoming data in case the decline in inflation is halted. This morning, RBNZ Chief Economist Conway gave a speech which was more hawkish than the market had expected, indicating that they remain vigilant on upside inflation risks.

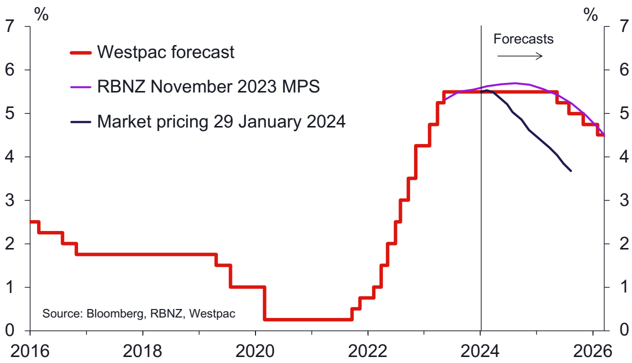
The key NZ events for interest rates markets during the month ahead are Q4 labour data (7 Feb) and the RBNZ MPS (28 Feb). Overseas, it's an action-packed week for markets, with highlights being the US Federal Reserve's rate decision, US jobs data, and AU CPI data. NZ 2yr swap rates have potential to rise slightly further during the month ahead, as markets reduce the chances of OCR cuts in H1, but should be capped by around 5.0%.

Foreign exchange.

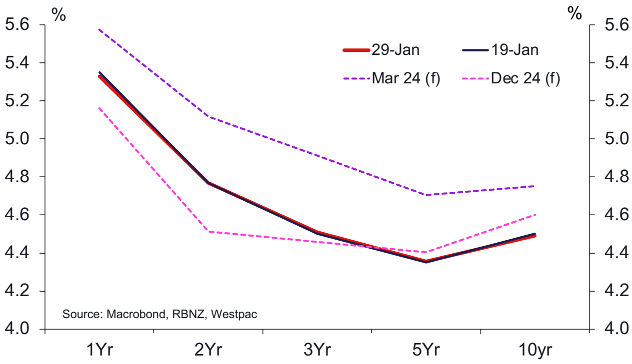
NZD/USD has fallen by around 3c in January – a correction of the 6c rise seen in November and December. The US dollar has continued to be the main driver of NZD/USD, with optimistic expectations the Fed would cut rates early in 2024 pared slightly in January. Such paring could extend further this week if the Fed cools the market's enthusiasm for pricing rate cuts, suggesting there's scope for the January decline in NZD/USD to extend to 0.6000 during the weeks ahead.

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, and 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. It is currently mid-range, but momentum suggest a move lower during the weeks ahead. Yield spreads support this view, but key will be developments in China.

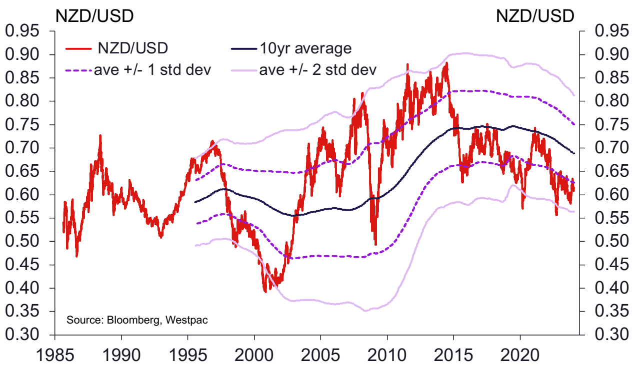
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-24
USD	0.614	0.579-0.635	0.555-0.743	0.653	0.63
AUD	0.929	0.915-0.937	0.873-0.992	0.934	0.90
EUR	0.567	0.548-0.572	0.517-0.637	0.585	0.55
GBP	0.483	0.477-0.497	0.464-0.544	0.508	0.49
JPY	90.5	87.1-91.2	61.3-91.2	77.9	86.5

The week ahead

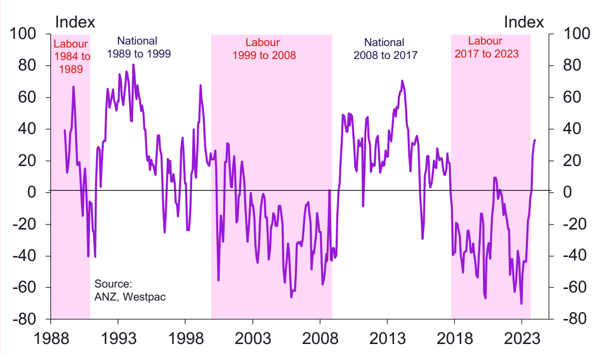
NZ Jan ANZBO business confidence

Jan 31, Last: 33.2

Business confidence has taken a sizeable step higher since October's election. However, while business sentiment has been on the rise, trading activity and hiring have actually remained subdued. We'll be watching the January survey to see if that divergence has continued into the new year. We're forecasting subdued economic growth through the early part of the year.

A key focus will be the survey's various price and inflation gauges. Consumer price inflation in New Zealand is dropping back, but many businesses are continuing to report pressures on operating costs and margins.

NZ ANZBO business confidence



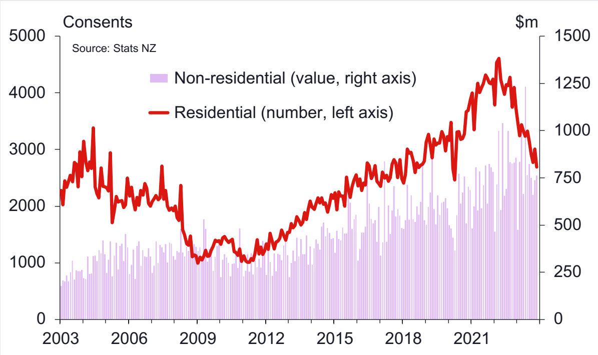
NZ Dec building consents

Feb 2, Last: –10.6%, Westpac f/c: +5.0%

Building consent issuance fell by nearly 11% in November. That was mainly due to falls in the lumpy apartment and retirement categories. Looking at the more stable categories (like standalone houses and town houses), the sharp slowdown that we've seen over the past year has continued, but is showing some signs of levelling off.

We expect a 5% bounce in consent issuance in December as some of the fall in volatile categories that we saw in November reverses. That would still leave the downtrend in consent issuance seen over the past year remaining in place.

NZ building consents

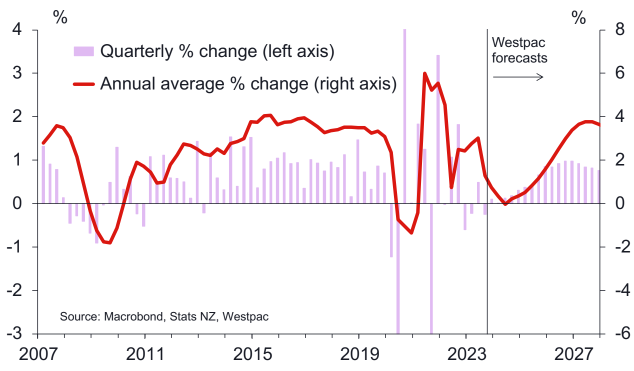


Economic and financial forecasts

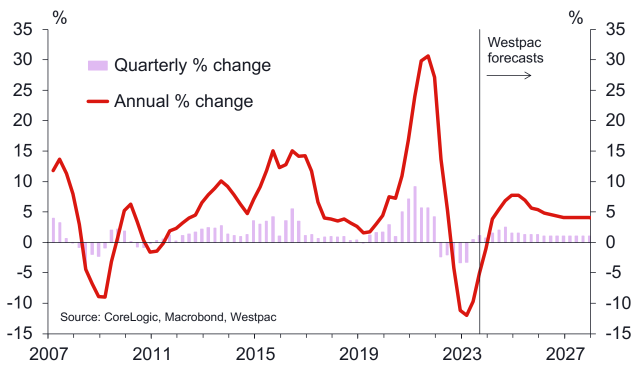
Economic indicators	Quarterly % change				Annual % change			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
GDP (production)	-0.3	0.1	0.0	0.1	2.4	0.7	0.3	1.6
Consumer price index	1.8	0.5	0.9	0.6	7.2	4.7	3.1	2.5
Employment change	-0.2	0.2	-0.1	0.0	1.7	2.1	-0.2	1.2
Unemployment rate	3.9	4.2	4.6	5.0	3.4	4.2	5.5	5.1
Labour cost index (all sectors)	1.1	0.9	0.8	0.9	4.1	4.2	3.4	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

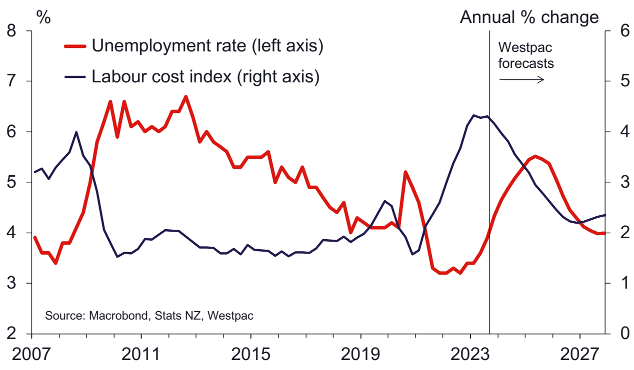
GDP growth



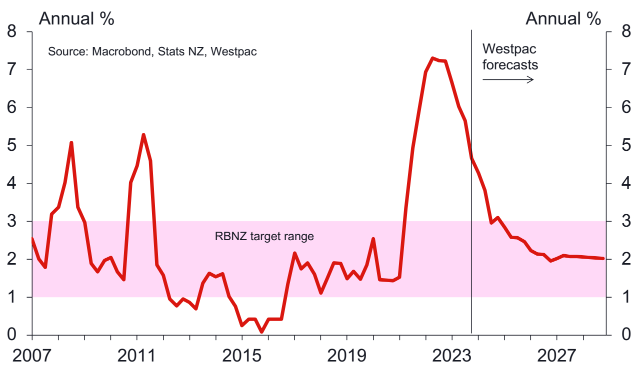
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
NZ	Dec trade balance $mn	–1234	–	-390	A smaller deficit likely, reflecting a seasonal pickup in exports.
	Dec employment indicator	0.1%	–	–0.8%	Hiring may have been pulled forward into November.
US	Jan Dallas Fed index	-9.3	–	–	Manufacturing conditions are soft across the regions.
Tue 30					
NZ	RBNZ Chief Economist Conway	–	–	–	Speech on monetary policy, incl. comments on recent data.
Aus	Dec retail sales	2.0%	–2.0%	–0.5%	Post Black Friday 'let down'.
Jpn	Dec jobless rate	2.5%	–	–	Tight labour market to facilitate sustainable wages growth.
Eur	Q4 GDP	–0.1%	–	–	Growth set to print about flat for the year.
US	Nov S&P/CS home price index	0.64%	–	–	Limited supply buoying price momentum.
	Jan consumer confidence index	110.7	111.6	–	Policy expectations shift, confidence upswing into year–end.
	Dec JOLTS job openings	8790k	–	–	Taken together, key series point to labour market balance.
Wed 31					
NZ	Jan ANZ business confidence	33.2	–	–	Confidence has firmed but trading activity still soft.
Aus	Q4 CPI %qtr	1.2%	0.8%	0.8%	Broad disinflationary forces outside of housing, and some...
	Q4 CPI %yr	5.4%	4.3%	4.3%	... market services, will see inflation continue to moderate.
	Q4 Trimmed Mean CPI %qtr	1.2%	0.9%	0.9%	A marginal downside risk to the December forecast as the...
	Q4 Trimmed Mean CPI %yr	5.2%	4.3%	4.4%	... Nov increase in household services was less than expected.
	Dec Monthly CPI Indicator %yr	4.3%	3.7%	3.0%	Inflationary pace to moderate with a 0.3%mth increase.
	Dec private sector credit	0.4%	0.4%	0.4%	Subdued pace, with elevated rates and economic slowdown.
Jpn	Dec industrial production	–0.9%	–	–	Subdued trend, downside risk near-term amid global slowdown.
Chn	Jan NBS manufacturing PMI	49.0	–	–	Policy support is limiting downside risks...
	Jan NBS non–manufacturing PMI	50.4	–	–	... across both manufacturing and services sectors.
US	Q4 employment cost index	1.1%	1.0%	–	Another robust read likely as tightness gradually fades.
	Jan Chicago PMI	47.2	48.1	–	Broadly speaking to soft conditions across the economy.
	FOMC policy decision, midpoint	5.375%	5.375%	5.375%	Progress towards target and risks the focus.
Thu 1					
Aus	Jan CoreLogic home value index	0.4%	–	0.5%	Monthly gains have been moderating since mid–2023.
	Dec dwelling approvals	1.6%	0.5%	–0.5%	Bumping around the bottom of the cycle.
	Q4 import price index	0.8%	0.6%	0.2%	Little changed, AUD TWI flat, gasoline prices modestly lower.
	Q4 export price index	–3.1%	2.2%	3.3%	Up in qtr but down over year – mirroring commodity prices.
Chn	Jan Caixin manufacturing PMI	50.8	–	–	More volatile than NBS, broadly signalling flat conditions.
Eur	Jan CPI %yr	2.9%	–	–	Food now comprises one–third of overall inflation.
	Dec unemployment rate	6.4%	–	–	Labour market historically tight despite broader slowdown.
UK	BoE policy decision	5.25%	–	5.25%	On hold and closely monitoring inflation's downtrend.
US	Jan ISM manufacturing	47.4	47.3	–	Manufacturing conditions are soft across the regions.
	Initial jobless claims	–	–	–	To remain at a low level, for now.
Fri 2					
NZ	Jan ANZ consumer confidence	93.1	–	–	Set to remain low due to continued financial pressures.
	Dec building permits	-10.6%	–	5.0%	Longer term down trend to remain in place.
Aus	Dec housing finance	1.0%	1.1%	2.5%	Solid upturn underway, led by established market...
	Dec owner occupier finance	0.5%	–	2.0%	... where both prices and turnover are moving higher...
	Dec investor finance	1.9%	–	3.5%	... investor activity starting to outperform slightly.
	Q4 PPI	1.8%	–	–	Falling energy prices should be the highlight in December.
US	Jan non–farm payrolls	216k	168k	150k	Payrolls likely to see weakness in coming months.
	Jan unemployment rate	3.7%	3.8%	3.8%	Upward pressure on unemployment rate to remain in place.
	Jan average hourly earnings %mth	0.4%	0.3%	0.3%	Wage pressures to slowly abate.
	Dec factory orders	2.6%	0.5%	–	Soft finish to the year.
	Jan Uni. of Michigan sentiment	78.8	78.8	–	Final estimate.

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