WEEKLY ECONOMIC COMMENTARY

6 Nov 2023 | **Westpac Economics Team** | **westpac.co.nz/economics** | nzeconomics@westpac.co.nz

Jobs data locks in RBNZ pause

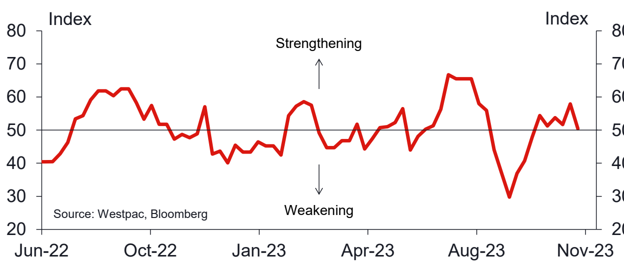
Last week we published our **latest quarterly Economic Overview**. The broad outlook for the New Zealand economy has not changed much in recent months. In short, we continue to think that sustained tight monetary policy settings – which are necessary to ensure that inflation returns to the RBNZ's target range – will mean that economic growth is relatively weak over the year ahead (and negative in per capita terms). That said, we have slightly revised up our forecast for growth, reflecting our assumption that the current large inflow of migrants will persist for longer than previously foreseen. We have also slightly revised up our forecasts for inflation and now no longer expect that it will return to the RBNZ's target range next year. This reflects our taking a more cautious view of the speed at which inflation might fall in parts of the service sector, rather than a significant change to our forecast of the real economy. As previously highlighted, we continue to forecast that the RBNZ will most likely need to lift the OCR further in 2024 while at this stage we don't see scope for policy easing until early 2025. But as always, the path taken by monetary policy will hinge on the flow of economic data and other developments – both in New Zealand and abroad – over the months ahead.

On that score, with prospects for continued disinflation tied inextricably to forecasts of increasing economic slack, last week there was significant interest in the labour market surveys for the September quarter. In summary, these provided some good news for the RBNZ. As we had expected, the unemployment rate increased by a further 0.3ppts to 3.9%, marking the highest reading in more than two years. Also of note, the so-called underutilisation rate – which amongst other things also captures those people that would like more work – increased by 0.5ppts to 10.4%. In the detail, employment fell 0.2% during the quarter, which was a weaker outcome than suggested by the tax-based Monthly Employment Indicator (MEI). While this could reflect conceptual and

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

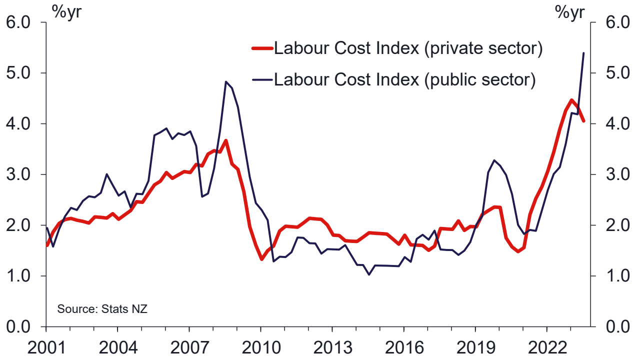


Key data and event outlook

Date	Event
7 Nov 23	RBA Monetary Policy Decision
9 Nov 23	NZ Govt finances for the 3 months to September
29 Nov 23	RBNZ Monetary Policy Statement and OCR
5 Dec 23	RBA Monetary Policy Decision
13 Dec 23	FOMC Meeting (Announced 14 Dec NZT)
14 Dec 23	NZ GDP September quarter
18 Dec 23	Half Year Economic and Fiscal Outlook (TBC)
16 Jan 24	QSBO Business Survey, December quarter (TBC)
24 Jan 24	NZ CPI, December quarter
6 Feb 24	RBA Monetary Policy Decision and SMP
7 Feb 24	NZ labour market statistics, December quarter
28 Feb 24	RBNZ Monetary Policy Statement and OCR

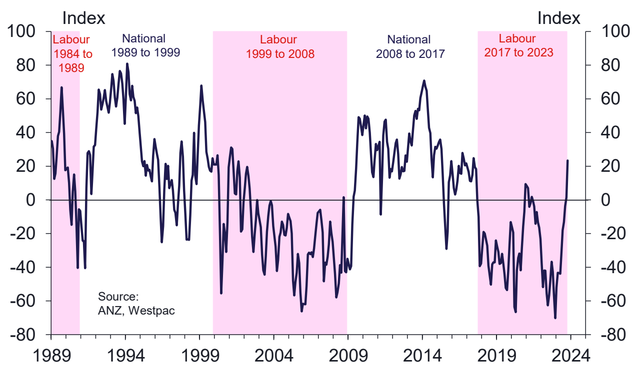
coverage differences between the MEI and household survey, we are inclined to think that rotation of the survey sample may explain much of the unexpected weakness in employment in the September quarter, especially as the labour force participation rate also surprised to the downside. We will be paying close attention to developments in the MEI over coming months.

Public and private sector wage growth



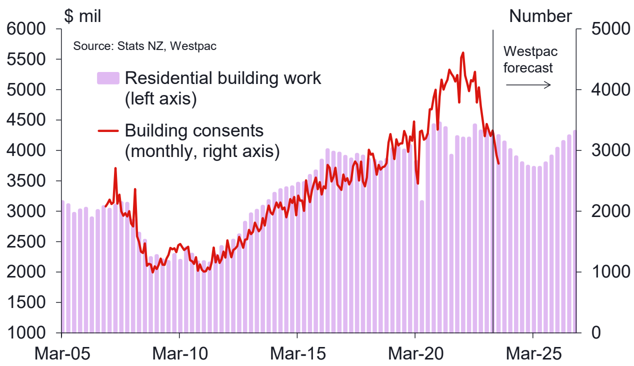
Most importantly, there were further signs that the uplift in the unemployment rate is beginning to take some of the heat out of wage growth. In particular, the private sector Labour Cost Index increased by a less than expected 0.9% in the September quarter. This marked the second consecutive quarter in which growth has printed 0.2ppts lower than in the same quarter a year earlier, and so annual growth has declined to 4.1% from a peak of 4.5% in the March quarter. Wage growth in the public sector was very strong, in part reflecting large settlements in the education sector. However, looking ahead, we expect wage growth to weaken in the public sector, lagging the private sector has it usually does. This is especially so given that the parties that will form the incoming centre-right government have pledged to focus on tight control of spending, which will likely include some job losses in the bureaucracy. Coming on top of the recent downside surprise in CPI inflation, last week's labour market news will almost certainly allow the RBNZ to remain on the sidelines at this year's final meeting on 29 November. But further significant progress in reducing inflation pressures will be required to keep the RBNZ on the sidelines next year.

Business confidence



Last week's other key economic data concerned building activity and business confidence. Somewhat disappointingly, the number of consents for dwellings fell by a further 5% in September and are now more than 30% lower than a year earlier. In addition, consents for commercial buildings were also weak, with the amount of floor-space consented over the past 12 months down 13% on the previous year. More positively, the ANZ's Business Outlook Survey pointed to a sharp lift in business confidence, while firms' assessment of their own trading outlook also improved significantly. That said, it remains to be seen to what extent this is simply a kneejerk reaction to the success of centre-right parties in last month's General Election. Elsewhere in the survey, key inflation indicators eased only modestly, and over coming months will need to make substantial further progress to arrive at levels consistent with inflation inside the RBNZ's target range.

Plunge in dwelling consents continuing



Aside from economic data, last week the RBNZ released its six-monthly *Financial Stability Report*. Unsurprisingly, the RBNZ concluded that New Zealand's banking system remains well placed to handle potential external shocks and a downturn in the economy, with banks' liquidity positions viewed as "strong" and asset quality described as "high". Looking ahead, the RBNZ noted that pockets of stress are likely to grow in the medium term as highly-indebted households continue to be tested by higher debt servicing burdens. In the farm sector, it was noted that a prolonged downturn in dairy prices could see a material pickup in loan losses for banks, and that farmers in some areas also face increased risk of drought conditions due to the impacts of El Niño. None of these comments would have been a surprise to market participants.

At the end of last week the formation of a new government moved a step closer with the release of the **final results of this year's General Election**. As history had suggested, following the counting of special votes, the centre-right National Party has lost 2 seats since election night, finishing with 48 seats. As a result, the combined seat-holding of National and its preferred coalition partner ACT is 59 seats – insufficient to command a majority in what will become a 123-seat parliament following the Port Waikato by-election on 25

November (even allowing for the fact that National will almost certainly gain a further seat at the by-election). It is worth noting that several electorate outcomes are very tight (for example, Te Pāti Māori holds one seat by just 4 votes) and are likely to be the subject of recount applications. However, this will have no impact on the party seat allocation nor the fact that the National and ACT parties will require the support of the NZ First party (8 seats) to command a majority in the new parliament.

Coalition talks will now move beyond the preliminary discussions that have been held to date. Although it could still be a couple of weeks before a formal coalition agreement is signed, the respective parties have indicated a desire to move as fast as possible. As we wrote in our **pre-election primer**, there is a reasonably high degree of commonality amongst the prospective coalition partners across key policy areas, but we can assume that the two minor parties will want some specific policy "wins" to demonstrate to their respective supporters. A quick agreement will be required if the new government is to release a mini-budget before the end of the year, as desired by PM-elect and National Party leader, Christopher Luxon.

Turning to the week ahead, the local diary is a quiet one. On Wednesday, the RBNZ's Survey of Expectations will reveal whether the gradual downtrend in (largely) professional forecasters' inflation expectations has remained intact. Earlier that day, the latest GDT dairy auction will also be of interest to see if the recent recovery in prices has been sustained. On Thursday, the Treasury will release the Government's Financial Statements for the three months to September, providing the first snapshot of how tax revenue is tracking in the current fiscal year. Developments here will help condition expectations regarding any further prospective changes in the government borrowing programme in next month's fiscal update and might have some impact on what the incoming government can deliver following coalition talks. On Friday, the week will end with the release of the Business NZ manufacturing PMI for October, which last month fell to a fresh post-GFC low (excluding the slumps associated with lockdowns during the pandemic).

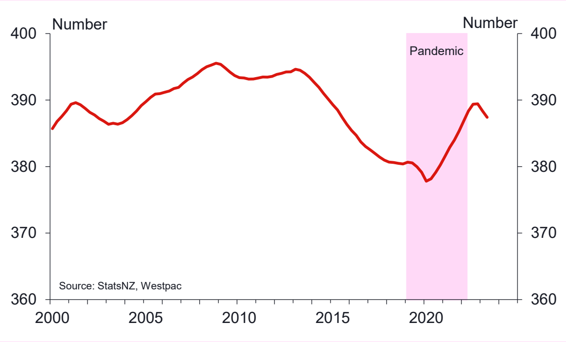
Darren Gibbs, Senior Economist

Chart of the week.

In the wake of the pandemic, house prices and home building surged at the same time as population growth fell sharply. That combination allowed some regions – most notably Auckland – to address much of the underbuilding of homes that we saw over the past decade. However, progress on this front was uneven, with many parts of the country still dealing with shortages of houses.

Now, conditions in New Zealand's housing market are changing again. With record levels of net migration, population growth has climbed to a multi-decade high. At the same time, new home building is turning down, with dwelling consent numbers down 20% over the past year. Combined, those conditions mean the coming year is likely to see growing pressure on the housing stock in many regions. And those pressures are likely to be strong in larger centres (like Auckland) which tend to attract more migrants.

Number of houses per 1000 people

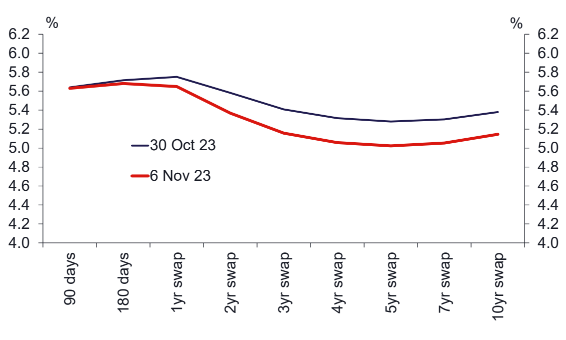


Fixed versus floating for mortgages.

The RBNZ has signalled that it expects to hold the cash rate at its current level of 5.50% for an extended period. We see a risk that the OCR could go higher in the coming months, and that interest rate cuts could be some time away.

We see value in fixing for terms as long as three years. Shorter terms could be more expensive, but would provide borrowers with greater flexibility.

NZ interest rates



Global wrap

US.

The Fed delivered the expected hawkish hold last week. That said, while Chair Powell left the door open for further tightening, he also noted that financial conditions had recently tightened significantly and that the full effects of tightening were yet to be felt. So with markets of the view that the Fed is done hiking, bonds rallied and the DXY fell. These moves were reinforced by a softer than expected 150k lift in non-farm payrolls in October (with 110k of downward revisions to the previous two months), a rise in the unemployment rate to 3.9% and a decline the average work week. Weaker than expected consumer confidence and business sectors surveys (including the ISMs) capped off the softer data flow and suggested that the sharp lift in GDP in Q3 would not be repeated in Q4. The dataflow is sparse over the coming week, so most interest will centre on a large flow of Fedspeak (including remarks by Powell).

Asia-Pacific.

Last week the BoJ announced that the 1% upper bound for the 10-year JGB would be changed from a hard cap to a ‘reference’ point, meaning that yields could trade above that level if conditions warrant. With markets expecting a more hawkish shift, the yen fell following the announcement. In China, the official and Caixin PMI gauges unexpectedly softened in October, with falls in output and orders, suggesting that further policy support will still be needed to boost confidence and demand. This week, trade and inflation data will provide further insights in China. In Australia, annual growth in retail sales beat expectations with a 2% gain in September, boosted by large price gains and strong net migration. October saw another solid 0.9% rise in house prices, leaving them up 6.8% over the past year. However, indications for construction remain subdued, with softness in construction finance and dwelling approvals. The focus in Australia this week will be Tuesday’s RBA meeting, with Westpac forecasting a 25bp lift in the policy rate.

Europe.

With the UK economy weakening, the BoE also delivered a hawkish hold (6-3 vote against a hike), with the statement noting that further tightening could be needed. The BoE’s projections for inflation were revised higher even as that for economic growth were revised down, suggesting that policy decisions will remain finely balanced. Euro-area GDP contracted by 0.1% in Q3 causing annual growth to fall to just 0.1% - on the cusp of recession. Meanwhile, annual inflation surprised to the downside, falling to 2.9% in October (down from 4.3%) and the unemployment rate edged up to 6.5% - developments that reinforced expectations that the ECB will remain on hold into 2024.

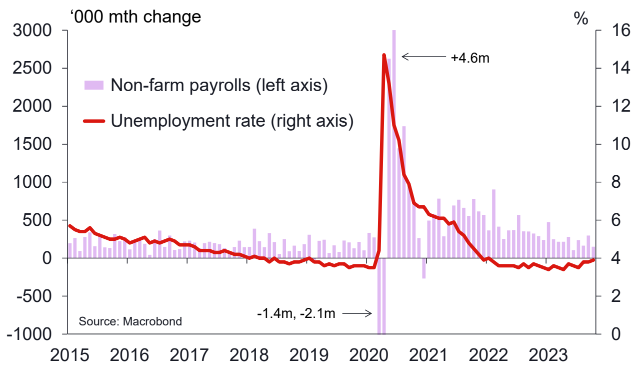
Trading partner real GDP (calendar years)

	Annual average % change			
	2021	2022	2023	2024
Australia	5.2	3.7	1.9	1.2
China	8.4	3.0	5.3	5.3
United States	5.9	2.1	2.2	1.4
Japan	2.1	1.1	1.6	1.0
East Asia ex China	4.3	4.5	3.5	4.3
India	9.1	6.8	6.4	6.4
Euro Zone	5.4	3.5	0.6	1.1
United Kingdom	7.6	4.0	0.3	0.5
NZ trading partners	6.2	3.2	3.4	3.3
World	6.3	3.4	3.0	3.1

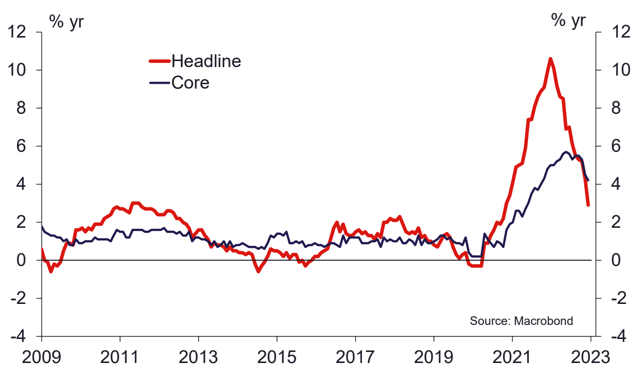
Australian & US interest rate outlook

	Latest	Dec-23	Jun-24	Dec-24
Australia				
Cash	4.10	4.35	4.35	3.85
90 Day BBSW	4.35	4.55	4.47	3.97
3 Year Swap	4.49	4.40	4.20	4.00
3 Year Bond	4.29	4.20	4.00	3.80
10 Year Bond	4.74	4.70	4.50	4.30
10 Year Spread to US (bps)	8	-10	-10	-10
US				
Fed Funds	5.375	5.375	4.875	4.375
US 10 Year Bond	4.66	4.80	4.60	4.40

US non-farm payrolls and unemployment rate



Euro area inflation



Financial markets wrap

Interest rates.

NZ swap rates fell sharply last week, with the 2yr swap down 26bp to 5.34% and the 10yr down 35bp to 5.10%. The catalysts were softer NZ labour data and lower US interest rates (in turn responding to softer US data and a less hawkish than expected Fed). These have cause market pricing for the RBNZ to recede: a November hike now seen as a zero chance, with a February hike just a 15% chance. A rate cut in August 2024 is seen as a 55% chance.

After the NZ markets closed on Friday, important US labour data was released. It was also softer than expected, supporting a view that the Fed has probably finished hiking. Markets pushed US rates sharply lower in response, and that will see NZ rates starting the week lower than the levels cited above.

This week's event calendar in NZ contains only second-tier data. The next major event will be the RBNZ MPS on 29 November. Offshore, the main event of relevance to NZ will be the RBA decision on Tuesday. Most economists expect a rate hike, and markets are pricing 65% chance of such.

The NZ yield curve has steepened sharply since July, and is looking technically stretched, indicating potential for a brief flattening phase before the steepening trend resumes. We expect the curve to steepen into year end and continue doing so next year.

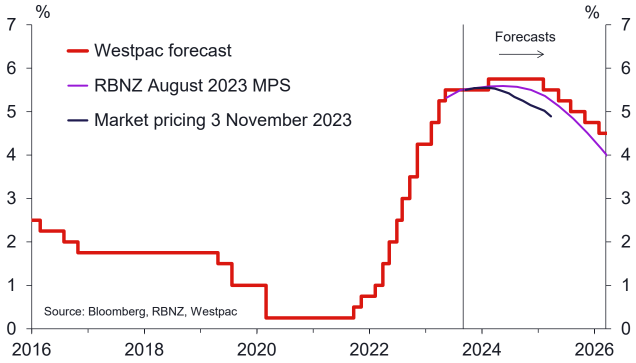
Foreign exchange.

NZD/USD tried to break below 0.5800 again last week, but again failed to follow through despite the softer NZ labour data. Dominating FX markets was the softer US dollar, which caused all other G10 currencies to rise. The NZD/USD reached 0.6001 on Friday and has potential to extend towards 0.6100 this week.

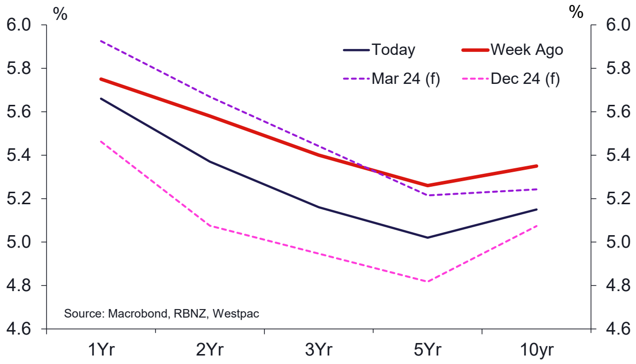
Over the past few weeks, we have been advocating hedging foreign currency receipts around 0.5800. The next few weeks are likely to be more advantageous for those hedging foreign currency payments.

Last week NZD/AUD consolidated its recent decline, perhaps looking ahead to this week's RBA decision. The AUD reaction will depend not only on whether the RBA hikes or not, but also guidance for the future path of the cash rate. A hawkish outcome could push the cross lower to 0.9100 – towards the lower end of its recent range – which might attract interest from NZ exporters.

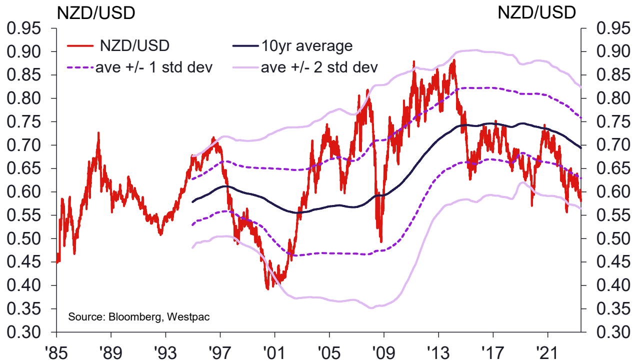
Official Cash Rate forecasts



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	0.600	0.578-0.611	0.555-0.743	0.656	0.62
AUD	0.921	0.915-0.939	0.873-0.992	0.934	0.89
EUR	0.559	0.543-0.570	0.517-0.637	0.587	0.55
GBP	0.485	0.464-0.492	0.464-0.551	0.510	0.49
JPY	89.5	86.0-89.8	61.3-89.8	77.3	86.1

The week ahead

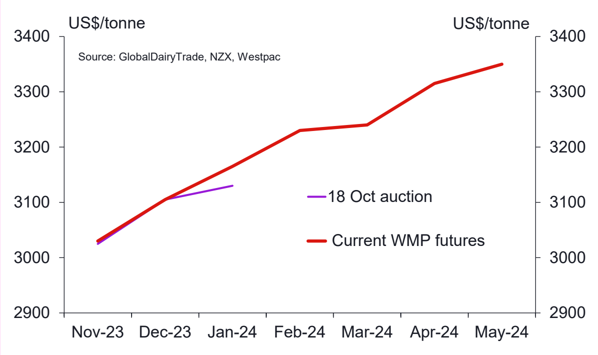
NZ GlobalDairyTrade auction, whole milk powder prices

Nov 8, Last: 4.2%, Westpac: -1.0%

We expect whole milk powder prices (WMP) to fall 1% at the upcoming auction. Note WMP prices jumped by 4.2% at the previous auction. Our pick is between the circa 3% fall at the recent mini (GDT pulse) auctions and the flat prices as indicated by the futures market.

Global dairy prices lifted off their lows over September and October. The likely drivers of the improvement were a lift in demand from Middle East buyers alongside increased drought risk over summer and/or autumn stemming from the El Niño weather pattern. In the short term, New Zealand spring production has been firm and this may explain the likely price fall at this auction.

Whole milk powder prices



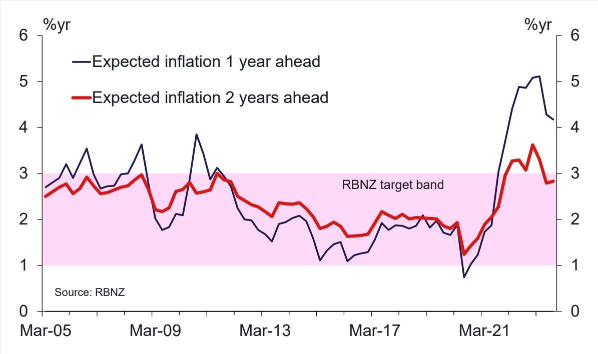
NZ Q4 RBNZ survey of expectations

Nov 8, Expected inflation 2 years ahead, last: +2.83%

The RBNZ's September survey showed that expectations for inflation over the next few years are, on average, continuing to soften. However, that easing has been gradual, and expectations remain above the 2% midpoint of the RBNZ's target band.

Inflation has continued to ease since the time of the RBNZ's last survey, with headline inflation dropping 5.6%. In addition, borrowing costs have continued to push higher. Against that backdrop, expectations for inflation are set to fall again in the December quarter survey. Even so, inflation expectations are likely to remain above 2%.

RBNZ survey of expectations

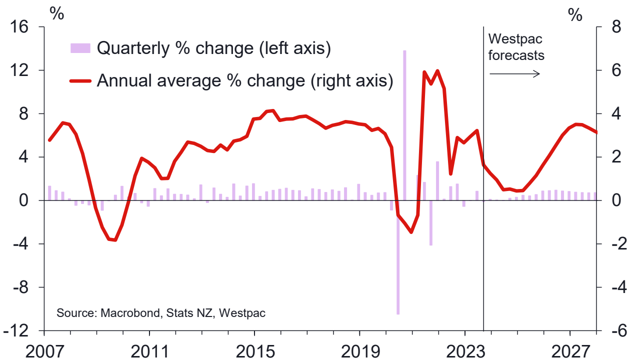


Economic and financial forecasts

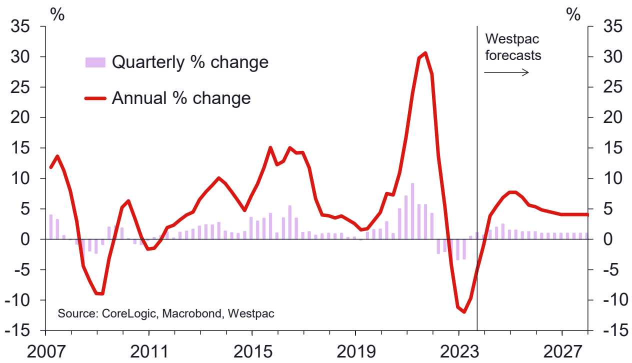
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.9	-0.1	0.1	0.2	6.0	2.7	1.2	0.9
Consumer price index	1.1	1.8	0.9	0.9	5.9	7.2	5.1	3.2
Employment change	1.0	-0.2	0.1	0.1	3.3	1.7	1.9	0.2
Unemployment rate	3.6	3.9	4.3	4.6	3.2	3.4	4.3	5.3
Labour cost index (all sectors)	1.1	1.1	0.9	0.8	2.6	4.1	4.2	3.4
Current account balance (% of GDP)	-7.5	-7.7	-7.3	-6.8	-5.8	-8.8	-7.3	-5.6
Terms of trade	0.4	-4.8	-1.7	2.9	2.8	-4.2	-7.5	9.5
House price index	0.5	2.1	1.0	1.5	27.0	-11.2	1.0	8.0

Financial forecasts	End of quarter				End of year			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
OCR	5.50	5.50	5.50	5.75	0.75	4.25	5.50	5.75
90 day bank bill	5.62	5.66	5.85	5.85	0.82	4.26	5.85	5.75
2 year swap	5.18	5.53	5.79	5.67	2.08	5.10	5.79	5.08
5 year swap	4.44	4.90	5.34	5.22	2.46	4.67	5.34	4.82
10 year bond	4.27	4.87	5.45	5.45	2.39	4.31	5.45	5.15
TWI	70.9	70.6	70.3	70.3	74.3	70.8	70.3	69.2
NZD/USD	0.62	0.61	0.60	0.61	0.70	0.60	0.60	0.62
NZD/AUD	0.93	0.92	0.91	0.91	0.95	0.92	0.91	0.89
NZD/EUR	0.57	0.56	0.56	0.56	0.61	0.59	0.56	0.55
NZD/GBP	0.49	0.48	0.49	0.49	0.52	0.51	0.49	0.49

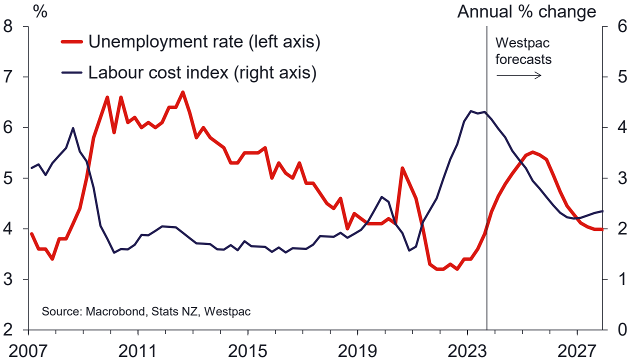
GDP growth



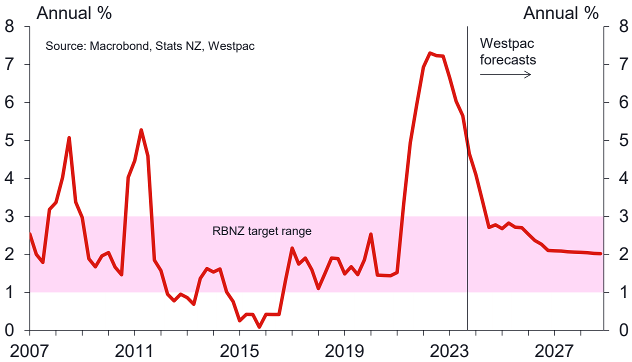
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 06					
NZ	Oct ANZ commodity prices	0.0	–	–	Dairy prices jumped over October.
Aus	Oct MI inflation gauge %yr	5.7%	–	–	Provides a general view of risks.
	Oct ANZ job ads	–0.1%	–	–	Broadly stable over last three months.
Eur	Nov Sentix investor confidence	–21.9	–20.7	–	Gloomy outlook as the impact of rate hikes materialise.
Tue 07					
Aus	RBA policy decision	4.10%	4.35%	4.35%	RBA to respond to upside risks to inflation outlook.
	Melbourne Cup	–	–	–	Public holiday (Vic); Vauban favoured by bookies.
Jpn	Sep household spending %yr	–2.5%	–2.7%	–	Real income pressures constraints spending momentum.
Chn	Oct trade balance US$bn	77.8	84.2	–	Asian demand has held up surplus through 2023.
	Oct foreign reserves US$bn	3115.1	–	–	Authorities focused on stability of TWI not USD/CNY.
Eur	Sep PPI %yr	–11.5%	–13.0%	–	Last year's energy inflation has almost fully cycled out.
US	Sep trade balance $bn	–58.3	–60.5	–	Likely to remain volatile given swings in demand and prices.
	Sep consumer credit $bn	–15.6	10.0	–	Interest rates to grow as a headwind for demand.
	Fedspeak	–	–	–	Logan and Schmid.
Wed 08					
NZ	GlobalDairyTrade auction (WMP)	4.2%	–	–1.0%	Dairy prices taking a breather after rising since August.
	Q4 RBNZ inflation expectations	2.83%	–	–	Above target, but set to continue easing back.
Eur	Sep retail sales	–1.2%	–	–	Broad–based weakness highlights fragility of consumption.
US	Sep wholesale inventories	0.0%	0.0%	–	Final estimate.
Thu 09					
Jpn	Sep current account balance ¥bn	2279.7	2988.9	–	Primary income supporting surplus through weak yen.
Chn	Oct CPI %yr	0.0%	–0.2%	–	Soft demand and capacity to limit consumer inflation...
	Oct PPI %yr	–2.5%	–2.8%	–	... while growing capacity holds back upstream price gains.
	Oct new loans, CNYbn	2311.8	650.0	–	Government support for credit growth building...
	Oct M2 money supply %yr	10.3%	–	–	... though gains likely limited until property support increases.
US	Initial jobless claims	217k	–	–	Low and will remain so for foreseeable future.
	FOMC Chair Powell	–	–	–	IMF Panel, "Monetary Policy Challenges in a Global Economy".
	Fedspeak	–	–	–	Bostic and Paese.
Fri 10					
NZ	Oct manufacturing PMI	45.3	–	–	Set to remain low in as demand continues to cool.
Aus	RBA Statement on Monetary Policy	–	–	–	Forecast update; inflation outlook in focus.
UK	Q3 GDP	0.2%	0.0%	–	Growth faltering under the weight of interest rate tightening.
US	Nov Uni. of Michigan sentiment	63.8	63.5	–	Expectations weak, likely to weigh on demand hence.
	Fedspeak	–	–	–	Bostic and Logan.

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