WEEKLY ECONOMIC COMMENTARY

16 Oct 2023 | **Westpac Economics Team** | **westpac.co.nz/economics** | nzeconomics@westpac.co.nz

The people have spoken

Saturday's General Election saw the balance of power in New Zealand's political landscape shifting to the right, with the National party set to lead the next government. National will need the support of at least the ACT party, and potentially New Zealand First. However, it will take several weeks before the exact shape of the new Government will be known.

Saturday's New Zealand General Election saw a significant 19% swing to the right compared to the 2020 election. The key gainers were the centre-right parties of National and ACT won a combined 61 seats. On the centre-left, Labour lost heavily, and the Greens and Te Pāti Māori gained ground. Te Pāti Māori did particularly well in the electorates at Labour's expense.

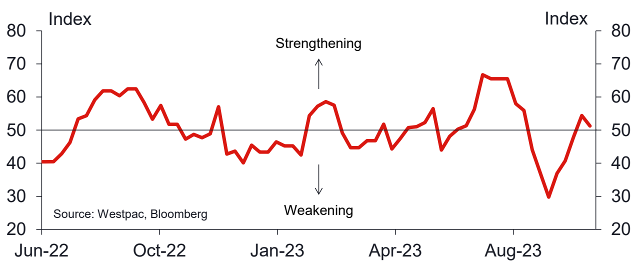
At present it seems likely that the next parliament will contain 122 seats – 121 allocated from the General Election and an additional 1 seat to be added following the Port Waikato by-election on 25 November (almost certain to be won by National). Importantly, once an estimated 567,000 special votes are counted, history suggests that National will drop 1-2 seats to the centre-left grouping. As a result, when all said and done, National and ACT are likely to finish with 60 or 61 seats in the new parliament – insufficient to command a majority. Hence the support of the NZ First Party will likely be needed to achieve a working majority.

The outcome of special votes and hence the official result will not be known until November 3 which will likely delay substantive coalition negotiations. Comments from the centre-right leaders suggest constructive coalition negotiations. National and ACT appear interested in dealing with NZ First, and NZ First have indicated an interest in helping National/ACT– although the details will matter.

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
17 Oct 23	CPI September quarter
1 Nov 23	Labour market statistics, September quarter
1 Nov 23	RBNZ Financial Stability Report
1 Nov 23	FOMC Meeting (Announced 2 Nov NZT)
3 Nov 23	Official results of General Election declared
7 Nov 23	RBA Board Meeting
9 Nov 23	Govt finances for the 3 months to September
29 Nov 23	RBNZ Monetary Policy Statement and OCR
5 Dec 23	RBA Board Meeting
13 Dec 23	FOMC Meeting (Announced 14 Dec NZT)
14 Dec 23	GDP September quarter
18 Dec 23	Half Year Economic and Fiscal Outlook (TBC)

Regardless of the exact form of the governing arrangement that transpires, we can assume that the two minor parties will want some policy "wins" to demonstrate to their respective supporters. There is a high degree of commonality among the right of centre parties around the ideas of:

- tax bracket adjustments (NZF favour a zero-rate bracket for incomes <$14,000).
- easing of tax obligations on property investors.
- reduced regulatory constraints on farmers.
- redistribution of carbon tax income to taxpayers.
- focusing the RBNZ on inflation control rather than its current dual mandate.

The key differences relate to the extent of spending cuts to be pursued (ACT and NZF generally favour greater government spending cuts) and the extent to which revenue from National's proposed tax on homes bought by foreigners can be relied on to fund tax cuts. NZF has been concerned that the PREFU fiscal projections are too optimistic (which we agree with) and that spending initiatives will need to be scaled back in coalition negotiations.

But NZ First has a few higher-cost spending initiatives in its manifesto that it may require to be funded to get their support. Should perhaps one of these need to be accommodated, then it is possible that an additional $1-5 bn of baseline spending cuts might be required over the period to 2026/27 (there are still unallocated operating allowances within National's fiscal plan, but utilising those would leave almost no room for additional spending initiatives over the next three years). The bottom line is more spending cuts may need to be agreed to get the coalition across the line.

We think that ACT's requirements may be easier for National to agree to and should result in a more contractionary stance relative to the PREFU/National's fiscal plan. Adding these requests to those of NZF probably will lead to a more contractionary fiscal stance than National indicated during its campaign.

There could be interest rate implications from a significant change in the fiscal stance but it's hard to see these materialising in the near term. Hence the RBNZ likely won't have much new information on the fiscal outlook at the time of its November 29 Monetary Policy Statement.

Financial market volatility may be slightly elevated as coalition negotiations evolve. However, centre-right's strong performance on the night will help to assuage some uncertainty.

Find **further coverage of our early take on the election result**, and the process that now lies ahead as National seeks to form a government, in our recent bulletin.

Migration inflation continuing to break records.

Since late last year, migrant arrivals have surged in New Zealand. Indeed, new estimates released this week suggests that the surge has been even larger than thought previously. In seasonally adjusted terms, on net, almost 10,000 people arrived in New Zealand in August. Moreover, arrivals in the year to July are around 7,000 higher than previously estimated. That's meant that the annual inflow grew to over 110,000 in the year to August – a new record and sufficient to lift annual population growth to a considerable 2.5%. To date the inflow seems to be helping to alleviate tightness in the labour market – helping to explain reports of record applications for the jobs on offer – while also underpinning a lift in house sales, prices and especially rents. How these competing influences on the economy and inflation continue to play out will have an important bearing on the required level of interest rates over the year ahead. Given the increasing size of this inflow, understanding the economic impact has certainly become more important than ever.

Despite these strong migrant inflows, the modest recovery in the housing market appears to have taken a breather in September. Our seasonal adjustment indicates that the number of house sales fell by around 3% during the month. As a result, sales were just 5% higher than a year earlier and remain low by historic standards. Meanwhile, we estimate that prices increased just 0.1% in the month – the smallest increase since April. We suspect that the proximity of the impending General Election will have dampened activity during the month, and this is also likely to be evident when October data are released next month. An informed read on housing market trends will probably not come available until the summer selling season kicks off in earnest once people return from the Christmas holiday period.

Sticky core.

The key risk event in New Zealand this week is release of the September quarter CPI. Following last week's softer-than-expected news regarding food prices and rents, we have slightly lowered our forecast and now expect the headline index to post a 1.9% lift in the quarter. That would see annual headline inflation edging gown down 0.2ppts to 5.8%.

The large quarterly increase that we foresee over the September quarter owes in part to a big seasonal lift in local council rates, while the annual increase in excise tax on alcohol will also take effect this quarter. Of course, the other special factor this quarter is a near 17% rebound in fuel prices. Importantly, reflecting our sense of ongoing momentum across the service sector, we expect that non-tradeable prices will rise by 1.7% during the quarter. While this would reduce the annual non-tradables inflation rate by 0.3ppts to 6.3%, this would leave it far above levels consistent with achieving the 1-3% inflation target.

Our forecast for headline inflation is 0.2ppts below the estimate published by the RBNZ in the August Monetary Policy Statement, which may reflect a decline in food prices since the RBNZ made its forecast. More importantly, our forecast for non-tradeable inflation is in line with that made by the RBNZ. A material upside surprise, especially to non-tradables inflation, would increase the likelihood that the RBNZ will feel compelled to lift the OCR further next month, especially coming after the upside surprise in the June quarter. On the other hand, the market may well breathe a sigh of relief should inflation print in line with our expectations or lower. We doubt that such a print would fully assuage the RBNZ's concerns about whether inflation will return to the target range quite as quickly as it had forecast in August, although it may lift the bar for a rate hike as soon as the November meeting. That said, there is plenty of additional economic data to be released in coming weeks, notably the September quarter labour market data on 1 November. And assuming a government is formed, the fiscal policy intentions of that government will also have a bearing on whether the RBNZ views further policy tightening to be warranted.

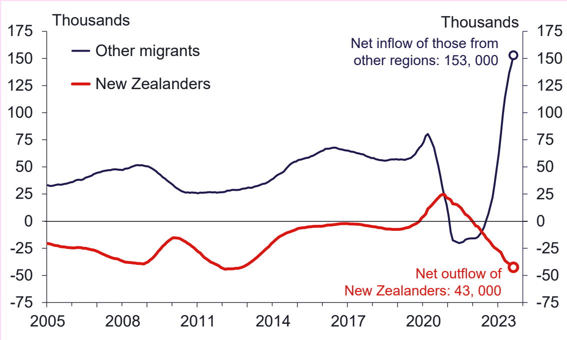
Darren Gibbs, Senior Economist

Chart of the week.

After delaying their travels during the pandemic, increasing numbers of New Zealanders are now travelling abroad. In fact, the net outflow of New Zealanders is now back at levels we last saw in 2012 (at which time outflows were picking up again following the Global Financial Crisis). And it's not just those in their 20s who are moving abroad, there's also been large numbers of those in their 30s and 40s travelling.

At the same time, arrivals into the country have risen to record levels, which has pushed population growth to 2.5%. The related increases in the labour force have meant that employers have found it easier to source workers, with many businesses reporting increases in job applicants. Even so, at this stage we aren't hearing that wage pressures are easing.

Difficulty finding skilled staff vs. wages growth

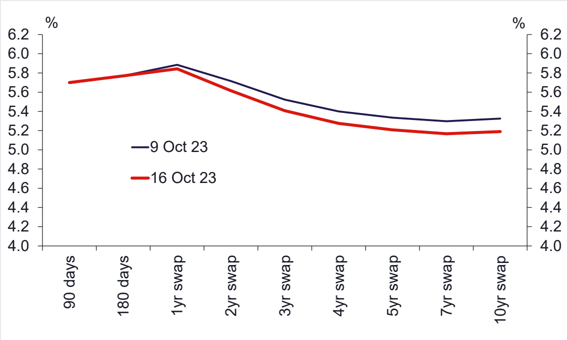


Fixed versus floating for mortgages.

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

The Middle East and crude oil.

Oil prices have lifted in light of developments in the Middle East, with Brent closing at almost $91/bbl on Friday as markets weighed the risk of bad news over the weekend. At this stage there has been no major escalation of the conflict across the region, but tensions are running high and the situation remains extremely fluid.

US.

Inflation data has retained a firm pulse with both the headline CPI and PPI printing slightly above expectations in August. The core CPI rose 0.3%, allowing annual inflation to fall to 4.1%. However, services prices ex-energy rose a very solid 0.6% during the month, led by higher prices for housing and accommodation. Meanwhile, the University of Michigan's survey pointed to a lift in consumers' year-ahead inflation expectations to 3.8%, underpinning a slump in the sentiment index to a 5-month low. Over the coming week Tuesday's retail sales and IP reports will cast more light on what its shaping up as a sturdy lift in GDP during Q3. This week will also bring housing-related data, the Philly Fed's factory survey, the Fed's Beige Book and a speech by Fed Chair Powell.

Asia-Pacific.

Last's week's Chinese inflation data was weaker than expected, with annual CPI inflation falling back to zero in September and producer prices down 2.5%. This week the focus will be on Wednesday's release of China's Q3 GDP report. We expect annual growth to slow to 4.4%, but monthly activity indicators for September, released the same day, will be scanned for any signs of a lift late in the quarter. Should today's PBOC MLF announcement point to further stimulus, this might indicate that disappointing data lie ahead. In Japan, Friday's CPI report will cast light on whether inflation is showing the persistence that will be required to prompt an eventual BoJ policy tightening. Following Tuesday's release of the minutes from this month's RBA meeting, attention in Australia will quickly turn to Thursday's labour force report. The unemployment rate is expected to remain at a low 3.7%, keeping the RBA in play should inflation data start to disappoint.

Europe.

Another relatively quiet week lies ahead in the euro area with the focus likely to be on sentiment-based data and the final CPI reading for September. In the UK the release of the latest labour market, retail spending and inflation reports will have an important bearing on whether the BoE resumes its tightening cycle early next month when it will also issue its November Monetary Policy Report.

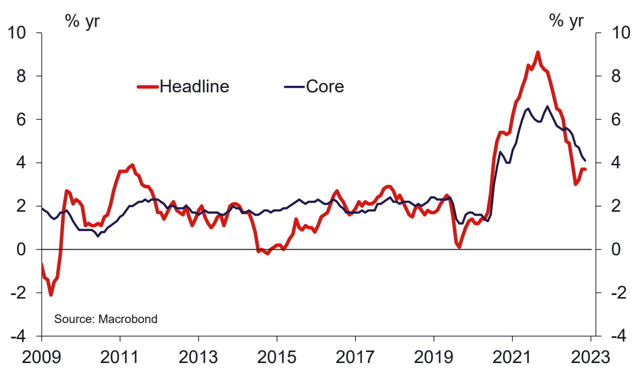
Trading partner real GDP (calendar years)

	Annual average % change			
	2021	2022	2023	2024
Australia	5.2	3.7	1.9	1.2
China	8.4	3.0	5.0	5.5
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	3.3	3.4
World	6.3	3.4	3.0	3.1

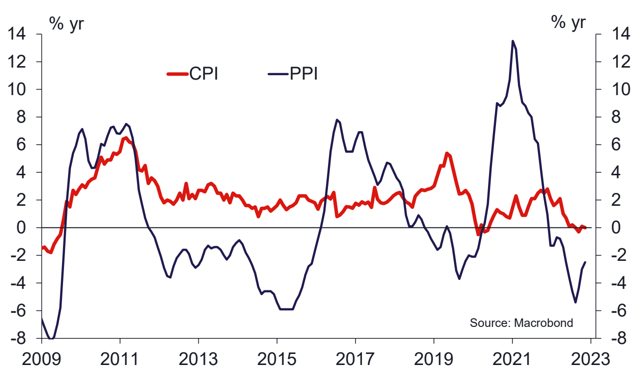
Australian & US interest rate outlook

	Latest	Dec-23	Jun-24	Dec-24
Australia				
Cash	4.10	4.10	4.10	3.60
90 Day BBSW	4.15	4.30	4.22	3.72
3 Year Swap	4.17	4.10	3.90	3.70
3 Year Bond	3.97	3.85	3.70	3.50
10 Year Bond	4.49	4.45	4.40	4.20
10 Year Spread to US (bps)	-18	-15	-20	-20
US				
Fed Funds	5.375	5.375	4.875	4.375
US 10 Year Bond	4.67	4.60	4.60	4.40

US CPI inflation



Chinese inflation



Financial markets wrap

Interest rates.

NZ swap rates ended last week lower, driven mainly by offshore yields. The 2yr swap fell from 5,71% to 5.65% via 5.60%, while the 5yr fell from 5.35% to 5.22%. Offshore yields remain buffeted by mixed central bank commentary and still firm inflation data.

Looking ahead, the main event which could ruffle NZ rates markets this week will be the NZ CPI data (Tuesday). Markets will focus on the core elements of the report, even if the headline rate softens slightly. Markets have priced only a 30% chance of an OCR hike at the next RBNZ meeting in November, so there is ample scope for a rise in yields if the data is read as stronger than expected.

Regarding NZ government bond yields, there may be a modest reaction (yields lower relative to swaps) on Monday reflecting the expected contraction in the fiscal stance, although markets will mostly reserve judgement until the new government's mini-budget, which may not be until December.

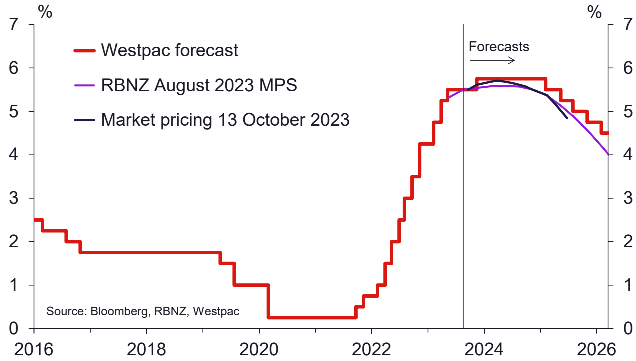
Foreign exchange.

Last week, NZD/USD rose to 0.6056 and then fell to end the week lower at 0.5885 – where it was two weeks ago. The moves mirrored the fall and rise in the US dollar. Improved global risk sentiment and some dovish Fedspeak were the initial drivers, with markets later reversing direction following firm US CPI data.

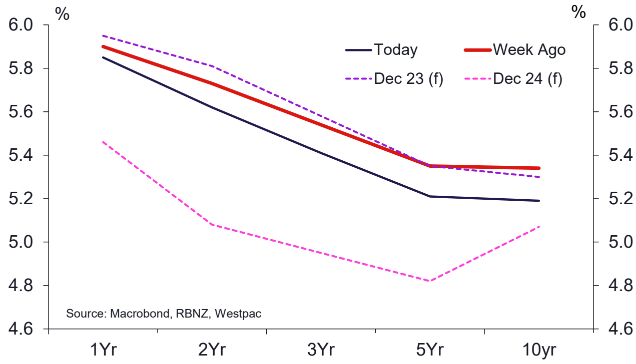
Looking ahead to this week, NZD/USD has a negative backdrop overall. We see potential for the early September low of 0.5860 to be tested. The strong US CPI data will resonate for some time, and the conflict involving Israel will impart a risk-averse tone – oil prices rose over 5% on Friday on concerns the conflict would escalate.

Partly offsetting the above will be the NZ election result, indicating a change of government to the centre-right bloc. The NZD typically rises slightly following election outcomes, reflecting the removal of uncertainty. That said, any positive effect will be more visible in crosses such as NZD/AUD, and we note that coalition formation could be some weeks away. Another potentially positive event will be the NZ CPI data on Tuesday if core inflation proves stronger than RBNZ has forecast. NZD/AUD is near a 5-month high, and could be attractive to importers seeking to hedge.

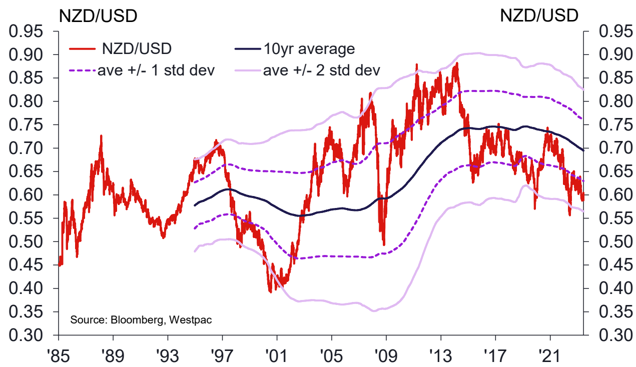
Official Cash Rate forecasts



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	0.592	0.586-0.635	0.555-0.743	0.656	0.62
AUD	0.938	0.916-0.939	0.873-0.992	0.934	0.89
EUR	0.563	0.543-0.570	0.517-0.637	0.587	0.55
GBP	0.487	0.464-0.492	0.464-0.551	0.511	0.48
JPY	88.4	86.0-89.8	61.3-89.8	77.1	84.9

The week ahead

NZ Q3 Consumer price inflation

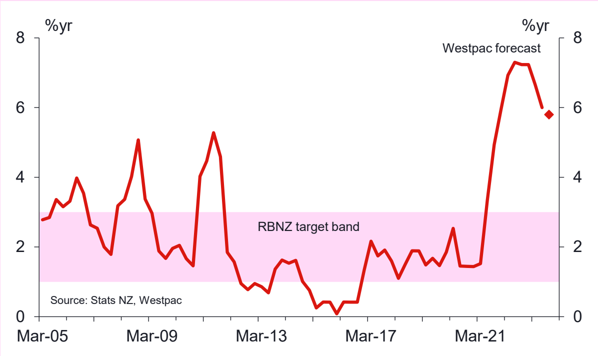
Oct 17, Quarterly – Last: +1.1%, Westpac: +1.9%
Annual – Last: +6.0%, Westpac: +5.8%

We estimate that New Zealand consumer prices rose by 1.9% in the September quarter. That would see annual inflation slip to 5.8%, down from 6.0% in the year to June.

The September quarter saw a sharp rise in fuel prices and other transport costs, as well as a large increase in local body rates and the annual increase in tobacco taxes. That's only partially offset by the softening in food prices in recent months.

Our forecast is a little lower than the RBNZ's projection (published back in August) reflecting a lower forecast for tradable prices. Even so, core inflation and non-tradables inflation are expected to remain red hot.

Consumers Price Index



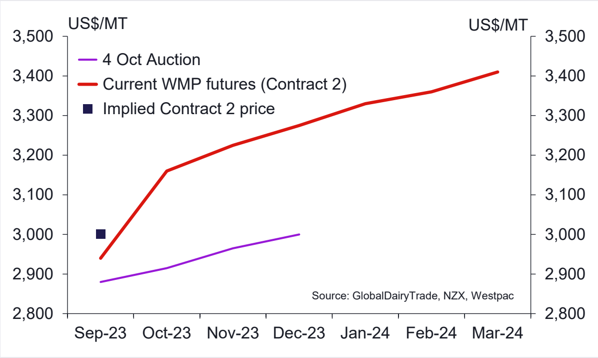
NZ GlobalDairyTrade auction, whole milk powder prices

Oct 18, Last: 4.8%, Westpac: 3.0%

We expect whole milk powder prices (WMP) to rise 3% at the upcoming auction. Note WMP prices jumped by 4.8% at the previous auction. Our pick is in line with the result at last week's mini (GDT pulse) auction, whereas the futures market is currently pointing to a rise of around 6%.

Market sentiment has turned over September and October. The likely drivers of the improvement are a lift in demand from Middle East buyers alongside increased drought risk (el Nino has been declared). From 2024, we anticipate that improving Chinese demand will gradually lift prices, although there is clear uncertainty as to the timing and magnitude of any further price recovery.

Whole milk powder prices

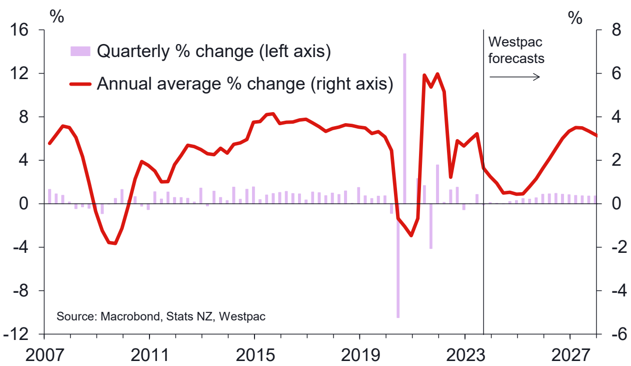


Economic and financial forecasts

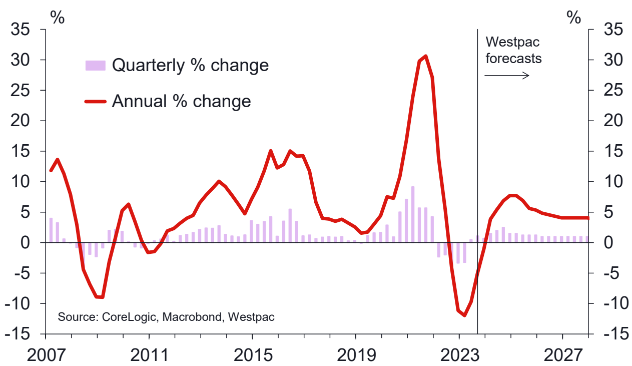
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.9	-0.1	0.1	0.0	6.0	2.7	1.3	0.4
Consumer price index	1.1	1.9	0.5	0.7	5.9	7.2	4.8	2.8
Employment change	1.0	0.4	0.0	0.0	3.3	1.7	2.5	-0.1
Unemployment rate	3.6	3.8	4.3	4.7	3.2	3.4	4.3	5.2
Labour cost index (all sectors)	1.1	1.1	1.0	0.8	2.6	4.1	4.2	3.3
Current account balance (% of GDP)	-7.5	-7.5	-7.0	-6.3	-5.8	-8.8	-7.0	-4.8
Terms of trade	0.4	-3.2	0.8	2.5	2.8	-4.2	-3.5	7.8
House price index	0.5	1.1	0.7	1.5	27.1	-11.2	-1.0	7.7

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	5.75	5.75	0.75	4.25	5.75	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	5.81	5.67	2.08	5.10	5.81	5.08
5 year swap	4.44	4.90	5.35	5.22	2.46	4.67	5.35	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	69.9	74.3	70.8	70.3	68.6
NZD/USD	0.62	0.61	0.61	0.61	0.70	0.60	0.61	0.62
NZD/AUD	0.93	0.92	0.92	0.92	0.95	0.92	0.92	0.89
NZD/EUR	0.57	0.56	0.55	0.55	0.61	0.59	0.55	0.55
NZD/GBP	0.49	0.48	0.48	0.48	0.52	0.51	0.48	0.48

GDP growth

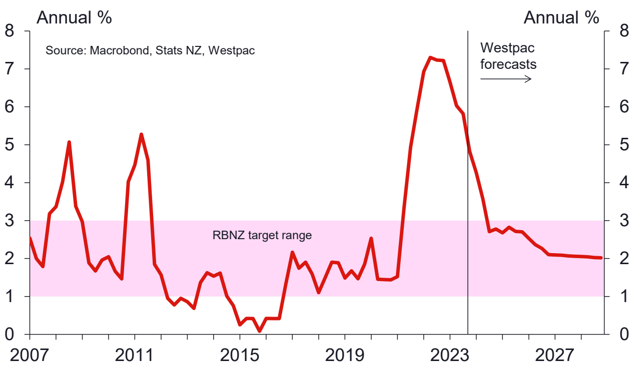


House prices



Employment and wage growth

Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 16					
NZ	Sep BusinessNZ PSI	47.1	–	–	Set to remain low due to mounting financial pressures.
Aus	RBA Assist' Governor (Financial Mkts)	–	–	–	Jones, speaking at AFR Cryptocurrency Summit.
Jpn	Aug industrial production	0.0%	–	–	Final estimate.
Eur	Aug trade balance €bn	2.9	–	–	Choppy profile highlights risks to external demand.
US	Oct Fed Empire state index	1.9	–5.0	–	Growing optimism over six-month demand outlook.
	Fedspeak	–	–	–	Harker.
Tue 17					
NZ	Q3 CPI %qtr	1.1%	1.9%	1.9%	High fuel prices partially offset by lower food prices.
	Q3 CPI %yr	6.0%	5.9%	5.8%	Core and domestic inflation still red hot.
Aus	RBA Minutes	–	–	–	More colour around the Board's views on risks.
Eur	Oct ZEW survey of expectations	–8.9	–	–	Tracking sideways, signalling weak momentum.
UK	Aug ILO unemployment rate	4.3%	4.3%	–	Rise in labour supply driving the lift in unemployment.
	Aug average weekly earnings %yr	8.5%	7.8%	–	Sustained lift in wage inflation of most concern for BoE.
US	Sep retail sales	0.6%	0.3%	–	Excluding vehicle sales and gasoline, spending soft.
	Sep industrial production	0.4%	–0.1%	–	Solid performance over the last two months.
	Aug business inventories	0.0%	0.3%	–	Broadly flat so far this year upon weakness in wholesale.
	Oct NAHB housing market index	45	45	–	Pessimism re-emerging as financial tightening impacts.
	Federal Reserve Beige Book	–	–	–	Update on economic conditions across the regions.
	Fedspeak	–	–	–	Williams, Barkin, Harker.
Wed 18					
NZ	GlobalDairyTrade auction (WMP)	4.8%	–	3.0%	Global dairy prices have turned after a sustained weak run.
Aus	RBA Governor Bullock	–	–	–	Speaking at AFSA Annual Summit Panel.
	RBA Head of International Dept.	0.0%	–	–	Smith, speaking at CFA Societies Conference.
	Sep Westpac–MI Leading Index	–0.50%	–	–	Pointing to growth remaining well below trend in early 2024.
Chn	Q3 GDP %yr	6.3%	4.5%	4.4%	Emerging signs of promise as households' precautionary...
	Sep retail sales ytd %yr	7.0%	6.7%	–	... savings ease and credit growth picks up modestly...
	Sep industrial production ytd %yr	3.9%	3.9%	–	... but headwinds remain, requiring further policy support...
	Sep fixed asset investment ytd %yr	3.2%	3.2%	–	... in the interim and robust investment in the medium-term.
Eur	Sep CPI %yr	4.3%	–	–	Final estimate.
UK	Sep CPI %yr	6.7%	6.2%	–	Services beginning to moderate from an elevated level.
US	Sep building permits	6.8%	–5.9%	–	Showing signs of promise as uptrend sustains momentum...
	Sep housing starts	–11.3%	8.5%	–	... only a partial carry-over to housing starts however.
Thu 19					
Aus	Sep employment change	64.9k	+20k	+20k	Labour market is at a turning point as employment growth...
	Sep unemployment rate	3.7%	3.7%	3.7%	... holds modestly below trend and U/E holds off its lows.
US	Initial jobless claims	209k	–	–	Will remain at low levels, for now.
	Oct Phily Fed index	–13.5	–6.4	–	Generally pointing to subdued conditions, albeit volatile.
	Sep existing home sales	–0.7%	–3.5%	–	Supply constraints and high rates weighing on sales activity.
	Sep leading index	–0.4%	–	–	Activity to slow ahead but not halt.
	FOMC Chair Powell	–	–	–	Speaking at Economic Club of New York.
	Fedspeak	–	–	–	Goolsbee, Bostic, Harker.
Fri 20					
NZ	Sep trade balance $mn	–2291	–	–2350	Earlier weakness in dairy prices leading to wider deficit.
Jpn	Sep CPI %yr	3.2%	3.0%	–	Falling energy prices are a key support.
UK	Oct GfK consumer sentiment	–21	–	–	Confidence recovering as inflation moderates and wages lift...
	Sep retail sales	0.4%	–	–	... pass-though to consumer spending will be limited for now.
US	Fedspeak	–	–	–	Logan, Harker.

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