



WEEKLY ECONOMIC COMMENTARY

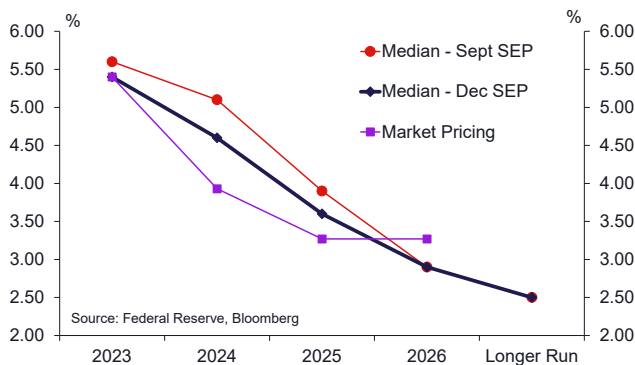


18 Dec 2023 | Westpac Economics Team | westpac.co.nz/economics | nzeconomics@westpac.co.nz

No further RBNZ tightening looks likely

Last week did not disappoint in terms of the importance of the data, both locally and internationally. For a while, markets have been speculating that central banks globally might shift tack towards interest rate cuts in 2024. This speculation reached a crescendo this week with the United States Federal Reserve indicating that US rates have likely reached their peak and that 75bps of cuts are possible in 2024. More broadly, there is a growing sense globally that central banks are done with rate rises and that interest rate reductions are coming – perhaps relatively soon.

FOMC interest rate expectations

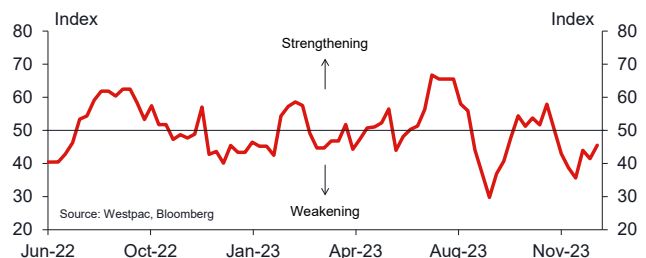


Locally, we saw data on elements of the Consumers Price Index and GDP which pushed in the same direction – i.e., towards expectations of weaker inflation pressures both now and over the medium term. This data suggests to us that the further 25bp increase in the OCR that we had expected to be delivered at the time of the February Monetary Policy Statement (MPS) is now much less likely, and instead it's more likely we see the OCR remain at 5.5% for 2024. As we **discussed in our review**, the GDP data tell us that the economy is in a much weaker position than we (and even more so, the RBNZ) thought even a few weeks ago. The implication for the RBNZ seems clear as

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



Happy holidays!

This is our last Weekly Economic Commentary of 2023. We'd like to say thank you to all our readers, and wish you all a Merry Christmas and a happy New Year.



The Weekly Economic Commentary will resume on 22 January 2024.

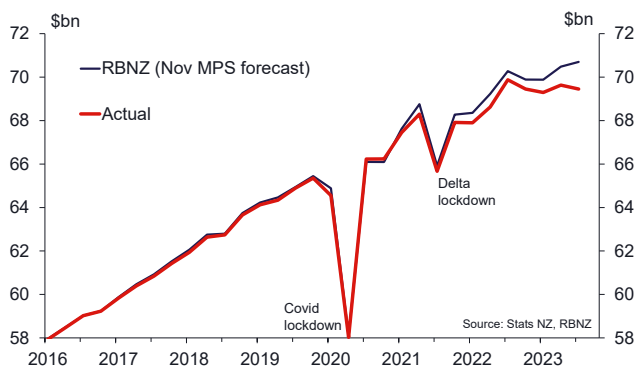
Westpac Economics Team

the new data will tell them that the more positive output gap, they included in their November 2023 MPS forecasts has been revised away. And with those revisions, much of the upward pressure on medium term inflation pressures and the need for a higher OCR will have been reversed.

We think it's likely, absent any further surprises, that the RBNZ will revert to something like their August 2023 MPS view that the OCR will remain at 5.5% until the latter part of 2024. We continue to see them as remaining much more cautious than markets on the prospects for lower rates. While the recent data provides a decent basis for revising down forecasts of inflation this is not the same as being confident those forecasts will be borne out. The RBNZ's new Remit requires a sole focus on inflation, and we are sure that they will need to be confident they can hit 2% CPI inflation in the second half of 2025 and meet the new Remit. All going well, we can see a path to where they get that confidence by the time of the August 2024 MPS – but there is a lot of water to go under the bridge before that happens. We think the **analysis in our recent note** remains relevant. We continue to see the strongest case for a gradual reduction in the OCR from the beginning of 2025.

Turning to the details on last week's data, the key Q3 GDP report showed that while we had expected a modest contraction in GDP in the quarter, and downward revisions to earlier quarters, the scale of both the contraction and revisions was greater than we had expected. GDP fell 0.3% in Q3 – a sharp contrast to the 0.3% increase that the RBNZ had forecast – and growth in the June quarter was revised down by 0.4ppts to 0.5%. Moreover, downward revisions to growth in earlier quarters means that the level of GDP in the September quarter was 1.8ppts lower than the RBNZ had estimated in the November MPS. As noted above, some of this difference is likely to flow through to the RBNZ's estimate of the output gap, leading the Bank to estimate less inflationary pressure than was previously the case (essentially reversing the hawkish revision made in the November MPS).

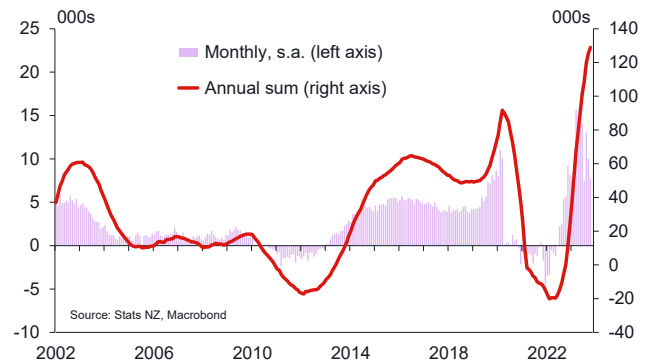
Production-based GDP



Other data was more mixed. On the strong side, another large net migrant inflow in October, and further upward

revisions to earlier months, lifted annual growth to a fresh record high of almost 129,000. This growth is expected to support stronger GDP outcomes over the coming year, not least through its impact on activity and prices in the housing market. Housing data showed house sales and prices rose modestly November and generally still look to suffering from their post-election malaise.

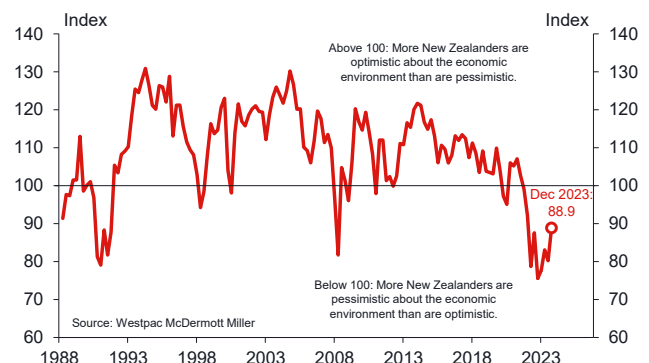
NZ net migrant inflows continue to set a record high



Less positively, short-term overseas visitor arrivals took a backward step in October, declining 8% to just 80% of the pre-pandemic level seen in October 2019. The BusinessNZ manufacturing PMI, which accurately signalled the weakness in the manufacturing sector seen in the Q3 GDP report, improved from an upwardly revised 42.9 to 46.7 in November. However, the index has remained below the key 50 level for a ninth consecutive month, with the new orders and employment indexes also remaining in contractionary territory.

The monthly CPI indicators for November pointed to further downside risk to the near-term outlook, mostly due to weaker than expected news regarding airfares. As a result, we revised down our Q4 CPI forecast to 0.3%, which would lower annual inflation dropping from 5.6% in the September quarter to 4.5% at the end of 2023 – 0.5ppts below the forecast made by the RBNZ in the November MPS. We have also modestly revised down our forecast for the key non-tradables component of the CPI by 0.1ppts to 0.7% for the quarter – 0.2ppts below the RBNZ's November forecast.

Consumer Confidence



Finally, more positively, Westpac's long running Consumer Confidence Index picked up in December, rising 8.7 points to 88.9. The survey showed households less pessimistic about the economic outlook – perhaps related to easing inflation and future tax cuts with the new government. The increase in confidence is very measured however and is coming from very low levels.

This week, the key focus will be the government's Half Yearly Economic and Fiscal Update (HYEFU). We are not expecting to see much detail on the government's fiscal plan, but it was interesting to see the government take the tough decision to cancel the Interislander ferry upgrade due to significant cost over-runs. This might suggest that any increased net spending pressures may be well contained – although comments from the Prime Minister and Minister of Finance seems to point to a weaker set of fiscal accounts than were presented in PREFU. Hence the government may make some broad assumptions that further savings will be found in future years to offset the weakness. The May Budget will have the detail here.

Kelly Eckhold, Chief Economist

Key data and event outlook

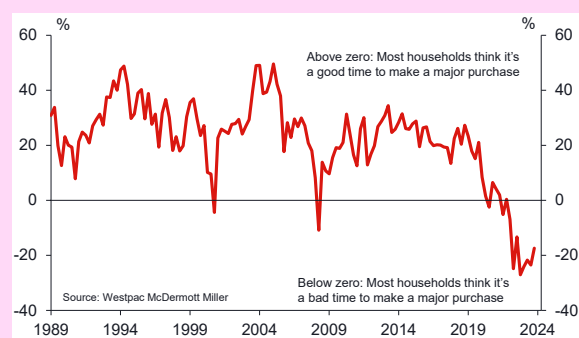
Date	Event
20 Dec 23	Half Year Economic and Fiscal Outlook
16 Jan 24	QSBO Business Survey, December quarter
18 Jan 24	Selected price indexes, December
24 Jan 24	NZ CPI, December quarter
31 Jan 24	FOMC Meeting (Announced 1 Feb NZT)
6 Feb 24	RBA Monetary Policy Decision and SMP
7 Feb 24	NZ labour market statistics, December quarter
14 Feb 24	Selected price indexes, January
28 Feb 24	RBNZ Monetary Policy Statement and OCR
13 Mar 24	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

Chart of the week.

While still low, consumer confidence picked up in our latest Westpac McDermott Miller Consumer Confidence survey, rising 8.7 points to 88.9 in December. Increasing numbers of New Zealanders expect the economy to strengthen over the coming year. They also expect their personal finances will improve over 2024.

But while confidence has been pushing higher, it's still low and households remain cautious about their spending. The number of households who think it's a good time to make a major purchase is still lingering close to all-time lows. Similarly, households have told us that they've been cutting back their spending on leisure activities. That's consistent with anecdotes that we've been hearing from retailers about subdued spending going into the Christmas shopping season.

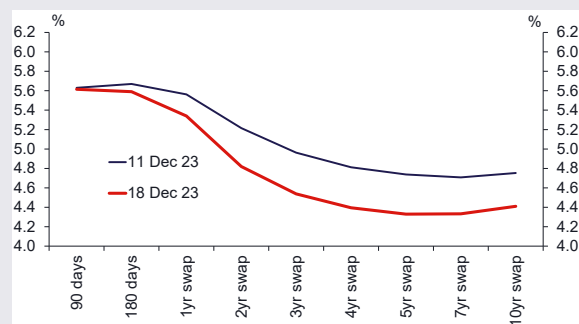
Is this a good or bad time to buy a major household item?



Fixed versus floating for mortgages.

At current rates, there is some value in fixing for two or three years as rates are lower and certainty can be obtained. However, as markets now expect potentially significant rate cuts from the RBNZ later in 2024, fixing for a shorter term would provide borrowers with greater flexibility if interest rates do in fact fall.

NZ interest rates



Global wrap

North America.

The FOMC delivered the expected on-hold decision at its last meeting of the year. However, the details of the policy statement were dovish. The dot plot showed that no participants expect further rate hikes, and the median expected fed funds rate at end 2024 was revised down 50bp to 4.6% (implying 75bps of cuts over the coming year). Expectations for the funds rate in 2025 were also revised down. The FOMC also revised down their inflation forecasts. The news prompted a sharp drop in US Treasury yields and the US dollar. Turning to other recent US data, retail sales were a little stronger than expected in November, rising 0.3%. November inflation was in line with expectations, rising 0.1% over the month to be up 3.1% for the year. And industrial production was softer than anticipated, rising just 0.2%. Over the coming week there will be a range of updates on the US housing market. We'll also get the November figures for personal income and spending, as well as the PCE deflator on Friday.

Asia-Pacific.

Australia recorded strong employment growth of 61.5k in November, with employment up 3.2% over the past year. However, with labour force participation rising to a record high, the unemployment rate has lifted to 3.9%, from 3.8% previously. In the business sector, while the latest NAB survey pointed to firm trading conditions, weak business confidence has seen plans for capital expenditure being dialled back. Tuesday's release of the RBA minutes will be watched for further colour on how the Board sees the risks for activity and inflation. In China, industrial production rose 6.6% in the year to December, beating expectations. However, retail sales rose by less than expected, reinforcing concerns about the momentum in demand. The PBoC will review rates on Wednesday. The Bank of Japan also meets this week on Tuesday.

Other.

European central banks have maintained a hawkish stance. While the ECB delivered the expected 'on hold' decision, Lagarde noted that there was no discussion of rate cuts and highlighted lingering concerns about inflation. Across the Channel, the BOE voted 6-to-3 to hold the Bank Rate, with the dissenters voting for another 25bp hike and the accompanying statement noting policy will need to remain restrictive to return inflation to target. The SNB also remained on hold, but noted it was prepared to hike again if necessary. Finally, the Norges Bank surprised with a 25bp hike noting that while inflation is cooling, it remains too high. This week's data calendar includes updates on the European and UK CPIs.

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	4.35	4.47	3.97	3.30
3 Year Swap	3.95	4.10	4.00	3.50
3 Year Bond	3.79	3.90	3.80	3.30
10 Year Bond	4.14	4.30	4.15	4.00
10 Year Spread to US (bps)	20	10	5	0
US				
Fed Funds	5.375	4.875	4.375	3.375
US 10 Year Bond	3.95	4.20	4.10	4.00

US and NZ 10 year government bond yields



Australian labour market



Financial markets wrap

Interest rates.

The rally in interest rate markets gathered pace last week. In part, this was driven by the more dovish than expected Fed. Markets had expected some push back against pricing of rate cuts next year, but instead the Fed lowered its end-24 fed funds forecast and its forecasts for core inflation. So, the market closed last week with 140bps of Fed easing priced in for 2024, while the 10Y UST closed at 3.91% - down 31bps for the week and back at levels last seen in July. Domestic markets also reacted to the softer Selected Price Indices and Q3 GDP (see main discussion). The market is now pricing almost 100bps of RBNZ easing next year, including almost a full easing at the May MPS meeting. As a result, 2yr swap closed last week at 4.82% - down 38bps for the week and the lowest weekly close since March.

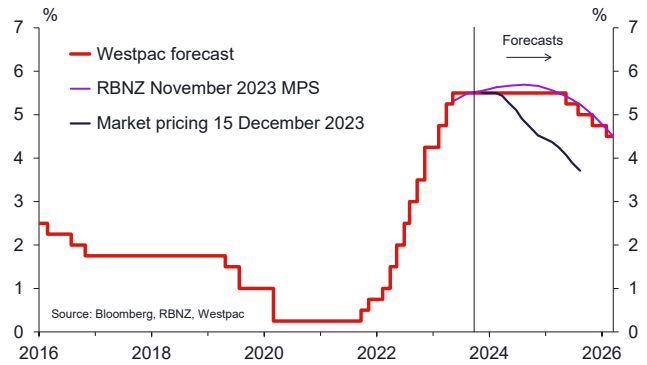
Locally, the focus this week will be Wednesday's fiscal update. We do not anticipate a material change in this year's NZGB borrowing programme, while the forecasts for subsequent years might be regarded as work in progress ahead of next year's full Budget. A focus will be whether any indication is given of the timing of the next NZGB syndication. While we no longer expect the RBNZ to hike rates next year, we continue to think that market pricing of future easing is too aggressive and so short maturity rates appear too low.

Foreign exchange.

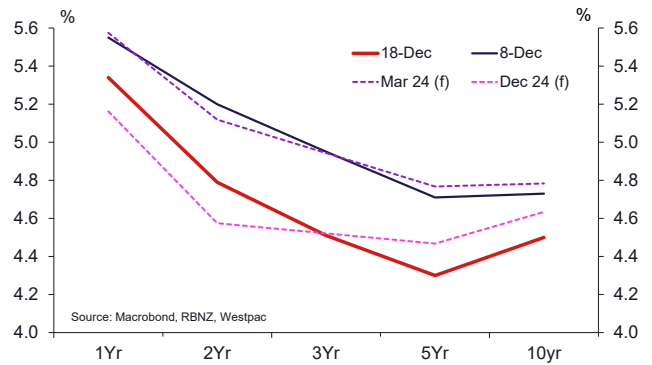
The US dollar tumbled last week, with DXY falling to a four-month low before rebounding slightly on Friday. The catalyst was the Fed's more dovish than expected forecasts and commentary. NZD/USD was a beneficiary of that USD weakness, trading as high as 0.6249 before closing the week just above 0.62 as soft local economic data took some of the gloss off the Kiwi. We continue to expect the US dollar to weaken during 2024 if the US is unable to deliver economic outperformance. As a result, there is the potential for NZD/USD to extend to 0.6300 and above during the next few months, especially if RBNZ significantly lags the Fed's policy easing cycle as we expect. In the interim, any dips to the 0.5900-0.6000 area would be worthy of consideration by exporters looking to hedge receipts.

The Kiwi has lost a modest amount of ground against some of the major crosses, including the AUD and JPY. This reflects the contrast provided by weak local GDP data, against solid jobs data in Australia and an upbeat Tankan survey in Japan. Tomorrow's BoJ policy meeting will be a key focus for the yen this week.

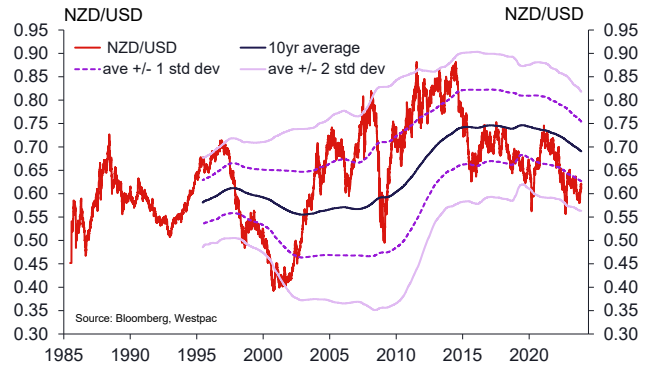
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mnt 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

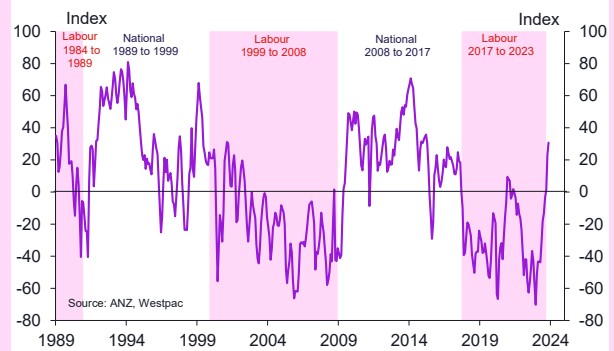
NZ Nov ANZBO business confidence

Nov 19, Last: 30.8

Business confidence took another step higher in November's ANZ Business Outlook survey. The headline confidence index rose to 30.8 in November, taking it back to levels we last saw in 2015. Business confidence has tended to be much stronger when New Zealand has a centre-right government (whose policies tend to be more business friendly), so this post-election bounce was expected.

With the election behind us and signs that economic activity is cooling, we'll be watching for signs of a softening in the survey's gauges of trading activity, hiring and investment spending. We'll also watch to see if the easing in inflation pressures seen over the past few months will continue.

Business confidence



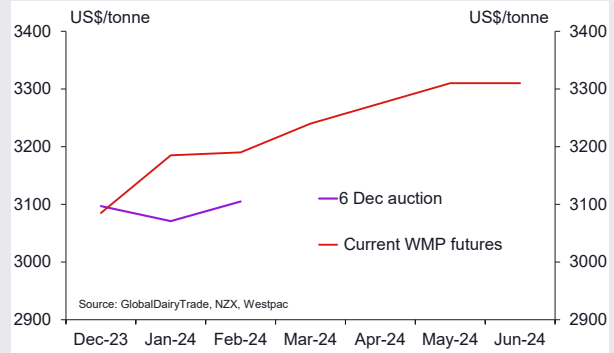
NZ GlobalDairy Trade auction, whole milk powder prices

Dec 20, Last: 2.1%, Westpac: 2.5%

We expect whole milk powder prices (WMP) to rise by 2.5% at the upcoming auction. WMP prices had risen 2.1% at the previous GDT auction. Our prediction is based on a 1.9% lift in WMP prices at the recent mini auction when compared to the previous GDT auction and a 3.1% increase in prices as indicated by the futures market.

Global dairy prices have edged higher recently following on from a sluggish November. Key factors are likely to be a strengthening in demand from the Middle East and growth from Southeast Asia, with tentative signs of an improvement in Chinese demand also a factor. Looking forward, all eyes will be on the key Chinese market to see whether demand can build on recent gains in 2024.

Whole milk powder prices



NZ Half-Year Economic and Fiscal Update

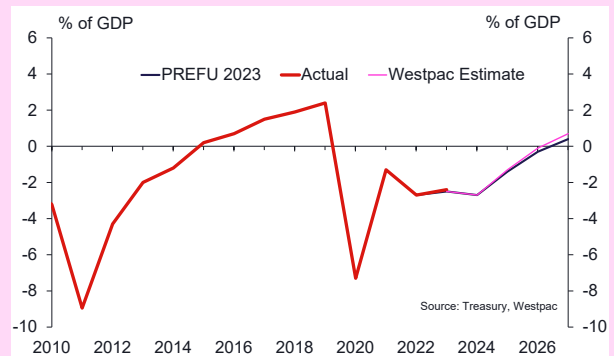
Dec 20

We expect little change in the Government's books at the Half-Year Update. The OBEGAL and bond programme forecasts will be broadly unchanged.

Also, we don't expect many fresh policy announcements on top of what has been agreed and announced by the Coalition Government.

That said, we expect the Minister Finance to signal a clear commitment to fiscal discipline, with more detail to follow in Budget 2024.

Operating balance (OBEGAL) as a % of GDP

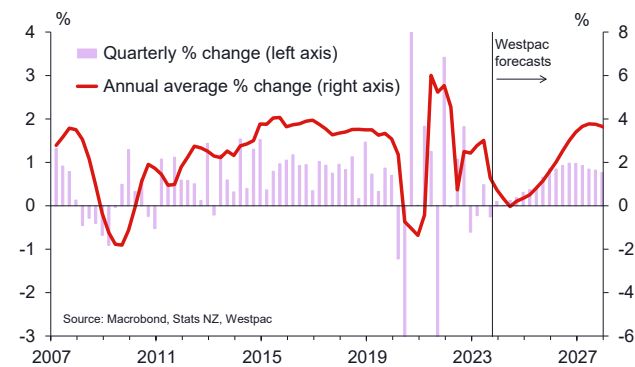


Economic and financial forecasts

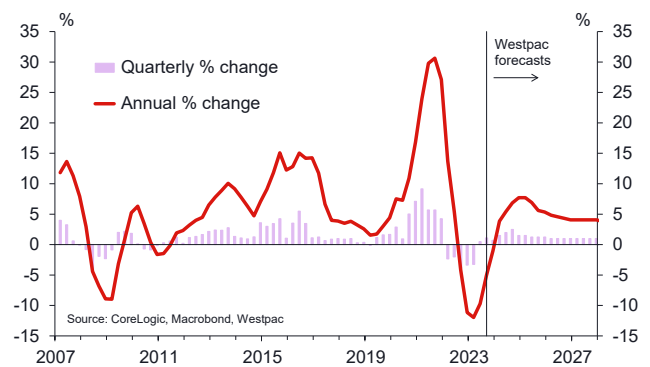
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.5	-0.3	0.1	0.0	5.5	2.4	0.7	0.3
Consumer price index	1.1	1.8	0.3	0.9	5.9	7.2	4.5	3.1
Employment change	1.0	-0.2	0.1	0.1	3.3	1.7	2.0	0.2
Unemployment rate	3.6	3.9	4.3	4.5	3.2	3.4	4.3	5.2
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	0.3	-0.6	-1.7	2.6	2.8	-4.2	-3.5	9.6
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	5.50	0.75	4.25	5.50	5.50
90 day bank bill	5.62	5.66	5.60	5.60	0.82	4.26	5.60	5.60
2 year swap	5.18	5.53	5.06	5.12	2.08	5.10	5.06	4.58
5 year swap	4.44	4.90	4.57	4.77	2.46	4.67	4.57	4.47
10 year bond	4.27	4.87	4.75	4.90	2.39	4.31	4.75	4.75
TWI	70.9	70.6	71.1	71.0	74.3	70.8	71.1	69.6
NZD/USD	0.62	0.61	0.61	0.62	0.70	0.60	0.61	0.63
NZD/AUD	0.93	0.92	0.92	0.92	0.95	0.92	0.92	0.90
NZD/EUR	0.57	0.56	0.56	0.57	0.61	0.59	0.56	0.55
NZD/GBP	0.49	0.48	0.50	0.50	0.52	0.51	0.50	0.49

GDP growth



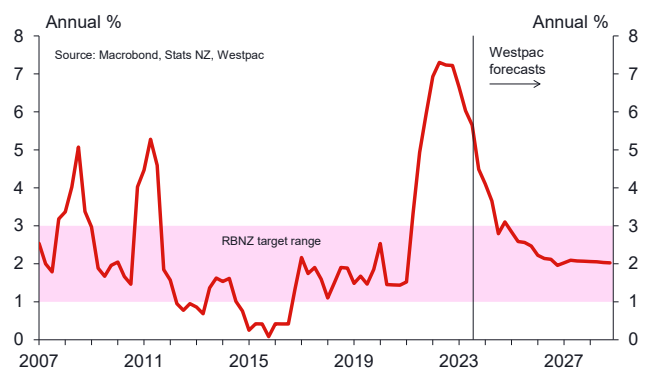
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Nov BusinessNZ PSI	48.9	-	-	Businesses have reported soft trading conditions.
US	Dec NAHB housing market index	34	38	-	Decline in term interest rates should aid housing in time.
Tue 19					
NZ	Nov trade balance \$mn	-1709	-	-	Exports increasing as imports cool.
	Dec ANZ business confidence	30.8	-	-	Confidence has lifted, but signs demand is cooling.
Aus	RBA Minutes	-	-	-	More colour around the Board's sensitivity to risks.
	Q4 ACCI-Westpac business survey	51.3	-	-	Conditions weakest in a decade (ex covid shock), & rising costs.
Jpn	BoJ policy decision	-0.10%	-0.10%	-0.10%	BoJ cautious on sustainability of CPI/wage growth.
Eur	Nov CPI %yr	2.4%	-	-	Final estimate.
US	Nov housing starts	1.9%	-0.9%	-	Additional capacity needed ...
	Nov building permits	1.8%	-2.5%	-	... but pipeline will take time to build.
	Fedspeak	-	-	-	Bostic.
Wed 20					
NZ	GlobalDairyTrade (WMP)	2.1%	-	2.5%	Dairy prices edge higher, but outlook depends on China
	Dec ANZ consumer confidence	91.9	-	-	Off its lows, but still weak.
	Half-Year Economic and Fiscal Update	-	-	-	OBEGAL and bond programme to be broadly unchanged.
Aus	Nov Westpac-MI Leading Index	-0.40%	-	-	Stuck below trend but may post an improvement.
Eur	Dec consumer confidence	-16.9	-	-	Easing inflation and policy pause should stabilise sentiment.
UK	Nov CPI %yr	4.6%	-	-	Services remains sticky; goods driving disinflation.
US	Nov existing home sales	-4.1%	-0.3%	-	Supply and demand are both negatives for market.
	Dec consumer confidence index	102.0	103.3	-	Sentiment fragile heading into Christmas period.
Thu 21					
US	Q3 GDP, annualised	5.2%	5.2%	5.2%	Final estimate.
	Dec Philly Fed index	-5.9	-3.0	-	Regional indicators suggest manufacturing sector...
	Dec Kansas City Fed index	-2	-	-	... is in a fragile state.
	Initial jobless claims	-	-	-	To remain at a low level for the foreseeable future.
	Nov leading index	-0.8%	-0.4%	-	Suggests growth is tracking at a below-trend pace.
Fri 22					
Aus	Nov private sector credit	0.3%	-	0.4%	Subdued growth - interest rates elevated, economy soft.
Jpn	Nov CPI %yr	3.3%	-	-	Tokyo CPI points to a loss of momentum in inflation.
UK	Nov retail sales	-0.3%	-	-	Discretionary spending to remain under pressure.
	Q3 GDP	0.0%	-	-	Final estimate.
US	Nov personal income	0.2%	0.4%	-	Wage growth still solid...
	Nov personal spending	0.2%	0.2%	-	... but real income growth limited.
	Nov PCE deflator	0.0%	0.0%	-	Inflation downtrend broadening; on track to return to target.
	Nov durable goods orders	-5.4%	2.4%	-	Headline orders volatile; core orders subdued.
	Nov new home sales	-5.6%	0.9%	-	Affordability to remain a significant headwind.
	Dec Uni. of Michigan sentiment	69.4	69.4	-	Final estimate.

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