



WEEKLY ECONOMIC COMMENTARY



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

Inflation down, but not out

While inflation in New Zealand is cooling, the big uncertainty for the RBNZ is how quickly it will drop back. Economic news over the past week will have made the RBNZ more comfortable that domestic demand is cooling and that inflation pressures are easing. This raises the hurdle to the RBNZ delivering the 25bp rate hike that we have pencilled in for the February meeting.

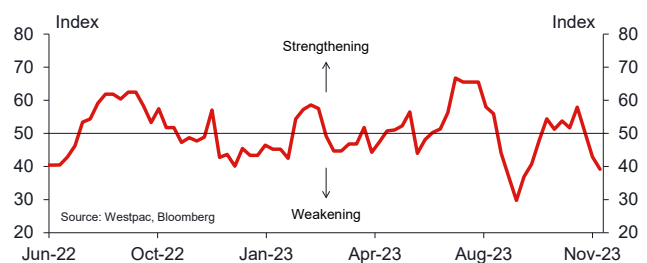
Last week we revised down our forecast for December quarter inflation to +0.6% from +0.9% previously. That would result in the annual inflation rate falling from 5.6% in the year to September to 4.8% by the end of this year – lower than the RBNZ’s last published forecast of 5.2%. This revision follows the release of Stats NZ’s expanded monthly prices report. In addition to previously provided information on food prices and housing rents, Stats NZ now also provides monthly information on alcoholic beverages and tobacco, fuel prices, airfares and accommodation services. Combined the monthly information now provided accounts for around 45% of household spending. As a result, this data provides us with timely information about some of the items that often drive the quarter-to-quarter swings in the overall CPI.

The October price update pointed to softness in some key areas. Most notably, food prices (which account for around 20% of consumer spending) posted a larger than expected 0.9% fall over the month. We also saw sharp falls in airfares, with the cost of international flights down 9.4%, and domestic airfares down 7.5%. Those surprises were only partially offset by an unexpected rise in tobacco prices. Most of the softness in inflation relates to the prices for tradable goods (most of which are imported) which have been weaker than both we and the RBNZ had expected over the past year. In part, that’s because global prices for many traded goods have been softening as pandemic-related disruptions to supply chains have eased. Tighter monetary policy will also be weighing on demand for imported goods

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

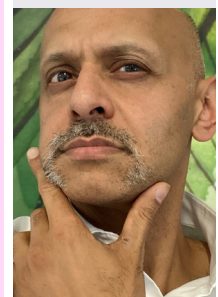


Movember

This month, the Westpac Economics and Strategy Team are growing moustaches in honour of Movember.

If you'd like to support the team, or if you'd like to learn more about the men's health issues that Movember supports, please follow the link below. Your support is greatly appreciated. All donations go directly to the Movember Foundation.

Mo' cam



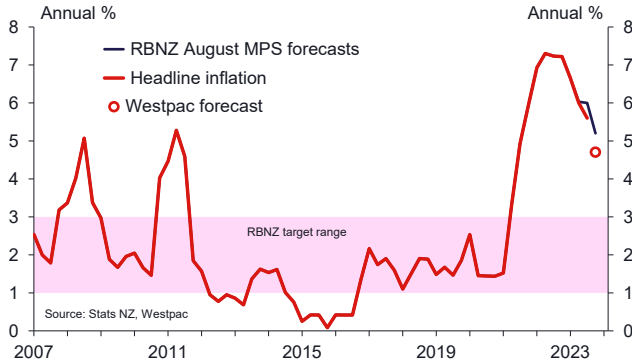
Satish Ranchhod
Senior Economist

Movember moustache progress day 20

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locally. The decline in airfares reflects rising capacity and competition in the sector as demand for travel has begun to normalise. This was to be expected, but the exact timing of these price declines was uncertain.

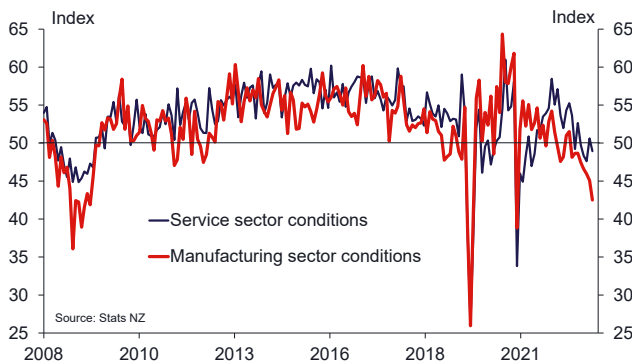
Inflation forecasts



By contrast, non-tradables inflation – mainly domestic services that are closely tied to the strength of domestic demand – has continued at a brisk pace two years after the RBNZ first raised the OCR. That’s consistent with the ongoing tightness in the labour market and strength in wage growth, which has only shown signs of peaking quite recently. Importantly, strength in domestic prices means that overall inflation is easing only gradually, even as import prices fall. We expect the CPI excluding food and fuel will rise by 5.2% in the year to December. That’s more moderate than the 6.1% rise we saw last quarter, but still highly elevated.

That said, there are signs that pressures in the New Zealand economy are cooling further, with recent data pointing to a weakening in domestic economic conditions. Notably, the latest retail spending report revealed that spending levels fell 0.7% in October, following a similar decline in the previous month (that’s despite continued increases in consumer prices and extraordinarily strong population growth). Meanwhile, in the business sector both the headline PMI and PSI indexes have dropped to contractionary levels, with the details pointing to weakness in both forward orders and hiring.

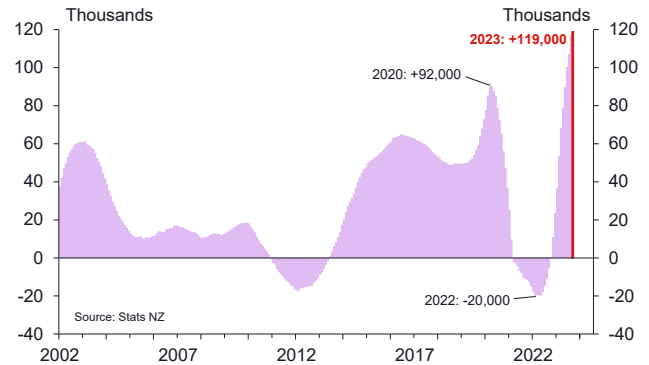
BusinessNZ PMI and PSI



Recent economic news hasn’t all been in one direction, however. Net migration has continued to break records,

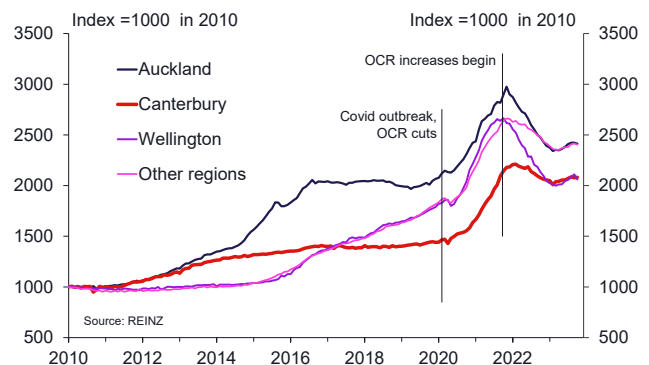
with arrivals into the country exceeding departures by nearly 119,000 in the year to September. And it’s likely that migration will continue to rise further for a few months yet – perhaps into the 125,000-130,000 range. Those large inflows are providing a degree of support under spending and are boosting demand for housing (especially rentals). However, at least at present, that hasn’t been sufficient to offset the dampening effects of high inflation and high interest rates.

Net migration



Recent news on the housing market has been mixed. In broad terms, prices are tracking sideways. Similarly, while sales are off their earlier lows, as yet they aren’t displaying a strong upward trend. In part, this ‘pause’ in the housing market may be related to the timing of October’s election, which may have seen some buyers sitting on the sidelines. In addition, the past month saw borrowing costs pushing higher, which will have dampened demand. We continue to expect a pick-up in the housing market over the coming year, supported by the cumulative impact of booming population growth and what are likely to be more investor-friendly policies from the incoming government. Even so, high interest rates will act as a constraint on house price growth over the coming year.

NZ’s housing market has stabilised, but not roaring away



Overall, the recent economic news on consumer prices will have left the RBNZ more comfortable that inflation pressures are continuing to ease. That reinforces our expectations that the OCR will be left on hold at the 29 November meeting (we will have more to say about our expectations for this meeting in our preview note

later this week). We currently still have a 25bp rate rise pencilled in for February, consistent with the ongoing strength in core inflation. However, the faster decline in headline inflation will help reduce the risk that inflation expectations become unanchored and so likely increases the already high hurdle for policy tightening. We'll review our profile for the OCR after digesting the messages in the RBNZ's policy statement next week.

The economic calendar over the coming week is fairly light. Highlights include Wednesday's GlobalDairyTrade auction (which we expect will show a rise in prices) and Friday's retail sales report, which we expect will confirm that spending was soft in the September quarter. We're also continuing to await the outcome of coalition negotiations and news on what policy trade-offs have been made by the members of the incoming government. Indications are that an agreement is now close at hand.

Satish Ranchhod, Senior Economist

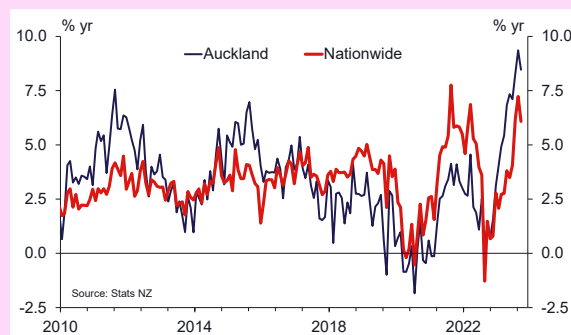
Key data and event outlook

Date	Event
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)
13 Dec 23	Selected price indexes, November
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
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
28 Feb 24	RBNZ Monetary Policy Statement and OCR

Chart of the week.

Population growth is surging on the back of record high levels of net migration. Although that's helping to support demand, strong financial headwinds mean that we're still left with a picture of subdued growth. However, one area where we are clearly seeing the impact of population inflows is the housing market. Although far from all migrants will buy a house, they still need somewhere to live. And that's seen rents rising rapidly, with nationwide rents up 6% over the past year. There have been especially large increases in larger centres like Auckland (up 8%) where most migrants settle. That's important for investors and supports our expectation for a pickup in the demand for rental investment properties over the next few years. We also expect the incoming government will introduce policies that will add to demand from investors (such as fully restoring interest deductibility).

New housing rents

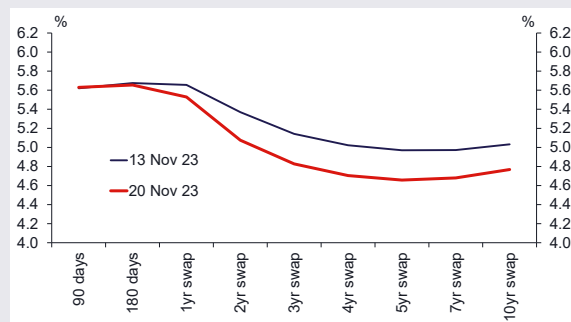


Fixed versus floating for mortgages.

The RBNZ has signalled that it expects to hold the cash rate at its current level of 5.50% for an extended period.

At current rates, we see value in fixing for two to three years. Shorter terms could be more expensive, but would provide borrowers with greater flexibility.

NZ interest rates



Global wrap

North America.

The past week was dominated initially by the US CPI report. With core inflation declining to a 2-year low of 4.0%, expectations regarding further Fed policy tightening were pared and bond yields fell very sharply as investors contemplated multiple policy easings next year. Despite a soft read on producer prices, markets retraced somewhat after retail sales proved a touch firmer than expected in October, albeit with annual growth slowing to 2.5% from 4.1% previously. However, softer IP, labour market and housing data sent yields to new lows late in the week. In other news, a government shutdown was again avoided after Congress passed another stopgap continuing resolution, which will fund operations until early in the New Year. The coming week is quiet, not least due to Thursday's Thanksgiving holiday, with the focus likely to be on housing and durable goods orders data, together with the latest set of FOMC minutes. In Canada, Tuesday's CPI report will take centre stage this week.

Asia-Pacific.

China's key activity indicators mostly outperformed expectations in October, with annual growth in retail sales rising to 7.5% - growth flattered by base effects - thanks in part to increased spending on communications equipment and home appliances. By contrast, Japan's GDP figures disappointed with a 0.5% contraction in Q3, led by weaker business capex and inventory building. And with consumer spending flat for the quarter, doubts remain whether the BoJ's much sought after 'virtuous cycle' from incomes to consumption is really taking hold. In Japan, attention this week will focus on Friday's CPI and flash PMI reports. In Australia, the labour market remained robust in October with employment rising by a further 0.4% and hours worked up 0.5% - results that may have been influenced by temporary hiring associated with the recent referendum. But with the labour force participation rate returning to a record high, the unemployment rate nudged up to 3.7%. This week the RBA will release the minutes from this month's Board meeting while Governor Bullock is also due to speak.

Europe.

The UK data were a mixed bag last week. The labour market was firmer than expected, with the unemployment rate unexpectedly steady at 4.2% in September. However, growth in wages did slow a little and annual CPI inflation eased to a lower than expected 4.6% (with core inflation falling to 5.7%). Looking ahead, Thursday's flash PMI reports for November will be a key focus in both the euro area and the UK. In addition, the UK government will release its Autumn Statement on Wednesday.

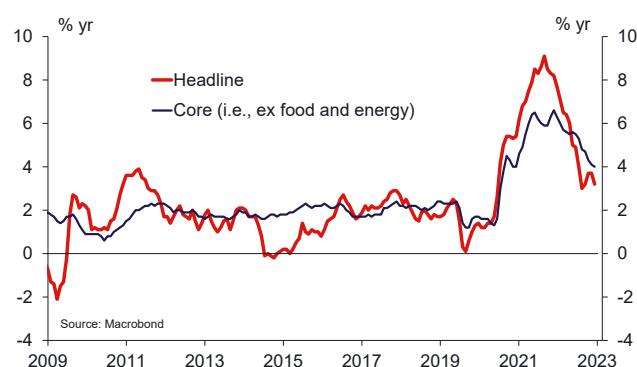
Trading partner real GDP (calendar years)

	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	2.4	1.5
Japan	2.1	1.1	1.8	1.1
East Asia ex China	4.3	4.5	3.4	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	3.1	3.1

Australian & US interest rate outlook

	Latest	Dec-23	Jun-24	Dec-24
Australia				
Cash	4.35	4.35	4.35	3.85
90 Day BBSW	4.32	4.55	4.47	3.97
3 Year Swap	4.27	4.50	4.30	4.10
3 Year Bond	4.07	4.30	4.10	3.90
10 Year Bond	4.45	4.70	4.50	4.30
10 Year Spread to US (bps)	1	-10	-10	-10
US				
Fed Funds	5.375	5.375	4.875	4.375
US 10 Year Bond	4.44	4.80	4.60	4.40

US CPI inflation



Japan GDP growth



Financial markets wrap

Interest rates.

NZ swap rates extended the six-week decline last week, with the 2yr swap now down a total of 80bp to Friday's low of 5.05% - a level last seen in May. The 10yr has fallen a total of 71bp to 4.74%. As has been the case recently, the catalysts have been both global and local. US rates fell sharply after softer CPI inflation data, while in NZ the data pulse has been softer (with the new monthly inflation indicator causing downward revisions to analysts' near-term inflation forecasts).

NZ markets continued to price no material chance of any further RBNZ rate hikes in this cycle. Rather, pricing for OCR cuts has been shifted earlier, with the first cut now seen in May 2024.

The NZ data calendar for the week ahead remains second-tier, with Q3 retail sales of some interest. It's a similar story in the US, which suggests any market movement is likely to be driven by sentiment. Investors remain assertive buyers of bonds and receivers of swap, so that further downside in rates is possible, although we'd caution that the short end looks technically stretched and in need of breather.

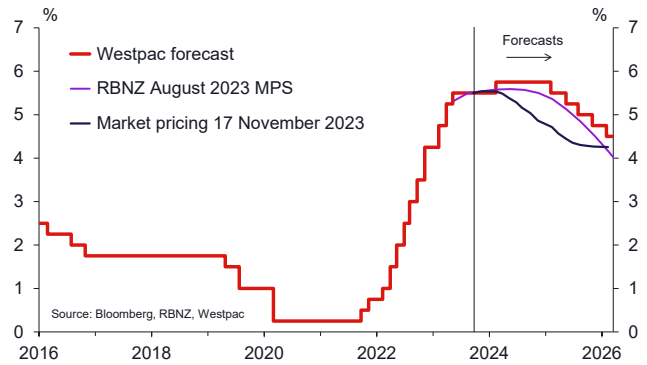
Foreign exchange.

NZD/USD was stronger overall in a choppy week. The main action was on Tuesday and Wednesday, when the weaker US CPI data caused a very sharp fall in the US dollar and, in turn, a sharp reversal in NZD/USD from 0.5864 to 0.6054.

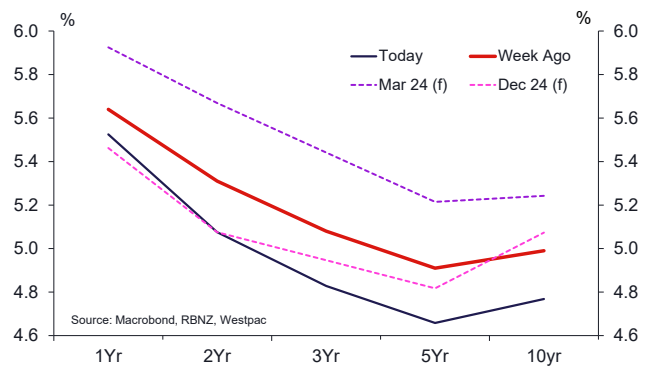
The USD remains vulnerable to further downside during the week ahead, the cumulative effect of softer economic data over the past month likely to weigh for some time. There's potential for last week's 0.6054 high to be retested and broken. Longer term, our forecast for NZD/USD in 2024 is higher, to 0.6200. That is based on an expectation the US dollar will weaken if previous US economic outperformance fails to repeat.

NZD/AUD did fall slightly last week, to around 0.9200, but it should be even lower given markets expect the RBA to deliver one more rate hike. We suspect geopolitics and China's economic fragility are weighing on AUD sentiment. Should an improvement in sentiment eventuate, we'd be looking for 0.9100 by year end.

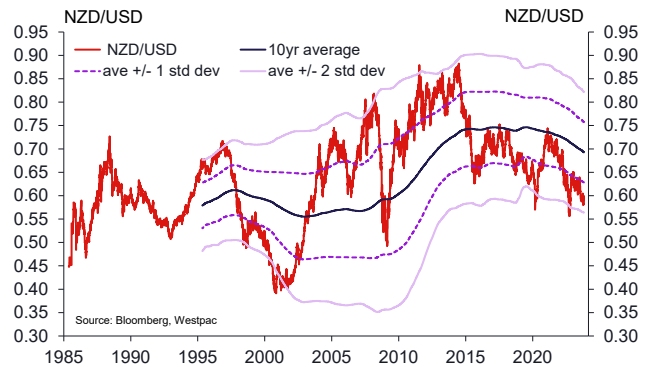
Official Cash Rate forecasts



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	0.599	0.578-0.604	0.555-0.743	0.655	0.62
AUD	0.920	0.915-0.939	0.873-0.992	0.934	0.89
EUR	0.549	0.543-0.570	0.517-0.637	0.586	0.55
GBP	0.481	0.464-0.492	0.464-0.551	0.510	0.49
JPY	89.6	86.0-90.8	61.3-90.8	77.4	86.1

The week ahead

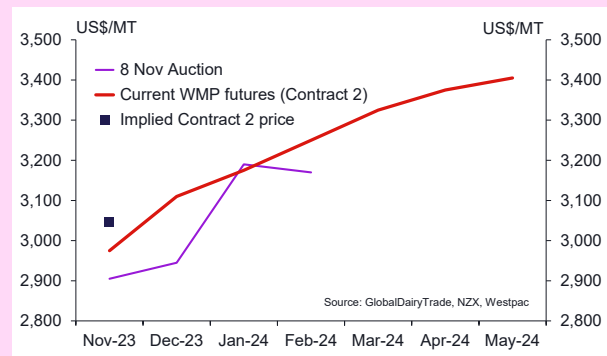
NZ GlobalDairyTrade auction, whole milk powder prices

Nov 22, Last: -2.7%, Westpac: +3.0%

We expect whole milk powder prices (WMP) to rise by 3% at the upcoming auction. If the result is in line with our expectations, then WMP prices will regain the ground lost at the previous auction. Our pick is roughly between the circa 2% rise at the recent mini (GDT pulse) auctions and the circa 5% price lift 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 what is shaping as a mixed result overall over November.

Whole milk powder prices



NZ Q3 retail spending (volumes)

Nov 24, Last: -1.0%, Westpac f/c: -2.0%

Retail spending was weak in the June quarter. Despite strong growth in the population and increases in tourism inflows, nominal spending levels fell 0.2% and the volume of goods sold was down 1%. There was particular softness in discretionary spending, with sizeable falls in both hospitality and durables spending.

With financial pressures continuing to eat away at households' purchasing power, we're forecasting further weakness in spending through the September quarter. We expect a 0.4% fall in nominal spending, with the volume of goods sold expected to have dropped 2.0%. Excluding the lumpy fuel and motor vehicle categories, we estimate that the volume of goods sold in 'core' retail categories fell by 0.2% over the quarter.

Retail spending (including forecasts)

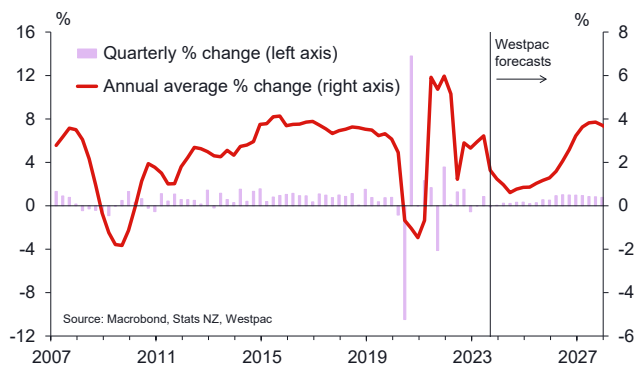


Economic and financial forecasts

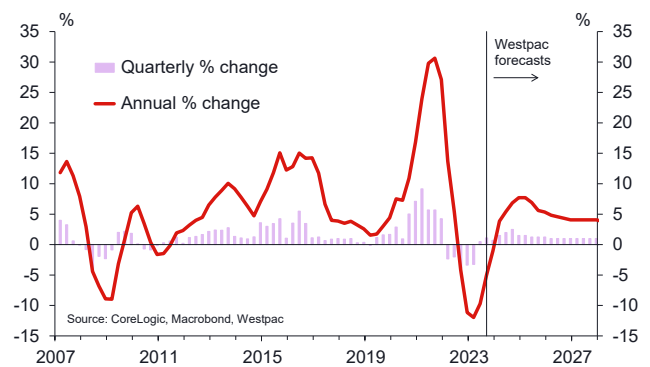
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.9	-0.1	0.1	0.2	6.0	2.7	1.2	0.9
Consumer price index	1.1	1.8	0.6	0.9	5.9	7.2	4.8	3.3
Employment change	1.0	-0.2	0.1	0.1	3.3	1.7	1.9	0.2
Unemployment rate	3.6	3.9	4.3	4.6	3.2	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



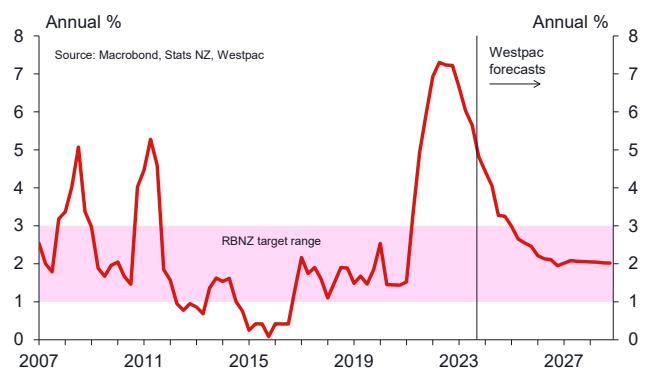
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
US	Oct leading index	-0.7%	-0.6%	-	Continues to point to below-trend growth.
Tue 21					
NZ	Oct trade balance \$mn	-2329	-	-1800	Earlier weakness in dairy prices leading to wider deficit.
Aus	RBA Governor Bullock	-	-	-	Panel participation at ASIC Annual Forum.
	RBA Acting Head of Domestic Mkts	-	-	-	Schwartz speaking at Australian Securitisation Forum.
	RBA Minutes	-	-	-	RBA's views on inflation outlook in focus.
US	Oct Chicago Fed activity index	0.02	-	-	Activity to slow ahead, not halt.
	Oct existing home sales	-2.0%	-1.5%	-	Affordability stretched as high rates and tight supply impact.
	FOMC November meeting minutes	-	-	-	Views on risks and the implications for policy the focus.
Wed 22					
NZ	GlobalDairyTrade (WMP)	-2.7%	-	3.0%	Dairy prices regaining lost ground from previous auction.
Aus	Oct Westpac-MI Leading Index	-0.34%	-	-	Slight improvement but still materially below trend.
	RBA Governor Bullock	-	-	-	Speaking at the ABE Annual Dinner.
Eur	Nov consumer confidence	-17.9	-	-	Easing inflation and policy pause will aid in time.
US	Oct durable goods orders	4.6%	-3.1%	-	Exceedingly volatile of late; ex transport performing well.
	Initial jobless claims	231k	-	-	To remain at low level, for now.
	Nov Uni. of Michigan sentiment	60.4	60.5	-	Final estimate.
Thu 23					
Eur	Nov HCOB manufacturing PMI	43.1	-	-	Outlook remains downbeat in Europe...
	Nov HCOB services PMI	47.8	-	-	... as growth in new orders continues to fall.
UK	Nov S&P Global manufacturing PMI	44.8	-	-	Similarly in the UK, industry is struggling as demand...
	Nov S&P Global services PMI	49.5	-	-	..., both internal and external, weakens.
US	Thanksgiving Day	-	-	-	Public holiday; markets closed.
Fri 24					
NZ	Q3 real retail sales	-1.0%	-0.8%	-2.0%	Financial pressures continue to weigh on spending.
Jpn	Oct CPI %yr	3.0%	3.4%	-	Tokyo CPI points to upside risk for underlying inflation.
	Nov Jibun Bank manufacturing PMI	48.7	-	-	Conditions in manufacturing remain weak...
	Nov Jibun Bank services PMI	51.6	-	-	... while support from services continues to wane.
UK	Nov GfK consumer sentiment	-30	-	-	Volatility reflective of an increasingly uncertain outlook.
US	Nov S&P Global manufacturing PMI	50.0	49.8	-	Manufacturing conditions are beginning to stabilise...
	Nov S&P Global services PMI	50.6	50.5	-	... services sector demand is positive but fragile.

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