WEEKLY ECONOMIC COMMENTARY

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

Times of change: A new government and prospects for lower rates.

The RBNZ will almost certainly leave the OCR unchanged this week. But the key interest is in what they have to say about the outlook and whether market expectations of rate cuts in 2024 will be validated. We expect they will be keen to push back on rate cut expectations as there is likely a lot of water to go under the bridge before those become a reality. A new government has been formed with the final coalition agreement delivering a policy package that is just a touch more contractionary than National campaigned on.

Market expectations for interest rates have swung around wildly in recent months. Two months ago, the higher for longer mantra was all the rage and long-term interest rates were rising fast and markets had priced a good chance of further OCR rises into the curve for 2024. More recently the tide has turned, and markets have now priced a decent chance of an OCR cut in May 2024.

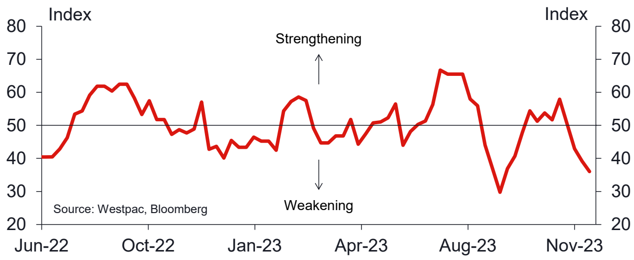
The dataflow recently has supported the markets move towards pricing in easings next year although we think there is quite a bit of water to go under the bridge for those easings to become a reality. There is clear evidence of a cyclical downturn in growth (although last week's flat retail trade outcome for the September quarter was the best outcome we have seen for some time). But there's a lot of work to do to bring core inflation back to the levels consistent with the 1-3% target range. And the clear message of the incoming government is that they expect the RBNZ to be firmly and solely focused on price stability.

Hence the key focus this week is on what the RBNZ has to say about the outlook for interest rates. We suspect

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

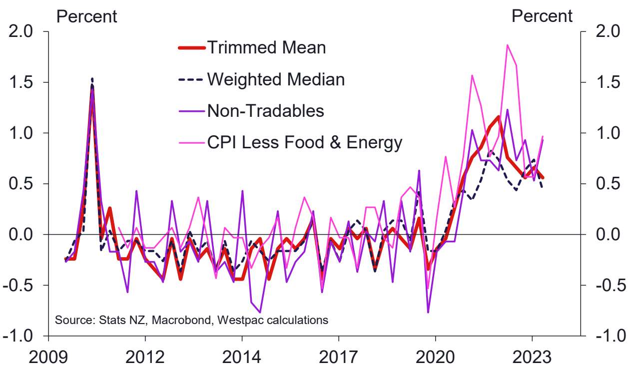
Imre Speizer
Market Strategist

Movember moustache progress day 23

Support the Westpac Economics Mo' Bros

they will be reluctant to validate market expectations for easing any time soon and hence they will deliver a forward track for the OCR that is little changed from the one projected in the August *Monetary Policy Statement (MPS)*. We think it will suggest that interest rates will remain unchanged for much if not all of 2024. We think that dovish talk of rate cuts will need to wait for the time when the RBNZ is sure that inflation will be inside the target range within about six months and when they have confidence it will stay there. They likely don't have that confidence now given that, so far, quarterly core inflation measures are sitting 0.5-1% above the levels seen over the 1995-2019 period. Rather we suspect that even if the stars align, the evidence to support a rate cut won't be available until the August 2024 *MPS* at the earliest.

Quarterly core inflation indicators relative to 1995-2019 average



The other big change is the forming of a new government. Given the overlapping policies in the parties' respective manifestos, as expected the final policy mix included in the coalition agreements had few surprises. National's tax cuts will be delivered as promised but will be funded differently from that campaigned on as the foreign home buyers' tax hasn't survived the negotiations. The government has found other cost savings and revenue initiatives to cover the costs of the tax cuts (for example by not increasing the Working for Families tax credit in 2026, changes to tobacco legislation and by delaying when tertiary students are eligible for a year of fees-free tuition – the latter reducing costs, as up to a third of students fail to complete their degree). Therefore, the new Government's overall fiscal policy stance, at least as regards the operating balance, appears likely to be moderately more contractionary than that which the outgoing government would have pursued. That said, we continue to think that some elements of the new government's programme – notably its policies that will encourage more investor participation in the housing market – will provide some offsetting stimulus to the economy.

On balance, the details of the coalition agreement announcement do not appear to call for any reassessment of our outlook for the economy, the RBNZ's monetary policy stance or the Crown debt programme.

Cabinet ministers will be sworn in today and the new Parliament will sit on 5 December. Parliament will likely sit under urgency to pass key legislation required to give effect to some of the items on the Government's "100-day plan". Given the extensive work programme of the new Government, the Prime Minister has indicated that the House will sit right up until Christmas and will probably resume shortly thereafter following a briefer holiday adjournment than would normally be the case.

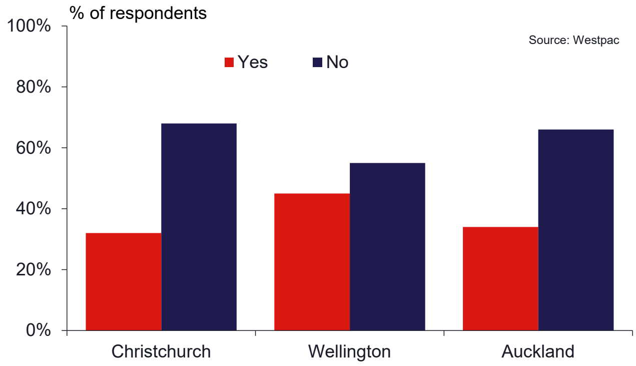
In the near term, a key focus will be the production of the foreshadowed "mini-Budget" which the incoming Minister of Finance has indicated will be published alongside the regular Half-Year Economic and Fiscal Update (HYEFU) sometime in December (this must be tabled before the House adjourns for the year, which will likely be on 21 December). In addition to providing the usual update on how the changes in the economic outlook since the Pre-Election Economic and Fiscal Update (PREFU) have impacted the fiscal outlook, we expect the HYEFU will give some indication of the Treasury's estimate of the financial impact of the Government's most important policy initiatives (such as the tax and spending cut programme). The implications of the remainder of the Government's programme will be set out in Budget 2024, which will likely be tabled in May as usual.

Something that will be of interest to markets is the implementation of the new government's intention to change the RBNZ's mandate to focus on inflation solely. The government sees this as a pressing priority, raising the question on how this will be achieved. Practically, this will require an adjustment of the RBNZ's Remit (which currently refers to two objectives, price stability and maximum sustainable employment). It may be possible to give effect to the new Government's policy with a new Remit (which doesn't require legislation), by reducing the importance of the employment objective in some way. But ultimately a more permanent and robust change to the RBNZ Act will be required (Sections 9 and 117).

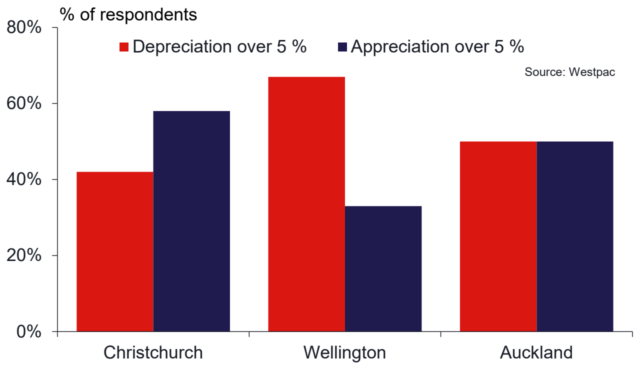
Finally, last week I travelled the country and presented our current economic forecasts to customers and took the opportunity to survey their views on the economic outlook. Interestingly, there was a broad consensus that, notwithstanding some of the dour economic news of late, the economy is not going to record a recession this year. Customers in Christchurch and Auckland were particularly positive which is perhaps understandable given the importance of tourism to the Canterbury economy and migration to Auckland.

Customers saw tangible signs that the labour market is easing, and that wage growth will be slower. Indeed, customers overwhelmingly see wage growth decelerating from current levels – a departure from the scepticism that was evident when we conducted the same exercise in August.

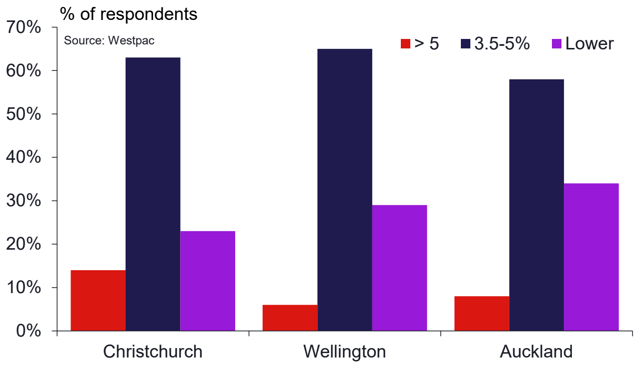
Do you expect the economy to be in recession by the end of 2023?



What's the biggest risk for the NZD/USD exchange rate over the next year?

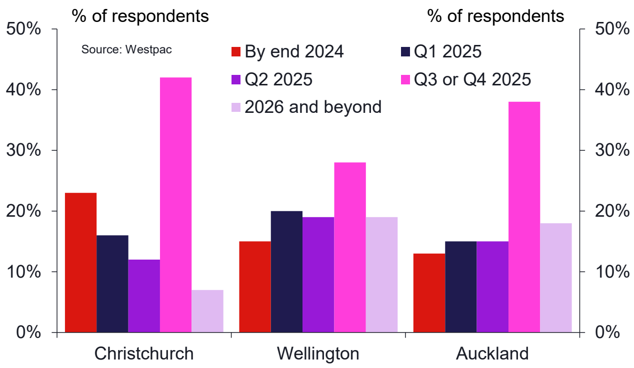


What are your expectations for wage growth in the next year?



Consistent with formal business surveys, customers are more pessimistic than most forecasters and the RBNZ on when inflation will return to the target range. A sizeable majority of people saw the return to the target range coming in the second half of 2025 or even later. The RBNZ has consistently seen this occurring in the September quarter of 2024. So, we have a gap to bridge there!

When will the annual CPI reach the RBNZ's target range?



Customers seemed to have a more mixed view of the exchange rate – although most centres seemed more upbeat about prospects for the NZD/USD compared to when I asked this question in August. Wellington customers seem the most pessimistic on this score (and indeed more generally).

Kelly Eckhold, Chief Economist

Key data and event outlook

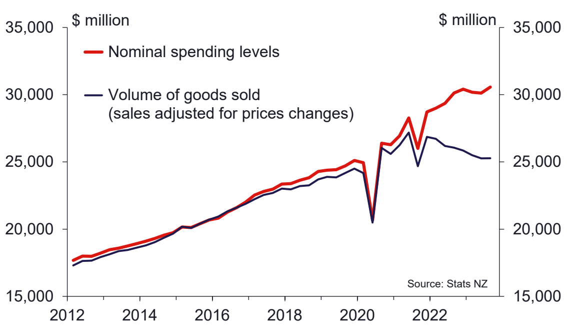
Date	Event
29 Nov 23	RBNZ Monetary Policy Statement and OCR
5 Dec 23	RBA Monetary Policy Decision
13 Dec 23	FOMC Meeting (Announced 14 Dec NZT)
13 Dec 23	Selected price indexes, November
14 Dec 23	NZ GDP September quarter
18 Dec 23	Half Year Economic and Fiscal Outlook (TBC)
16 Jan 24	QSBO Business Survey, 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.

Cash registers around the country are continuing to ring, with nominal retail spending levels rising by 1.5% in the September quarter. That was a larger than expected rise and was underpinned by increased spending on groceries and durable goods like hardware.

But while we saw resilience in spending over the September quarter, the longer-term trend is looking soggy. Over the past year, nominal spending levels have risen by 1.1%. But over that same period, prices rose by 4.6%, and the population increased by more than 2%. Putting that all together leaves us with a soft picture of underlying spending appetites. The volume of goods sold fell by more than 3% over the past year. And on a per capita basis, the fall in spending levels has been closer to 5%. Looking ahead, with economic growth slowing and continued pressure on households' finances, we expect spending will continue softening through the December shopping season and into the New Year.

Retail spending and the cost of living squeeze

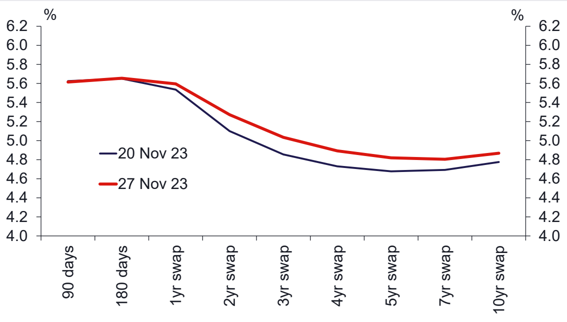


Fixed versus floating for mortgages.

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.

November's FOMC minutes provided a little more colour on the Fed's thinking. Committee members noted that it was "critical" that policy remained "sufficiently restrictive," and that further tightening of policy would be appropriate if progress on inflation was insufficient. However, committee members also noted that the risks around the outlook had become more "two sided," with upside risks to inflation, but downside risks for activity and the labour market. The minutes did not have a large impact on market expectations that the peak in the rate hike cycle has already been reached.

US data over the past week was mixed. Updates on existing home sales and the Chicago Fed National Activity Index both fell short of expectations, while the manufacturing PMI dropped to a three-month low. We also saw a fall in durable goods orders. On the positive side, the services PMI recorded a stronger than expected rise to 50.8, and we also saw jobless claims dropping back. Across in Canada, CPI inflation fell to 3.1% from 3.8% previously, reinforcing expectations that the BOC rate hiking cycle has come to an end. It's a busy week ahead, the highlights of which will be Thursday's updates on personal income and spending, along with the PCE deflator. We'll also get several business surveys through the week, including the ISM and Beige Book, as well as an updated estimate of Q3 GDP growth.

Asia-Pacific.

November's RBA minutes provided limited new information. The Board noted resilience in the labour market and domestic demand, and a more gradual than expected easing in core inflation. Importantly, the Board highlighted concerns about inflation expectations and businesses' pricing decisions and noted that the RBA staff's forecasts would show "higher inflation if they had not been predicated on one or two rate rises." Despite such concerns, we don't think conditions will warrant further rate hikes with both inflation and the labour market to soften over the coming years. Upcoming data this week includes updates on retail spending (Tuesday) and the monthly CPI indicator for October (Wednesday). Also out this week are updates on China's official PMI/PSI and the Caixin PMI, as well as data on Japanese industrial production and the labour market.

Other.

Over the past week, speakers from both the ECB and BOE continued to highlight concerns about inflation and pushed back against suggestions of early cuts. In the UK the composite PMI did climb marginally above 50, but it continued to point to soft conditions.

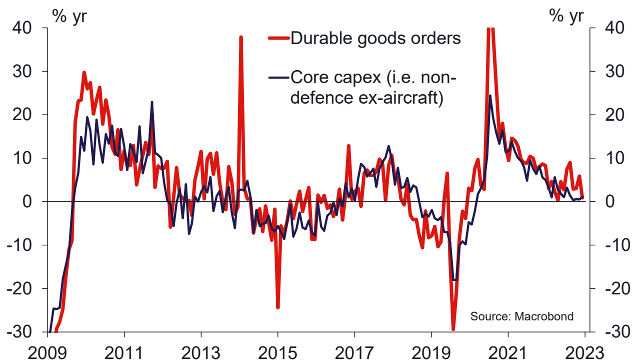
Trading partner real GDP (calendar years)

	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

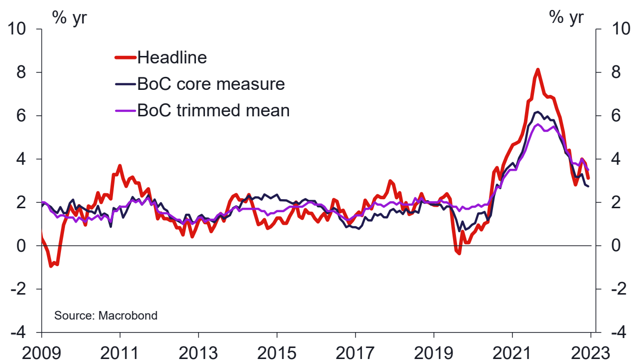
Australian & US interest rate outlook

	Latest	Dec-23	Jun-24	Dec-24
Australia				
Cash	4.35	4.35	4.35	3.85
90 Day BBSW	4.38	4.55	4.47	3.97
3 Year Swap	4.39	4.50	4.30	4.10
3 Year Bond	4.18	4.30	4.10	3.90
10 Year Bond	4.54	4.70	4.50	4.30
10 Year Spread to US (bps)	10	-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 durable goods orders



Canadian CPI inflation



Financial markets wrap

Interest rates.

NZ swap rates rebounded last week, having earlier fallen sharply in response to softer economic data but arguably overshooting. For example, markets at one point had priced a rate cut as early as May 2024 – a scenario we would consider unlikely. Such pricing has rebounded over the past few days, to now price the first OCR cut to occur in August 2024. The 2yr swap at 5.27% is around 20bp higher than a week ago, and could run even higher this week, although much will depend on the outcome of the RBNZ's Monetary Policy Statement on Wednesday.

The RBNZ will almost certainly leave the OCR unchanged at 5.50%, but markets could still react in either direction. Market attention will be focussed on the OCR forecast, which in August showed a peak of 5.59%. A reduction to, say, 5.50% would cause swap rates to fall, while a retention of the 5.59% peak would probably cause a rise. The guidance language and the Governor's press conference also hold market-moving potential.

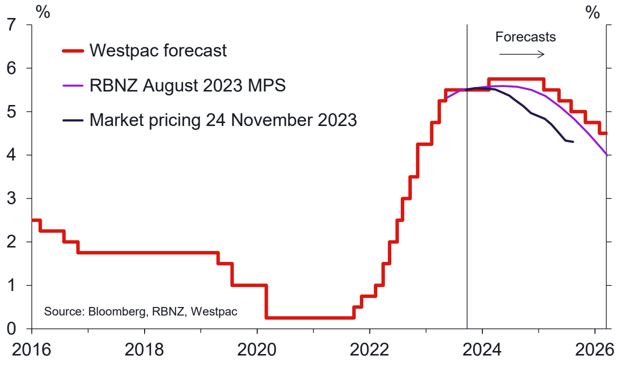
Foreign exchange.

NZD/USD's rally, which started in late October, extended to close the week in the high 0.60s, and at the highest level since August. That was mostly a result of further US dollar weakness and improved risk sentiment.

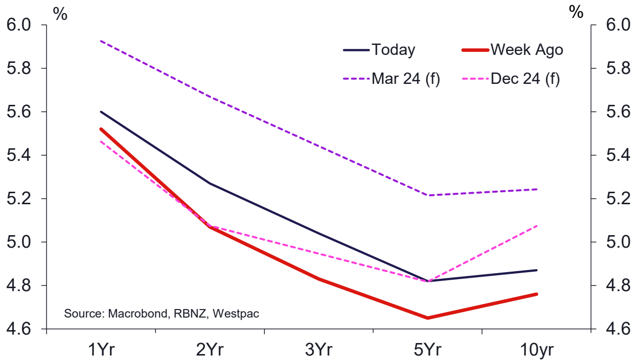
We expect the US dollar to weaken further into year end and during 2024 if the US is unable to deliver economic outperformance (its economy was exceptional in 2021 and much of 2022, and for part of H2 2023). Such a scenario would see NZD/USD reaching 0.6200 during the next few months. Any dips to around 0.5900 in the interim would be worthy of consideration by exporters.

NZD/AUD looks neutral near term in the mid-0.92s. We see risks skewed to the downside, with 0.9100 possible by year end. A major driver of the cross is likely to be relative interest rates, with NZ's yield advantage eroding as markets price the RBA to hike again.

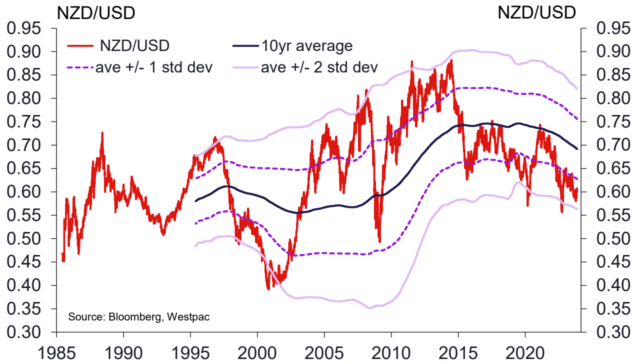
Official Cash Rate forecasts



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	0.607	0.578-0.605	0.555-0.743	0.655	0.62
AUD	0.923	0.915-0.939	0.873-0.992	0.934	0.89
EUR	0.556	0.545-0.570	0.517-0.637	0.586	0.55
GBP	0.483	0.467-0.492	0.464-0.551	0.510	0.49
JPY	90.9	86.4-90.8	61.3-90.8	77.4	86.1

The week ahead

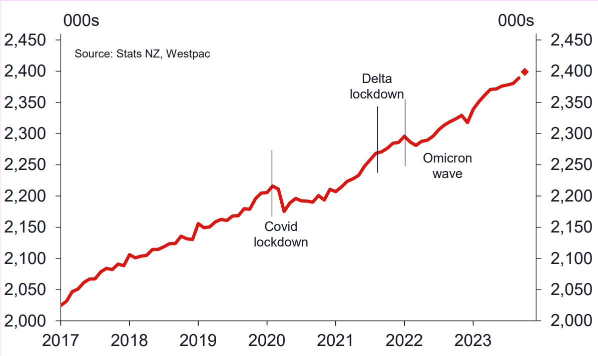
NZ Oct Monthly employment indicator

Nov 28, Last: 0.4%, Westpac f/c: 0.4%

The monthly employment indicator is drawn from income tax data, making it a fairly comprehensive record of the number of people in work. And helpfully, while there are conceptual differences, it generally does a good job of predicting the more widely followed quarterly household survey measure of employment.

Job growth was very robust over the first half of 2023, with a surge in migrant inflows allowing employers to fill long-standing vacancies. While growth has slowed somewhat in recent months, October's job count is likely to be impacted positively by the circa 20,000 people temporarily employed to run the General Election.

NZ monthly filled jobs



NZ RBNZ Monetary Policy Statement

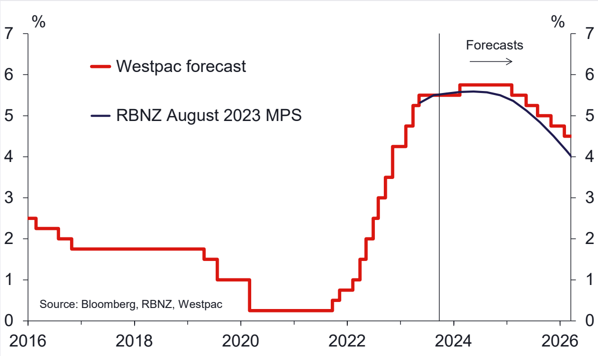
Nov 29, Last: 5.50%, Westpac f/c: 5.50%, Mkt f/c: 5.50%

We expect the RBNZ will leave the OCR unchanged at 5.50% at its November policy meeting. The RBNZ's forward profile for the OCR is likely to be little changed and suggest no change in the OCR in 2024.

On balance, recent data will have left the RBNZ more comfortable with an 'on hold' stance. Notably, price data indicates that imported inflation is easing faster than previously anticipated. In addition, we have continued to see weakness in cyclical demand indicators, such as retail spending, the PMIs, credit growth and imports.

Short term inflation forecasts will be reduced, but the longer-term profile will likely be little changed. The RBNZ will be keen to ensure as much of the recent increase in mortgage rates remains in place for a while.

Official Cash Rate forecasts



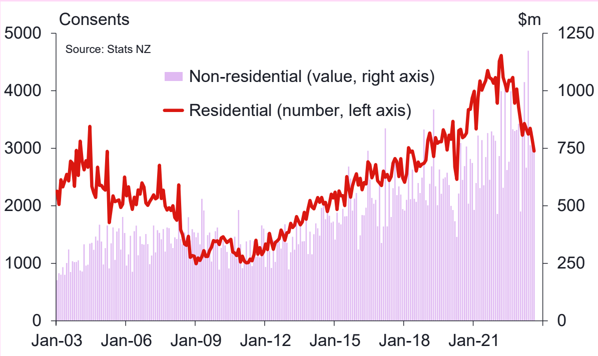
NZ Oct building consents

Nov 30, Last: –4.7%, Westpac f/c: –2.0%

The downturn in New Zealand's building sector has been deepening. Residential building consent numbers dropped another 5% in September, taking monthly consent issuance back to levels below those we saw prior to the pandemic. We're also seeing fewer commercial projects coming to market, with the amount of non-residential floor-space being consented down 13% over the past year. Underlying this downturn have been challenging financial conditions in the building sector, with sharp increases in building costs and interest rates, as well as a downturn in the housing market and slowing economic growth.

We expect the October update will show that monthly residential consent numbers have fallen a further 2%. That would see annual consent issuance dropping back below 40,000 – its lowest level in three years.

NZ building consents



The week ahead

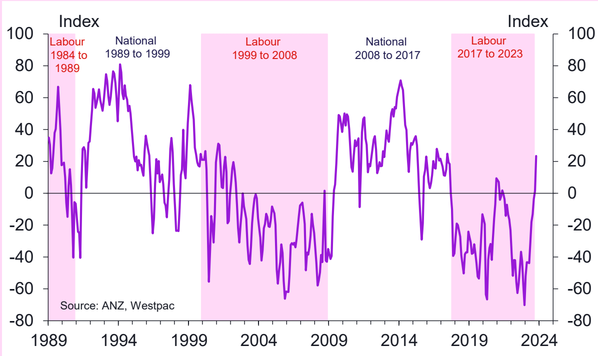
NZ Nov ANZBO business confidence

Nov 30, Last: 23.4

Business confidence rocketed higher in October, rising to its highest level since 2017. Business confidence has tended to be much stronger when New Zealand has centre-right governments (whose policies tend to be more business friendly). And given the swing in New Zealand's recent General Election, this latest increase in business confidence wasn't unexpected. But it wasn't just business confidence that picked up in October. We also saw a rise in firms' expectations for their own trading activity.

We expect much – if not all – of the post-election surge in sentiment will be sustained in the November survey. However, we'll be keeping a close eye on the gauges of trading activity, hiring and investment spending given other signs of softening activity. Cost pressures are also expected to have remained strong.

Business confidence

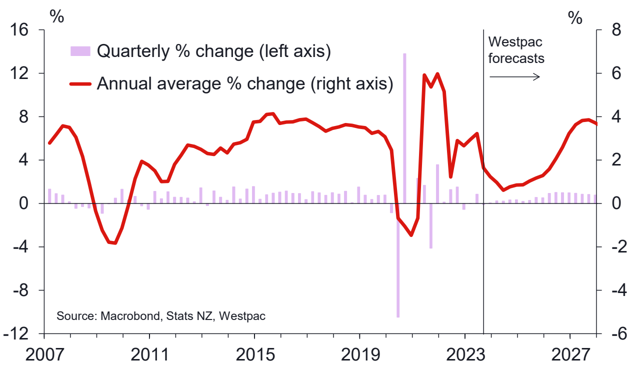


Economic and financial forecasts

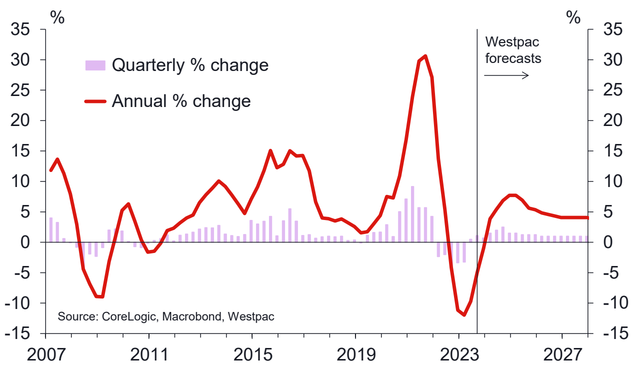
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.9	-0.1	0.1	0.2	6.0	2.7	1.2	0.9
Consumer price index	1.1	1.8	0.6	0.9	5.9	7.2	4.8	3.3
Employment change	1.0	-0.2	0.1	0.1	3.3	1.7	1.9	0.2
Unemployment rate	3.6	3.9	4.3	4.6	3.2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

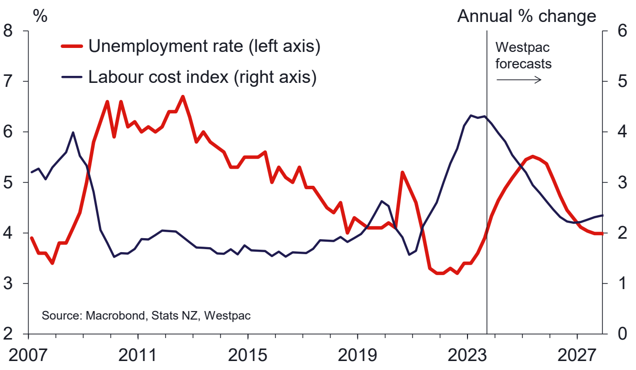
GDP growth



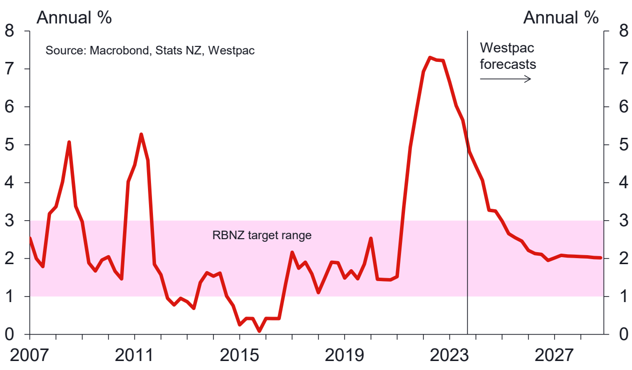
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
Chn	Oct industrial profits %yr	11.9%	–	–	High costs keeping profits weak.
US	Oct new home sales	12.3%	–4.8%	–	Low inventory and high rates putting pressure on sales.
	Nov Dallas Fed index	–19.2	–16.0	–	Manufacturing activity slowly recovering.
Tue 28					
NZ	Oct monthly employment indicator	0.4%	–	0.4%	Should be boosted by about 20k of election-related hiring.
Aus	Oct retail sales	0.9%	0.2%	0.2%	Some of Sep's lift looks to have been temporary.
US	Nov consumer confidence index	102.6	101.0	–	Pause in rate hikes gives consumers hope.
	Nov Richmond Fed index	3	1	–	Manufacturing outlook still rocky.
	Fedspeak	–	–	–	Goolsbee, Waller.
Wed 29					
NZ	RBNZ policy decision	5.50%	5.50%	5.50%	Still on hold, likely to discourage thoughts of an early easing.
Aus	Oct Monthly CPI Indicator %yr	5.6%	5.2%	5.3%	A goods heavy month points to a softer print.
	Q3 construction work	0.4%	0.5%	1.3%	Further gains, led by public works and business construction.
Eur	Nov economic confidence	93.3	–	–	Emerging resilience in economy could turn confidence.
US	Oct wholesale inventories	0.2%	–	–	Uncertainty around demand outlook to keep inventories low.
	Q3 GDP, annualised	4.9%	5.0%	–	Second estimate.
	Federal Reserve's Beige Book	–	–	–	Update on economic conditions across the regions.
	Fedspeak	–	–	–	Mester.
Thu 30					
NZ	Oct building permits	–4.7%	–	–2.0%	Weakening trend likely remains in place.
	Nov ANZ business confidence	23.4	–	–	Post-election lift in sentiment is likely to be sustained.
Aus	Oct dwelling approvals	–4.6%	1.7%	1.0%	Bumping around weak levels.
	Q3 private business capex	2.8%	0.8%	–0.6%	B&S up, equipment to dip (albeit risks are to the upside).
	2023/24 capex plans, $bn	157.8	–	–	Est 3 $158bn, +7% vs Est 3 yr ago. Est 4 $169bn?
	Oct private sector credit	0.5%	0.4%	0.4%	Growth broadly steady at a subdued 0.4%/mth.
Jpn	Oct industrial production	0.5%	0.8%	–	Simmering foreign demand weighing on production.
Chn	Nov manufacturing PMI	49.5	50.0	–	Manufacturing in solid shape, but stimulus to take time…
	Nov non-manufacturing PMI	50.6	51.5	–	… in boosting property sector and services more broadly.
Eur	Nov CPI %yr	2.9%	–	–	Further deceleration expected as energy prices cycle out.
	Oct unemployment rate	6.5%	–	–	Employment gains held despite a slowing in the economy.
US	Oct personal income	0.3%	0.2%	–	A softer labour market is cooling wage gains.
	Oct personal spending	0.7%	0.2%	–	Belts are tightening as savings dwindle.
	Oct PCE deflator	0.4%	0.1%	–	Downshift expected after a surprise flat CPI reading.
	Nov Chicago PMI	44.0	46.0	–	Businesses downbeat as financial conditions remain tight.
	Initial jobless claims	209k	–	–	Still low, for now.
Fri 01					
NZ	Nov ANZ consumer confidence	88.1	–	–	Confidence likely to remain low as financial pressures bite.
Aus	Nov CoreLogic home value index	0.9%	–	0.7%	Price gains moderated a touch in Nov.
Jpn	Oct jobless rate	2.6%	2.6%	–	Tight labour market conditions create space for wage growth.
Chn	Nov Caixin manufacturing PMI	49.5	–	–	Impact of stimulus could be seen amongst smaller firms.
US	Nov ISM manufacturing	46.7	47.7	–	Manufacturing to remain under pressure.
	Oct construction spending	0.4%	0.4%	–	High rates dissaude new projects.
	FOMC Chair Powell	–	–	–	Speaking at a fireside chat and a roundtable discussion.

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