WEEKLY ECONOMIC COMMENTARY

15 Apr 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Staying the course – again!

The highlight of the past week was the RBNZ's April *Monetary Policy Review*. **As we discussed in our review note**, the RBNZ disappointed markets looking for a dovish tilt. Conversely, we were not at all surprised at the RBNZ's unchanged stance and outlook, and we haven't changed our forecasts for the OCR to remain on hold through 2024, with the first cut to 5.25% in February 2025. We think that the extremely brief length of the press statement (140 vs 309 words in February) tells us that the RBNZ really had little to say on top of the story presented previously.

It seems the RBNZ largely agreed with our read on the dataflow since the February *Statement*. GDP data for Q4 were a touch weaker than forecast, while confidence indicators show the shine is coming off a bit such that a pickup in growth in H2 might be less certain. Meanwhile, the inflation picture looks less favourable than the RBNZ hoped. Given recent monthly price index data, the near-term CPI outlook seems stronger than the RBNZ expected. In addition, the exchange rate is weaker, energy prices are a lot higher, and pricing indicators in sentiment surveys point to lingering cost pressures.

This weaker growth momentum/stronger short term inflation picture is leading to a broadly unchanged stance. Reasonable people can argue over whether that stance is a smidge more hawkish or dovish overall – there's certainly been plenty of debate about that small point around here!

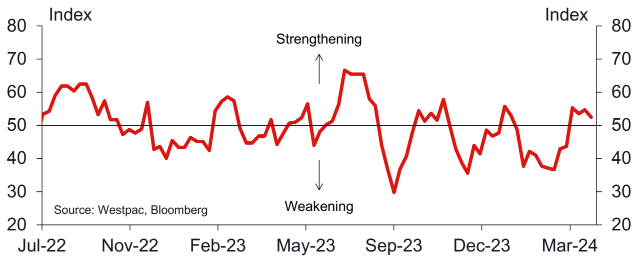
This still leaves a yawning gap between where market perceptions of the path the OCR will follow over the balance of 2024 (first easing by October and 50bp by the end of the year) compared to our forecasts and those of the RBNZ (first 25bp easing in Q1/Q2 2025). We think that's a very big gap to fill which raises the question on what it might take to shift the RBNZ closer to market views?

A dovish pivot could occur once the RBNZ gains sufficient confidence that inflation will reach the 2% target

Key views

	Last 3 months	Next 3 months	Next year
Global economy	→	→	↗
NZ economy	→	→	↗
Inflation	↘	↘	↓
2 year swap	↗	→	↘
10 year swap	→	→	↘
NZD/USD	↘	↗	↗
NZD/AUD	↘	↗	↘

Westpac New Zealand Data Pulse Index



Key data and event outlook

Date	Event
17 Apr 24	NZ CPI, March quarter
1 May 24	NZ Labour market statistics, March quarter
1 May 24	RBNZ to release Financial Stability Report
1 May 24	FOMC Meeting (Announced 2 May NZT)
7 May 24	Govt financial statements for 9 mths to March
7 May 24	RBA Monetary Policy Decision and SMP
13 May 24	NZ Selected price indexes, April
22 May 24	RBNZ Monetary Policy Statement and OCR
30 May 24	Govt to release Budget 2024
5 Jun 24	Govt financial statements for 10 mths to April
14 Jun 24	NZ Selected price indexes, May
18 Jun 24	RBA Monetary Policy Decision
20 Jun 24	NZ GDP, March quarter
11 Jul 24	NZ Selected price indexes, June

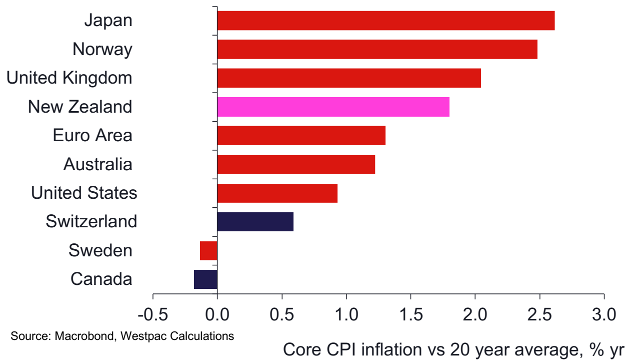
midpoint acceptably quickly. Right now, that expectation is that inflation will reach 2% by end of 2025, conditional on keeping the OCR at 5.5% until 2025. In the near term, attention will focus on the March quarter CPI (17 April), where the level of core inflation will be especially key; and the March quarter labour market reports (1 May), where long awaited signs of labour market adjustment will be sought.

However, time is getting short to influence those H2 2025 outcomes. The RBNZ pragmatically acknowledges this in **the record of meeting** by noting that while they have limited tolerance to extend the horizon to when 2% inflation is expected to be reached, there are three criteria that could extend that timeframe and hence allow for earlier than otherwise easing. They are: headline inflation needs to be inside the target range; inflation expectations should no longer be elevated; and pricing intentions are no longer elevated.

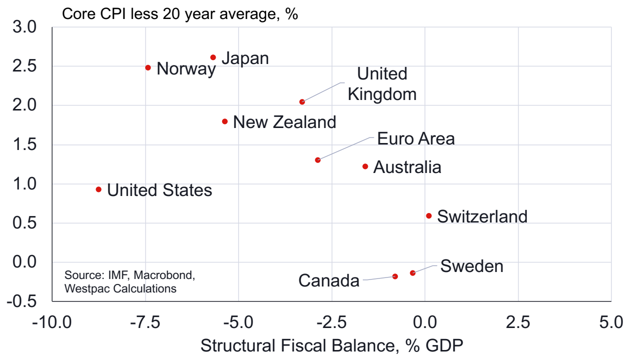
We think it will be very difficult to meet these tough conditions to allow easing to come as early as August. Headline inflation is forecast to be inside the target range in Q3 2024, but the RBNZ will not know if this has occurred until October. Similarly, inflation expectations and pricing intentions are around one standard deviation above their average since 1995 (as shown in the 'Chart of the week') and in our judgement might not reach those levels for at least six months.

This all points to a November easing as a best-case scenario, which implies a maximum of 25bps of easing in 2024. We are currently more pessimistic than this best-case scenario given recent trends in non-tradables inflation and the labour market. This means that we don't see New Zealand as the vanguard of advanced economy policy easing (Switzerland has already eased, and there are prospects of policy easing in Canada and the euro area soon). The relatively high level of core inflation in New Zealand compared to the long-term average is in part driven by a relatively weak fiscal position. It helps explain the RBNZ's tardy pivot to easing, despite having been one of the earliest advanced country central banks to begin tightening.

Core CPI Inflation vs the 20-year average



Structural fiscal balance vs core inflation less 20-year average

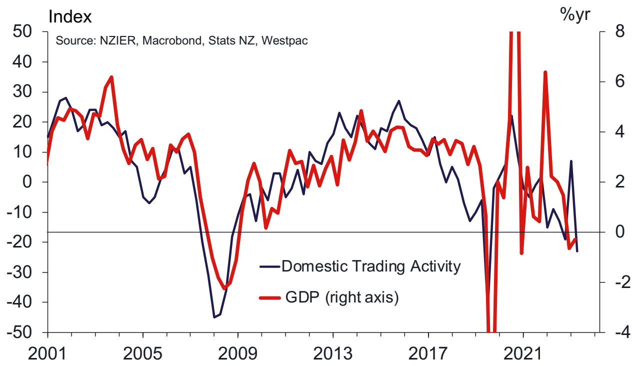


Last week the ongoing surge in inward migration prompted the Government to tighten some of the criteria for work visas. For the Accredited Employer Work Visa (AEWV), the requirements to show work experience and qualifications have been tightened. And for lower-skilled jobs, the English language requirements have been strengthened and the maximum length of stay has been shortened. The AEWV currently accounts for around 30% of migrant arrivals (including the partners of workers). We have not revised our migration forecasts because of these rule changes. Our view is that migration inflows will slow over the course of this year, but we think that deteriorating work prospects as the economy slows will be the more important determinant of migrant movements.

On the data front, last week the NZIER's QSBO survey indicated that business confidence came back down to earth with a thud in March, after a strong bounce last December. Businesses reported much tougher conditions over the last quarter and were downbeat on their investment and hiring plans. We were wary of the previous quarter's results, which may have reflected initial hopes about the election of a centre-right government. The other positive factor at the time was the sense that inflation was finally easing from its highs. However, the latest survey showed that firms are finding that cost pressures have been slow to recede.

General business sentiment fell to a net -24% in March, from -10% in December. That was still an improvement on the pre-election readings of -50% or worse. However, firms' own trading activity (which has a closer relationship with GDP growth) was sharply lower. A net 23% saw worse results over the past quarter, the weakest reading since the Covid lockdown. Expectations for trading activity over the coming months also turned negative again. These results present some downside risk to our near-term GDP forecasts, where we expect some weakly positive growth (though remaining below population growth).

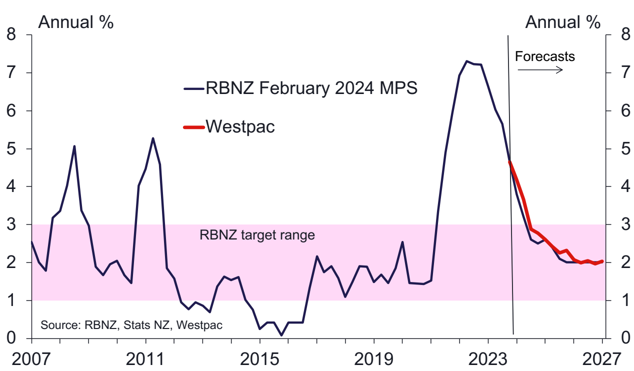
Domestic trading conditions and GDP growth



As far as inflation is concerned, a net 35% of firms reported that they had increased their prices in the last three months, down from 39% last quarter. Intentions to raise prices also receded modestly, from 36% to 32%. This softening comes as capacity pressures for businesses have continued to fade. The ease of finding workers remained at its highest levels since 2010, and a lack of demand is increasingly becoming the main constraint on growth. Even so, cost increases over the last three months remained high, and expectations ticked higher again this quarter. Our discussions with businesses have revealed concerns about costs such as a sharp rise in council rates and a potential rebound in shipping costs.

In the week ahead, we expect the March quarter inflation report (out on Wednesday) will show that consumer prices rose 0.8% in the first three months of the year. That would see the annual inflation rate drop to 4.2%, down from 4.7% at the end of 2023. This outcome will be stronger than the RBNZ's most recent published forecast for a 0.4% increase. However, the RBNZ's recent policy statement indicated that they are braced for a higher result on the day reflecting the firmness in monthly price data since their forecast was finalised back in February. The key issue will be the composition of inflation. We expect this week's update will show that non-tradables inflation has remained sticky in the early part of the year, with measures of core inflation lingering around 4%.

CPI inflation

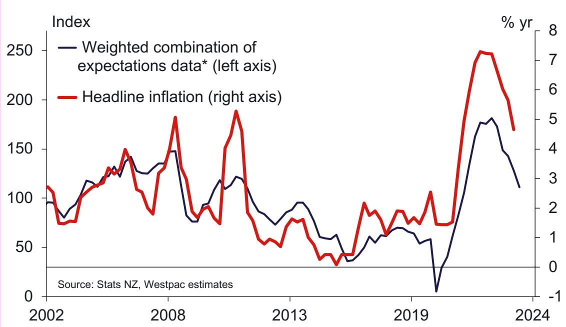


Kelly Eckhold, Chief Economist

Chart of the week.

Last week the RBNZ reiterated that they had limited tolerance for extending the time that it was expected to take to return inflation to target *"while inflation expectations and pricing intentions remain elevated"*. That's because when expectations for inflation are high, businesses are likely to increase prices by a larger amount, meaning inflation could stay high for longer. In the chart below, we've combined survey data on expectations for inflation, wage growth and cost pressures, as well as businesses' plans for price changes. The past year has seen expectations for inflation pressures easing across the range of measures we looked at. Even so, most of these measures remain elevated, including the number of businesses planning on raising their prices. On top of that, we expect that inflation will ease more gradually than the RBNZ has assumed in the near term. Putting that together, we continue to think that rate reductions are some way off, with markets pushing out expectations for rate cuts over the past week.

Inflation expectations may remain elevated for six more months

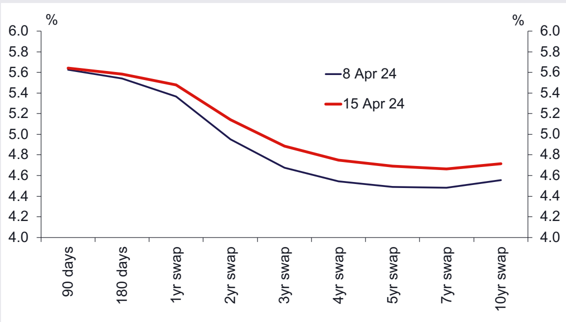


* Combination of survey data on businesses' expectations for price changes, wage growth, and data on both households and businesses expectations for inflation.

Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in April. While further OCR hikes don't look likely in the current cycle, easings are still some way off. For borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

Interest rate markets around the world were rattled by the US CPI for March, which rose by more than expected – up 0.4% for the month and 3.5% on a year ago. Energy prices contributed positively for the first time since February 2023, and the continuing surge in car insurance premiums saw transport costs jump. The housing component continues to give outsized support to inflation, both because of its large weighting in the CPI and the gradual pace of its moderation. An array of Fed speakers emphasised the need for patience, with their expectations leaning towards fewer rate cuts this year.

Asia-Pacific.

Confidence remains low in Australia, with declines in both consumer and business sentiment surveys. Any sustained lift is unlikely to be achieved until both the upcoming tax cuts and the beginning of a monetary easing cycle work their way through the economy. We expect the March labour force survey (out Thursday) to show some unwinding of February's volatility, which saw a 116k rise in jobs and a drop in the unemployment rate from 4.1% to 3.7%. Shifting seasonal patterns are making it harder to interpret the monthly figures, but the general trend is a gradual rise in unemployment as job growth falls behind population growth.

China's economy is expected to have started the year in robust shape, with market expectations for March quarter GDP (out Tuesday) at around 6% annualised. However, base effects would still see the annual growth rate edge down from 5.2% to 5.0%. Activity has been very mixed by sector, with high-tech manufacturing and infrastructure remaining strong while property investment continues to go backwards. Meanwhile the consumer is slowly regaining strength and optimism, a welcome sign for New Zealand's largely consumer-oriented exports.

Europe.

The ECB remained on hold but opened the door for a first rate cut in June, noting that: "If the Governing Council's updated assessment…were to further increase its confidence that inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction." While progress in reducing inflation has been seen, services inflation has remained sticky at around 4%yr, accounting for more than 70% of total inflation. The ECB's bank lending survey meanwhile points to policy having a restrictive impact, with business loan demand falling sharply and credit conditions tightening. We think that the data in the lead-up to the June meeting should give the ECB the confidence to begin easing.

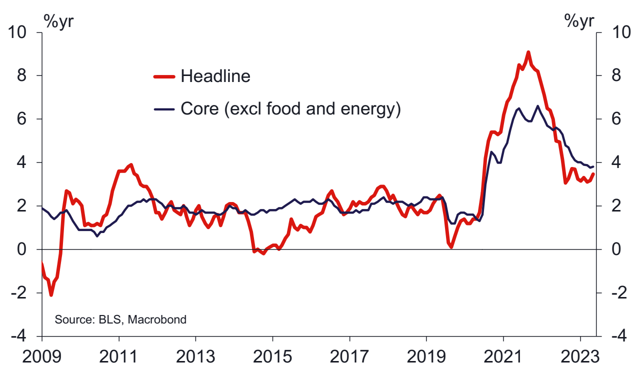
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	**2023**	**2024**	**2025**
Australia	3.8	2.1	1.3	2.2
China	3.0	5.2	5.2	5.0
United States	2.1	2.5	2.6	1.4
Japan	1.0	2.0	0.7	1.0
East Asia ex China	4.5	3.4	4.1	4.2
India	7.2	7.7	6.5	6.5
Euro Zone	3.3	0.4	0.5	1.5
United Kingdom	4.1	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.4	3.4
World	3.5	3.3	3.3	3.1

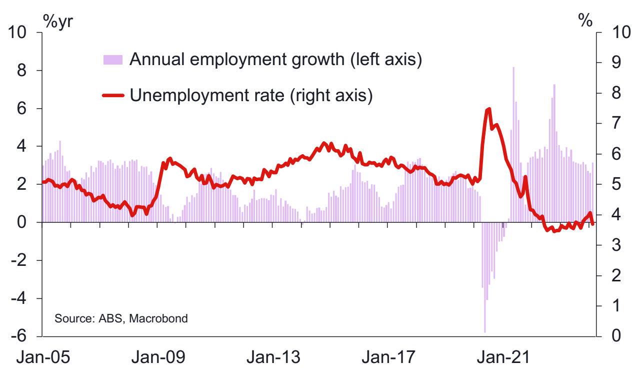
Australian & US interest rate outlook

	12-Apr	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	3.85	3.10
90 Day BBSW	4.34	4.37	3.92	3.30
3 Year Swap	4.08	3.95	3.75	3.50
3 Year Bond	3.87	3.75	3.55	3.30
10 Year Bond	4.28	4.05	3.85	4.00
10 Year Spread to US (bps)	-3	5	5	0
US				
Fed Funds	5.375	5.125	4.375	3.375
US 10 Year Bond	4.56	4.00	3.80	4.00

US CPI inflation



Australian labour market



Financial markets wrap

Interest rates.

NZ swap rates last week rose further following strong US CPI data. The 2yr has risen around 30bps so far this month and could extend that even further to the 5.25% area this week if our forecast for NZ Q1 CPI proves correct (Westpac f/c 0.8%q/q, RBNZ f/c 0.4%, market estimate 0.6%). The RBNZ MPR last week didn't ruffle markets much, largely repeating the key messages from the February MPS.

OCR pricing of cuts has been pared in the wake of the strong US CPI data. But August is still seen as a 60% chance (our economists forecast no cut until February 2025). There is ample scope for volatility during the next few months given this pre-easing on-hold period will be the longest in OCR history.

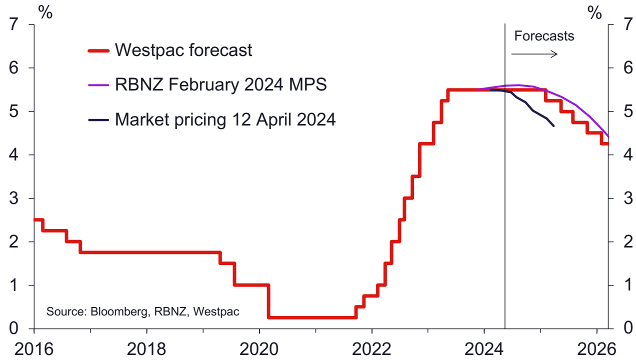
Foreign exchange.

NZD/USD is currently testing support at 0.5940. A break of that level would then target 0.5865, which would attract exporter hedging interest. The US dollar strengthened last week following strong inflation data and hawkish Fed commentary. And on Friday there was shift towards defensive currencies (such as the USD) in expectation of an attack by Iran on Israel that occurred over the weekend. Following that event, tensions in the region remain elevated. While this recent flare up may be contained, there are concerns that the conflict could escalate. Developments in the Middle East will be a driver of risk appetites in FX and commodity markets.

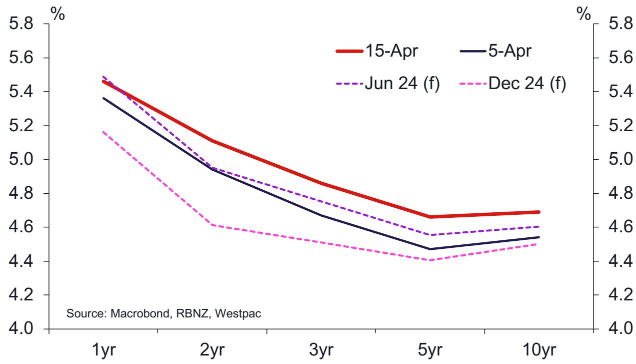
Looking to the week ahead, we have important NZ economic data – Q1 CPI – which we expect to be stronger than the RBNZ and the market expects. If our forecast for a 0.8%q/q gain proves correct, the NZD will probably bounce on the day, but the effect will be most obvious against the AUD. NZD/AUD has formed a near-term base at 0.9130 and is poised to break above 0.9210. Geopolitical tensions and low iron ore prices are weighing on the AUD.

Much further ahead, we forecast a NZD/USD rebound to 0.6300, which is contingent on our forecasts for the Fed and RBNZ (easing to start in June 2024 and February 2025, respectively).

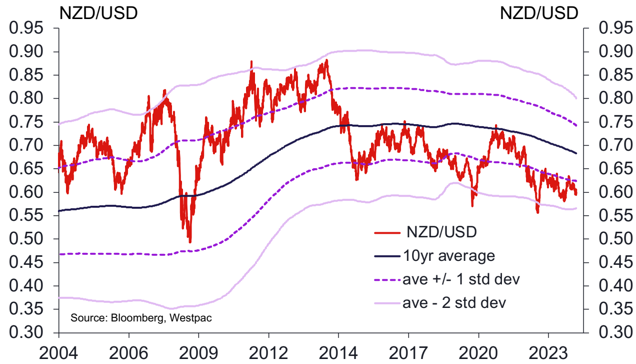
Official Cash Rate forecasts



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	0.594	0.595-0.623	0.555-0.743	0.649	0.64
AUD	0.919	0.914-0.944	0.873-0.992	0.932	0.91
EUR	0.559	0.553-0.572	0.517-0.637	0.583	0.56
GBP	0.477	0.474-0.490	0.464-0.544	0.507	0.50
JPY	91.0	89.8-93.1	61.3-93.1	78.6	90.2

The week ahead

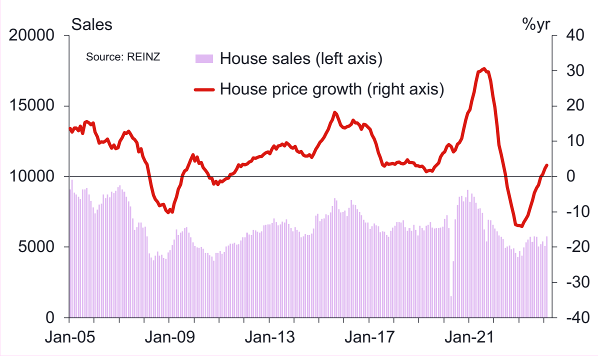
NZ Mar REINZ house sales and prices

Apr 17, Sales* – Last: +13.9% mth, +37.9% annual
Prices* – Last: 0.0% mth, +3.2% annual
*** Monthly figures based on Westpac seasonal adjustment**

The New Zealand housing market has seen a surge in new listings since the start of the year. While that has inevitably led to a lift in the number of sales – up 14% in February, following an unusually slow January – the market has struggled to digest this additional supply. The auction clearance rate has slumped, and the stock of unsold homes on the market has risen to an eight-year high.

The REINZ house price index was flat in seasonally adjusted terms in February, and is up by 0.7% over the last three months. This resilience in prices seems at odds with the current congestion in sales, but we think this reflects the balance of the opposing forces on the property market: increased supply and still-high mortgage rates, versus a migration-led surge in population growth and impending tax changes that favour property investors.

REINZ house prices and sales



NZ Q1 Consumer price inflation

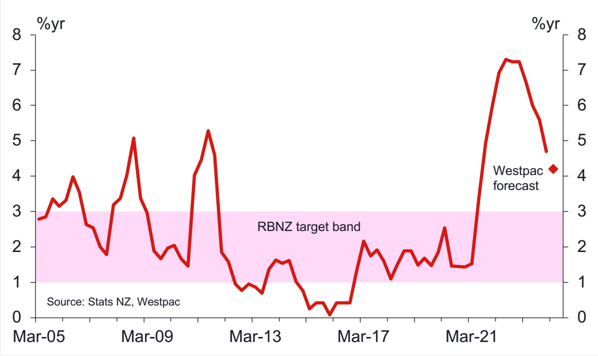
Apr 17,
Quarterly – Last: +0.5%, Westpac: +0.8%, Market: +0.6%
Annual – Last: +4.7%, Westpac: +4.2%, Market: +4.0%

We estimate that New Zealand consumer prices rose by 0.8% in the March quarter. That would see annual inflation dropping to 4.2%, down from 4.7% at the end of 2023.

The easing in inflation is mainly related to an easing in tradables prices. The domestic non-tradables components have been firmer, with core inflation measures also set to remain well above the RBNZ's target range.

The RBNZ's last published set of projections assumed a muted 0.4% rise. That forecast was finalised back in February – before the release of monthly price data for the last two months of the quarter. The RBNZ has already noted the upside risk to their earlier forecast. The key focus is where the RBNZ will be surprised – firmness in domestic prices (as we expect) will be of greater significance than swings in volatile items like airfares.

Consumers Price Index

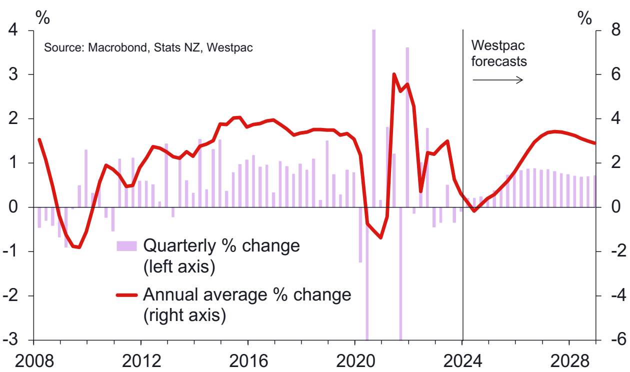


Economic and financial forecasts

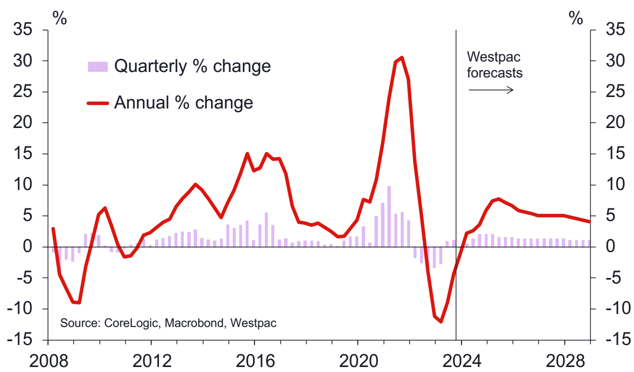
Economic indicators	Quarterly % change				Annual % change			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
GDP (production)	-0.1	0.2	0.2	0.2	2.4	0.6	0.4	1.6
Consumer price index	0.5	0.8	0.6	1.0	7.2	4.7	2.8	2.3
Employment change	0.4	0.1	0.1	0.0	1.7	2.4	0.3	1.0
Unemployment rate	4.0	4.3	4.6	4.9	3.4	4.0	5.1	5.2
Labour cost index (all sectors)	1.0	0.8	0.8	0.9	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-6.9	-6.3	-6.0	-5.5	-8.8	-6.9	-4.9	-3.9
Terms of trade	-7.8	6.4	2.7	1.5	-4.2	-10.6	12.0	3.4
House price index	-0.2	0.5	1.3	2.0	-11.2	-1.1	5.9	6.7

Financial forecasts	End of quarter				End of year			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.65	5.67	5.60	5.60	4.26	5.65	5.50	4.50
2 year swap	5.28	4.92	4.95	4.80	5.10	5.28	4.60	4.00
5 year swap	4.84	4.40	4.55	4.50	4.67	4.84	4.40	4.15
10 year bond	5.09	4.69	4.80	4.70	4.31	5.09	4.60	4.25
TWI	70.8	71.6	72.4	72.1	70.8	70.8	71.7	70.1
NZD/USD	0.60	0.61	0.63	0.64	0.60	0.60	0.64	0.65
NZD/AUD	0.93	0.93	0.93	0.92	0.92	0.93	0.91	0.89
NZD/EUR	0.56	0.56	0.57	0.56	0.59	0.56	0.56	0.56
NZD/GBP	0.49	0.48	0.50	0.50	0.51	0.49	0.50	0.50

GDP growth

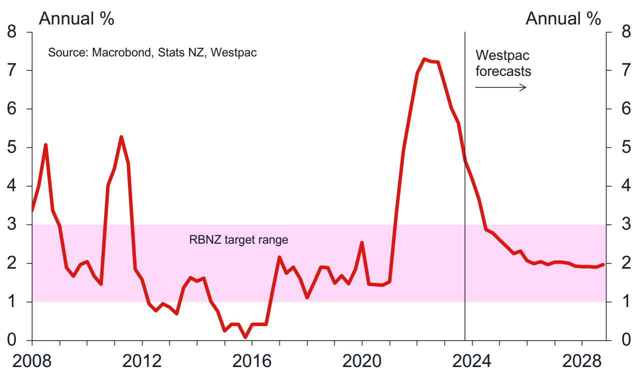


House prices



Employment and wage growth

Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 15					
NZ	Mar BusinessNZ PSI	53.0	–	–	Business conditions have continued to cool.
	Feb net migration	2870	–	–	Likely to be further large revisions to previous months.
Jpn	Feb machinery orders	–1.7%	0.8%	–	Weak export demand contributing to low orders.
Eur	Feb industrial production	–3.2%	1.0%	–	Manufacturing under pressure across the region.
US	Mar retail sales	0.6%	0.4%	–	Growth to decelerate to a below-trend pace this year.
	Apr NY Fed Empire state index	–20.9	–5.0	–	Manufacturing sentiment weighed down by costs.
	Feb business inventories	0.0%	0.3%	–	Run-down remains centred on wholesale inventories.
	Apr NAHB housing market index	51	51	–	Homebuilder sentiment recovery has a long road ahead.
Tue 16					
Chn	Q1 GDP %yr	5.2%	5.0%	5.0%	Chinese economy has started the year in robust shape...
	Mar retail sales ytd %yr	5.5%	5.5%	–	... consumption slowly improving and will contribute in time...
	Mar industrial production ytd %yr	7.0%	6.6%	–	... but for now, manufacturing and infrastructure are key...
	Mar fixed asset investment ytd %yr	4.2%	4.0%	–	... as the picture around property investment remains fragile.
Eur	Apr ZEW survey of expectations	33.5	–	–	Prospects of rate cuts buoying sentiment.
	Feb trade balance €bn	28.1	–	–	Trade poised to be a key support to growth in Q1 2024.
UK	Feb average weekly earnings %yr	5.6%	–	–	Tight labour market keeping wages sticky and strong.
US	Mar industrial production	0.1%	0.4%	–	Tracking a broadly flat to slightly negative trend.
	Mar housing starts	10.7%	–2.7%	–	Borrowing costs remain a headwind for builders...
	Mar building permits	2.4%	–0.3%	–	... creating risks for the pipeline.
	Fedspeak	–	–	–	Daly.
Wed 17					
NZ	GlobalDairyTrade auction (WMP)	3.4%	–	–	GDT Pulse, futures prices up slightly from previous auction.
	Mar REINZ house sales %yr	37.9%	–	–	A surge in listings will inevitably have lifted turnover...
	Mar REINZ house prices %yr	3.2%	–	–	... while likely keeping a lid on prices.
	Q1 CPI %qtr	0.5%	0.6%	0.8%	Firm domestic pressures, while import price ease.
	Q1 CPI %yr	4.7%	4.0%	4.2%	Headline and core rates still above RBNZ's midpoint.
Aus	Mar Westpac-MI Leading Index	0.03%	–	–	Pull-back in commodity prices a negative in March.
Eur	Mar CPI %yr	2.4%	2.4%	–	Final estimate.
UK	Mar CPI %yr	3.4%	–	–	Services inflation in line with BoE's forecast.
US	Federal Reserve's Beige Book	–	–	–	Update on economic conditions across the regions.
	Fedspeak	–	–	–	Mester.
Thu 18					
Aus	Mar employment change	116.5k	flat	–40k	Some 'payback' from an unusually strong February...
	Mar unemployment rate	3.7%	3.9%	4.0%	... but March will be key for assessing the trend.
	RBA Bulletin	–	–	–	Quarterly publication containing RBA research articles.
US	Apr Phily Fed index	3.2	0.0	–	Subdued outlook for manufacturing...
	Mar leading index	0.1%	–0.1%	–	... and for the broader economy still.
	Mar existing home sales	9.5%	–5.1%	–	Listings starting to lift, but demand remains robust.
	Initial jobless claims	211k	–	–	To remain relatively low.
	Fedspeak	–	–	–	Bowman, Williams, Bostic.
Fri 19					
Jpn	Mar CPI %yr	2.8%	2.8%	–	Demand slowdown evident in ex. food and energy measure.
UK	Mar retail sales	0.0%	–	–	Barely registering a pulse.

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