WEEKLY ECONOMIC COMMENTARY

18 Mar 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

It’s a long, long road

Last week’s data was another mixed bag in terms of gauging the direction of the New Zealand economy. Overall, though, it reinforced one of our key messages: it’s going to be a long wait before the Reserve Bank feels satisfied that inflation pressures have been brought under control.

Economic activity itself has been subdued in recent times. We expect Thursday’s report to show that GDP was flat over the December 2023 quarter. While services sectors are still benefiting to some degree from the recovery in international tourism, the more domestically-focused parts of the economy are feeling the pinch of high interest rates. **Our detailed preview is here**.

That softness in domestic demand has continued into the early part of this year. Credit and debit card spending fell by 1.8% in February, reversing a 2% rise in January. Spending has effectively been flat over the last year in dollar terms, which implies that it has fallen further in inflation-adjusted terms.

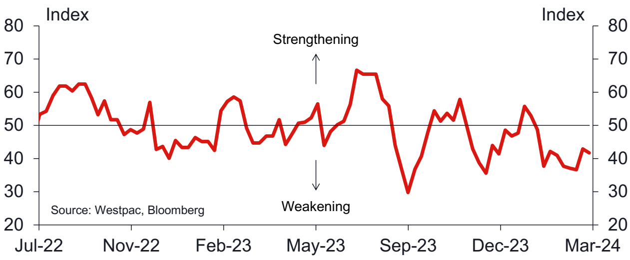
The details show that the biggest slowdown has been in interest rate-sensitive and discretionary areas. Spending on durable household goods (like furnishings) was down 0.9% in February and has fallen around 8% over the past year. There’s been a similar drop in spending on apparel. Grocery spending has been more resilient, but our discussions with retailers indicate that households are dealing with rising prices by switching to more budget-friendly options, and foregoing ‘nice to haves’ in favour of necessities.

The housing market has remained fairly muted so far as well. While activity picked up in February, that came after an exceptionally slow January. House sales rose by 14% in seasonally adjusted terms, taking them back up to the highs seen last year, but still well below the long-run average. February saw a surge in new listings hitting the market, so it was perhaps inevitable that we’d see a lift in turnover as well. However, supply is still outpacing

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

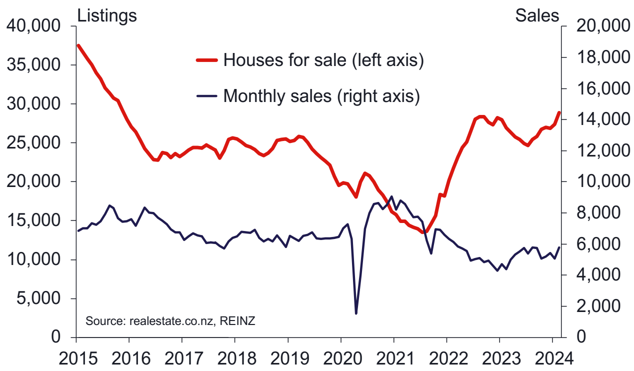


Key data and event outlook

Date	Event
19 Mar 24	RBA Monetary Policy Decision and SMP
20 Mar 24	FOMC Meeting (Announced 21 Mar NZT)
21 Mar 24	GDP, December quarter
27 Mar 24	Govt to release Budget Policy Statement
9 Apr 24	QSBO business survey, March quarter
10 Apr 24	RBNZ Monetary Policy Review
12 Apr 24	NZ Selected price indexes, March
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	RBA Monetary Policy Decision and SMP
13 May 24	NZ Selected price indexes, April
22 May 24	RBNZ Monetary Policy Statement and OCR

demand, and the stock of unsold homes on the market has continued to rise.

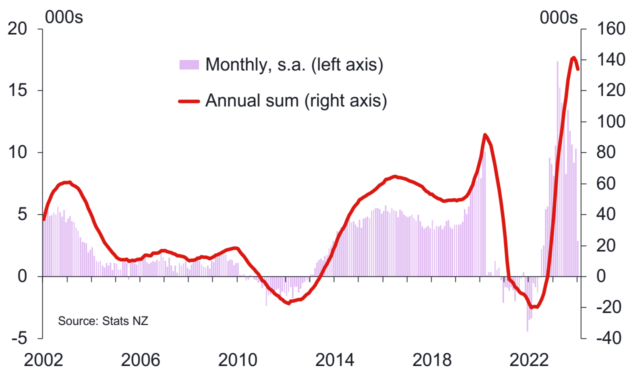
House sales and listings, seasonally adjusted



The REINZ house price index was flat for the month in seasonally adjusted terms. Prices seem to have stabilised in recent months and are up about 3% from the low point that they reached a year ago. We expect to see further gains over the year head, as population pressures grow and changes to the tax treatment of investment properties bring buyers back to the market. But an easing in mortgage rates is the most crucial missing element at the moment.

The weak momentum in the economy has come despite a surge in population growth. The latest migration figures showed another upward revision to the already record-high net inflows, reaching an annual peak of 141,000 people last November. The January figures suggested a sharp slowdown in the net inflow, led by a rise in departures. However, there appear to be ongoing issues with these estimates over the Christmas / New Year period: people going overseas on holiday or to visit family are initially being identified as emigrants.

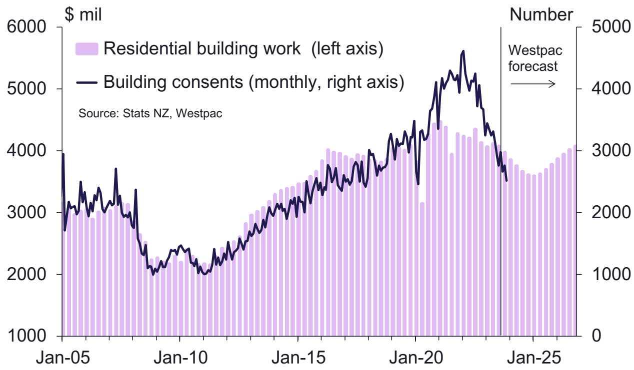
Net migration



The Reserve Bank took a more moderate stance on migration in its February *Monetary Policy Statement*, compared to November where it declared that "the effects on aggregate demand are becoming apparent". It's unclear whether strong population growth is adding to inflation as a whole, but there are certainly some areas where the pressures are apparent – most notably on the housing stock. Rental inflation is steadily rising, with rents on new tenancies up 6% in the year to February.

That pressure could intensify from here. **Our update on the residential construction sector** shows that the pace of homebuilding has fallen behind population growth again. And even if net migration slows as we expect in the years ahead, the building industry is facing an even sharper slowdown, as higher building costs and interest rates put the squeeze on new developments.

Residential building and consent numbers



Finally, the selected prices report for February prompted us to revise up our forecast for inflation in the March quarter. Food prices have eased back, reversing some of the rise that we saw last year after the crop damage caused by Cyclone Gabrielle. But this was more than offset by the strength in rents, and in overseas airfares and accommodation (coinciding with the Taylor Swift concerts in Australia). **Our detailed review can be found here**.

We now expect that New Zealand consumer prices will rise by 0.8% in the March quarter, from a previous forecast of 0.7%. That would see the annual inflation rate fall from 4.7% to 4.2%, which would be the lowest since June 2021, but still some way above the Reserve Bank's 1-3% target range.

Crucially, our forecast for the March quarter is double what the RBNZ was expecting in its February statement. This upside risk to the RBNZ's view is coming in both the imported and the domestically-driven categories. It's still true to say that inflation is cooling down. But the question is whether it's happening fast enough for the RBNZ's liking; their long-held view that inflation will drop below 3% in the September quarter is now hanging in the balance.

Michael Gordon, Senior Economist

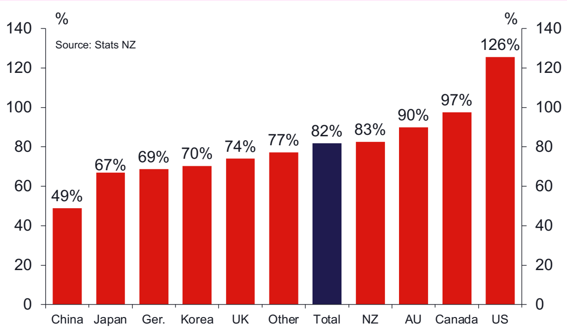
Chart of the week.

Tourism data released over the past week pointed to a pick-up in foreign visitor arrivals in January. However, arrivals continue to track a little lower than we had expected in our recent Economic Overview, with overall inflows just 82% of their January 2019 level.

Boosted by increased flights into New Zealand, arrivals from the US were 126% of their January 2019 level. However, overall arrivals continue to be weighed down by weak activity from Asia (China sitting at just 49%) and Europe (the UK sitting at 74%).

By contrast, short-term departures by New Zealand residents now stand at 102% of their January 2019 level. This implies that the net impact of tourism on the New Zealand economy presently remains much smaller than prior to the pandemic.

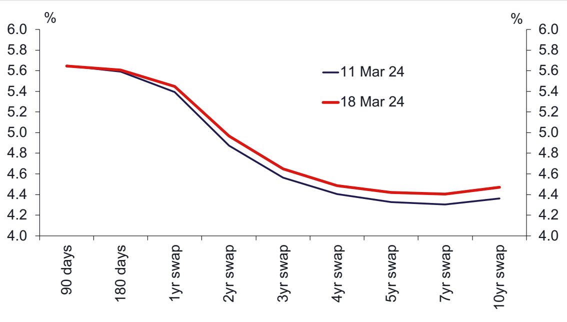
Tourist arrivals – January 2024 vs January 2019



Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in February. While further OCR hikes don't look likely, easings are still some way off. 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.

Last week's US CPI was again stronger than expected, albeit annual core inflation still edged down to 3.8%. Together with an upward surprise in the PPI later in the week, this might come as a disappointment to FOMC members looking for further progress towards the 2% inflation target (the detail suggests that the Fed's key inflation metric – the core PCE deflator – may hold steady at 2.8%). In other news, retail spending rebounded less than expected in February, while factory production and consumer sentiment data also disappointed. The highlight this week will be the FOMC meeting (Thursday morning NZT). While the Fed's policy rate will doubtless remain unchanged, the focus will be on the updated policy "dot plot", together with Chair Powell's press conference, to see whether the Fed is still on track to deliver three 25bp rate cuts this year (risks seem skewed towards the Fed delivering less). On the data front, this week will bring news on housing, construction and manufacturing activity, together with the flash PMI readings for March. CPI and retail spending data will take centre stage in Canada.

Europe.

Last week, ECB commentary pointed to broad agreement amongst Council members that policy settings will likely begin easing in the spring. In the UK, prospects for the BoE to follow were helped by news that wage growth had fallen to an 18-month low. This week much of the interest in both the euro area and the UK will centre on Thursday's flash PMI readings, with February data hinting at a stabilising outlook in both economies. In the UK, CPI data will also be released on Tuesday, while the BoE's policy review on Thursday will be of interest given the unusual three-way split vote recorded at the prior meeting.

Asia-Pacific.

In Japan, Tuesday's BoJ policy meeting will be a key focus for markets, with newswire reports and recent comments from officials hinting that the Bank may abandon its negative rate policy. Prospects of a hike (the first since 2007) were boosted after RENGO reported average spring wage hikes of 5.28% – the most in 33 years. Elsewhere in Asia, today China will print its key domestic activity indicators for the January-February period, providing some early insight into the prospects of achieving this year's challenging target of 5% GDP growth. In Australia, the focus early this week will be on Tuesday's RBA decision and press conference. We expect the RBA to leave its policy rate at 4.35%, and perhaps express some comfort with recent developments in activity and inflation indicators. On the data front, Thursday's labour market report will be of greatest interest.

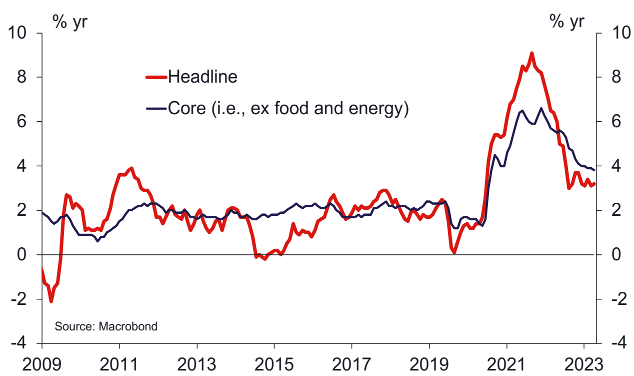
Trading partner real GDP (calendar years)

	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	6.4
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

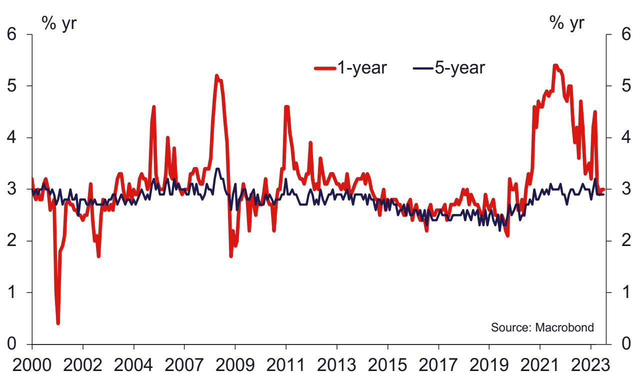
Australian & US interest rate outlook

	15-Mar	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	3.93	3.95	3.75	3.50
3 Year Bond	3.74	3.75	3.55	3.30
10 Year Bond	4.13	4.05	3.85	4.00
10 Year Spread to US (bps)	-15	5	5	0
US				
Fed Funds	5.375	5.125	4.375	3.375
US 10 Year Bond	4.08	4.00	3.80	4.00

US CPI inflation



US University of Michigan inflation expectations



Financial markets wrap

Interest rates.

NZ swap rates will likely be led higher this week by the US markets, ahead of and following the FOMC, if they do indeed remove a cut from the dot plot profile for 2024. A 10bp rise in the 2yr to 5.10% is plausible, but at that level we'd expect receivers to enter en-masse.

Multi-week/month, there is potential for further downside in rates, the 2yr below 4.60%, but in a much slower manner than has been the case given there's still plenty of easing priced in. Markets price a 60% chance of a cut in August and a 100% chance of cuts at the following three meeting (our economists forecast the first cut in Feb 2025). Moreover, this pre-easing on-hold period will be more volatile than past ones, given it will be the longest in OCR history.

The week ahead could be a volatile one for NZ rates markets , with the Fed's FOMC, RBA, AU jobs, and NZ GDP on tap.

Foreign exchange.

The six-week old 0.6040-0.6220 range in NZD/USD persists, with attempts at breaking higher and lower all failing so far. This week the downside will be in focus. Should 0.6040 give way, 0.6000 would likely be tested soon afterwards, offering attractive levels for exporters.

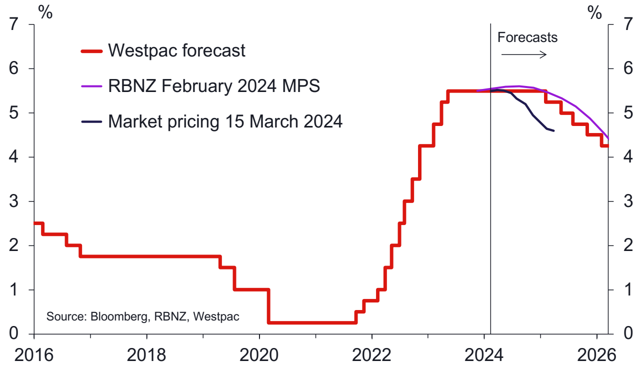
The US dollar has rebounded over the past week, driven by concerns the Federal Reserve's FOMC meeting this week may project fewer rate cuts this year than the three which were indicated at its previous meeting. US bond yields have risen as a result, in turn boosting the US dollar.

There's NZ event risk too, from the Q3 GDP data on Thursday, which we expect to be soft (0.0%q/q).

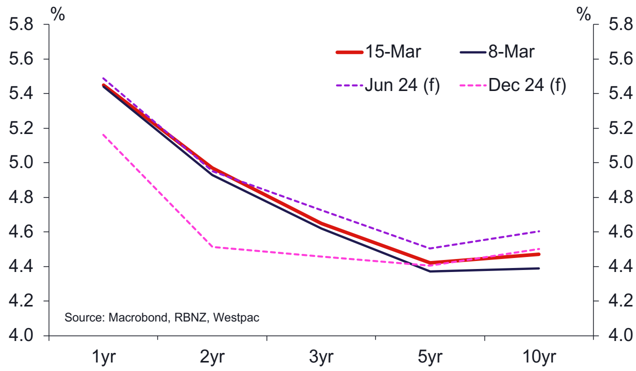
Multi-month, though, we remain bullish, seeing potential for 0.6300+. That is based on expectations that the RBNZ's next easing cycle will start much later than the US Federal Reserve's (our economists forecast June 2024 and February 2025, respectively).

NZD/AUD has extended the decline since the dovish RBNZ MPS surprise and could extend further to the 0.9200 area during the weeks ahead, despite falling iron ore prices. NZ-AU yield spreads have been the dominant influence this year. On that score, the RBA's rhetoric at this week's meeting will be important.

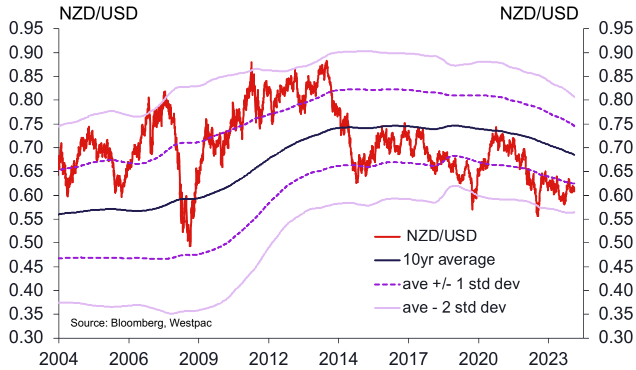
Official Cash Rate forecasts



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	0.609	0.605-0.635	0.555-0.743	0.651	0.64
AUD	0.928	0.923-0.944	0.873-0.992	0.933	0.91
EUR	0.559	0.558-0.572	0.517-0.637	0.584	0.56
GBP	0.478	0.478-0.497	0.464-0.544	0.507	0.50
JPY	90.7	88.1-93.1	61.3-93.1	78.3	88.3

The week ahead

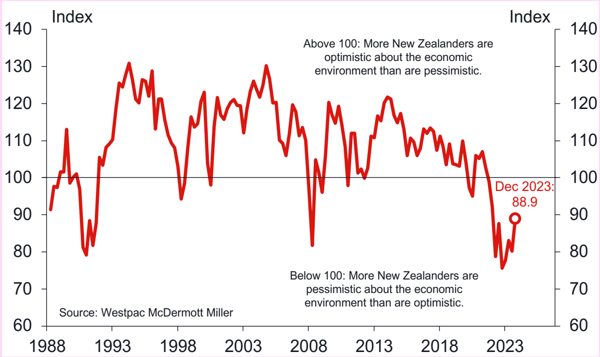
NZ Q1 Westpac McDermott Miller Consumer Confidence

Mar 20, Last: 88.9

The Westpac McDermott Miller Consumer Confidence Index rose 8.7 points in December. That left confidence at levels that were still well below average, with spending appetites remaining weak.

Our upcoming survey was in the field during the early part of March. Recent months have seen signs that inflation is cooling. However, both inflation and interest rates remain elevated. We've also seen economic growth stalling and the labour market softening.

Consumer Confidence



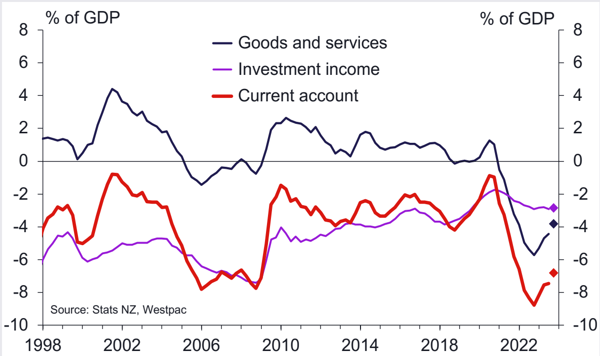
NZ Q4 current account balance

Mar 20, Last 7.6% of GDP (year to September), WBC f/c 6.8% of GDP (year to December)

A severely overheated economy and the closed borders combined to drive the current account deficit to almost 9% of GDP in 2022. Since then, with domestic demand slowing under the weight of tight financial conditions, and tourist and foreign student inflows resuming, the deficit has begun to narrow.

We expect very weak imports of goods to drive a further narrowing of the goods deficit in Q4. And so combined with signalled upward revisions to exports of education services, we expect the current account deficit to have narrowed to 6.8% of GDP in 2023.

Annual current account balance



NZ Q4 GDP

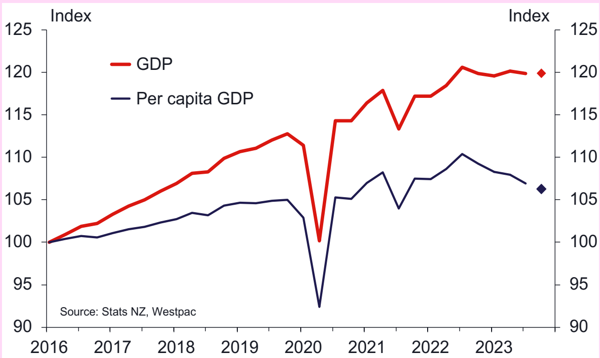
Mar 21, Last: -0.3%, Westpac f/c: 0%, Mkt f/c: 0%

We estimate that GDP was flat in the December 2023 quarter. This is in line with the Reserve Bank's forecast in its February Monetary Policy Statement, and is likely to be around the middle of the range of market forecasts.

Goods-producing sectors remained relatively soft over the quarter, while the services sectors have continued to benefit to some degree from the recovery in tourism.

Based on our forecast, economic activity has been flat over the last year, despite a migration-driven surge in population growth. The extent of the decline in per-capita output reflects how overheated the economy had become in the first place, as a result of the monetary and fiscal stimulus during the Covid period.

Real GDP level

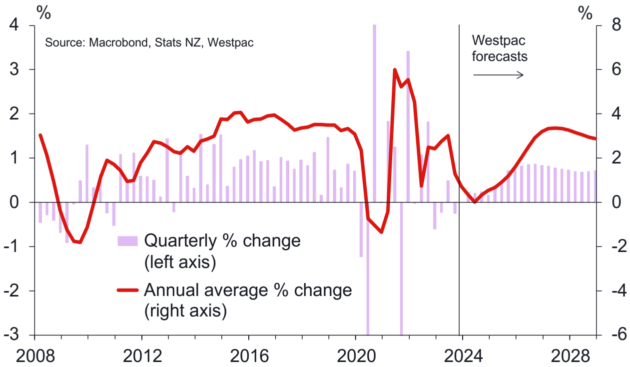


Economic and financial forecasts

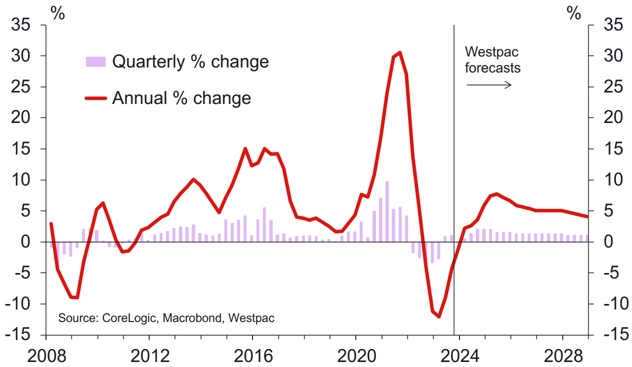
Economic indicators	Quarterly % change				Annual % change			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
GDP (production)	-0.3	0.0	0.2	0.2	2.4	0.7	0.5	1.6
Consumer price index	1.8	0.5	0.8	0.6	7.2	4.7	2.8	2.3
Employment change	-0.1	0.4	0.0	0.2	1.7	2.4	0.3	1.0
Unemployment rate	3.9	4.0	4.3	4.6	3.4	4.0	5.1	5.2
Labour cost index (all sectors)	1.1	1.0	0.8	0.8	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-7.6	-7.0	-6.4	-5.8	-8.8	-7.0	-4.4	-3.6
Terms of trade	-0.6	0.3	2.0	2.0	-4.2	-1.5	6.1	3.4
House price index	1.0	-0.2	0.5	1.3	-11.2	-1.1	5.9	6.7

Financial forecasts	End of quarter				End of year			
	Sep-23	Dec-23	Mar-24	Jun-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	5.66	5.65	5.60	5.60	4.26	5.65	5.50	4.50
2 year swap	5.53	5.28	5.10	4.95	5.10	5.28	4.50	4.00
5 year swap	4.90	4.84	4.60	4.50	4.67	4.84	4.40	4.10
10 year bond	4.87	5.09	4.85	4.70	4.31	5.09	4.60	4.25
TWI	70.6	70.8	72.2	72.3	70.8	70.8	71.7	70.0
NZD/USD	0.61	0.60	0.62	0.63	0.60	0.60	0.64	0.65
NZD/AUD	0.92	0.93	0.94	0.93	0.92	0.93	0.91	0.89
NZD/EUR	0.56	0.56	0.57	0.57	0.59	0.56	0.56	0.56
NZD/GBP	0.48	0.49	0.49	0.50	0.51	0.49	0.50	0.50

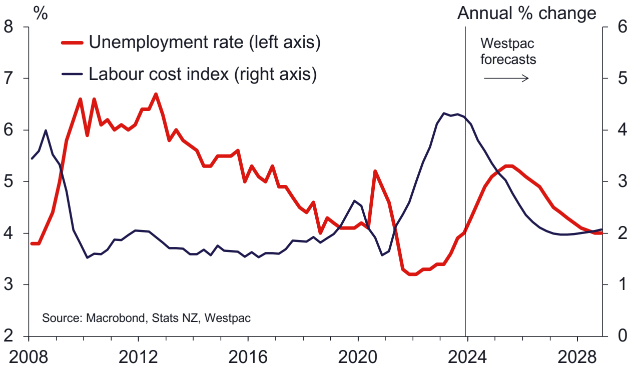
GDP growth



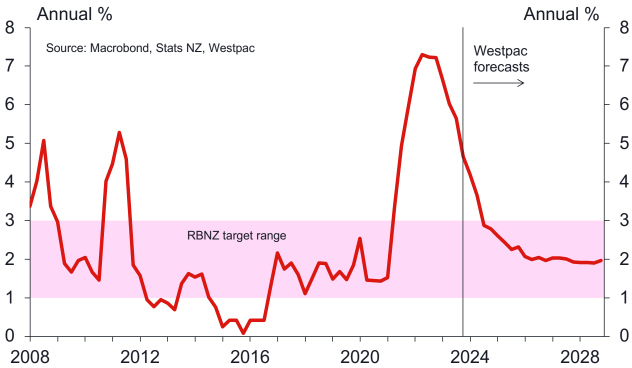
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Feb BusinessNZ PSI	52.1	–	–	Modest trend upwards seen in recent months, but volatile.
Jpn	Jan core machinery orders	2.7%	–0.7%	–	Weak export demand contributing to low orders.
Chn	Feb retail sales ytd %yr	5.0%	5.5%	–	Lunar new year will buoy consumer spending.
	Feb industrial production ytd %yr	5.0%	5.2%	–	Stimulus struggles to support investment…
	Feb fixed asset investment ytd %yr	3.2%	3.2%	–	… ahead risking weakness in production.
Eur	Jan trade balance €bn	13.0	–	–	Softening regional demand a risk.
US	Mar NAHB housing market index	48	48	–	Homebuilder sentiment recovery has a long road ahead.
Tue 19					
Aus	RBA policy decision	4.35%	4.35%	4.35%	Board will be comforted by Q4 National Accounts.
Jpn	BoJ policy decision	–0.10%	–0.10%	–0.10%	Fragile economy necessitates continuation of support.
Eur	Mar ZEW survey of expectations	25	–	–	Prospect of rate cuts to support sentiment, in time.
US	Feb housing starts	–14.8%	7.4%	–	High borrowing costs are dissuading builders from starting…
	Feb building permits	–0.3%	2.0%	–	… new projects, creating risks for the pipeline.
Wed 20					
NZ	GlobalDairyTrade auction (WMP)	–2.8%	–	–	GDT Pulse –2%, futures –3% compared to previous auction.
	Q1 Westpac–MM Consumer Conf.	88.9	–		Households still facing challenging conditions.
	Q4 current account % of GDP	–7.6%	–	–6.8%	Deficit shrinking as domestic demand slows.
Eur	Mar consumer confidence	–15.5	–	–	Consumers are uncertain about the outlook ahead.
UK	Feb CPI %yr	4.0%	–	–	Services inflation robust, to the concern of the BoE.
US	FOMC policy decision, midpoint	5.375%	5.375%	5.375%	Guidance from revised forecasts on timing of easing.
Thu 21					
NZ	Q4 GDP	–0.3%	0.1%	0.0%	Activity subdued, declining in per capita terms.
Aus	RBA Chief Operating Officer	–	–	–	Panel Participant at Reuters Conference; new role at RBA.
	Feb employment change	+0.5k	+40k	+40k	Partial 'rebound' from January seasonal volatility…
	Feb unemployment rate	4.1%	4.0%	4.0%	… should not distract from soft underlying momentum.
Jpn	Mar Jibun Bank manufacturing PMI	47.2	–	–	Poor productivity weighs on manufacturing sector…
	Mar Jibun Bank services PMI	52.9	–	–	… services still upbeat as tourists come in droves.
Eur	Mar HCOB manufacturing PMI	46.5	–	–	Weakness is broadening across the economy…
	Mar HCOB services PMI	50.2	–	–	… as restrictive policy continues to impact.
UK	Mar S&P Global manufacturing PMI	47.5	–	–	Softening demand conditions taking precedence…
	Mar S&P Global services PMI	53.8	–	–	… services remains surprisingly resilient.
	BoE policy decision	5.25%	–	5.25%	Sticky wages and deteriorating growth create a challenge.
US	Mar Phily Fed index	5.2	–4.0	–	Subdued outlook for manufacturing…
	Feb leading index	–0.4%	–0.2%	–	… and the broader economy.
	Mar S&P Global manufacturing PMI	52.2	51.8	–	Optimism persists despite tight financial conditions…
	Mar S&P Global services PMI	52.3	52.0	–	… seeing modest growth across both sectors.
	Feb existing home sales	3.1%	–2.0%	–	Low inventories support prices but weigh on volume.
	Initial jobless claims	209k	–	–	To remain relatively low, for now.
Fri 22					
NZ	Feb trade balance $mn	–976	–	–131	A smaller deficit thanks to a seasonal slowing in imports.
Aus	RBA Financial Stability Review	–	–	–	Half-yearly update on financial system conditions and risks.
Jpn	Feb CPI %yr	2.2%	2.9%	–	Base effects to drive an unconvincing lift in February.
UK	Mar GfK consumer sentiment	–21	–	–	Restrictive policy setting remains a headwind…
	Feb retail sales	3.4%	–	–	… to both confidence and spending.
US	Fedspeak	–	–	–	Bostic.

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