WEEKLY ECONOMIC COMMENTARY

9 Oct 2023 | **Westpac Economics Team** | **westpac.co.nz/economics** | nzeconomics@westpac.co.nz

High for longer; probably still higher too.

The RBNZ left the OCR at 5.5%. The forward view espoused was less hawkish than anticipated but affirmed that they are not expecting to lower the OCR for a protracted period. While they recognise some stronger indicators of late, they expect higher long term interest rates and an easing of the labour market and economic growth to eventually bring inflation down. We remain less convinced and have revised our forward profile for the OCR to reflect the 'higher for longer' message coming from the data, markets and to some extent the RBNZ.

It was a very busy week for the economy and markets that culminated in a much-watched RBNZ Monetary Policy Review that surprised a market expecting a more hawkish stance. The RBNZ still sees risks that there is a chance that the economy doesn't slow as much as required to bring inflation down or that inflation itself proves more persistent than hoped. But these risks are balanced in their eyes by the significant increase in long-term interest rates we discussed in last week's "chart of the week" and the slew of cyclical demand and labour market indicators that suggest a slowdown in growth in the second half of 2023 and an easing labour market.

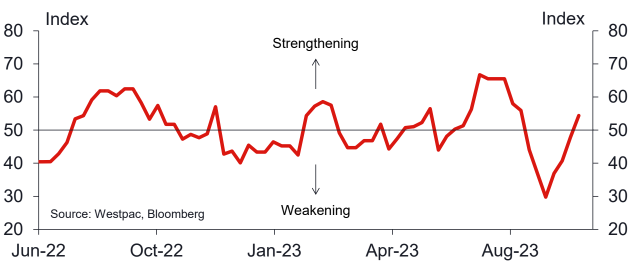
Risks to wage growth remain a key consideration for the RBNZ. On that front, we saw in last week's Quarterly Survey of Business Opinion (QSBO) showed signs of easing conditions as the inflow of migrants is being integrated into an economy still in need of labour.

The bottom line for the RBNZ is that they think they can stand pat – potentially for quite a long time – and let past tightening do the work. Buried deeply in the MPR minutes was some sign that the recent data (for example strong H1 2023 GDP, stronger house prices, the recent bounce-

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



Key data and event outlook

Date	Event
14 Oct 23	General Election
17 Oct 23	CPI September quarter
1 Nov 23	Labour market statistics, September quarter
1 Nov 23	RBNZ Financial Stability Report
1 Nov 23	FOMC Meeting (Announced 2 Nov NZT)
3 Nov 23	Official results of General Election declared
7 Nov 23	RBA Board Meeting
29 Nov 23	RBNZ Monetary Policy Statement and OCR
5 Dec 23	RBA Board Meeting
13 Dec 23	FOMC Meeting (Announced 14 Dec NZT)
14 Dec 23	GDP September quarter
18 Dec 23	Half Year Economic and Fiscal Outlook (TBC)

back in dairy prices) had raised the risks a bit. But rather than pushing the RBNZ towards additional hikes in the short term, the response to those developments for now is has been to push out the time when easing might be contemplated, with the Monetary Policy Committee noting that *"interest rates may need to remain at a restrictive level for a more sustained period of time"*. The RBNZ's August interest rate projections didn't show rate reduction until late 2024. But based on the updated comments in the MPR, we suspect that the RBNZ now isn't contemplating cuts until sometime in 2025.

Our view on this is that we are not convinced that enough has been done – so in terms of inflation risks we think the OCR increase ball is still in play – but we can certainly see the MPC's reaction function quite clearly. It's a hurdle to get the MPC to move and the upcoming September quarter CPI and labour market data due in the next few weeks will be critical in seeing if we can get the required movement there. Hence, we still see an increase in the OCR at the November Statement – contingent on a strong set of core inflation and labour market outcomes in the next few weeks.

Further out though, we have made changes to our forward view. We have been running with the idea that the RBNZ would respond to building inflation pressures relatively quickly, thus bringing inflation down faster and allowing for earlier interest rate cuts. This is not the MPC's revealed reaction function now. Hence, we are responding to this information by revising up our future profile for the OCR and hence longer-term interest rates. We now don't see an easing in 2024 – we think this could come in early 2025 – and hence our forecasts for longer term rates are now higher.

Our updated interest rate profile is much more consistent with the message coming from the data but especially the financial markets which have sharply revised up interest rate expectations globally. This information might reflect many things (animal spirits, debt supply, risk premia) that could be tightening financial conditions even though the growth and inflation outlook is weak. Alternatively, it could reflect the view that recession risks are receding, or that inflation pressures are more persistent. That inflation persistence message is the one that resonates most clearly to us.

Change in RBNZ forecasts of the economy, November 2022 MPS vs August 2023 MPS

	Forecast horizon		
	June 2023	June 2024	June 2025
Annual Net Migration	+64.9 k	+45.5 k	+ 26.7 k
GDP growth	-0.2 %	+0.6 %	+1.3 %
Unemployment rate	-0.3 %	-0.2 %	-0.4 %

Source: RBNZ and Westpac calculations

A lot of things have changed since the RBNZ charted their course to push the OCR to 5.5 % in late 2022. Key issues have been an entirely unanticipated migration boom that is taking population growth to levels not seen since the 1960's and a marked turnaround in the fiscal stance in 2023/24 from one where fiscal policy could have helped the RBNZ to reduce growth and inflation pressures to one where the fiscal stance is frustrating those goals.

Fiscal Impulse % Nominal Potential GDP

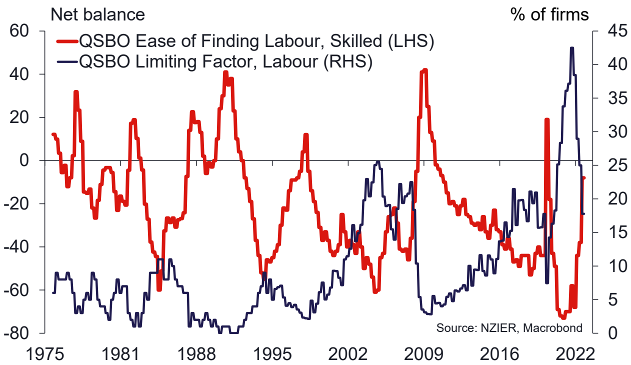
	2023/24	2024/25	2025/26	2026/27
2022 HYEFU	-0.8	-2.0	-0.7	-1.1
2023 PREFU	2.0	-1.2	-2.2	-0.8
Difference	+2.8	+0.9	-1.5	+0.3

Source: The Treasury and Westpac calculations

As a result, since 2022 the RBNZ's growth forecasts have been significantly revised up and unemployment rate forecasts revised down, while the RBNZ's inflation forecasts have remained well anchored around the idea that inflation will return to the 1-3 % target range by end 2024. The RBNZ's assumptions might prove correct (for example if the growth potential of the economy has increased significantly with population growth), or indeed another negative shock hits us and drives the economy and inflation down (for example an extension of the fall in the terms of trade seen this year as the Chinese economic outlook has weakened). However, we are concerned that inflation might persist and that the RBNZ's interest rate strategy may not have been sufficiently adjusted to accommodate these factors. It may be that an OCR of 5.5% is insufficient to bring inflation down fast enough without risking a rise in inflation expectations, which could compound upward pressures on costs and wages. Households and businesses might not see much respite from the pressures they have been under for a while now in that scenario.

Either way, it looks like we should be prepared for interest rates that are either higher for longer or high for longer. The data will tell us which of those outcomes we see.

Labour market indicators are easing

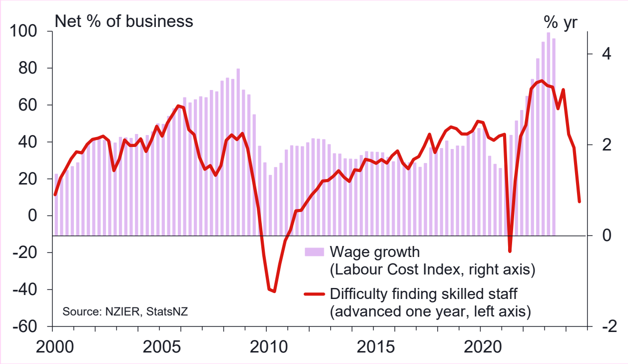


Kelly Eckhold, Chief Economist

Chart of the week.

With the reopening of the border, net migration has surged and businesses are reporting that it's become easier to source the skilled labour that has been in short supply for the past few years. Typically, that sort of easing in labour market tightness would also be associated with a slowdown in wage growth. However, our recent discussions with businesses have pointed to continued upward pressure on wages. That's because the labour market remains tight, with unemployment at just 3.6%. In addition, high rates of inflation are underpinning continued claims for cost of living adjustments. Those factors mean that wage growth is likely to remain firm in the near term. However, it could be a quite different picture next year: with economic activity now turning down, workers are likely to find that it will become increasingly difficult to push through large wage claims.

Difficulty finding skilled staff vs. wages growth

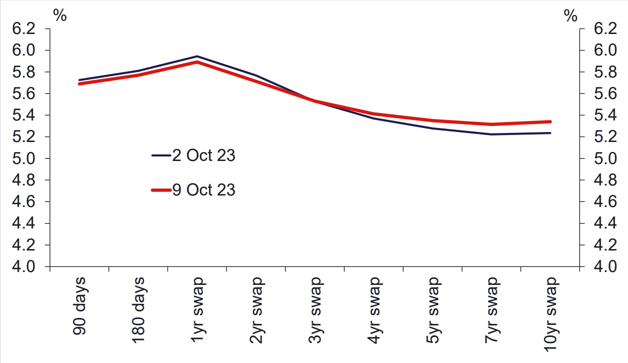


Fixed versus floating for mortgages.

The RBNZ has signalled that it expects to hold the cash rate at its current level of 5.50% for an extended period. We see a risk that the OCR could go higher in the coming months, and that interest rate cuts could be some time away.

We see value in fixing for terms as long as three years. Shorter terms could be more expensive, but would provide borrowers with greater flexibility.

NZ interest rates



Global wrap

The Middle East and crude oil.

The past couple of months has seen a strong run-up in the price of crude, with Brent peaking at over $96/bbl in response to OPEC+ supply cuts and earlier signs of strong demand – a move that threatened to hold headline inflation higher for longer. And so central banks would have taken some comfort last week from a sharp pull back in prices, with Brent closing at just over $84/bbl (Dec '23). Following this weekend's disturbing developments in Israel and the Gaza Strip, it seems likely that prices will rebound at least a little as participants price some risk that fighting between Israel and Hamas might evolve into a broader regional conflict. However, at this stage, we are taking some comfort from Saudi comments calling for a de-escalation of the crisis and from the US strong calling that other parties in the region not to get involved.

US.

Non-farm payrolls rose a stronger than expected 336k in September, causing an initial sharp sell-off in bond markets. However, the household survey pointed to somewhat slower job growth of 205k, and so the unemployment rate remained steady at 3.8%. Markets also took some comfort from news that annual wages growth slowed to 4.2%. This week most interest will centre on Thursday's CPI report. We expect a 0.3% lift in the core CPI, causing annual inflation to decline to 4.3%. Other key releases this week include the PPI and the preliminary University of Michigan consumer survey.

Asia-Pacific.

This week China returns from its Golden Week holiday and so markets will be looking for any clues on how consumer spending has fared over the holiday period (according to the tourism ministry, domestic spending has increased just 1.9% compared with the 2019 holiday period). On Wednesday September credit figures will be assessed for any signs of stimulus while inflation data will take centre stage on Friday. In Japan, following last week's upbeat BoJ's Tankan survey, the Economy Watchers Survey will cast more light on sentiment while machinery orders data will provide an indication of trends in capex. The focus during a quiet week in Australia will be the business and consumer sentiment reports released on Tuesday.

Europe.

A quiet week lies ahead in the euro area with the focus likely to be on IP reports for August. In the UK the key day this week is Thursday, with the August GDP report casting light on a potential contraction in Q3 GDP following an unexpectedly steep 0.5% decline in activity in July.

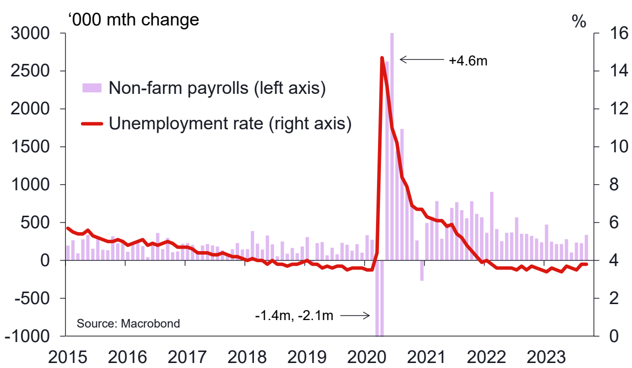
Trading partner real GDP (calendar years)

	Annual average % change			
	2021	2022	2023	2024
Australia	5.2	3.7	1.9	1.2
China	8.4	3.0	5.0	5.5
United States	5.9	2.1	2.2	1.4
Japan	2.1	1.1	1.6	1.0
East Asia ex China	4.3	4.5	3.5	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	3.3	3.4
World	6.3	3.4	3.0	3.1

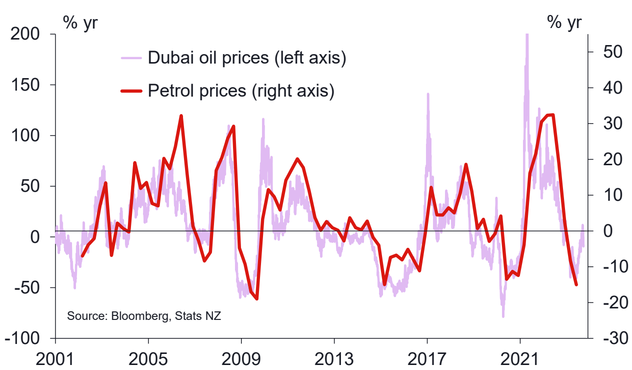
Australian & US interest rate outlook

	Latest	Dec-23	Jun-24	Dec-24
Australia				
Cash	4.10	4.10	4.10	3.60
90 Day BBSW	4.14	4.30	4.22	3.72
3 Year Swap	4.25	4.10	3.90	3.70
3 Year Bond	4.04	3.85	3.70	3.50
10 Year Bond	4.60	4.45	4.40	4.20
10 Year Spread to US (bps)	-19	-15	-20	-20
US				
Fed Funds	5.375	5.375	4.875	4.375
US 10 Year Bond	4.79	4.60	4.60	4.40

US non-farm payrolls and unemployment rate



NZ petrol prices and Dubai oil prices



Financial markets wrap

Interest rates.

NZ swap rates rose to multi-year highs last week, driven mostly by offshore yields. The 2yr swap reached 5.85% – highest since 2008, while the 10yr swap reached 5.37% – highest since 2011. The RBNZ announced the OCR would remain at 5.5%, which was expected by the market, but there was a dovish surprise via the lack of hints of a tightening bias. That caused short term rates to fall slightly but long-term rates still closed higher, assisted by an overnight sell-off in the US (perhaps in the expectation that inflation could remain high without further rate hikes).

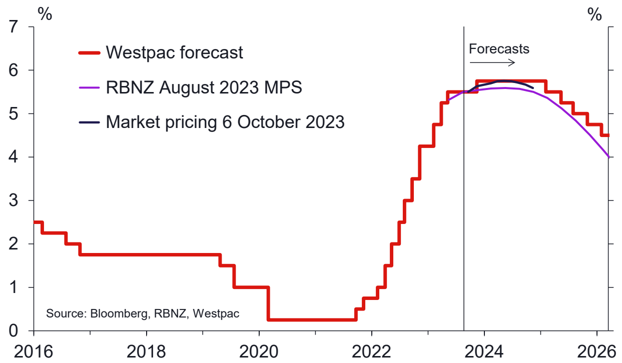
Looking ahead, the main event which could ruffle NZ rates markets this week will be the US CPI report (Thurs. night NZT). Markets are expecting a slight decline in both headline and core inflation – a stickier outcome would elicit a rise in bond yields, which would ripple through to NZ rates, particularly longer maturities. There's also NZ data on tap this week, which overall will add to the economic picture. Markets have priced a 45% chance of an OCR hike at the MPS on 29 November, so there's potential for short term rates to swing either way in response to data surprises. We remain of the view that the yield curve will continue to steepen (i.e. become less inverted). Borrowers may wish to consider coverage levels in this higher-for-longer yield environment.

Foreign exchange.

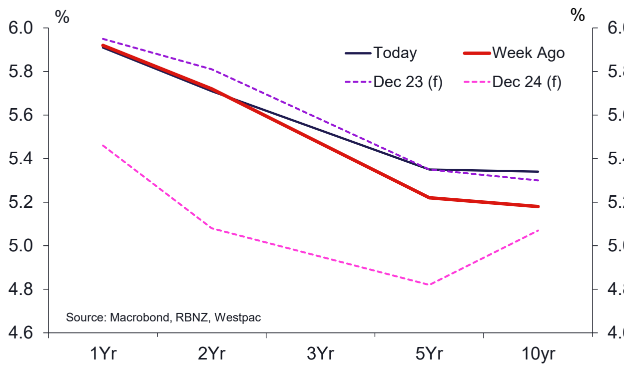
Last week the US dollar, which had been rising since mid-July and causing the NZD/USD's decline, stuttered. That was despite overall strong economic data, with a partial explanation being the stabilisation and improvement in risk sentiment (proxied by the equity markets). Another explanation is that the USD had risen quite sharply over the past two months, and so some consolidation was warranted. This backdrop has allowed NZD/USD to stabilise above 0.5860, and start a gradual recovery.

This week's initial risk event for NZD/USD will be any further escalation of weekend developments in the Middle East, which would weigh on all 'risky' assets. Later in the week the US CPI data could move the USD in either direction. US and Middle East surprises aside, we wouldn't be surprised to see NZD/USD grinding higher to the 0.6050 area during the week ahead. NZ's economic data has been mixed but mostly better than expected, resulting in the NZD being the best performer among G10 over the past week and month. Exporters might consider hedging levels in the event of a further short-term lift in the exchange rate. We note that a messy outcome at this coming week's General Election could weigh on the NZD early next week.

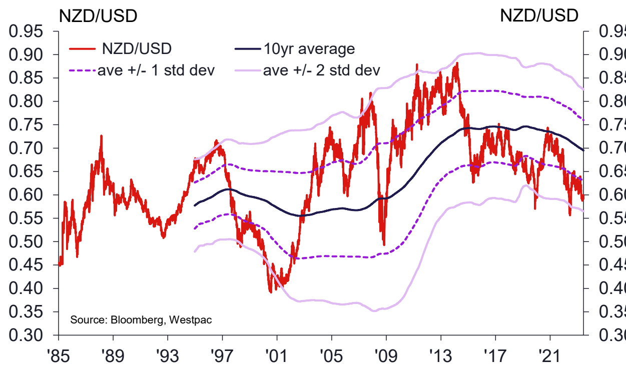
Official Cash Rate forecasts



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	0.596	0.586-0.635	0.555-0.743	0.657	0.62
AUD	0.938	0.916-0.936	0.873-0.992	0.934	0.89
EUR	0.565	0.543-0.570	0.517-0.637	0.587	0.55
GBP	0.489	0.464-0.491	0.464-0.551	0.511	0.48
JPY	89.0	86.0-89.6	61.3-89.6	77.0	84.9

The week ahead

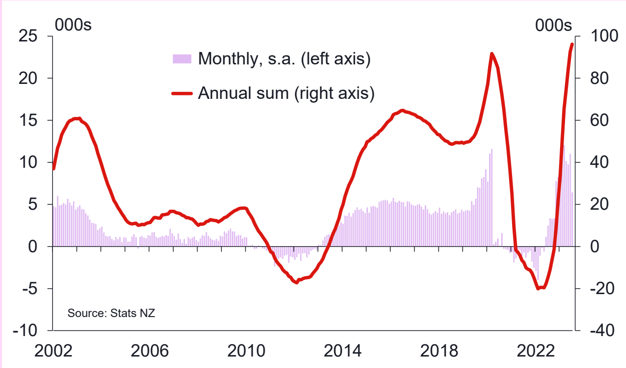
NZ August net migration

Oct 11, Last: +5,786

Net migrant inflows have increased sharply since late last year, rising to over 96,000 in the year to July. Inflows have been boosted by a sharp lift in entrants on work visas to fill skill shortages accumulated during the pandemic, together with the return of foreign students. These inflows have only been partially offset by an increased level of departures.

While the provisional inflow in July was the smallest in nine months (based on our seasonal adjustment), there has of been a recent tendency for subsequent upward revisions. So we will paying attention to both the estimate for August and any revisions to earlier data. It is also worth noting that Stats NZ will resume issuing official seasonally adjusted estimates this month.

NZ net migration



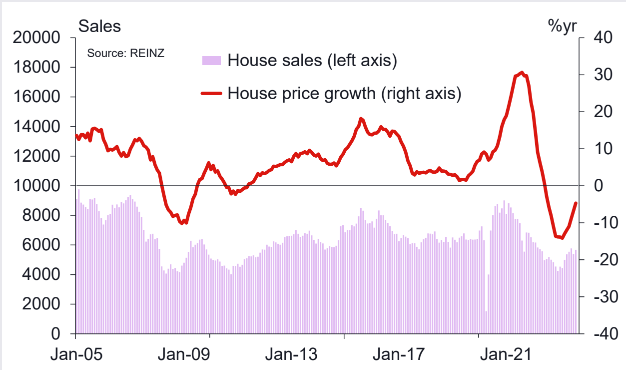
NZ Sep REINZ house sales and prices

Oct 12, Sales – Last: +5.2% mth,* +9.2% annual
Prices – Last: +0.8% mth,* -4.7% annual
***Seasonally adjusted by Westpac**

New Zealand's housing market has found a base, but it's not roaring away. Sales have picked up in recent months, but they remain at low levels. Similarly, the sharp fall in house prices seen over the past year has been arrested.

With the upcoming election, interest rates pushing higher and investors sitting on the sidelines, we could see a lull in the market in September. More generally, however, we expect the recent stabilisation to continue over the next few months. Population growth has picked up, and we are seeing signs that confidence is returning to the housing market, with days to sell easing back.

REINZ house prices and sales



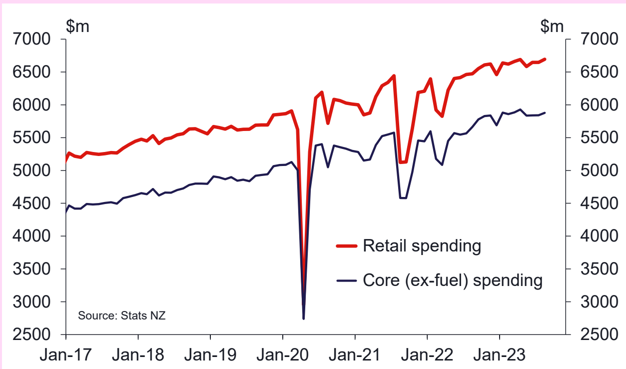
NZ Sep retail card spending

Oct 13, Last: +0.7, Westpac f/c: +0.3%

Retail spending rose by 0.7% in August. However, beneath the surface, demand conditions are cooling. The growth in spending we have seen has been underpinned by rapid increases in the population and increases in consumer prices, rather than individual households taking home more goods.

We're forecasting a 0.3% rise in retail spending in September. However, that largely due to the sharp rise in fuel prices over the past month, which is crowding out spending in other areas. Core spending (excl. fuel) is expected to be subdued.

NZ monthly retail card spending

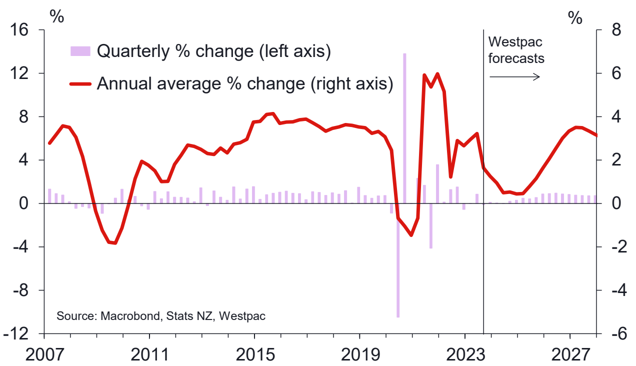


Economic and financial forecasts

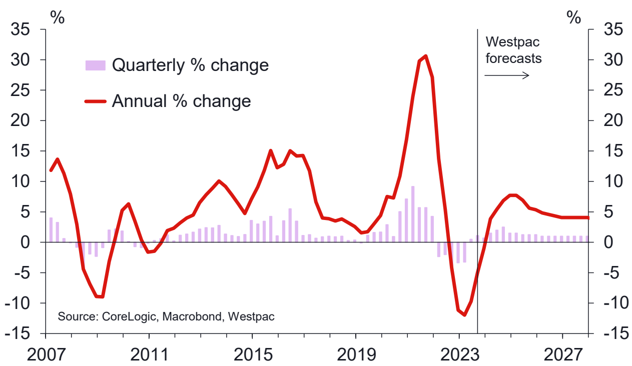
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.9	-0.1	0.1	0.0	6.0	2.7	1.3	0.4
Consumer price index	1.1	2.0	0.5	0.7	5.9	7.2	4.9	2.9
Employment change	1.0	0.3	-0.1	-0.1	3.3	1.7	2.3	0.0
Unemployment rate	3.6	3.8	4.3	4.7	3.2	3.4	4.3	5.2
Labour cost index (all sectors)	1.1	1.1	1.0	0.8	2.6	4.1	4.2	3.3
Current account balance (% of GDP)	-7.5	-7.5	-7.0	-6.3	-5.8	-8.8	-7.0	-4.7
Terms of trade	0.4	-3.2	0.8	2.5	2.8	-4.2	-3.5	7.8
House price index	0.5	1.1	0.7	1.5	27.1	-11.2	-1.0	7.7

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	5.75	5.75	0.75	4.25	5.75	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	5.81	5.67	2.08	5.10	5.81	5.08
5 year swap	4.44	4.90	5.35	5.22	2.46	4.67	5.35	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	69.9	74.3	70.8	70.3	68.6
NZD/USD	0.62	0.61	0.61	0.61	0.70	0.60	0.61	0.62
NZD/AUD	0.93	0.92	0.92	0.92	0.95	0.92	0.92	0.89
NZD/EUR	0.57	0.56	0.55	0.55	0.61	0.59	0.55	0.55
NZD/GBP	0.49	0.48	0.48	0.48	0.52	0.51	0.48	0.48

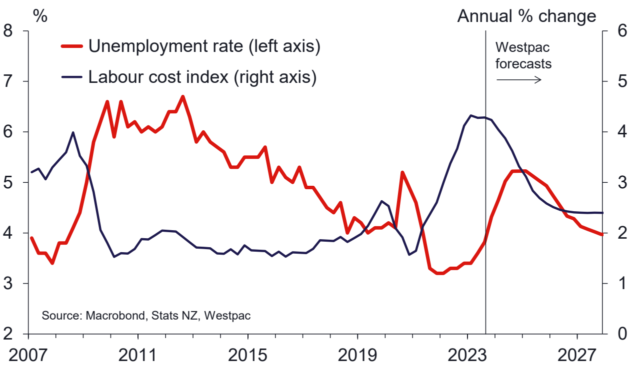
GDP growth



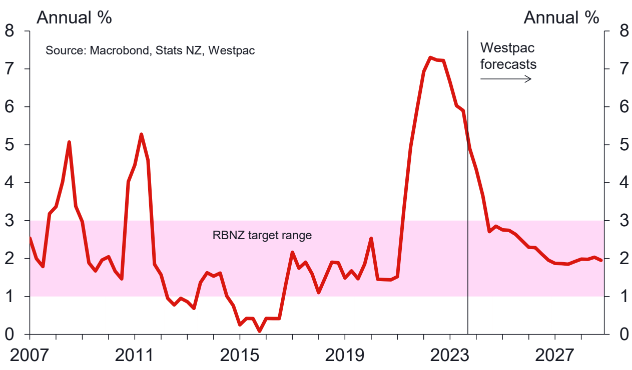
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 09					
Chn	Sep new loans CNYbn	1358	2500	–	Subdued investment intentions are reflecting in a large...
	Sep M2 money supply %yr	10.6%	10.6%	–	... stock of time deposits and weaker loans growth.
Eur	Oct Sentix investor confidence	–21.5	–23.0	–	Pessimism around outlook keeping confidence low.
US	Fedspeak	–	–	–	Barr, Logan, Jefferson.
Tue 10					
Aus	Oct WBC–MI Consumer Sentiment	79.7	–	–	Rate pause has done little to lift the consumer mood so far.
	Sep NAB business survey	13	–	–	Conditions well off 2022 highs, but little change since May.
Jpn	Aug current account balance ¥bn	2771.7	3090.9	–	Primary income is supporting surplus through weak Yen.
US	Sep NFIB small business optimism	91.3	–	–	Uptrend struggling to maintain momentum.
	Aug wholesale inventories	–0.1%	–	–	Final estimate.
	Fedspeak	–	–	–	Bostic, Waller, Kashkari.
Wed 11					
NZ	Aug net migration	5786	–	–	Peaking, but yet to show a convincing downtrend.
Aus	RBA Assist' Governor (Financial Mkts)	–	–	–	Kent, Channels of Transmission, Bloomberg.
US	Sep PPI	0.7%	0.3%	–	Smaller gain anticipated following August's oil price surge.
	FOMC September meeting minutes	–	–	–	Provides colour on balance of risks for the next rate hike.
	Fedspeak	–	–	–	Daly, Bowman, Collins.
Thu 12					
NZ	Sep REINZ house sales %yr	9.2%	–	–	The market has found a base and is tilting upwards...
	Sep REINZ house prices %yr	–4.7%	–	–	... but volumes remain limited at this stage.
	Sep food price index	0.5%	–	0.1%	Seasonal drop in fruit and vegetable prices.
Aus	Oct MI inflation expectations	4.6%	–	–	Downtrend has resumed, back near April levels.
Jpn	Aug core machinery orders	–1.1%	0.4%	–	Overall weakness but cars are a bright spot.
UK	Aug monthly GDP	–0.5%	–	–	Weakness in services to add pressure to output growth.
	Aug trade balance £bn	–3.4	–	–	Weak consumer demand and European slump maintain deficit.
US	Sep CPI	0.6%	0.3%	0.3%	Topping out of oil prices to see similar lift in headline and core.
	Initial jobless claims	207k	–	–	To remain near lows, for now.
	Fedspeak	–	–	–	Bostic, Collins.
Fri 13					
NZ	Sep manufacturing PMI	46.1	–	–	Set to remain low in face of mounting financial pressures.
	Sep retail card spending	0.7%	–	0.3%	Higher fuel prices crowding out other spending.
Aus	Sep overseas arrivals (preliminary)	1547.2k	–	–	Permanent and long-term net inflows at very strong levels.
Chn	Sep CPI %yr	0.1%	0.2%	–	Managed prices and subdued spending keeping prices low.
	Sep PPI %yr	–3.0%	–2.4%	–	Excess capacity to keep PPI low.
	Sep trade balance US$bn	68.2	73.7	–	Stronger exports to regional partners to widen surplus.
Eur	Aug industrial production	–1.1%	–	–	Weaker demand to keep production weak.
US	Sep import price index	0.5%	0.6%	–	Excluding oil, prices are holding flat.
	Oct Uni. of Michigan sentiment	68.1	67.5	–	Sentiment to remain weak, focus on inflation expectations.
	Fedspeak	–	–	–	Harker.

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