WEEKLY ECONOMIC COMMENTARY

02 Sep 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Bounce-back watch

Financial conditions have eased significantly in the last two months. The weakness in activity data over the May and June period that culminated in a sharp turn to the dovish side from the RBNZ in July and August has been the driver. Short term wholesale swap rates are down around 100bps which has seen mortgage rates fall 50-100bps. In the case of mortgage rates, these are now at levels not seen since late 2022/early 2023. Forward starting wholesale borrowing rates now sit as low as 3.25% – levels not seen since late 2021.

This easing in financial conditions naturally raises the question of how consumers and businesses will react. We have two possible hypotheses for why activity took such a dive in the middle of the year. The first is that it was a natural reflection of the lags from the tightening cycle that concluded in May 2023 and the "peak transmission" of tight monetary conditions on the economy. The second is the weakness stemmed from pessimism among households and businesses that interest rate relief wouldn't be coming for a while and that adjustment would be required to navigate a prolonged period of tight conditions.

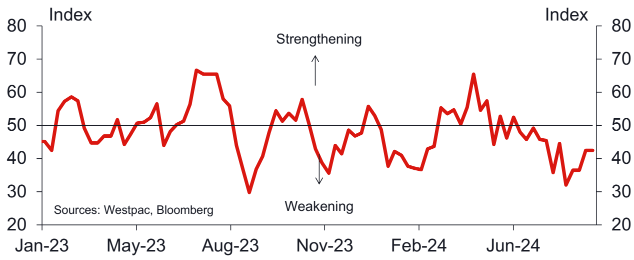
The response to the easing in conditions should tell us something about which hypothesis is most accurate. The RBNZ recognized this when they pointed to the importance of the path of short term "forward looking" indicators in guiding the future path of interest rates. If conditions are just very tight, then the economic response should be modest until a significant easing in actual interest rates occurs. If recent trends are a function of pessimism on when relief will arrive then we should see activity indicators revert to levels closer to where they were earlier in the year.

Last week we saw some initial improvement in the housing market activity, purchasing manager indexes and the "Truckometer" traffic indexes. This week's data continued the theme of rebound. The strongest result was in the ANZ's Business Outlook survey. While firms

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

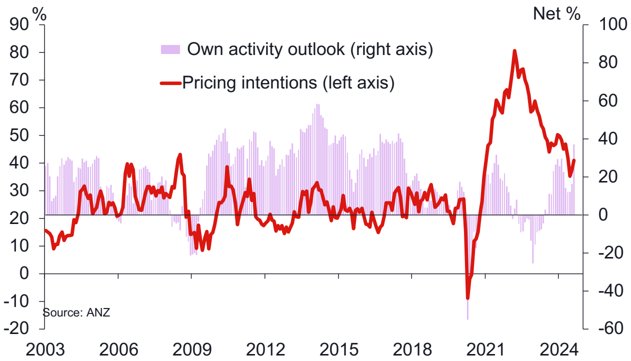


Key data and event outlook

Date	Event
12 Sep 24	NZ Selected price indexes, August
18 Sep 24	FOMC Meeting (Announced 19 Sep NZT)
19 Sep 24	NZ GDP, June quarter
24 Sep 24	RBA Monetary Policy Decision
1 Oct 24	NZIER QSBO survey, September quarter
9 Oct 24	RBNZ OCR Review
11 Oct 24	NZ Selected price indexes, September
16 Oct 24	NZ CPI, September quarter
5 Nov 24	RBA Monetary Policy Decision
27 Nov 24	RBNZ OCR Review & Monetary Policy Statement

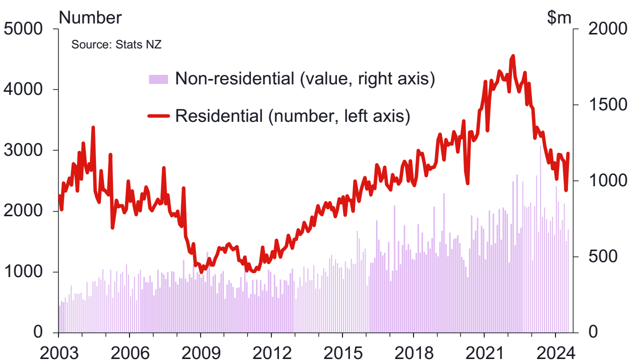
remained downbeat about recent activity levels, the survey showed a sharp lift in headline confidence to a decade-high while firm's expectations for their own activity a year from now rose to the most optimistic level since 2017. Firms' confidence was up across a range of measures, including hiring and investment intentions and expected profits. Pricing intentions indicators also ticked up a bit perhaps reflecting optimism that improved demand will help protect margins. To remove any doubt about the source of this newfound optimism, expectations about the availability of credit rose to their second highest since this question was added to the survey in 2009.

Business activity outlook and inflation expectations



In other news, housing consents rebounded strongly from what was likely a holiday-affected June. Consents rose by 26% in seasonally adjusted terms, more than reversing the 17% fall in June. Taking an average of the two months, the trend in homebuilding remains soft – approvals have arguably flattened out in recent months, but at a level that's around 30% below the peak seen in 2022. The data remains consistent with still weak construction activity for a while yet. There is uncertainty about how long it will take for lower interest rates to begin to drive house prices higher, in turn bringing developers off the sidelines. We do see a marked pickup in mortgage applications volumes since early July, perhaps indicating we are in the early stages of that recovery.

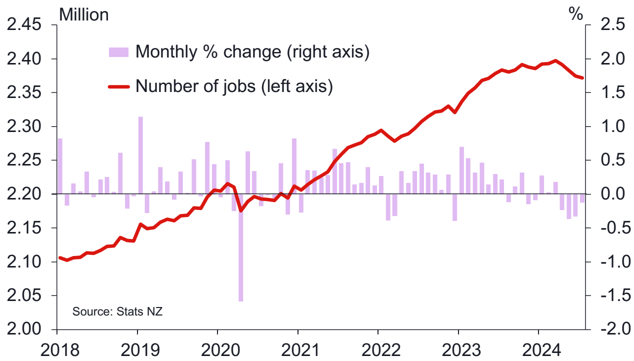
Building consents



Consumers appeared more confident in August. The ANZ Consumer Confidence Index rose 4pts in August after a 5pt rise in July, thus correcting the sharp fall seen from March to June. Consumers still look very cautious compared to businesses.

The most negative indicator seen this week (but still less weak than feared) were the tax-based jobs data for July. These fell 0.1%m/m – the fourth straight monthly decline – leaving filled jobs down 1.1% from their March 2024 peak. This is a weak trend in such a short period considering filled jobs fell by 5% over the much longer Global Financial Crisis period. These data suggest we will see weak employment growth in the Q3 HLFS and are consistent with our forecast of a rise in the unemployment rate from 4.6% to 5%.

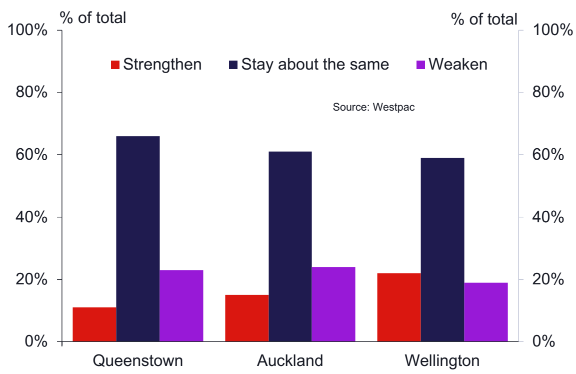
Monthly Employment Indicator filled jobs



The overall assessment from last week's data is that we think the RBNZ will be generally relieved at the signs that the move to policy easing is having an impact. We suspect these sorts of trends, if sustained, reduce the risk of 50bps cuts coming at the remaining meetings in 2025.

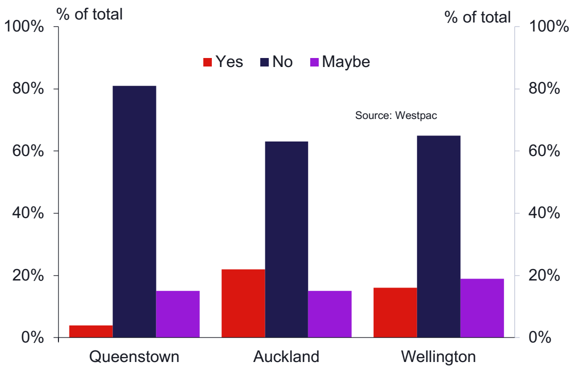
In the last few weeks, we have had the opportunity to present to large groups of clients in Queenstown, Wellington and Auckland on the economic outlook. Part of those presentations includes a survey of customers views on the economy. Customers generally remained downbeat on the near term direction of the economy and perceived that the weak growth seen in the last 3-6 months was likely to persist.

What will GDP growth do in the next 6 months



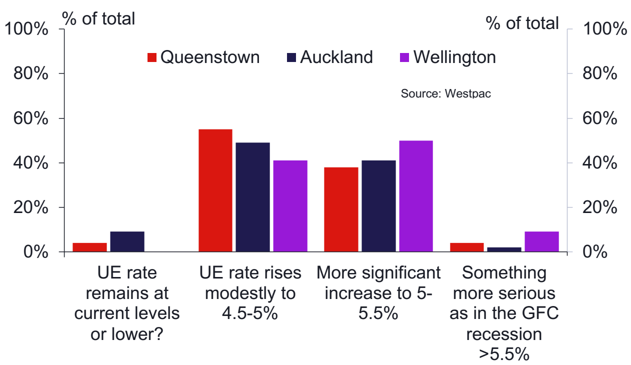
Customers also were pessimistic about medium term fiscal trends and didn't agree with the government's view that surplus would be achieved in 2028. We agree with that sentiment and suspect the December HYEFU will show 2029 becoming the new 2028 with reality lagging some time afterwards.

Will the fiscal deficit be balanced by 2028?



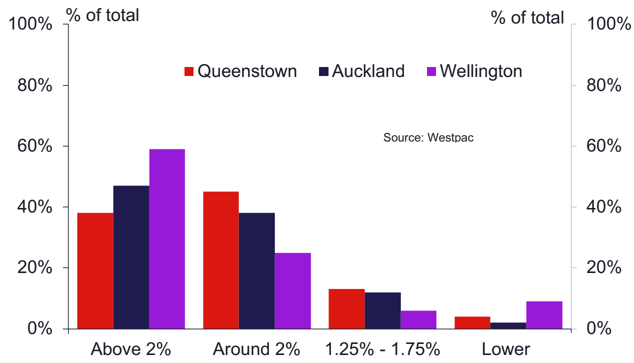
Customers seem sure that a further rise in the unemployment rate is in train and are fairly evenly split on whether the year end level will be above or below 5%. Wellington based customers look notably more pessimistic on this score (understandably) whereas Queenstown customers are more optimistic (also reasonably).

How far will the labour market adjust by year end?



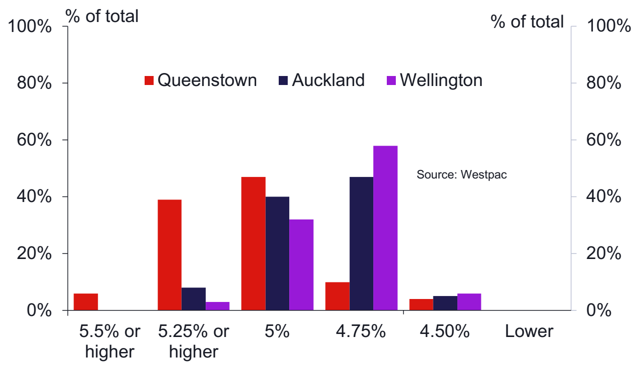
Some very interesting insights came from a question posed on where annual inflation will bottom in coming years. Financial markets have priced in a front-loaded easing cycle with some risk that inflation undershoots 2% meaningfully. Customers on the other hand don't see those risks. We would agree with that sentiment given the RBNZ has commenced easing even while non-tradables inflation remains very high and sticky. Much will depend on how the RBNZ implements policy in 2025 should inflation only slowly fall towards 2%. It will be unfortunate if policy easing persists after inflation shows signs of bottoming as that would be a repeat of the same error in the post-Covid period where excessive easing created a boom-bust cycle.

What will be the low point for annual inflation in coming years?



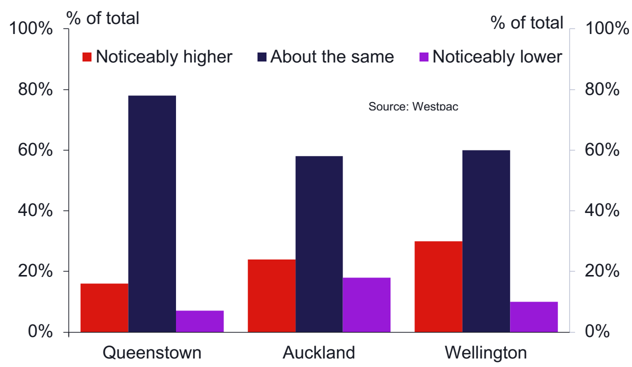
Customers seemed sure that at least one and perhaps two 25 bp cuts would come this year which is interesting given markets price more. Wellingtonians again look more eager for cuts.

Where do you expect the OCR to end the year?



Customers seemed more unsure on the path for the NZD/USD exchange rate with perhaps some modest bias to expecting some appreciation.

Where do you think the NZD/USD will be in a year?

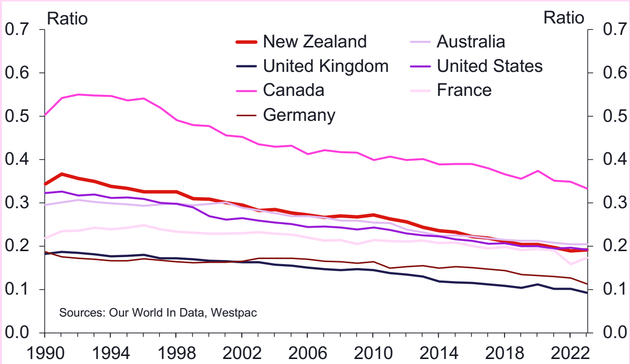


Kelly Eckhold, Chief Economist NZ

Chart of the week.

Much has been written recently on electricity shortages and the associated steep rise in wholesale prices. Total electricity generation in New Zealand has been stable for around 15 years as growth in renewable energy generation has been associated with a phase out of less climate friendly options. Economic growth has continued though as ongoing improvements in energy efficiency have occurred. Our Chart of the Week illustrates those improvements in efficiency among advanced economies. It's an open question on whether current generation capacity has sufficient resilience to ensure stable energy prices. The balance will be between further improvements in efficiency versus increased demand as the economy grows. The trend towards rising energy prices seems to suggest that we will need more generation capacity over time.

Electricity use relative to GDP

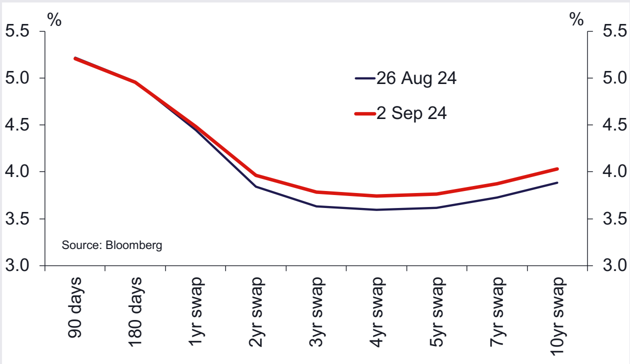


Fixed versus floating for mortgages.

Softer economic conditions have prompted the RBNZ to begin reducing the OCR. We expect further 25bp cuts at the October and November reviews, with easing continuing at a more gradual pace through 2025. However, market interest rates have factored in a much faster and deeper easing cycle than we are expecting.

With a significant amount of OCR easing already factored into longer-term mortgage rates, this suggests that it's now more attractive to fix for longer periods than it has been for a while – perhaps even for terms as long as two to three years. Mortgage rates for shorter terms of up to a year are substantially higher now but are likely to fall in the coming months towards current longer term fixed rates and might allow participation in a deeper easing cycle than markets expect.

NZ interest rates



Global wrap

North America.

Economic data continues to point to a soft landing for the US economy. The PCE deflator, the Fed's preferred inflation measure, rose 0.2% in July, in line with forecasts, with the annual rate holding steady at 2.5%. Personal spending rose 0.4% in July, which was on top of a consumer-led upward revision to June quarter GDP (from 2.8% to 3.0% annualised). So, while a rate cut is all but locked in for the Fed's 18-19 September meeting, there is little support for a larger 50bp move at this stage. This week's employment reports for August could be more telling, though, if payrolls growth falls short of market forecasts or the unemployment rate rises further from its current 4.3%.

Elsewhere, the Bank of Canada is expected to deliver its third rate cut this year at Wednesday night's policy meeting. However, its role as a bellwether for small commodity-exporting economies has diminished lately, with inflation in Canada having receded much further than it has in New Zealand or Australia.

Asia-Pacific.

Australia's monthly CPI indicator saw the annual pace ease from 3.8% to 3.4% in July. Cost-of-living relief measures were crucial to this step-down, with electricity prices falling 6.4% in the month as state and federal rebates started to kick in; further state measures will see prices drop further in August. The data calendar has otherwise been dominated by the final flurry of quarterly indicators ahead of the release of June quarter GDP this Wednesday. We're expecting a 0.3% rise for the quarter, which would see annual growth slow to 1.0%. The domestic demand impulse (consumers, businesses and government) is expected to remain weak, with goods exports and tourism earnings providing most of the momentum.

Europe.

Despite soft national level CPI releases, the pullback in the Eurozone CPI did not exceed consensus and the key, sticky, services measure ticked up from 4.0% yr to 4.2%yr. ECB officials kept open the door to a September rate cut, but with increased caution over the path thereafter. EU Budget concerns will rise in coming weeks, especially with France still yet to form a government.

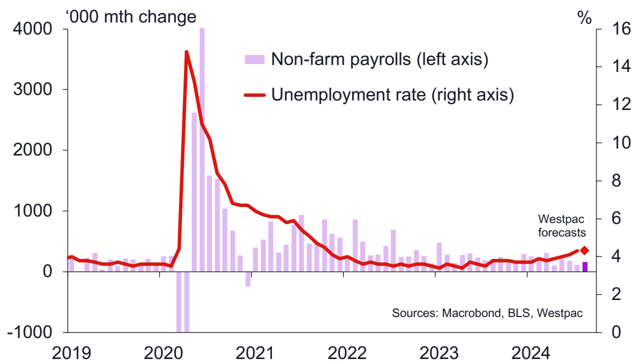
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.0	1.3	2.2	3.1
China	5.2	5.0	4.9	4.7
United States	2.5	2.5	1.7	1.7
Japan	1.9	0.3	1.1	0.9
East Asia ex China	3.3	4.2	4.2	4.1
India	7.8	7.0	6.8	6.5
Euro Zone	0.4	0.6	1.5	1.3
United Kingdom	0.1	0.6	1.3	1.4
NZ trading partners	3.4	3.3	3.4	3.4
World	3.2	3.3	3.3	3.2

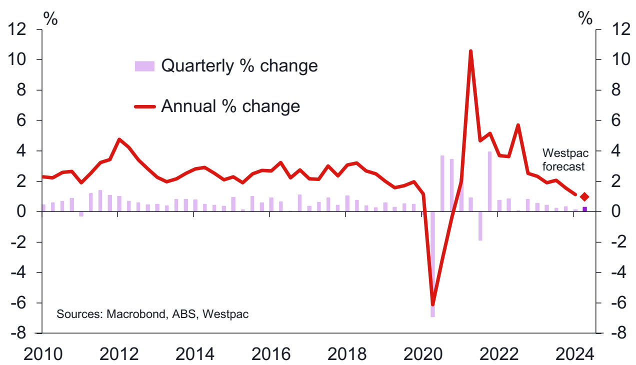
Australian & US interest rate outlook

	30-Aug-24	Sep-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.35	3.35
90 Day BBSW	4.39	4.42	4.42	3.50
3 Year Swap	3.60	3.75	3.70	3.50
3 Year Bond	3.56	3.70	3.65	3.35
10 Year Bond	3.96	4.00	3.90	4.05
10 Year Spread to US (bps)	10	15	15	5
US				
Fed Funds	5.375	5.125	4.625	3.375
US 10 Year Bond	3.86	3.85	3.75	4.00

US non-farm payrolls and unemployment rate



Australian GDP growth



Financial markets wrap

Interest rates.

NZ swap rates appear to have found a base after the very steep decline in the wake of the RBNZ's July pivot. The 2yr swap rate has opened this week at 3.96%, up from 3.87% a week earlier. Some better local data – notably a sharp lift in the forward-looking components of the ANZ's business confidence survey – contributed to the lift in yields. Yields have also drifted higher in the US.

The market is still pricing 30bps of policy easing at the RBNZ's October review and 40bps of easing at the November MPS. In total, the market prices a further 225bps of easing, taking the OCR to a terminal rate of around 3%. With so much of the easing cycle already priced in – indeed more than we expect will ultimately be delivered – it will require fresh negative news surprises in NZ or abroad for longer-tenor swap rates to fall.

The coming week's local diary is very light and so the direction of NZ swap rates is likely to be dictated by events offshore. On that score, the US ISM reports on Tuesday and Thursday respectively, followed by Friday's US payrolls report, will be the key focus. The Bank of Canada's policy review will also warrant attention.

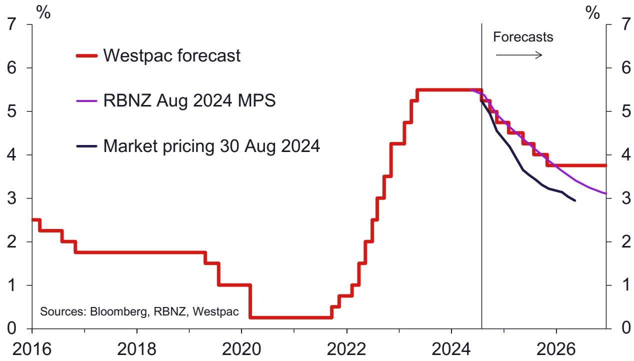
Foreign exchange.

The US dollar lifted the past week, helped by a slightly firmer Q2 GDP report. Even so the NZD/USD was able to build modestly on its earlier break of key resistance at 0.6220, with sharply improved domestic business confidence giving the Kiwi a boost. The recent price action suggests that NZD/USD could see higher levels in the weeks ahead, perhaps moving towards the 0.6350 area.

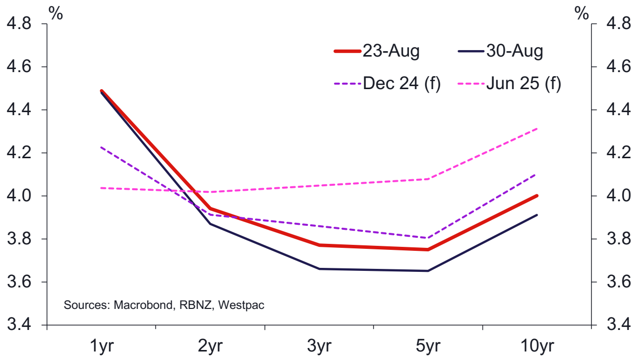
This week's domestic diary is unlikely offer the NZ dollar direction, although another firm outcome at Tuesday GDT dairy auction would be supportive at the margin. The US dollar will be sensitive to this week's key US data, especially Friday's payrolls report. The outcome could settle whether the Fed opts for a 25bp or 50bps rate cut at next month's policy meeting, as well as guide expectations for what the updated "dot plot" will signal for future meetings.

The Kiwi's outperformance saw the NZD/AUD trade above 0.9250 at one point mid last week – levels last seen back in June. Multi-month, we remain bearish, targeting 0.8900, given the contrasting stances of the RBA and RBNZ, and contrasting fiscal and current accounts. However, prospects for this week will depend on Wednesday's Australian Q2 GDP report and how that shapes expectations regarding future RBA policy action.

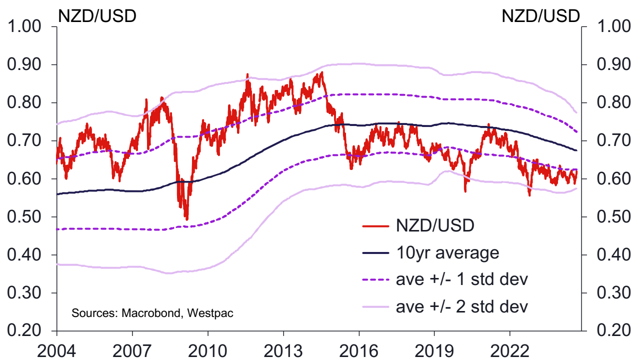
Official Cash Rate forecasts



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	0.625	0.586-0.628	0.555-0.743	0.645	0.61
AUD	0.924	0.897-0.929	0.873-0.992	0.930	0.91
EUR	0.566	0.542-0.573	0.517-0.637	0.581	0.55
GBP	0.476	0.456-0.484	0.456-0.535	0.503	0.47
JPY	91.3	86.1-98.6	61.3-98.6	80.3	91.5

The week ahead

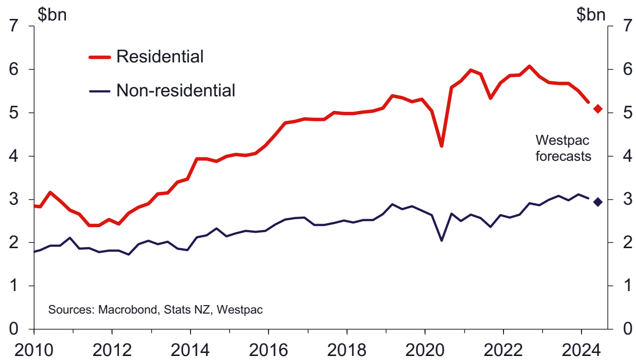
Q2 Building work put in place

Sep 6, Last: -4.0%, Westpac f/c: -3.0%

Building activity fell 4% in the March quarter as residential construction continued to fall and non-residential building also took a leg down. We expect further declines in both areas in the June quarter with tough financial conditions and low business confidence weighing on new development.

The key area of uncertainty is non-residential construction which can be volatile on a quarter-to-quarter basis. But smoothing through such quarterly noise, the direction for building activity is down.

Real building work put in place

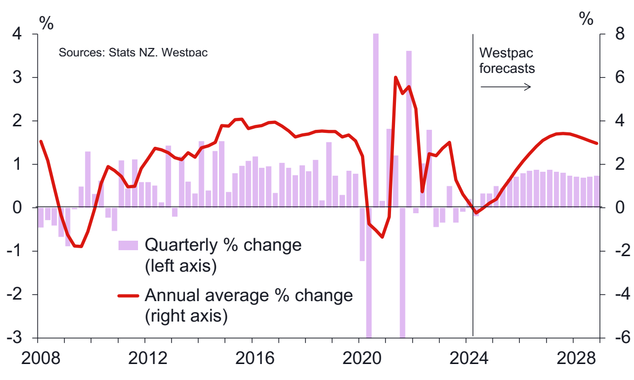


Economic and financial forecasts

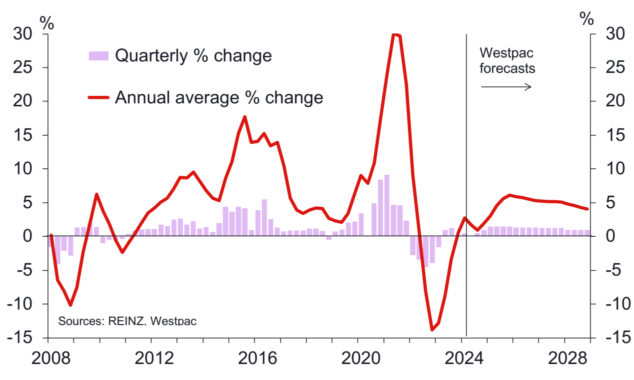
Economic indicators	Quarterly % change				Annual % change			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
GDP (production)	0.2	-0.6	-0.2	0.4	0.6	-0.3	1.3	2.3
Consumer price index	0.6	0.4	1.1	0.3	4.7	2.5	2.2	2.1
Employment change	-0.3	0.4	-0.4	-0.2	2.9	-0.4	-0.1	1.5
Unemployment rate	4.4	4.6	5.0	5.3	4.0	5.3	5.6	4.9
Labour cost index (all sectors)	0.9	1.2	0.7	0.7	4.3	3.5	2.3	1.9
Current account balance (% of GDP)	-6.8	-6.5	-6.0	-5.3	-6.9	-5.3	-4.0	-4.2
Terms of trade	5.1	3.2	1.7	-0.5	-10.7	9.8	2.4	1.8
House price index	0.4	-0.4	0.0	0.5	0.6	0.5	6.4	4.1

Financial forecasts	End of quarter				End of year			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
OCR	5.50	5.50	5.25	4.75	5.50	4.75	3.75	3.75
90 day bank bill	5.66	5.63	5.05	4.75	5.65	4.75	3.85	3.85
2 year swap	4.91	5.01	3.80	3.90	5.28	3.90	4.00	4.00
5 year swap	4.40	4.53	3.65	3.80	4.85	3.80	4.25	4.25
10 year bond	4.69	4.74	4.20	4.20	5.09	4.20	4.40	4.35
TWI	71.6	71.4	70.4	70.8	70.8	70.8	70.6	69.9
NZD/USD	0.61	0.61	0.60	0.61	0.60	0.61	0.63	0.64
NZD/AUD	0.93	0.92	0.91	0.91	0.93	0.91	0.89	0.88
NZD/EUR	0.56	0.56	0.55	0.55	0.56	0.55	0.56	0.56
NZD/GBP	0.48	0.48	0.47	0.47	0.49	0.47	0.48	0.48

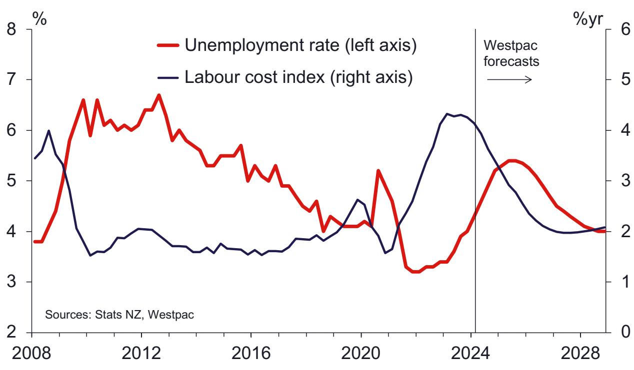
GDP growth



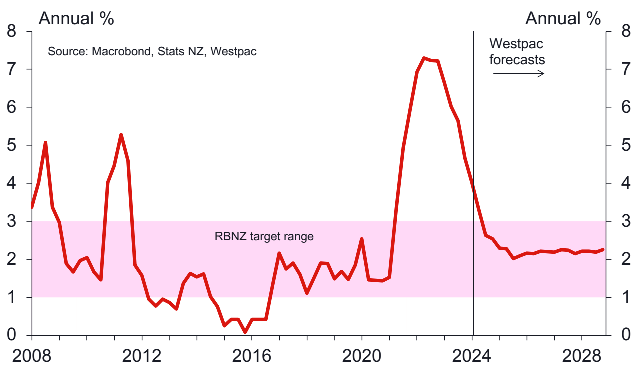
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 02					
Aus	Aug CoreLogic Home Value Index	0.5%	–	0.6%	Prices soft in Melb but still surging in Bris-Adel-Perth.
	Q2 Inventories	1.3%	–0.2%	–0.3%	Inventories set to detract from activity growth.
	Q2 Company Profits	–2.5%	–0.5%	–2.0%	Mining profits moderating as commodity prices ease.
	Jul Dwelling Approvals	–6.5%	2.5%	2.5%	Bumping around 12yr lows.
	Aug ANZ-Indeed Job Ads	–3.0%	–	–	Pointing to balance returning to labour market.
	Aug MI Inflation Gauge, %yr	2.8%	–	–	Provides a general view of risks.
Chn	Aug Caixin Manufacturing PMI	49.8	50.0	–	High-tech manufacturing strong, other sub-sectors soft.
World	Aug S&P Global Manufacturing PMI	–	–	–	Final estimate for Japan, Europe, UK.
Tue 03					
NZ	Q2 Terms Of Trade	5.1%	2.7%	3.2%	Strong lift in meat and dairy export prices.
Aus	Q2 Current Account Balance, $bn	–4.9	-5.5	–10.0	Deficit expected to widen as commodity prices ease.
US	Jul Construction Spending	–0.3%	0.1%	–	Weakness to persist due to costs and uncertainty.
	Aug ISM Manufacturing Index	46.8	48.1	–	Manufacturing weak and outlook a headwind for jobs.
Wed 04					
NZ	GlobalDairyTrade Auction	5.5%	–	–	Futures prices up further since strong late Aug auction.
	Aug ANZ Commodity Prices	–1.7%	–	1.0%	Strong lift in world dairy prices in August.
Aus	Q2 GDP	0.1%	0.2%	0.3%	Growth to remain sluggish, domestic demand weak.
Chn	Aug Caixin Services PMI	52.1	52.1	–	Consumers concerned over outlook.
US	Jul JOLTS Job Openings, 000s	8184	–	–	Back in line with pre-pandemic averages.
	Jul Factory Orders	–3.3%	4.7%	–	Ex transport, demand is weak.
	Federal Reserve Beige Book	–	–	–	An update on economic conditions across the regions.
Can	Bank of Canada Policy Decision	4.50%	4.25%	–	Easing cycle to continue through 2025.
World	Aug S&P Global Services PMI	–	–	–	Final estimate for Japan, Europe and UK.
Thu 05					
NZ	Aug CoreLogic Home Value Index	–0.5%	–	–	Revamped index shows price falls in the last five months.
Aus	Aug Trade Balance, $bn	5.6	5.0	5.0	Goods surplus is narrowing as prices ease.
	RBA Governor Bullock	–	–	–	Speech to The Anika Foundation, Sydney 12:00pm AEST.
Eur	Jul Retail Sales	–0.3%	0.1%	–	Consumers to slowly regain their footing.
US	Initial Jobless Claims, 000s	231	–	–	Demure, for now.
	Aug ISM Non–Manufacturing Index	51.4	51.4	–	Consumers remain resilient.
Fri 06					
NZ	Q2 Building Work Put In Place	–4.0%	–2.7%	–3.0%	Residential and non-res work both continuing to soften.
Aus	Jul Housing Finance	1.3%	1.0%	1.0%	Upturn moving through a minor consolidation.
Jpn	Jul Household Spending	–1.4%	1.2%	–	Wages yet to support a pick up in spending.
Eur	Q2 GDP	0.3%	0.3%	–	Growth to return to trend in time.
US	Aug Non–Farm Payrolls, 000s	114	165	160	Demand and supply now balanced; risks skewed down.
	Aug Unemployment Rate	4.3%	4.2%	4.3%	Unemployment rate to drift up over next 12 months.
	Aug Average Hourly Earnings	0.2%	0.3%	0.2%	Slack to weigh on wage growth.

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