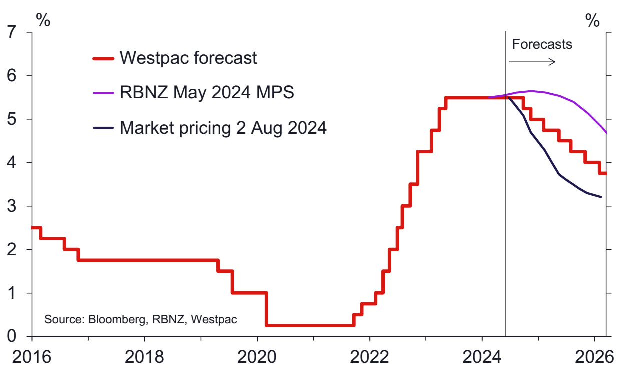
WEEKLY ECONOMIC COMMENTARY

05 Aug 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Earlier OCR cuts coming

Westpac's new economic forecasts, which will be released tomorrow with our latest Economic *Overview*, include significant downward revisions in the growth and inflation outlook. As a result, we now see the RBNZ starting to temper the degree of restriction from their October *Monetary Policy Review* by reducing the OCR by 25bp to 5.25% (previously, we expected rate reductions to begin in November). We continue to expect a further 25bp cut in November, leaving the OCR at 5% at year end. Our longer-term forecast for the OCR is unchanged, with the OCR to fall to 4.5% at the May 2025 *Monetary Policy Statement* and to reach our current estimate of the terminal rate of 3.75% in early 2026.

Official Cash Rate forecasts



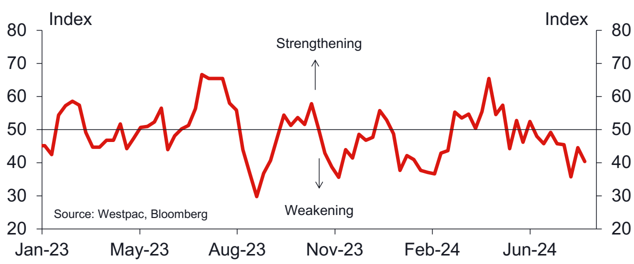
Recent data suggest that economic activity dipped more sharply than previously expected in the June quarter of 2024. This is evident in a raft of higher frequency indicators such as business and consumer confidence and the Purchasing Manager Indices. We think that GDP fell 0.6% in the June quarter. Given this weak performance, it looks likely that growth will continue to be subdued in the second half of 2024.

Importantly, we now also see definitive signs that the labour market is adjusting more quickly to the weak growth profile that has been in place for some time. We now expect the unemployment rate to move more quickly to a higher peak of 5.6% in 2025. Recent data on filled

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
6 Aug 24	RBA Monetary Policy Decision
7 Aug 24	Labour market statistics, June quarter
8 Aug 24	RBNZ Survey of Expectations, June quarter
14 Aug 24	RBNZ OCR Review & Monetary Policy Statement
15 Aug 24	NZ Selected price indexes, July
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

jobs show this weaker trend has been firmly in place since early April and picked up in May and June.

These weaker growth and labour market trends and expectations will give the RBNZ comfort that the path of inflation towards 2% is more assured than had been the case earlier in 2024. Combined with recent softer-than-expected headline inflation outcomes – which show that the 1-3% target range will likely finally be reached in the September quarter – the RBNZ will have confidence to begin tempering the degree of restriction.

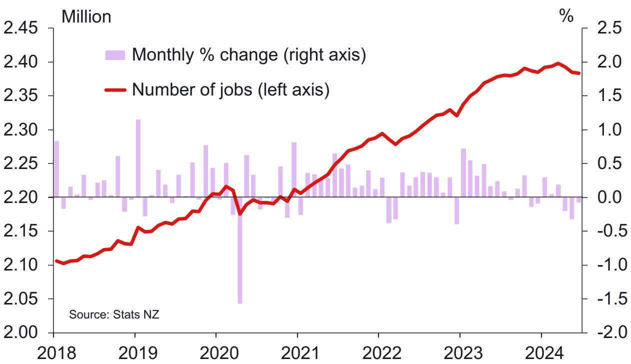
We don't see the RBNZ panicking and embarking on a more sudden or protracted easing path. Domestic inflation remains uncomfortably high, and this will continue to worry the RBNZ. We continue to see core inflation measures falling relatively slowly – albeit more surely – in the year ahead. So, while there is certainly a case for reducing the degree of restriction, we don't see the RBNZ being keen on getting too far ahead of itself and moving quickly toward or into easy territory. Rather, we expect the RBNZ to take a measured and data dependent approach. The future path of the OCR will be determined by the data, and not the calendar.

Controlled descent.

Looking ahead to this week, the June quarter labour market surveys are shaping up to be crucial for interest rate watchers. The RBNZ's change of tone in its policy review last month has opened the door for an earlier start to OCR cuts, with financial markets speculating that the first move could come as soon as next week's Monetary Policy Statement. While it's possible that a significantly weaker set of results could force the RBNZ's hand in this way, we're not expecting this week's figures to reach that mark.

We're expecting a 0.4% fall in employment over the June quarter, based on the higher-frequency Monthly Employment Indicator (MEI). The MEI is drawn from income tax records provided by employers, making it a comprehensive record of the number of people in work. There are some conceptual differences between this and the employment measure in the quarterly Household Labour Force Survey (HLFS), but generally it has been a useful predictor of the latter.

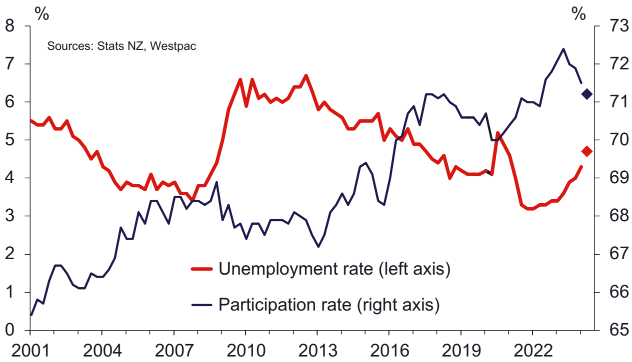
Monthly Employment Indicator, filled jobs



The slowdown in jobs is happening at a time of still-strong population growth. While the rate of net inward migration has passed its peak, the working-age population is still up by around 3% over the last year. With job creation no longer absorbing the growth in the labour force, this is a recipe for rising unemployment.

Having reached a record low of 3.2% in early 2022, the rise in the unemployment rate was gradual at first, but has picked up the pace in recent quarters. We expect it to rise to .7% for the June quarter, from 4.3% in the March quarter. This is in line with market forecasts, and only a little higher than the 4.6% that the RBNZ had assumed in its May *Monetary Policy Statement*.

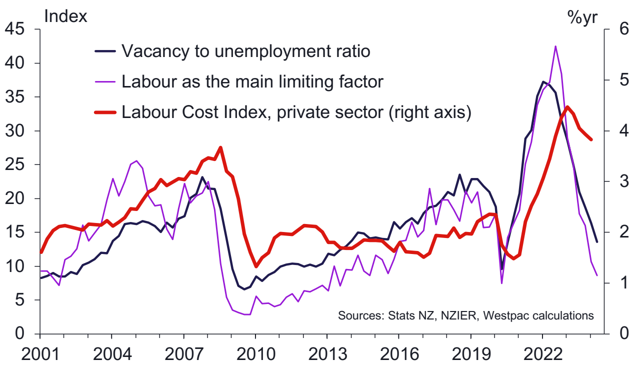
Unemployment and participation rates



A range of indicators show that the labour shortages that plagued employers in previous years are now a distant memory. That's due to the combination of a surge of migrant workers to fill the gaps once the border was reopened, and a drop in demand for new workers as the economy has cooled off. Businesses report that labour is no longer hard to find, and job advertisements have now fallen below pre-Covid levels.

With this shift in the labour market balance, we're now finally seeing an easing in wage inflation – typically one of the last shoes to drop in the economic cycle. The slowdown has been masked to some degree by public sector pay agreements that were set by the previous government and staggered over several periods, and that will be a factor again in the June quarter results. However, we expect to see clearer evidence of slowing in the private sector measure of wage growth, down from 3.8% to 3.4% annually.

Labour market tightness and wage growth



Overall, while the economy is clearly slowing, it appears to be in keeping with the recession that the RBNZ has been looking to 'engineer' over the last couple of years in order to bring high inflation back to target. And there are signs that at least some of the recent gloom reflects disappointment among households and businesses with the RBNZ's earlier messaging that interest rate relief could be a long time away.

The ANZ business opinion survey released last week showed a solid lift in business sentiment in July, albeit more around general conditions than their own prospects. July saw a marked softening in the RBNZ's stance, followed by a June quarter CPI result that was lower than market and RBNZ forecasts. It's not entirely clear how these events affected the results – ANZ noted that the responses from later in the month were lower for the cost and pricing gauges, but not noticeably different for the activity indicators. So we'll wait and see whether this change in sentiment continues into the August survey.

We'll also be watching whether lower interest rates play a role in reviving the housing market. Last week CoreLogic launched its new house price index for New Zealand, which adjusts sale prices for the features of each individual property (bringing it into line with the methodology it uses in Australia). The new measure shows that house prices fell by 0.5% in July, the fifth straight month of declines.

Separate data on listings from realestate.co.nz shows that the stock of unsold homes on the market is at a nine-year high and continues to rise. Together these suggest that the housing market remains in a logjam, with a gap between what buyers are willing to pay and what sellers are willing to accept. Falling mortgage rates will help to close this gap, though we suspect that any meaningful lift in prices will be more of a 2025 story.

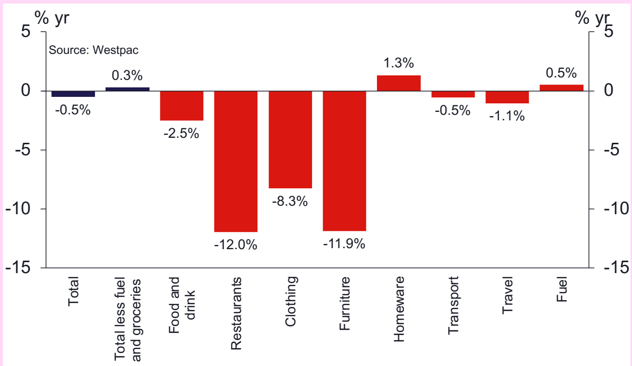
Kelly Eckhold, Chief Economist

Michael Gordon, Senior Economist

Chart of the week.

New Zealanders have been keeping their wallets firmly shut. Retail spending in the three months to July was down 0.5% compared to the same time last year (based on our tracker of spending on Westpac-issued debit and credit cards). That weakness in spending reflects the continued squeeze on households' finances, with increases in living costs and still-high interest rates. On top of that, the labour market is weakening and increasing numbers of New Zealanders are concerned about their job security. Those headwinds have seen sharp declines in discretionary spending areas like dining out, clothing and home furnishings. From this week, many households will get a boost to their spending power from tax cuts and other support measures. However, with continued financial headwinds, we suspect spending will remain soft for some time yet.

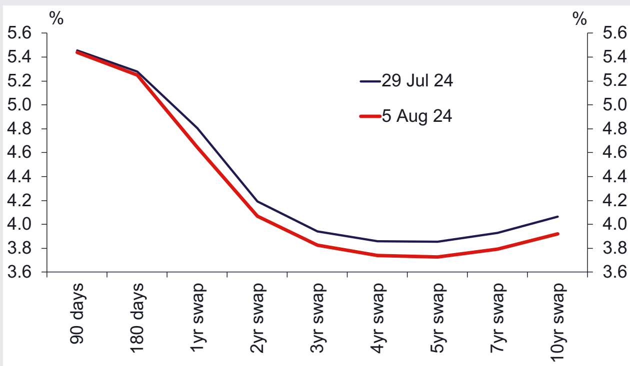
Spending growth (three months to July vs same time last year)



Fixed versus floating for mortgages.

With inflation cooling and softness in economic conditions, expectations for OCR reductions from the RBNZ have been pulled forward. We're forecasting the first OCR reduction in October, with the OCR to fall to 4.50% by mid-2025. For borrowers with more flexibility, fixing for a shorter term could be advantageous with the potential for downward pressure on mortgage rates over the coming months. However, for borrowers who favour greater certainty, at current rates fixing for up to one year could be attractive.

NZ interest rates



Global wrap

United States.

As expected, the Fed left its policy settings steady last week. Importantly, Chair Powell indicated growing confidence that inflation is tracking down towards the Fed's target, and that a rate cut may be on the table for discussion at next month's meeting. On the data front, the July employment report was much weaker than expected, with non-farm payrolls rising a tepid 114k, the unemployment rate rising 0.2ppts to 4.3% and average hourly earnings advancing just 0.2%m/m – an outcome that may partly reflect impacts from Hurricane Beryl. Earlier in the week, the Employment Cost Index grew a less than expected 0.9%q/q in Q2 – a result welcomed by Powell during his press conference – and the manufacturing ISM also disappointed expectations. The coming week is relatively quiet on the data front, with today's services ISM report of greatest note. This will leave the focus on Fedspeak and any new political developments.

Europe.

Advance estimates indicate that GDP in the euro area grew 0.3% in Q2, the same as in Q1. This outcome, despite an unexpected contraction in Germany, owed to stronger growth in France and Spain. Flash inflation data for July was also slightly firmer than expected, with core inflation steady at 2/9%y/y. In the UK, in a finely balanced decision, the BoE cut its policy rate by 25bps to 5.0% but indicated it would take a cautious approach to further easing over coming meetings. The European calendar is lightly populated over the coming week.

Asia-Pacific.

In Japan, the BoJ raised its policy rate to "around 0.25%" and laid out a plan to halve the rate of its monthly JGB purchases to JPY3tn by early 2026. The BoJ plans to continue policy normalisation at future meetings so long as activity, prices and financial conditions evolve as expected. In China, concerns about the economy grew after the official PMIs again nudged lower in July, with the composite index now at its lowest level since December 2022. This week will see the release of China's trade and inflation reports for July. Closer to home, Australia's CPI rose 1.0%q/q in Q2, meeting expectations. However, core measures were softer than expected. This caused a significant rally in interest rate markets, which now price a 50% chance of a rate cut at the RBA's November Board meeting (which remains Westpac's view). On Tuesday the RBA will have the opportunity to provide its verdict on this data. We expect the Board to leave the cash rate at 4.35%, and for now perhaps continue to signal that is has an open mind regarding the next policy move.

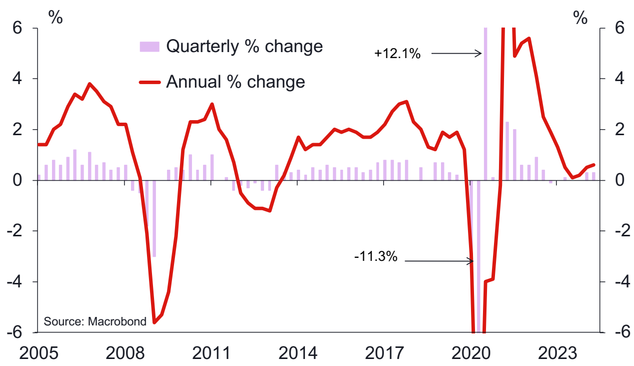
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.0	1.3	2.2	3.1
China	5.2	5.0	4.9	4.8
United States	2.5	2.5	1.5	1.6
Japan	1.9	0.4	1.0	0.9
East Asia ex China	3.3	4.2	4.2	4.1
India	7.8	6.9	6.7	6.5
Euro Zone	0.4	0.6	1.5	1.3
United Kingdom	0.1	0.6	1.3	1.3
NZ trading partners	3.4	3.3	3.4	3.4
World	3.2	3.3	3.3	3.2

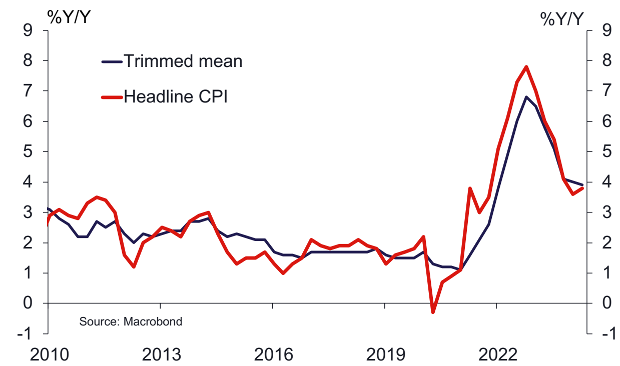
Australian & US interest rate outlook

	02-Aug-24	Sep-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.10
90 Day BBSW	4.41	4.42	4.19	3.30
3 Year Swap	3.74	4.10	4.00	3.50
3 Year Bond	3.68	3.90	3.80	3.30
10 Year Bond	4.06	4.30	4.25	4.00
10 Year Spread to US (bps)	10	-10	-5	0
US				
Fed Funds	5.375	5.125	4.875	3.875
US 10 Year Bond	3.96	4.40	4.30	4.00

Euro area GDP growth



Australian CPI inflation



Fixed income and foreign exchange

Interest rates.

NZ swap rates fell further last week, mostly driven by offshore developments. Notable was the US labour data on Friday which was much softer than expected, causing a 26bp fall in 2yr bond yields. That caused the 2yr swap rate to open this morning 9bp lower at 4.05% - the lowest since August 2022.

From here, further downside during the next few weeks is possible, even though swap rates look technically stretched. The 2yr could break below 4.00%. There will be two important events during the week ahead – NZ labour data and the RBA decision.

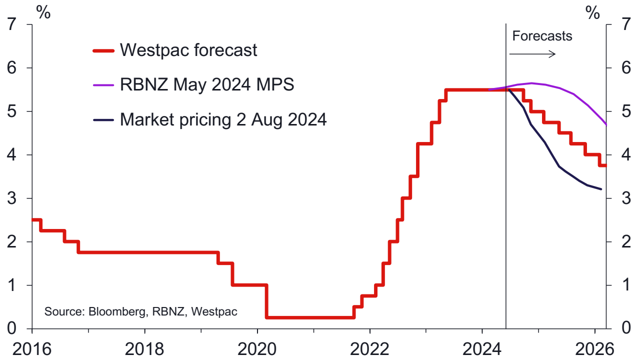
The former is expected to show an increase in the unemployment rate to 4.7%, and anything higher would cause market pricing to reflect a higher chance of an OCR cut at the 14 August MPS (up from 85% currently). We forecast the first cut to be in October (brought forward from November previously). The RBA event could add to the downside impetus in AU and NZ rates, if it shifts its stance more than markets expect in a dovish direction in reaction to last week's AU CPI news.

Foreign exchange.

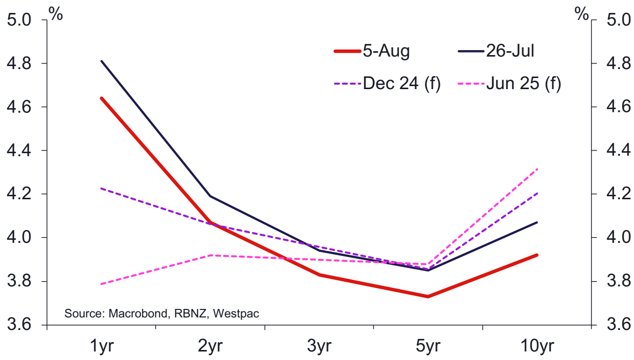
NZD/USD looks neutral for the week ahead, torn between the sharp fall in US yields and the potential for lower NZ yields if NZ labour data on Wednesday disappoints. NZ-US yield spreads jumped sharply last week, helping NZD/USD recover from a 0.5860 low. But 0.6000 is likely to be a cap near term, while the spectre of earlier RBNZ easing weighs on the market. In addition, global risk sentiment has suffered recently from recession fears and Middle East tensions.

NZD/AUD broke higher last week following the softer AU CPI data and could extend to 0.9200 during the week ahead if the RBA's stance at Tuesday's meeting is more dovish than markets expect. But add NZ labour data to the mix and we have a volatile week in store for the cross. Multi-month, we favour a lower cross, 0.89 or lower, given NZ-AU yield spreads are likely to remain narrow, and Australia's superior current account and fiscal accounts are likely to persist.

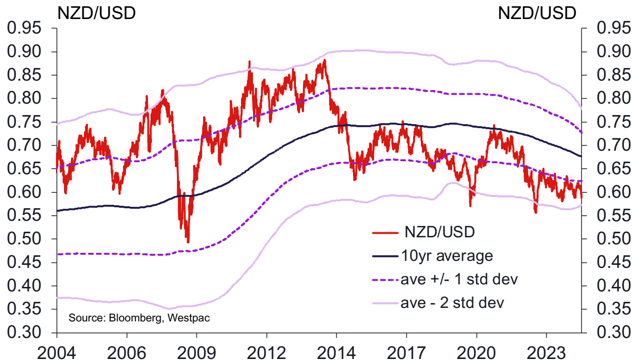
Official Cash Rate forecasts



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	0.596	0.586-0.620	0.555-0.743	0.646	0.61
AUD	0.914	0.897-0.929	0.873-0.992	0.930	0.91
EUR	0.546	0.542-0.573	0.517-0.637	0.582	0.55
GBP	0.465	0.456-0.484	0.456-0.54	0.504	0.48
JPY	87.5	88.7-98.6	61.3-98.6	79.9	96.4

The week ahead

Q2 Labour Market Surveys

Aug 7, Unemployment Rate, Last: 4.3%, Westpac f/c: 4.7%
Labour Cost Index (Private), Last 0.8%, Westpac f/c: 0.7%

The New Zealand labour market is clearly softening, with higher-frequency indicators pointing to outright job losses in recent months. We estimate that the unemployment rate rose from 4.3% to 4.7% in the June quarter.

Wage growth is slowing from its highs, though this may be masked again in the June quarter by public sector pay agreements.

Labour market indicators

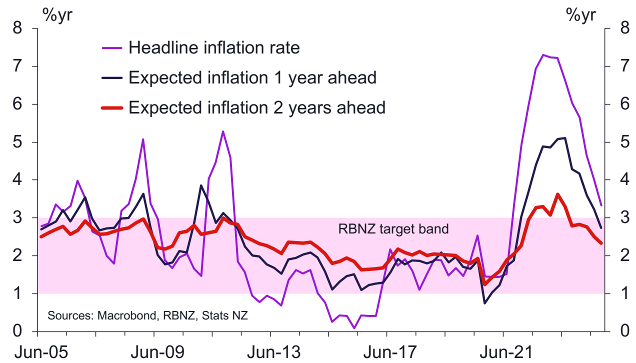
Q3 RBNZ Survey of Expectations

Aug 8, Expected Inflation – one year ahead, Last: 2.7%
Expected Inflation – two years ahead, Last: 2.3%

While dwelling consent issuance has fallen sharply over the past year, the downturn looks like it is finding a base. For the past few months, consent issuance has been running a little over 2,800 per month. We expect to see a modest drop in May, but for the flattening trend to continue.

Although dwelling consent issuance may be finding a floor, any material pickup is still a long way off. Developers are likely to remain cautious about bringing projects to market until the housing market begins to recover.

RBNZ Survey of Expectations

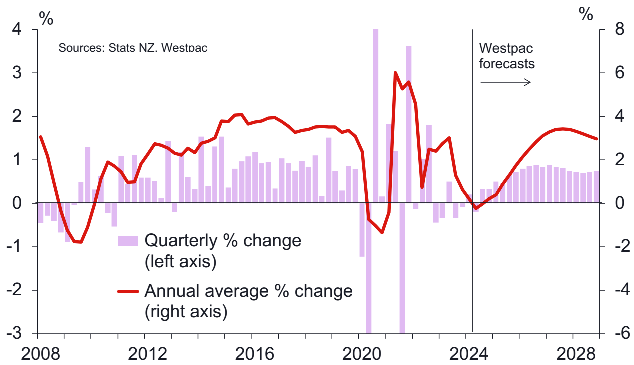


Economic and financial forecasts

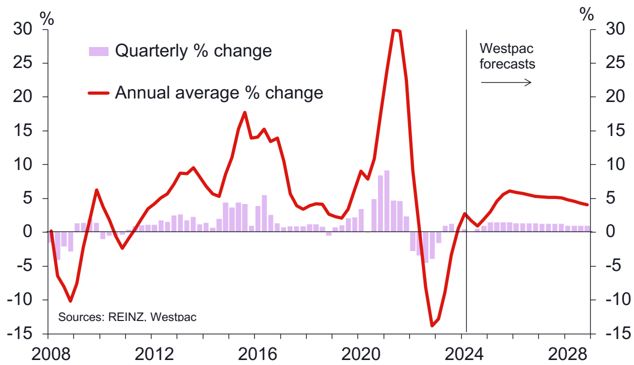
Economic indicators	Quarterly % change				Annual % change			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
GDP (production)	0.2	-0.2	0.3	0.3	0.6	0.2	1.7	3.2
Consumer price index	0.6	0.4	1.1	0.4	4.7	2.5	2.1	2.2
Employment change	-0.2	0.2	0.1	0.1	2.7	0.1	0.9	1.8
Unemployment rate	4.3	4.6	4.9	5.2	4.0	5.2	5.4	4.7
Labour cost index (all sectors)	0.9	0.9	0.8	0.8	4.3	3.4	2.5	2.0
Current account balance (% of GDP)	-6.8	-6.4	-5.9	-5.3	-6.9	-5.3	-4.6	-4.3
Terms of trade	5.1	4.0	2.2	0.6	-10.7	12.3	0.7	2.3
House price index	0.5	0.0	0.5	1.0	0.6	2.0	6.1	5.1

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	5.50	5.00	5.50	5.00	4.00	3.75
90 day bank bill	5.66	5.63	5.50	5.25	5.65	5.25	4.00	3.85
2 year swap	4.91	5.01	4.30	4.20	5.28	4.20	3.90	4.00
5 year swap	4.40	4.53	3.95	3.90	4.85	3.90	4.00	4.25
10 year bond	4.69	4.74	4.40	4.35	5.09	4.35	4.30	4.35
TWI	71.6	71.4	70.8	71.1	70.8	71.1	70.6	69.8
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	0.55	0.56
NZD/GBP	0.48	0.48	0.47	0.48	0.49	0.48	0.48	0.49

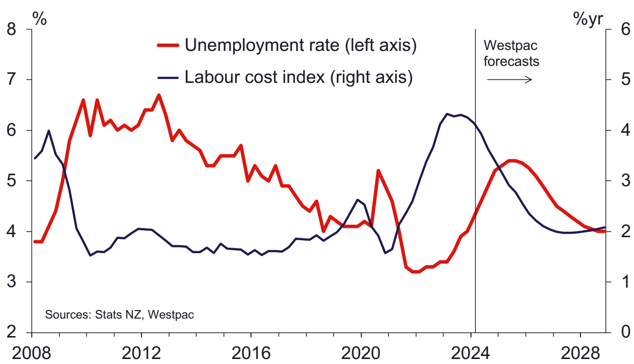
GDP growth



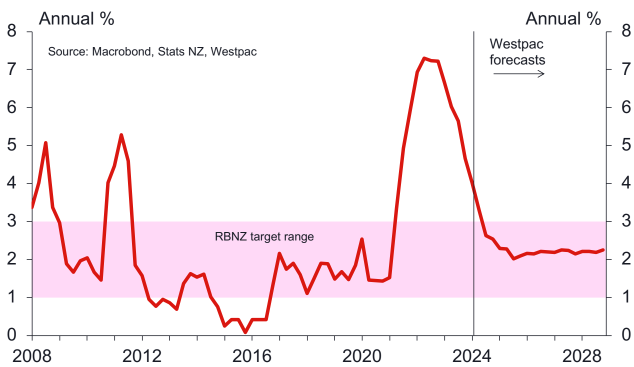
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 05					
NZ	Jul ANZ Commodity Prices, %mth	1.5	–	–3.0	Sharp drop in dairy prices, partly offset by gains in meat.
Aus	Bank Holiday	–	–	–	For NSW and ACT.
	Jul MI Inflation Gauge, %yr	3.2	–	–	Provides a general view of risks.
Chn	Jul Caixin Services PMI, pts	51.2	51.5	–	Consumer to remain concerned and under pressure.
Eur	Aug Sentix Investor Confidence, pts	–7.3	–	–	Inflation near target and rate cuts constructive.
	Jun PPI, %yr	–4.2	–	–	Upstream price pressures absent.
US	Jul ISM Non–Manufacturing, pts	48.8	51.3	–	Points to downside risks to benign baseline growth view.
	Jul Senior Loan Officer Opinion	–	–	–	Banks cautious but willing to lend currently.
	Fedspeak	–	–	–	Goolsbee, Daly.
Int'l	Jul S&P Global Services PMI, pts	–	–	–	Final estimate for Japan, Eurozone, UK and US.
Tue 06					
Aus	Jul ANZ Job Ads, %mth	–2.2	–	–	Balance is gradually returning to the labour market.
	Aug RBA Policy Decision, %	4.35	4.35	4.35	Q2 CPI writes-off chances of a hike. Refreshed forecasts ...
	Statement on Monetary Policy	–	–	–	... will shed light on the RBA's views of the balance of risks.
Jpn	Jun Household Spending , %yr	–1.8	–0.8	–	Points to downside risk around consumption.
Eur	Jun Retail Sales, %mth	0.1	–	–	Growth trend robust but mixed by country.
US	Jun Trade Balance, $bn	–75.1	–72.6	–	Should narrow given weakness in goods consumption.
Wed 07					
NZ	Aug GlobalDairyTrade Auction, %chg	0.4	–	–	Milk powder futures down slightly since last auction.
	Q2 Unemployment Rate, %	4.3	4.7	4.7	The rise in unemployment is gathering momentum ...
	Q2 Employment, %qtr	–0.2	–0.2	–0.4	... with tax data showing a fall in jobs in recent months ...
	Q2 Labour Cost Index (Private), %qtr	0.8	0.8	0.7	... that will eventually lead to greater wage restraint.
Aus	RBA Governor Bullock	–	–	–	Speech at the Annual Rotary Lecture.
Chn	Jul Trade Balance, US$bn	99.1	99.5	–	Benefiting from strong demand across Asia.
	Jul Foreign Reserves, US$bn	3222	3240	–	Authorities comfortable with TWI stability.
US	Jun Consumer Credit, $bn	11.4	10.3	–	Rates and labour market uncertainty are headwinds.
Thu 08					
NZ	Q3 RBNZ Inflation Expectations, %yr	2.3	–	–	Expectations to continue falling.
Jpn	Jun Current Account Balance, ¥bn	2849.9	1873.7	–	Investment income not as supportive of Yen as it use to be.
US	Aug Initial Jobless Claims, 000's	249	–	–	Still very, very low.
	Fedspeak	–	–	–	Barkin.
Fri 09					
Chn	Jul CPI, %yr	0.2	0.4	–	Soft consumer demand ...
	Jul PPI , %yr	–0.8	–0.9	–	... and increased capacity to lead to very weak inflation.
	Q2 Current Account Balance, US$bn	39.2	–	–	Trade position strong and set to remain that way.
	Jul M2 Money Supply, %yr	6.2	6	–	Credit demand weak, policy support necessary.

CONTACT

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

Kelly Eckhold, Chief Economist | +64 9 348 9382 | +64 21 786 758 | kelly.eckhold@westpac.co.nz

Satish Ranchhod, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Darren Gibbs, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Michael Gordon, Senior Economist | +64 9 336 5670 | +64 21 749 506 | michael.gordon@westpac.co.nz

Paul Clark, Industry Economist | +64 9 336 5656 | +64 21 713 704 | paul.clark@westpac.co.nz

Imre Speizer, Market Strategist | +64 9 336 9929 | +64 21 769 968 | imre.speizer@westpac.co.nz

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