WEEKLY ECONOMIC COMMENTARY

10 Jun 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Spotlighting agriculture

Global Dairy Trade auction results.

One of the key events last week was the Global Dairy Trade auction. The overall dairy price index rose 1.7% on the previous auction, which was in line with expectations. Prices have now risen for five consecutive auctions, and are 16% up on this time last year, and 12% higher than at the beginning of this year.

There were gains for all the major products. Whole milk powder (WMP) prices rose 1.7%, underpinned by lower offer volumes and stronger demand from Southeast Asia/Oceania. Buyers from North Asia, which includes China, as well as those from the Middle East were also evident, purchasing similar volumes as they did at the previous auction.

Skim milk powder (SMP) prices were also up, rising 3% on stronger demand out of Europe, which is past its seasonal production peak, as well as from North Asia. Meanwhile, Anhydrous milkfat (AMF) prices lifted 0.9%, mostly on buying out of the Middle East, settling at another record high, while butter prices, underpinned by stronger demand out of China, edged ever closer to previous record highs. AMF prices are now 58% higher than a year ago, while butter is up 28%.

There were, however, some notable exceptions. Lightly traded buttermilk powder (BMP) jumped 10.4%, but much of that is likely to be due to BMP not being available at the previous action. Lactose was only negative result from the auction, with prices falling 1.9%.

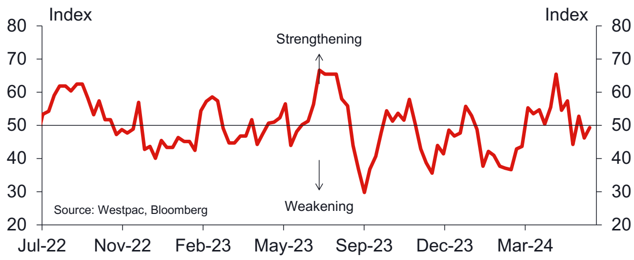
Farmgate milk price forecasts.

All of this is potentially good news for news for farmers, who will be hoping that the recent lift in dairy prices translates into higher farmgate milk prices over the 2024/25 season.

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
5 Jun 24	Govt financial statements for 10 mths to April
12 Jun 24	FOMC Meeting (Announced 13 June NZT)
14 Jun 24	NZ Selected price indexes, May
18 Jun 24	RBA Monetary Policy Decision
20 Jun 24	NZ GDP, March quarter
2 Jul 24	NZIER QSBO server, June quarter
4 Jul 24	Govt financial statements for 11 mths to May
10 Jul 24	RBNZ OCR Review
11 Jul 24	NZ Selected price indexes, June
17 Jul 24	NZ CPI, June quarter
31 Jul 24	FOMC Meeting (Announced 1 Aug NZT)
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

Our mid-point forecast for the milk payout is currently $8.40 per kg ms. That has remained unchanged since March when dairy prices were lower than they are today. That's also bit below the $8.55 that the futures market is suggesting but well up on Fonterra's rather cautious season opening mid-point forecast of $8.00.

At first blush, the recent pick up in dairy prices suggests there is upside risk to our farmgate milk price forecast. However, it important to remember that the season has just begun. There is a lot more water to go under the bridge over the coming months that could help sway prices and the exchange rate.

Productivity in agriculture.

Keeping with the agricultural theme, we recently published a report on **productivity in the agricultural sector**.

Improving productivity is important for farmers. Typically price takers, their living standards/quality of life/wellbeing are, in large part, tied to their ability to control unit costs of production. Producing more output for a given level of input can certainly help in that regard.

More broadly, lifting productivity could help the sector make a meaningful contribution to the Government's goal of doubling the value of New Zealand exports over the next 10 years.

The sector itself has performed well on the productivity front. In its heyday back in the 1980s agricultural productivity rose by about 40%, slowing to around 30% a decade later. The catalyst was a series of market reforms, which as soon followed by a period of rapid mechanisation, the pursuit of economies of scale, and changes in land use, evidenced in part by the conversion of beef and sheep farms into dairy.

Indeed, between 1978 and 2023 multi-factor productivity in the agricultural sector grew by a whopping 189%. Contrast that to the fast-expanding services sector, which saw growth of 33% over the same period and the paltry 2% recorded for the goods producing sector, which includes manufacturing and construction. Even today, the agricultural sector continues to outperform its peers.

That said, the trajectory of productivity growth in the agricultural sector has slowed markedly over recent decades. There are two key factors at play here. The first is the extent to which actual levels of agricultural production have edged ever closer to the ecological limits of what can be farmed. We think that like their peers in other first world country, farmers in New Zealand already operate close to these limits. The second is the diminishing marginal returns that can be generated from ongoing investment in mechanisation (and new technologies).

Given the importance of productivity, the question then is what can be done to lift it?

In essence we think that requires both a change in production mix and farming practice. In the first instance, that is about changing the volume of different inputs in the production mix to deliver maximum greatest output gains.

In the second it's about changing the quality of factor inputs used in the production process. In the case of labour, that is about improving the skills and competencies of the workforce. On the job learning has always been a feature of agriculture. Education is becoming increasingly important as farmers seek to bridge their lack of understanding of how technologies can deliver smarter and faster operations that make their life easier.

For capital, it's about getting more out of machinery, plant, and equipment as well as land, and livestock through the adoption of smart or precision farming practices that leverage off cutting edge technologies and data driven approaches. Think sensors, drones, artificial intelligence, robotic process automation and enhanced data analytics - just to name a few.

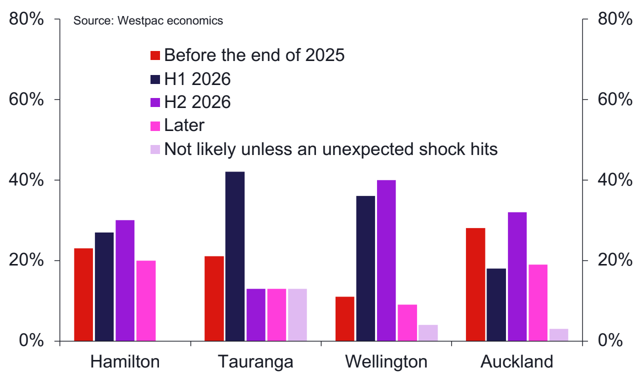
There are, of course, obstacles to adopting smart farming practices and new digital technologies. Some farmers are set in their ways and prefer the tried and trusted. Cost is also an issue, especially when they are upfront and returns on investment take time to materialise. It's also true that adopting new technologies can disrupt existing operations.

These obstacles are significant, but they can be overcome. New Zealand's farmers have a long tradition of innovation and adopting new technologies, and there is no reason why that cannot continue in the future.

Customer feedback – How will the economic landscape evolve?

In the last two weeks, we have been holding presentations with customers around the country to discuss the key messages in our **Economic Overview**. At these presentations we asked customers their views on how the economic outlook will evolve.

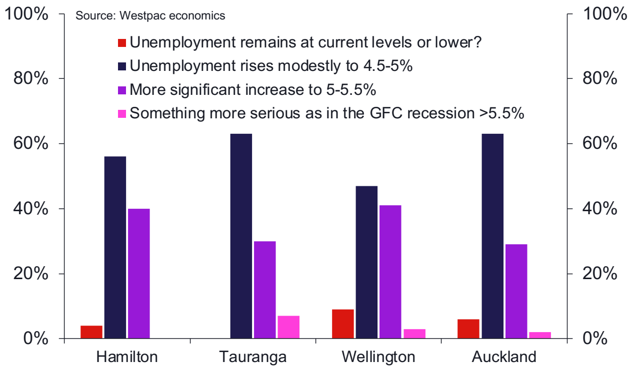
When will the annual CPI reach 2%?



When asked about when they expect that CPI inflation will reach 2%, customers generally expected the disinflation process to take some time. Late 2026 was a popular choice in most centres (although in Tauranga the most popular option was the first half of 2026). This gels with the RBNZ's view and that of our own forecasts which suggest inflation will not settle close to 2% until 2026.

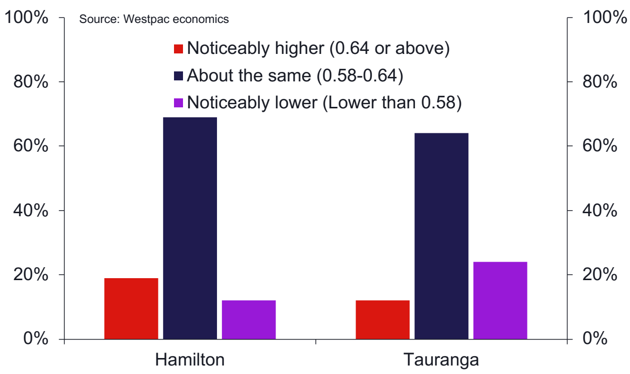
The fortunes of the labour market will be key in determining the pace and durability of the disinflation process. Customers universally expect the labour market to ease this year – although the expected pace of easing looks consistent with our own QEO projections (5.2% by end 2024) and the RBNZ (5%). A meltdown in the labour market (as occurred in the global financial crisis) is not seen as likely at this point.

Where will the unemployment rate end 2024?



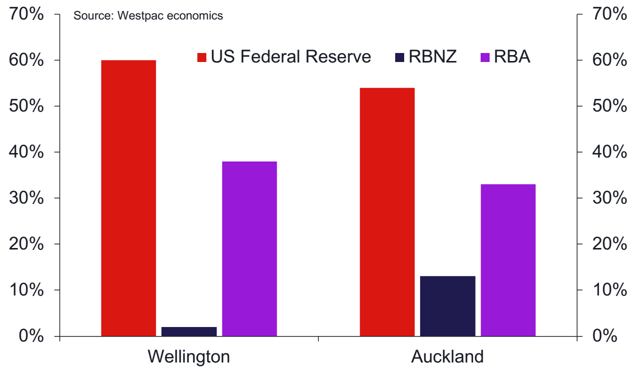
Customers don't seem to have a strong view on the direction of the currency for the rest of 2024 – again consistent with our expectation of a fairly flat performance this year.

Where will NZD/USD end 2024?



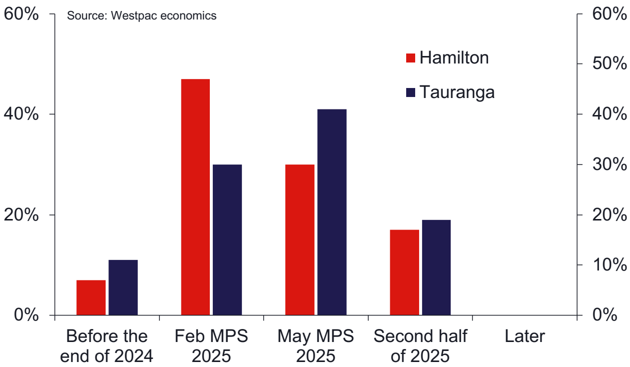
Westpac's Group Chief Economist Luci Ellis joined us for the Auckland and Wellington events. We added a different question to gauge views on which central bank will ease first. Customers see New Zealand as being last out of the gate on this score. Westpac Group's global forecasts also reflect this view as we see easings in the US in September, Australia in November and New Zealand in February.

Which central bank will ease first?



Finally in the regions we asked customers a more detailed question on when the RBNZ would begin to ease. 2025 looks like the most popular option which is consistent with our view that a February 2025 easing looks most likely all going well (and later if not!).

When will the RBNZ commence easing?

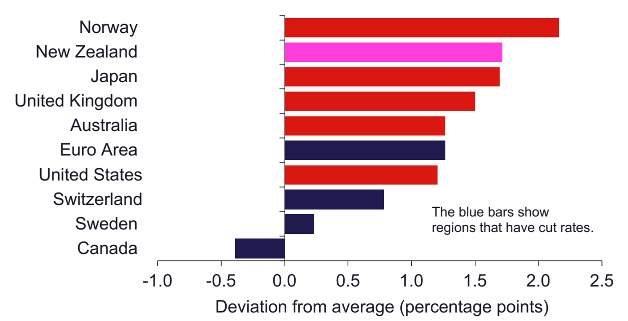


Paul Clark, Industry Economist

Chart of the week.

The last week saw both the Bank of Canada and the European Central Bank kick off their easing cycles. They join Sweden and Switzerland as the advanced economy central banks in the vanguard of the global easing cycle. The key factor that is allowing these central banks to ease earlier is their much better progress in reducing inflation. As our chart of the week shows, those central banks where inflation is closer to long run averages are the ones able to move first. They are also countries where relatively less fiscal stimulus was applied during the Covid period and hence their economies were less overheated. New Zealand is some way further back and has core inflation closer to countries which retain a tightening bias (Japan indeed is in a tightening cycle). More inflation progress through the balance of this year will be required – especially for non-tradable services sector inflation – before the RBNZ will be able to join their peers.

Core CPI inflation vs the 20-year average



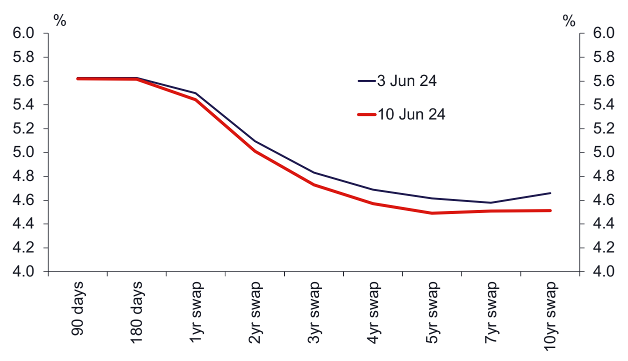
Source: Macrobond, Westpac Calculations. March data for NZ & Australia, April data for Japan, UK, US, Canada, Norway, Sweden, May Euro area & Switzerland.

Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in May and signalled that rate cuts are still some way off. Westpac is not forecasting OCR reductions until early 2025.

For borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

US non-farm payrolls rose by 272k in May, beating analysts' expectations by a sizeable margin. Hourly earnings were up 4.1% over the past year, and hours worked have also picked up. The accompanying household survey did show that the unemployment rate has pushed higher, climbing to 3.96% (from 3.86%). Even so, the overall tone of the May labour market update was firm, which has dampened analysts' expectations for earlier rate cuts from the Fed. Other US data have been more mixed. April saw falls in both residential and non-residential construction, while the manufacturing ISM softened in May. In contrast, the non-manufacturing ISM rose to 53.4. The focus over the week ahead will be the FOMC's policy meeting. No change in rates is expected, but the assessment of economic conditions will be closely watched. Ahead of the meeting, markets will be focused on the May CPI report, particularly given concerns about sticky service sector inflation. Over in Canada, the BOC cut the overnight rate by 25 bps last week. The accompanying statement highlighted the easing in underlying inflation and expectations that inflation will continue to soften. The BoC noted that "monetary policy no longer needs to be as restrictive", but also noted that "risks to the inflation outlook remain".

Asia-Pacific.

Australia's March quarter GDP printed broadly as expected, rising 0.1% / 1.1% yr. Growth in the March quarter was underpinned by firm household consumption spending (though per capita spending remains weak). Other parts of the domestic economy have been softer, with falls in business investment and construction. Across in China, recent data have highlighted the ongoing divergence between the domestic and externally focused parts of the economy. Export growth picked up to 7.6% yr in May. In contrast, import growth has slowed to 1.8% yr. If we look at the economy more generally, we're left with a mixed picture of economic conditions. Although we did see firmness in the latest Caixin manufacturing and services PMIs, other indicators (such as the official PMIs) have been softer. Overall, momentum in the economy appears limited.

Europe.

The ECB cut its policy rate 25 bps last week – the first cut in five years. However, the policy statement struck a hawkish tone, with the ECB noting that they are not pre-committing to a path of further rate cuts and future decisions would be data dependent. The ECB's inflation forecasts were revised higher, indicating that policy will need to remain restrictive for some time yet.

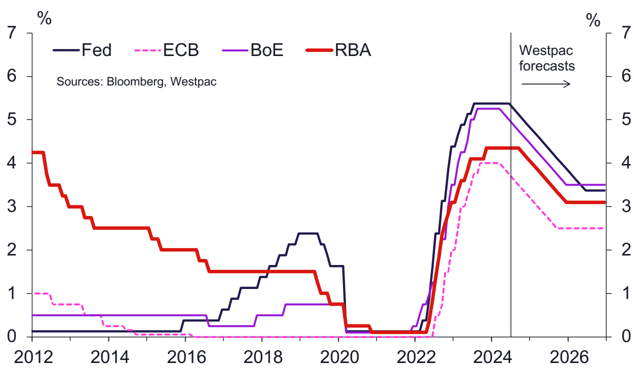
Trading partner real GDP (calendar years)

	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	2.5	1.5
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	6.7
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

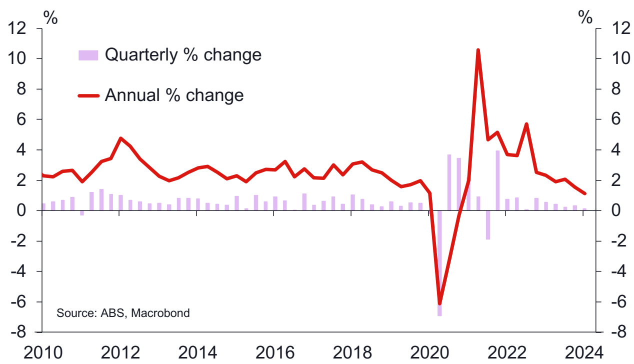
Australian & US interest rate outlook

	7 Jun	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.10
90 Day BBSW	4.35	4.37	4.17	3.30
3 Year Swap	4.07	4.20	4.00	3.50
3 Year Bond	3.90	4.00	3.80	3.30
10 Year Bond	4.23	4.35	4.25	4.00
10 Year Spread to US (bps)	-7	-15	-5	0
US				
Fed Funds	5.375	5.375	4.875	3.875
US 10 Year Bond	4.30	4.50	4.30	4.00

Global central bank policy rates



Australian GDP growth



Financial markets wrap

Interest rates.

NZ swap rates continued to oscillate with data surprises and events last week, most of which were offshore. The highlights were the Bank of Canada's rate cut and dovish guidance, and then the monthly US payrolls data on Friday which was stronger than expected.

The NZ 2yr swap rate is currently at 5.06% and should be contained inside a 4.90%-5.20% range during the week ahead. There's no major NZ event risks this week – Friday's monthly CPI data probably of greatest importance – but markets will be vulnerable to any surprises from the US Federal Reserve's interest rate decision. While the policy rate will almost surely remain unchanged, markets expect an upward shift in the Fed's interest rate projection. Chair Powell's press conference will also be closely watched.

NZ markets have priced an OCR cut in November as a 100% chance, which is one meeting earlier than our forecast of February 2025.

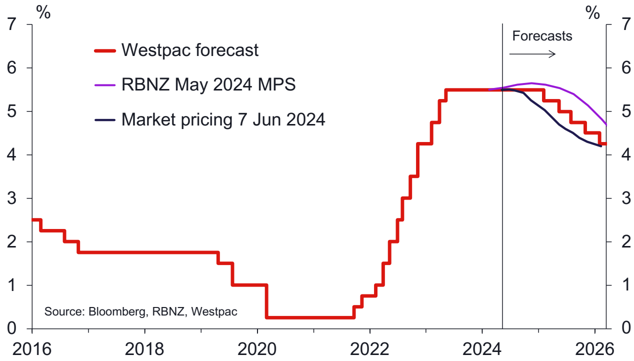
Foreign exchange.

NZD/USD extended the rally which started in mid-April to 0.6215 – a total gain of 3.6 cents – before reversing abruptly on Friday due to the US payrolls data surprise. We expect it to range around 0.6100 ahead of Thursday's FOMC outcome. That outcome will likely set the tone for the broad US dollar during the weeks ahead.

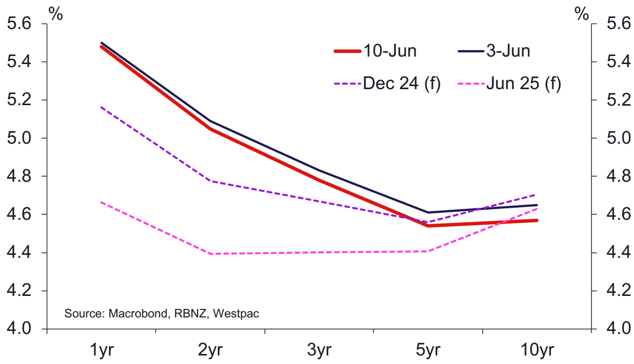
Our multi-month forecast remains modestly bullish, targeting 0.6300 in Q3. That is conditional on our forecasts for the Fed and RBNZ (easing to start in September 2024 and February 2025, respectively). We see the main risk to this outlook being a delay in the Fed's easing cycle, in which case NZD/USD would sit closer to its current level of 0.6100.

NZD/AUD's rally from 0.9067 in early May extended to 0.9315 last week, and that may be the extent of it. While we wouldn't rule out further gains, given RBA pricing appears too hawkish and RBNZ pricing appears too dovish (relative to our forecasts), a pullback to 0.9200 this week is our base case. AU labour data on Thursday poses event risk.

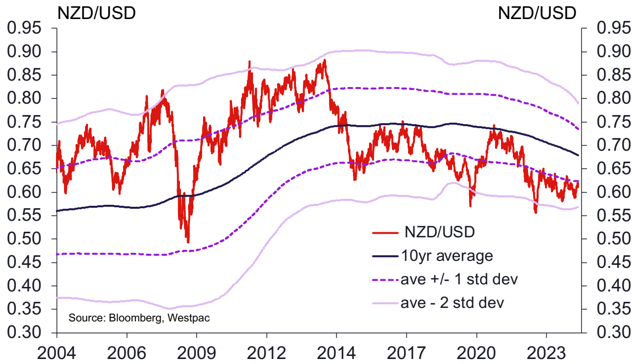
Official Cash Rate forecasts



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	0.611	0.586-0.620	0.555-0.743	0.648	0.61
AUD	0.927	0.907-0.933	0.873-0.992	0.932	0.91
EUR	0.566	0.552-0.57	0.517-0.637	0.583	0.55
GBP	0.480	0.471-0.484	0.464-0.544	0.506	0.48
JPY	95.6	90.2-96.7	61.3-96.7	79.2	93.9

The week ahead

NZ May retail card spending

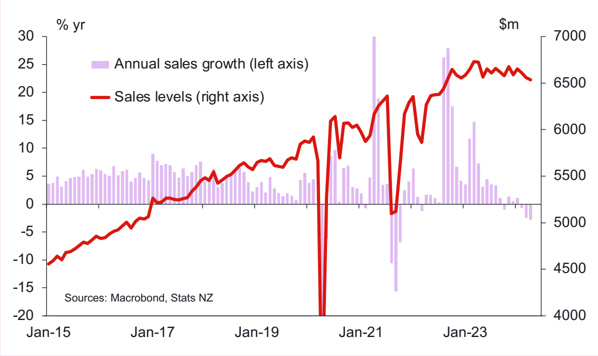
June 13, Last: -0.4%, Westpac f/c: -0.3%

Total retail spending fell 0.4% in April. That followed a 0.7% fall in March and was the fourth decline in the past five months.

We're forecasting another 0.3% fall in spending in May. While we expect continued modest gains in grocery purchases (related to strong population growth), spending in other areas has been dropping back. That includes notable softness in spending on durables and apparel.

The longer-term trend in spending remains weak. Households' budgets remain under pressure from continued high interest rates and still high inflation. At the same time, the labour market is softening. Those conditions (along with the related softness in sentiment) means that spending appetites are likely to remain weak for some time yet.

NZ monthly retail sales



NZ May monthly selected price indices

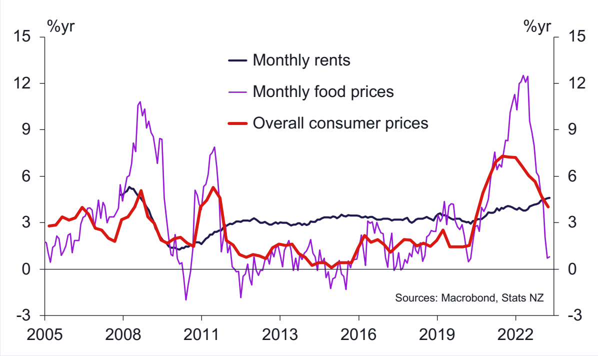
June 14

Stats NZ's suite of monthly price data covers around 45% of the CPI, providing timely updates on some of the more volatile components of inflation.

In terms of the big items, we're expecting a 3% fall in fuel prices in May, along with a 0.4% rise in food prices (including a lift in takeaway food prices related to the increase in the minimum wage).

On the domestic front, the key focus will be housing rents. Rental growth tends to be more modest through the middle part of the year. Accordingly, we expect a 0.3% rise this month (following increases of around 0.4% to 0.5% in recent months). If that slowdown doesn't occur, it would reinforce the RBNZ's concerns about the stickiness in domestic inflation.

Consumer prices

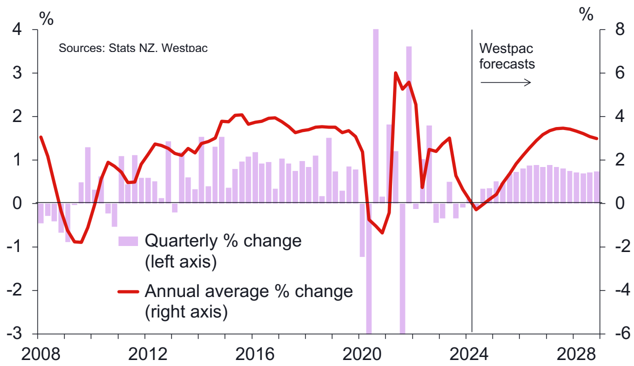


Economic and financial forecasts

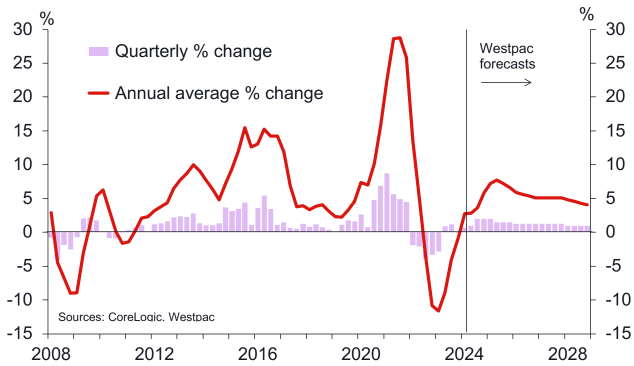
Economic indicators	Quarterly % change				Annual % change			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
GDP (production)	-0.1	0.1	-0.1	0.3	2.4	0.6	0.2	1.8
Consumer price index	0.5	0.6	0.8	1.1	7.2	4.7	2.9	2.2
Employment change	0.4	-0.2	0.2	0.1	1.7	2.7	0.1	0.9
Unemployment rate	4.0	4.3	4.6	4.9	3.4	4.0	5.2	5.4
Labour cost index (all sectors)	1.0	0.9	0.9	0.8	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-6.9	-6.2	-5.7	-5.1	-8.8	-6.9	-4.4	-4.1
Terms of trade	-7.8	4.6	1.9	1.3	-4.2	-10.6	8.1	0.8
House price index	-0.1	0.7	1.0	2.0	-10.8	-0.9	5.8	6.7

Financial forecasts	End of quarter				End of year			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.65	5.66	5.60	5.60	4.27	5.65	5.50	4.50
2 year swap	5.28	4.91	5.10	5.00	5.10	5.28	4.80	4.15
5 year swap	4.85	4.40	4.75	4.65	4.67	4.85	4.55	4.30
10 year bond	5.09	4.69	5.00	4.90	4.31	5.09	4.80	4.50
TWI	70.8	71.6	70.3	70.5	70.8	70.8	70.8	72.0
NZD/USD	0.60	0.61	0.60	0.60	0.60	0.60	0.61	0.65
NZD/AUD	0.93	0.93	0.91	0.91	0.92	0.93	0.91	0.91
NZD/EUR	0.56	0.56	0.55	0.55	0.59	0.56	0.55	0.57
NZD/GBP	0.49	0.48	0.47	0.47	0.51	0.49	0.48	0.49

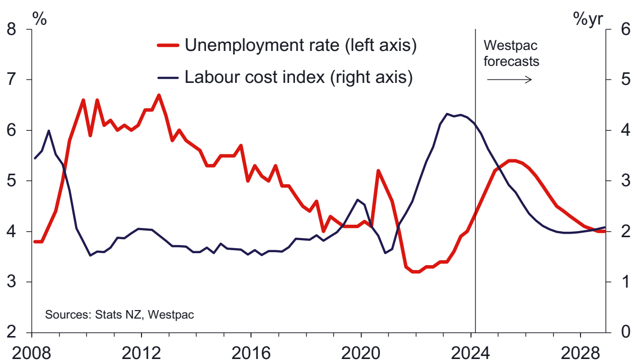
GDP growth



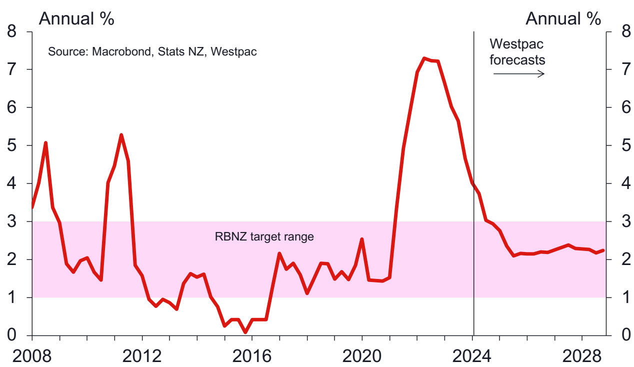
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
Aus	King's Birthday	–	–	–	All states except WA and Qld. Markets closed.
Jpn	Q1 GDP %qtr	–0.5%	–0.5%	–	Final estimate.
	Apr Current Account Balance ¥bn	3398.8	–	–	Weak Yen beneficial for exports.
Chn	May M2 Money Supply %yr	7.2%	7.2%	–	Further policy support needed to accelerate…
	May Aggregate Financing CNYbn ytd	12731	15030	–	… credit and money supply. Due June 10–15.
Eur	Jun Sentix Investor Confidence	–3.6	–	–	Policy easing should benefit sentiment in coming months.
Tue 11					
Aus	May NAB Business Survey	7	–	–	Conditions easing, broadly in line with average levels.
UK	Apr Unemployment Rate %	4.3%	4.3%	–	Labour market tightness persists…
	Apr Average Weekly Earnings %yr	5.7%	–	–	… keeping wage growth sticky.
US	May NFIB Small Business Optimism	89.7	89.7	–	Small business concern over outlook building.
Wed 12					
NZ	Apr Net Migration	4910	–	–	Easing from its highs, but revisions still clouding the picture.
Chn	May CPI %yr	0.3%	0.4%	–	Weak demand is keeping CPI inflation subdued…
	May PPI %yr	–2.5%	–1.5%	–	… as growing capacity weighs on upstream prices.
UK	Apr Monthly GDP %mth	0.4%	0.0%	–	Growth risks are amplified supporting the case for a cut.
US	May CPI %mth	0.3%	0.1%	0.1%	CPI ex–shelter at target, has been for some time.
	FOMC Policy Decision (midpoint)	5.375%	5.375%	5.375%	Commentary around labour market key. Sep likely first cut.
Thu 13					
NZ	May Retail Card Spending %mth	–0.4%	–	–0.3%	Continued weakness in discretionary spending.
Aus	May Employment Change 000's	38.5	25.0	45.0	Many persons not working but with a job lined up for May…
	May Unemployment Rate %	4.1%	4.0%	4.0%	… should see employment move higher and U/E round down.
Eur	Apr Industrial Production %mth	0.6%	–	–	Slowing demand a headwind for production.
US	May PPI %mth	0.5%	0.1%	–	Producers continue to face cost pressures according to PMIs.
	Initial Jobless Claims	229k	–	–	To remain low, for now.
	Fedspeak	–	–	–	Williams.
Fri 14					
NZ	May Manufacturing PMI	48.9	–	–	Businesses continue to report sluggish demand.
	May Food Prices %mth	0.5%	–	0.4%	Modest increases, including a lift in the price of takeaways.
	May Housing Rents %mth	0.5%	–	0.3%	Will be an important indicator of domestic price pressures.
Jpn	BoJ Policy Decision (upper)	0.10%	–	–	Data does not support another move quite yet.
Eur	Apr Trade Balance €bn	17.3	–	–	Global easing over 2024/25 should benefit exports.
US	May Import Price Index %mth	0.9%	0.1%	–	Shipping costs a lingering pressure.
	Jun Uni. of Michigan Sentiment	69.1	73.0	–	Inflation expectations to remain benign.
	Fedspeak	–	–	–	Goolsbee.

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