



WEEKLY ECONOMIC COMMENTARY

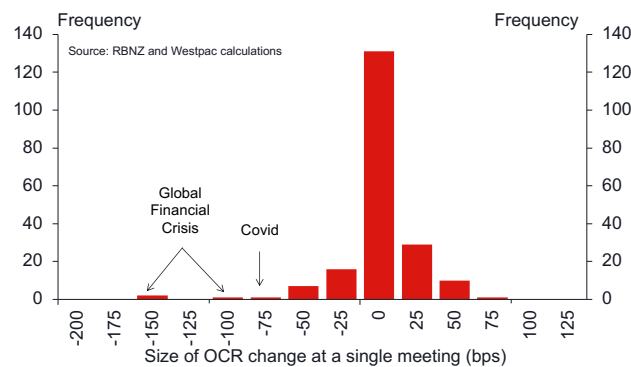


14 Oct 2024 | Westpac Economics Team | westpac.co.nz/economics | economics@westpac.co.nz

The wait is over

Going into the October RBNZ policy review, the only question was the size of the OCR cut that the Bank would choose to deliver. As it turned out, the RBNZ chose to cut the OCR by 50bps to 4.75%, as we expected. Looking ahead, the brief policy statement and the record of meeting provided little guidance aside from a reference to a 4.75% OCR still being judged to be restrictive. The RBNZ indicated that the decision to be taken at the next meeting on 27 November would be data dependent.

Frequency of RBNZ OCR changes – single meeting



The 50bp easing was a step up in the pace of easing compared to that forecast by the RBNZ in their August Monetary Policy Statement. A 50bp cut (or larger) is relatively unusual – especially outside of times of crisis. The RBNZ motivated this shift in pace by taking a relatively dovish interpretation of the data flow since August. The table below shows some snippets comparing the language used by the RBNZ in August compared to October. We didn't see many, if any, areas where the RBNZ took a more cautious or hawkish tone. This is perhaps remarkable given the extent to which financial conditions have eased since August, and the degree to which forecasts for the OCR by year end have been revised lower.

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
16 Oct 24	NZ CPI, September quarter
5 Nov 24	RBA Monetary Policy Decision
5 Nov 24	US elections (Results from 6 Nov NZT)
6 Nov 24	Labour market statistics, September quarter
6 Nov 24	RBNZ Financial Stability Report
7 Nov 24	FOMC Meeting (Announced 8 Nov NZT)
7 Nov 24	Govt financial statement, 3 months to September
11 Nov 24	RBNZ Survey of Expectations, September quarter
14 Nov 24	NZ Selected price indexes, October
27 Nov 24	RBNZ OCR Review & Monetary Policy Statement
5 Dec 24 (tbc)	Govt financial statement, 4 months to October
10 Dec 24	RBA Monetary Policy Decision
16 Dec 24	NZ Selected price indexes, November
17 Dec 24	Half-Year Economic and Fiscal Update

Key points from the RBNZ's August and October policy statements

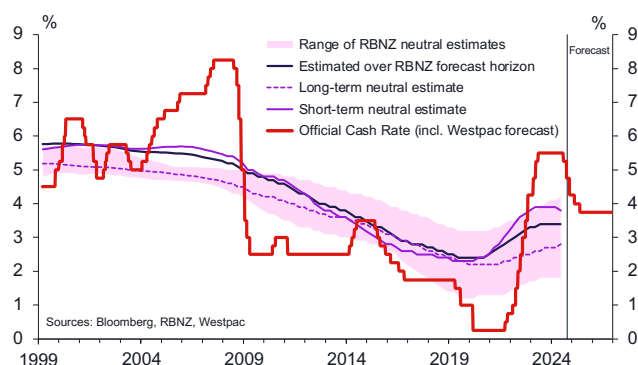
	October review	August MPS
Activity	<p>The Committee agreed that domestic activity is weak.</p> <p>Economic activity in New Zealand is subdued, in part due to restrictive monetary policy.</p> <p>Members agreed that increasing excess capacity is leading to lower inflationary pressure in the New Zealand economy.</p>	<p>The Committee noted that the weakening in domestic economic activity observed in the July Monetary Policy Review has become more pronounced and broad-based.</p> <p>The Committee discussed possible reasons for the current economic weakness. Alongside restrictive monetary policy, an earlier or larger impact of tighter fiscal policy could be constraining domestic demand. Falling net migration may also be playing a role.</p>
Labour	Labour market conditions are expected to ease further...	The June quarter data suggest that employment growth has slowed...
Financial conditions	While wholesale and bank interest rates have declined, financial conditions remain restrictive.	While domestic financial conditions remain restrictive, they have loosened over recent months.
Inflation	The Committee assesses that annual consumer price inflation is within its 1 to 3 percent inflation target range and converging on the 2 percent midpoint.	New Zealand's annual consumer price inflation is returning to within the Monetary Policy Committee's 1 to 3 percent target band.
Risk	Members agreed that an OCR of 4.75 percent is still restrictive.	Members noted that monetary policy will need to remain restrictive for some time to ensure that domestic inflationary pressures continue to dissipate.

We think a key driver of the RBNZ's more dovish stance reflects their greater confidence that inflation will print close to the middle of the target range very soon. Indeed, we expect that this week's September quarter CPI will show that annual inflation has fallen to 2.2% - down from 3.3% in June and the first time that inflation has been inside the RBNZ's target band since 2021. That easing in inflation has predominantly been due to falls in the prices of imported tradable goods, while domestic inflation (which is a bigger focus for the RBNZ) remains hot. Even so, the RBNZ is now feeling more comfortable about the inflation landscape, especially as inflation expectations look well contained.

Another factor is the perceived restrictive level of the OCR compared to estimates of neutral. As the MPC's confidence that the level of inflation will soon settle around 2% has grown, so too has its discomfort with the level of the OCR relative to neutral. Hence the OCR is now being moved relatively quickly even as some indicators of an expected recovery in the domestic economy have started to perk up a bit.

The RBNZ has just one opportunity to review the level of the OCR between now and February 2025, whereas most of their advanced economy peers have 2-3 meeting opportunities. This gap in the schedule is likely also driving the increased easing pace right now.

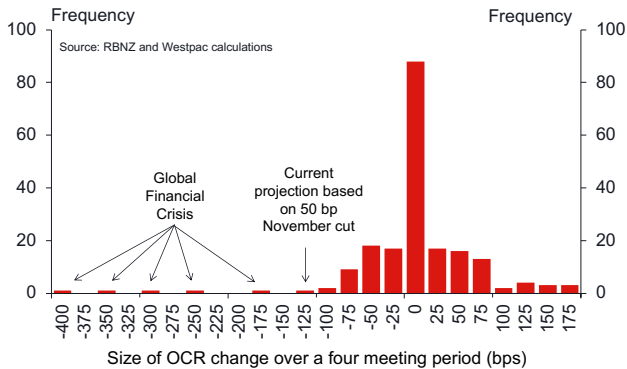
Official Cash Rate and RBNZ estimates of neutral



We saw no pushback on our expectation (and market pricing) for another 50bp easing at the November Monetary Policy Statement. Hence this remains the modal expected outcome. There has been some market discussion of the chances of a super-sized 75bp cut at the 27 November meeting. But we think that chance looks relatively low given cuts of that size or larger have been historically reserved for times of crisis (during Covid or the Global Financial Crisis period) that we don't see right now. It's also the case that, assuming the OCR is cut by 50bp at the November meeting, the OCR will have been adjusted lower by a historically large amount in the 4-month period since August. It was only in the

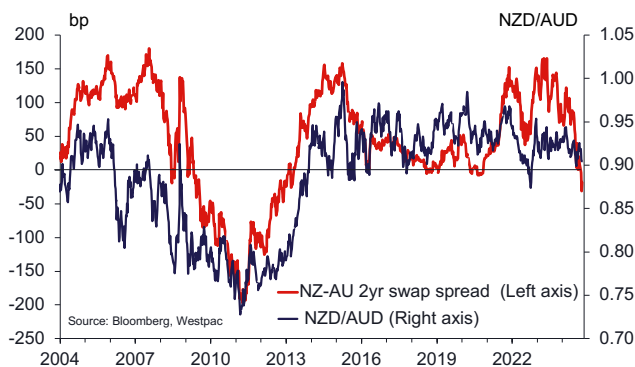
Global Financial Crisis period that the OCR moved down by more as quickly. And needless to say, those were very different times.

Frequency of RBNZ OCR changes – four meeting period



The New Zealand dollar now seems more precariously placed than it has been for quite some years. New Zealand has a classic “twin deficits” problem, and our forecasts don’t envisage a significant current account correction any time soon. Something that might help with that would be a move lower in the exchange rate on a trade weighted basis. Our forecasts have long envisaged an underperformance of the NZD on average across the TWI basket – even if we can hold our ground versus a weakening US dollar. Given the RBNZ seems set to continue to cut more aggressively than the US and Australian central banks, we may be entering a period where the NZD settles into a new weaker range. Our medium-term NZD/AUD forecasts envisage a move in NZD/AUD towards 0.86 – a level not seen since the GFC period when interest rate differentials to Australia last plumbed low levels.

NZD/AUD vs yield spreads



Data over the past week was largely as expected and hasn’t altered our expectations for muted growth through the latter part of the year. The latest PMI showed modest improvements in business activity and forward orders, but remained at subdued levels. In the tourism sector, visitor numbers are continuing to trend higher, but that’s occurring gradually, with arrivals still only around 80% of their 2019 level. Lastly, net migration inflows continued to ease in August with annual migration slowing to just

under 54,000 people, compared to a net 65,000 in July and a peak of 136,000 in October last year. We’re forecasting annual net migration will slow to zero for the 2025 calendar year, reflecting the soft economy and fewer job opportunities in New Zealand.

Looking ahead, the data is likely to determine the ultimate size of the RBNZ’s November adjustment. We see a high chance of the 50bp move currently forecast, with the next most likely option being a 25bp cut. Key releases include the Q3 CPI (16 October), RBNZ Assistant Governor Silk’s speech on monetary policy transmission (16 October) and the Q3 labour market data (6 November). There may also be economic and financial markets implications of the outcomes of the US presidential election (5 November) and the 7 November FOMC meeting.

Finally, we note that the final audited accounts for the 2023/24 fiscal year reported an operating deficit (OBEGAL) that was \$1.8bn larger than the Budget 2024 forecast. This reflected an upside surprise to spending that was larger than the upside surprise to revenue (the latter driven largely by tax on investment income). Importantly, most of the upside surprise to spending sat outside the core government sector (for example in state-owned enterprises) or was non-cash in nature. As a result, combined with the partial prefunding of the current fiscal year that was undertaken back in June, the core Crown residual cash deficit – which drives the Government bond programme – was \$2.6bn lower than the Budget 2024 forecast. Attention will now turn to 7 November when the Treasury will release financial data for the first three months of the current fiscal year. This data will help to determine whether there is any adjustment to this year’s bond programme when the Half-Year Economic and Fiscal Update (HYEFU) is released on 17 December. Following a succession of very large upward revisions at similar updates, at this stage any revision in HYEFU seems likely to be small.

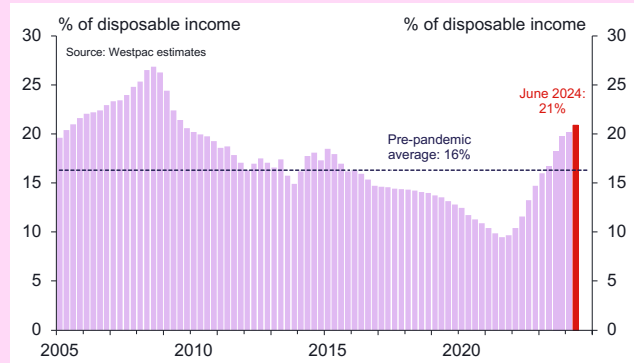
Kelly Eckhold, Chief Economist

Chart of the week.

Household finances have continued to be squeezed. We estimate that on average households' disposable incomes rose 2.8% in the year to June. That's below the 3.3% rise in consumer prices over the same period. And on top of higher living costs, many households have been confronted by large increases in interest rates. In fact, we estimate that for households with mortgages, their spending on interest costs has risen from a low of 10% in 2021 to 21% now. That's the highest it's been in more than a decade. Those financial pressures have seen households winding back their spending on items like furnishings and dining out. But even with that restraint in spending, household savings levels have been going backwards. And compounding that pressure on some households' budgets has been a softening of the labour market.

The good news is that it looks like the worst may be behind us. Consumer price inflation is dropping back, and interest rates have started to drop. While it will take some time for that to flow through to households' back pockets, we expect those factors will support a recovery in economic growth over the year ahead. We've already seen economic confidence starting to tilt higher in recent weeks.

Spending on interest costs (households with mortgages)

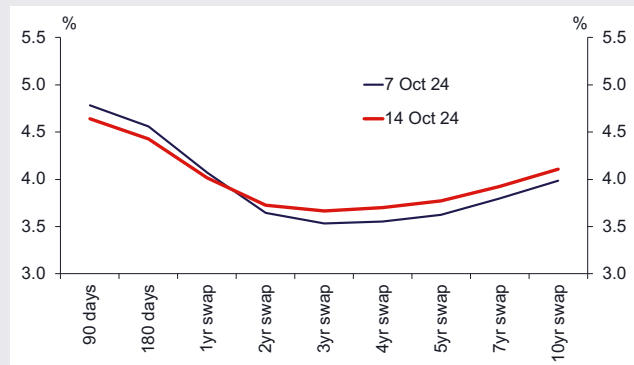


Fixed versus floating for mortgages.

The RBNZ followed up August's 25bp cut in the OCR with a supersized 50bp cut at last week's October policy review. We expect another 50bp cut at the November review, with further, but more gradual, cuts in 2025.

A significant amount of OCR easing is 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.

NZ interest rates



Global wrap

North America.

A rebound in volatile apparel prices and a large increase in healthcare costs caused a larger-than expected 0.3% rise in the US core CPI in September, even as growth in previously troubling shelter prices slowed to 0.2%. However, the core PPI rose a less troubling 0.2% and consumer sentiment edged lower in October. Minutes from the last FOMC meeting indicated that some participants had preferred or could have supported a 25bps rate cut, consolidating expectations that a further 50bps rate cut is unlikely at the Fed's November meeting. The highlight of this week's diary is likely to be Thursday's September retail sales report. This week will also bring news from the manufacturing and construction sectors, while several Fed speeches are scheduled across the week. Staying in the region, Canada's September inflation data will also be of interest ahead of next week's BoC policy meeting.

Europe

The focus in the euro area over the coming week will be on Thursday's ECB policy meeting. In common with the consensus, with President Lagarde recently expressing growing confidence that inflation will be back into line with its inflation target, we expect the ECB to cut its key policy rate by a further 25bps. This week's data flow includes the ECB's Bank Lending Survey and final euro area CPI inflation data for September. A busy week for data in the UK includes news on the labour market, the September CPI and PPI reports and September retail spending.

Asia-Pacific

Chinese equities retraced somewhat last week with a lack of further stimulus announcements disappointing investors. Inflation data, released over the weekend, was weaker than expected with producer prices falling 2.8%/y in September. Looking ahead, China will release trade data today, followed on Friday by its key domestic activity indicators for September, together with Q3 GDP. Growth is expected to have slowed to 4.6%/y, motivating the range of stimulus measures announced by policymakers in recent weeks. Japan will print IP and trade reports ahead of the September CPI report on Friday. In Australia, the Westpac consumer confidence index rose 6.2% to 89.8 in October – still downbeat, but a two and a half year high. Expectations appear to have been buoyed by interest rate cuts abroad and signs that inflation is moderating locally. Business confidence also appears to have found a floor with the NAB business conditions index rising 3pts to +7 – about in line with the average level over the past year. This week attention will be on the labour market, with Thursday's labour force survey expect to reveal a steady 4.2% jobless rate.

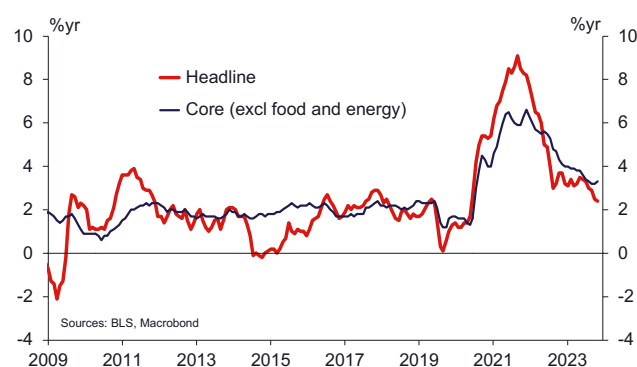
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.0	1.3	2.2	2.4
China	5.2	5.0	4.8	4.5
United States	2.9	2.7	1.8	1.7
Japan	1.9	0.1	1.1	0.9
East Asia ex China	3.3	4.2	4.1	4.1
India	7.8	7.0	6.8	6.5
Euro Zone	0.4	0.6	1.5	1.5
United Kingdom	0.1	1.0	1.3	1.4
NZ trading partners	3.3	3.2	3.3	3.2
World	3.2	3.3	3.3	3.2

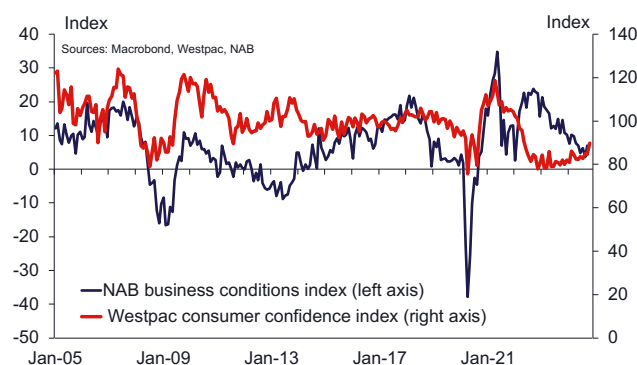
Australian & US interest rate outlook

	11 Oct	Dec-24	Mar-25	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.35
90 Day BBSW	4.42	4.42	4.19	3.50
3 Year Swap	3.81	3.60	3.60	3.50
3 Year Bond	3.78	3.55	3.50	3.35
10 Year Bond	4.22	3.90	3.90	4.05
10 Year Spread to US (bps)	16	15	15	5
US				
Fed Funds	4.875	4.375	3.875	3.375
US 10 Year Bond	4.06	3.75	3.75	4.00

US CPI inflation



Australian consumer & business confidence



Financial markets wrap

Interest rates.

NZ swap rates started to form a base two weeks ago, and continued in that vein last week, despite a large 50bp OCR cut by the RBNZ. There are two explanations for this.

First, the whole easing cycle had already been priced in, so that the RBNZ MPR needed to deliver a signal of faster-than-priced future easing. It did not (actually, it didn't say anything about the pace of future easing).

Second, global yields, led by the US, have been rising over the past few weeks (in turn due to some firmer US data and less dovish Fed speak), and these are always influential on NZ rates.

Looking ahead, there is scope for another 50bp OCR cut in November, but that is fully priced by markets. Thus, it will require surprises from data and events to push swap rates much lower from here.

The 2yr swap formed a bottom at 3.50% in early October. Whether that level holds during the week ahead will largely depend on the outcome of the NZ CPI data update for Q3, which is released on Wednesday.

Foreign exchange.

Near term risks to NZD/USD remain negative. It has retraced 62% of the Jul-Sep rally, and if 0.6060 support gives way, we'd be targeting 0.5980. That level, if seen, should provide an opportunity for NZ exporters to consider hedging receipts.

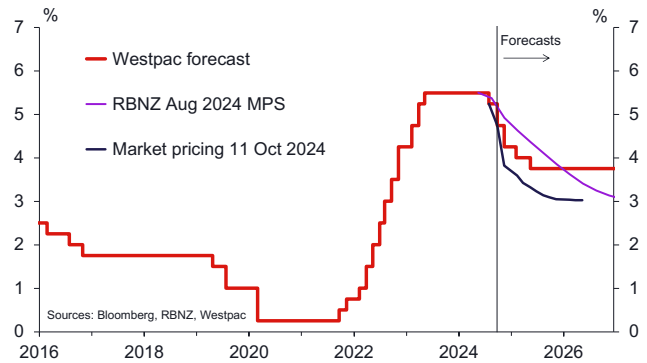
The two most important influences over the near term will be USD strength and NZ-US interest rate differences.

The USD has been strengthening as Fed easing expectations have been pared, following some strong US data. In addition, Fed officials have hinted at a slower pace of easing ahead, even though the latest rate cut was a large 50bp. Geopolitical risks emanating from the Middle East have further supported the safe-haven USD.

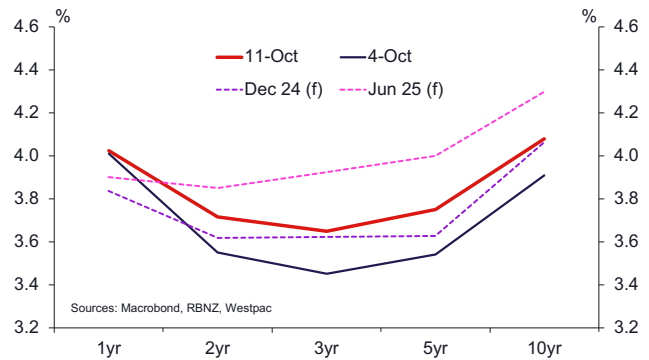
Regarding NZ-US yield spreads, these are now negative for shorter maturities (the 2yr OIS spread is at -18bp). The combination of US Fed market pricing adjusting higher and RBNZ pricing adjusting lower has pushed NZ-US yield spreads to the lowest levels since 2020.

NZ-AU yield spreads have also become negative. The NZD/AUD has fallen 2c over the past month, but not enough to capture the sharp fall in yield spreads. A period of catch-up is warranted, and we see potential for further weakness to 0.89 multi-week. Event risk this week comes from NZ CPI data on Wednesday and AU labour data on Thursday.

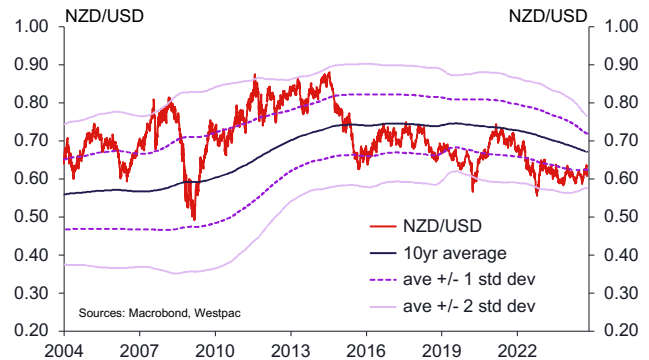
Official Cash Rate forecasts



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	0.586-0.636	0.555-0.743	0.645	0.62
AUD	0.902	0.897-0.925	0.873-0.992	0.929	0.90
EUR	0.556	0.542-0.569	0.517-0.637	0.581	0.56
GBP	0.467	0.456-0.476	0.456-0.535	0.502	0.47
JPY	91.1	86.1-96.9	61.3-98.6	80.8	88.0

The week ahead

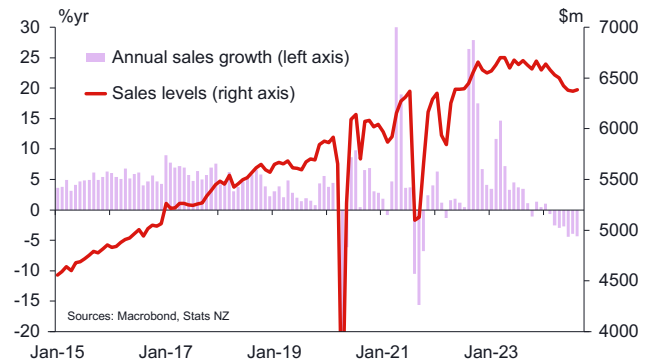
Sep retail card spending

Oct 14, Last: +0.2%, Westpac f/c: +0.1%

Retail spending levels rose 0.2% in August. That was the first rise in seven months. But while that rise will have been welcome news for retailers, August's gain was actually fairly modest, especially as tax cuts were rolled out from 31 July.

Spending has been weighed down in recent months by the combination of large increases in living costs and high borrowing costs. Those headwinds are easing, but haven't fully dissipated yet. As a result, we expect that spending growth will remain muted in September.

Monthly retail card spending



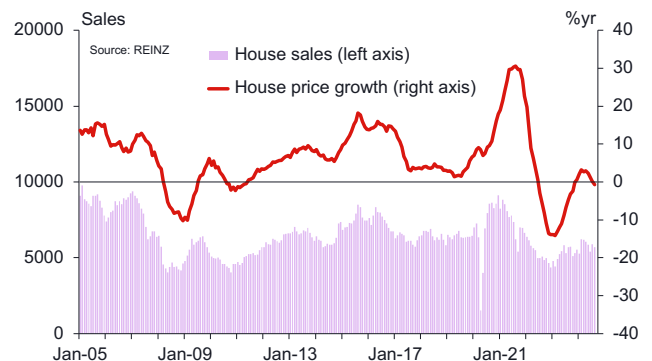
Sep REINZ house prices and sales

Oct 15, Prices Last: -0.8%yr; Sales Last: -0.7%yr

Consistent with reports from real estate agencies, we expect the September housing market report will show that sales have increased, albeit from low levels. However, house price growth is expected to remain muted due to the sizeable inventory of unsold homes.

Mortgage rates have started to drop, and this will support the market over time. However, it will take time to fully pass through to housing market activity.

REINZ house prices and sales



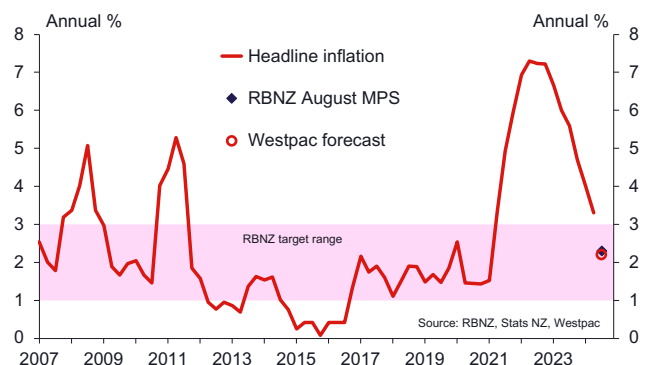
Q3 CPI

Oct 16, Quarterly Last: +0.4%, Westpac f/c: +0.7%, Mkt f/c: +0.7%

Annual Last: +3.3%, Westpac f/c: +2.2%

We estimate that New Zealand consumer prices rose by 0.7% in the September quarter. That would see annual inflation dropping to 2.2% – the first time it's been below 3% since 2021. Adding to inflation in the September quarter are large increases in local council rates, insurance premiums and food prices. Those increases are balanced against lower prices for fuel and imported durable items. Our forecast is slightly below the RBNZ's forecast from their August Monetary Policy Statement, reflecting weaker fuel prices in recent months as the oil price has fallen.

Annual headline inflation

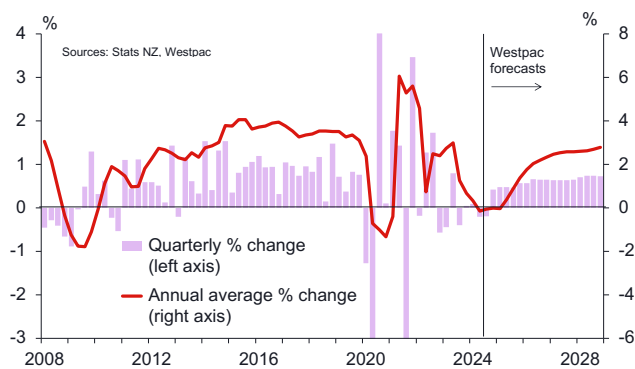


Economic and financial forecasts

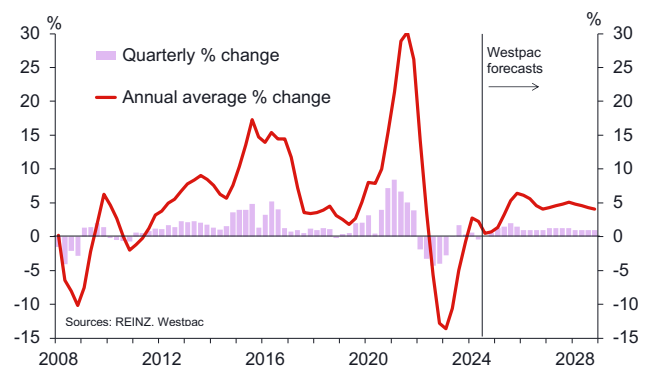
Economic indicators	Quarterly % change				Annual % change			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
GDP (production)	0.1	-0.2	-0.2	0.4	0.7	0.0	1.4	2.3
Consumer price index	0.6	0.4	0.7	0.3	4.7	2.1	2.3	2.1
Employment change	-0.3	0.4	-0.4	-0.2	2.9	-0.4	-0.1	1.5
Unemployment rate	4.4	4.6	5.0	5.3	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)	-6.7	-6.7	-6.3	-6.0	-7.1	-6.0	-5.2	-5.5
Terms of trade	5.1	2.0	1.7	0.5	-10.7	9.6	0.4	2.4
House price index	0.4	-0.4	0.0	0.5	0.6	0.5	6.3	4.0

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	4.25	5.50	4.25	3.75	3.75
90 day bank bill	5.66	5.63	5.31	4.25	5.65	4.25	3.85	3.85
2 year swap	4.91	5.01	4.06	3.60	5.28	3.60	4.00	4.00
5 year swap	4.40	4.53	3.81	3.65	4.85	3.65	4.25	4.25
10 year bond	4.69	4.74	4.31	4.15	5.09	4.15	4.40	4.35
TWI	71.6	71.4	70.9	70.3	70.8	70.3	69.8	69.1
NZD/USD	0.61	0.61	0.61	0.62	0.60	0.62	0.64	0.64
NZD/AUD	0.93	0.92	0.91	0.90	0.93	0.90	0.87	0.86
NZD/EUR	0.56	0.56	0.56	0.56	0.56	0.56	0.56	0.56
NZD/GBP	0.48	0.48	0.47	0.47	0.49	0.47	0.47	0.47

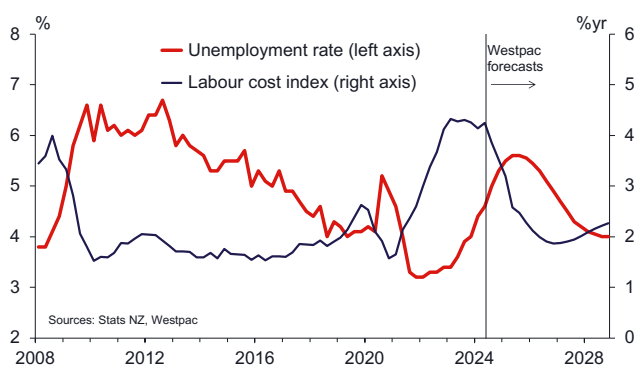
GDP growth



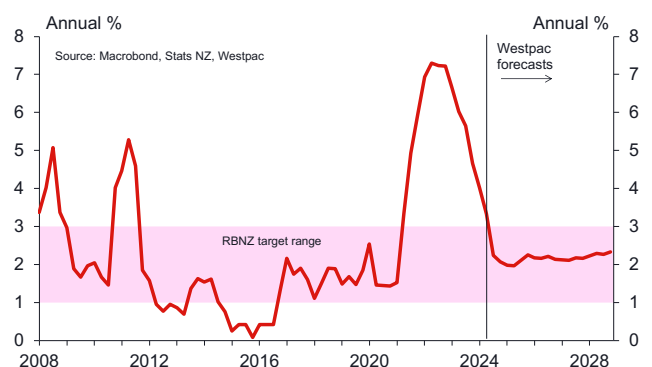
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 14					
NZ	Sep BusinessNZ PSI, index	45.5	-	-	Off its lows but still very weak in August.
	Sep Retail Card Spending, %mth	0.2	-	0.1	Spending growth remains muted.
Chn	Sep Trade Balance, US\$bn	91	91.2	-	Exports benefitting from firm demand in Asia.
US	Columbus Day	-	-	-	Stock markets closed; bond markets remain open.
Tue 15					
NZ	Sep REINZ House Sales, %yr	-0.7	-	-	Signs that buyer interest is lifting on lower mortgage rates...
	Sep REINZ House Prices, %yr	-0.8	-	-	... but price gains likely to be limited for now.
Eur	Oct ZEW Survey of Expectations, index	9.3	-	-	Euro area growth outlook worsening.
	Aug Industrial Production, %mth	-0.3	1.2	-	Remains subdued in the face of weak global demand.
UK	Aug ILO Unemployment Rate, %	4.1	4.1	-	Likely to stabilise after a decrease in the last few months...
	Aug Average Weekly Earnings, %yr	4	-	-	... as wage growth continues to ease.
US	Oct Fed Empire State, index	11.5	0	-	Manufacturers turning slightly more optimistic.
	Fedspeak	-	-	-	Daly, Waller.
Wed 16					
NZ	Q3 CPI, %qtr	0.4	0.7	0.7	Boost from rates, insurance and food prices.
	Q3 CPI, %yr	3.3	2.2	2.2	Import prices weak, domestic prices easing but still firm.
Aus	RBA Assist' Gov. (Economic)	-	-	-	Hunter speaking at Citi Conference.
	Sep Westpac-MI Leading Index, %ann'd	-0.27	-	-	Points to below-trend growth.
Jpn	Aug Core Machinery Orders, %mth	-0.1	0.3	-	Unlikely to signal a bigger increase in investment.
UK	Sep CPI, %yr	2.2	1.9	-	Focus on services inflation.
US	Sep Import Price Index, %mth	-0.3	-0.3	-	Shipping costs a potential risk.
Thu 17					
Aus	Sep Employment Change, 000s	47.5	22.3	40	Employment tracking broadly in line with population...
	Sep Unemployment Rate, %	4.2	4.2	4.2	... as elevated population gradually lifts U/E higher.
Eur	Aug Trade Balance, €bn	15.5	-	-	Exports suffer from weak external demand.
	Sep CPI, %yr	2.2	1.8	-	Final estimate for September.
	Oct ECB Policy Decision (Deposit), %	3.5	3.25	-	Weaker economic backdrop warrants policy action.
US	Sep Retail Sales, %mth	0.1	0.2	-	Consumer spending growth maintained firm in Q3.
	Oct Philly Fed, index	1.7	3	-	Business conditions remain suboptimal.
	Initial Jobless Claims	258	230	-	Effects of the hurricanes likely to skew the picture.
	Sep Industrial Production, %mth	0.8	-0.1	-	A broadly flat trend is set to continue.
	Aug Business Inventories, %mth	0.4	0.3	-	Increased somewhat in recent months.
	Oct NAHB Housing Market, index	41	42	-	Clues for effects of lower interest rates.
Fri 18					
Jpn	Sep CPI, %yr	3	2.5	-	Focus on the underlying inflationary pressures.
Chn	Q3 GDP, %yr	4.7	4.6	-	GDP growth will remain below the 5% target...
	Sep Retail Sales, %yr ytd	3.4	3.3	-	... as consumer spending remains depressed..
	Sep Industrial Production, %yr ytd	5.8	5.7	-	... and manufacturing struggles to regain momentum.
	Sep Fixed Asset Investment, %yr ytd	3.4	3.3	-	Investment growth driven solely by state-owned entities.
UK	Sep Retail Sales, %mth	1	-	-	Stronger consumer spending as inflation has come down.
US	Sep Housing Starts, %mth	9.6	-0.5	-	Lower borrowing costs should support more activity...
	Sep Building Permits, %mth	4.6	-0.3	-	... but the effect will probably come with a lag.
	Fedspeak	-	-	-	Kashkari.

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