



# WEEKLY ECONOMIC COMMENTARY

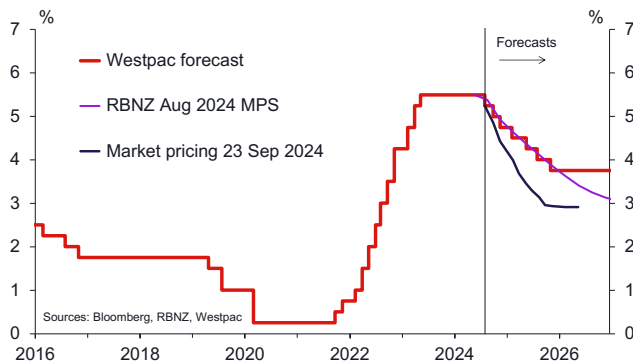


23 Sep 2024 | Westpac Economics Team | [westpac.co.nz/economics](https://westpac.co.nz/economics) | [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

## More of the same

With economic activity continuing to contract, questions are swirling around how far and how fast the RBNZ will cut rates over the coming year, especially in the wake of the FOMC's larger than expected cut last week. Financial markets are pricing in a series of rapid rate cuts, including at least one 50bp cut before the end of this year. However, we expect that the RBNZ will continue to move in measured 25bp steps, with a further 50bps of cuts this year and another 100bps over 2025.

### Official Cash Rate forecasts



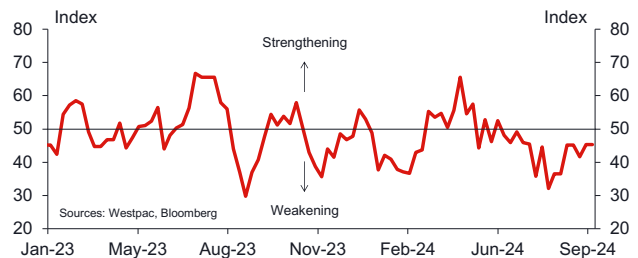
Last week's update on GDP showed that economic activity in New Zealand shrunk by 0.2% in the June quarter, leaving activity down 0.5% on where it was a year ago. While that's obviously not a great result, June's decline was not as weak as we or the RBNZ had feared. We were expecting a 0.4% fall. Similarly, the RBNZ had factored in a 0.5% contraction in its August policy statement forecasts.

Stepping back and looking at the longer-term trends, economic activity in New Zealand has effectively been tracking sideways for two years now, with parts of the economy like the hospitality and retail sectors doing it tough. On a per capita basis, economic activity has now dropped back to the levels that we saw just prior to the pandemic.

### 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	→	↘	↘

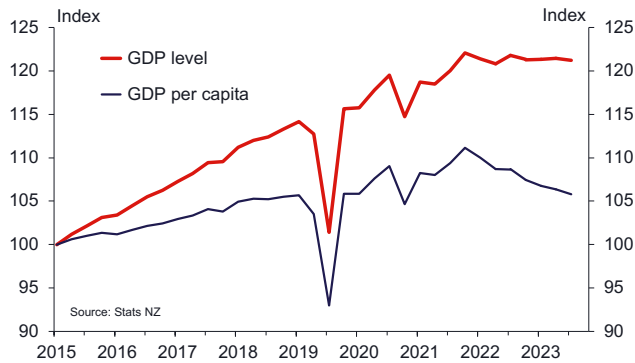
### Westpac New Zealand Data Pulse Index



### Key data and event outlook

Date	Event
24 Sep 24	RBA Monetary Policy Decision
1 Oct 24	NZIER QSBO survey, September quarter
9 Oct 24	RBNZ OCR Review
10 Oct 24	Govt to release 2023-24 Financial Statements
11 Oct 24	NZ Selected price indexes, September
16 Oct 24	NZ CPI, September quarter
5 Nov 24	RBA Monetary Policy Decision
6 Nov 24	Labour market statistics, September quarter
7 Nov 24	FOMC Meeting (Announced 8 Nov NZT)
7 Nov 24 (tbc)	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
10 Dec 24	RBA Monetary Policy Decision

## Production GDP level



But while the economy is far from being ‘strong,’ the June quarter result will have been a welcome relief for the RBNZ. Ahead of the release, a range of higher frequency indicators such as the PMI surveys had deteriorated sharply, signalling the possibility that the economy had entered a much tougher period. Instead, last week’s GDP report showed that although the economy is continuing to contract, the pace of that decline remains gradual and no worse than we’ve seen in recent quarters.

We expect that economic growth will remain subdued through the back part of this year, with unemployment continuing to push higher. We also expect that inflation will fall below 3% in the September quarter for the first time in three years, and that it will track close to 2% over the year ahead.

Given that softening in economic conditions, we’re forecasting that the RBNZ will cut the OCR by 25bps at its next two meetings, with further gradual cuts pencilled in for 2025. That would see the cash rate falling to 3.75% by the end of next year.

In contrast, financial markets are pricing in the chance of more front-loaded rate cuts. Market pricing is currently consistent with at least one 50bp cut this year, and deeper cuts over 2025. Those expectations were reinforced by last week’s 50bp cut from the US Federal Reserve.

While we’ll be watching economic conditions closely over the coming months, we don’t think the tone of recent data in New Zealand indicates the need for the RBNZ to step up the pace of easing beyond what they signalled in their August statement (shown in the chart on page 1). In terms of the starting point for the economy, the June quarter GDP report was slightly ahead of the RBNZ’s expectations. In addition, several high frequency indicators that pointed to weakening activity in the middle part of the year have picked up again, such as the PMIs and building consent issuance. While still weak, they’re consistent with a further gradual cooling in activity, rather than a sudden deepening downturn in activity.

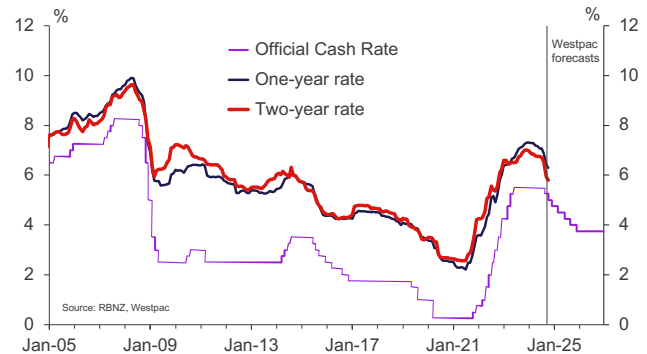
Meanwhile, price pressures have been easing in line with the RBNZ’s forecasts. Although the latest monthly updates from Stats NZ have shown some softness, that has mostly been because of volatile items, like the cost

of travel and accommodation, which aren’t the key focus of policy. More broadly, the direction of travel looks consistent with the RBNZ’s forecasts for inflation to trend back to target over the year ahead. Our own discussions with businesses have highlighted ongoing pressure on operating costs.

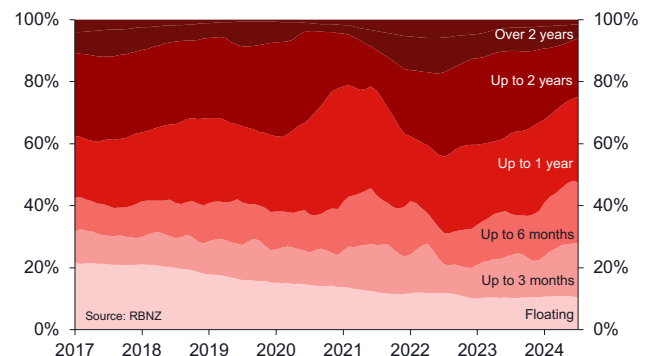
Importantly, even though the RBNZ has only cut the OCR by 25bps thus far, borrowing costs for households have fallen much more sharply. Since 31 July (before the RBNZ’s August OCR cut), one-year fixed mortgage rates have fallen by around 60bps and two-year fixed mortgage rates have fallen by 75bps. It’s also worth noting that borrowers have been rolling on to shorter fixed-term mortgages over the past year in anticipation of rate cuts. That means that, although it will take time for rate cuts to ripple through the economy, by the end of this year close to half of all borrowers will have rolled on to lower rates. That’s been a welcome relief to households, with our own Westpac McDermott Miller survey of New Zealand household showing that pessimism about the economic outlook is dissipating. Anecdotally, we’re also hearing that inquiry levels in the housing market are also picking up again.

There’s only a limited amount of data still to come ahead of the RBNZ’s next policy meeting on 9 October. Key updates to watch will be the NZIER’s survey of business opinion (1 October) and the weekly updates on the jobs market. Barring major surprises on those fronts, a 25bp move from the RBNZ still looks most likely in October.

## How much mortgage relief is coming?



## Share of mortgages by time to refixing



## New Zealand's current account and credit rating.

Along with last week's GDP release were the latest figures on New Zealand's current account. In contrast to expectations that New Zealand's current account deficit would shrink, it remained at 6.7% of GDP in the year to June. As **discussed in our recent report**, that highlights an important risk to New Zealand's credit rating. New Zealand is one of the world's most highly rated sovereigns. That's important as a country's sovereign rating sets the ceiling for ratings of other entities operating in that country, which in turn can affect the cost and access to credit.

However, we do have some vulnerabilities. Notably, in its most recent review of New Zealand, Fitch noted that a failure to reduce current account deficits, leading to a rapid build-up of net external debt, could lead to a ratings action or downgrade. The level of fiscal debt also raises some concerns.

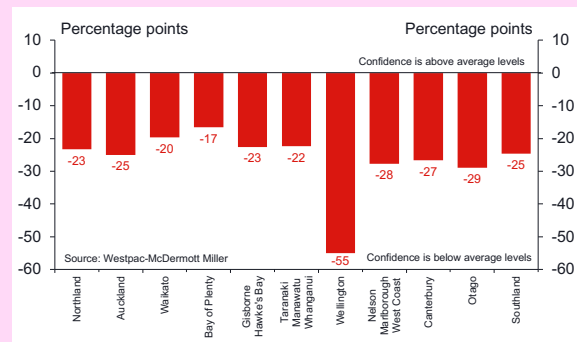
While ratings agencies currently seem comfortable with New Zealand's rating, downgrades could occur in the event of a major negative economic shock or natural disaster, or a change in fiscal strategy that brings into doubt the commitment to reduce debt and deficits over time. Risks to New Zealand's rating could be at least partially mitigated if the Government takes steps to build buffers that allow for the impact of inevitable future negative events.

**Satish Ranchhod**, Senior Economist

## Chart of the week.

Economic confidence remains low across the nation with households still grappling with strong financial headwinds, including high mortgage rates and large increases in the cost of living. Confidence is especially low in the Capital, where the winding back of Government spending and related public sector job losses have seen spending levels falling sharply and businesses across the region reporting weak demand. But while households and businesses have been feeling the pinch, they are starting to feel a bit more optimistic (or at least less pessimistic about the outlook). In particular, with interest rates now dropping back a growing number of households are set to see their financial positions improving over the year ahead. That's consistent with our forecast for a pickup in GDP growth over 2025 as the RBNZ continues to cut the OCR.

### Westpac McDermott Miller Regional Confidence (difference from long run average)

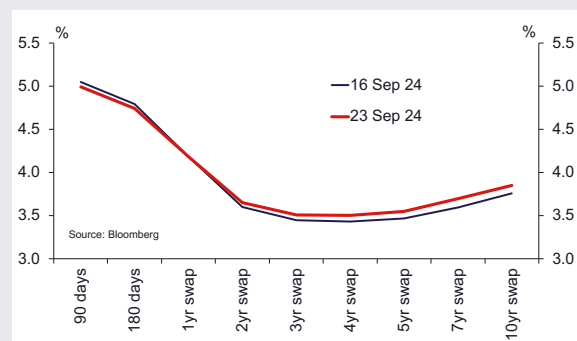


## Fixed versus floating for mortgages.

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.

The Federal Reserve kicked off its long-awaited easing cycle last week with an outsized 50bp cut, bringing the fed funds rate target range to 4.75-5.00%. Chair Powell's remarks emphasised that the outsized move was a response to balancing risks and so as to not "get behind" with policy. The FOMC's revised forecasts also made clear members remain constructive on the outlook, with unemployment forecast to peak only 0.2ppts above the current level at 4.4% and GDP growth forecast to be 2.0% in 2024 through 2027 (slightly above the Committee's 'longer run' estimate of trend growth of 1.8%). As a result, the FOMC projects a slow normalisation after a rapid start, with another 50bps of cuts seen by end-2024 (noting two meetings remain in 2024), then a further 150bps through 2025 and 2026 to 2.9%, the FOMC's current estimate of neutral. We expect US growth to modestly disappoint the FOMC's forecasts, but also see lingering risks for inflation. We therefore see the funds rate reaching a low of 3.375% for this cycle in late-2025, with that rate then held through 2026.

## Europe.

European central banks were a more circumspect bunch last week. As widely expected, the Bank of England kept rates steady in an 8-1 vote. The messaging was hawkish, emphasising the need to "squeeze persistent inflationary pressure". The August CPI was up 2.2% on a year ago, but inflation is forecast to pick up again to 2.5% by year-end. Also as expected, the Norges Bank left its policy rate unchanged at 4.5% and said there will be no change "for some time ahead". Various ECB officials, in explaining this month's rate cut, signalled that a further move in October was unlikely but that the December meeting, with updated economic projections, would be live.

## Asia-Pacific.

Australian employment grew by 47k in August, while the unemployment rate was unchanged at 4.2%. The result again emphasised the strength of labour demand, supporting our view that economic growth will accelerate in 2025 as inflation abates and the RBA is able to ease policy. Rate cuts won't be coming quickly though – we expect this Tuesday's policy review to again be firmly on hold. The RBA has clearly telegraphed that it does not expect to begin policy easing until next year, and the soft Q2 GDP figures earlier this month are unlikely to have shifted their thinking. The RBA's rate decision comes before the August monthly CPI indicator on Friday, with cost-of-living relief measures expected to bring annual inflation down to 2.7%.

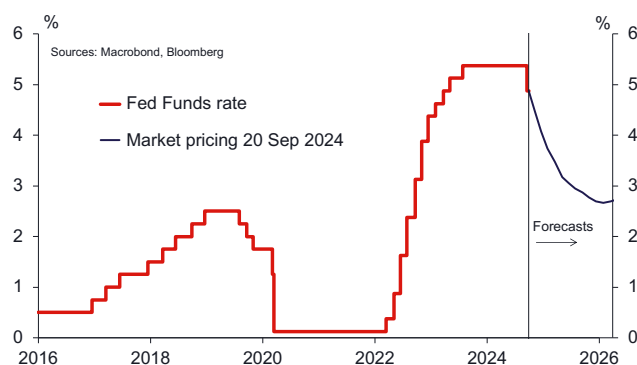
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.0	1.3	2.2	2.4
China	5.2	4.8	4.5	4.5
United States	2.5	2.6	1.7	1.7
Japan	1.9	0.2	1.1	0.9
East Asia ex China	3.3	4.3	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	0.9	1.3	1.4
NZ trading partners	3.3	3.2	3.2	3.2
World	3.2	3.3	3.2	3.2

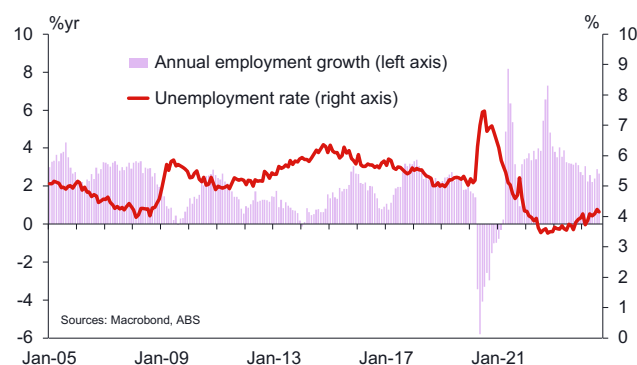
Australian & US interest rate outlook

	20 Sep	Sep-24	Dec-24	Dec-25
<b>Australia</b>				
Cash	4.35	4.35	4.10	3.35
90 Day BBSW	4.42	4.42	4.19	3.50
3 Year Swap	3.52	3.60	3.6	3.50
3 Year Bond	3.51	3.55	3.5	3.35
10 Year Bond	3.92	3.90	3.9	4.05
10 Year Spread to US (bps)	21	15	15	5
<b>US</b>				
Fed Funds	4.875	4.375	3.875	3.375
US 10 Year Bond	3.71	3.75	3.75	4.00

US Fed Funds rate



Australian labour market



# Financial markets wrap

## Interest rates.

NZ swap rates consolidated at multi-year lows last week. The whole RBNZ easing cycle is arguably already priced in, and local and offshore events last week did not provide any justification for pushing rates lower. The Fed started its easing cycle with a larger than expected 50bp, but Chair Powell indicated a more measured pace ahead. NZ GDP data was not as weak as feared. And Australian labour data delivered an upside surprise.

The event calendar this week is dominated by US and Australia. The highlight for markets will be the US core PCE inflation update. It is the Fed's preferred measure of inflation and the recent pace has fallen below the 2.0% target. There's also US GDP and US inflation expectations to watch. In Australia, we have the RBA decision on Tuesday, likely to be an on-hold one, with guidance unlikely to signal any easing this year. There's also the monthly CPI inflation data, likely to soften due to electricity rebates.

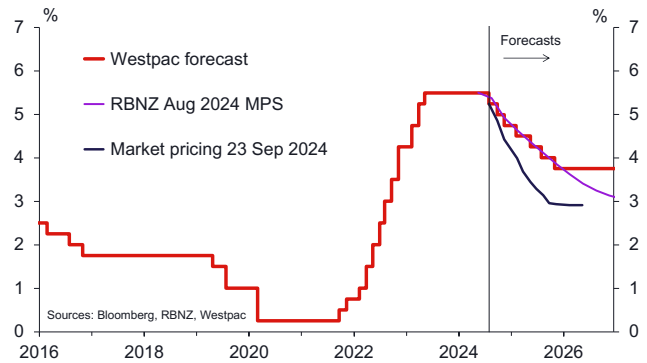
The 2yr swap rate, currently at 3.65%, is likely to be contained by a 3.50%-3.90% range during the week ahead. Market pricing for the OCR remains stretched – the next three meetings have 125bp of rate cuts priced in (Westpac forecasts 75bp).

## Foreign exchange.

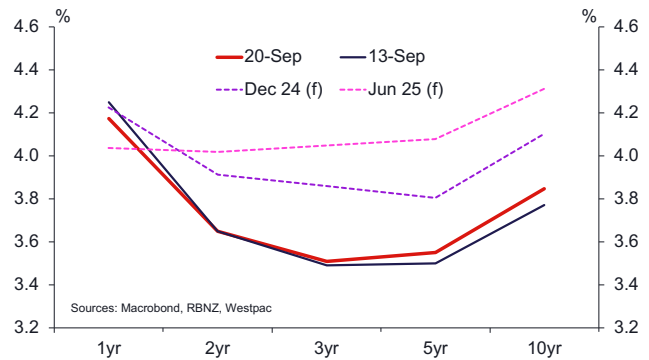
NZD/USD's recent rally, from 0.6105 to 0.6270, could extend to 0.6300 during the next week or two. The US dollar remains on the back foot, with markets continuing to speculate on further large 50bp rate cuts. In addition, the expectation of falling US interest rates has boosted risk sentiment in equity markets (the S&P500 made a record high last week), in turn supporting risk-sensitive currencies such as the NZD. The US economic data released this week (see interest rate section above) will be influential.

NZD/AUD has been stuck around the mid-0.91s during the past few days, but remains vulnerable to further downside. The RBA's guidance and AU CPI outcome will be the main influences this week. Also noteworthy is NZD/JPY, which experienced a very large fall in July and August, but has since consolidated around 89. Last week the BoJ held its policy rate steady at +0.25% and signalled the next hike could be later than markets had expected. The cross could rise further into the low 90s during the weeks ahead.

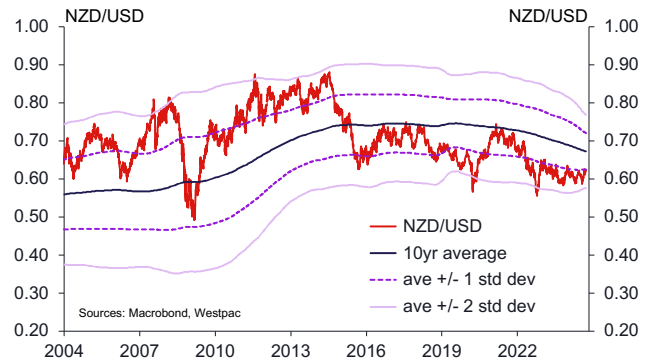
Official Cash Rate forecasts



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	0.624	0.586-0.628	0.555-0.743	0.645	0.62
AUD	0.918	0.897-0.925	0.873-0.992	0.929	0.91
EUR	0.558	0.542-0.571	0.517-0.637	0.581	0.56
GBP	0.468	0.456-0.483	0.456-0.535	0.503	0.47
JPY	89.8	86.1-98.6	61.3-98.6	80.5	88.3

# The week ahead

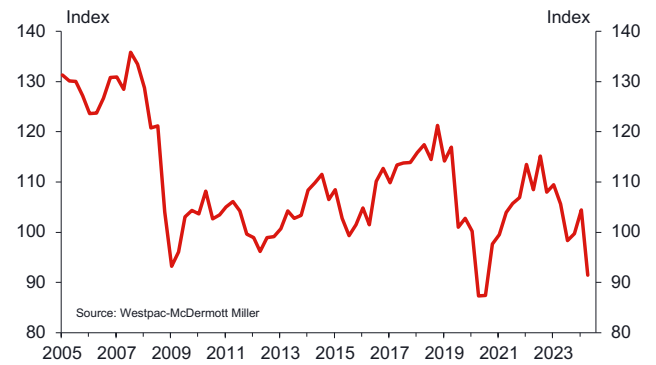
## Q3 Westpac-McDermott Miller Employment Confidence Index

Sep 24, Last: 91.4

The Employment Confidence Index fell sharply in June, reaching its lowest level since the 2020 Covid lockdown. The fall was led by worsening perceptions about job availability.

The latest survey was conducted in early September. Since the last survey, the RBNZ has begun easing interest rates much sooner than previously signalled, but unemployment has risen and job advertisements have fallen further.

Employment Confidence Index



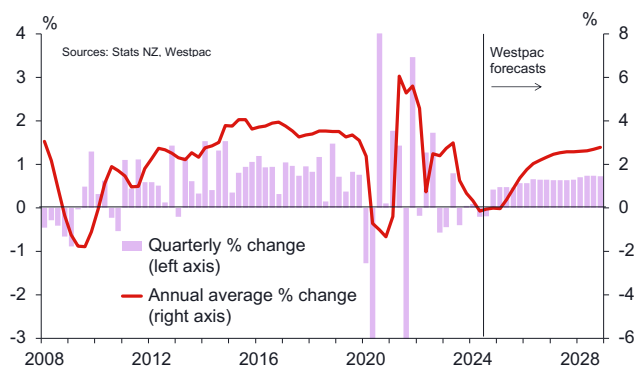


# Economic and financial forecasts

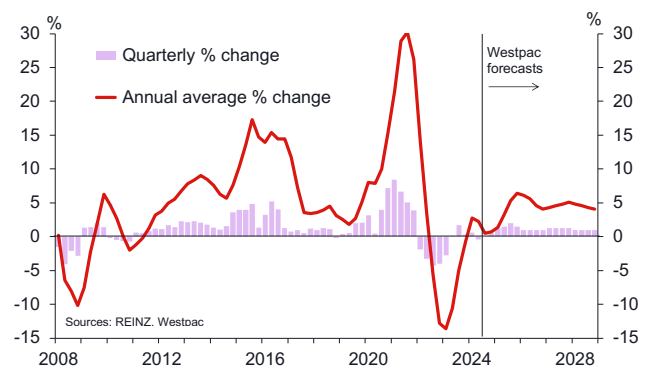
Economic indicators	Quarterly % change				Annual % change			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
GDP (production)	0.1	-0.2	-0.2	0.4	0.7	0.0	1.4	2.3
Consumer price index	0.6	0.4	0.9	0.3	4.7	2.2	2.2	2.1
Employment change	-0.3	0.4	-0.4	-0.2	2.9	-0.4	-0.1	1.5
Unemployment rate	4.4	4.6	5.0	5.3	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	-6.4	-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	71.0	71.2	70.8	71.2	70.6	69.4
NZD/USD	0.61	0.61	0.62	0.62	0.60	0.62	0.64	0.64
NZD/AUD	0.93	0.92	0.92	0.91	0.93	0.91	0.88	0.88
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	0.48	0.47

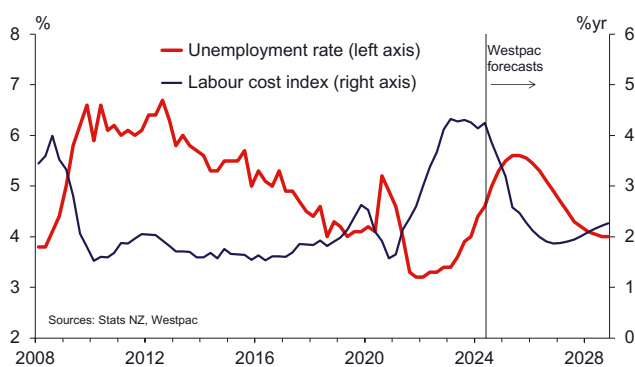
GDP growth



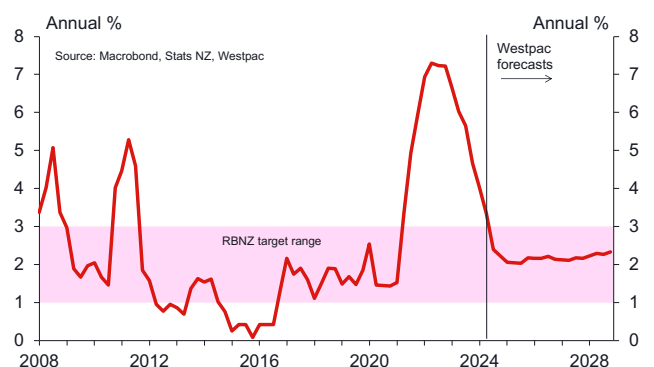
House prices



Unemployment and wage growth



Consumer price inflation



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 23</b>					
<b>NZ</b>	Aug Trade Balance, \$mn	-963	-	-1658	Seasonal fall in exports.
<b>Eur</b>	Sep HCOB Manufacturing PMI, index	45.8	-	-	Weak demand has European manufacturing in dire straits...
	Sep HCOB Services PMI, index	52.9	-	-	... creating downside risks to the recovery in 2024/25.
<b>UK</b>	Sep S&P Global Manufacturing PMI, index	52.5	-	-	Conditions in the UK are on firmer footing..
	Sep S&P Global Services PMI, index	53.7	-	-	... especially in services, where price pressures are key.
<b>US</b>	Aug Chicago Fed Activity Index, index	-0.34	-0.20	-	Volatile around a level consistent with trend growth.
	Sep S&P Global Manufacturing PMI, index	47.9	48.5	-	Offers a similar sectoral picture to the ISMs...
	Sep S&P Global Services PMI, index	55.7	55.2	-	... but has pointed to slightly firmer conditions.
	Fedspeak	-	-	-	Bostic, Goolsbee.
<b>Tue 24</b>					
<b>NZ</b>	Q3 Westpac-MM Employ' Conf., index	91.4	-	-	Confidence fell last quarter as job prospects declined.
<b>Aus</b>	Sep RBA Policy Decision, %	4.35	4.35	4.35	To remain poised and patient.
<b>Jpn</b>	Sep Jibun Bank Manufacturing PMI, index	49.8	-	-	Industry struggling to build momentum in demand...
	Sep Jibun Bank Services PMI, index	53.7	-	-	... tourism-related services exports remain a key support.
<b>Ger</b>	Sep IFO Business Climate Survey, index	86.6	-	-	Soft global demand remains a headwind.
<b>US</b>	Sep CB Consumer Confidence, index	103.3	102.8	-	Rate cuts likely to buoy sentiment ahead.
	Sep Richmond Fed Index, index	-19	-	-	Manufacturing conditions are soft across the regions.
<b>Wed 25</b>					
<b>Aus</b>	Aug Monthly CPI Indicator, %yr	3.5	2.7	2.7	Rebates to drive down electricity prices again.
<b>US</b>	Aug New Home Sales, %mth	10.6	-6.6	-	Affordability and inventory constraints still at play.
<b>Thu 26</b>					
<b>Aus</b>	Q3 Job Vacancies, %qtr	-2.7	-	-	Labour market is gradually moving into balance.
	Sep RBA Financial Stability Review	-	-	-	Update on the state of and risks to the financial system.
<b>Eur</b>	Aug M3 Money Supply, %yr	2.3	-	-	Picking up as policy turns a corner.
<b>US</b>	Q2 GDP, %ann'd	3	2.9	-	Minor revision anticipated in the final estimate.
	Aug Durable Goods Orders, %mth	9.8	-2.9	-	Investment outlook challenged by politics and cycle.
	Initial Jobless Claims	219	-	-	Consistent with slowing job creation, not job shedding.
	Aug Pending Home Sales, %mth	-5.5	-	-	Affordability and inventory constraints at play.
	Sep Kansas City Fed, index	-3.0	-	-	Manufacturing conditions are soft across the regions.
	FOMC Chair Powell	-	-	-	Pre-recorded remarks at treasury market conference.
	Fedspeak	-	-	-	Collins, Kugler, Williams, Barr, Kashkari.
<b>Fri 27</b>					
<b>NZ</b>	Sep ANZ Consumer Confidence, index	92.2	-	-	Still low, but financial pressures are now easing.
<b>Jpn</b>	Sep Tokyo CPI, %yr	2.6	2.2	-	Path to sustainable at-target inflation is in sight.
<b>Chn</b>	Aug Industrial Profits, %yr	4.1	-	-	Base effects putting a floor under this measure of profits.
<b>Eur</b>	Sep Economic Confidence, index	96.6	-	-	Rate cuts to support the broader economy, in time.
<b>US</b>	Aug Personal Income, %mth	0.3	0.4	-	Softening labour market to slow income growth...
	Aug Personal Spending, %mth	0.5	0.3	-	... and eventually household spending.
	Aug PCE Deflator, %mth	0.2	0.1	-	Inflation is at target on an ex shelter basis.
	Aug Wholesale Inventories, %mth	0.2	-	-	Steady inv-to-sales points to sound orders management.
	Sep Uni. Of Michigan Sentiment, index	69	-	-	Final estimate.



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