WEEKLY ECONOMIC COMMENTARY

25 Nov 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

RBNZ to take another large step towards neutral

It was a relatively quiet week for economic data in New Zealand. The key activity indicators released continued to point to subdued activity, while pricing indicators were somewhat mixed.

Starting with activity, MBIE's index of online job advertising weakened in October, following a small increase in September. Standing back, while still down about 30% compared with a year earlier, the index has flattened off in recent months at an 11-year low (excluding the short-lived downward spike associated with the pandemic). Scaling for the fact that employment has grown by around 30% over this period, advertising has fallen to levels not seen since 2010.

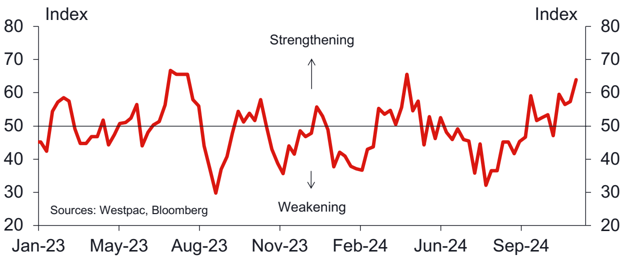
Meanwhile, the BusinessNZ Performance of Services Index nudged just 0.3pts higher to 46.0 in October, remaining in contractionary territory and around 7pts below the long-term average. This accords with last week's manufacturing counterpart, which disappointingly fell back to a similar reading of 45.8. So while the building blocks of economic recovery are falling into place, for now trading conditions remain quite tough. This is consistent with the forecasts in our recently updated *Economic Overview*, which predicted that it will be mid-next year before growth picks up to a solid pace.

Following a softer than expected CPI report, the business price indexes painted a mixed picture in the September quarter. The producer price indexes for both inputs and outputs posted strong growth during the quarter, so that their annual growth rates picked up to 5.1% and 4.2% respectively. Both indexes were influenced by large increases associated with higher commodity prices in the dairy sector – growth that continued this week with a further 1.9% rise in the GDT index at the latest auction. Indeed, given the recent trend in prices, we have again **revised up our forecast** of this season's Fonterra milk payout to $10 kg/ms. Our new forecast implies that

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
27 Nov 24	RBNZ OCR Review & Monetary Policy Statement
5 Dec 24	Govt financial statements, 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
18 Dec 24	FOMC Meeting (Announced 19 Dec NZT)
19 Dec 24	NZ GDP, September quarter
14 Jan 25 (tbc)	QSBO business survey, December quarter
16 Jan 25	NZ Selected price indexes, December
22 Jan 25	NZ CPI, December quarter
29 Jan 25	FOMC Meeting (Announced 30 Jan NZT)
5 Feb 25	Labour market statistics, December quarter
13 Feb 25	RBNZ Survey of Expectations, December quarter
14 Feb 25	NZ Selected price indexes, January

farmer revenues will be more than $4bn higher than last season (about 1% of GDP), which should provide a strong boost to New Zealand's rural regions.

By contrast, prices for capital goods rose just 0.1% in the September quarter, causing annual growth to slow to 2.1%. Prices for machinery fell 0.5% during the quarter and so were up just 1.2%y/y. Meanwhile, the RBNZ's household survey reported that the median 1-year ahead inflation expectation fell to 3.0% in the December quarter – the lowest reading in three years and now back in line with the pre-pandemic average.

Looking ahead to the coming week, the main domestic focus will be Wednesday's RBNZ policy review and Monetary Policy Statement (MPS) – the final review this year. As we set out in our preview, we think **it is very likely that the RBNZ will reduce the OCR** by a further 50bps to 4.25% (80% probability). We see only a small chance (about 15%) that the RBNZ will elect to slow the pace of easing to 25bps, especially given the sizeable gap to the next policy review in February. Similarly, we only see a small chance (about 5%) that the RBNZ will decide to cut the OCR by 75bps and thus accelerate the time at which policy returns to a fully neutral setting (back in August the RBNZ forecast that the OCR would fall to around 3% by the end of 2026).

With a 50bps easing fully priced by financial markets, the reaction on the day will depend on the guidance provided by the RBNZ regarding the outlook for policy in 2025 and beyond – the formal baseline OCR projection and how the Bank describes the balance of risks around that forecast. Our central expectation is that the RBNZ will project the OCR to decline to around 3.50% by the end of next year – around 35bps lower than projected in the August MPS. That more front-loaded easing will reflect increased confidence regarding the outlook for inflation, with actual inflation tracking below the forecast made in August, even as activity and labour market trends track broadly in line with expectations. Such a track would still imply a slower pace of easing next year.

But there are other possibilities that we need to consider. For example, it is possible that the RBNZ could project the OCR to end next year at a similar level to that forecast previously. The recent strong lift in business confidence and improved dairy commodity prices might cause the RBNZ to take a cautious approach to further lowering the OCR, the closer it moves to the neutral zone (recognising the uncertainty that surrounds any estimate of where the neutral policy rate lies). Concerns about the potential for weakness in the exchange rate – thus disrupting the current helpful disinflation in the traded goods sector – might also be a consideration.

On the other hand, it is also possible that the RBNZ could lower its year-end target for the OCR. It might do this if recent price and wage outcomes – both slightly softer than expected – are viewed as providing a very high degree of confidence that inflation will stay close to the target midpoint. If so, the RBNZ would likely want to more quickly move policy towards a neutral setting, so as to mitigate the possibility that a slow economic recovery could push inflation well below the target midpoint for a period.

As always, the minutes (or "record") of the meeting will need to be read closely and will offer additional insights into policymakers thinking that is not captured in the central interest rate projection. This is especially the case now, with the recent re-election of President Trump already impacting the mix and level of financial conditions in New Zealand. Moreover, the possibility that Trump will implement broad-based tariffs on imports into the US presents clear downside risks to the exports of both New Zealand and its key trading partners. Given the various uncertainties surrounding the outlook, policymakers will doubtless want to keep all options open for the February meeting, especially with a full round of GDP, labour market and CPI data to be released ahead of that meeting.

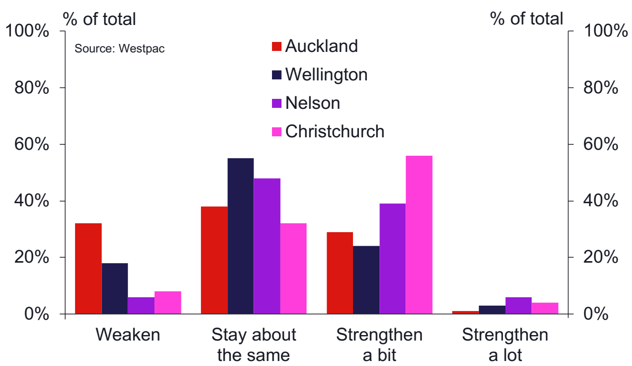
Feedback from businesses around the country.

Over the past couple of weeks, we've been talking to businesses in Auckland, Wellington, Nelson and Christchurch about economic conditions and their expectations for the coming year.

Starting off with economic growth, the softness seen over the past year was expected to continue over the next few months. Most of the businesses we spoke to expected that economic activity would remain subdued over the next six months or strengthen just a little.

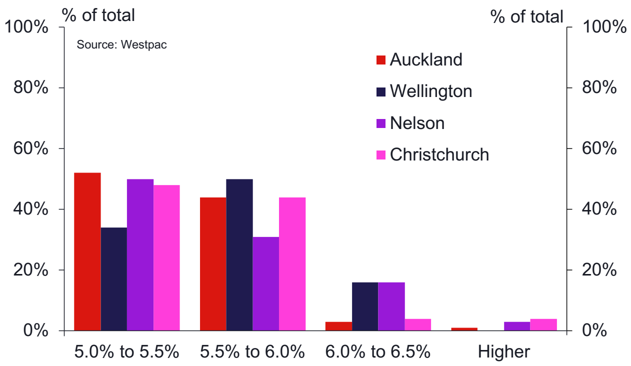
Looking across the country, those in the South Island tended to be more optimistic than those in the North. The recovery in agriculture export prices is likely to be a key factor boosting sentiment in the South. In contrast, in Wellington we heard continued nervousness about the impact of reductions in public sector spending. Somewhat surprisingly, businesses in Auckland were less upbeat than those elsewhere.

What do you expect GDP growth to do over the next 6 months?



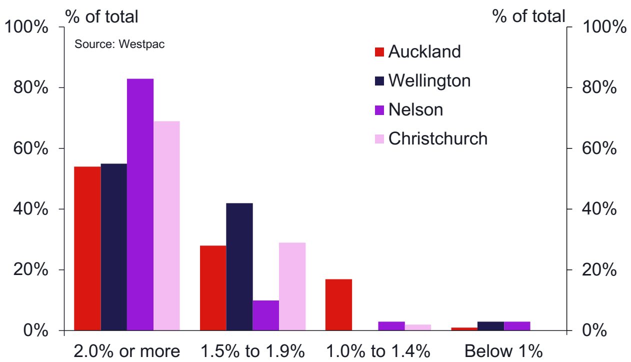
With economic growth expected to remain soft for some time yet, businesses also expect the jobs market will continue to soften. Unemployment was expected to rise from 4.8% currently to a peak of around 5.5% or a bit higher over the coming year.

Where will the unemployment rate peak?



But while economic conditions are expected to remain soft in the near term, businesses are feeling more optimistic about the economy's longer-term trajectory. That's mainly a result of an easing in the powerful financial headwinds that have dampened economic growth over the past few years. In particular, inflation has dropped back, and most businesses we spoke to now expect that it will settle around 2% over the year ahead. However, a number of businesses are expecting that inflation will drop into the lower part of the RBNZ's target band.

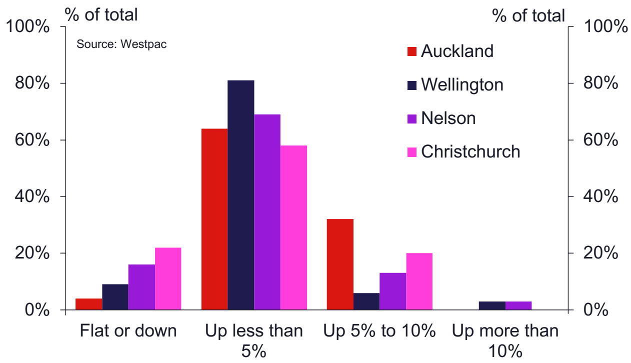
What will be the low point for annual inflation in coming years?



With a better contained inflation outlook, we're expecting the RBNZ will deliver another 50bp rate cut this week and further gradual cuts next year. Those rate cuts were clearly helping to boost confidence, with businesses generally expecting to see growth gradually trending higher over 2025.

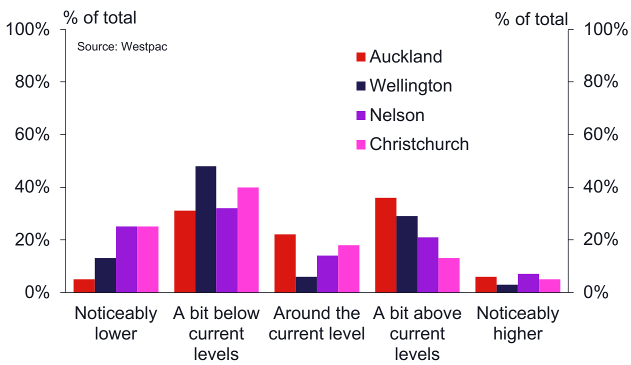
Lower interest rates are also expected to provide a boost to the housing market. However, most of those we spoke to expected that house price growth would remain modest, with prices expected to rise by less than 5% over 2025.

What will house prices do in 2025?



Businesses we spoke to in every region had a lot of questions about the global backdrop and the outlook for trade, especially in the wake of the US election. There was also a lot of uncertainty around the outlook for the NZ dollar, with businesses equally split on the direction of the NZD/USD over the coming year.

Where do you think the NZD/USD will end next year?

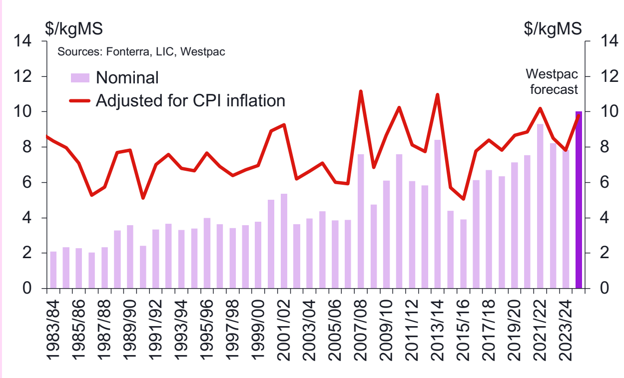


Darren Gibbs, Senior Economist
Satish Ranchhod, Senior Economist

Chart of the week.

We've revised up our forecast for this season's farmgate milk price to $10.00 per kilo of milksolids (up from our previous forecast of $9.00/kg). That puts us at the top end of Fonterra's recently updated forecast range of $9 to $10 per kilo (midpoint of $9.50). That would be the highest farmgate milk price on record. However, over the past couple of years there's also been a more general rise in consumer prices and businesses' operating costs. Adjusting for those high levels of inflation, our forecast is certainly above average, but there have been four previous years where the milk price was higher in inflation-adjusted terms. It's also worth noting that none of those previous highs were sustained, and in some cases were followed by sharply lower prices in the following season. With strong increases in operating costs over the past year, DairyNZ currently estimates a breakeven price of $8.15/ kg for a typical dairy farm, up from $8.01/kg last season. That said, a $10 milk price would leave substantial room for farmers to spend and invest, even after catching up on maintenance and other costs that might have been deferred during the previous tougher season.

Farmgate milk price

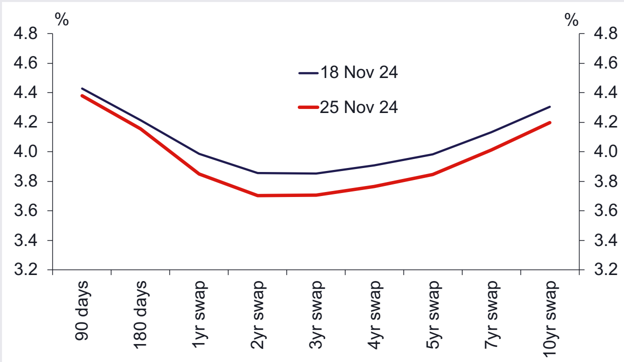


Fixed versus floating for mortgages.

The RBNZ followed up August's 25bp cut in the OCR with a supersized 50bp cut at its 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.

The US dataflow was relatively sparse last week. The composite PMI strengthened to 55.3 in November, marking the highest reading since April 2022, while homebuilder confidence rose to a 7-month high. Existing home sales rebounded from a 14-month low in October while initial jobless claims remained low, signalling a still healthy labour market. The final results of the University of Michigan's survey for November confirmed that year-ahead expected inflation had fallen to a near four-year low of 2.6%, while 5-year ahead expected inflation revisited last year's high of 3.2%. The coming week's diary is only slightly busier, with the data flow front-loaded due to Thursday's Thanksgiving holiday. The highlights are likely to be Tuesday's Conference Board consumer survey and release of the latest FOMC minutes, followed by Wednesday's release of the core PCE deflator and durable goods orders for October.

North of the border, prospects for a greater than 25bp easing at the Bank of Canada's December meeting were dented as CPI inflation rose to a greater-than-expected 2.0%y/y in October. Canadian retail sales rose 0.4%m/m in October, meeting market expectations. Canada will print Q3 data on Friday.

Europe.

In contrast to the US, the flash November PMIs pointed to a further weakening of growth momentum in Europe, with the composite index slumping to 48.1 in the euro area and 49.9 in the UK. In both cases, weaker readings in the services sector were the key driver of the downturn. Final data confirmed that euro area inflation stood at 2.0%y/y in October. In the UK, the CPI increased a firmer than expected 2.3%y/y in October, but retail spending posted an unexpectedly sharp 0.7% decline in October. This week will see the release of further sentiment-based data in Europe, starting with today's German Ifo survey. Later in the week attention will turn to inflation, with flash euro area CPI data for November due for release on Friday.

Asia-Pacific.

In Japan, machinery orders posted a disappointing 4.8%y/y decline in September, but the flash composite PMI nudged up to 49.8 in November. Looking to the week ahead, Japan will print labour market, construction, IP and Tokyo CPI data on Friday. In Australia, the focus will be Wednesday's October CPI indicator release, together with capex indicators that will cast light on Q3 GDP growth. RBA Governor Bullock is also set to speak. China's official PMI readings for November will be released on Saturday.

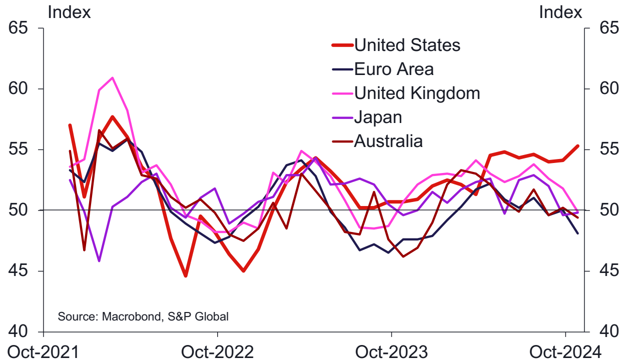
Trading partner real GDP (calendar years)

	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	2.3	2.0
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	1.4	1.5
NZ trading partners	3.3	3.2	3.4	3.2
World	3.2	3.3	3.3	3.3

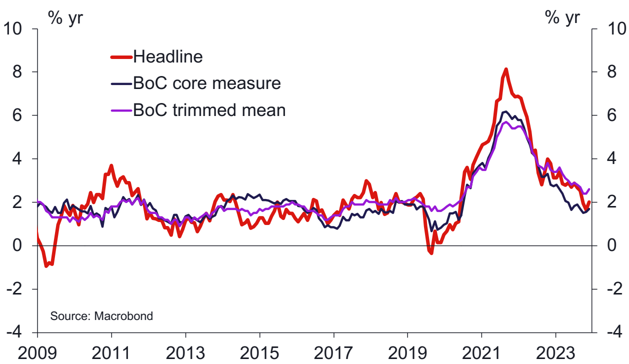
Australian & US interest rate outlook

	22 Nov	Dec-24	Mar-25	Dec-25
Australia				
Cash	4.35	4.35	4.35	3.35
90 Day BBSW	4.43	4.43	4.43	3.50
3 Year Swap	4.05	4.00	3.90	3.80
3 Year Bond	4.09	3.95	3.80	3.65
10 Year Bond	4.55	4.50	4.45	4.55
10 Year Spread to US (bps)	14	20	15	5
US				
Fed Funds	4.625	4.375	3.875	3.375
US 10 Year Bond	4.41	4.30	4.30	4.50

S&P Global composite PMI readings



Canadian CPI inflation



Financial markets wrap

Interest rates.

NZ swap rates are in consolidation mode, the 2yr between 3.50% and 3.95% during the past two months and likely to remain so during the month ahead.

That is because the RBNZ easing cycle is fully priced for a 50bp OCR cut this week and a cycle low OCR of 3.50%. As easing continues into early next year, short maturity rates (up to 12 months) will mechanically fall further to reflect the OCR but longer terms will see little impact – the latter have already priced the easings, and have started pricing the next tightening cycle.

The main event risk for rates markets this week will be the RBNZ MPS on Wednesday, which will almost certainly see the OCR cut by 50bp (markets assign a 25% chance of a bigger 75bp cut). There will be much interest in the new OCR projection, which is likely to be changed from the August MPS (the latter projected endpoints of 3.85% and 3.13% for 2025 and 2026 respectively).

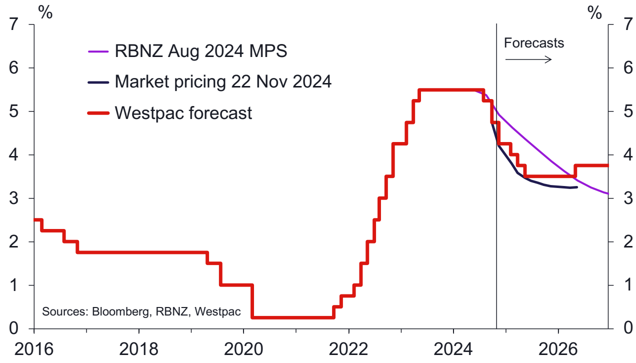
Foreign exchange.

NZD/USD has broken a key support level at 0.5850 and looks destined to test the next one at 0.5775. Should that give way, a move towards 0.5500 would be signalled.

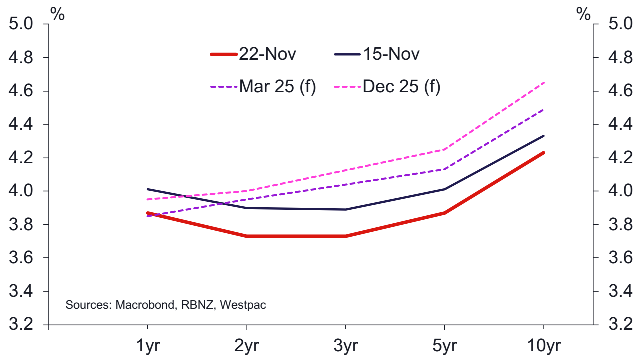
The main driver remains the strong US dollar, which in the wake of the US election has risen to the highest level since November 2022. The new Trump administration, when it takes effect in January, is expected to be economic growth supportive. In addition to the US dollar effect, NZ-US yield spreads continue to weigh on NZD/USD, being negative and at the lowest level since 2019.

Yield spreads are also depressing NZD/AUD, which we expect to test 0.89 during the next few weeks. The main driver is likely to be the RBNZ-RBA contrast – the former likely to continue easing and to retain a dovish stance, the latter on hold and adopting a neutral or slightly hawkish stance. Into next year, though, we are cautious, remembering the previous Trump administration caused a US-China trade war which hurt the AUD, in particular.

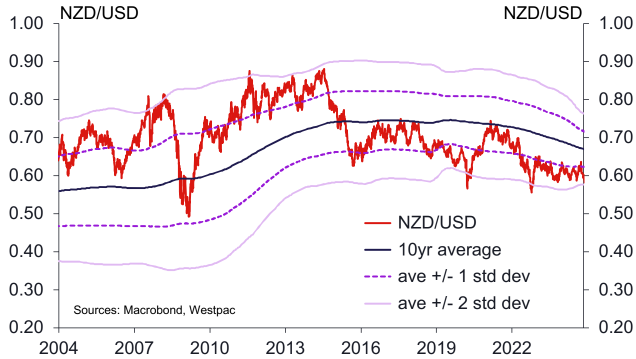
Official Cash Rate forecasts



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	0.583	0.583-0.636	0.555-0.743	0.644	0.59
AUD	0.896	0.896-0.925	0.873-0.992	0.929	0.89
EUR	0.558	0.548-0.569	0.517-0.637	0.580	0.55
GBP	0.465	0.458-0.476	0.456-0.535	0.501	0.46
JPY	90.2	86.5-92.1	61.3-98.6	81.3	90.3

The week ahead

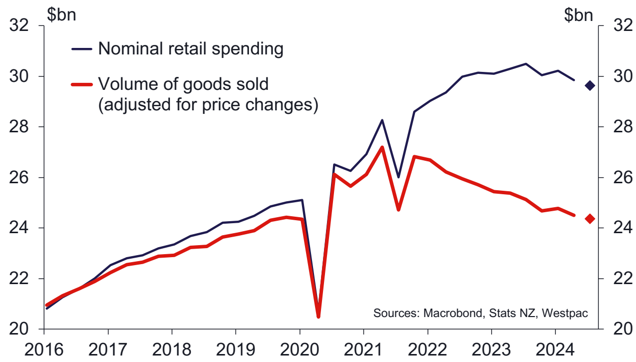
Q3 Retail Spending

Nov 25, Last: -1.2%, Westpac forecast: -0.5%

Retail spending levels dropped through the first half of this year in response to continued pressure on households' finances. There's been particular softness in spending in discretionary areas, like household durables and apparel.

We expect that pattern will be repeated in the September quarter report and are forecasting a 0.5% drop in quarterly retail volumes and a similar decline in nominal spending levels. While the financial pressures that have squeezed spending over the past year are easing, a turnaround isn't expected until next year.

Retail trade survey



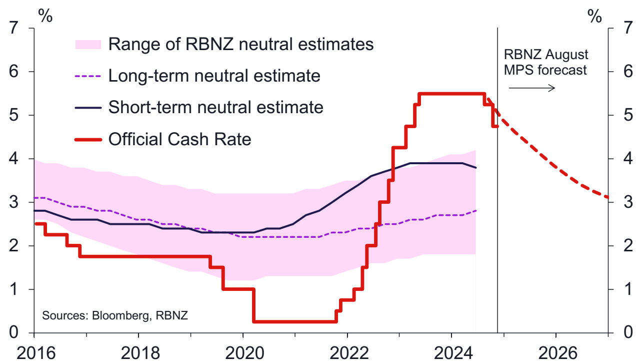
Nov RBNZ Monetary Policy Statement

Nov 27, Last: 4.75%, Westpac forecast: 4.25%, Market: 4.25%

We expect the RBNZ will cut the OCR by a further 50bps to 4.25% at its November meeting. The RBNZ will likely indicate increased confidence that pricing and wage setting behaviour will quickly normalise now that annual CPI inflation is close to 2%.

The accompanying projections will likely suggest further OCR cuts in 2025 and a 3.5% OCR by year-end (around 35bps lower than they forecast back in August). The RBNZ's terminal rate will likely still be in the 3-3.5% zone after 2025.

Official Cash Rate and RBNZ estimates of neutral



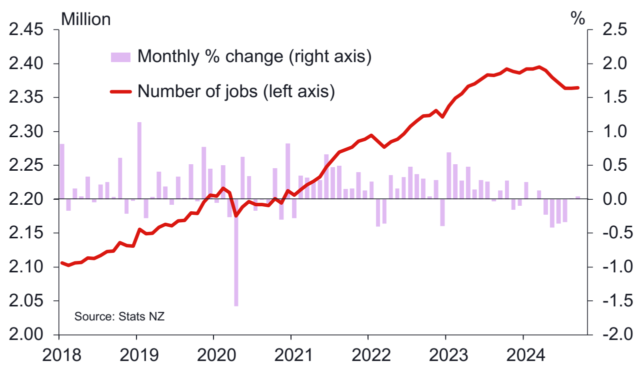
Oct Monthly Employment Indicator

Nov 28, Last: flat, Westpac forecast: -0.2%

New Zealand's prolonged economic slowdown is now clearly impacting the labour market, with the Monthly Employment Indicator (MEI) turning to net job losses since April. While the last two months have been flat, this series tends to be revised down in the months after its initial release.

Job advertisements have stabilised in recent months but at very low levels, and the weekly snapshots of the MEI data suggest that the usual upturn in hiring ahead of Christmas has yet to emerge. We expect a 0.2% fall for October (which again is likely to be revised lower in subsequent releases).

Monthly Employment Indicator filled jobs



The week ahead

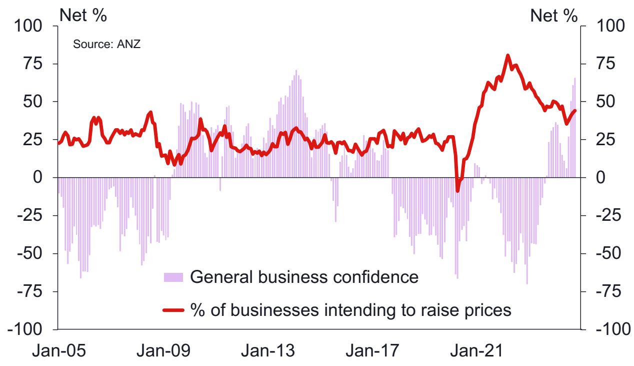
Nov ANZ Business Confidence

Nov 28, Last: 65.7

Interest rate cuts, with the prospect of more to come, have sparked a surge in surveyed business confidence, with general expectations for the year ahead reaching 10-year highs. That optimism has yet to be matched by the reality; firms still report that their activity is down on the same time last year, though the gap is closing.

The price measures in the survey will also be of interest. While general inflation expectations have eased (and may fall further this time, in response to the Q3 CPI release in late October), firms' own pricing intentions have been ticking higher again in recent months.

Business confidence and pricing intentions

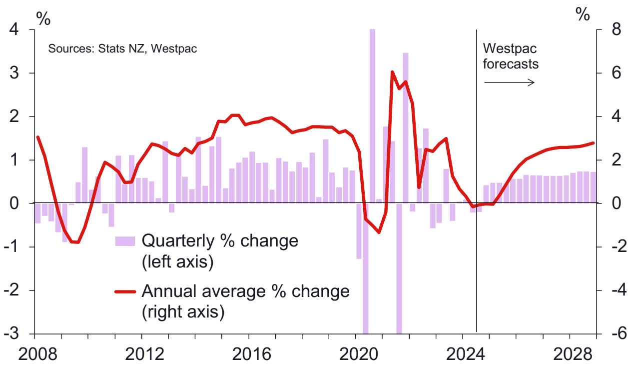


Economic and financial forecasts

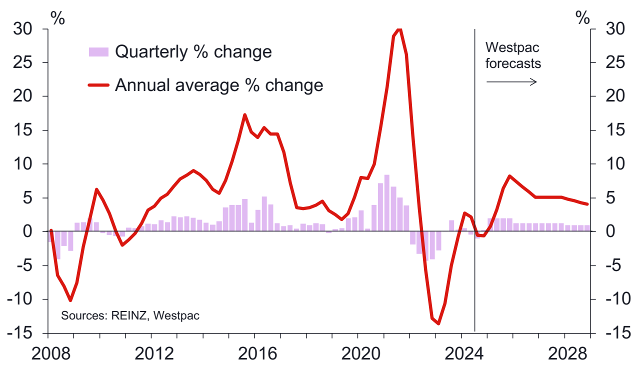
Economic indicators	Quarterly % change				Annual % change			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
GDP (production)	-0.2	-0.2	0.3	0.4	0.7	0.0	1.5	2.8
Consumer price index	0.4	0.6	0.4	0.5	4.7	2.1	2.0	2.1
Employment change	0.2	-0.5	-0.3	-0.1	2.8	-1.0	0.2	2.1
Unemployment rate	4.6	4.8	5.1	5.3	4.0	5.1	5.4	4.6
Labour cost index (all sectors)	1.2	0.6	0.7	0.5	4.3	3.5	2.0	1.8
Current account balance (% of GDP)	-6.7	-6.3	-5.7	-5.0	-7.1	-5.7	-3.9	-4.5
Terms of trade	2.0	2.0	4.9	1.4	-10.7	14.8	0.8	1.1
House price index	-0.4	-1.0	0.3	2.0	-0.6	-0.6	8.2	5.1

Financial forecasts	End of quarter				End of year			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
OCR	5.50	5.25	4.25	4.00	5.50	4.25	3.50	3.75
90 day bank bill	5.63	5.31	4.25	3.80	5.65	4.25	3.60	3.85
2 year swap	5.01	4.06	3.80	3.80	5.28	3.80	3.95	4.00
5 year swap	4.53	3.81	3.85	3.90	4.85	3.85	4.15	4.25
10 year bond	4.74	4.31	4.55	4.55	5.09	4.55	4.70	4.85
TWI	71.4	70.9	69.0	68.1	70.8	69.0	66.7	67.6
NZD/USD	0.61	0.61	0.59	0.59	0.60	0.59	0.59	0.61
NZD/AUD	0.92	0.91	0.89	0.88	0.93	0.89	0.85	0.85
NZD/EUR	0.56	0.56	0.55	0.54	0.56	0.55	0.54	0.55
NZD/GBP	0.48	0.47	0.46	0.45	0.49	0.46	0.45	0.46

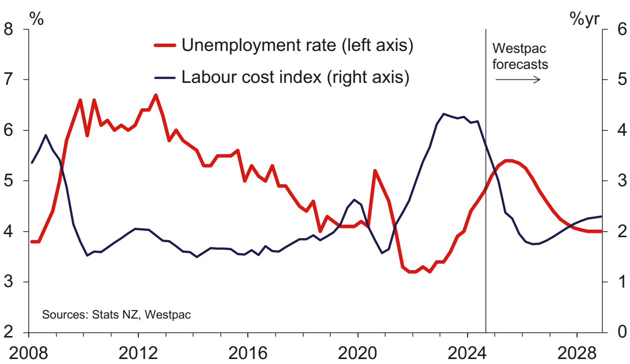
GDP growth



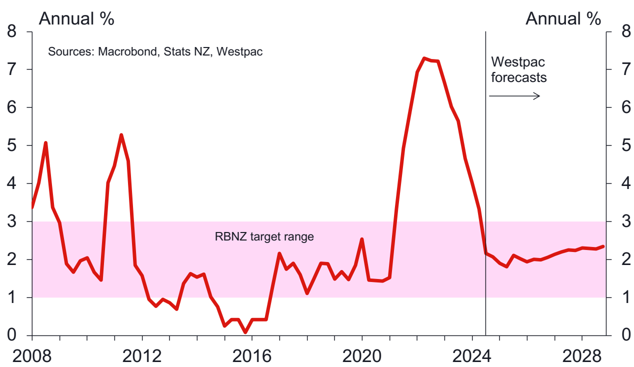
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 25					
NZ	Q3 Real Retail Sales, %qtr	–1.2	–0.5	–0.5	Spending restrained by subdued confidence.
	Oct Trade Balance , $mn	–2108	–	–1450	Deficit to narrow as seasonal lift in exports begins.
Ger	Nov IFO Business Climate Survey, index	86.5	–	–	Points to downside risks for activity.
US	Oct Chicago Fed Activity, index	–0.28	–	–	Volatile around a level consistent with trend growth.
	Nov Dallas Fed, index	–3	–1.8	–	Manufacturing broadly soft on average across the regions.
Tue 26					
US	Sep S&P/CS Home Price Index, %mth	0.35	–	–	Annual price growth moving off highs from earlier in the year.
	Oct New Home Sales, %mth	4.1	–2.2	–	Tight inventory will continue to provide underlying support.
	Nov CB Consumer Confidence, index	108.7	112.5	–	Labour market critical to supporting household confidence.
	Nov Richmond Fed, index	–14	–	–	Manufacturing broadly soft on average across the regions.
	Nov FOMC Minutes	–	–	–	More colour around views on balance of risks.
Wed 27					
NZ	Nov RBNZ Policy Decision, %	4.75	4.25	4.25	Lower inflation allows a large step towards neutral.
Aus	Q3 Construction Work Done, %qtr	0.1	0.5	flat	Capacity constraints continue to weigh on construction activity.
	Oct Monthly CPI Indicator, %yr	2.1	2.3	2.3	Partial inflation indicator expected to fall in Oct (–0.2%mth).
Chn	Oct Industrial Profits, %yr	–27.1	–	–	Base effects, falling producer prices and weak demand at play.
US	Q3 GDP, %ann'd	2.8	2.8	–	No revisions anticipated in second estimate.
	Oct Personal Income, %mth	0.3	0.3	–	Growth in wages continues to slow…
	Oct Personal Spending, %mth	0.5	0.4	–	… consumers use savings to support spending.
	Oct PCE Deflator, %mth	0.2	0.2	–	Consistent with inflation sustainably at target.
	Oct Durable Goods Orders, %mth	–0.7	0.5	–	Core orders tracking a gradual uptrend.
	Oct Wholesale Inventories, %mth	–0.2	–	–	Steady inv–to–sales points to sound orders management.
	Initial Jobless Claims	213	–	–	Downside risks to labour market are growing.
Thu 28					
NZ	Oct Employment Indicator, %mth	0.0	–	–0.2	Weekly data point to a small decline this month.
	Nov ANZ Business Confidence, index	65.7	–	–	Confidence already lofty; pricing the focus this month.
Aus	Q3 Private New Capital Expenditure, %qtr	–2.2	1	0.9	Set to partially retrace the decline from Q2.
	Est 4 2024/25 CAPEX Plans, $bn	170.7	–	–	Capital stock growing at pace with population.
	RBA Governor Bullock	–	–	–	Speech at the Annual CEDA Conference.
Eur	Nov EC Economic Confidence, index	95.6	–	–	Flat as soft business confidence offsets consumer recovery.
US	Thanksgiving	–	–	–	Markets closed.
Fri 29					
NZ	Nov ANZ Consumer Confidence, index	91.2	–	–	Worries about job security weighing on sentiment.
Aus	Oct Private Sector Credit, %mth	0.5	0.5	0.5	Maintaining a stable growth trend.
Jpn	Oct Jobless Rate, %	2.4	2.5	–	Labour market set to remain tight for foreseeable future.
	Nov Tokyo CPI, %yr	1.8	2.2	–	Authorities growing confident in sustainable inflation.
	Oct Industrial Production, %mth	1.6	4	–	Greater volatility masking a soft underlying trend.
Eur	Nov CPI, %yr	–	–	–	Disinflation starting to stall; all eyes on sticky services.
US	Nov Chicago PMI, index	41.6	–	–	Points to downside risks for manufacturing.
Sat 30					
Chn	Nov NBS Manufacturing PMI, index	50.1	50.3	–	Recovery in employment and confidence is critical…
	Nov NBS Non–Manufacturing PMI, index	50.2	–	–	… before authorities green–light further stimulus.

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