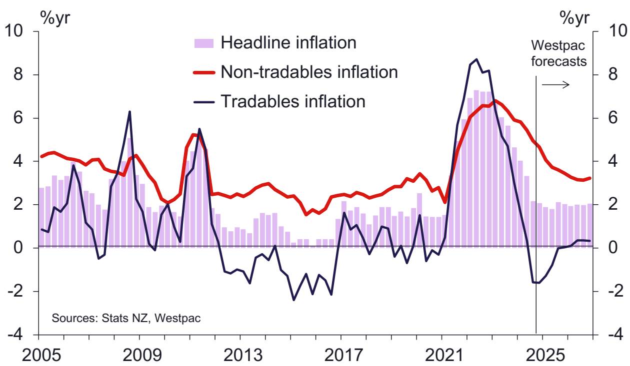
WEEKLY ECONOMIC COMMENTARY

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

Back in the band!

Our **final Economic Overview for 2024** lays out how we see the economy evolving now that inflation is back comfortably in the middle of the RBNZ's 1-3% target band. Inflation has slowed significantly in the last six months such that it now looks likely to be comfortably near 2% for the first time since 2021. Domestically-generated inflation remains high and should still take some time to fully normalise. However, the RBNZ now has more degrees of freedom to manage future challenges than they have had for quite some time.

Inflation components



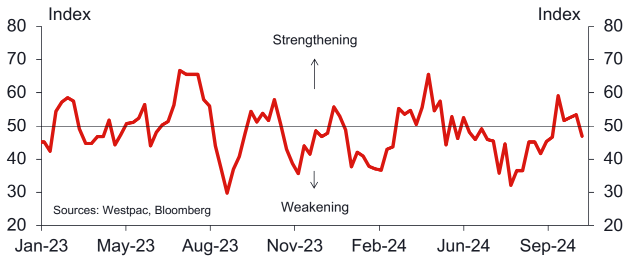
One consequence of this increased freedom is that the RBNZ has been able to step up the pace of easing even though domestically-generated inflation remains on the high side and a bit sticky. There's still a need for a period of excess capacity to encourage the economy to work off those last vestiges of Covid and post-Covid excess. But relatively low imported tradables inflation has removed the risks of high headline inflation feeding into expectations and price-setting behaviour. Hence there's no need for interest rates to be at levels calibrated to reduce inflation when the task ahead is to stabilise inflation around 2%.

This means the OCR can move closer to neutral more quickly. We affirm our view that the RBNZ will deliver

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

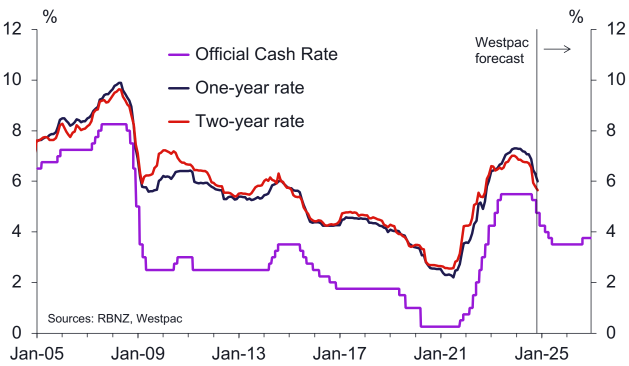


Key data and event outlook

Date	Event
5 Nov 24	RBA Monetary Policy Decision
5 Nov 24	US elections (Results from 6 Nov NZT)
5 Nov 24	RBNZ Financial Stability Report
6 Nov 24	Labour market statistics, September quarter
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
18 Dec 24	FOMC Meeting (Announced 19 Dec NZT)

another 50bp cut before Christmas. And we expect further cuts early next year that will take the OCR into mildly stimulatory territory at 3.50% by mid-2025. We think the pace of easing should slow in 2025 as the OCR will be closer to the neutral zone. There is a lot of uncertainty on where that neutral OCR level is (we think it's around 3.75%, while the RBNZ has more like 3% in mind). We will all learn more next year as we observe how the economy responds to the rapid easing in the second half of 2024. Easing more gradually makes sense as the risks of materially overshooting the goal rise as the neutral zone nears. The RBNZ will need time to assess.

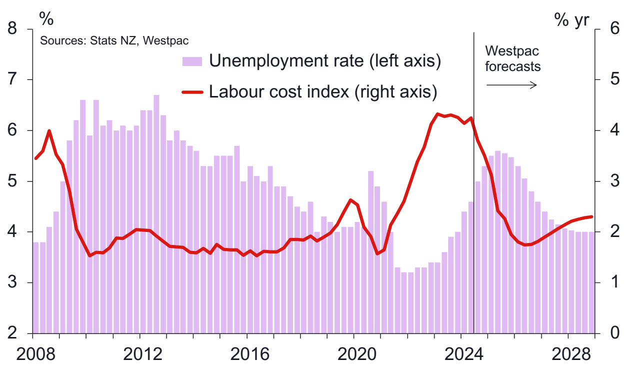
Official Cash Rate and mortgage rates



The RBNZ Governor channelled many of these sentiments in his speaking engagements in Washington DC last week. He saw scope to move interest rates towards neutral (the nautical reference he used was that the neutral rate was one of the RBNZ's guiding stars). He also noted that life on the RBNZ MPC is easier when inflation is fluctuating around 2% and that he wouldn't be losing any sleep with outcomes a little either side of 2%.

It's going to be a while yet before households feel totally out of the woods. The labour market is set to continue softening as past weakness in output plays through. The unemployment rate won't peak until the second half of 2025 and there will still be some job losses to come. While inflation won't be as much of a challenge to household budgets in the year ahead, wage growth will be adjusting lower such that stubbornly high non-tradables inflation reduces.

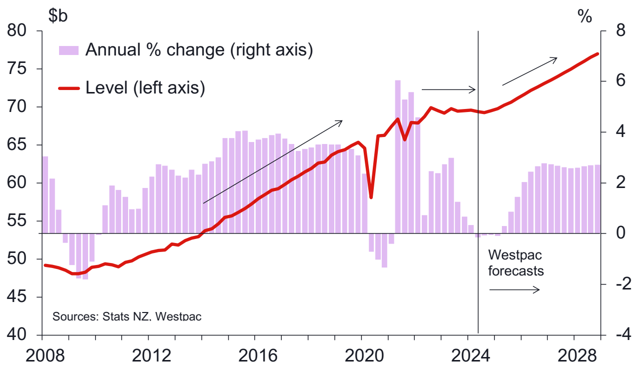
Employment and wage growth



We now think it's looking more likely that the OCR will spend some time modestly below the assumed neutral level of 3.75% in the year ahead. We don't see much of a need for very stimulatory settings being required – hence we see the trough in the OCR at 3.5%. But we do note that it's unusual for interest rates to bottom out at neutral levels – generally some degree of overshoot occurs.

We think the economy seems well placed to recover as lower interest rates and improving export incomes provide support. Hence the extent of overshoot should be modest. Stronger business and consumer sentiment and stirrings in the housing market point to better times ahead. And with any cycle a reversion towards higher interest rates eventually follows. The median length of time the OCR has spent at a cyclical low since the adoption of the OCR is 12 months. We think it will be around 12 months before the OCR returns to 3.75% from that 3.5% low point. However, the shape and timing of that next tightening cycle is necessarily speculative at this early stage.

GDP growth gradually retracing pre-pandemic trends



Significant uncertainties remain. Geopolitical tensions and the upcoming US election could significantly impact financial markets (especially the exchange rate) and global trade (for example if a Trump administration imposes tariffs or if tensions between the West and China increase). The RBNZ is well positioned to adjust policy if required, such is the benefit of having the OCR close to neutral levels.

New Zealand's large twin current account and fiscal deficits mean that adjustment is still needed. If those adjustments can't or won't happen, then the exchange rate will likely do the adjustment for us.

But for now, we should enjoy being back in the band.

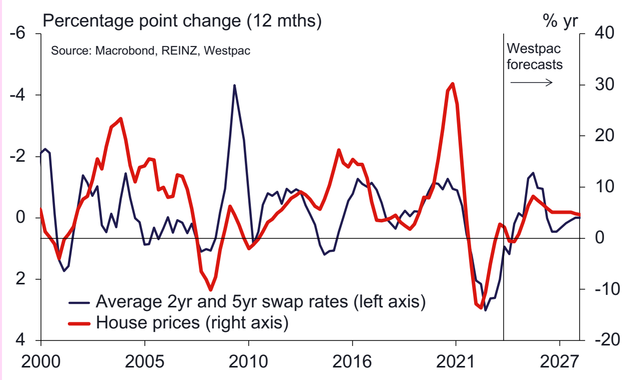
Kelly Eckhold, Chief Economist

Chart of the week.

We've revised up our forecast for house prices. We now expect that prices will rise by around 8% next year and by about 5% in 2026.

The housing market underperformed our expectations over the past year, with prices moving sideways amidst low sales and plentiful listings. However, lower interest rates are laying the basis for a solid recovery, and we expect confidence will return to the market. That strengthening in the housing market should also support a recovery in residential construction activity from the second half of next year. But even with interest rates moving down, we expect 'solid' rather than 'exceptional' price gains given that unemployment will be at cycle highs and population growth at cycle lows in 2025 and 2026.

House price growth vs interest rates

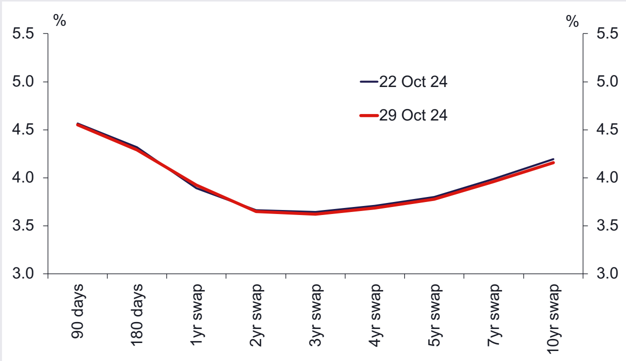


Fixed versus floating for mortgages.

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.

With polling indicating that the Trump Presidential campaign has been gaining momentum, the USD and government bond yields moved higher over the past week. On the monetary policy front, expectations for Fed rate cuts continued to be scaled back with comments from FOMC speakers like Logan, Kashkari, and Schmid supportive of gradual rate reductions. Data over the past week, including the Fed's Beige Book and regional business surveys generally pointed to stable economic conditions, including a firm jobs market. This week's data calendar includes updates on Q3 GDP (Wednesday), personal income and spending (Thursday) and non-farm payrolls (Friday).

Across in Canada, the BOC cut its overnight target rate by 50bp to 3.75%. That was the fourth cut in this cycle and stepped up the pace of easing from the 25bp cuts in recent meetings. The accompanying statement indicated that more cuts are likely, though the timing and pace of future action will be guided by data.

Europe.

Expectations for rate cuts from the ECB have been dialled up in the wake of the October policy meeting, with a 50bp cut priced in for the December meeting. However, comments from ECB President Lagarde and other speakers have raised questions about how fast rates will fall, noting that a cautious and data dependent approach is appropriate. This week we'll get updates on eurozone GDP (Wednesday) and inflation (Thursday). In the UK, the focus will be on Wednesday's Budget with the public finances expected to remain under significant pressure.

Asia Pacific.

Japan's snap election saw the Liberal Democratic Party losing its majority in the lower house. While this does not necessarily mean a change in government, it does raise the risk of near-term political instability as new power sharing agreements need to be negotiated. On the data front, Japan's October PMIs pointed to softness in business sector conditions, with an eighth consecutive month of decline in the manufacturing sector and a downturn in the services sector. Looking to the week ahead, on Thursday the BOJ meets with no change in the policy rate expected, while that day will also see China release its official PMIs for October. In Australia the key focus will be Wednesday's Q3 CPI update. We expect cost of living support measures will pull the headline result down to 2.9%, while core measures are expected to ease more gradually. There will also be updates on Australian retail sales (Thursday) and house prices (Friday).

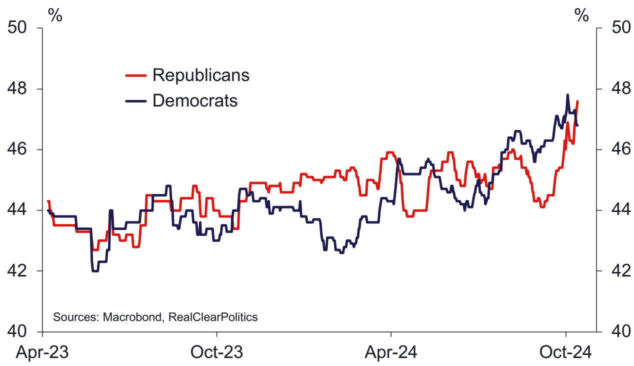
Trading partner real GDP (calendar years)

	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

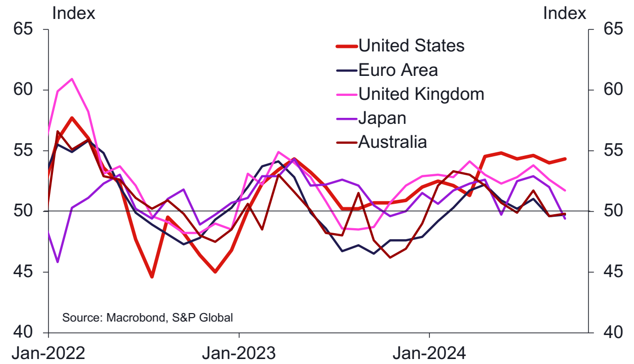
Australian & US interest rate outlook

	25 Oct	Dec-24	Mar-25	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.35
90 Day BBSW	4.38	4.42	4.19	3.50
3 Year Swap	3.91	3.60	3.60	3.50
3 Year Bond	3.90	3.55	3.50	3.35
10 Year Bond	4.40	3.90	3.90	4.05
10 Year Spread to US (bps)	23	15	15	5
US				
Fed Funds	4.875	4.375	3.875	3.375
US 10 Year Bond	4.17	3.75	3.75	4.00

US congressional polling



S&P Global composite PMI readings



Financial markets wrap

Interest rates.

NZ swap rates remain in consolidation mode, having formed a base early in October. The 2yr swap formed a bottom at 3.50% – the lowest since 2022. A reasonable range to expect during the week ahead is 3.50%-3.80%.

There isn't any major NZ economic data this week, the next major event being the labour data released on 6 November. But there's plenty of event risk from Australia, via its Q3 CPI data (30 Oct). And the US will print GDP, PCE inflation, and monthly payrolls.

There is plenty priced in for this RBNZ easing cycle, with a 50bp cut at the next meeting in November fully priced, and even a 75bp cut 25% priced. There's a high bar for the market to price much more easing, requiring significant downside economic data surprises. The US rates market, which influences NZ's market, has unwound some of the aggressive easing pricing of a few months ago, because data outturns there have beaten depressed expectations.

We expect the RBNZ meeting in November to deliver a 50bp cut. If that proves correct, and as long as RBNZ guidance is not too dovish, then the market could push rates higher in response.

Foreign exchange

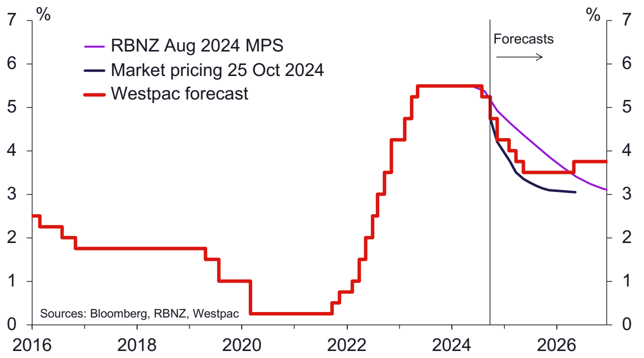
The NZD/USD has fallen 4c this month, and near-term risks remain negative. It retraced 62% of the Jul-Sep rally, and if 0.5980 support gives way, we'd be targeting the 0.5850-0.5900 area during the week ahead. That area, if seen, should provide an opportunity for NZ exporters to consider hedging receipts.

US events will remain at the fore this week and next. Markets have priced a Trump win in the 5 November election as USD-positive. Against that, US payrolls data risks being softer than expected, which would hurt the USD. In short, expect more volatility in the USD, and in turn NZD/USD.

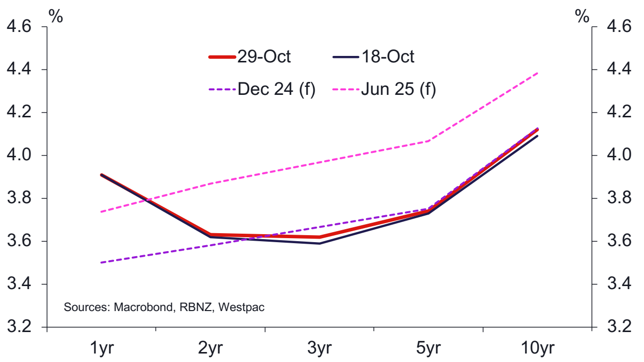
NZ-US yield spreads continue to decline, are now negative for short maturities, and are at the lowest levels since 2020. Negative yield spreads have been uncommon since the NZD floated in 1985 and are a disincentive to hold NZD vs USD.

NZ-AU yield spreads have also become negative, for the first time since 2012, and have helped depress NZD/AUD. The cross fell over 2c from mid-September but has recently become rangebound in the 0.90s. Tomorrow's AU CPI data poses major event risk for the cross. Longer term, though, we remain bearish, targeting 0.89, given the negative yield spreads as well as NZ's fiscal and current account deficits.

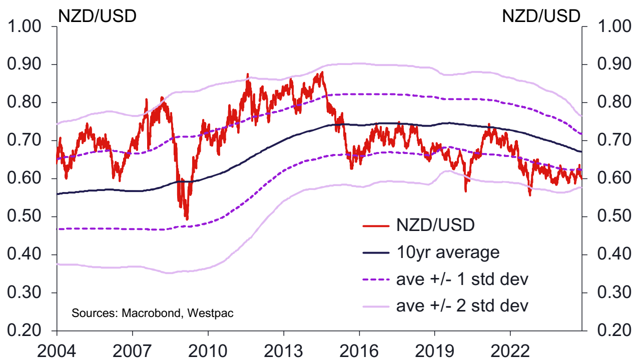
Official Cash Rate forecasts



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	0.598	0.586-0.636	0.555-0.743	0.645	0.62
AUD	0.908	0.897-0.925	0.873-0.992	0.929	0.90
EUR	0.553	0.542-0.569	0.517-0.637	0.581	0.56
GBP	0.461	0.456-0.476	0.456-0.535	0.502	0.47
JPY	91.6	86.1-91.8	61.3-98.6	80.9	88.0

The week ahead

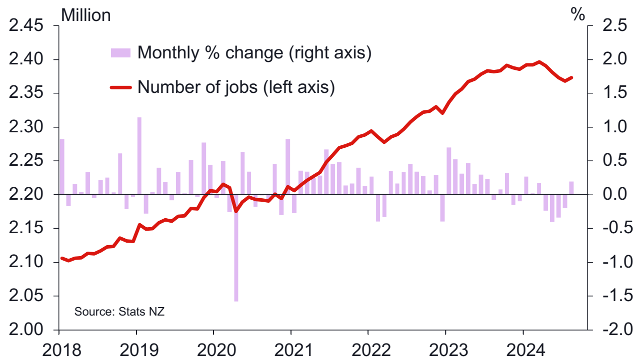
Sep employment indicator

Oct 29, Last: +0.2%, Westpac f/c: -0.2%

The Monthly Employment Indicator (MEI) rose by 0.2% in August, following four months of declines. However, this series has tended to be revised down from its initial release, which suggests that the slide in jobs may not actually be over yet. The weekly snapshots provided by Stats NZ point to another modest fall in September.

The number of filled jobs in August was down 0.4% on a year earlier. Manufacturing, construction and retail have seen extended declines over the last year, but in recent months they have increasingly been joined by a range of services industries.

Monthly Employment Indicator filled jobs



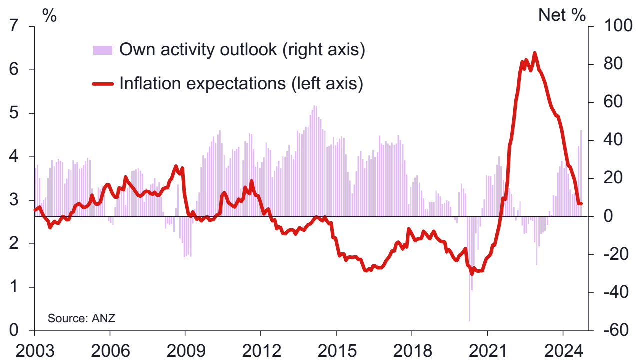
Oct ANZ business confidence

Oct 31, Last: 60.9

Business confidence continued its resurgence in September, reaching its highest level in a decade, after the Reserve Bank delivered its first OCR cut and signalled more to come. That sentiment is likely to fuel the October survey as well, with the RBNZ delivering an even larger 50bp cut early in the month. That said, the surge in confidence has been rooted more in hope than reality so far: firms continue to report that their own activity is well down on a year ago.

The inflation measures will also be of interest. Firms report that their cost pressures have been slow to recede, and pricing intentions remain above pre-Covid levels.

Business activity outlook and inflation expectations

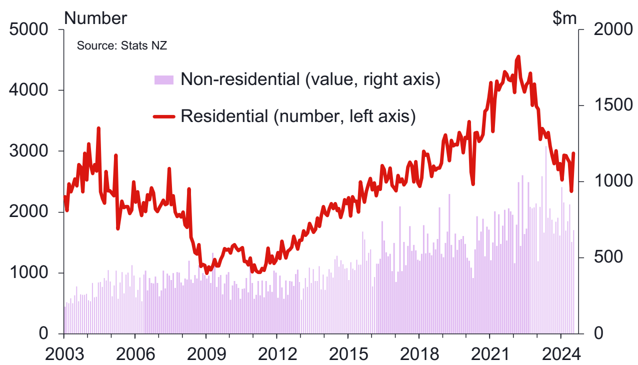


Sep building consents

Nov 1, Last: -5.3%, Westpac f/c: -5.0%

We're forecasting a modest 5% drop in residential consent numbers in September. July and August's numbers included a large number of retirement village consents, which is likely to normalise this month. Smoothing through that month-to-month volatility, the earlier downtrend in consent issuance looks like it has found a base. We expect that consents will remain around current levels for the remainder of this year. While interest rates are dropping, a pickup in consents probably won't be seen until mid-2025. In the non-residential space, weak economic activity is expected to continue weighing on new developments.

Building consents

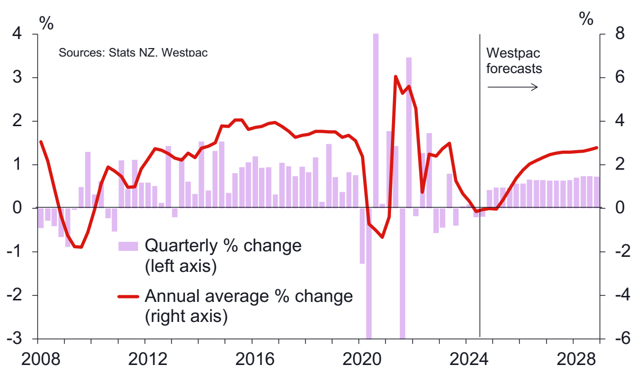


Economic and financial forecasts

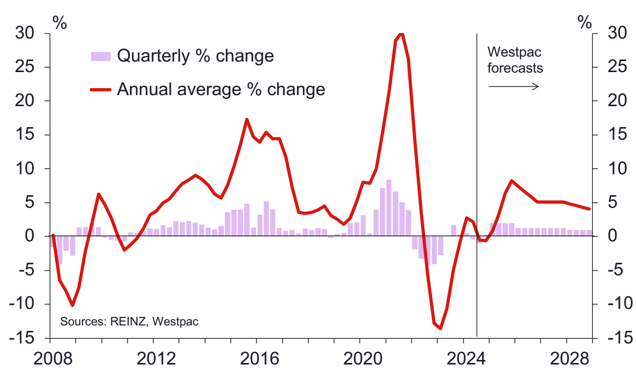
Economic indicators	Quarterly % change				Annual % change			
	Jun-24	Sep-24	Dec-24	Mar-25	2023	2024	2025	2026
GDP (production)	-0.2	-0.2	0.3	0.4	0.7	0.0	1.5	2.8
Consumer price index	0.4	0.6	0.4	0.5	4.7	2.1	2.0	2.1
Employment change	0.4	-0.6	-0.3	-0.2	2.9	-0.7	0.1	2.1
Unemployment rate	4.6	5.0	5.3	5.5	4.0	5.3	5.5	4.6
Labour cost index (all sectors)	1.2	0.7	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	0.2	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	3.50	3.60	5.28	3.50	3.95	4.00
5 year swap	4.53	3.81	3.70	3.75	4.85	3.70	4.15	4.25
10 year bond	4.74	4.31	4.20	4.20	5.09	4.20	4.40	4.35
TWI	71.4	70.9	70.3	70.7	70.8	70.3	69.8	69.1
NZD/USD	0.61	0.61	0.62	0.63	0.60	0.62	0.64	0.64
NZD/AUD	0.92	0.91	0.90	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	0.47	0.47	0.47	0.49	0.47	0.47	0.47

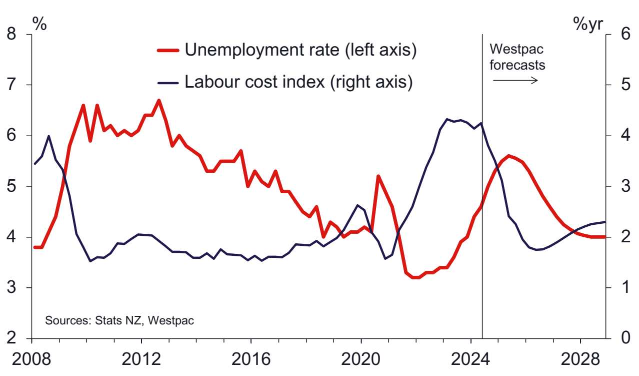
GDP growth



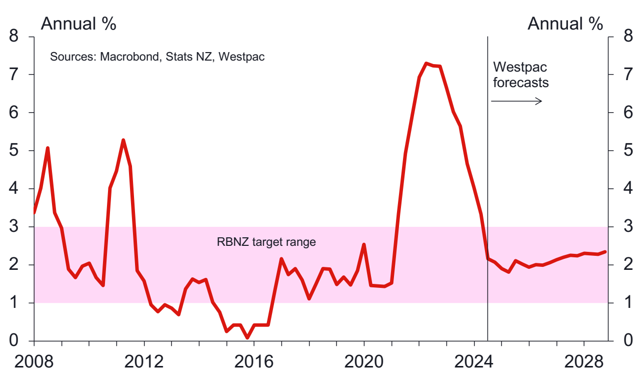
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Tue 29					
NZ	Sep Employment Indicator, %mth	0.2	–	–0.2	Weekly snapshots have remained soft.
Jpn	Sep Unemployment Rate, %	2.5	2.5	–	Labour market expected to remain tight.
US	Sep Wholesale Inventories, %mth	0.1	–	–	Steady inv-to-sales ratio points to sound orders mngt.
	Sep JOLTS Job Openings, 000s	8040	7900	–	Volatile data has a propensity to unsettle markets…
	Oct CB Consumer Confidence, index	98.7	98.8	–	… ahead of all-important payrolls figures later in the week.
Wed 30					
Aus	Q3 CPI, %qtr	1.0	0.3	0.3	Cost of living rebates & fuel detracts –0.66ppt from CPI…
	Q3 CPI, %yr	3.8	2.9	2.9	… bringing annual pace sub–3% for first time since Q1 2021.
	Q3 Trimmed Mean CPI, %qtr	0.8	0.7	0.7	Electricity & auto fuel trimmed from the core measure…
	Q3 Trimmed Mean CPI, %yr	3.9	3.5	3.5	… but we are still seeing an overall moderation.
	Sep Monthly CPI Indicator, %yr	2.7	2.3	2.2	The monthly indicator still highlights unfolding disinflation.
Eur	Q3 GDP, %qtr	0.2	0.2	–	Modest increase, on the back of a healthier consumer…
	Oct EC Economic Confidence Survey, index	96.2	96.3	–	… but fragile business confidence spells lingering risks.
US	Q3 GDP, %ann'd	3.0	3.0	–	Broadly similar pace of growth expected.
Thu 31					
NZ	Oct ANZ Business Confidence, index	60.9	–	–	Rate cuts boosting confidence more than activity.
Aus	Q3 Import Price Index, %qtr	1.0	–0.3	–	Commodity prices continue to move lower off peak.
	Q3 Export Price Index, %qtr	–5.9	–4.0	–	Will be a critical input to quarterly trade data.
	Sep Dwelling Approvals, %mth	–6.1	2.1	1	Modest gain as private detached houses track soft uptrend.
	Sep Retail Sales, %mth	0.7	0.2	1	Tax cuts gaining some traction, not yet driving large gains…
	Q3 Real Retail Sales, %qtr	–0.3	0.4	0.8	… but with disinflation, volumes look to have risen in Q3.
	Sep Private Sector Credit, %mth	0.5	0.5	0.5	Maintaining a stable growth trend.
Jpn	Oct BoJ Policy Decision, %	0.25	0.25	–	More evidence of sustainable inflation needed.
	Sep Industrial Production, %mth	-3.3	0.8	–	Greater volatility masking soft underlying trend.
Chn	Oct NBS Manufacturing PMI, index	49.8	50	–	Still early days to see a response to recent stimulus…
	Oct NBS Non–Manufacturing PMI, index	50	50.5	–	… but any signs of improving momentum will be welcome.
Eur	Oct HICP, %yr	1.8	1.9	–	Core inflation trickling slowly toward target.
	Sep Unemployment Rate, %	6.4	6.4	–	Hovering around record lows.
US	Q3 Employment Cost Index, %qtr	0.9	0.9	–	Softer labour market dynamics…
	Sep Personal Income, %mth	0.2	0.4	–	… are gradually slowing gains in incomes…
	Sep Personal Spending, %mth	0.2	0.4	–	… and will eventually household spending.
	Sep PCE Deflator, %mth	0.1	0.3	–	Inflation is at target on an ex–shelter basis.
	Initial Jobless Claims	227	–	–	Easing back after temporary disruptions.
Fri 01					
NZ	Sep Building Permits, %mth	–5.3	–	–5.0	The fall in issuance is finding a base.
Aus	Oct CoreLogic Home Value Index, %mth	0.5	–	0.3	Daily index points to a loss of momentum in October.
	Sep Housing Finance, %mth	1.0	1.0	1.0	Set to show a broadly similar picture…
	Sep Owner Occupier Finance, %mth	0.7	–	0.8	… construction–related lending a little firmer…
	Sep Investor Finance, %mth	1.4	–	1.5	… but investors likely to outstrip owner–occupiers.
	Sep Household Spending Indicator, %mth	flat	0.2	2.0	To supersede retail trade data in 2025.
Chn	Oct Caixin Manufacturing PMI, index	49.3	–	–	Painting a similar picture to the official PMIs.
US	Oct Non–Farm Payrolls, 000s	254	120	–	Hurricane disruptions present a temporary headwind…
	Oct Unemployment Rate, %	4.1	4.1	–	… but with the labour market having moved broadly into…
	Oct Average Hourly Earnings, %mth	0.4	0.3	–	… balance, wage gains should start to slow.
	Oct ISM Manufacturing, index	47.2	47.6	–	Manufacturing in contraction, mirroring regional surveys.
World	S&P Global Manufacturing PMI	–	–	–	Final estimate for Japan, UK and US.

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