WEEKLY ECONOMIC COMMENTARY

30 Sep 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Will the RBNZ be 'slow and steady' or 'fast and furious'?

The RBNZ has now fired the starting gun on the easing cycle. But how far and fast will the Official Cash Rate drop?

The RBNZ's August policy statement forecasts were consistent with measured cuts, showing the OCR falling by 60bps this year and a further 110bps in 2025. Although the RBNZ doesn't signal exactly how fast the OCR could fall, their forecast path looks consistent with a series of steady 25bp cuts.

In contrast, financial markets are pricing in a more aggressive easing cycle, with at least one 50bp cut priced in before the end of this year and the OCR expected to fall by around 200bps by mid-year.

Our expectation is that the RBNZ will move in measured 25bp steps, with the OCR to drop to 3.75% next year. However, as we discuss in **our recent 'Hawks, doves, and kiwis' report**, there are reasonable arguments that can be made for moving either more cautiously or more aggressively.

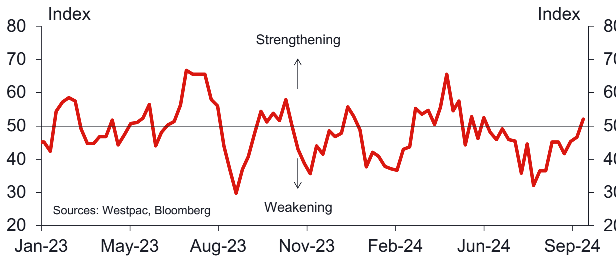
On the hawkish side of the ledger, one factor suggesting that a more gradual easing of the OCR might be appropriate is lingering strength in domestic inflation. Even though the cutting cycle is now underway, non-tradables inflation remains elevated, coming in at 5.4% in the year to June. And that strength is not just because of continued large increases in insurance premiums or local council rates – non-tradables excluding the cost of housing, insurance and government charges is still running hot.

Similarly, while the economy has been softening, it is not quite as weak as the RBNZ assumed back in August. While the RBNZ (and ourselves) were braced for a further downturn in GDP growth mid-year, the pace of that decline remains gradual and no worse than we've seen in recent quarters. That means the economy is starting

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

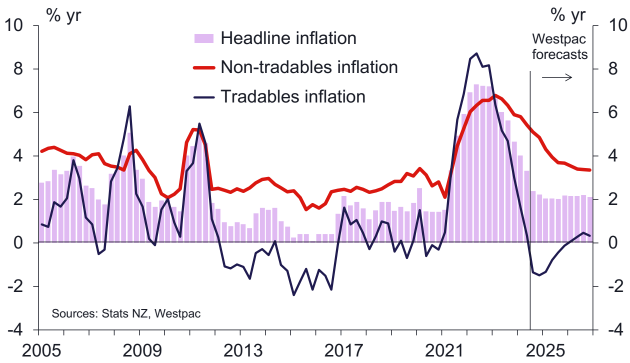


Key data and event outlook

Date	Event
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
16 Dec 24	NZ Selected price indexes, November

from a position of marginally less excess capacity than the RBNZ previously assumed, and this was crucial to the case for front loaded easing. Furthermore, some of the weakness that we saw in indicators of economic activity mid-year has now dissipated.

Inflation



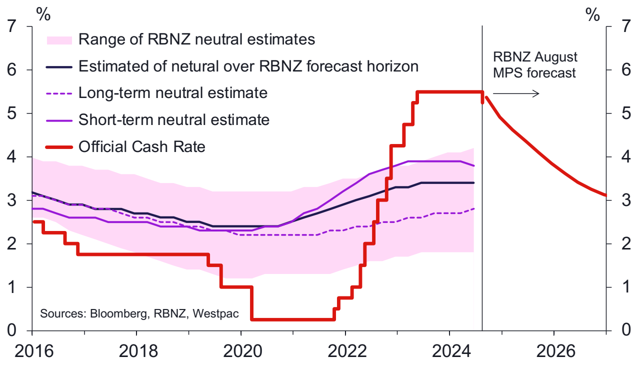
Importantly, a key lesson from the pandemic is that monetary policy works and that rapid changes in interest rates can generate large changes in demand and inflation. Even though the RBNZ has only reduced the OCR by 25bps to date, mortgage rates have fallen more sharply, and that will be hitting many households' back pockets by the end of this year. Further sharp reductions in interest rates would boost demand and would throw petrol on the simmering embers of the housing market, and that could reignite inflation.

On the other hand, arguments can also be made for deeper or more front-loaded cuts. First is that inflation is no-longer a barrier to rate reductions. Inflation has already fallen from over 7% in 2022 to 3.3% in the June quarter. It's set to drop to 2.4% in the September quarter and continue softening over the year ahead.

At the same time, the downturn in growth has seen significant slack in the economy opening up. GDP has been nudging down since late 2022 and the negative output gap is estimated to have increased to around >1%. With demand likely to remain muted through the back part of 2024, spare capacity is set to continue building. We're also seeing slack accumulating in the labour market.

Notably, at a time when CPI will soon be close to the target midpoint and when the economy is increasingly operating with spare capacity, the OCR and shorter-term interest rates remain at levels that are continuing to significantly restrain demand. A faster reduction in rates would help to return domestic demand to normal levels over the year ahead, rather than pushing it into a position of excess demand / strong inflation pressures as hawks fear. That could also help to fend off a deeper than needed slowdown in activity, the labour market or inflation that could necessitate a deeper easing cycle down the line.

Official Cash Rate and RBNZ estimates of neutral



Labour market softness.

With competing arguments on both sides, economic data will warrant close scrutiny over the coming months, and a key area of focus will be the labour market. The unemployment rate has pushed higher in the first half of the year, rising to 4.6%. More recent labour market indicators like filled jobs and job advertisements, as well as feedback from businesses, point to a further softening in the jobs market in the back part of the year. We expect unemployment to rise to 5.3% by the end of this year (in line with the RBNZ's forecast). Against that backdrop, **workers confidence about the state of the labour market** has languished at low levels. Notably, while employment confidence is low in Wellington where there have been high-profile public sector job losses, confidence is also low in other regions. That reflects that there have also been widespread job losses in the private sector, including in the retail, hospitality, construction and manufacturing sectors.

Moo-ving on up.

Turning to New Zealand's all-important rural sector, improving market conditions and rising dairy auction prices have prompted us to revise **our farmgate milk price forecast for this season** from $8.70 per kilo of milk solids to $9.00. That should be welcome news for our dairy farmers, with DairyNZ estimating a breakeven price of $8.09. World dairy prices have certainly been resilient. While whole and skim milk powder prices have moved sideways around their long-term averages in recent months, milkfats sit at or are close to record highs.

Our new milk price forecast assumes a modest pullback in dairy prices from current levels by the end of the season. That reflects the potential for higher than anticipated global supply. New Zealand production has started off this current season strongly, which could add significant volume into the market. Chinese and US production has also started to lift following weakness early in the season.

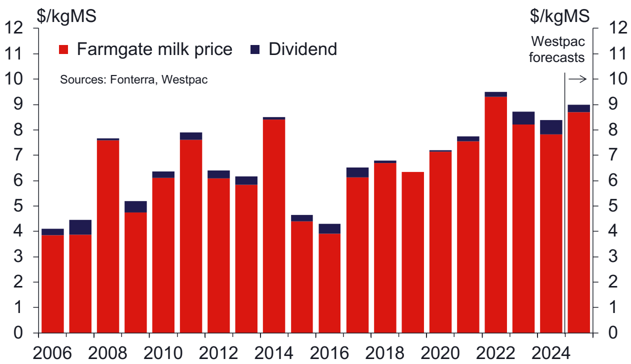
It's not just in dairy where things seem to be on the up. Our report published last week also suggests **better**

times ahead for the horticulture and viticulture sectors. Those sectors are big export earners. Kiwifruit exports for the year ending August 2024 were worth $3.1bn, while apples contributed just under $1bn. Add another $2bn or so of wine into the mix, and the sector is our third biggest export earner.

The sector is one of the most productive in the New Zealand economy, and also is one of the most efficient producers of fruit internationally. Much of that has to do with ideal growing conditions in regional New Zealand. Being a counter-seasonal producer also helps, meaning we can supply the world market at times when few others are. The sector also spends large on R&D delivering both process efficiencies as well as products tailored to customer preferences.

It's also got to do with increasing demand for high quality fruit with positive health benefits. Population growth and rising incomes in increasingly diversified export markets should ensure that this remains the case. In the years ahead, supply is likely to be a key factor that determines prices. Careful management here is likely to lead to superior orchard gate returns.

Farmgate milk prices



Working from home or going out for coffee?

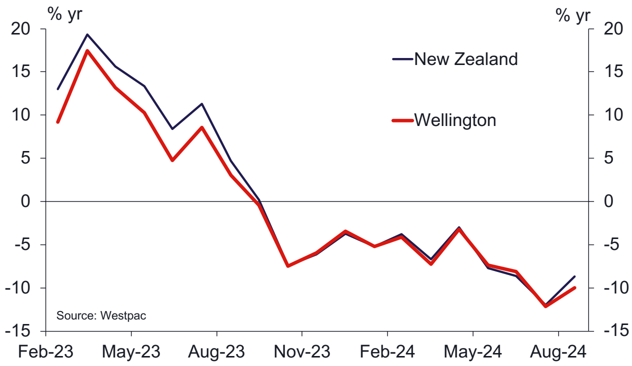
Working from home (WFH) has become increasingly widespread since the pandemic. Data from Seek show that around 9% of advertised jobs can now be done from home (up from only around 1% prior to the pandemic) and a recent report from CBRE shows that office attendance for the average worker is now just over three days each week. Working from home has been especially popular in Wellington, where around 13% of job ads include work from home options. It's also popular in Auckland.

With increases in WFH, the related reductions in foot traffic has certainly dented spending in bars and restaurants in city centres, with some of that lost to suburban areas and delivery services. Combined with pandemic-related lockdowns, that's resulted in tough times for many hospitality businesses in recent years, especially in metro-areas.

But while changes in where people work will have impacted spending, there's been a bigger impact from the squeeze on household finances. The downturn in hospitality spending has become much more pronounced since late-2022, well after WHF had became widespread. Notably, the fall in spending has been right across the country, even in areas where working from home isn't as prevalent. Around that time, we saw inflation surging to over 7% and interest rates rose rapidly. Those financial pressures have sucked a lot of cash out of households' wallets and have seen discretionary spending falling sharply. That's been compounded by the softening of the labour market over the past year.

In Wellington, where working from home is prevalent, hospitality spending has taken a notable step down since mid-2023. At that time, the impact of interest rate hikes was being felt much more sharply as borrowers were rolling off the low rates that were on offer during the pandemic and on to much higher rates.

Hospitality spending (Rolling three-month averages)



Satish Ranchhod, Senior Economist
Paul Clark, Industry Economist

We're on LinkedIn!

We're now posting all our updates on the Westpac Economics LinkedIn page. Follow to stay up to date with our research.

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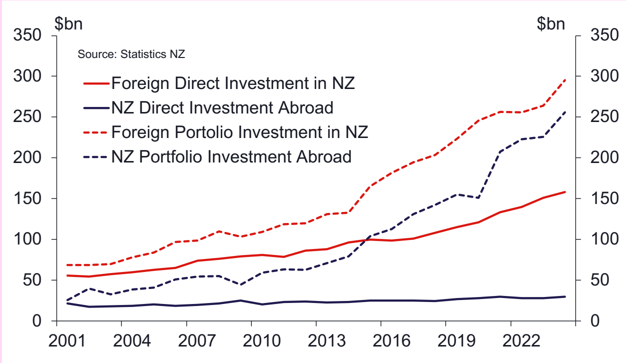
Westpac Economics Team

Chart of the week.

A consequence of New Zealand's sustained current account deficits is a growing stock of net liabilities with the rest of the world – an increase of $111bn over the past 23 years. When we look at the composition of those net liabilities, we find that New Zealand's stock of portfolio investments abroad and foreign portfolio investments in New Zealand have both grown significantly over the past 23 years and at a very similar pace – the latter remaining around $40bn greater across the period. So almost all the deterioration in New Zealand's net liabilities is explained by the fact that New Zealand's direct foreign assets have barely grown at all, whereas the value of foreign ownership of New Zealand assets has grown by more than $100bn. Of the latter, about $65bn is accounted for by investment from Australia. By industry, foreign ownership of assets in the finance and insurance sector has increased by $52bn.

Foreign direct investment in NZ continues to grow

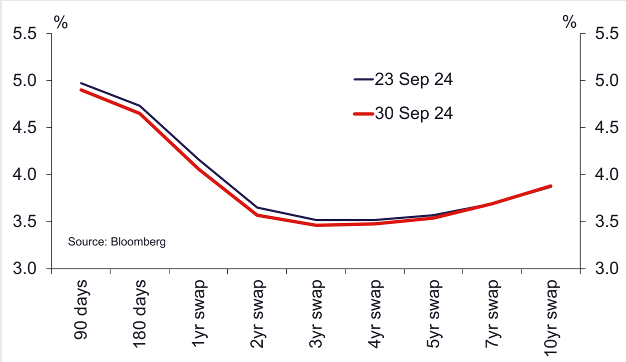


Fixed versus floating for mortgages.

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 US economic data painted a mixed picture last week. While the flash S&P composite PMI eased only marginally to a still solid 54.4 in September, the Conference Board's consumer survey reported the largest decline in confidence in three years amidst a less positive assessment of the labour market. However, initial jobless claims printed at a low 218k last week, indicating that layoffs remain low even if job growth has slowed. On the inflation front, the core PCE deflator – the Fed's preferred metric – rose just 0.1%m/m in August, coming in slightly below the market's expectation. This week the focus in the US will be clearly on Friday's September employment report – the first of two such reports before the Fed's next meeting in November. Ahead of that report, the ISM's manufacturing and services surveys and the JOLTS survey will be scrutinised for further clues about evolving labour market conditions.

Europe.

Last week's flash PMI readings for September proved disappointing, especially in the euro area where the composite PMI fell 2.1pts to a contractionary 48.9 – the weakest reading since January. The UK's composite PMI also softened in September but remained in expansionary territory at 52.9. Meanwhile, flash September inflation readings printed well below expectations in both France and Spain. Today will bring the release of further regional inflation data in the euro area, while the flash CPI reading for the euro area in aggregate will follow on Tuesday. Final manufacturing and services PMI readings for September will also be released this week.

Asia-Pacific.

The key news in Asia last week was the announcement of a slew of new measures to support China's economy. These included a cut in official interest rates and banks' reserve requirements, a lowering of deposit requirements for mortgages on second homes and funds to support the ailing stock market (the latter helping to spark a 12% rebound in the Shanghai index). In addition, reports indicate that significant fiscal stimulus measures are also in the pipeline that might provide a more direct boost to consumer spending and indebted local governments. China will print its official and Caixin PMI readings for September today, casting light on the magnitude of the headwinds that policymakers are currently facing. In Japan, the focus this week will be on Wednesday's release of the BoJ's closely-watched Tankan survey – a key input that will be considered by policymakers at next month's Board meeting.

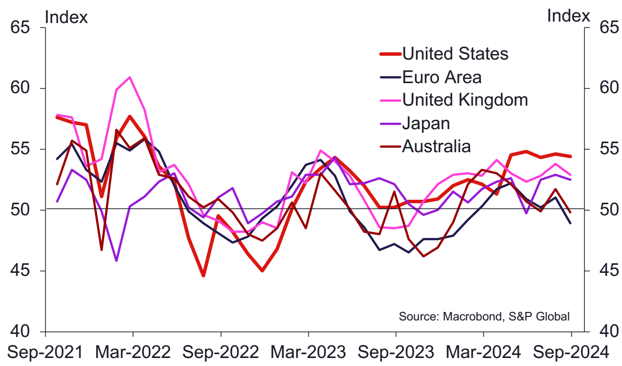
Trading partner real GDP (calendar years)

	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

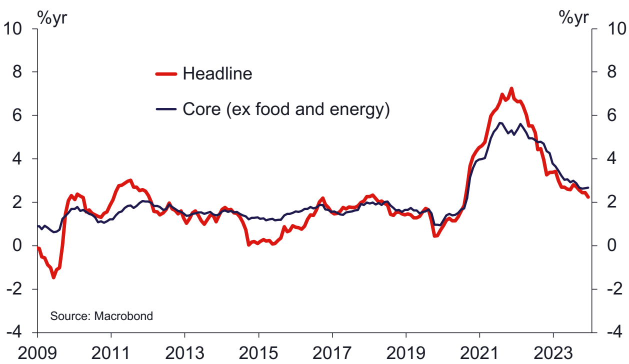
Australian & US interest rate outlook

	27 Sep	Sep-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.35
90 Day BBSW	4.44	4.42	4.19	3.50
3 Year Swap	3.54	3.60	3.60	3.50
3 Year Bond	3.54	3.55	3.50	3.35
10 Year Bond	3.96	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	3.80	3.75	3.75	4.00

S&P Global composite PMI readings



US PCE deflator



Financial markets wrap

Interest rates.

NZ swap rates fell slightly further last week, outpacing offshore moves as markets continue to expect the RBNZ to be one of the most assertive central banks in the global easing cycle.

The event calendar this week holds domestic interest, with Tuesday's quarterly NZIER business survey the clear highlight. It is the most comprehensive of NZ's business surveys and is closely watched by the RBNZ. Internationally, the highlight will be Friday's US payrolls data, with labour market developments key to the pace of future Fed rate cuts.

The 2yr swap rate, currently at 3.57% (lowest since May 2022), could fall further this week but is likely to be contained by a 3.50%-3.80% range. Market pricing for the OCR remains stretched – the next three meetings have 125bp of rate cuts priced in (Westpac forecasts 75bp), and for the next meeting on 9 October there is a 70% chance of a large 50bp cut priced – but we don't expect the rates market to abandon its dovish bias anytime soon.

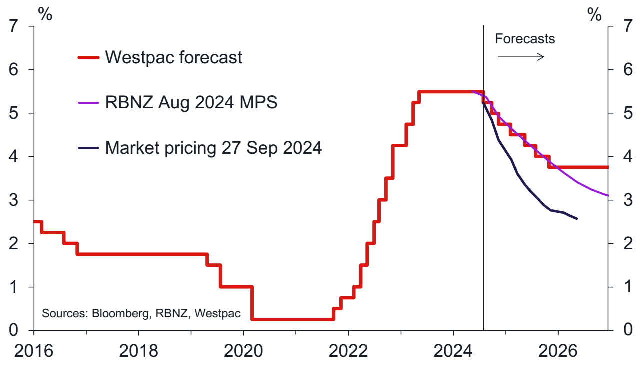
Foreign exchange.

NZD/USD' has rallied from 0.6100 to 0.6357 over the past three weeks and could extend this move to 0.6400 during the week ahead.

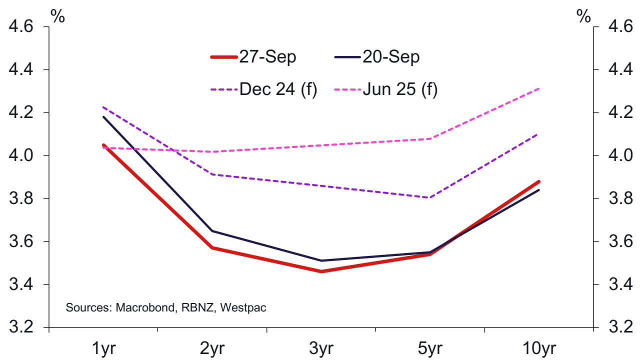
The US dollar remains on the back foot, with markets continuing to speculate on further large 50bp rate cuts from the Fed. In turn, those expectations of lower US interest rates have boosted risk sentiment (the S&P500 made fresh record highs last week), benefitting risk-sensitive currencies such as the NZD. US payrolls data this week will be influential on the US dollar. Regarding risks to our view, an escalation of Middle East tensions could cause a US dollar rebound.

NZD/AUD remains stalled in the 0.9150-0.9200 area, torn between the impact of the significant stimulus which China announced last week and declining NZ-AU yield spreads. Our outlook for the week ahead remains neutral.

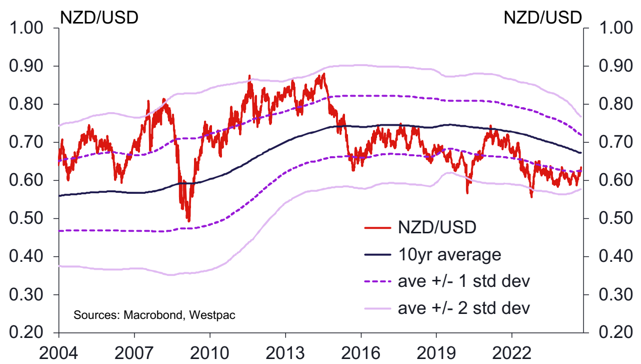
Official Cash Rate forecasts



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	0.634	0.586-0.634	0.555-0.743	0.645	0.62
AUD	0.918	0.897-0.925	0.873-0.992	0.929	0.91
EUR	0.568	0.542-0.568	0.517-0.637	0.581	0.56
GBP	0.474	0.456-0.481	0.456-0.535	0.502	0.47
JPY	90.2	86.1-98.6	61.3-98.6	80.6	88.3

The week ahead

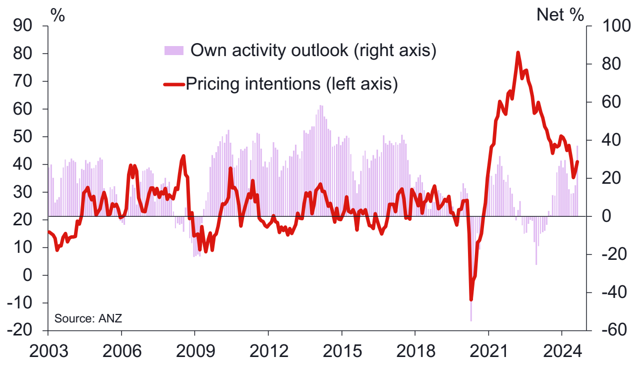
NZ ANZBO business confidence

Sep 30, Last: 50.6

Business confidence took flight in August following the earlier than expected start of the RBNZ's easing cycle. But while businesses are feeling more optimistic about the economy's trajectory, trading activity over the past year has remained soft.

We expect the August survey will point to continued softness in trading activity in recent months. But the key thing to watch will be expectation components. Nervousness about the outlook is easing, but that's not likely to pass through to increases in hiring or investment intentions just yet.

Business activity outlook and inflation expectations



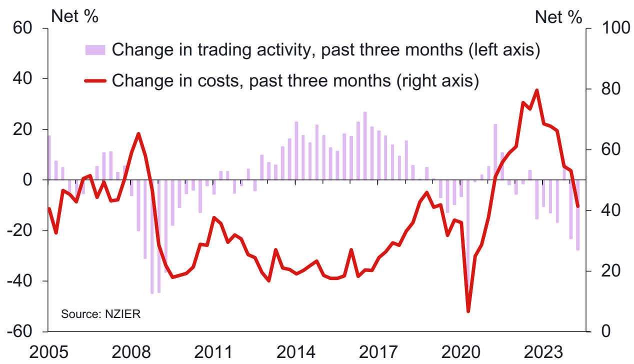
Q3 NZIER Survey of Business Opinion

Oct 1, General business confidence - last: -35.4

With the RBNZ's rate cutting cycle now in train, we expect the latest Survey of Business Opinion will show that business confidence has picked up from the lows seen earlier in the year. However, indicators of hiring and investment are still likely to remain subdued for now.

Importantly, the backwards looking gauges of activity (which have tended to be timely indicators of GDP growth) are likely to have remained muted through the middle part of the year, with businesses reporting weak trading activity.

NZIER Quarterly Survey of Business Opinion



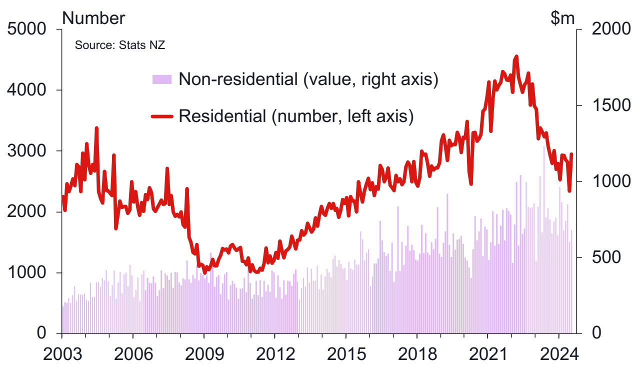
Aug building consents

Oct 1, Last: +26.2%, Westpac f/c: -10%

Dwelling consents rose 26% in July, more than reversing the previous month's large holiday-related fall. Some of that rise was due to 'lumpy' issuance in some categories, and as a result we expect consent numbers will post a sizeable drop in August. That would take consents back to the soft levels we saw in the early part of the year. Consent issuance looks like it is finding a base. However, a pickup 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



The week ahead

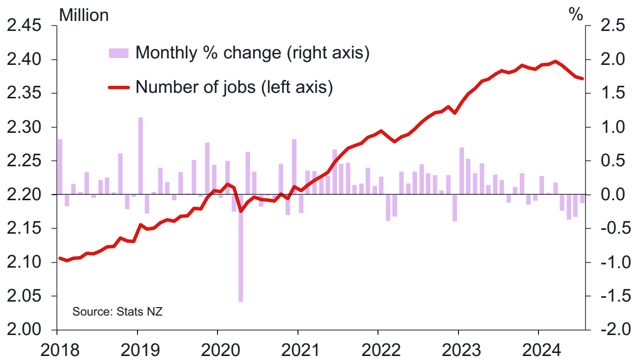
NZ employment indicator

Oct 4, Last: -0.1%, Westpac f/c: Flat

The Monthly Employment Indicator (MEI) fell by 0.1% in July, its fourth straight month of decline. The number of filled jobs is now down 0.5% on the same time a year ago. Job losses are now becoming apparent across many industries. Manufacturing, construction and retail have seen extended declines over the last year, but they are increasingly being joined by a range of services sectors. Healthcare, public administration and finance are among the few remaining sources of growth.

Weekly jobs updates have flattened off in recent weeks, and we expect the MEI to be about flat for August. However, recent experience suggests that job numbers over the past month or two are likely to be revised lower.

Monthly Employment Indicator filled jobs

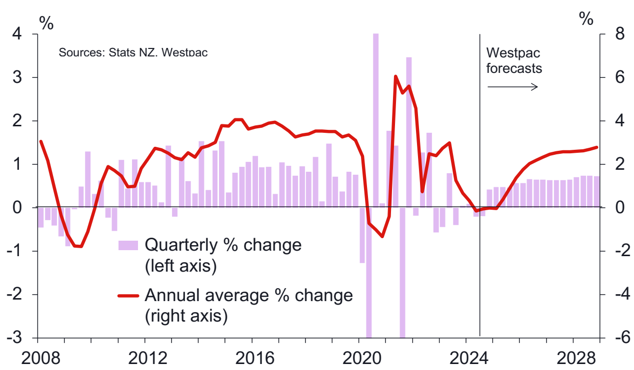


Economic and financial forecasts

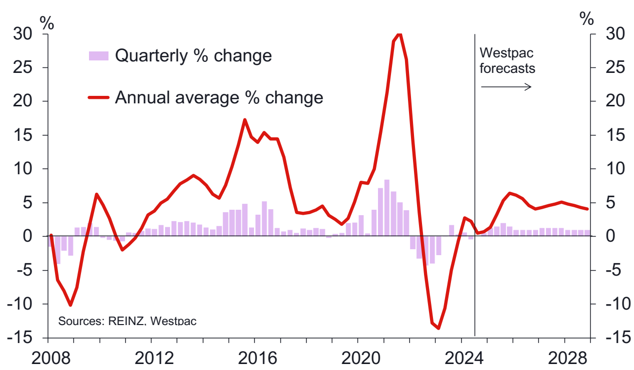
Economic indicators	Quarterly % change				Annual % change			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
GDP (production)	0.1	-0.2	-0.2	0.4	0.7	0.0	1.4	2.3
Consumer price index	0.6	0.4	0.9	0.3	4.7	2.2	2.2	2.1
Employment change	-0.3	0.4	-0.4	-0.2	2.9	-0.4	-0.1	1.5
Unemployment rate	4.4	4.6	5.0	5.3	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)	-6.7	-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	4.75	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

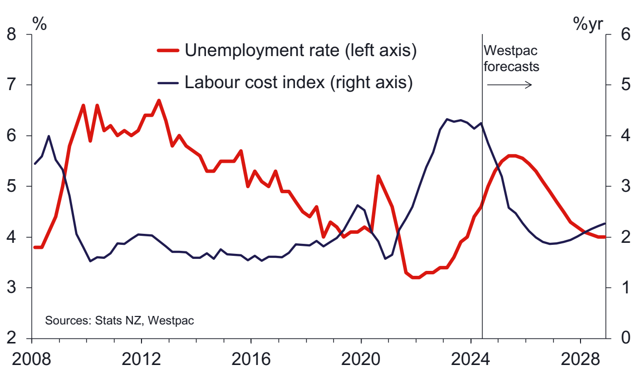
GDP growth



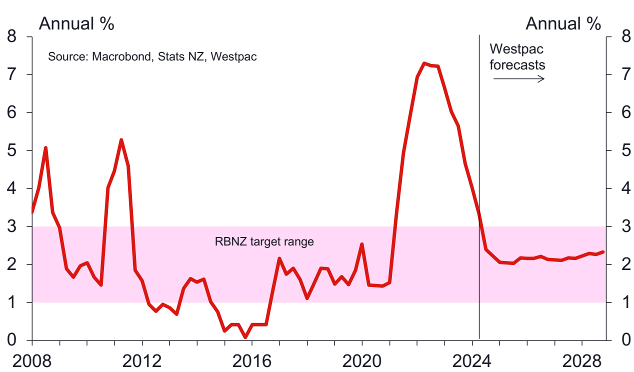
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 30					
NZ	Sep ANZ Business Confidence, index	50.6	–	–	Has picked up in the wake of the RBNZ's OCR cut.
Aus	Aug Private Sector Credit, %mth	0.5	0.5	0.4	Similar growth rate should to be maintained.
Jpn	Aug Industrial Production, %mth	3.1	-0.5	–	Bad weather likely tempered production in the month.
Chn	Sep NBS Manufacturing PMI, index	49.1	49.5	–	Weather shocks and weak demand…
	Sep NBS Non-Manufacturing PMI, index	50.3	50.5	–	…to keep the economic momentum subued in September.
	Sep Caixin Manufacturing PMI, index	50.4	50.5	–	Downside risks will stick around until recently…
	Sep Caixin Services PMI, index	51.6	51.6	–	…announced policy measures begin to flow through.
US	Sep Chicago PMI, index	46.1	46.8	–	Manufacturing remains weak…
	Sep Dallas Fed Index, index	–9.7	-10.6	–	…across the regions.
	FOMC Chair Powell	–	-	–	Speaking at National Association for Business Economics.
Tue 1					
NZ	Aug NZIER Survey of Business Opinion	26.2	–	–	Trading conditions still soft, but confidence firming.
	Aug Building Permits, %mth	26.2	–	-10	Normalisation after recent swings, levels still low.
Aus	Sep Corelogic Home Value Index, %mth	0.5	-	0.6	Rising at a slower pace with bigger regional variations.
	Aug Dwelling Approvals, %mth	10.4	-5.5	–7.0	Coming off unit spike in July. Conditions still subdued.
	Aug Retail Sales, %mth	flat	0.4	0.9	Should show more of a tax cut boost after flat July.
Jpn	Aug Jobless Rate, %	2.7	2.6	–	Labour market expected to remain tight.
	Q3 Tankan Large Manufacturers, index	13	12	–	Weak external demand a headwind for manufacturers.
Eur	Sep CPI, %yr	2.2	-	–	Pressure on services prices to lessen post-Olympics.
US	Aug Construction Spending, %mth	–0.3	0.1	–	Rate cuts to provide impetus to the sector going forward.
	Aug JOLTS Job Openings, 000s	7673	-	–	Labour demand continues to moderate.
	Sep ISM Manufacturing, index	47.2	47.6	–	Manufacturing activity still in contraction territory.
	Fedspeak	–	-	–	Bostic, Barkin, Collins.
World	Sep S&P Global Manufacturing PMI, index	49.5	-	–	Final estimate for Japan, Eurozone, UK and US.
Wed 2					
Eur	Aug Unemployment Rate, %	6.4	–	–	Hovering around historically low levels.
US	Fedspeak	–	–	–	Hammack, Musalem, Bowman.
Thu 3					
NZ	Sep ANZ Commodity Prices, %mth	–2.1	–	–	High diary prices to underpin lift in overall prices.
Aus	Aug Trade Balance, $bn	6	5.5	6.4	Another small improvement in the trade balance expected
US	Initial Jobless Claims	218	-	–	To remain subdued, at least for now.
	Aug Factory Orders, %mth	5	0.2	–	July momentum unlikely to persist.
	Sep ISM Non-Manufacturing, index	51.5	51.5	–	To stay in expansionary territory amid consumer resilience.
World	Sep S&P Global Services PMI, index	53.8	-	–	Final estimate for Japan, Eurozone, UK and US.
Fri 4					
NZ	Aug Employment Indicator, %mth	–0.1	–	Flat	Weekly jobs updates have flattened off in recent weeks.
Aus	Aug Housing Finance, %mth	3.9	1	1	Uptrend continues but likely at a slightly slower pace …
	Aug Owner Occupier Finance, %mth	2.9	-	0.4	… in Aug as construction-related loans tick back a touch …
	Aug Investor Finance, %mth	5.4	-	2	… investor activity now clearly outperforming.
	Aug Household Spending, %mth	0.8	0.5	–	New measure set to eventually take over from retail survey.
US	Sep Non-Farm Payrolls, 000s	142	140	–	Weaker than expected results realised in recent months…
	Sep Unemployment Rate, %	4.2	4.2	–	…with unemployment to drift higher over the next year.
	Sep Average Hourly Earnings, %mth	0.4	0.3	–	Softening labour market to weigh on wage growth.

CONTACT

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

Kelly Eckhold, Chief Economist | +64 9 348 9382 | +64 21 786 758 | kelly.eckhold@westpac.co.nz

Satish Ranchhod, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Darren Gibbs, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Michael Gordon, Senior Economist | +64 9 336 5670 | +64 21 749 506 | michael.gordon@westpac.co.nz

Paul Clark, Industry Economist | +64 9 336 5656 | +64 21 713 704 | paul.clark@westpac.co.nz

Imre Speizer, Market Strategist | +64 9 336 9929 | +64 21 769 968 | imre.speizer@westpac.co.nz

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