WEEKLY ECONOMIC COMMENTARY

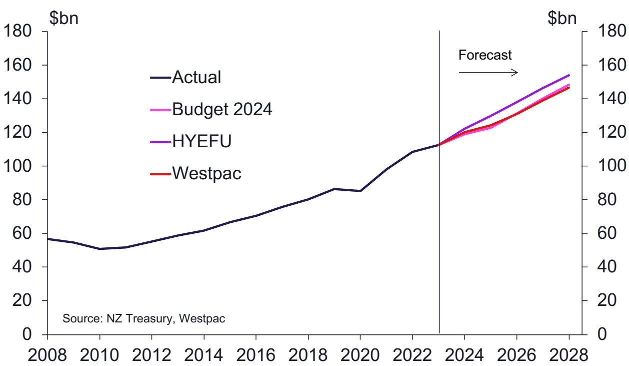
4 Jun 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Budget 2024 confirms bumpy road back to surplus

The focus in New Zealand last week was the release of Budget 2024. This provided the first official costings of the policies of the new Government, as well as an updated outlook for operating balances and debt based on a much weaker economy than had been assumed when the last update was published in December.

As it turns out, the Government more-or-less delivered on all the spending and revenue initiatives that had been proposed in the coalition agreements, including raising income tax thresholds for low to middle income earners (beginning 31 July), funded by significant savings, reprioritisations and revenue initiatives. So, as we expected, the key driver of the revisions to the fiscal outlook were on the revenue side of the ledger, with a weaker profile for nominal GDP leading to a more than $18bn shortfall in tax revenue across the forecast period.

Core Crown tax revenue

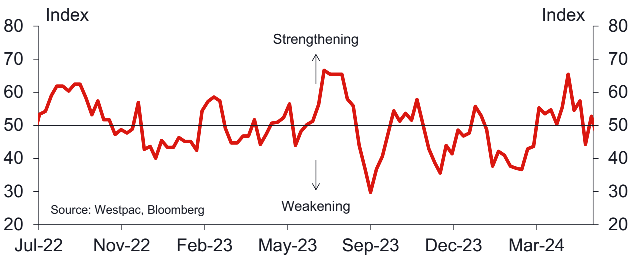


In the near-term, the fiscal outlook was portrayed even more negatively than we had expected, with an operating (OBEGAL) deficit of 3.1% of GDP now expected in 2024/25 – more than double that forecast in December and larger than the 2.7% of GDP deficit now forecast for the current fiscal year. Thereafter, the Government has set itself very

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

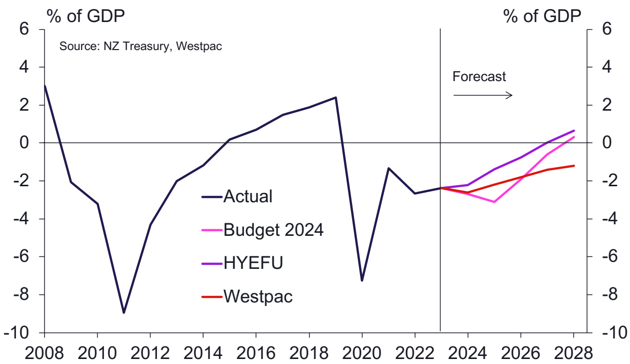


Key data and event outlook

Date	Event
5 Jun 24	Govt financial statements for 10 mths to April
12 Jun 24	FOMC Meeting (Announced 13 June NZT)
14 Jun 24	NZ Selected price indexes, May
18 Jun 24	RBA Monetary Policy Decision
20 Jun 24	NZ GDP, March quarter
2 Jul 24	NZIER QSBO server, June quarter
4 Jul 24	Govt financial statements for 11 mths to May
11 Jul 24	NZ Selected price indexes, June
17 Jul 24	NZ CPI, June quarter
31 Jul 24	FOMC Meeting (Announced 1 Aug NZT)
7 Aug 24	Labour market statistics, June quarter
8 Aug 24	RBNZ Survey of Expectations, June quarter
15 Aug 24	NZ Selected price indexes, July

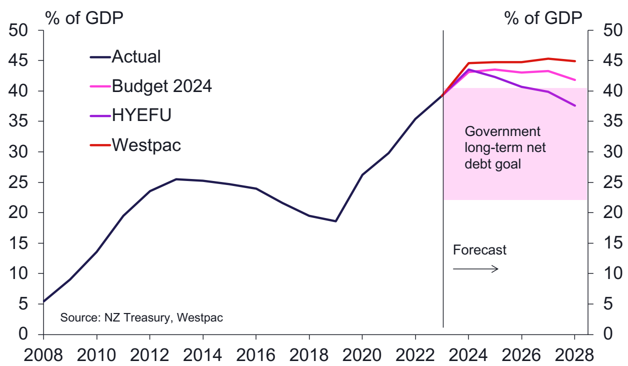
skinny annual operating allowances of just $2.4bn to fund new initiatives in subsequent Budgets. On that basis, government spending as a share of GDP is forecast to decline by more than 2ppts, allowing the Government to forecast a tiny OBEGAL surplus of 0.3% of GDP in 2027/28, which was in line with our expectations.

Operating balance (OBEGAL), % of GDP



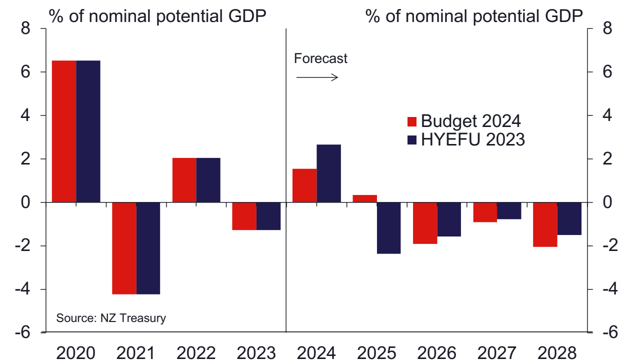
The weaker fiscal outlook has necessitated a lift in the Government's borrowing programme, with bond issuance now forecast to be $12bn greater across the forecast period than forecast in December. While this was a slightly smaller lift than we had expected, this was only possible due to a $4bn increase in short-term borrowings (Treasury bills and Euro Commercial Paper) and the curtailment of the usual buyback of maturing bonds. The maximum size of nominal bond lines has been raised by $7bn to $25bn.

Net core Crown debt, % of GDP



The weaker near-term outlook for OBEGAL means that the Treasury's estimate of the fiscal impulse now implies that the fiscal stance is not contractionary in the 2024/25 year compared to the December update. We think that this explains why the tone of the RBNZ's commentary around fiscal policy in the May Monetary Policy Statement (MPS) was notably more hawkish than that offered previously. While the formal projections in the MPS were based on publicly available data, the RBNZ had been briefed on the broad parameters of Budget 2024. Budget 2024 is not a game changer for the RBNZ, but a tighter fiscal stance would have been welcomed. Given the higher inflation outlook, a game changer is not required to introduce risk into the future RBNZ view. We continue to see news of ongoing non-tradables price increases (air travel related cost increases, utilities increases) which is not putting downside risk into our short term inflation forecasts.

Fiscal Impulse

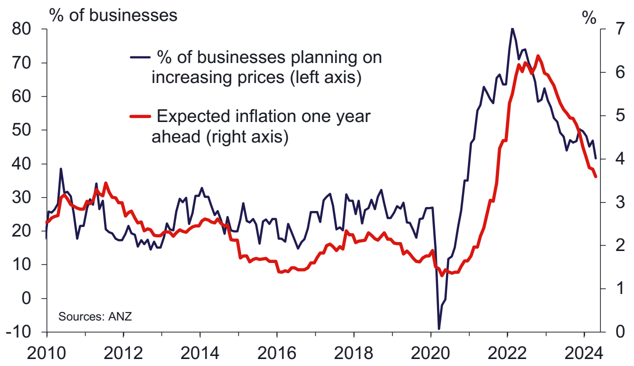


Looking ahead, the risks to the Budget outlook still appear to lie to the downside. Living within such tight fiscal allowances will be challenging for the Government, especially given population growth. It is notable that the Treasury's forecasts are based on an optimistic assessment of the outlook for inflation, which allows the Treasury to project a significant easing of monetary policy by the middle of next year. This leads the Treasury to forecast a relative rapid rebound in the economy than we think is likely, and means that the Treasury's forecasts of financing costs are lower than our own. On the revenue side, should the remaining carbon auctions fail to clear – as would appear to be the risk – that would present an additional source of fiscal risk.

While the underlying detail of Budget 2024 might ordinarily have been expected to be somewhat bearish for the bond market, a small decline in yields following the announcement suggests that investors were braced for even worse news – although the shift towards shorter maturity issuance is likely also a factor.

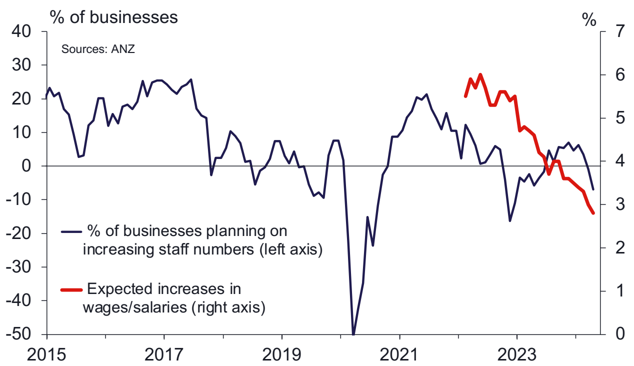
Last week's ANZ Business Outlook survey provided some better news for the RBNZ. After moving sideways for several months, the proportion of firms forecasting a rise in their selling prices over the next three months stepped down and firms' year-ahead inflation expectations fell. These are both factors the RBNZ has said would be important in giving them confidence to ultimately ease once inflation moves inside the target range. The survey also pointed to an ongoing weak activity outlook – with the construction sector notably weak (as is clear from a raft of indicators). Overall, we see the ANZ survey as consistent with our view that activity is likely contracting modestly in the current quarter following a very small expansion in the March quarter.

Inflation expectations and pricing intentions



The labour market needs to continue to weaken if non-tradables inflation is to fall from current elevated levels. The ANZ's survey also provided some optimism that this process is ongoing as a net 7% of respondents now expect to reduce employment levels while a net 16% reported lower employment levels than a year earlier. Firms also expect wage growth of just 2.8% over the next 12 months. The Monthly Employment Indicator did point to a 0.1% lift in filled jobs during April which may end up revised lower subsequently, but seems consistent with our view of flat employment growth over the period ahead.

Forecast wage growth and hiring intentions



Looking ahead to the coming week, we will be interested to see the first reports on real estate activity during May. Other than that, international trade, construction and business financial data reports will cast light on whether the economy grew in Q1. The results of the latest GDT dairy auction will also be of interest, especially following stronger-than-expected outcomes over the prior two auctions.

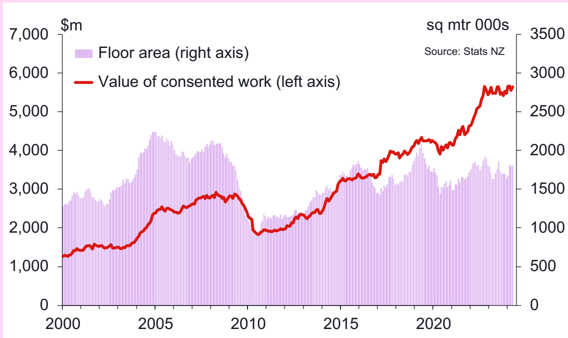
Darren Gibbs, Senior Economist

Chart of the week.

Non-residential building has risen strongly since the pandemic. However, we expect that will give way to a period of softer activity over the coming year. With a downturn in economic growth and nervousness about the outlook, businesses have become increasingly cautious about their capital spending. In the non-residential construction sector, those concerns have been compounded by large increases in building costs and financing costs.

The amount of private non-residential work being consented has already flattened out over the past year. However, trends are mixed across segments. At the weaker end of the spectrum, we're continuing to see lower amounts of retail and restaurant space being developed, reflecting challenging demand conditions. There has also been a downturn in the amount of hotel space being built following a large amount of activity in the late-2010s. At the firmer end, the amount of storage and industrial space being build has held up. In addition, the amount of new office space under development has picked up as businesses reassess their operating models and increasingly opt for modern environmentally friendly spaces (however, that demand for new space also means reduced demand for lower grade space).

Commercial building consents flat

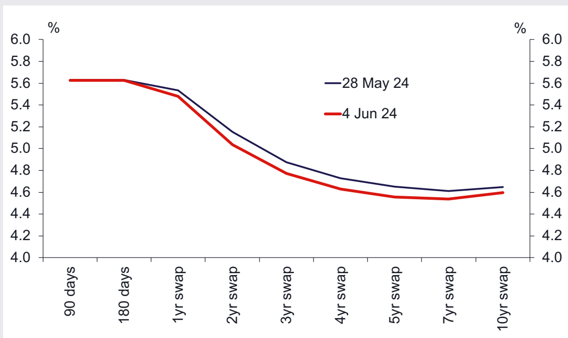


Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in May and signalled that rate cuts are stills some way off. Westpac is not forecasting OCR reductions until early 2025.

For borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

The Fed's Beige Book for May highlighted that the cracks are starting to show in the US economy after an extraordinary run of growth through 2023. Most districts reported "slight or modest growth", with "negligible to modest job gains" and wage pressures at or nearing pre-Covid levels. Other data releases in the last week have reinforced that message. Q1 GDP growth was revised marginally lower to a 1.3% annualised rate (previous 1.6%), and the May manufacturing PMI turned out weaker than expected, falling from 49.2 to 48.7. The personal consumption deflator (the Fed's preferred inflation measure) rose 2.7%yr in April, in line with market expectations. The pace of inflation has substantially cooled, though there are still concerns that it may be settling into a range above the Fed's 2% target. Looking further north, the Bank of Canada is widely expected to join the ECB in starting to ease monetary policy this week.

Europe.

As various ECB speakers have signalled in recent weeks, we expect the ECB to kick off its easing cycle at its meeting on Thursday night, reducing the policy rate by 25bp to 3.75%. But subsequent easing is likely to be modest in scale and pace, with economic momentum and risks to be assessed meeting by meeting. The preliminary CPI estimate for May saw core inflation lift from 2.7% to 2.9%, while the unemployment rate edged down from 6.5% to 6.4% in April, highlighting the lingering risks for wage growth and services sector inflation.

Asia-Pacific.

Australian economic data has been mixed over the last week. Activity measures have remained subdued, with retail sales recording a feeble 0.1% gain in April, and dwelling approvals falling by 0.3%. Meanwhile, the monthly CPI indicator rose to 3.6%yr in April, highlighting that – as we see elsewhere in the world – inflation pressures are proving to be sticky in some areas. March quarter GDP will be released on Wednesday; we expect a subdued 0.3% rise for the quarter, with weak consumer spending driving the result.

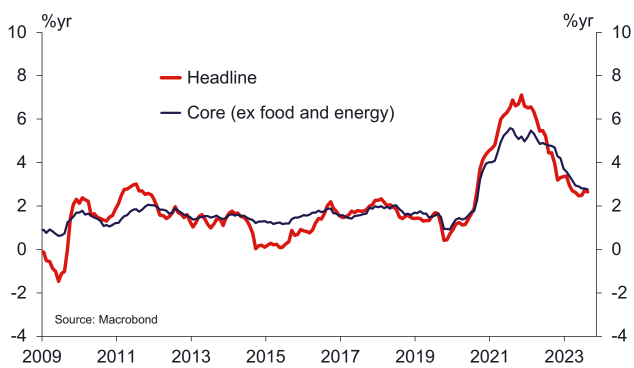
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	2023	2024	2025
Australia	3.8	2.1	1.3	2.2
China	3.0	5.2	5.2	5.0
United States	2.1	2.5	2.5	1.5
Japan	1.0	2.0	0.7	1.0
East Asia ex China	4.5	3.4	4.1	4.2
India	7.2	7.7	6.5	6.7
Euro Zone	3.3	0.4	0.5	1.5
United Kingdom	4.1	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.4	3.4
World	3.5	3.3	3.3	3.1

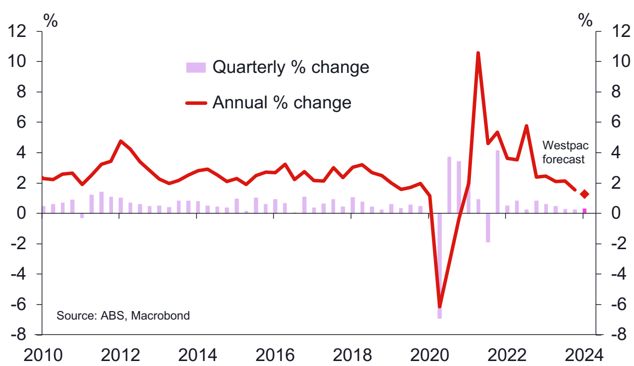
Australian & US interest rate outlook

	31 May	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.10
90 Day BBSW	4.35	4.37	4.17	3.30
3 Year Swap	4.18	4.20	4.00	3.50
3 Year Bond	4.05	4.00	4.80	3.30
10 Year Bond	4.41	4.35	4.25	4.00
10 Year Spread to US (bps)	-14	-15	-5	0
US				
Fed Funds	5.375	5.375	4.875	3.875
US 10 Year Bond	4.55	4.50	4.30	4.00

US PCE deflator



Australian GDP growth



Financial markets wrap

Interest rates.

NZ swap rates were volatile last week, initially rising and then falling with US interest rates (which in turn responded to mixed economic data). The 2yr swap rose to 5.21% and then reversed abruptly, currently at 5.04% following another data-led fall in US rates overnight.

We expect NZ rates to fall further this week, the 2yr targeting 4.90%. Global events will be influential, the ECB and Bank of Canada both expected to start their easing cycles, which should lend a dovish tone to interest rate markets. In the US, the highlight will be the monthly payrolls data. We'll also keep an eye on oil prices, which fell sharply on Friday (reflecting postponed OPEC cuts and soft demand) and could run further which would dampen inflation expectations and bond yields.

Market pricing for the first OCR cut is at a 90% chance in November. Westpac Economics continue to forecast no cut until February 2025.

Foreign exchange.

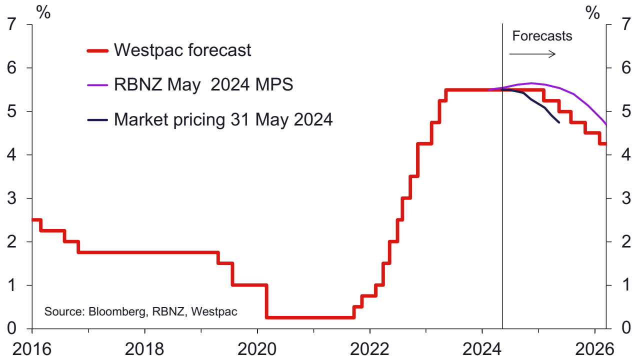
Following a period of consolidation during the second half of May, NZD/USD has extended the rally which started in mid-April at around 0.5850, reaching 0.6193 at the time of writing. We are targeting 0.6220 this week, with potential for a move even higher.

The main driver of the Kiwi's move higher has been the weakening US dollar, but the hawkish shift by the RBNZ at its May MPS has also been influential. NZ-US yield spreads appear to have bottomed at a multi-year low and should be supportive near term at least. That said, there's major event risk from US payrolls data on Friday.

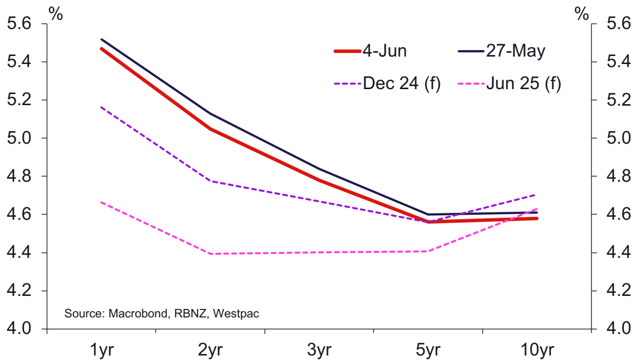
Looking further ahead to the September quarter, if our forecasts for the Fed and RBNZ (easing to start in September 2024 and February 2025, respectively) are eventually priced by markets, NZD/USD could reach 0.6300. A major risk to this outlook is the Fed delaying its easing cycle because inflation remains too high.

NZD/AUD has risen from 0.9067 in early May to 0.9274 at the time of writing and has potential to reach 0.9300 this week. Market pricing for the RBA and RBNZ seems overdone in opposing directions (RBA pricing too hawkish), and markets are wary of Australia's Q1 GDP data this week.

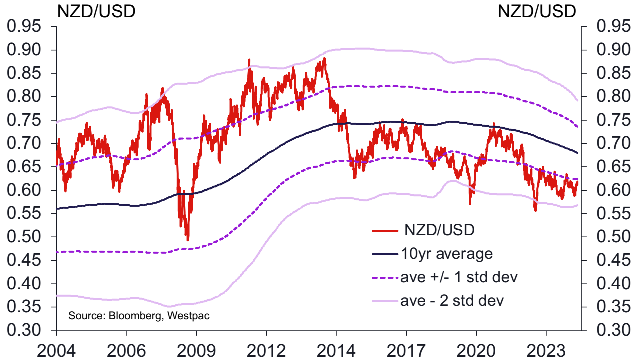
Official Cash Rate forecasts



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	0.619	0.586-0.619	0.555-0.743	0.648	0.61
AUD	0.926	0.907-0.937	0.873-0.992	0.932	0.91
EUR	0.568	0.552-0.568	0.517-0.637	0.583	0.55
GBP	0.483	0.471-0.483	0.464-0.544	0.506	0.48
JPY	96.5	90.2-96.5	61.3-96.5	79.1	93.9

The week ahead

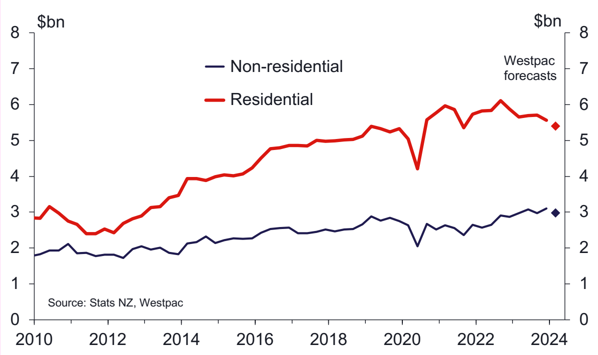
NZ Q1 building work put in place

June 6, Last: -0.1%, Westpac f/c: –3.3%

Construction activity was broadly steady in the December quarter, falling just 0.1%. However, underlying the resilience in total building activity, residential construction has been trending down. That offset firmer non-residential construction over the quarter.

We're forecasting a 3.3% fall in total construction activity in the March quarter. The downturn in residential building is deepening, with financial headwinds and the soft housing market putting the brakes on new development. In addition, softening economic activity and mounting uncertainty about the outlook is increasingly weighing on non-residential work.

NZ real building work put in place

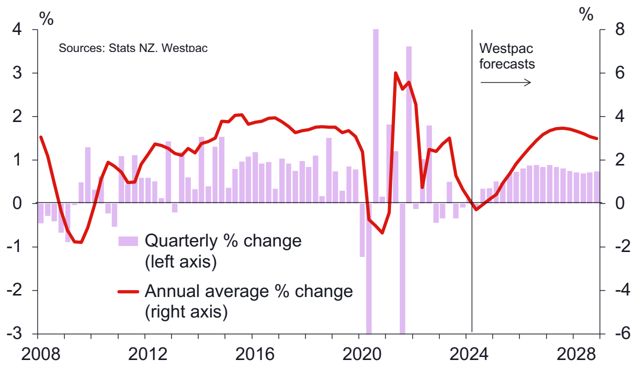


Economic and financial forecasts

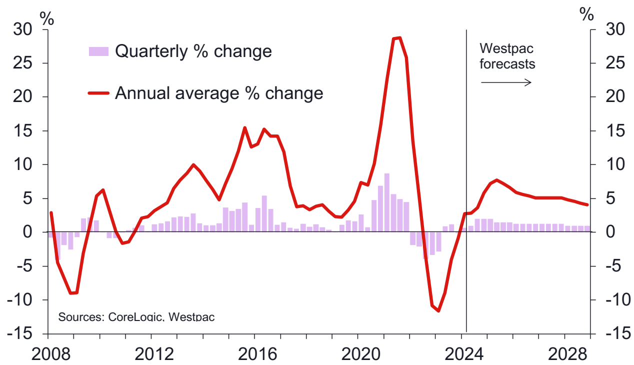
Economic indicators	Quarterly % change				Annual % change			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
GDP (production)	-0.1	0.1	-0.1	0.3	2.4	0.6	0.2	1.8
Consumer price index	0.5	0.6	0.8	1.1	7.2	4.7	2.9	2.2
Employment change	0.4	-0.2	0.2	0.1	1.7	2.7	0.1	0.9
Unemployment rate	4.0	4.3	4.6	4.9	3.4	4.0	5.2	5.4
Labour cost index (all sectors)	1.0	0.9	0.9	0.8	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-6.9	-6.2	-5.7	-5.1	-8.8	-6.9	-4.4	-4.1
Terms of trade	-7.8	4.6	1.9	1.3	-4.2	-10.6	8.1	0.8
House price index	-0.1	0.7	1.0	2.0	-10.8	-0.9	5.8	6.7

Financial forecasts	End of quarter				End of year			
	Dec-23	Mar-24	Jun-24	Sep-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.65	5.66	5.60	5.60	4.27	5.65	5.50	4.50
2 year swap	5.28	4.91	5.10	5.00	5.10	5.28	4.80	4.15
5 year swap	4.85	4.40	4.75	4.65	4.67	4.85	4.55	4.30
10 year bond	5.09	4.69	5.00	4.90	4.31	5.09	4.80	4.50
TWI	70.8	71.6	70.3	70.4	70.8	70.8	70.8	72.0
NZD/USD	0.60	0.61	0.60	0.60	0.60	0.60	0.61	0.65
NZD/AUD	0.93	0.93	0.91	0.91	0.92	0.93	0.91	0.91
NZD/EUR	0.56	0.56	0.55	0.55	0.59	0.56	0.55	0.57
NZD/GBP	0.49	0.48	0.47	0.47	0.51	0.49	0.48	0.49

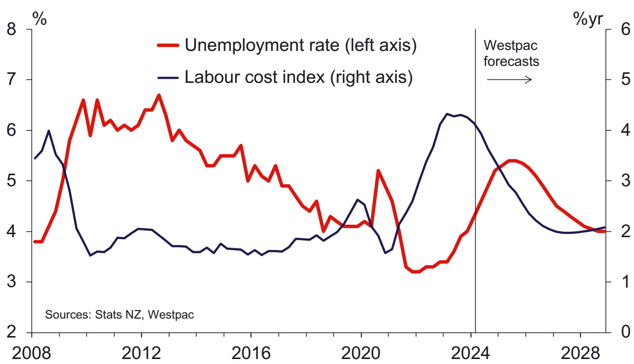
GDP growth



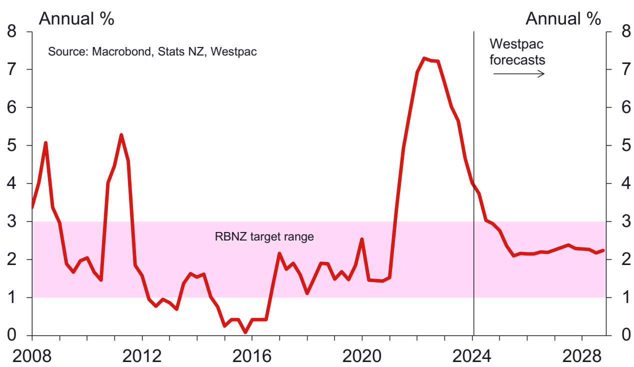
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 03					
NZ	King's Birthday	–	–	–	Public holiday; markets closed.
Aus	May CoreLogic Home Prices %mth	0.6%	–	0.8%	Daily firmer in May but may be partly seasonal.
	May MI Inflation Gauge %yr	3.7%	–	–	Provides a general view on risks.
	May ANZ–Indeed Job Ads %mth	2.8%	–	–	Generally tracking flat so far in 2024.
Chn	May Caixin Manufacturing PMI	51.4	51.6	–	High-tech strong, but the rest face uncertain outlook.
US	May ISM Manufacturing	49.2	49.7	–	Employment series pointing to job losses.
	Apr Construction Spending %mth	–0.2%	0.2%	–	High financing costs a significant concern.
Global	May S&P Global Manufacturing PMI	–	–	–	Final estimate.
Tue 04					
Aus	Q1 Private Non-Farm Inventories %qtr	–1.7%	0.8%	1.0%	Expected to contribute 0.9ppts to activity.
	Q1 Company Profits %qtr	7.4%	–1.0%	–1.0%	Mining sector set to weigh on profits in the quarter.
	Q1 Current Account Balance $bn	11.8	5.9	4.1	Flat commodity prices, rising imports to drive narrowing.
	Q1 Net Exports (ppt cont'n)	+0.6	–0.7	–0.3	Swinging from a positive contribution to a drag on growth.
US	Apr JOLTS Job Openings	8488k	8300k	–	Businesses are slowing, but not halting, hiring.
	Apr Factory Orders %mth	1.6%	0.7%	–	Durable goods orders suggest robust headline print.
Wed 05					
NZ	GlobalDairyTrade Auction	3.3%	–	–	GDT Pulse suggests prices holding around current levels.
	Q1 Terms of Trade %qtr	–7.8%	–	4.6%	A rebound expected after a surprisingly steep fall in Q4.
Aus	Q1 GDP %qtr	0.2%	0.2%	0.3%	Weak consumption sees domestic demand stall.
Chn	May Caixin Services PMI	52.5	52.6	–	Consumers seeing silver linings as stimulus feeds through.
Eur	Apr PPI %yr	–7.5%	–5.3%	–	Shipping costs add risk to producer prices.
US	May ISM Non-Manufacturing PMI	49.4	51.0	–	Service sector experiencing mixed conditions.
Can	Bank of Canada Policy Decision	5.00%	4.75%	4.75%	Risks to growth to prompt a cautious cut.
Global	May S&P Global Services PMI	–	–	–	Final estimate.
Thu 06					
NZ	Q1 Building Work %qtr	–0.1%	–	–3.3%	Residential and commercial activity dropping back.
	May ANZ Commodity Prices %mth	0.5%	–	1.0%	World dairy prices picked up further in April.
Aus	Apr Housing Finance %mth	3.1%	1.5%	3.0%	Should see a similar gain to March's - established market...
	Apr Owner Occupier Finance %mth	2.8%	–	3.0%	... still seeing prices tick higher with volumes a bit better...
	Apr Investor Finance %mth	3.8%	–	3.0%	... new homes sales also point to uptick for construction loans.
	Apr Goods Trade Balance $bn	5.0	5.5	6.2	Exports to remain soft; imports may retrace recent gains.
Eur	Apr Retail Sales %mth	0.8%	–	–	Weak demand as tight policy dissuades consumers.
	ECB Policy Decision (Deposit Rate)	4.00%	3.75%	3.75%	Rate cut expected as inflation nears 2%.
US	Apr Trade Balance US$bn	–69.4	–69.8	–69.0	Asian demand supporting exports.
	Initial jobless claims	219k	–	–	To remain low, for now.
Fri 07					
Aus	RBA Deputy Governor	–	–	–	Hauser fireside chat at "Australia's Economic Outlook".
Jpn	Apr Household Spending %yr	–1.2%	0.6%	–	Up-tick expected as higher wages feed through.
Chn	May Trade Balance US$bn	72.4	70.0	–	Asian partners supporting the surplus.
	May Foreign Reserves US$bn	3201	–	–	Remains robust.
Eur	Q1 GDP %qtr	0.3%	0.3%	–	Final estimate.
US	May Non-Farm Payrolls	175k	180k	165k	Further deceleration in train, bringing demand and...
	May Unemployment Rate %	3.9%	3.9%	3.9%	... supply into balance. Downside risk remain prompting...
	May Average Hourly Earnings %mth	0.2%	0.3%	0.3%	... a slowdown in wage growth.
	Apr Consumer Credit %mth	6.274	10.2	–	Slowing momentum argues for modest gains hence.

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