ECONOMIC BULLETIN

Hawks, doves, and kiwis.

7 Feb 2025 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz
Kelly Eckhold, Chief Economist | +64 21 786 758 | kelly.eckhold@westpac.co.nz | X: @kellyenz

Overview.

The entire flock has had a joyous few weeks on the beach over the Christmas break, but all good things come to an end. Since the last Hawks and Doves note back in September much has changed.

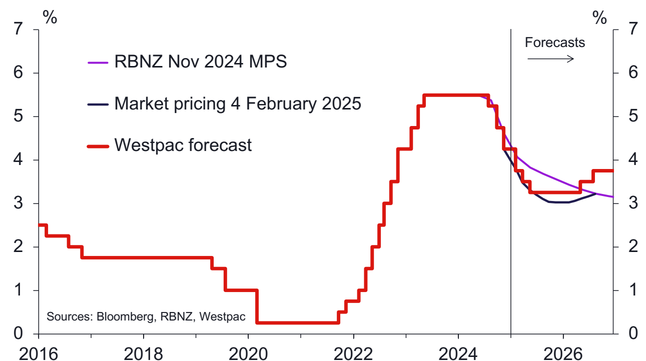
The RBNZ delivered the expected 50bp cut and provided a forward projection in line with what we expected. But the RBNZ was unexpectedly definitive on how quickly they would move towards the neutral zone in the upcoming February Monetary Policy Statement. This means the hawks and doves alike seem sure that it will take a lot to move the RBNZ away from that 50 bp cut signalled but there is more divergence on what happens after that.

In December and January, we got both rough and smooth data that gave both sides something to hold onto. The very weak GDP data seemed to point firmly in the direction of the Dove's view that interest rates might have a way to fall yet – and those cuts need to occur with urgency if we are to get out of the hole. On the other hand, there are a range of indicators suggesting the turn is here.

In addition, the exchange rate has taken a big leg lower and could well go much lower yet – especially as US interest rates seem on hold for now. Hence the Hawk remains concerned that inflation might not fall much further and a surge in growth might see cost-of-living pressures reignite.

So, with that in mind, we traverse some arguments we think both sides of the debate might make when determining the outlook for the OCR over 2025.

Official Cash Rate forecasts



The Hawk's Eye View.

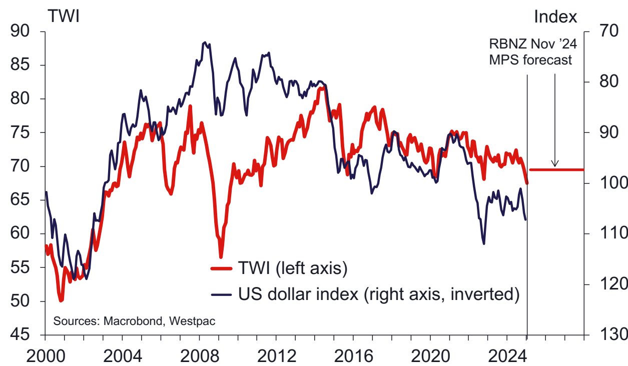
Tradables inflation won't be the big disinflationary impulse that it was over the past couple of years, leaving the CPI in the top half of the 1-3 percent target range.

- Tradables inflation has fallen from around 9% in 2022 to -1% in the year to December.
- The post-pandemic adjustment in import prices has largely played out, with the earlier falls in tradables prices coming to a halt in the December quarter.
- More recently, increases in global goods prices have been seen in major economies and commodity prices for food have been rising (especially for dairy and meat).
- Forecasts indicate that the overall CPI is likely to remain in the top half of the RBNZ's 1-3% range. The December quarter CPI saw the first upside surprise for the RBNZ in 4 quarters.
- There is little room for manoeuvre if an inflation shock hits.

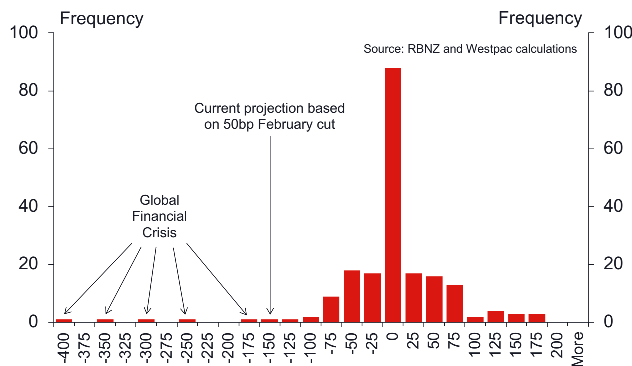
The exchange rate has been weak of late and looks set to remain that way or even weaken further, complicating inflation control.

- The NZ dollar has fallen sharply in recent months and is down over 11% versus the USD and 6% on a TWI basis since early October when it became clear that Trump would win the White House.
- The resulting stronger US dollar and higher global interest rates seems likely to continue to pressure the NZ dollar now NZ interest rates lie below those of the US and Australia.
- A weaker NZD would frustrate further weakness in traded goods prices and could increase prices in some categories – for example fuel.
- Significant further easing beyond that contemplated by markets could trigger further depreciation, frustrating the MPC's inflation goals.

TWI and US dollar index



Distribution of total change in the OCR over four meetings



Global macro policy uncertainty is significant and could trigger strong inflation pressures.

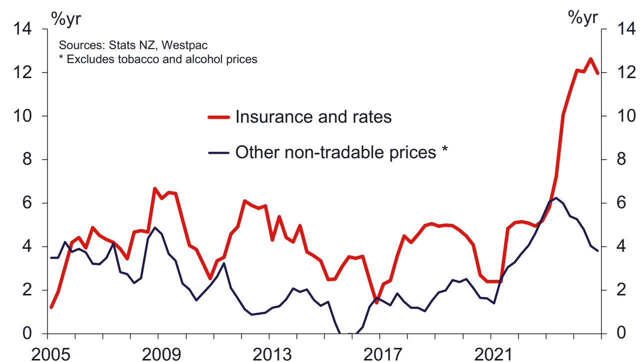
- Global macro policy is in a state of flux making the economic outlook very uncertain. The implications for global interest and exchange rates, the global economic outlook and commodity prices are unclear. Things could evolve in either direction.
- This uncertainty, the complexity of potential outcomes, and the fact that a lot of easing has already occurred, implies the RBNZ should move cautiously.
- Future shocks in the geopolitical space may more appropriately be buffered by the exchange rate than interest rates.

Continued rapid cuts after February are risky given signs of a recovery in the economy and the proximity of the OCR to the neutral zone.

- The full impact of interest rates cuts to date has not been felt. Over the coming six months many mortgages will reprice, reducing interest costs and boosting demand.
- Consumer spending has picked up and the housing market has stabilised with some forward indicators looking strong. The labour market has found a further footing which should eventually bolster consumer sentiment.
- The OCR at 3.75% will be close to the RBNZ's stated 2.5-3.5% range, meaning further cuts from here are more likely to be entering the stimulatory zone than has been the case in the easing cycle till now.

The Dove's Tale.

Domestic inflation components



With headline inflation already close to the target midpoint and the economy operating below trend, the OCR should be moved to the midpoint of the RBNZ's neutral range without delay.

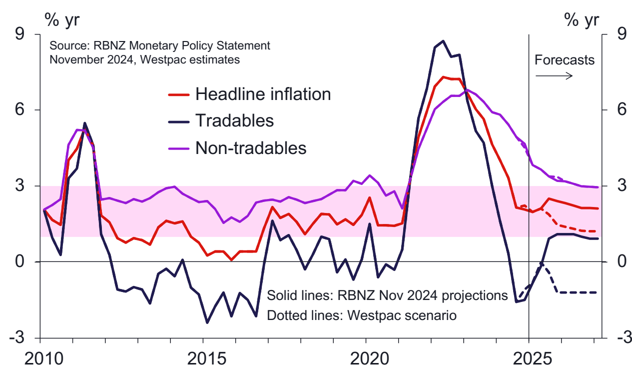
- Headline inflation of 2.2%y/y is already consistent with the inflation target and non-tradables inflation is likely to continue to fall as the negative output gap pushes down on domestically generated inflation with a lag.
- Yet even a 50bp cut would leave the OCR above the upper end of the RBNZ's estimate for the neutral OCR (2.5-3.5%) and some way above the 3% neutral rate estimate.
- There's no strong case to keep the OCR above the 3% neutral rate, especially with fiscal policy settings forecast to tighten in coming years. Hence a larger than 50bp cut could be contemplated in February and another large cut in the April meeting implemented to bring the OCR expeditiously to 3%.

- This would best position policy to respond should outright stimulatory conditions be required for a time to close the output gap more quickly if required.

While tariffs are likely to be inflationary in the US, they could be negative for growth and deflationary in some countries, including in NZ.

- President Trump has suggested that broad-based tariffs are likely to be imposed, and NZ may not be exempted. Global growth would be undermined, and disinflation could occur outside the US, especially in countries that do not retaliate against tariffs.
- Some categories of manufactured goods might reduce in price pushing the CPI down into the lower half of the 1-2% target range.
- A prompt reduction in the OCR to a neutral setting, and then ultimately a stimulatory OCR – and a lower exchange rate – may be required to support the economy if significant tariffs do eventuate.
- Rapidly reducing the OCR would provide cheap insurance against these global uncertainties.

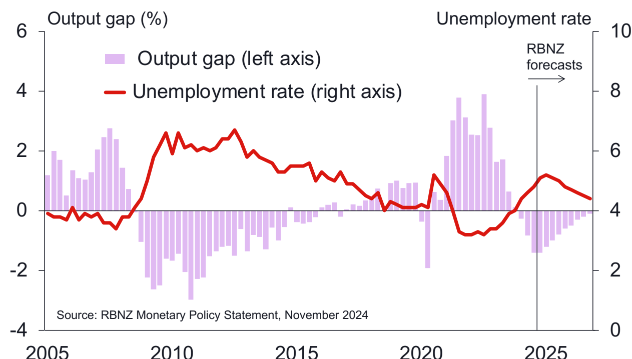
Inflation - Lower tradables scenario



GDP growth in mid-2024 was epically weak and means the output gap is much more negative than thought. The economy won't sustainably pick up without much lower interest rates.

- It's clear that the high interest rates in 2023/24 broke the back of the economy.
- Consumers and businesses have been relieved by the rate cuts to date but need much more to invest and consume.
- Consumer and business surveys show that current conditions are weak. It is the expectations elements of those surveys that project strength – but these expectations will be disappointed without much lower interest rates.
- The current yield curve is consistent with only a bit more easing from here whereas consumers are expecting mortgage rates over 100 points lower than current levels. Businesses similarly seem reluctant to commit to borrowing at wholesale rates close to 3% as they suspect something more is coming.
- The MPC needs to deliver on these expectations, or the economy won't sustainably pick up.

RBNZ output gap and unemployment forecasts (Nov 24 MPS)



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

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

DISCLAIMER

Things you should know.

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer.

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures.

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment recommendations disclosure.

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

Westpac Banking Corporation.