ECONOMIC BULLETIN

Outlook for 2025 and week ahead calendar.

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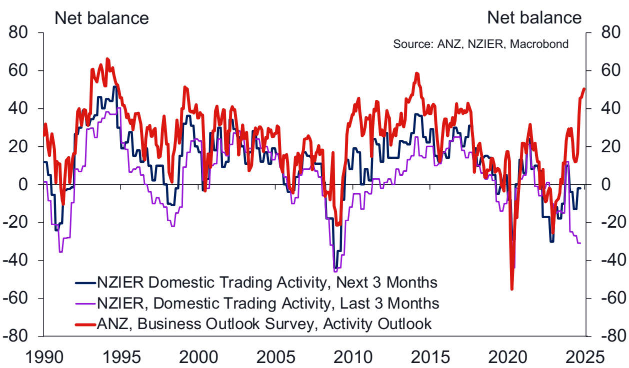
2025 is here… ready or not!

Happy New Year to all our readers! We hope you all had a break and some good times with friends and family.

Thus far in 2025 it has been very calm on the economic front as New Zealand has taken its annual beach break. Things will warm up this week as the normal data flow resumes. The NZIER Quarterly Survey of Business Opinion (due Tuesday 14 January) should be a highlight as it will give us clues on whether the economy has returned to low growth after a rough couple of quarters in mid-2024.

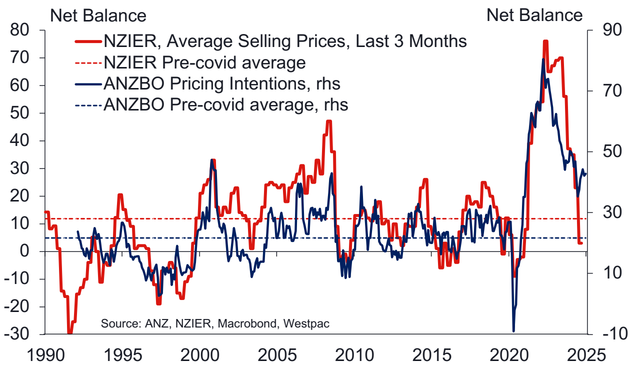
The last QSBO report (released in October) painted a particularly downbeat picture of economic activity. We will be hoping for some catch up of the domestic trading activity indicators in line with the much more positive signals seen in measures such as the ANZBO business confidence survey in recent months – although it's doubtful the bounce will fully reflect those overly optimistic indicators.

NZIER versus ANZ Business confidence indicators



It will also be important to see where the inflation indicators land. The Q3 QSBO was notable in giving a much more placid view of inflation pressures compared to the ANZBO pricing intentions indicators. The latter still look consistent with inflation pressures holding up. If we see a more subdued and placid read on these indicators in the Q4 data, then the dovish members of the RBNZ's MPC will feel even more confident that the move in the OCR to neutral levels needs to continue at pace.

NZIER versus ANZBO pricing indicators



We'll also get some other important data this week on building consents, the labour market, selected price indices and perhaps REINZ house prices. It's fair to say it will be the QSBO that will be the most influential domestic data points this week.

2025 promises to be a tumultuous year. As we go into it, we see markets primed to reflect the consequences of the RBNZ continuing along its unusually explicit path of frontloading policy easing. The RBNZ's strongly-signalled 50bps OCR cut in February seems likely to be delivered, especially given that astonishingly weak GDP data for Q2 and Q3 2024. While those data may have overstated the weakness in the economy in the middle of 2024, it is fuel for the argument of MPC doves who will ask why the OCR remains in restrictive territory (by the RBNZ's reckoning), even after a 50bps February cut to 3.75%.

The New Zealand dollar is taking on more of the weight of policy easing given US and Australian policy rates still look sticky and higher than the NZ OCR. The TWI is around 3% lower than the level assumed by the RBNZ back in November and will be increasingly creeping into discussions around inflation risks given so much of the progress we made in 2024 on headline inflation came from very weak import prices.

However, beyond February, uncertainty on the path for interest rates and the exchange rate grows. Hence the distribution of outcomes will start to widen markedly and may look better balanced than the string of historically large cuts we have seen since August 2024.

We see six key issues as being important in determining the RBNZ's course in 2025.

Issue #1 – the economic response to the significant easing which has occurred.

The RBNZ has delivered a historic amount of easing over the past six months (at least outside of the Global Financial Crisis period). A critical question now is how quickly the economy will respond as this will determine what happens over the rest of 2025.

Leading indicators suggest that New Zealand's economy is set to recover. Business confidence has already rebounded sharply, and consumer confidence has moved up off its lows. In addition, some more forward-looking housing market indicators are at a three-year high. These positive signs point to a potential upswing in economic activity as the effects of the RBNZ's easing measures begin to take hold. Or do they?

Residual concerns remain about whether an OCR that troughs around 3.25% will prove to be sufficiently expansionary to encourage a durable pick up in spending. Will the level of interest rates or the change in rates since mid-2024 have the more significant impact on economic behaviour? Data on the housing market, employment trends and retail spending released in the first half of 2025 will be crucial in setting the tone for the RBNZ's policy trajectory. The NZD will likely take its cue from that trajectory. We expect underperformance of the NZD given the shocking state of the current account, low/negative interest rate differentials and also the structurally weak fiscal position which the pre-Christmas HYEFU showed will be slow to correct.

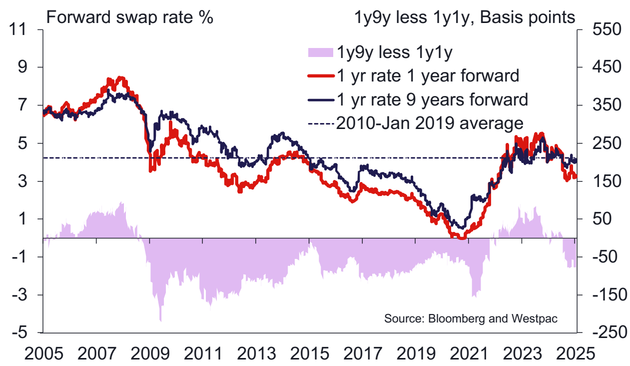
Issue #2 – Will the RBNZ over-ease?

Despite the substantial easing already undertaken, the RBNZ intends to front-load the easing intended in 2025. The Governor has indicated a wide but also low range for its estimate of the neutral OCR. The lower end of the indicated range at 2.5% is notable given the global context of relatively higher interest rates. If the RBNZ moves the OCR quickly to the middle or lower end of that range, and it turns out that the neutral rate lies at the top end of the range, then the RBNZ may over-ease in 2025.

Should the RBNZ ease too aggressively, this could prepare the ground for a tightening cycle in 2026. If overshooting is significant then an earlier and more pronounced tightening phase in 2026 could result.

The yield curve is showing some signs that these overshoot risks are more prominent than they have been for a while. Long term interest rates have not fallen with the OCR since August. Hence the yield curve has flipped around from recession consistent inversion to growth consistent "normality". An interesting indicator of the neutral short-term interest rate suggested by Isabel Schnabel at the ECB – the 1-year swap rate 9 years forward - looks consistent with a neutral OCR closer to 4% than 3%. This all looks consistent with our view that a more realistic view for the neutral OCR is more like 3.75% as opposed to 3% (or lower) and as such cuts after February will likely be stoking the economy and setting up the next cycle. Watch this space!

The yield curve implies policy is now relatively stimulatory



Issue #3 – The global economic backdrop.

The global economic environment and geopolitical risks have been issues highlighted by the RBNZ as critical factors. In 2024, global growth has been generally subdued. But now many central banks have eased monetary policy significantly as inflation pressures have receded. This could bode well for global growth in 2025, barring any adverse shocks or underestimation of the lagged effects of previous policy tightening.

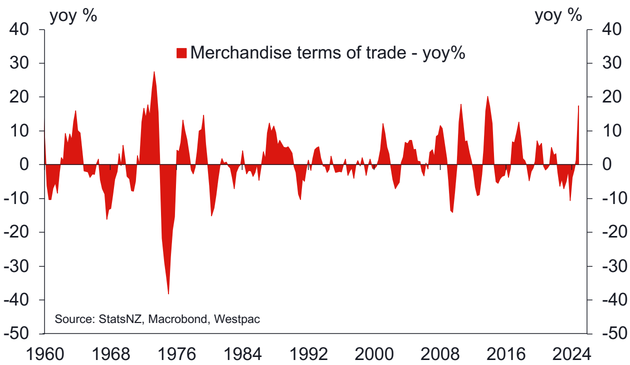
The policy agenda of US President Donald Trump, particularly in terms of fiscal stimulus and trade restrictions, adds another layer of uncertainty. While increased fiscal stimulus could support growth in the US, trade restrictions and tariffs could create a more challenging inernational trade environment. The balance between these opposing forces will be crucial in determining the overall impact on New Zealand's export prospects and economic performance. The NZD is likely to be especially driven by what the new trade environment entails.

Issue #4 – The durability of the recovery in the terms of trade.

One of the surprises of 2024 was the strength in New Zealand's terms of trade, despite sluggish Chinese growth. Both demand and supply factors have supported export prices, while lower global inflation has helped keep import prices in check. This improvement in the terms of trade will boost national income by approximately 1% of GDP during the current dairy season, assisting the economic recovery and helping to push growth back towards trend.

The key question is whether this recovery will extend in both magnitude and duration. A single good year can bring the economy back to trend, but two consecutive strong years could set the stage for the next up cycle (we expect that some of the current year's boost to dairy incomes will be used to retire debt, rather than be recycled back into the economy). However, this optimism could be tempered if China's economic weakness persists or if global growth remains subdued. Having said that, the news from the Chinese authorities looks more positive than it has for a while as they have signalled more expansive monetary and fiscal measures to support their weak domestic demand.

Will NZ's Terms of Trade boom ... or bust?



Issue #5 – The labour market outlook.

With inflation now under control, the RBNZ may increasingly focus on ensuring that unemployment does not overshoot. While the RBNZ doesn't have an explicit employment mandate, it's required to mitigate unnecessary economic volatility. Current forecasts suggest that unemployment will peak between 5 and 5.5%. This is likely an acceptable outcome but watching labour market developments will be crucial to confirm whether these forecasts materialize. The data on job advertisements in early 2025 may give a good indication on the timing/likelihood of a turnaround in the unemployment rate and the policy stance.

Issue #6 – Will the Government pivot from fiscal austerity to a growth agenda?

With inflation well within the target range, the Government appears to be shifting its focus towards a growth agenda. Efforts at fiscal consolidation have managed to control spending growth this year, but the simultaneous granting of tax cuts means that there has been no improvement in the operating balance (especially with weak economic growth weighing on revenues). Treasury forecasts still assume austerity in spending that may prove unrealistic if the Government wants to encourage growth. Even if the Government is not the ultimate funder, it is keen to facilitate the deployment of private capital to help meet New Zealand's significant infrastructure needs. The HYEFU showed the fiscal envelope is very small given current fiscal targets. The extent to which the government chooses to push that envelope (and the reaction of the ratings agencies who have thus far been relatively quiet) could be critical.

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 13					
NZ	Nov Building Permits, %mth	–5.2	–	flat	Consent issuance has stabilised, but isn't rising yet.
	Nov Employment Indicator, %mth	–0.1	–	flat	Weekly snapshots point to a subdued jobs market.
Aus	Dec ANZ-Indeed Job Ads, %mth	–1.3	–	–	Pointing to easing tightness in labour market.
US	Dec Monthly Budget Statement, $bn	–366.8	–	–	Recent downside surprises due to higher medicare spending.
Tue 14					
NZ	Q4 NZIER Survey of Business Opinion, index	–4.8	–	–	Important gauge of activity and cost pressures.
Jpn	Nov Current Account Balance, ¥bn	2456.9	–	–	Trade deficit largely narrowing.
US	Dec NFIB Small Business Optimism, index	101.7	–	–	Election results take index to highest level since June 2021.
	Dec PPI, %mth	0.4	–	–	Services prices remain a key source of producer price pressure.
	Fedspeak	–	–	–	Schmid.
Wed 15					
NZ	Q4 Westpac-MM Employment Conf., index	81.2	–	–	Down in Q3 on weaker job opportunities.
Chn	Q4 GDP, %ann	0.046	–	–	China should reach its “around 5%” growth target for 2024 ...
	Dec Retail Sales, %yr ytd	3.5	–	–	... despite weakness in household demand.
	Dec Industrial Production, %yr ytd	5.8	–	–	Officials vowed to raise the fiscal deficit target as they put ...
	Dec Fixed Asset Investment, %yr ytd	3.3	–	–	... reviving consumption at the top of their 2025 policy agenda.
Eur	Nov Industrial Production, %mth	–1.2	–	–	Has recorded only one lift in 2024.
UK	Dec CPI, %ann	2.6	–	–	Goods prices lift; inflation likely to stay above 2% in 2025.
US	Dec CPI, %mth	0.3	–	–	Disinflation continuing, but pace at risk of slowing in 2025.
	Jan Fed Empire State, index	0.2	–	–	Broadly consistent with reads from ISM Manufacturing survey.
	Fedspeak	–	–	–	Barkin, Kashkari, Williams and Goolsbee.
Thu 16					
NZ	Dec Food Price Index, %mth	–0.1	–	0.1	Seasonal fall in beverages, limit gains in other prices.
	Dec Housing Rents (Stock), %mth	0.2	–	0.3	Signs that the pressures on rents have eased.
Aus	Dec Employment Change, 000s	35.6	–	25	Employment solid but off Q3's robust pace; some scope for ...
	Dec Unemployment Rate, %	3.9	–	4	... a bounce-back in participation, risking an uptick in U/E.
Eur	Nov Trade Balance, €bn	6.1	–	–	Trade surplus down from a peak of €28.1b in January 2024.
UK	Nov Monthly GDP, %mth	–0.1	–	–	Q4 off to a shaky start.
US	Dec Retail Sales, %mth	0.7	–	–	Holiday season spending's missing piece.
	Dec Import Price Index, %mth	0.1	–	–	October and November prints have been firmer than expected.
	Jan Philly Fed, index	–	–	–	Quite volatile in recent months.
	Initial Jobless Claims	–	–	–	Should start to normalise.
	Nov Business Inventories, %mth	0.1	–	–	Inventories have increased since March 2024.
	Jan NAHB Housing Market, index	46	–	–	Expectations for removal of regulatory hurdles lift confidence.
Fri 17					
NZ	Dec Manufacturing PMI, index	45.5	–	–	Current conditions remain soft.
Eur	Dec CPI, %ann	2.3	–	–	Final estimate.
UK	Dec Retail Sales, %mth	–	–	–	Completes the festive season spend.
US	Dec Housing Starts, %mth	–1.8	–	–	Has declined for three consecutive months ...
	Dec Building Permits, %mth	6.1	–	–	... but permits bounced back following weather disruptions.
	Dec Industrial Production, %mth	–0.1	–	–	Weighed down by weakness in manufacturing sector.

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