WEEKLY ECONOMIC COMMENTARY

17 Feb 2025 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Mind that left tail!

Last week we launched our **first Economic Overview of the year** with the theme *"Turning the corner"*, reflecting our more optimistic view for growth for 2025 and beyond relative to 2024. But there are significant risks on either side of our core view that interest rates and the New Zealand dollar have a bit further to fall depending on how things turn out. I think it's worth putting special focus on outcomes at the lower end of the distribution, beginning with the outcome of the RBNZ's interest rate decision this week.

After a rough 2024 where growth went significantly backwards, we now see the economy at a turning point from negative to positive growth. There are plenty of mixed indicators, as one would expect at a turning point. But there are at least two key drivers that should mean growth returns to trend by the end of 2025.

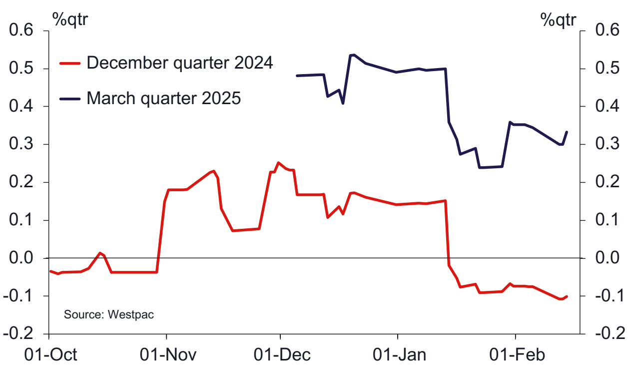
The first key factor is the impact that the significant interest rate cuts the RBNZ is delivering has on consumers, the housing market and businesses. Mortgage rates are down significantly from a year ago and will deliver significant cash flow benefits for mortgaged households in short order. Borrowers are likely to increasingly migrate to longer-term fixed rates, which are especially low, in coming months. House prices should benefit from these tailwinds (we see house prices rising by around 7% this year) as should discretionary spending. As consumer confidence and spending improves, businesses will become increasingly confident that their expectations of stronger future activity are being realised, thus supporting investment and hiring.

The second key factor is the boost that the primary sector is receiving from higher commodity export prices. The dairy sector is doing especially well, and we have upgraded our already record nominal **milk price forecast for the 2024/25 season** to $10.30/kg and introduced an opening forecast of $10/kg for the 2025/26 season. The merchandise terms of trade rose around 17%

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 GDP nowcasts



Key data and event outlook

Date	Event
18 Feb 25	RBA Monetary Policy Decision
19 Feb 25	RBNZ OCR Review & Monetary Policy Statement
6 Mar 25	Govt Financial Statements, 7 mths to January
14 Mar 25	NZ Selected price indexes, February
19 Mar 25	FOMC Meeting (Announced 20 Mar NZT)
20 Mar 25	NZ GDP, December quarter
1 Apr 25	RBA Monetary Policy Decision
8 Apr 25	NZIER QSBO Business Survey, March quarter
9 Apr 25	RBNZ OCR Review
15 Apr 25	NZ Selected price indexes, March
17 Apr 25	NZ CPI, March quarter

in 2024, and we see another 4% in 2025. Price gains have also occurred outside the dairy sector with horticulture, forestry and even the much-maligned meat sector receiving stronger returns in 2024.

These price gains come at a time of good climatic conditions and falling costs. These serendipitous conditions imply the regional economies will be receiving an income boost of perhaps 1-2% GDP compared to previous years. We suspect that while sentiment in the major urban areas will remain weak until the labour market turns, activity in the regions will lead.

We see annual inflation as remaining well anchored around 2% over the medium term. For 2025, the headline inflation rate seems likely to edge up to as high as 2.7%y/y as the impact of a weaker exchange rate and firmer soft commodity prices push up tradables inflation from the relatively low levels of 2024. But the still-weakening labour market and accumulated negative output gap should see domestically generated non-tradables inflation continue to fall. It's those domestic inflation dynamics that we assume (hopefully not too optimistically) will be more permanent and, in the end, be of more relevance to the RBNZ.

This relatively positive outlook implies that after this week's last larger-than-usual 50bp cut to 3.75%, the RBNZ should slow the pace of easing from here. We see an OCR at 3.75% as being broadly neutral, so further cuts after February will be dipping into (mildly) stimulatory territory. The RBNZ though doesn't agree and continues to emphasise 3% as the mid-point of a wide range for the neutral OCR. We suspect they will keep nudging the OCR toward 3% until substantive signs of a turnaround in the labour market emerge – which should be from mid-year all going well.

But before we get to the rosier future we need to confront where we are now. Last week's data saw a continuation of some rougher and smoother indicators. Consumer spending pulled back 1.6% in January, giving back some of that large increase we saw in December (though the longer-term trend remains positive). The manufacturing PMI registered a decent rebound to 51.4 in January, coming off a disappointing outcome in December. If mirrored in this week's generally more upbeat services PMI, that could portend an economy on track to return to trend growth. The ANZ Truckometer's Heavy Traffic Index also rose strongly in January. Friday's Selected Price Indices were somewhere in between these outcomes. Low rental inflation suggested muted domestic inflation pressures. Rising food prices seem to conform with our view for 2025 that inflation will be stable to rising overall, but with a change in composition from 2024's trend of weak tradables inflation and firm non-tradables inflation.

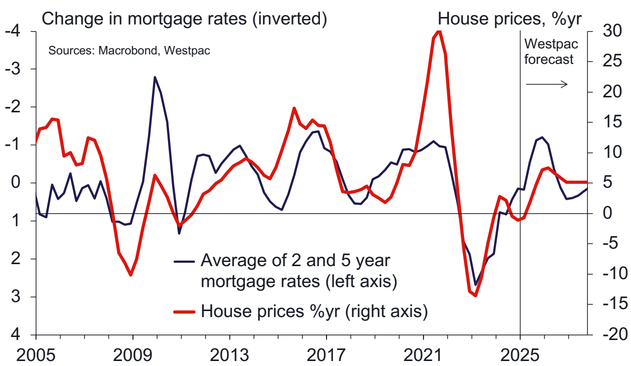
Risks are significant around the medium-term outlook. It's fair to say we have thus far taken a sanguine view of the extent to which global trade issues will impinge on global growth and inflation. And we don't currently expect New Zealand to be singled out for tariffs. But developments here could turn out to be less favourable. Fortunately, we think that the exchange rate will adjust lower, buffering the export sector, should downside risks become tangible. Hence the left tail of the likely range for the NZ dollar could be tested in the year ahead.

More immediately, it's worth considering the distribution of potential outcomes for the OCR. The RBNZ gave strong guidance back in November that it saw a 50bp cut in the OCR as more likely than not. This guidance has anchored market and analyst expectations and is a key reason why we and the market see a 50bp cut as by far the most likely outcome of the **RBNZ meeting this week**. However, the left side of the distribution for the OCR could be explored next week should the RBNZ believe the economy is "in a hole", as noted by the RBNZ's Chief Economist on 29 January. This would be especially so if the Monetary Policy Committee were to put a lot of weight on getting the OCR quickly to 3% – the midpoint of the RBNZ's range of estimates of the neutral rate. A larger than 50bp move this week seems unlikely but it's an outside chance that's worth considering and is certainly not priced.

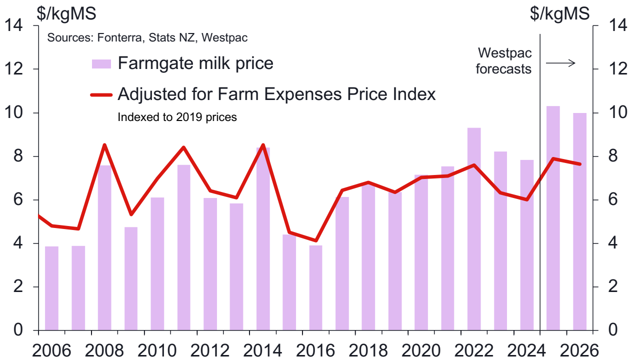
To be clear, I think this would be the wrong move as it's getting well past time to cut the pace of easing and see what impact the work to date is going to have on the outlook. Aggressive cuts from here are likely to be procyclical and set up the tightening cycle we already have pencilled in for the second half of 2026. And right now, the chances of a 1% CPI inflation rate look remote. Hence the case for stimulatory monetary conditions remains unclear.

In any case, let's mind those left tails!

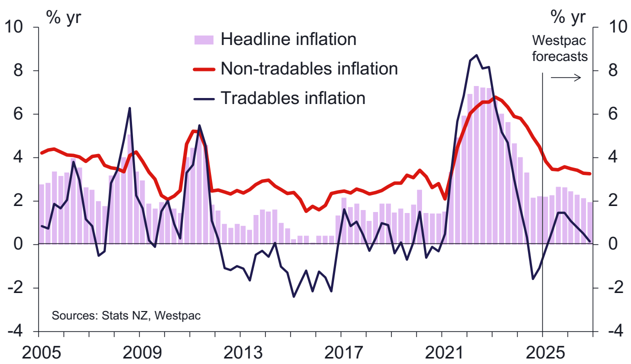
House price growth vs interest rates



Farmgate milk prices



Inflation components



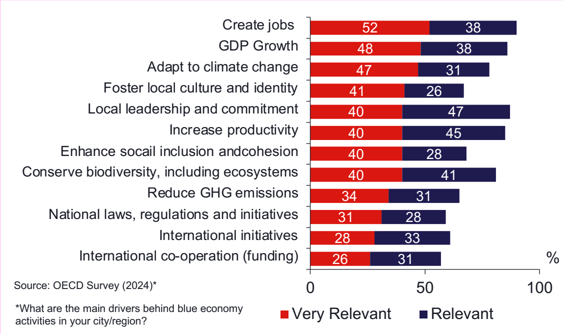
Kelly Eckhold, Chief Economist

Chart of the week.

The blue economy is big business with great potential for New Zealand. Our report out later this week, *"Why New Zealand needs to transition to a blue economy"*, suggests that it could make a meaningful contribution to the Government's overall goal of doubling exports over the next 10 years, generating as much as $14bn of goods and services exports by 2035. Getting there will require the regeneration of marine ecosystems, including a focus on areas like shipping, wild capture fishing, aquaculture, renewable energy and tourism.

Transitioning to a blue economy will be challenging. Among other things it requires an equitable partnership, between government, businesses, local communities, Māori and iwi – all of whom have a unique relationship with the ocean, and the potential to affect it. It will also require a large amount of investment as well as collaboration across several sectors.

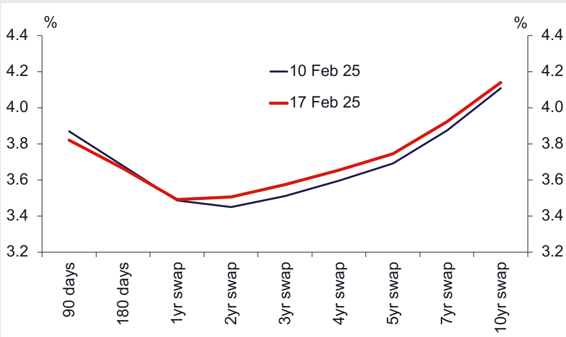
Impact of blue economy activities by relevance



Fixed versus floating for mortgages.

We're forecasting the cash rate to bottom at 3.25% in mid-2025 and see balanced risks around that forecast. Markets have factored in more easing than this into mortgage rates and suggest the OCR will bottom closer to 3%. Longer term mortgage rates have fallen – in some cases significantly – and now look attractive to fix for longer periods, particularly in the two- to three-year space. Shorter term mortgage rates are likely to fall in the near term once the RBNZ cuts 50bp this month but would still likely remain above current longer term fixed rates. Fixing shorter than a year is a bet that the OCR bottoms somewhat lower than 3%.

NZ interest rates



Global wrap

North America.

Inflation expectations have lifted in the US, in part stoked by concerns about the impact of tariffs. Last week's CPI report for January added to those inflation worries, with both headline and core inflation unexpectedly edging up 0.1ppts to 3.0%y/y and 3.3%y/y respectively. Inflation was also firm at the producer level in January, although the components that feed into calculating the Fed's preferred inflation gauge – the core PCE deflator – were more benign. Activity data was disappointing, with retail sales falling a surprise 0.9%m/m in January and manufacturing output also edging lower. This week's economic diary is relatively sparsely populated, suggesting that any market volatility is more likely to be driven by developments in US tariff policy. US markets are closed today for the Presidents' Day holiday. As far as data is concerned the focus is likely to be on the flash PMIs for February, several regional manufacturing surveys and a few housing market indicators. The minutes from the last FOMC meeting will be released on Wednesday and a large number of FOMC members will speak this week.

Europe.

European growth momentum was weaker in Q4 with both the euro area and UK economies expanding 0.1%q/q. ECB President Lagarde said that the disinflation process remained on track, but noted risks posed by global trade frictions. Looking at the week ahead, Friday's flash February PMI readings will be a key focus in the euro area and the UK. The UK will also print key labour market, inflation and retail sales reports this week. Germany will hold a federal election on Sunday, with recent polls pointing to the return of a CDU/CSU-led coalition.

Asia-Pacific.

Across the Tasman, consumer confidence held steady in February with an unsettled global backdrop countered by expectations that interest rate relief is close at hand. Firms reported weaker business conditions in the January NAB survey, with the latest reading also below the historical average. The focus this week will be tomorrow's RBA policy decision. Westpac expects the RBA to cut its policy rate by 25bps to 4.1%. Assuming that cut is delivered, interest will centre on any guidance regarding the likely timing and quantum of further policy easing. This week's Australian dataflow is centred on the labour market, with the Q4 Wage Price Index out on Wednesday and the January Labour Force report out on Thursday. In Japan, prospects for further gradual policy tightening over coming months will be informed by today's Q4 GDP report and Friday's January inflation data. There are no major data ahead in China this week.

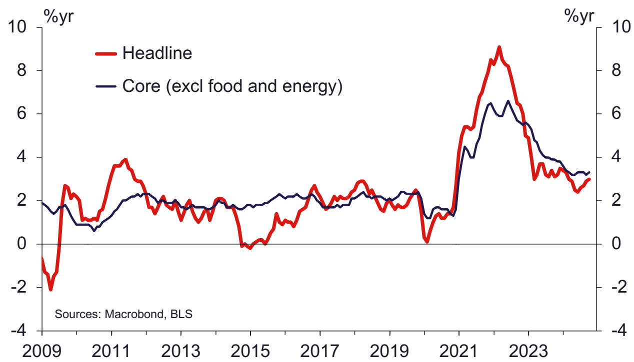
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.1	1.1	2.0	2.2
China	5.2	5.0	4.8	4.5
United States	2.5	2.8	2.6	2.0
Japan	1.9	-0.1	1.2	1.0
East Asia ex China	3.3	4.3	4.1	4.1
India	7.8	6.6	6.6	6.5
Euro Zone	0.4	0.7	0.9	1.0
United Kingdom	0.1	0.7	0.6	1.2
NZ trading partners	3.3	3.3	3.3	3.2
World	3.2	3.3	3.3	3.2

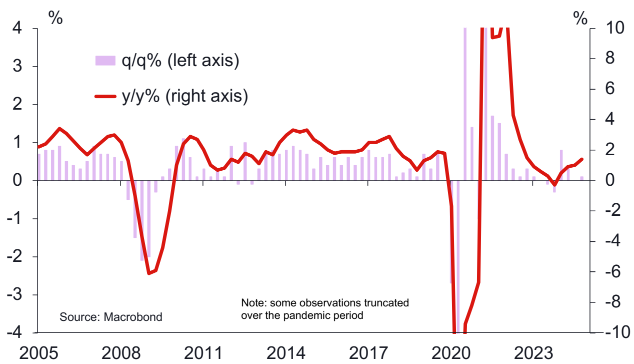
Australian & US interest rate outlook

	14 Feb	Mar-25	Dec-25	Dec-26
Australia				
Cash	4.35	4.10	3.35	3.35
90 Day BBSW	4.18	4.20	3.50	3.55
3 Year Swap	3.81	3.75	3.80	4.00
3 Year Bond	3.83	3.75	3.75	3.85
10 Year Bond	4.41	4.45	4.70	4.65
10 Year Spread to US (bps)	-12	-15	-25	-15
US				
Fed Funds	4.375	4.375	4.375	3.875
US 10 Year Bond	4.53	4.60	4.95	4.80

US CPI inflation



UK GDP growth



Financial markets wrap

Interest rates.

NZD/USD on Friday broke above its 2-month old range of 0.5540-0.5725, potentially signalling further upside during the next few weeks. If the break is sustained today, we'd be targeting around 0.5850. Multi-month we remain bearish, expecting 0.5500 to be tested, and so any near-term strength would be a hedging opportunity for importers. Possible catalysts for a near term rally in NZD/USD include positioning – speculative short positions in NZD/USD futures are extremely large and vulnerable to any NZD-positive or USD-negative news (such as the disappointing US retail sales data on Friday).

The RBNZ MPS this week poses two-way risks. The RBNZ will almost surely cut the OCR by 50bp, but changes to its OCR forecast and other guidance could be either less or more dovish than markets have priced in.

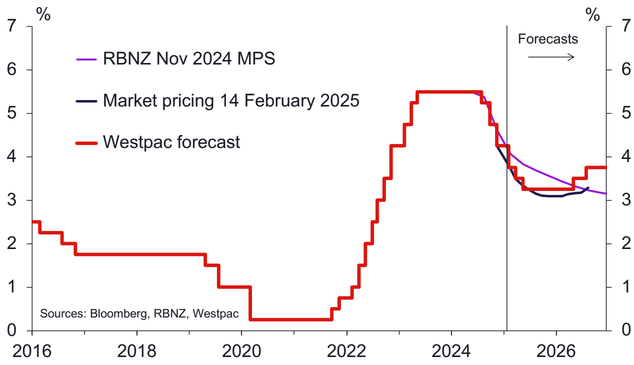
Multi-month, the US dollar is expected to remain the dominant driver of NZD/USD. We expect a resumption of the US dollar's uptrend, supported by the US economy, which in turn will delay any further Fed rate cuts. In addition, the outlook for US import tariffs should be clearer by April.

Interest rates.

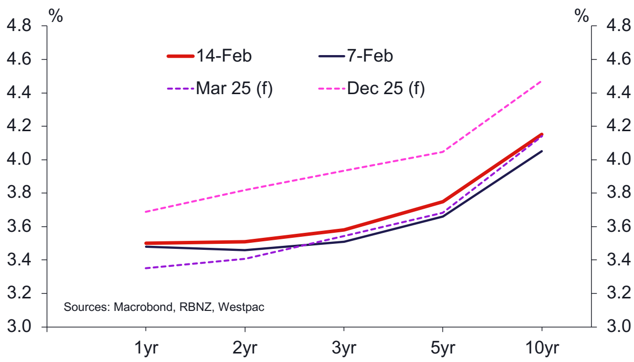
The NZ 2yr swap rate has been stuck in a range of 3.33%-3.65% over the past two months, and we expect that to hold during the week ahead, barring a surprise from the RBNZ's MPS. Multi-month, we see potential for higher rates given the large pipeline of mortgages due for refinancing over the next few months. There's little sign yet of a pickup in mortgage fixing, but the 19 February MPS could be a catalyst. Confirmation of the 50bp cut plus potentially lower advertised mortgage rates could incentivise fixing.

The OIS market has priced in a 100% chance of a 50bp cut this Wednesday and has 3.10% as the terminal rate by October 2025. That's not markedly different from Westpac's forecast of a 50bp cut to be followed by two 25bp cuts, taking the OCR to a terminal rate of 3.25% by May. It should be noted, though, that the RBNZ has a history of surprising markets. Most recently, at the November 2024 MPS, Governor Orr in his press conference explicitly signalled a 50bp cut was likely in February. The MPS this Wednesday will contain plenty of opportunities for a surprise, via the media release, detailed forecasts, narrative, or press conference.

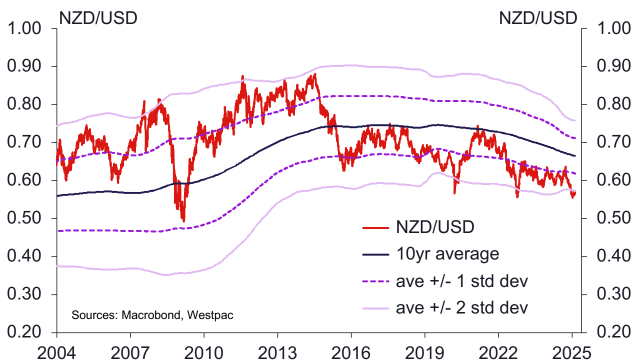
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-25
USD	0.573	0.554-0.591	0.554-0.743	0.640	0.54
AUD	0.901	0.895-0.912	0.873-0.992	0.926	0.87
EUR	0.546	0.539-0.560	0.517-0.637	0.578	0.53
GBP	0.456	0.447-0.466	0.447-0.535	0.499	0.44
JPY	87.2	85.5-91.6	61.3-98.6	82.0	82.1

The week ahead

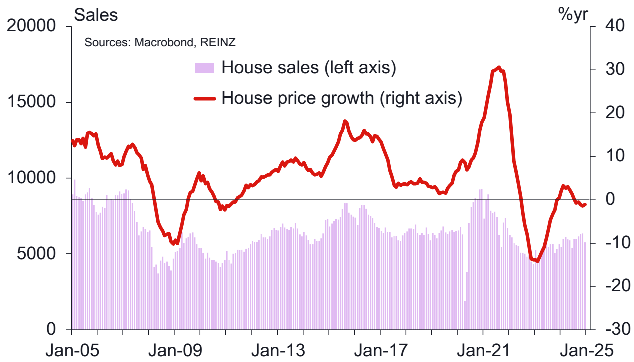
Jan REINZ House Prices and Sales

Feb 17 (TBC), Prices Last: –1.1%yr; Sales Last: +1.8%yr

As mortgage rates have fallen, we've seen clear signs of a revival in interest among potential buyers, with home loan applications well up on a year ago. However, that has yet to translate into a lift in activity. December sales in particular were unusually low, partly affected by a drop-off in new listings which have since picked up strongly in January.

House prices have risen slightly over the last few months, having fallen through the first half of last year. We expect prices to gain some momentum in the months ahead, with a 7% rise over 2025.

REINZ house prices and sales

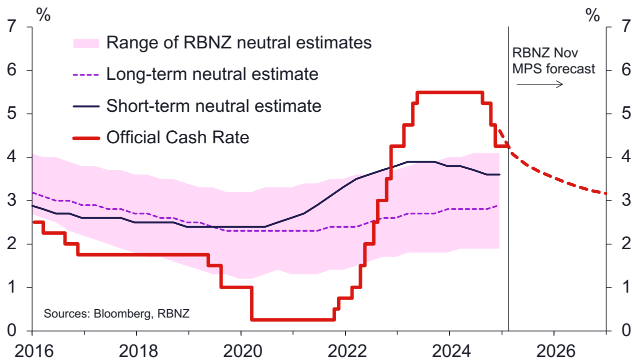


RBNZ Monetary Policy Statement

Feb 19, Last: 4.25%, Westpac forecast: 3.75%, Market: 3.75%

We expect the RBNZ will cut the OCR by 50bps to 3.75% at its February policy meeting. The accompanying policy statement is likely to signal further easing is likely over 2025, but at a more gradual pace. We see the RBNZ projecting an end-2025 OCR of around 3.25% and an unchanged terminal rate of about 3%. While the RBNZ's medium term inflation projections are likely to remain close to 2%, their near-term CPI forecasts will likely be revised slightly higher due to the weaker TWI and higher commodity prices. The RBNZ will likely note significant risks associated with global trade policies, although few conclusions will be drawn given the significant uncertainties.

Official Cash Rate and RBNZ estimates of neutral

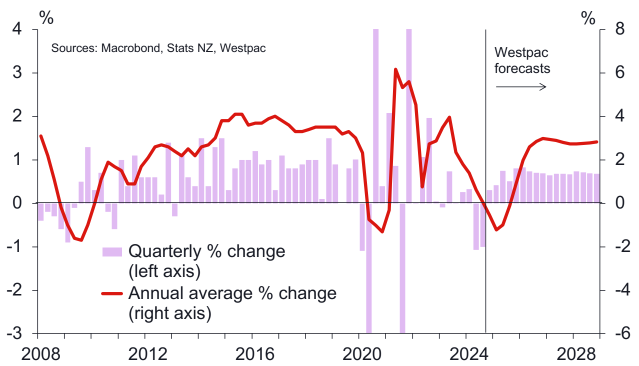


Economic and financial forecasts

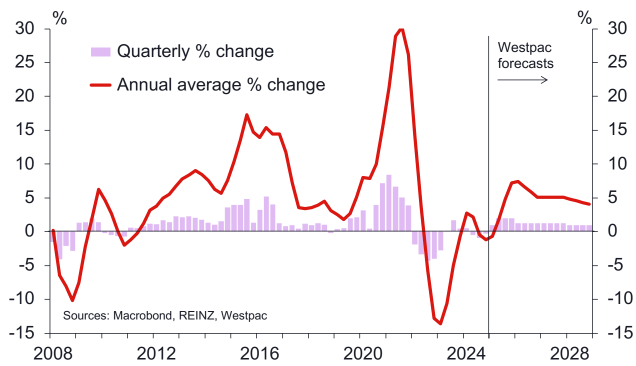
Economic indicators	Quarterly % change				Annual % change			
	Sep-24	Dec-24	Mar-25	Jun-25	2023	2024	2025	2026
GDP (production)	-1.0	0.3	0.4	0.8	1.8	-0.5	0.9	3.0
Consumer price index	0.6	0.5	0.6	0.5	4.7	2.2	2.6	2.0
Employment change	-0.6	-0.1	-0.1	0.0	2.8	-1.1	0.4	1.9
Unemployment rate	4.8	5.1	5.3	5.4	4.0	5.1	5.3	4.6
Labour cost index (all sectors)	0.6	0.6	0.6	0.5	4.3	3.3	2.2	1.8
Current account balance (% of GDP)	-6.4	-5.9	-5.0	-4.1	-6.9	-5.9	-3.5	-4.3
Terms of trade	2.5	6.5	5.9	0.7	-10.7	17.2	4.2	2.1
House price index	-0.9	-0.2	1.0	2.0	-0.6	-1.2	7.2	5.1

Financial forecasts	End of quarter				End of year			
	Sep-24	Dec-24	Mar-25	Jun-25	2023	2024	2025	2026
OCR	5.25	4.25	3.75	3.25	5.50	4.25	3.25	3.75
90 day bank bill	5.31	4.45	3.55	3.35	5.65	4.45	3.35	3.85
2 year swap	4.06	3.64	3.40	3.50	5.28	3.64	3.80	4.00
5 year swap	3.81	3.73	3.70	3.80	4.85	3.73	4.05	4.25
10 year bond	4.31	4.51	4.60	4.70	5.09	4.51	4.90	4.95
TWI	70.9	69.5	65.7	65.5	70.8	69.5	64.5	67.4
NZD/USD	0.61	0.59	0.54	0.54	0.60	0.59	0.54	0.59
NZD/AUD	0.91	0.91	0.90	0.90	0.93	0.91	0.87	0.87
NZD/EUR	0.56	0.55	0.54	0.54	0.56	0.55	0.53	0.56
NZD/GBP	0.47	0.46	0.44	0.44	0.49	0.46	0.44	0.46

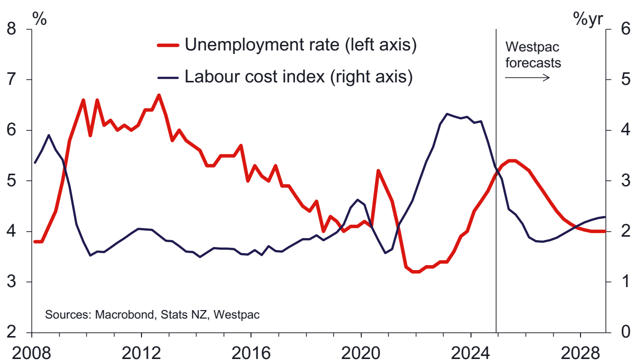
GDP growth



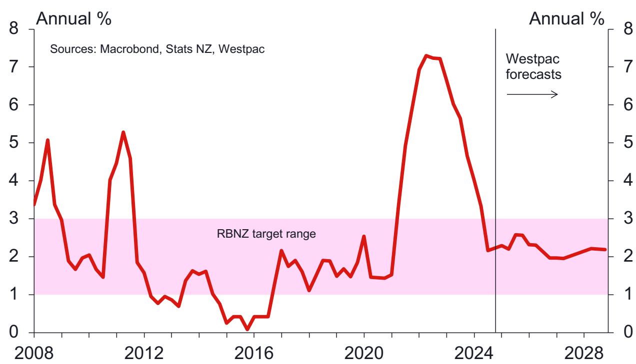
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 17					
NZ	Jan BusinessNZ PSI, index	47.9	–	–	Should start 2025 on a brighter note.
	Dec Net Migration, no.	2070	–	–	Migrant inflows stabilising; tourist inflows picking up.
	Jan REINZ House Sales, %yr	1.8	–	–	Due this week. Loan demand is picking up, but…
	Jan REINZ House Prices, %yr	–1.1	–	–	… prices have moved sideways in recent months.
Jpn	Q4 GDP, %qtr	0.3	0.3	–	Recovery in household consumption to materialise in 2025.
Eur	Dec Trade Balance, €bn	12.9	14	–	Pre-tariff rush to support export volumes.
US	Fedspeak	–	–	–	Harker, Bowman.
Tue 18					
Aus	RBA Policy Decision	4.35	4.1	4.1	Easing inflation gives green light to start policy easing…
	RBA Statement on Monetary Policy	–	–	–	… cautiously at a gradual pace of 25bps/quarter.
Eur	Feb ZEW Survey Of Expectations, index	18	–	–	Businesses are circumspect amidst tariff uncertainty.
UK	Dec ILO Unemployment Rate, %	4.4	4.6	–	Scarce labour supply meets dwindling demand…
	Dec Average Weekly Earnings, %ann	5.6	–	–	… putting downward pressure on wages.
US	Feb Fed Empire State, index	–12.6	–1.0	–	Forward indicators to provide early reaction on Trump's tariffs.
	Fedspeak	–	–	–	Waller, Daly.
Wed 19					
NZ	RBNZ Policy Decision	4.25	3.75	3.75	RBNZ likely to signal slower easing at future meetings.
Aus	Jan Westpac–MI Leading Index, %ann'd	0.25	–	–	Growth signal has improved, but it is not particularly strong.
	Q4 Wage Price Index, %qtr	0.8	0.8	0.8	Wage pressures easing pointing to downside risk to our f/c.
Jpn	Dec Core Machinery Orders, %mth	3.4	0.4	–	Pointing to a solid turnout for business investment in Q4.
UK	Jan CPI, %ann	2.5	2.7	–	Decelerating but energy to add pressure to headline inflation.
US	Jan Housing Starts, %mth	15.8	–7.0	–	High rates and building costs remain as hurdles…
	Jan Building Permits, %mth	–0.7	–2.3	–	… to the much–needed expansion in housing supply.
	Jan FOMC Minutes	–	–	–	Key focus on uncertainties: inflation's persistence and tariffs.
Thu 20					
Aus	Jan Employment Change, 000s	56.3	20	15	January has been seasonally weaker in recent years…
	Jan Unemployment Rate, %	4	4.1	4.1	… but there remains risks to both sides.
Eur	Feb Consumer Confidence, index	–14.2	–13.9	–	Slowing growth to hamper consumer view on outlook.
US	Feb Phily Fed, index	44.3	25.4	–	Forward indicators to provide early reaction on Trump's tariffs.
	Initial Jobless Claims	213	–	–	To remain low, for now.
	Fedspeak	–	–	–	Jefferson, Goolsbee, Musalem, Barr.
Fri 21					
NZ	Jan Trade Balance , $mn	219	–	–750	Back in deficit due to a holiday-induced lull in exports.
Aus	RBA Parliamentary Testimony	–	–	–	RBA's top brass to appear before House of Representatives.
Jpn	Jan CPI, %ann	3.6	4	–	Food and energy prices keep pressure on headline.
	Feb Jibun Bank Manufacturing PMI, index	48.7	–	–	Uncertainty around tariffs is at the fore…
	Feb Jibun Bank Services PMI, index	53	–	–	… while tourism lends a hand to services sector.
Eur	Feb HCOB Manufacturing PMI, index	46.6	46.7	–	European manufacturing in contraction since mid-2022…
	Feb HCOB Global Services PMI, index	51.3	51.5	–	… and a delayed recovery in services is stalling progress.
UK	Feb Gfk Consumer Sentiment, index	–22	–	–	Pain from cost-of-living and a slowing economy…
	Jan Retail Sales, %mth	–0.3	–	–	… is manifesting as weakness in consumer spending…
	Feb S&P Global Manufacturing PMI, index	48.3	–	–	… with broad impacts across already-weak manufacturing…
	Feb S&P Global Services PMI, index	50.8	–	–	… and a continued slowdown in services activity.
US	Feb S&P Global Manufacturing PMI, index	51.2	–	–	Reactions to tariff announcements will be key…
	Feb S&P Global Services PMI, index	52.9	–	–	… while fading seasonal disruptions could support services.
	Feb Uni. Of Michigan Sentiment, index	67.8	–	–	Revisions to inflation expectation of importance.
	Fedspeak	–	–	–	Kugler, Jefferson.

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