AUSTRALIA & NEW ZEALAND WEEKLY.

Week beginning 22 January 2024

Editorial: The beats of their own drums.

Australia: Westpac-MI Leading Index, business survey, Australia Day public holiday.

NZ: Q4 CPI.

Japan: BoJ policy decision, Tokyo CPI.

Eurozone: ECB policy decision, consumer confidence.

US: Q4 GDP, durable goods orders, personal income and spending, PCE deflator, regional surveys.

Global: S&P Global PMIs.

Key economic & financial forecasts.

INFORMATION CONTAINED IN THIS REPORT
CURRENT AS AT 19 JANUARY 2024.

WESTPAC INSTITUTIONAL BANK

The beats of their own drums

The world is entering 2024 with global inflation declining, but still high. Goods price inflation has retreated as pandemic-related disruptions to supply chains have resolved. Services inflation is still high in many economies but it, too, is decelerating as domestic economies and especially labour markets soften. This means that, in most cases, a near-term rebound in domestic inflation is not a material concern.

Markets are looking ahead to the point that central banks can start cutting interest rates from current contractionary policy stances. This is likely to happen once they are confident inflation will return to target soon. They do not have to wait until inflation actually reaches the target. This is an implication of the lagged effects of monetary policy: central banks need to be forward-looking, reacting to shifts in the outlook and the risks around that outlook, and not necessarily to the latest data surprise.

Several major central banks have started communicating publicly about the timing of future rate cuts. In some cases, including the Federal Reserve and the ECB, this has been to hose down market expectations that these policymakers consider overly enthusiastic. Nonetheless, these policymakers are acknowledging that rate cuts are coming within the year.

Australia has been later to the inflation surge and disinflation than peer economies. We were later to open up after the pandemic, and for institutional reasons, some of the other supply shocks have had a more drawn-out effect here as well. For example, while Russia invaded Ukraine in February 2022, it was July 2023 before Australian households started seeing the effects of higher energy prices in their electricity bills. The extraordinary surge in labour supply here has both delayed and dampened the upswing in wages growth; our wage bargaining institutions have played a role here as well.

As a result, the RBA will be later than its peers to cut rates, too. We currently expect that the RBA will reach that point around its September meeting. This is noticeably later than market pricing for the Fed or the ECB.

We are often asked whether the RBA (or the central bank of any other small open economy) can operate on such different timing. The answer is that they can. When the exchange rate floats, monetary policy can move quite independently in response to domestic needs. Global factors will have a common influence on the actions of all monetary policymakers, as we saw during the pandemic. But as long as the exchange rate floats, central banks can respond to the domestic implications of that common factor, not to the responses of their larger counterparts.

An examination of recent history makes this clear. Central banks do move their policy rates on different timetables. For example, in early 2008 and in the mid 2010s, the RBA and the Federal Reserve were moving in opposite directions. The domestic situations differed and so did the monetary policy response.

The floating exchange rate regime makes this possible because the exchange rate then adjusts to absorb the shifts in investment flows attracted by changing relative yields. Yes, higher rates relative to the major economies attract capital flows, but they also push the exchange rate up. This makes the trade more expensive, and so less attractive. So there are limits to the speculative capital flows that will be induced by the interest differential, if that is the kind of thing that worries you.

That exchange rate adjustment is in fact part of the transmission mechanism of monetary policy and works to support what the central bank is trying to achieve. If the rate differential increases (or in the near term for Australia, becomes less negative than before), and the exchange rate appreciates, that tends to put downward pressure on the domestic prices of internationally traded goods and services. This includes domestically produced tradable items, which must compete with foreign producers. The result is lower inflation, at least for a time.

There are situations when this adjustment is uncomfortable. But this is more of an issue for emerging markets, where sudden shifts in capital flows can cause market disruption. Countries with dominant trading relationships with another economy might be reluctant to see too much appreciation against its currency, because of the impact on exporting businesses. That isn't the situation for Australia in relation to the United States.

We therefore do not see any barriers to the RBA operating on its own timetable, driven by its own view of the domestic inflation outlook, different from that in the United States. This timing difference also underpins our view that the Australian dollar will appreciate over 2024, especially against the US dollar.

Of course, if everyone expects central banks to act as we expect, that will already be priced into exchange rates and there is no further impetus for them to move. When we talk about year-end expectations for an exchange rate, though, it's a more subtle story of the balance of risks and where markets are more likely to be surprised relative to current pricing. Once the US Fed starts to move, that source of uncertainty is removed – and shifts in beliefs about RBA timing will be the remaining source of pricing action from interest differentials.

There are many risks around this central view, including geopolitical events and the headwinds to growth in China. Short-term movements in exchange rates can be driven by risk sentiment. In Australia's case, the outlook for key commodity prices also tends to shape the outlook for the exchange rate. The outlook for both interest and exchange rates will always evolve with events.

The important thing to remember is that the rates outlook in each economy depends on the economic outlook in that economy. Central banks don't have to follow the Fed mechanically. They can work to the beat of their own drum.

Luci Ellis, Chief Economist Westpac Group

"Luci Ellis is a member of the Australian Statistics Advisory Council (ASAC) which is a key advisory body to the Minister and the Australian Bureau of Statistics on statistical services. Luci does not have access to sensitive data/reports in her capacity as a member of ASAC.".

The January edition of the Westpac-MI Consumer Sentiment Index showed cost-of-living pressures and concerns over elevated interested rates remain firmly entrenched in the minds of consumers. Highlighting the significance of these factors, at 81.0, the index is currently among the bottom 7% of observations since the inception of the survey in the 1970's. Perceptions of 'family finances versus a year ago' are almost 30ppts below long-run average levels and expectations for the year ahead are 13ppts below average. It is unsurprising then 'time to buy a major household item' fell heavily in the month to be 37ppts below average. In 2023, the labour market provided a degree of insulation against cost pressures, offering opportunities to find a better job or pick up more hours. Views here are beginning to shift however, the Unemployment Expectations Index softening to 130.7 in January, a result slightly above the long-run average.

That development is consistent with the overarching tone of the December Labour Force Survey. The seasonally adjusted headline figures from the survey were impacted by shifts in seasonal patterns into year-end, perhaps a consequence of the growing prominence of Black Friday Sales. Abstracting from this volatility, both employment growth and hours worked are slowing and the unemployment rate is drifting higher. While these dynamics point to emerging slack, the labour market is still very tight versus history and remains a critical support to households. Inflation continuing to trend lower, as forecast, will allow modest policy easing by the RBA from the September quarter, aiding activity and limiting excess capacity in the labour market.

In the UK, the CPI surprised to the upside rising 4.0%yr in December driven by recreation and culture as well as alcoholic beverages and tobacco. Energy prices continued to dampen the annual number, however. Inflation's breadth is narrowing: 71% of the CPI basket grew above 2% compared to almost 90% at the start of 2023. But services inflation remains sticky and is now responsible for almost all inflation. Wages remain a concern for the inflation outlook. Data released this week showed wages growth has eased from 7.2%yr to a still-elevated 6.5%yr. Last week's Decision Maker Panel survey also showed wage expectations edged up to 5.2%yr at the turn of the year. The BoE arguably has the most significant challenge across the developed world in reining in inflation.

In the US, anecdotes from the Federal Reserve's Beige Book provided evidence of balance in the labour market with contacts reporting "larger applicant pools, lower turnover rates, more selective hiring by firms, and easing wage pressures". Sentiment around prices was benign: consumer price sensitivity causing retail firms to reconsider pushing through increases in the cost of production, insurance premium hikes having a broad impact on businesses cost across the economy.

While a majority of Federal Reserve Districts reported "little or no change in economic activity" in the latest survey period, retail sales beat expectations in December, total sales rising 0.6%mth and the control group (which feeds into GDP) 0.8%. For consumers, there is a growing tension between greater comfort with the cost of living (given mortgage rates are fixed for 30-years and inflation is returning to target) and growing uncertainty over job prospects. The net result is likely to be a period of below-trend consumption in 2024, though bursts of activity are still likely.

Of Fed speakers this week, Governor Christopher Waller's remarks at the Brookings Institute received the most attention. Market participants viewed his discussion of current conditions and prior rate cutting cycles as an attempt to rein in the market's expectations vis a vis both the timing and scale of rate cuts. We instead assess his intent as being focused on the extent of easing over 2024, with Governor Waller twice noting that the 3 and 6-month rate of core PCE inflation "has been hovering close to a 2 percent annual rate", the FOMC's target, where it is expected to remain in coming months.

To us, an effective way to manage expectations over the policy response to a soft landing is to cut in March but then signal in revised March forecasts that the decision was one of the three cuts the FOMC projected for calendar 2024 at the December 2023 meeting. Westpac's view remains that four cuts will be delivered by the FOMC in 2024; even after this week's data and remarks, the market still has almost six priced.

In Asia, Q4 GDP showed that the Chinese economy expanded by 5.2%yr, meeting the government's growth target of 'around 5%'. Fixed asset investment grew by a modest 3% overall, but investment in high-tech industries was much stronger at 10%, with some key sub-sectors related to electric vehicles and green power stronger still. China has focussed on research and development for goods related to the green transition over the past decade and is now ramping up capacity to meet burgeoning global demand.

This industrial strength is a striking contrast to the uncertainty that continues to burden consumers. There are promising signs regarding discretionary consumption, but households remain very cautious on housing's outlook. An end to the now two-year contraction in house prices and investment will need additional support from authorities. Until this transpires, consumer demand will remain at risk given the hit household wealth has taken. All told, we remain of the view that China can achieve growth at or above 5% in 2024 and 2025 but, at least in the near-term, downside risks bear careful monitoring.

Week ahead & data wrap

Key factors to watch in 2024

Happy New Year! Given the holiday break, we didn't see much news of note in New Zealand since Christmas. Rather market trends have been dominated by global events and fluctuating expectations for monetary policy. Markets have tended to take an aggressive view on the timing and extent of policy interest rate cuts in most jurisdictions and this has flowed through into expectations for the RBNZ in 2024.

The RBNZ finished 2023 with a hawkish perspective on the interest rate outlook. That reflected their frustration with the apparently slow pace of deceleration in core inflation pressures. The RBNZ also likely has concerns that conditions in some sectors of the economy (for example housing and the labour market) might make it harder to bring inflation sustainably back to the middle of the 1-3% target range by the second half of 2025. The new government only increased the pressure on the RBNZ to perform in their core role when they refocused the RBNZ's mandate to a sole focus on inflation control in December, as they campaigned on during the 2023 election.

Since then, the situation has shifted as data showed stagnant economic growth since the middle of 2022 despite historic levels of inward migration and population growth. It is remarkable that, despite this apparently weak economy, core inflation pressures have remained so robust. This might be telling us that potential growth has not been as strong as we thought through the post-COVID period – which could be a concern looking forward in terms of the level of growth we can expect and in relation to the speed with which we might anticipate inflation to sustainably decline. But, more likely, we suspect that the RBNZ will continue to think that potential growth, while perhaps a bit weaker than earlier appreciated, will have been moving ahead in the last year as the population has grown, and hence the level of excess capacity will have been building in recent quarters. As a result, we suspect they will be more comfortable that core inflation pressures will moderate sooner than they worried about in late 2023, and consequently the case for a further OCR increase will have dissipated and that rate cuts may eventually come into view.

Recent inflation data will have given the RBNZ more comfort that inflation expectations are well in check. The new monthly selected price indices confirm rapid disinflation in tradable goods and food prices. We think headline inflation will have moved back below 5% for the first time since mid-2021. The RBNZ will hence likely have greater confidence that overall inflation will be at 3% or lower by the end of 2024. Such confidence will be a critical plank in the case for a reduction in the OCR in 2024. We see the headline CPI at 4.7% for the year to December when the CPI is released next week.

Looking ahead for 2024 then, what are the key issues to keep an eye on to gauge what happens next? We remain much more cautious on the potential for near term and significant rate cuts than markets. We continue to see as a base case the OCR remaining at 5.5% through 2024 as we think inflation will continue to prove sticky, and we don't think the RBNZ will have much scope for taking risks of not reaching 2% CPI inflation in the second half of 2025. Given the policy lags, the work done with interest rates over the next few quarters will be most relevant to those H2 2025 outcomes.

We see four key issues to focus on in determining the timing of any OCR cuts in 2024:

- **Significant deceleration in core inflation indicators.** An enduring feature of 2023 (at least before Q4) was the stickiness of core inflation indicators such as non-tradables inflation. These indicators need to sustainably decline to make the case for OCR cuts. We suspect we won't see such evidence until the middle of the year at the earliest – although next week's data will provide a critical starting point.

- **Ongoing economic momentum.** Growth went backwards in 2023. The year seems to have been bookended with a technical recession at the start and potentially one at the end. Growth likely ended the year weak and might have picked up a bit right at the end. The extent of any growth pickup (or not) in 2024 will be critical in providing confidence that the RBNZ's inflation goal will be met. The housing market will be key – it will be interesting to see how housing responds to lower mortgage rates through 2024.

- **The strength of the labour market.** Even though growth apparently went backwards the labour market continued to move forward in 2023. The extent to which this continues through 2024 will be key to the assessment of wage and inflation pressures.

- **Global geopolitical issues and their domestic influence.** 2023 was a year of serendipitous disinflation. We saw the full benefit of eased supply chains and lower energy and food prices reflected in tradables inflation (and a couple of core inflation elements such as construction costs and domestic airfares). 2024 looks set to be a much more turbulent year given the US presidential election (and the impact on already tense Chinese relations), the ongoing Russian war, and now significant trade disruptions from tensions in the Middle East. Disinflationary tailwinds could turn into headwinds and frustrate the RBNZ even if growth remains weak. The performance of the weak Chinese economy will be a key factor to watch.

Kelly Eckhold, Chief Economist NZ

Round-up of local data released over the last week

Date	Release	Previous	Actual	Westpac f/c
Tue 16	Q4 NZIER Survey of Business Opinion	-49.0	-10.2	–
Wed 17	Dec retail card spending	1.7%	-2.0%	-0.2%
Thu 18	REINZ house sales %yr	12.2%	14.1%	–
	REINZ house prices %yr	-0.1%	0.5%	–
	Dec food prices	-0.2%	-0.1%	–
Fri 19	Nov manufacturing PMI	46.5	43.1	–
	Nov net migration	9090	2740	–

DATA PREVIEWS

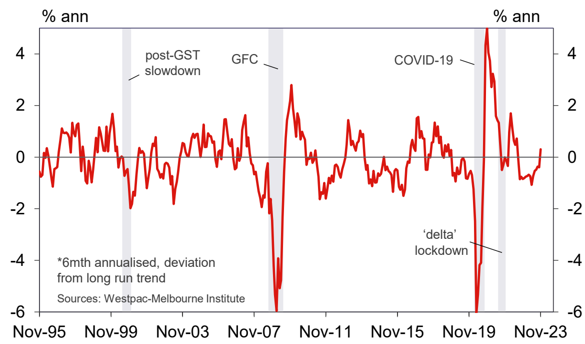
Aus Dec Westpac-MI Leading Index

Jan 24, Last: 0.30%

The Leading Index growth rate rose to +0.30% in November, lifting into positive territory for the first time since July 2022. While this points to an improvement in momentum, the November read was affected by one-off boosts with the underlying picture more consistent with stabilisation than the beginning of a cyclical upturn.

The December update will include another mixed batch of monthly updates. On the plus side, the ASX200 continued to rally, up a further 7.1% in the month, with commodity prices also rising 3.2% (in AUD terms) and dwelling approvals extending on the previous month's gain. However, sentiment measures remained subdued at weak levels and total hours worked recorded a notable –0.5% decline.

Westpac-MI Leading Index



NZ Q4 Consumer Price Inflation

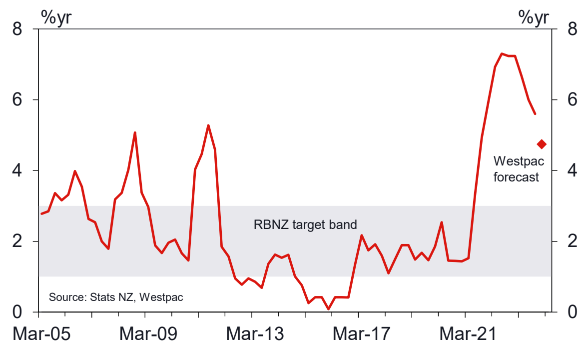
Jan 24, Quarterly – Last: +1.8%, Westpac: +0.5%, Market: +0.5%
Jan 24, Annual – Last: +5.6%, Westpac: +4.7%, Market: +4.7%

We estimate that New Zealand consumer prices rose by 0.5% in the December quarter. That would see annual inflation dropping to 4.7%, down from 5.6% in the year to September.

Inflation is being pulled down by softness in import prices, including the price for food, fuel and airfares. However, domestic inflation pressures remain strong and are easing more gradually.

Our forecast is lower than the RBNZ's projection (published back in November) with most of that difference due to prices of volatile imported items. The key focus for the RBNZ will be the measures of core inflation which are easing, but remain uncomfortably high.

NZ Consumers Price Index



US Q4 GDP (%yr)

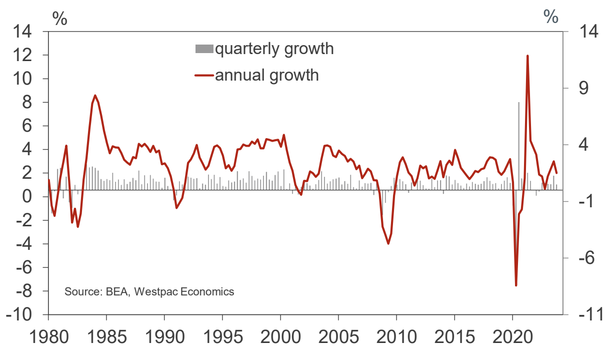
Jan 25, Last 4.9%, Mkt f/c: 1.9%, WBC f/c: 2.0%

US GDP growth is expected to decelerate back to around trend in Q4 after an extraordinary Q3. The consumer remains the primary support for total growth, with established households benefitting from fixed 30-year mortgage rates and a historically-strong labour market. Consumers are also now experiencing real wage gains.

That said, there is growing evidence of slack building in the labour market and job shedding becoming more prevalent. Support for business investment also looks to be waning, arguably in part because interest costs are set to rise through 2024 and 2025 amid economic uncertainty.

Fortunately, the FOMC's success with inflation means they will be able to ease policy through 2024 and 2025. In our view, active policy making can limit the downside for the US economy, with growth troughing below trend instead of below zero.

US GDP to slip below trend in 2024



For the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 22					
US	Dec leading index	–0.5%	–0.3%	–	Rain clouds are forming.
Tue 23					
Aus	Dec NAB business survey	+9	–	–	Conditions have cooled, mood deeply pessimistic at –9.
NZ	Dec BusinessNZ PSI	51.2	–	–	Economic activity cooling, but services more resilient.
Jpn	BoJ policy decision	–0.10%	–	–0.10%	Lack of demand-side inflation will keep rates steady.
Eur	Jan consumer confidence	–15	–14	–	Rate hikes and high prices weighing on consumers.
US	Jan Richmond Fed index	–11	–	–	Manufacturing activity coming under pressure.
Wed 24					
Aus	Dec Westpac–MI Leading Index	0.30%	–	–	Looks to be stabilising rather than turning up.
NZ	Q4 CPI %qtr	1.8%	0.5%	0.5%	Inflation is dropping due to weaker import prices…
	Q4 CPI %yr	5.6%	4.7%	4.7%	… but domestic price pressures remain elevated.
Jpn	Jan Jibun Bank manufacturing PMI	47.9	–	–	Car manufacturing a bright spot.
	Jan Jibun Bank services PMI	51.5	–	–	Tourism is keeping services spending strong.
Eur	Jan HCOB manufacturing PMI	44.4	–	–	Weakness expected as demand dries up for European goods.
	Jan HCOB services PMI	48.8	–	–	Tepid consumption warrants a downbeat view.
UK	Jan S&P Global manufacturing PMI	46.2	–	–	Weakness to persist…
	Jan S&P Global services PMI	53.4	–	–	… throughout most of the economy.
US	Jan S&P Global manufacturing PMI	47.9	48.0	–	Higher costs are weighing on manufacturers minds.
	Jan S&P Global services PMI	51.4	51.0	–	Uncertainty on how much long consumer resilience will last.
Can	BoC policy decision	5.00%	5.00%	–	Pause and hawkish statement expected to ward off hawks.
Thu 25					
Aus	RBA Bulletin	–	–	–	Quarterly bulletin containing research articles.
Eur	ECB policy decision (deposit rate)	4.00%	4.00%	–	Cuts still some time away; services inflation remains strong
Ger	Jan IFO business climate survey	86.4	86.9	–	Businesses still pessimistic; fixed rate roll-over looms.
US	Q4 GDP, annualised	4.9%	1.9%	2.0%	Q4 likely to prove transition quarter, above to below trend.
	Dec durable goods orders	5.4%	1.0%	–	Weaker demand to show through in orders.
	Dec Chicago Fed activity index	0.03	–	–	Economy is slowly building capacity.
	Dec wholesale inventories	–0.2%	–0.2%	–	Firms drew down on inventories over holidays.
	Dec new home sales	-12.2%	10.1%	–	Post-holiday rebound.
	Jan Kansas City Fed index	–1	–	–	Manufacturing activity is weak.
	Initial jobless claims	187k	–	–	To remain low for now.
Fri 26					
Aus	Australia Day	–	–	–	Public holiday; markets closed.
Jpn	Jan Tokyo CPI %yr	2.4%	2.0%	–	Further deceleration expected as import prices ease.
UK	Jan GfK consumer sentiment	-22	–	–	Weakness persists as rate cuts remain distant.
US	Dec personal income	0.4%	0.3%	0.4%	Wage growth is moderating…
	Dec personal spending	0.3%	0.4%	0.4%	… but consumer spending has remained surprisingly resilient.
	Dec PCE deflator	–0.1%	0.2%	0.2%	Rents lower weight and alternative inputs to keep below CPI.
	Dec pending home sales	0.0%	–	–	Supply constraints keeping sales low.
Sat 27					
Chn	Dec industrial profits ytd %yr	–4.4%	–	–	Profit growth will gradually improve this year.

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Forecasts

Interest rate forecasts

Australia	Latest (19 Jan)	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Cash	4.35	4.35	4.35	4.10	3.85	3.60	3.35	3.10	3.10
90 Day BBSW	4.34	4.55	4.47	4.22	3.97	3.72	3.47	3.30	3.30
3 Year Swap	4.03	4.15	4.10	4.05	4.00	3.90	3.70	3.60	3.50
3 Year Bond	3.86	3.95	3.90	3.85	3.80	3.70	3.50	3.40	3.30
10 Year Bond	4.29	4.35	4.30	4.20	4.15	4.10	4.05	4.00	4.00
10 Year Spread to US (bps)	13	10	10	5	5	5	0	0	0
US									
Fed Funds	5.375	5.125	4.875	4.625	4.375	4.125	3.875	3.625	3.375
US 10 Year Bond	4.16	4.25	4.20	4.15	4.10	4.05	4.05	4.00	4.00
New Zealand									
Cash	5.50	5.50	5.50	5.50	5.50	5.25	5.00	4.75	4.50
90 day bill	5.65	5.60	5.60	5.60	5.50	5.25	4.95	4.75	4.50
2 year swap	4.78	5.10	4.95	4.75	4.50	4.40	4.15	4.10	4.00
10 Year Bond	4.70	4.85	4.80	4.75	4.70	4.60	4.50	4.45	4.35
10 Year spread to US	54	60	60	60	60	55	45	45	35

Exchange rate forecasts

Australia	Latest (19 Jan)	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
AUD/USD	0.6582	0.67	0.68	0.69	0.70	0.71	0.72	0.72	0.73
NZD/USD	0.6114	0.62	0.62	0.62	0.63	0.63	0.63	0.63	0.64
USD/JPY	148.29	145	144	141	138	135	132	130	127
EUR/USD	1.0888	1.09	1.11	1.13	1.14	1.15	1.16	1.17	1.17
GBP/USD	1.2712	1.26	1.27	1.28	1.29	1.30	1.30	1.31	1.31
USD/CNY	7.1957	7.10	6.90	6.80	6.70	6.60	6.50	6.40	6.30
AUD/NZD	1.0778	1.08	1.11	1.11	1.11	1.13	1.14	1.14	1.15

Australian economic growth forecasts

	2023			2024				Calendar years			
% change	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	2022	2023f	2024f	2025f
GDP % qtr	0.4	0.2	0.2	0.3	0.3	0.4	0.5	–	–	–	–
%yr end	2.0	2.1	1.4	1.2	1.0	1.3	1.6	2.3	1.4	1.6	2.5
Unemployment rate %	3.6	3.7	3.9	3.9	4.2	4.4	4.5	3.5	3.9	4.5	4.6
Wages (WPI)	0.9	1.3	0.9	0.9	0.8	0.8	0.7	–	–	–	–
annual chg	3.6	4.0	4.1	4.1	4.0	3.5	3.2	3.3	4.1	3.2	3.0
CPI Headline	0.8	1.2	0.8	0.7	0.8	1.0	0.7	–	–	–	–
annual chg	6.0	5.4	4.3	3.5	3.5	3.3	3.2	7.8	4.3	3.2	2.8
Trimmed mean	1.0	1.2	0.9	0.9	0.8	0.8	0.7	–	–	–	–
annual chg	5.9	5.2	4.4	4.0	3.8	3.4	3.2	6.8	4.4	3.2	2.8

New Zealand economic growth forecasts

	2023			2024				Calendar years			
% change	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	2022	2023f	2024f	2025f
GDP % qtr	0.5	–0.3	0.1	0.0	0.1	0.2	0.3	–	–	–	–
Annual avg change	3.0	1.3	0.7	0.3	0.0	0.2	0.3	2.4	0.7	0.3	1.6
Unemployment rate %	3.6	3.9	4.3	4.5	4.8	5.0	5.2	3.4	4.3	5.2	5.3
CPI % qtr	1.1	1.8	0.5	0.9	0.6	0.9	0.6	–	–	–	–
Annual change	6.0	5.6	4.7	4.3	3.8	3.0	3.1	7.2	4.7	3.1	2.5

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