WEEKLY ECONOMIC COMMENTARY

4 Dec 2023 | **Westpac Economics Team** | **westpac.co.nz/economics** | nzeconomics@westpac.co.nz

Now is not the time for rate cuts

The RBNZ poured ice water over the emerging market trend to price in OCR cuts in 2024. Rather, the RBNZ lifted their forecasts for interest rates reflecting increased concern on the demand impact of strong net migration, sticky core inflation and the future fiscal stance. RBNZ meetings next year are now live in terms of the potential for increased interest rates. Data on core inflation, growth, migration, house prices and the future fiscal stance will be key in determining if the OCR remains at 5.5% or rises further in 2024.

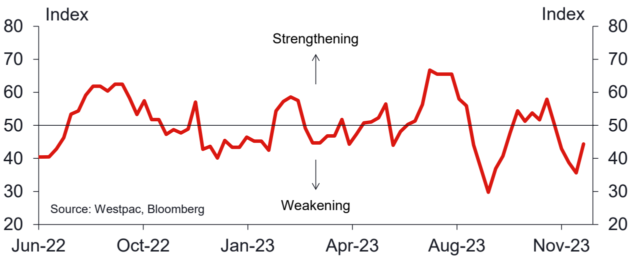
As widely expected, the RBNZ left the OCR at 5.5% at its final policy review for this year. Of much greater interest to markets was what the Bank had to say about the outlook for the OCR next year and beyond.

The updated projections in the accompanying *Monetary Policy Statement (MPS)* contained significant revisions from those published back in August. A key change is that the RBNZ's projections reflect a heightened risk that a further 25bp OCR hike will be required in 2024. The probability of a further 25bp hike in 2024 is now estimated at around 75% compared with 36% previously (the peak OCR increased to 5.69% from 5.59% previously). Thereafter, the RBNZ's projections imply a modest easing cycle from mid-2025 – much later than implied by current market pricing. The RBNZ's revised OCR track now closely resembles our own – albeit with the tightening coming around 6 months later.

Key views

	Last 3 months	Next 3 months	Next year
Global economy	↘	↘	↗
NZ economy	↓	→	↗
Inflation	↘	↘	↓
Short-term interest rates	→	↗	→
Long-term interest rates	→	↗	↘
NZD/USD	↗	→	→
NZD/AUD	↗	↘	↘

Westpac New Zealand Data Pulse Index

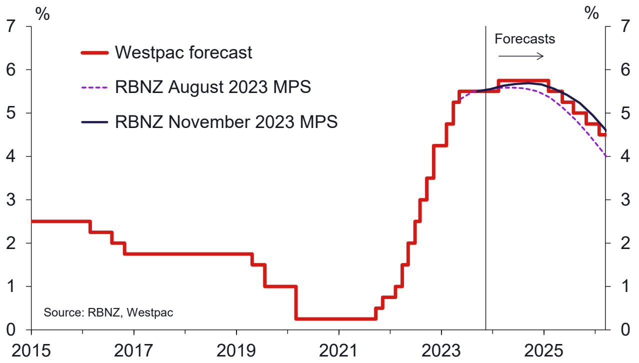


Movember

A big thank you from the Eco and Strategy team to everyone who supported our moustache-growing efforts this Movember! If you'd still like to contribute, or if you'd like to learn more about the men's health issues that Movember supports, please follow the link below.

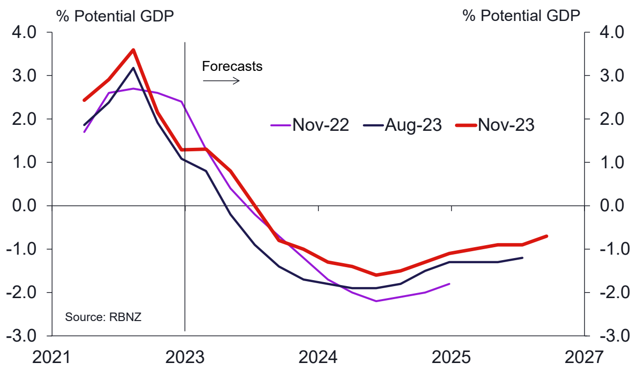
Donate to Movember

Official Cash Rate forecasts



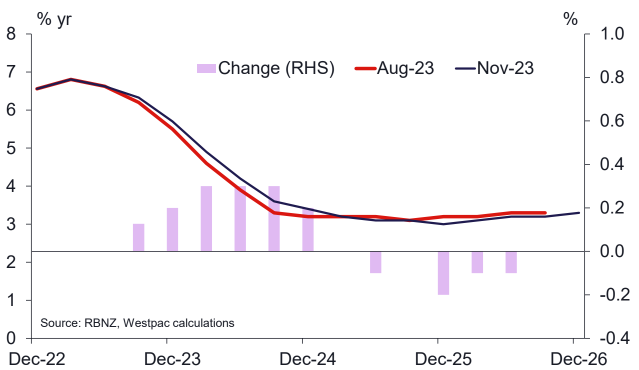
The key drivers of the more heightened perceptions of inflation risk stem from a reassessment of the medium-term impact of very strong migration driven population growth. In addition, the RBNZ has become more cautious on the pace to which they expect core inflation pressures to moderate. That reassessment is reflected in a stronger housing market (and rents) profile, stronger near-term growth, and lower unemployment forecasts and a higher profile for government investment in the infrastructure required to support a growing population.

RBNZ Output Gap estimates/forecasts



The bottom line is an upwards revision to the RBNZ's medium term inflation forecasts (from mid-2024 onwards) even with higher interest rates. On top of this, the RBNZ notes an asymmetric risk profile around medium-term inflation outcomes – with upside risks there.

RBNZ Non-tradables inflation estimates/forecasts

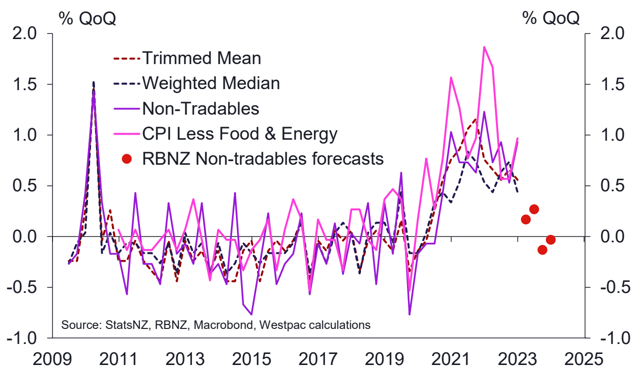


The RBNZ seems more focused on ensuring that inflation hits the middle of the target range in the next 18 months to 2 years. Hence, given still persistent core inflation, strong population growth and an upwardly revised long-run neutral OCR (increased a further 25bp to 2.5%) the clear message is the balance of risks has shifted towards a need for further tightening. And certainly, there is reduced tolerance for upside surprises to inflation – which is also consistent with the new government's objectives when the new Monetary Policy Committee Remit (and new RBNZ Act) is promulgated.

The upshot is that we retain our view that the OCR will be increased by 25bps at the February *MPS*. The RBNZ's message and core concerns now map more closely to our own. The relatively high probability of a hike in Q3 2024 indicates that all meetings from now should be considered "live". The Governor noted, the RBNZ is now "willing" to act if needed.

We think there are two key messages to take from the RBNZ news this week. Firstly, the market is on notice that policy easings are very unlikely for the foreseeable future. Easings are going to need to be motivated by a much weaker run of data on future core inflation pressures, and housing market trends. **Our recent note on what it will take for rate cuts to become reality** still seems very relevant. Secondly, a message for the new Government is that the fiscal stance needs to be noticeably tighter than was embodied in the Pre-Election Economic and Fiscal Update (PREFU). The new Government's fiscal plans in the forthcoming Half-Year Economic and Fiscal Update (HYEFU) need to reflect a tight stance to avert the need for a higher OCR.

Quarterly core inflation indicators relative to 1995-2019 average



There is still plenty of water to flow under the bridge ahead of the February 2024 *MPS* and so it's possible a hike in the OCR comes later than February (or not at all). We will be watching the following key data and events:

- **The Q3 GDP report on 14 December.** Next week will see some key partial indicators of Q3 GDP. We currently expect modestly weaker growth than the 0.3% factored by the RBNZ. The tone of that report (and the interpretation of downward revisions to historical data already foreshadowed by Stats NZ) will be important.

- **Migration data and all housing-related data.** The RBNZ's concern about the impact of migrant inflows on domestic demand, including via the housing market, which makes data on migrant inflows, housing turnover, house prices and dwelling rentals over coming months critical.
- **The HYEFU.** The new fiscal stance (and other policy changes) will be factored into the RBNZ's February Statement. The updated estimated "fiscal impulse" and analysis of other new policies (investor housing) will be very important.
- **The Q4 CPI report on 24 January and preceding monthly updates.** Non-tradables inflation will be key. We currently forecast the Q4 outcome to be slightly below the RBNZ's updated forecast, but the data needs to confirm a significant step-down in core inflation indicators (see chart).
- **The Q4 labour market surveys on 7 February.** These Labour market indicators were downplayed by the RBNZ this week and our forecasts for Q4 don't materially differ to the RBNZ's. But we are sure that wages and unemployment rate trends will ultimately matter.

Data last week was a bit of a mixed bag for the RBNZ. There was some welcome reduction in inflation expectations in the ANZ business confidence survey while activity indicators continued to improve a touch and pricing expectations outside of retail looked quite sticky. Building consents bounced a solid 8.7% in October but we think that's more volatility as opposed to changing the underlying weak trend.

A final note on forthcoming changes to the RBNZ's Remit and Act to focus the RBNZ solely on inflation control. We don't think that these adjustments will do much for the conduct of policy in most circumstances. Perhaps an exception would be the case of supply shocks which might temporarily boost inflation. However, in the current context we think these adjustments will affect the RBNZ's assessment of the balance of risks for policy in the next year or so. The government is sending the RBNZ a clear message that inflation needs to be its highest priority and there is no room to be taking chances that might cause inflation to remain well above 2% in mid-2025. Hence, we think the upshot is that we should expect the RBNZ to be unforgiving of any shocks that boost the growth and inflation outlook over the next year. Also, the RBNZ will likely be less willing to pre-emptively ease, as markets seem to currently expect. A pre-emptive easing that turned out to be the wrong judgement would not be greeted warmly by the Minister given the new Remit.

Kelly Eckhold, Chief Economist

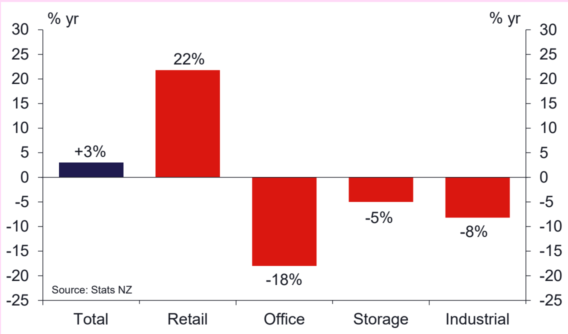
Key data and event outlook

Date	Event
5 Dec 23	RBA Monetary Policy Decision
5 Dec 23	Govt Financial Statements, 4 months to October
13 Dec 23	FOMC Meeting (Announced 14 Dec NZT)
13 Dec 23	Selected price indexes, November
14 Dec 23	NZ GDP September quarter
20 Dec 23	Half Year Economic and Fiscal Outlook (TBC)
16 Jan 24	QSBO Business Survey, December quarter
24 Jan 24	NZ CPI, December quarter
31 Jan 24	FOMC Meeting (Announced 1 Feb NZT)
6 Feb 24	RBA Monetary Policy Decision and SMP
7 Feb 24	NZ labour market statistics, December quarter
28 Feb 24	RBNZ Monetary Policy Statement and OCR

Chart of the week.

The amount of new commercial property being consented is slowing as high interest rates and concerns about slowing demand put the brakes on investor activity. Following strong growth in recent years, there's been a notable slowdown in the amount of industrial and storage space being consented. There's also been a sharp drop in the amount of office space in development, however trends in the market for office space are varied. A-Grade property remains in demand, though businesses are re-thinking how much and what sort of spaces they need given changing work practices (such as the increased prevalence of remote working). In contrast, the demand for lower grade office space remains weak. While up on this time last year, the amount of retail space being developed remains low, with softening consumer spending and the continuing shift to online trading weighing on the demand for space.

Value of non-residential building consents

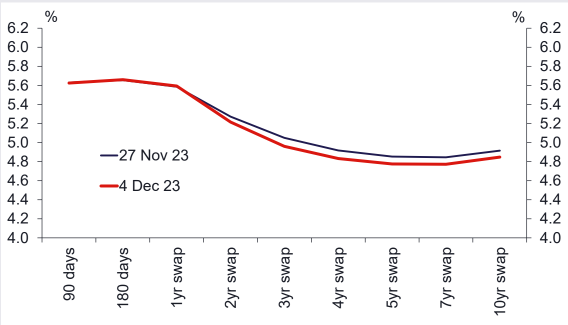


Fixed versus floating for mortgages.

The RBNZ held the OCR at 5.50% at its November policy meeting and signalled the chance of another rate hike over the year ahead. The RBNZ's updated projections indicate that rate cuts over the year ahead are unlikely.

At current rates, we see value in fixing for two to three years. Shorter terms could be more expensive, but would provide borrowers with greater flexibility.

NZ interest rates



Global wrap

US

Markets took a dovish view of FOMC Chair Powell's comments on Friday. Powell pushed back on suggestions that the Fed would cut over the year ahead and noted they are prepared to hike if necessary. However, he also noted that policy was "well into restrictive territory" and that inflation is "moving in the right direction. So we think the right thing to be doing now is to be moving carefully." Comments from other Fed speakers this week also downplayed the chances of cuts, but similarly highlighted the progress on inflation.

US data over the past week was mixed. GDP growth in Q3 was revised higher, though consumption spending was revised down. Moving into the back part of the year, business surveys generally pointed to ongoing softness. That included the October ISM (which remained low at 46.7) and the latest Beige Book which reported softening activity in several districts. In the household sector, personal income and spending growth both slowed in October, while the core PCE deflator eased to 3.5% (all as expected). Looking ahead, the focus for the coming week will be Friday's November non-farm payrolls report, which we expect to show jobs growth of 180k over November.

Asia-Pacific

Australia's monthly CPI surprised to the downside in October, coming in at 4.9% – down from 5.6% in September. Retail spending was also down, with per-capita spending levels dropping sharply over the past year. On the upside, house price growth has remained firm. We've also seen resilience in construction activity and businesses' capital expenditure. Given the recent mix of data, we expect the RBA will remain on hold at Tuesday's policy meeting. However, if inflation fails to ease back, a further tightening could occur next year. On the data front, the main event will be the September quarter GDP update (out Wednesday) which we expect will show a modest 0.4% increase over the quarter.

Across in China, the PMIs pointed to softness in both the manufacturing and services sector. That's reinforced expectations for further government stimulus. Consistent with the softness in activity, inflation data out on Friday is expected to be weak.

Europe

Inflation in the EU has continued to cool, slowing to 2.4%yr in November (down from 2.9%). Even so, ECB speakers (including Lagarde) have continued to highlight concerns about upside risks for prices. Similarly, the BOE Governor and Deputy Governor both played down the chances of rate cuts in the UK.

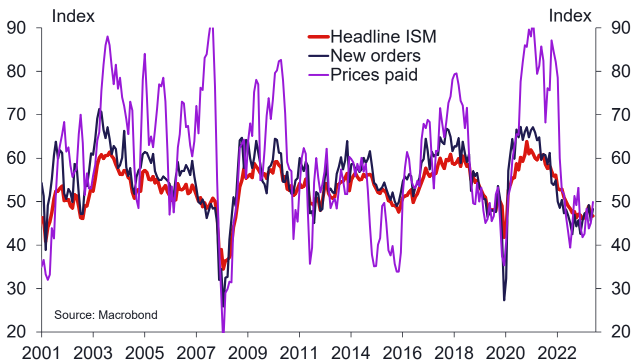
Trading partner real GDP (calendar years)

	Annual average % change			
	2021	2022	2023	2024
Australia	5.2	3.7	1.9	1.2
China	8.4	3.0	5.3	5.3
United States	5.9	2.1	2.4	1.5
Japan	2.1	1.1	1.8	1.1
East Asia ex China	4.3	4.5	3.4	4.3
India	9.1	6.8	6.4	6.4
Euro Zone	5.4	3.5	0.6	1.1
United Kingdom	7.6	4.0	0.3	0.5
NZ trading partners	6.2	3.2	3.4	3.3
World	6.3	3.4	3.1	3.1

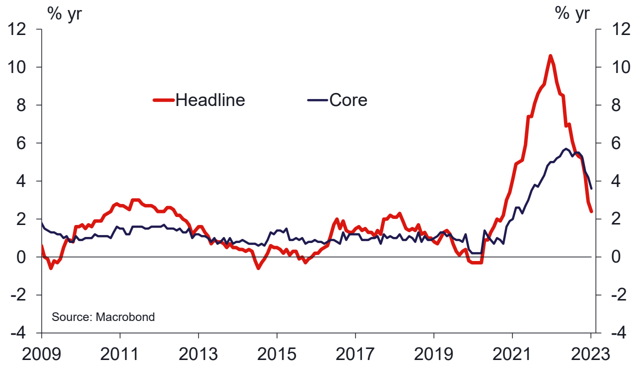
Australian & US interest rate outlook

	Latest	Dec-23	Jun-24	Dec-24
Australia				
Cash	4.35	4.35	4.35	3.85
90 Day BBSW	4.37	4.55	4.47	3.97
3 Year Swap	4.28	4.50	4.30	4.10
3 Year Bond	4.08	4.30	4.10	3.90
10 Year Bond	4.50	4.70	4.50	4.30
10 Year Spread to US (bps)	17	-10	-10	-10
US				
Fed Funds	5.375	5.375	4.875	4.375
US 10 Year Bond	4.33	4.80	4.60	4.40

US ISM manufacturing



Euro area inflation



Financial markets wrap

Interest rates.

The RBNZ MPS last week delivered a hawkish surprise to analysts and markets, by raising, rather than lowering its OCR forecast. It now implies a 75% chance of a rate hike in 2024, from a 35% chance previously. Demand side pressures from higher migration were a major concern. The NZ interest rate market's response to the MPS was measured, though, and the 2yr swap rate ended the week 6bp lower at 5.22%.

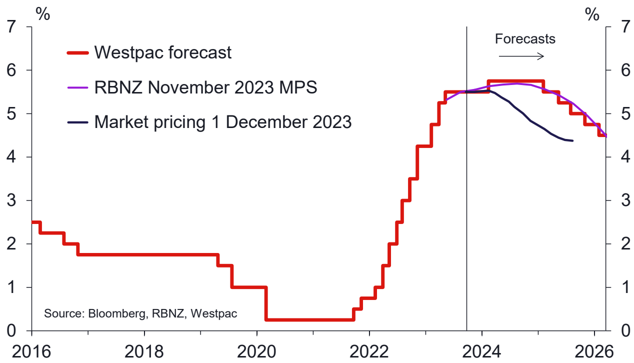
The main reason for this is that offshore rates have fallen to multi-month lows, with US interest rate markets aggressively pricing Fed rate cuts as early as March 2024 following dovish commentary from some Fed officials during the week. Fed Chair Powell on Friday pushed back against speculation of easing timing, but less forcefully than was expected, and market rates fell further in response.

Over the next few weeks, US jobs and CPI inflation data, as well as the FOMC decision on 14 December, will be important for global interest rates. Locally, we'll be closely watching migration (12 Dec), GDP (14 Dec), and CPI data (24 Jan), as well as the half-year fiscal update and mini-budget (sometime in the second half of December). Short maturity rates in NZ appear too low given the latest RBNZ warning that inflation could remain too high, and we see potential for the 2yr swap to rise to 5.30% and beyond during the month ahead.

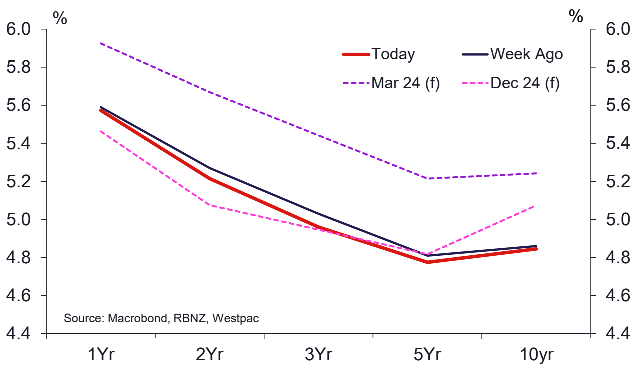
Foreign exchange.

NZD/USD's rally, which started in late October, extended further last week to 0.6210 on Friday - the highest level since 1 August. As has been the case during the past month, that was mostly a result of further US dollar weakness and improved risk sentiment, which in turn were driven by soft US economic data and less hawkish Fedspeak. The hawkish RBNZ surprise made a small contribution. We continue to expect the US dollar to weaken further into year end and during 2024 if the US is unable to deliver economic outperformance (its economy was exceptional in 2021 and much of 2022, and for part of H2 2023). There's potential for NZD/USD to extend to 0.6300 and above during the next few months. In the interim, any dips to the 0.5900-0.6000 area would be worthy of consideration by exporters looking to hedge receipts. Noteworthy among the crosses, and potentially of interest to importers, is NZD/AUD, which rose over a cent to 0.9344 last week following the hawkish RBNZ and softer AU monthly inflation data. It could extend to 0.9400 this week. NZD/EUR also rose, helped by some dovish ECB comments, and looks poised to extend towards 0.5800 this week. NZD/JPY is arguably the most exceptional cross, sitting at the highest level since 2015. It will fall sharply when the BoJ increases its policy rate, but timing on that is unclear.

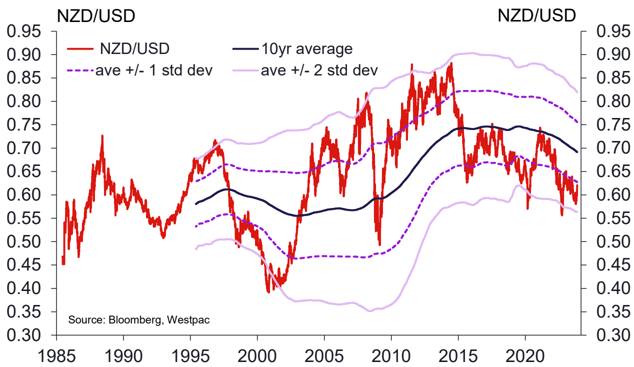
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mnth range	5yr range	5yr avg	Dec-24
USD	0.621	0.578-0.621	0.555-0.743	0.654	0.62
AUD	0.931	0.915-0.939	0.873-0.992	0.934	0.89
EUR	0.570	0.546-0.570	0.517-0.637	0.586	0.55
GBP	0.488	0.467-0.492	0.464-0.551	0.510	0.49
JPY	91.0	86.5-91.2	61.3-91.2	77.5	86.1

The week ahead

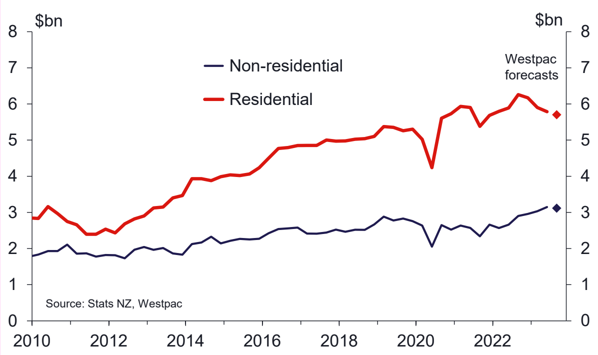
NZ Q3 building work put in place

Dec 5, Last: –0.1%, Westpac f/c: –1.4%

The June quarter saw a modest rise in building activity, with an increase in non-residential construction offsetting a drop in residential work.

We're forecasting a 1.4% fall in construction activity in the September quarter. Residential building activity is expected to continue declining, and we're also expecting a pull-back in non-residential construction work. Tougher financial conditions (including higher interest rates) are weighing on building activity. That's been compounded by the slowdown in economic growth, which has meant that developers and project initiators are cautious about bringing new work to market.

NZ real building work put in place



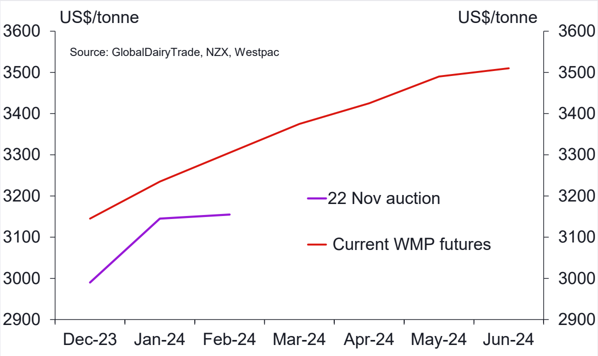
NZ GlobalDairyTrade auction, whole milk powder prices

Dec 6, Last: 1.9%, Westpac f/c: +2.0%

We expect whole milk powder prices (WMP) to rise by 2% at the upcoming auction. WMP prices lifted 1.9% at the previous auction. Our pick roughly splits the flat result at the recent mini (GDT pulse) auctions and the circa 5% price lift as indicated by the futures market.

Global dairy prices bounced off their lows over September and October. The likely drivers of the improvement were a lift in demand from Middle East buyers alongside increased drought risk over summer and/or autumn stemming from the El Nino weather pattern. Prices consolidated over November and in the short term, we expect further consolidation.

Whole milk powder prices

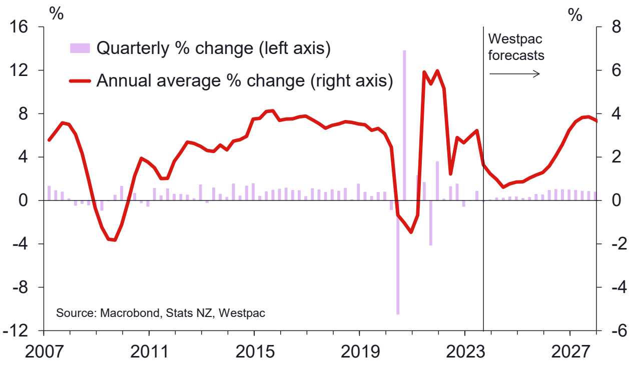


Economic and financial forecasts

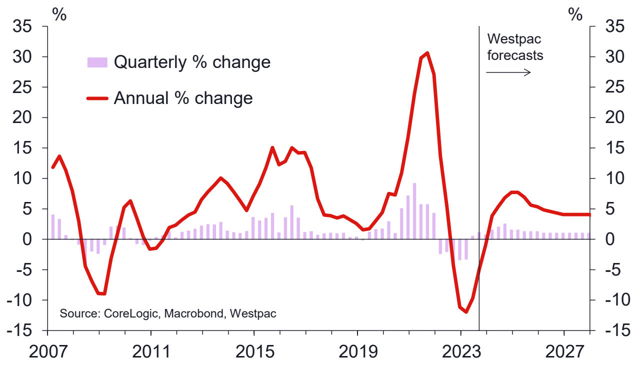
Economic indicators	Quarterly % change				Annual % change			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
GDP (production)	0.9	-0.1	0.1	0.2	6.0	2.7	1.2	0.9
Consumer price index	1.1	1.8	0.6	0.9	5.9	7.2	4.8	3.3
Employment change	1.0	-0.2	0.1	0.1	3.3	1.7	2.0	0.2
Unemployment rate	3.6	3.9	4.3	4.5	3.2	3.4	4.3	5.2
Labour cost index (all sectors)	1.1	1.1	0.9	0.8	2.6	4.1	4.2	3.4
Current account balance (% of GDP)	-7.5	-7.7	-7.3	-6.8	-5.8	-8.8	-7.3	-5.6
Terms of trade	0.4	-4.8	-1.7	2.9	2.8	-4.2	-7.5	9.5
House price index	0.5	2.1	1.0	1.5	27.0	-11.2	1.0	8.0

Financial forecasts	End of quarter				End of year			
	Jun-23	Sep-23	Dec-23	Mar-24	2021	2022	2023	2024
OCR	5.50	5.50	5.50	5.75	0.75	4.25	5.50	5.75
90 day bank bill	5.62	5.66	5.85	5.85	0.82	4.26	5.85	5.75
2 year swap	5.18	5.53	5.79	5.67	2.08	5.10	5.79	5.08
5 year swap	4.44	4.90	5.34	5.22	2.46	4.67	5.34	4.82
10 year bond	4.27	4.87	5.45	5.45	2.39	4.31	5.45	5.15
TWI	70.9	70.6	70.3	70.3	74.3	70.8	70.3	69.2
NZD/USD	0.62	0.61	0.60	0.61	0.70	0.60	0.60	0.62
NZD/AUD	0.93	0.92	0.91	0.91	0.95	0.92	0.91	0.89
NZD/EUR	0.57	0.56	0.56	0.56	0.61	0.59	0.56	0.55
NZD/GBP	0.49	0.48	0.49	0.49	0.52	0.51	0.49	0.49

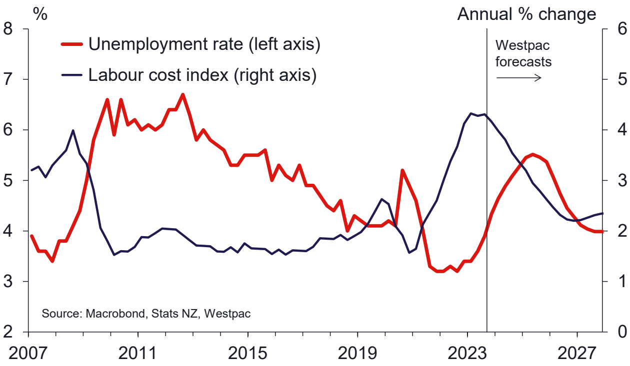
GDP growth



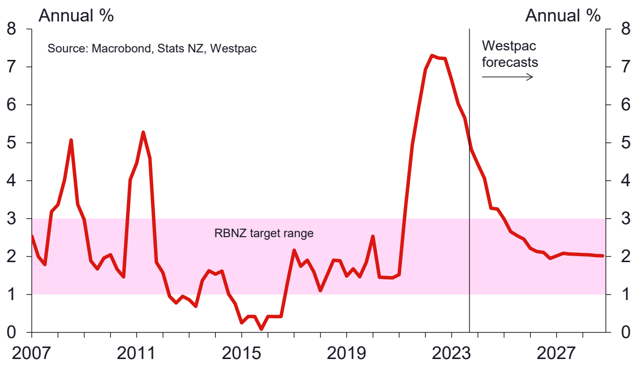
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
NZ	Q3 terms of trade	0.4%	–	–2.5%	Export (meat) prices fell over Q3; oil prices rose.
Aus	Oct housing finance	0.6%	1.1%	3.2%	Price-led upturn has been slow to feed into finance so far …
	Oct investor finance	2.0%	–	3.0%	… but should show through more clearly in Oct figures …
	Oct owner occupier finance	–0.1%	–	3.3%	… with temp. boost to construction lifting own-occ as well.
	Q3 company profits	–13.1%	1.5%	–1.2%	Lower commodity prices & challenging domestic backdrop.
	Q3 inventories	–1.9%	–0.8%	–0.6%	To decline (on soft demand) but at a slower rate.
	Nov MI inflation gauge %yr	5.1%	–	–	Provides a general view of risks.
	Nov ANZ job ads	–3.0%	–	–	Downtrend resumes, following little–change over Jun–Oct.
Eur	Dec Sentix investor confidence	–18.6	–	–	Stable but fragile.
US	Oct factory orders	2.8%	–2.6%	–	Underlying trend has firmed following soft patch over H1.
Tue 05					
NZ	Q3 building work	–0.1%	–	–1.4%	Residential and non–residential turning down.
	Nov ANZ commodity prices	2.9%	–	–	Dairy prices sideways; meat prices down.
Aus	Q3 current account, $bn	7.7	3.3	1.0	Narrows on smaller trade surplus as terms of trade falls.
	Q3 net exports, ppts cont'n	+0.8	–0.2	–0.4	Imports a strong Q3 reading outstrips further lift in exports.
	Q3 public demand	1.2%	–	0.3%	Resumption of subdued growth post H1 2023 investment burst.
	RBA policy decision	4.35%	4.35%	4.35%	To remain on hold and alert to upside risks.
Jpn	Nov Tokyo CPI %yr	3.2%	3.0%	–	BoJ unperturbed, aiming to reanchor inflation expectations.
Chn	Nov Caixin services PMI	50.4	50.7	–	Services demand remains subdued.
Eur	Oct PPI %yr	–12.4%	–	–	Last year's energy inflation has almost fully cycled out.
US	Nov ISM non–manufacturing	51.8	52.5	–	Outlook becoming more uncertain.
	Oct JOLTS job openings	9553k	9440k	–	Gradually easing off peak as labour demand cools.
Wed 06					
NZ	GlobalDairyTrade (WMP)	1.9%	–	2.0%	Dairy prices consolidating September/October gains.
Aus	Q3 GDP	0.4%	0.4%	0.4%	Growth stuck in the slow lane, as domestic demand cools.
Eur	Oct retail sales	–0.3%	–	–	Broad–based weakness highlights pressure on households.
US	Nov ADP employment change	113k	120k	–	Often at odds with BLS survey.
	Oct trade balance $bn	–61.5	–63.0	–	Monthly volatility masks trend towards smaller deficits.
Thu 07					
Aus	Oct trade in goods balance $bn	6.8	7.5	9.5	X's +3.5%, higher prices. M's -2.9%, partial unwind of 7.5% jump.
Chn	Nov trade balance US$bn	56.5	48.15	–	Diverging trends: Asian demand strong, Eur/US softening.
	Nov foreign reserves US$bn	3101.2	–	–	Authorities focused on stability of TWI not USD/CNY.
Eur	Q3 GDP	–0.1%	–	–	Final estimate.
US	Initial jobless claims	218k	–	–	Still near its lows, for now.
	Oct consumer credit $bn	9.1	9.0	–	Interest rates growing as a headwind for credit demand.
Fri 08					
Aus	RBA Head of Financial Stability	–	–	–	Brischetto, speaking at Banking & Fin. Stability conference.
Jpn	Q3 GDP	–0.5%	–	–	Final estimate.
	Oct household spending %yr	–2.8%	–2.9%	–	Broad-based weakness, as real cash earnings remain negative.
	Oct current account balance ¥bn	2723.6	–	–	Surplus sustained at elevated level.
US	Nov non–farm payrolls	150k	200k	180k	Watch for negative revisions to prior months…
	Nov unemployment rate	3.9%	3.9%	3.9%	… given household employment and surveys…
	Nov average hourly earnings %mth	0.2%	0.3%	0.2%	… are materially weaker. Wage g'th not a threat to CPI.
	Dec Uni. of Michigan sentiment	61.3	–	–	Little–changed from mid–year as expectations sour.
Sat 09					
Chn	Nov CPI %yr	–0.2%	–0.2%	–	Soft demand and capacity limiting consumer inflation…
	Nov PPI %yr	–2.6%	–3.0%	–	… as growing capacity holds back upstream price gains.

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