WEEKLY ECONOMIC COMMENTARY

12 Feb 2024 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz

Plenty to ponder

Last week's labour market surveys will have left the Reserve Bank with some mixed feelings. Higher interest rates are cooling the New Zealand economy, and unemployment has continued to rise. But the process isn't happening as fast as hoped, and wage growth remains much higher than what would be consistent with the 2% inflation target. These results, along with a string of data and events this week, will give markets a lot to ponder ahead of the next RBNZ policy statement.

The Household Labour Force Survey (HLFS) showed that the unemployment rate rose from 3.9% to 4.0% in the December quarter. From one perspective, that's a substantial rise from the cycle low of 3.2% that was reached in early 2022. But it's still a very low rate compared to history – equaling the low point reached in the pre-Covid years, when the labour market was clearly becoming tight.

The result was stronger than the increase to 4.2% that we and the Reserve Bank were forecasting. However, the reasons for the 'miss' were well within the normal range of outcomes. The number of people employed rose by 0.4%, slightly more than the 0.3% that we estimated, but much in line with the already-published Monthly Employment Indicator. At the same time, the labour force participation rate dipped slightly to 71.9%, with more teenagers and retirees exiting from the workforce altogether.

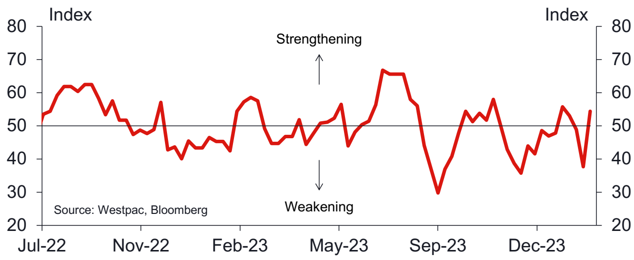
Employment is still growing at a reasonable clip, up 2.4% over the last year. But that's been in the context of very strong population growth. Record net inward migration (almost 130,000 people over the last year) has boosted the working-age population by around 3% over that time. And a cooling economy means that jobs growth is not keeping pace with population growth.

The slower than expected rise in unemployment will be of some concern to the Reserve Bank. Unemployment is not a goal in and of itself, and as of late last year,

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

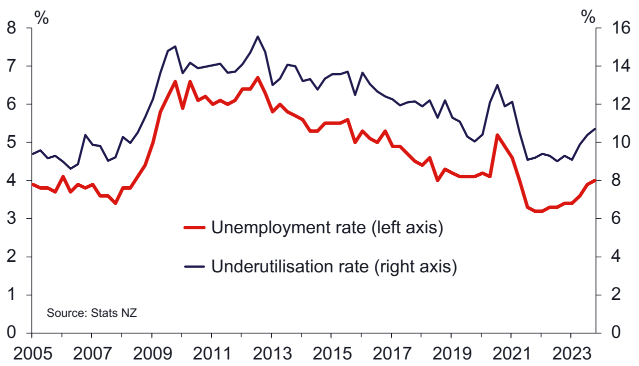


Key data and event outlook

Date	Event
12 Feb 24	RBNZ Governor Orr to speak at FEC
14 Feb 24	NZ selected price indexes, January
16 Feb 24	RBNZ Governor Orr to speak on inflation remit
28 Feb 24	RBNZ Monetary Policy Statement and OCR
13 Mar 24	NZ selected price indexes, February
19 Mar 24	RBA Monetary Policy Decision and SMP
20 Mar 24	FOMC Meeting (Announced 21 Mar NZT)
21 Mar 24	GDP, December quarter
9 Apr 24	QSBO business survey, March quarter
10 Apr 24	RBNZ Monetary Policy Review
12 Apr 24	NZ Selected price indexes, Mar
1 May 24	NZ labour market statistics, March quarter
1 May 24	FOMC Meeting (Announced 2 May NZT)

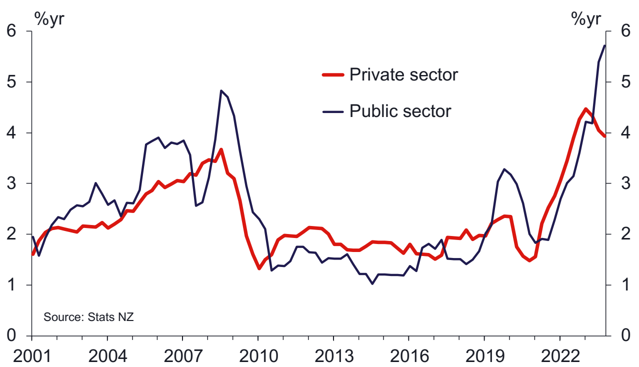
the requirement to "support maximum sustainable employment" has been removed from the RBNZ's mandate, leaving inflation as the sole focus. Even so, labour market measures are a useful real-time indicator of how hot the economy is running, and hence the likely degree of future inflation pressures.

Unemployment and underutilisation rates



The other unwelcome – and related – surprise for the RBNZ was that wage growth is not cooling as quickly as expected. That's been partly exacerbated by some substantial pay agreements in health and education in the last two quarters, lifting public sector wage growth to 5.7% over the last year – the highest on record going back to 1994. Private sector wage growth has more clearly passed its peak, but it remains fairly robust: up 1.0% in the December quarter, and 3.9% on a year ago. That's still a long way from what would be consistent with the RBNZ's overall inflation target of 2%.

Public and private sector wage growth



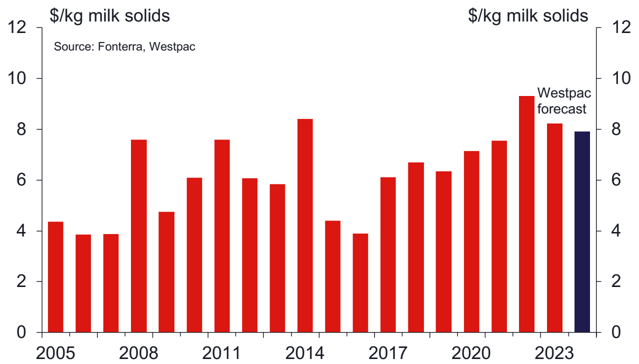
We shouldn't lose sight of the fact that monetary policy is working; the economy is cooling, and inflation will continue to track down towards the target range. The concern for the RBNZ is whether it will get there within a reasonable timeframe. For the last year or so, the RBNZ has been consistently forecasting inflation to drop below 3% in the September quarter of 2024 – a date that is no longer all that far away.

The labour market figures on their own are unlikely to spur the RBNZ to a fresh round of interest rate hikes – and they will need to be balanced against softer-than-expected GDP and inflation outturns since the November *Monetary Policy Statement*. We think this data vindicates the stance we have had for a while that the OCR will remain unchanged in 2024. It's plausible, though, that the RBNZ continues to express its previous concern that an interest rate increase could come in the next six months if core inflation pressures don't adequately recede. The 28 February *Statement* would be an ideal platform to lay out the case for that move.

The other economic update of note last week was a further rise in prices at the GlobalDairyTrade auction, with the key product of whole milk powder up by 3.4%. The rebound in dairy prices over recent months has been something of a surprise, given the range of forces that seemed to be weighed against them. Chinese consumers remain on shaky ground, and fears that an El Niño-led drought could curtail milk production in New Zealand have now faded.

The rise in auction prices means that we have revised up our farmgate milk price forecast for this season from $7.50/kg to $7.90/kg, putting it towards the upper end of Fonterra's most recent guidance of $7-8/kg. That would provide some relief to dairy farmers, though it's hardly a bumper result. A sharp rise in on-farm costs in the last couple of years means that some farmers will still be operating below break-even for this season.

Farmgate milk prices



The week ahead.

The unusually long gap between policy reviews means that any communication from the RBNZ ahead of the February *Statement* will be eagerly followed by the market. This week there are two speaking opportunities. On Monday, senior RBNZ staff including Governor Orr will be appearing before Parliament's Finance and Expenditure Committee; the sessions will cover the *Financial Stability Report* and the *Annual Report* that were released last year, but the discussion could range more widely.

Then on Friday, Governor Orr will be delivering a keynote speech at the University of Waikato Economic Forum. The brief for the speech indicates that it will be covering all of the RBNZ's functions. But regarding monetary policy in particular, it refers to "the shift from transitory to more stubborn underlying inflation," which hints that the RBNZ still sees inflation as a problem that needs to be actively managed.

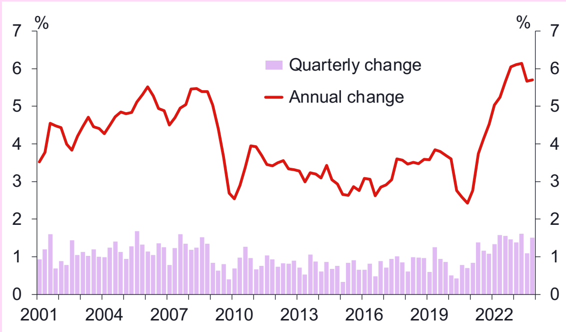
There are several other noteworthy data releases throughout the week, including the survey of inflation expectations, the selected monthly price indices, card spending, house sales and migration – see our preview boxes for more detail. Some of these will be coming off some relatively weak results at the end of last year, so this week's updates will shed some light on whether this reflected a Christmas-period lull, or a more sustained softening in the economy.

Michael Gordon, Senior Economist

Chart of the week.

The Labour Cost Index (LCI) provides the most like-for-like comparison of unit labour costs over time. That excludes pay increases related to productivity improvements or job promotions. For a better reflection of what workers are actually receiving, Stats NZ also provides an unadjusted version of the LCI. This measure has risen by 5.7% over the last year – well above what would be consistent with 2% consumer price inflation. And while the September quarter results hinted at an easing in the pace of growth, the December quarter proved to be surprisingly strong.

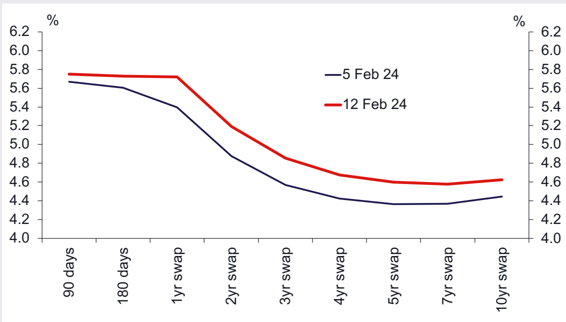
Analytical unadjusted LCI, private sector



Fixed versus floating for mortgages.

With inflation dropping back, we don't expect that the RBNZ will take the OCR higher. However, we still think OCR reductions are a way off. Fixing for a shorter term would provide borrowers with greater flexibility if mortgage rates fall later this year. However, for borrowers who favour certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

The US data flow remained robust last week, with the ISM services index rising to a 4-month high of 53.4 and weekly initial jobless claims still low at just 218k. However, the Fed's Senior Loan Officer Survey reported tighter standards and weaker demand for business and commercial real estate loans over the past quarter. Reflecting on the recent data flow and Fed communications, Westpac now expects the first Fed easing to occur in June this year – three months later than forecast previously – but continue to look for 100bps of easing across 2024. The focus in the US this week will be Tuesday's CPI report, to see whether core inflation is continuing to evolve in a manner that will give the Fed the confidence required to begin a policy easing cycle. On the activity front, given the recent surprising resilience seen in consumer spending, the focus will be on Thursday's retail sales report for January. The latest IP report and Philly Fed manufacturing and NAHB housing surveys will also be released on Thursday while PPI and housing starts reports will follow on Friday. Also on Friday, the University of Michigan will release the preliminary findings of its consumer survey for February – of interest given the recent sharp decline in inflation expectations.

Europe.

As far as data is concerned, the key focus in Europe next week will be on the latest labour market (Tuesday), CPI (Wednesday), GDP (Thursday) and retail sales (Friday) reports in the UK. The second estimate of euro area GDP growth for Q4 will be released Wednesday.

Asia-Pacific.

In China, the CPI fell 0.8% in the year to January – a soft outcome, but one that owed in part to the timing of the Lunar New Year holiday. Producer prices fell 2.5% from a year earlier, improving only slightly from last year. With the Lunar New Year holiday underway, Chinese markets will remain closed until 19 February. In Japan, household spending data disappointing markets, while respondents to the Economy Watchers survey were less positive about the current state of the economy. The focus this week will be Thursday's preliminary read on GDP in Q4, with the market expecting a modest rebound after a 0.7% contraction in Q3. In Australia the RBA left its policy rate on hold last week. While the accompanying commentary was less hawkish than previously, the RBA has not ruled out the possibility of a further hike. This week the latest consumer and business confidence surveys will attract interest on Tuesday, but the focus will be Thursday's Labour Force report for January. Westpac expects the unemployment rate to nudge up to a 2-year high of 4.0%.

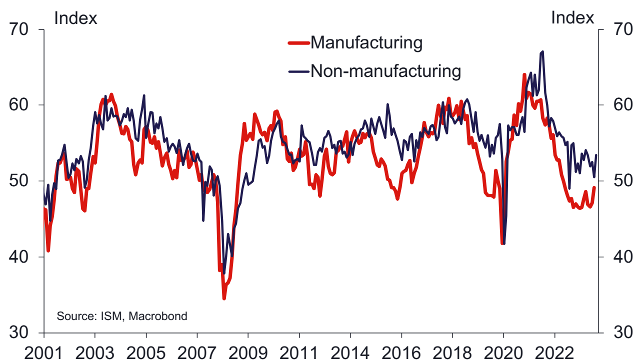
Trading partner real GDP (calendar years)

	Annual average % change			
	2022	2023	2024	2025
Australia	3.8	2.0	1.3	2.2
China	3.0	5.3	5.3	5.0
United States	2.1	2.5	2.6	1.3
Japan	1.0	2.0	0.9	0.9
East Asia ex China	4.5	3.4	4.2	4.3
India	7.2	6.4	6.4	6.4
Euro Zone	3.3	0.5	1.1	1.1
United Kingdom	4.1	0.4	0.5	1.3
NZ trading partners	3.3	3.4	3.5	3.4
World	3.5	3.3	3.3	3.1

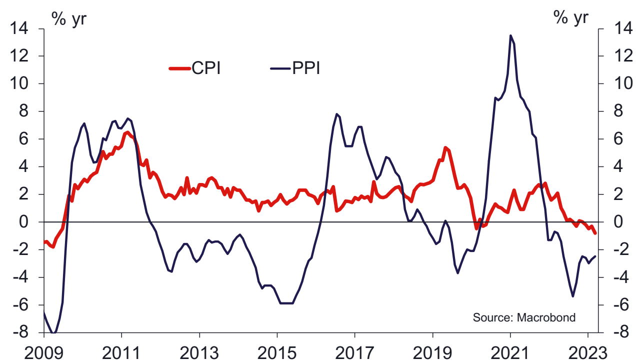
Australian & US interest rate outlook

	9-Feb	Jun-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	3.85	3.10
90 Day BBSW	4.34	4.37	3.92	3.30
3 Year Swap	3.89	3.95	3.75	3.50
3 Year Bond	3.69	3.75	3.55	3.30
10 Year Bond	4.13	4.05	3.85	4.00
10 Year Spread to US (bps)	-2	5	5	0
US				
Fed Funds	5.375	5.125	4.375	3.375
US 10 Year Bond	4.15	4.00	3.80	4.00

US ISM manufacturing and non-manufacturing



Chinese inflation



Financial markets wrap

Interest rates.

NZ swap rates rose sharply last week, the 2yr up 45bps to a 3 month high of 5.19%. The initial catalyst was strong US jobs data, which caused US yields to surge, and other countries to follow suit. Then we had NZ labour data, which caused markets to reduce the likelihood of the RBNZ easing this year. On Friday, a bank revised its OCR forecast from cuts to hikes. Markets pricing for the OCR has flipped, with a hike at the 28 February MPS now seen as a 50% chance, and May seen as a certainty of a hike (last week it was seen as a 40% chance of a cut!). A rate cut in November is seen as a 100% chance, implying there will be a dramatic reversal in RBNZ stance. This is not the view of our economists, who continue to expect a long period on hold, and easing to start in February 2025. We expect market pricing will remain volatile, and guess that it will look quite different in a few months' time.

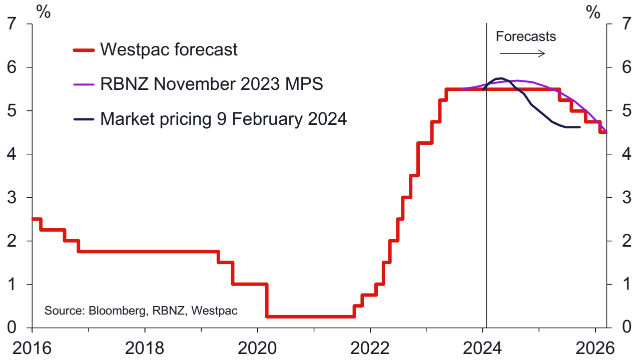
This week contains a number of events which are likely to cause market volatility. Probably of most importance will be RBNZ Governor Orr's speech on Friday, where he will discuss monetary policy and inflation. Markets will closely scrutinise the content for any perceived clues to the 28 February MPS. Governor Orr will also appear before Parliament's Finance and Expenditure Committee today, where the Q&A will be of particular interest. Datawise, inflation expectations, retail spending, house prices, and migration are on tap in NZ, while overseas, US CPI data and Australian jobs data will be influential. Previously, we had expected the 2yr swap to be capped around 5.00%, but in light of the surprises mentioned above, now see the 5.25%-5.35% as the ceiling for the recent rise in yields.

Foreign exchange.

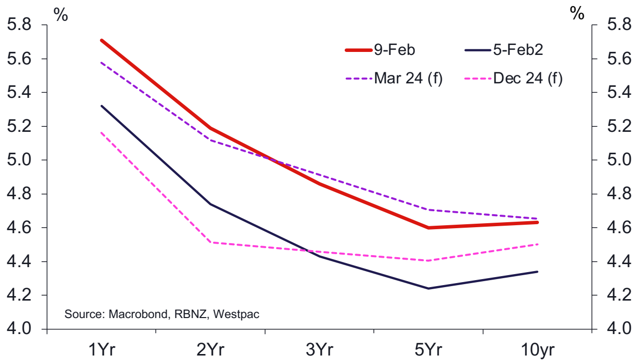
NZD/USD has been the clear outperformer among G10 currencies over the past week, mainly due to the local events described in the interest rate section above. The local events have been powerful to dominate a still firm US dollar. NZD/USD has been confined to a range over the past month, between 0.6040 and 0.6175, but it now looks poised to break higher. If it did, there would be potential to head towards 0.6300 multi-month. The justification for such a rise would be growing expectations that the RBNZ's next easing cycle will start much later than the US Federal Reserve's. Such a rise would also present a hedging opportunity for NZ importers.

NZD outperformance has also caused NZD/AUD to break above its year-old range, signalling a move to 0.9500 during the weeks ahead, and potentially even higher. Expectations of the RBNZ vs the RBA will be the dominant driver, with longer-term fundamentals such as relative fiscal and current account outlooks (which argue for a lower cross) taking a back seat for now.

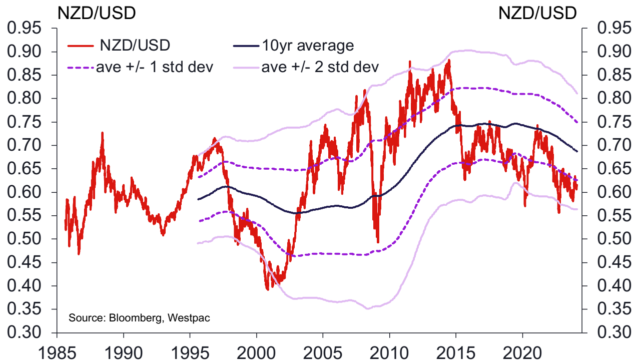
Official Cash Rate forecasts



Swap rates



NZD/USD vs rolling 10yr average



FX recent developments

	Historical data				F'cast
	Spot	3mth range	5yr range	5yr avg	Dec-24
USD	0.615	0.588-0.635	0.555-0.743	0.652	0.64
AUD	0.943	0.920-0.942	0.873-0.992	0.933	0.91
EUR	0.570	0.549-0.572	0.517-0.637	0.585	0.56
GBP	0.487	0.478-0.497	0.464-0.544	0.508	0.50
JPY	91.9	88.1-91.3	61.3-91.3	78.0	88.3

The week ahead

NZ Q1 RBNZ Survey of Expectations

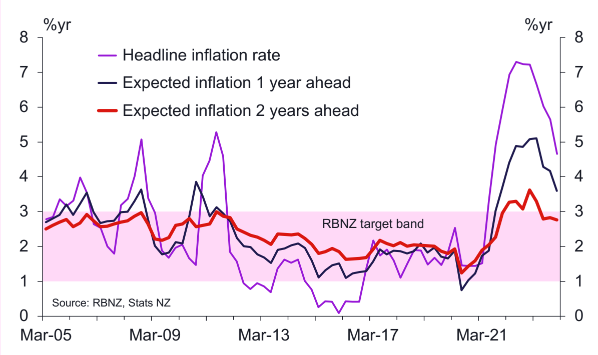
Feb 13, Last: Expected inflation two years ahead: +2.76%

With headline inflation dropping back, we expect that the slide in shorter term inflation expectations seen in recent months will continue in the RBNZ's latest Survey of Expectations. That includes a fall in the closely watched survey of inflation 2 years ahead.

The RBNZ looks at a range of surveys and the importance of this particular measure has waned over time. However, the softening in expectations seen in recent months will still be welcome news to the RBNZ.

While short-term inflation expectations are dropping back, longer term expectations have lingered at levels above 2%. Given the RBNZ's concerns about the ongoing strength of domestic inflation, we'll be watching to see if that strength has continued in the early part of 2024.

RBNZ Survey of Expectations



NZ Jan REINZ house sales and prices

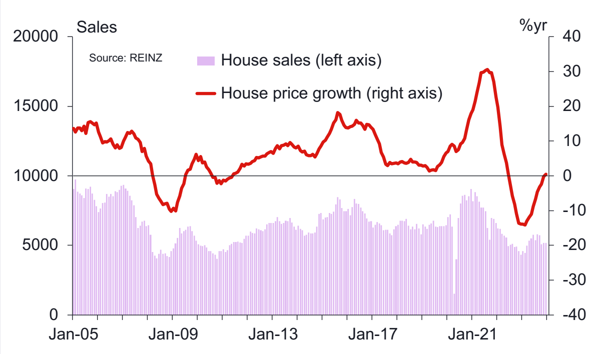
Feb 14, Sales* – Last: -0.4% mth, +14.2% annual
Prices* – Last: -0.3% mth, +0.5% annual

* Monthly figures based on Westpac seasonal adjustment

New Zealand's housing market continued to tread water in December. Sales have picked up from the very low levels we saw at the start of 2023, but they remain subdued. Similarly, prices have continued to track sideways.

We expect that high interest rates will have again been a brake on house price growth and sales in January. However, that softness is expected to gradually give way to a period of stronger activity over the coming year. Population growth is booming and real estate agents are reporting a pick-up in buyer interest. In addition, the new Government plans to introduce policies that will help to boost investor demand.

REINZ house prices and sales



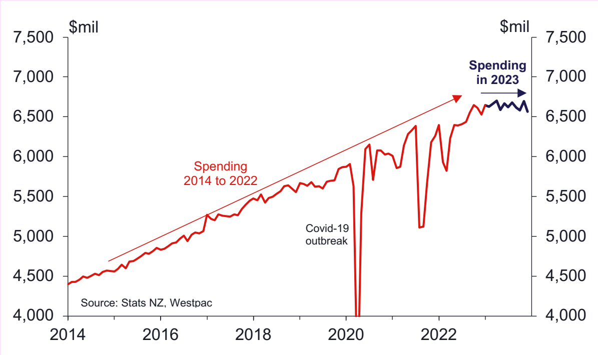
NZ Jan retail card spending

Feb 14, Last: -2.0%, Westpac f/c: +0.5%

The retail sector ended 2023 on a soft note, with spending levels falling by 2% in December. Nominal spending levels effectively tracked sideways over the past 12 months. That's despite population growth of around 2% and price rises of close to 5%.

After December's weakness, we're forecasting a modest 0.5% rebound in January. However, smoothing through the month-to-month volatility, the momentum in spending remains weak. While the rapid increases in the population are providing a floor under demand, spending on items in discretionary areas (such as household durables) continues to be dampened by tight financial conditions.

New Zealand retail spending growth has stalled



The week ahead

NZ Jan monthly selected price indices

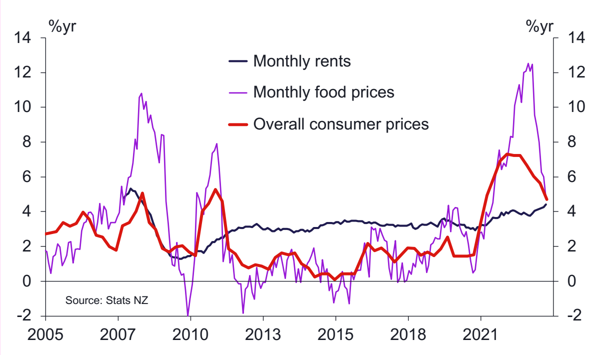
Feb 14

Stats NZ's expanded suite of monthly price data covers around 45% of the CPI, helping to remove much of the uncertainty around the quarter-to-quarter swings in the inflation.

We expect that the January update will show a 1% fall in fuel prices and a 1% seasonal rise in food prices. In addition, a key focus for the RBNZ will be rents. In line with recent trends, we are expecting a 0.4% rise over the month, which would leave rents up a solid 4.6% over the past year.

We'll also be keeping a close eye on airfares, which have swung around sharply in recent months, accounting for much of the volatility in the overall CPI. International airfares rose 42% in December. We expect prices to hold steady in January, with an easing expected later in the quarter.

NZ selected consumer prices



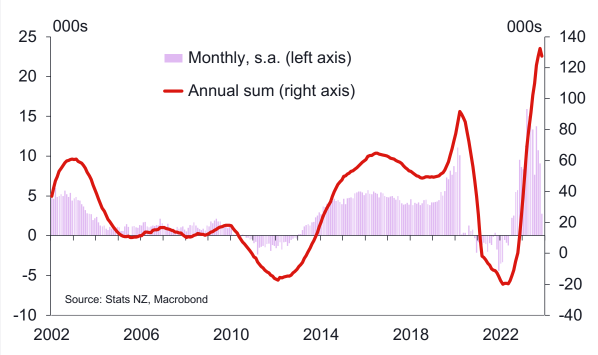
NZ Dec net migration

Feb 15, last: +2,740 mth, +127,412 annual

The November migration figures suggested a plunge in net inflows, driven by a near-doubling in departures. However, migration data can be substantially revised as more information about people's movements becomes available, and in this case even Stats NZ warned that people should "make their own judgement" as to how to use these results. If the November figures were in error, the most likely cause is that holidaymakers were misclassified as migrants, due to spending more time out of the country than they have in the previous few years.

Foreign arrivals have remained high, although down from the peaks reached earlier in 2023. There is probably still an element of catch-up after the Covid border closure delayed people's plans. But we think that, over time, a slowing economy and fewer job prospects will reduce New Zealand's appeal as a destination for migrants.

NZ net migration

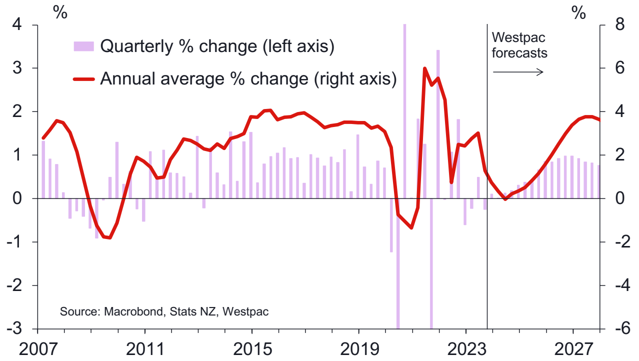


Economic and financial forecasts

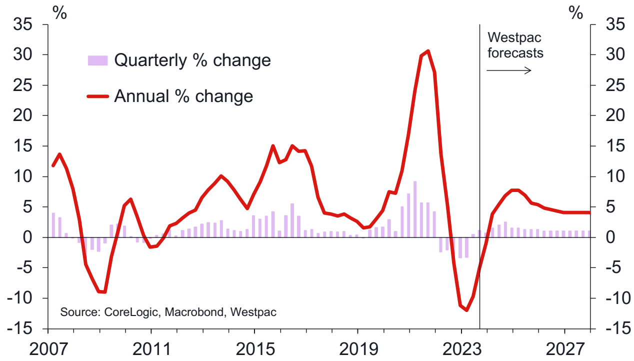
Economic indicators	Quarterly % change				Annual % change			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
GDP (production)	-0.3	0.1	0.0	0.1	2.4	0.7	0.3	1.6
Consumer price index	1.8	0.5	0.9	0.6	7.2	4.7	3.1	2.5
Employment change	-0.2	0.2	-0.1	0.0	1.7	2.1	-0.2	1.2
Unemployment rate	3.9	4.0	4.3	4.6	3.4	4.0	5.1	5.2
Labour cost index (all sectors)	1.1	1.0	0.8	0.8	4.1	4.3	3.4	2.5
Current account balance (% of GDP)	-7.6	-7.1	-6.5	-6.2	-8.8	-7.1	-5.2	-4.0
Terms of trade	-0.6	-1.7	2.6	2.2	-4.2	-3.5	9.6	5.8
House price index	2.1	1.0	1.5	2.0	-11.2	1.0	8.0	6.4

Financial forecasts	End of quarter				End of year			
	Sep-23	Dec-23	Mar-24	Jun-24	2022	2023	2024	2025
OCR	5.50	5.50	5.50	5.50	4.25	5.50	5.50	4.50
90 day bank bill	5.66	5.65	5.60	5.60	4.26	5.65	5.50	4.50
2 year swap	5.53	5.28	5.10	4.95	5.10	5.28	4.50	4.00
5 year swap	4.90	4.84	4.70	4.60	4.67	4.84	4.40	4.10
10 year bond	4.87	5.09	4.85	4.70	4.31	5.09	4.60	4.25
TWI	70.6	70.8	71.7	71.5	70.8	70.8	71.1	69.5
NZD/USD	0.61	0.60	0.62	0.63	0.60	0.60	0.64	0.65
NZD/AUD	0.92	0.93	0.94	0.93	0.92	0.93	0.91	0.89
NZD/EUR	0.56	0.56	0.57	0.57	0.59	0.56	0.56	0.56
NZD/GBP	0.48	0.49	0.50	0.50	0.51	0.49	0.50	0.50

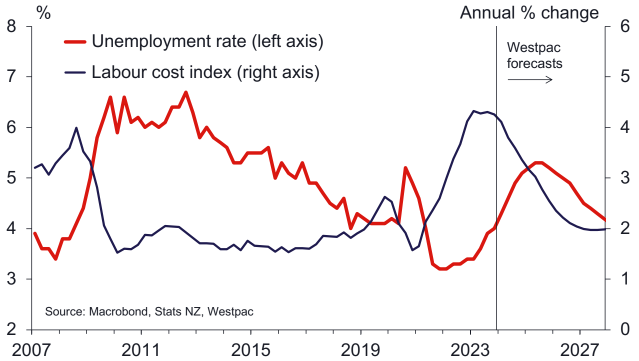
GDP growth



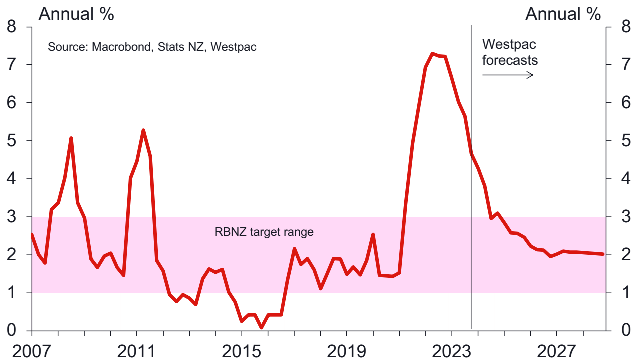
House prices



Employment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	RBNZ Gov, Board Chair and others	–	–	–	Speaking at Finance and Expenditure Committee.
Asia	Lunar New Year	–	–	–	New Year on Feb 10th, ongoing until Feb 14th.
US	Fedspeak	–	–	–	Barkin, Kashkari.
Tue 13					
NZ	Q1 RBNZ 2yr inflation exp. survey	2.76%	–	–	Likely to fall again, consistent with drop in actual inflation.
Aus	Feb Westpac–MI Cons. Sentiment	81.0	–	–	Easing inflation, re-jigged Stage 3 tax cuts may impact.
	Jan NAB business survey	7	–	–	Conditions slowdown continues. Downbeat mood, at –1.
	RBA Head of Economic Analysis	–	–	–	Speaking at ABE Annual Forecasting Conference.
Eur	Feb ZEW survey of expectations	22.7	–	–	Rate hikes weigh on confidence and conditions.
UK	Dec average weekly earnings %yr	6.5%	–	–	Decelerating briskly, but still too high for BoE's comfort.
US	Jan CPI	0.3%	0.2%	0.2%	Shelter prices keeping the pressure on headline.
	Jan NFIB small business optimism	91.9	–	–	Focus centred on employment and prices.
Wed 14					
NZ	Jan REINZ house sales %yr	14.2%	–	–	TBC. Sales have flattened off at low levels…
	Jan REINZ house prices %yr	0.5%	–	–	… and market momentum is limited at this stage.
	Jan retail card spending	–2.0%	–	0.5%	Spending appetites remain subdued.
	Jan selected price indices	–	–	–	Updates on key prices, incl. food, fuel, rents and airfares.
Eur	Q4 GDP	0.0%	0.0%	–	Second estimate to provide more colour on growth mix…
	Dec industrial production	–0.1%	–	–	… and confirm the broad-based weakness in production.
UK	Jan CPI %yr	4.0%	4.3%	–	Services inflation is only gradually abating, at best.
US	Fedspeak	–	–	–	Goolsbee, Barr.
Thu 15					
NZ	Dec net migration	2740	–	–	Annual inflow looks like it's close to its peak.
Aus	Jan employment change	–65.1k	+27.5k	+15.0k	Jan is the most seasonal time of year for the labour market..
	Jan unemployment rate %	3.9%	4.0%	4.0%	… decline in hours worked and a rise in U/E are clear risks.
	Feb MI inflation expectations	4.5%	–	–	Provides a general view of risks.
Jpn	Q4 GDP	–0.7%	0.3%	–	Household consumption set to remain in a fragile state.
Eur	Dec trade balance €bn	14.8	–	–	Surplus driven by lower imports, as local demand falters.
UK	Q4 GDP	–0.1%	0.0%	–	Activity has stalled virtually flat; technical recession a risk.
US	Jan retail sales	0.6%	–0.2%	–	Post-Christmas hangover in retail spending.
	Jan industrial production	0.1%	0.4%	–	Tracking a subdued trend into year-end…
	Feb Philly Fed index	–10.6	–9.0	–	… as the regions struggle to shake off…
	Feb Fed Empire state index	–43.7	–10.0	–	… lingering uncertainty and growing pessimism.
	Jan import price index	0.0%	–0.1%	–	Benefitting from the global deceleration in goods prices.
	Dec business inventories	–0.1%	0.4%	–	Perceptions of weak demand is key.
	Feb NAHB housing market index	44	–	–	Long road ahead for recovery in homebuilder sentiment.
	Initial jobless claims	218k	–	–	To remain at a relatively low level, for now.
Fri 16					
NZ	Jan manufacturing PMI	43.1	–	–	Likely to remain at contractionary levels.
	RBNZ Governor Orr	–	–	–	Speech on inflation and the RBNZ's target, NZ 7:40am.
UK	Jan retail sales	–3.2%	–	–	Consumers downbeat as financial conditions remain tight.
US	Jan housing starts	–4.3%	0.0%	–	Starts dwindle as cost of financing dissuade…
	Jan building permits	1.8%	1.5%	–	… builders from starting new projects.
	Jan PPI	–0.1%	0.1%	–	Some volatility in global commodities markets.
	Feb Uni. of Michigan sentiment	79.0	79.0	–	Inflation expectations will be closely monitored.
	Fedspeak	–	–	–	Bostic, Daly.

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