



WEEKLY ECONOMIC COMMENTARY



8 Jul 2024 | Westpac Economics Team | westpac.co.nz/economics | economics@westpac.co.nz

Keeping it tight

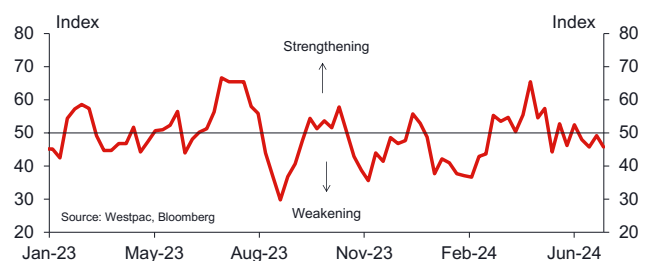
The key event this week in New Zealand will be the RBNZ’s latest policy review, with the decision to be announced at 2pm on Wednesday. That said, we are not anticipating any change in the OCR – which will remain at 5.5% – or the guidance that “...monetary policy needs to remain restrictive to ensure inflation returns to target within a reasonable timeframe”. The overall tone of the RBNZ’s communication is likely to be similar to that seen in May, when the Bank pushed out the timing of its first policy easing to August next year. While there have been some developments since the RBNZ’s May meeting that might shift the policy outlook at the margin, there are several very important data releases that lie ahead in coming weeks – notably the Q2 CPI and labour market reports. The RBNZ will want to see this data before contemplating any change in stance. The August Monetary Policy Statement meeting will see the RBNZ present updated projections for the economy and a refreshed track for the OCR and would be the more likely vehicle for communicating a less hawkish stance – one more consistent with our forecast of a first policy easing in February next year.

With the key policy message likely unchanged, we expect the policy statement accompanying this week’s decision will be very brief, much as was the case with the April policy review. The main interest therefore will likely fall on the nuances conveyed in the discussion in the Record of Meeting, which might provide some insight into how the RBNZ is provisionally interpreting recent developments. Back in May, the RBNZ noted that some upside risks to growth and inflation potentially could come from the fiscal outlook. This week’s review is the RBNZ’s first opportunity to update its view now the Budget is public. We anticipate the RBNZ will continue to retain a hawkish perspective with respect to fiscal risks as Budget 2024 ended up being slightly less contractionary than the projections the RBNZ’s forecasts were based on. However, we doubt the Bank will be drawing definitive

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 New Zealand Data Pulse Index



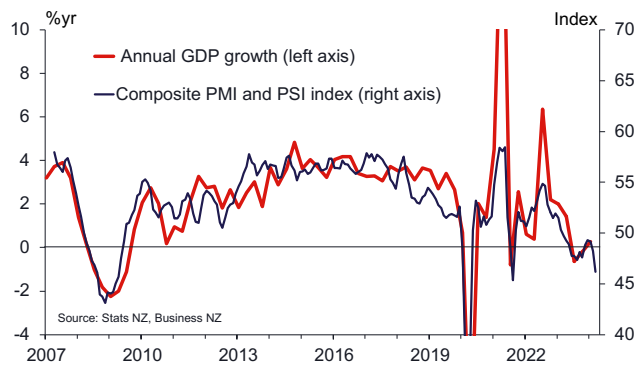
Key data and event outlook

Date	Event
10 Jul 24	RBNZ OCR Review
11 Jul 24	NZ Selected price indexes, June
17 Jul 24	NZ CPI, June quarter
31 Jul 24	FOMC Meeting (Announced 1 Aug NZT)
6 Aug 24	RBA Monetary Policy Decision & SMP
7 Aug 24	Labour market statistics, June quarter
8 Aug 24	RBNZ Survey of Expectations, June quarter
14 Aug 24	RBNZ OCR Review & Monetary Policy Statement
15 Aug 24	NZ Selected price indexes, July
12 Sep 24	NZ Selected price indexes, August
18 Sep 24	FOMC Meeting (Announced 19 Sep NZT)
19 Sep 24	NZ GDP, June quarter
24 Sep 24	RBA Monetary Policy Decision
1 Oct 24	NZIER QSBO survey, September quarter

conclusions as no forecasts will be presented at this review and it is too early to judge the impact that tax cuts (timed to begin at the end of July) will have on consumer spending and inflation.

On the other hand, while the March quarter GDP outcome printed in line with the RBNZ's expectations, recent data pertaining to the June quarter has been very soft – indeed suggesting that the economy has likely contracted during the quarter, in contrast to the RBNZ's expectations. Following some very weak PMI data in mid-June, last week's NZIER QSBO survey confirmed that economic activity remained weak in the June quarter – particularly in the interest-sensitive construction sector – with a net 28% of respondents reporting a decline in their own domestic trading activity. Considering the weakness seen in recent top-down activity indicators, we have nudged down our early estimate of Q2 GDP growth to -0.2%/q/q from -0.1%/q/q previously.

Q2 GDP looks weak based on the PMI indicators



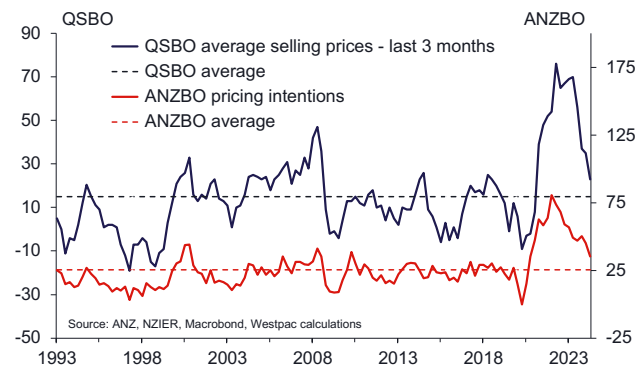
Within the survey firms reported a weaker outlook for investment and employment. Almost 61% of firms reported that lack of demand was the single biggest constraint on output – the most since 2013. Meanwhile, less than 9% of firms cited lack of labour as the biggest constraint – the least since 2014 when the nationwide COVID lockdown quarter is excluded. Indeed, the broad sweep of labour market indicators in the QSBO confirmed that the unemployment rate almost certainly increased further during the quarter. The Monthly Employment Indicator (MEI), also released last week, pointed to a broadly unchanged level of filled jobs in May. However, the MEI has been consistently overestimating employment on its first release, with April employment levels revised down 0.2ppts to now report a 0.1% decline. So, with the working age population continuing to grow, the RBNZ might be thinking they have some upside risks to their unemployment rate projections (which are 0.2ppts lower than Westpac's by the end of 2024).

Factors constraining business activity



On the pricing side of the ledger, we don't see very much to have moved the RBNZ's short term inflation forecasts. At this stage the partial monthly CPI data suggest the Q2 CPI will be in line with the RBNZ's May forecast of 0.6%. House prices have been flat recently and might have some modest downside risks in the RBNZ's forecasts given recent trends. Pricing indicators in both the ANZ and QSBO business surveys suggest that inflation pressures are receding but remain somewhat elevated. The most recent pricing intentions data – which have posted notable declines since the RBNZ's May meeting – will have added to the RBNZ's confidence. However, the RBNZ will want to see these intentions translated into the hard data, with the next couple of quarterly CPI prints most important in that regard.

Pricing intentions indicators compared to average



All up, we don't think the markets will get a dovish tilt that supports recent market pricing (around a 60% chance of an easing in the October Review and around 39bps priced in by end 2024).

Aside from the RBNZ's policy meeting, there are several data releases due this week which will also have a bearing on the policy outlook. On Thursday, Statistics NZ will release the Selected Price Indexes for June, which cover about 45% of the CPI regimen. Following this report, we will finalise our pick for the Q2 CPI, which will be released on 17 July. On Wednesday, we will receive an update on migrant and tourist flows for the month of May. Recent data has suggested that net migrant inflows have slowed from the very high peak levels seen last

year, while the pace of recovery in tourist inflows has slowed markedly. Friday will bring the release of news on consumer spending (which is likely to have remained soft in June if anecdotal and survey reports are any guide) and the latest manufacturing PMI (which has been in contractionary territory since March last year). Finally, late in the week we will receive the REINZ housing report for June. Here too, anecdotal reports point to a still subdued housing market with house prices tracking broadly sideways since September last year.

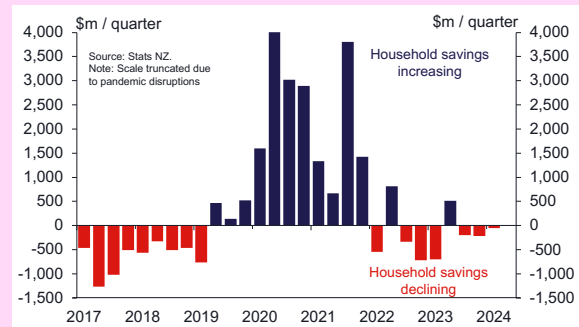
Kelly Eckhold, Chief Economist

Chart of the week.

Adjusting for when borrowers fixed their mortgages, the average mortgage rate that households are actually paying has risen from a low of 3.2% in 2021 to 6.3% now. That's drained a lot of money out of households' wallets. For example, if you have an average priced home with an 80% mortgage, that change would add around \$290/week to your mortgage bill. Combined with strong cost of living pressures, the rise in interest costs has seen per capita household spending falling by nearly 2% over the past year. At the same time the lift in household savings that we saw following the pandemic has gone into reverse – household savings have fallen in six of the past seven quarters.

Although we don't expect any further OCR hikes from the RBNZ, some households are still rolling off the low mortgage rates that were on offer in recent years. But in contrast to the large and rapid increases seen over the past year, the remaining change will be much more modest and gradual. However, for some households the impact of those increases could be compounded by the effects of the slowing labour market.

Household savings dropping back again

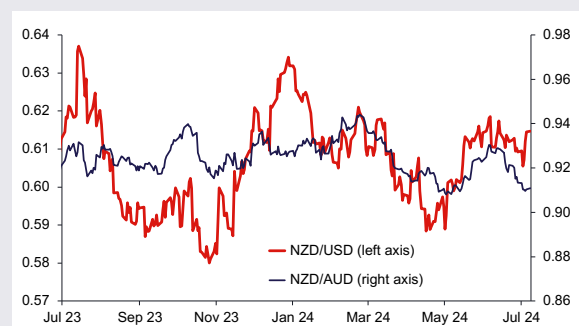


Fixed versus floating for mortgages.

The RBNZ left the OCR on hold in May and signalled that rate cuts are still some way off. Westpac is not forecasting OCR reductions until early 2025.

For borrowers favouring certainty, at current fixed rates we see value in fixing for as long as two years.

NZ interest rates



Global wrap

North America.

US data took on a softer tone last week, particularly in regard to the labour market. Both the manufacturing and services PMIs were below 50 in June, with the employment measures well below their long-run averages. The 206k rise in non-farm payrolls was slightly ahead of market forecasts, but it was accompanied by sizeable downward revisions to the previous two months, a further rise in the unemployment rate to 4.1%, and average hourly earnings growth slowing from 4.1%yr to 3.9%yr. FOMC chair Powell's testimony to Congress this week will provide important clues as to whether interest rate cuts are on track to begin in September as we're expecting. Thursday's June CPI report will also be closely analysed by markets.

Europe.

In Europe the focus over the past week was on the UK and French elections. As polls had predicted, the Labour party won a landslide victory in the UK, giving it a strong mandate to implement its policy manifesto. In France, initial projections from the second-round of voting suggests that the far-right National Rally party has failed to win a majority, with the left-wing New Popular Front alliance appearing to have won the greatest number of votes thanks to tactical voting by leftist and centrist voters. But with no one bloc holding a majority, a period of uncertainty now lies ahead as the various parties across the left and centre seek to form a new stable government. The coming week is quiet as far as European data is concerned.

Asia-Pacific.

The minutes of the RBA's June meeting provided more colour around the Board's deliberations. Discussion of another rate hike was premised on concerns that demand had continued to outstrip supply and that this imbalance could continue, increasing the possibility that inflation will take longer to sustainably return to target. However, the case for leaving policy unchanged was deemed stronger, with the Board of the view that "the economy was still broadly tracking on a path consistent with returning inflation to target in 2026, while preserving as many of the gains in employment as possible." Australian data last week showed a stronger than expected lift in retail sales in May (up 0.6%), while house prices continue to forge ahead at a solid pace. Inflation and trade reports take centre stage in China this week.

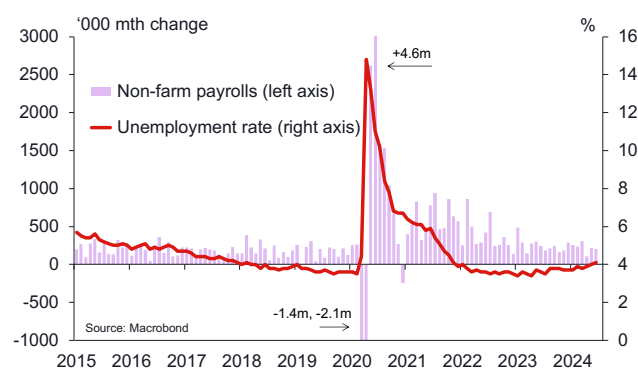
Trading partner real GDP (calendar years)

	Annual average % change			
	2023	2024	2025	2026
Australia	2.0	1.3	2.2	3.1
China	5.2	5.2	5.0	4.8
United States	2.5	2.5	1.5	1.6
Japan	1.9	0.4	1.0	0.9
East Asia ex China	3.3	4.2	4.2	4.1
India	7.8	6.9	6.7	6.5
Euro Zone	0.4	0.6	1.5	1.3
United Kingdom	0.1	0.6	1.3	1.3
NZ trading partners	3.4	3.4	3.4	3.4
World	3.2	3.3	3.3	3.2

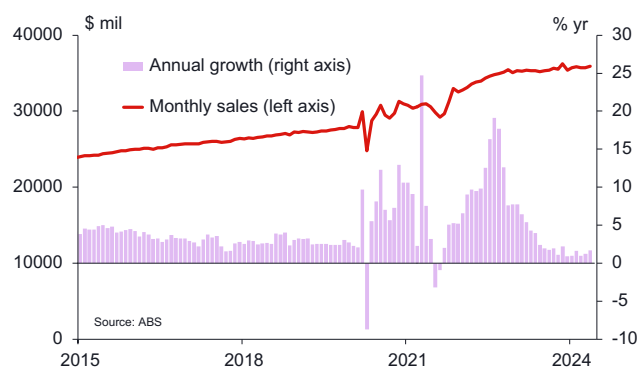
Australian & US interest rate outlook

	5 Jul	Sep-24	Dec-24	Dec-25
Australia				
Cash	4.35	4.35	4.10	3.10
90 Day BBSW	4.46	4.42	4.19	3.30
3 Year Swap	4.28	4.10	4.00	3.50
3 Year Bond	4.16	3.90	3.80	3.30
10 Year Bond	4.41	4.30	4.25	4.00
10 Year Spread to US (bps)	5	-10	-5	0
US				
Fed Funds	5.375	5.125	4.875	3.875
US 10 Year Bond	4.37	4.40	4.30	4.00

US non-farm payrolls and unemployment rate



Australian monthly retail sales



Financial markets wrap

Interest rates.

NZ swap rates fell last week, receivers emboldened by a softening NZ economic data pulse. On Friday evening, softer US labour data caused a sharp fall in US yields, and that has spilled over to NZ this morning. The 2yr swap has broken below its multi-month range bottom at 4.88% and is now at 4.84%. We see potential for this move to extend to 4.80% - the March/April low - during the week ahead, absent surprises, as speculative receiving gathers pace.

The main known events which could surprise this week are the RBNZ policy review and US CPI data and Fed Chair Powell's testimony. We don't expect the RBNZ's statement to differ much from that in May, whereas markets will be watching for any dovish shift in stance (which means they could be disappointed if none is forthcoming). Market pricing assigns a 30% chance to a cut in August, and 60% to October, both quite aggressive relative to our forecast of a first easing in February 2025.

Foreign exchange.

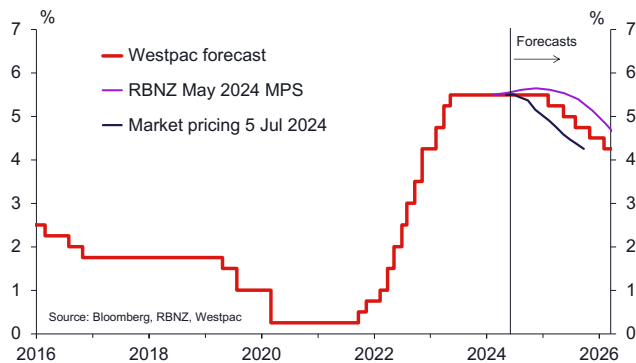
NZD/USD remains in a bullish state near term, with potential to test the multi-month high of 0.6220. Some near-term noise is possible given the EUR's negative reaction this morning to early projections of the French election. But that aside, the key development for the US dollar, and thus NZD/USD, has been Friday's softer than expect US labour data, which has raised expectations of a Fed rate cut, and in turn pushed the US dollar lower.

Our medium-term view has for some time been that the Fed would start cutting earlier than the RBNZ (we expect the Fed to start cutting in September 2024, well before the RBNZ in February 2025), and that would push NZ-US yield spreads higher, which would help support NZD/USD. This view is starting to take shape. The RBNZ part of the view will be in focus this Wednesday, but we don't expect any significant shift in stance. The August MPS is a more likely forum for any major changes.

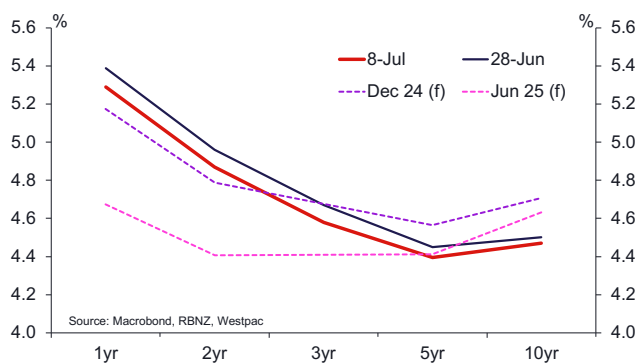
Among the crosses, NZD/AUD retains potential to fall slightly further to 0.9065 – a one-year low. The RBA is more hawkish than the RBNZ, and AU CPI data was stronger than expected. That said, AU markets are pricing an RBA rate hike, which we disagree with, limiting the extent of further AUD outperformance. NZD/JPY made a fresh post-1986 high of 99.04 this morning, which should be attractive to NZ importers. The yen remains weak amid tepid intervention so far from the MoF and BoJ, although the July meeting could signal a change.

NZD/EUR could bounce to the 0.5700-0.5750 area if uncertainty regarding the composition of the French government persists. It could be many days before there is some clarity.

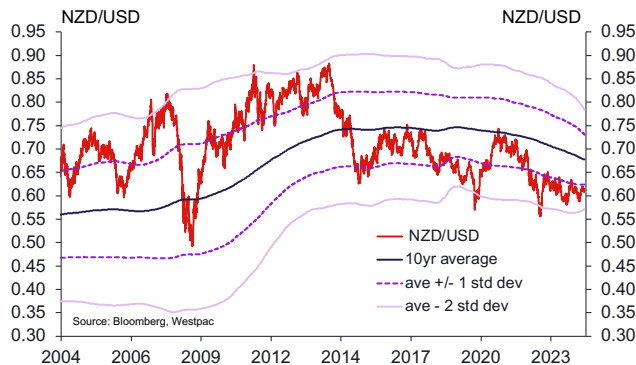
Official Cash Rate forecasts



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	0.614	0.586-0.620	0.555-0.743	0.647	0.61
AUD	0.912	0.907-0.929	0.873-0.992	0.931	0.91
EUR	0.568	0.552-0.573	0.517-0.637	0.582	0.55
GBP	0.480	0.471-0.484	0.464-0.544	0.505	0.48
JPY	98.6	90.4-98.6	61.3-98.6	79.6	96.4

The week ahead

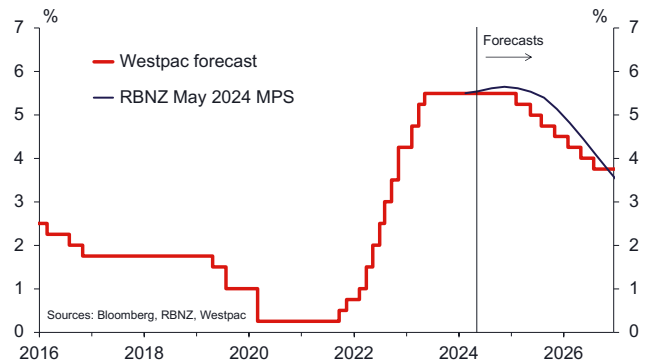
RBNZ monetary policy review

Jul 10, Last: 5.50%, Westpac f/c: 5.50%, Mkt f/c: 5.50%

We expect the RBNZ to leave the OCR at 5.50%, with a brief accompanying statement.

The RBNZ will emphasise the upside risks to inflation emanating from the less contractionary than expected Budget 2024. But they will balance this with some dovish messages around potential downside risks to growth as the economy continues to stall and the labour market eases.

Official Cash Rate forecasts



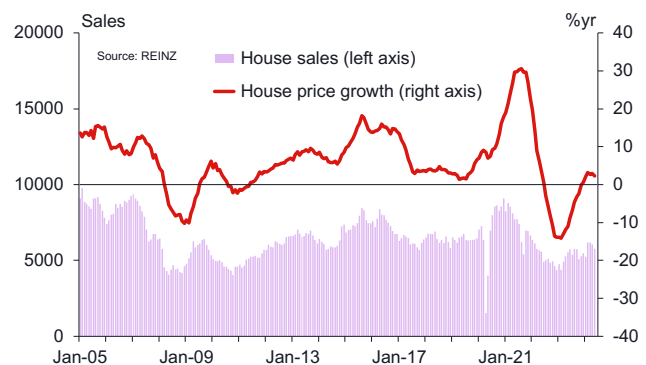
REINZ Jun house sales

**Jul 11 (TBC), Sales, Last: -5.2% mth, +6.8% annual
Prices, Last: -0.3% mth, +2.3% annual**

New Zealand's housing market remained subdued in May. Sales fell for the third month in a row after a surge in activity at the start of the year, while prices have effectively been tracking sideways since last September.

We expect the current softness in the market will eventually give way to a period of stronger activity, underpinned by population growth and policy changes to support investor demand. It may be later this year before we see a meaningful drop in fixed-term mortgage rates, with the RBNZ expected to hold the OCR until 2025.

REINZ house prices and sales



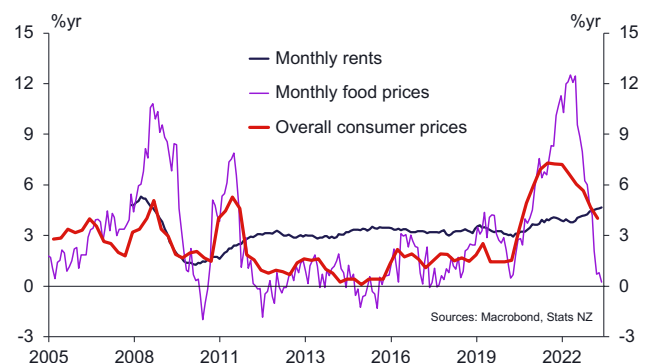
NZ Jun selected price indices

Jul 11

Stats NZ's suite of monthly price data covers around 45% of the CPI, providing a timely update on some of the more volatile components of inflation. We expect a 4% fall in fuel prices in June, along with a 1% rise in food prices (related to a seasonal lift in fresh produce prices). On the domestic front, we expect a 0.3% rise in rents.

A key focus will be whether the cooling in price pressures in discretionary spending area seen recently, like takeaway food and holiday/travel costs, has continued. While these prices are not typically a focus for monetary policy, easing pressures across a range of goods and services would be encouraging for the RBNZ.

Consumer prices



The week ahead

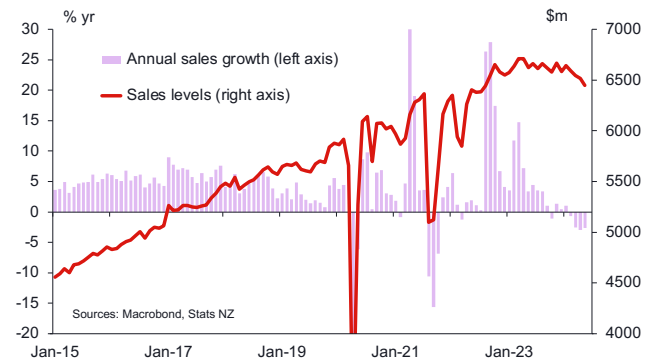
NZ Jun retail card spending

12 Jul, Last: -1.1%, Westpac f/c: -0.2%

Total retail spending fell 1.1% in May, its fourth consecutive month of decline. Falls in spending have been widespread across categories other than food. That weakness has been a result of continued pressure on households' finances from cost-of-living increases and high interest rates.

We're forecasting another modest 0.2% fall in June. While spending on food is expected to be up, spending in discretionary categories is expected to continue dropping back. Petrol prices also fell over the month.

NZ monthly retail sales

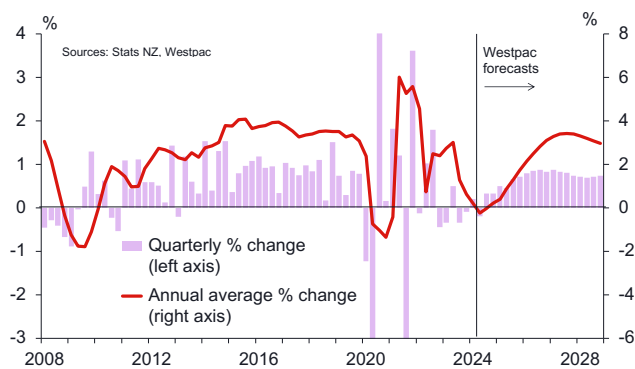


Economic and financial forecasts

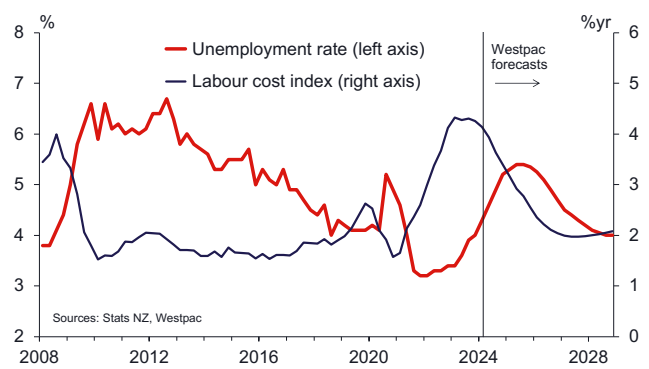
Economic indicators	Quarterly % change				Annual % change			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
GDP (production)	0.2	-0.2	0.3	0.3	0.6	0.2	1.7	3.2
Consumer price index	0.6	0.6	1.1	0.4	4.7	2.8	2.2	2.2
Employment change	-0.2	0.2	0.1	0.1	2.7	0.1	0.9	1.8
Unemployment rate	4.3	4.6	4.9	5.2	4.0	5.2	5.4	4.7
Labour cost index (all sectors)	0.9	0.9	0.8	0.8	4.3	3.4	2.5	2.0
Current account balance (% of GDP)	-6.8	-6.4	-5.9	-5.3	-6.9	-5.3	-4.6	-4.3
Terms of trade	5.1	4.0	2.2	0.6	-10.7	12.3	0.7	2.3
House price index	0.5	0.0	0.5	1.0	0.6	2.0	6.1	5.1

Financial forecasts	End of quarter				End of year			
	Mar-24	Jun-24	Sep-24	Dec-24	2023	2024	2025	2026
OCR	5.50	5.50	5.50	5.50	5.50	5.50	4.50	3.75
90 day bank bill	5.66	5.63	5.60	5.50	5.65	5.50	4.50	3.85
2 year swap	4.91	5.01	5.00	4.80	5.28	4.80	4.15	4.00
5 year swap	4.40	4.53	4.65	4.55	4.85	4.55	4.30	4.25
10 year bond	4.69	4.74	4.90	4.80	5.09	4.80	4.50	4.35
TWI	71.6	71.4	70.5	70.9	70.8	70.9	72.1	70.5
NZD/USD	0.61	0.61	0.60	0.61	0.60	0.61	0.65	0.65
NZD/AUD	0.93	0.92	0.91	0.91	0.93	0.91	0.91	0.89
NZD/EUR	0.56	0.56	0.55	0.55	0.56	0.55	0.57	0.57
NZD/GBP	0.48	0.48	0.47	0.48	0.49	0.48	0.49	0.50

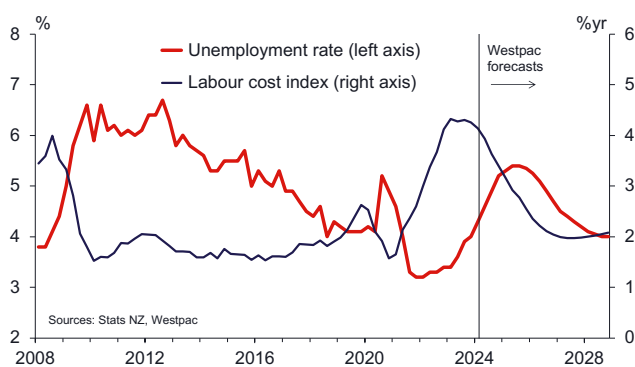
GDP growth



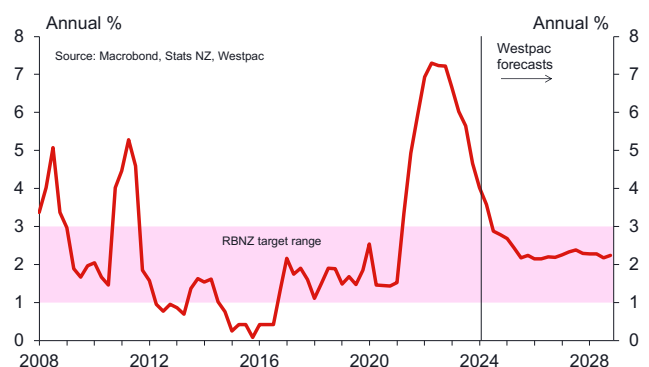
House prices



Unemployment and wage growth



Consumer price inflation



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 08					
Aus	May Housing Finance, %mth	4.8	1.8	-2.0	Minor consolidation after several strong monthly gains...
	May Owner Occupier Finance, %mth	4.3	-	-2.0	... temporary factors supporting owner-occupier loans...
	May Investor Finance, %mth	5.6	-	-2.0	... investor activity has outperformed.
Jpn	May Current Account Balance, ¥bn	2050.5	2393.5	-	Weak yen is supporting inflows.
Eur	Jul Sentix Investor Confidence, pts	0.3	0.0	-	Rate cuts are igniting confidence.
US	May Consumer Credit, \$bn	6.4	11	-	Expected to rise as buffer runs out.
Tue 09					
Aus	Jul Westpac-MI Consumer Sentiment, pts	83.6	-	-	Tax cuts go live but more inflation and rate rise concerns?
	Jun NAB Business Conditions, pts	6	-	-	Conditions gradually moderating to below-average levels.
Chn	Jun M2 Money Supply, %yr	7.0	6.8	-	Due between July 9-15.
US	Jun NFIB Small Business Optimism, pts	90.5	89.0	-	Uncertainty around elections keeps sentiment contained.
	FOMC Chair Powell	-	-	-	Testifies before Senate Banking and Housing Committee.
Wed 10					
NZ	May Net Migration, mth	7380	-	-	Easing from its highs, but revisions cloud the picture.
	Jul RBNZ Policy Decision, %	5.50	5.50	5.50	Expecting a brief statement ahead of key data.
Chn	Jun CPI, %yr	0.3	0.4	-	Excess capacity alongside weak demand will...
	Jun PPI, %yr	-1.4	-0.8	-	... continue to limit price growth.
US	FOMC Chair Powell	-	-	-	Testifies before the House Financial Services Committee.
Thu 11					
NZ	Jun REINZ House Prices, %yr	2.3	-	-	Expected date. The housing market remains in stalemate...
	Jun REINZ House Sales, %yr	6.8	-	-	... while high borrowing costs keep buyers on the sideline.
	Jun Food Price Index, %mth	-0.2	-	1.0	Watching for signs price pressures are continuing to ease.
Aus	Jul MI Inflation Expectations, %yr	4.4	-	-	Provides a general view of risks.
Jpn	May Core Machinery Orders, %mth	-2.9	0.9	-	Developed world demand is hampering orders.
Kor	Jul Bank of Korea Policy Decision, %	3.50	3.50	-	Inflation risks remain negating confidence for a rate cut.
UK	May Monthly GDP, %mth	0.0	-	-	Restrictive policy keeps growth constrained.
US	Jun CPI, %mth	0.0	0.1	-	Shelter is holding up the headline figure.
	Initial Jobless Claims, 000's	238	-	-	To remain low, for now.
	Fedspeak	-	-	-	Musalem.
Fri 12					
NZ	Jun Manufacturing PMI, pts	47.2	-	-	Businesses continue to report sluggish demand.
	Jun Retail Card Spending, %mth	-1.1	-	-0.2	Households' spending appetites remain weak.
Chn	Jun Trade Balance, US\$bn	82.6	84.7	-	Asian demand is supporting the surplus.
US	Jun PPI, %mth	-0.2	0.1	-	Easing oil and commodity prices lowers producer costs.
	Jul Uni. of Michigan Sentiment, pts	68.2	67.0	-	Inflation expectations gauge of key importance.

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