



# ECONOMIC BULLETIN

Hawks, doves, and kiwis.



22 Feb 2024 | **Westpac Economics Team** | [westpac.co.nz/economics](https://westpac.co.nz/economics) | [economics@westpac.co.nz](mailto:economics@westpac.co.nz)  
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Financial markets and economic commentators' views have seesawed in the three months since we last produced this "hawks and doves" note.

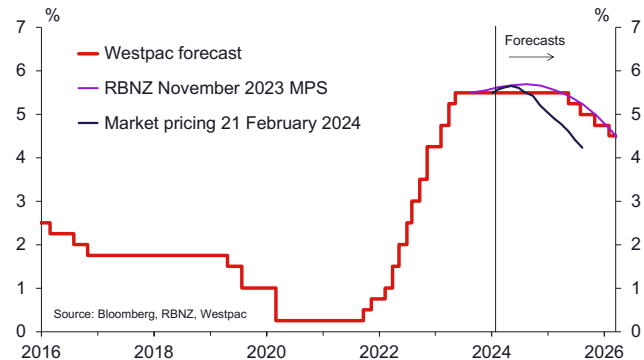
The RBNZ hawks emerged from their nest at the release of the November Monetary Policy Statement, threatening to soar high and push the OCR to a new cycle high some time in 2024.

However, the markets were less convinced by that hawkish view. Instead, they took their lead from the global doves who, with encouragement from the US Federal Reserve, charged back and helped drive forward expectations of OCR cuts. Some commentators even discussed a chance of a rate cut by mid-year. Some weak local growth and lower than expected headline inflation data provided sustenance to the bevy of doves.

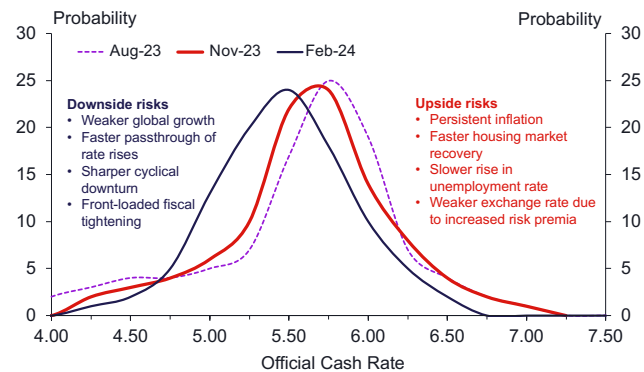
More recently, news that the labour market hasn't adjusted as quickly as expected, that the Fed might not be as dovish as previously thought, and some hawkish sounding rhetoric from RBNZ officials, saw the doves retreat and the hawks regain the initiative. Markets briefly flirted with the idea of a February tightening again. And while that pricing has receded, markets are no longer entirely ruling out the possibility that 2024 will be the year of the hawk (and not the dragon).

So, with arguments on both sides, the Westpac Economics team has again been considering how the outlook for monetary policy might evolve over the coming year or so. To help organise our thoughts and promote thought and debate, we have marshalled a range of hawkish and dovish considerations that, while not exhaustive, might be debated by those driving the future direction of policy. As always, we invite feedback on the perspectives we discuss here and any additional relevant viewpoints.

## Official Cash Rate forecasts



## OCR Risk Scenarios - February 2025



## The Hawk's Eye View.

**The RBNZ is on a knife edge and is running short on time** to take action to drive inflation to the 2% mid-point of the target range in the second half of 2025.

- The RBNZ's new mandate allows no real room to wait and hope inflation pressures moderate.
- Firms indicate a desire to push through price increases implying inflation might get stuck above 3%.

**Non-tradables inflation has not cooled as fast as the RBNZ expected** so downside surprises to headline inflation might not continue if disinflation in the tradables sector stalls (*Figure 1*).

- Much of the strength in domestic inflation owes the resilience in wage growth and migration. On both of those fronts, there are clear risks that they will continue to add to domestic inflation pressures over the coming year.
- However, there have also been large increases for a range of other items such as local authority rates and electricity. Crucially, the coming years are likely to see continued strong pressures on such costs (for instance, many local authorities have highlighted growing pressure on their budgets). While such prices may not be directly affected by changes in monetary policy, the RBNZ does not have the headroom to absorb upside surprises on this front if they want to get back to 2% in a reasonable timeframe.

**The labour market is not adjusting sufficiently** to ensure inflation returns to 2% (*Figure 2*).

- The unemployment rate again undershot RBNZ expectations in Q4 2023 and will require a further revision of the RBNZ's forecasts.
- Wage growth remains resilient and needs to fall faster to ensure core inflation pressures recede. Weaker wage growth will be critical in ensuring that services inflation falls back from still very elevated levels.

**The external environment is tentatively improving** and some of the downside risks to the external sector have reduced (*Figure 3*).

- Commodity prices and the terms of trade have improved noticeably since the RBNZ's last set of forecasts. The farmgate milk price will likely exceed breakeven levels next season – a better outlook than feared in August 2023.
- Chinese economic growth managed to exceed the government's target and further economic stimulus is in train that should underpin demand.

**Fiscal policy has not supported disinflation** in 2023 and, with the demand for core public services continuing to grow, it may not be adequately tightened to control inflation risks.

- The HYEPU continued a trend towards a weakening in the fiscal outlook (*Figure 8*).
- The fiscal impulse on the economy was revised slightly higher – even assuming a significant tightening in 2024/25.
- The new government will struggle to adjust fiscal settings by enough given strong population growth.

**The migration cycle is not turning fast** and will underpin demand as 2024 progresses.

- Migration driven population growth has already caused rents inflation to explode (*Figure 4*).
- House prices will increasingly reflect population growth as 2024 goes on in line with usual lags between migration and house prices.
- Consumption and investment will be underpinned by these trends.

## The Dove's Tale.

**Economic momentum is very weak** – indeed, much weaker than the RBNZ had estimated (*Figure 5*).

- GDP growth in the 6 months to September was a full 1ppts weaker than the RBNZ had assumed in November i.e., policy is now restraining the economy more than expected.
- Recent weakness in activity doesn't solely reflect weaker potential growth due to weak productivity growth, it also reflects recessionary spending behaviour which may persist.
- Sustained weakness in output growth is likely to be reflected in the labour market this year.

**Headline inflation will decline sharply** in coming quarters, helping to further lower inflation expectations.

- The RBNZ has a headline CPI target, not a non-tradables target, and the former is falling faster than expected and forecast to return to the 1-3% target range this year (*Figure 6*).
- While non-tradables inflation has declined more slowly than expected (so far), the more rapid than expected decline in tradables inflation has more than offset this and is buying the RBNZ more time to reduce non-tradables inflation to more comfortable levels.
- Headline inflation will decline sharply in coming quarters, strongly reinforcing the decline in inflation expectations that is already underway (and which suggests that the RBNZ's commitment to returning inflation to 2% remains credible).

**The labour market is rebalancing sufficiently** to take the heat out of wage pressures and hence out of non-tradables inflation (*Figure 7*).

- Business surveys show that the difficulty of finding workers has eased dramatically, and job ads have not only slowed but are below pre-Covid levels.
- Direct surveys of expected future wage growth (ANZ, RBNZ) point to a significant decline in wage inflation over the coming year.
- To date an easing in wage growth has been confounded by government influences (public sector pay agreements, minimum wage hikes) and a tourism industry in a rehiring phase after the border was reopened. Neither is likely to play the same role in the year ahead.
- Labour markets have been resilient in many countries and yet inflation has fallen nonetheless.

**Government policy is now beginning to work in the same direction as monetary policy** (*Figure 8*).

- Fiscal policy is now turning contractionary, adding restraint to the economy in support of monetary policy as well as dealing with the structural fiscal deficit.

- Cutting regulation and red tape will also help to lower business costs and so inflation pressures.
- This year's 2% minimum wage decision provided an important signal regarding wage restraint and the Government's intentions to take hard decisions to help bring down inflation.

**The RBNZ's concerns about migration are simply not panning out.**

- In the November MPS the RBNZ claimed that: "While population growth has eased supply constraints, the effects on aggregate demand are becoming apparent. This is increasing the risk of inflation remaining above target."
- Aside from the understandable pressures on the rental stock, this effect has been far from "apparent". Household consumption has been flat to falling despite strong population growth, generalised inflation is slowing, and the housing market has lost its puff again after a brief mid-year pickup.

**Tightening further would add unnecessary volatility to the economy.**

- Tightening further to achieve a quicker decline in inflation would result in a steeper downturn in the economy, potentially making it more difficult to calibrate the eventual easing cycle.
- Adding unnecessary volatility to growth and interest rates increases uncertainty for people and businesses.

**Global economic conditions remain (mostly) weak and easing cycles are drawing closer.**

- Most of NZ's trading partners (the US excepted) experienced a weak end to 2023 and there is significant uncertainty about how these economies will perform this year.
- Monetary policy easing is expected in many trading partners economies in the second half of this year. This will support growth but could see the NZ dollar pressured upwards as interest rate differentials between New Zealand and elsewhere widen.

## Hawks.

Figure 1: RBNZ non-tradables inflation forecasts have been disappointed

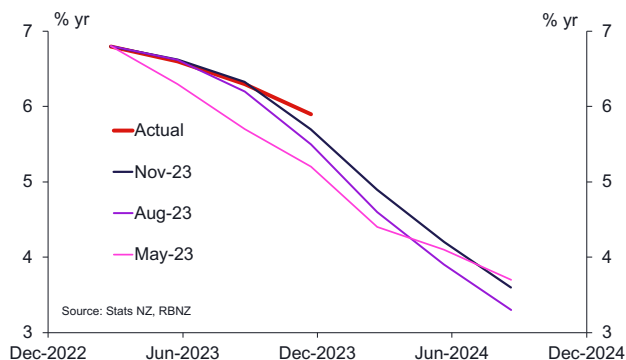


Figure 2: Unemployment is not rising as quickly as the RBNZ forecast

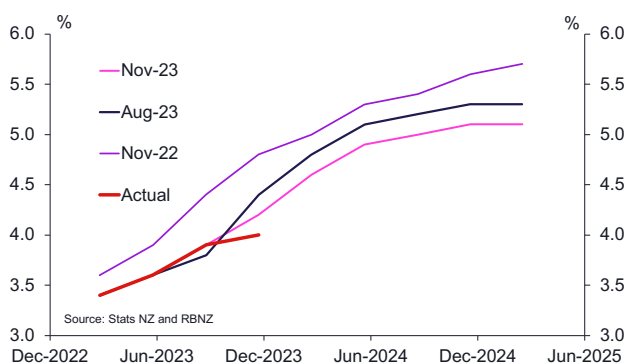


Figure 3: Downside external sector risks have receded

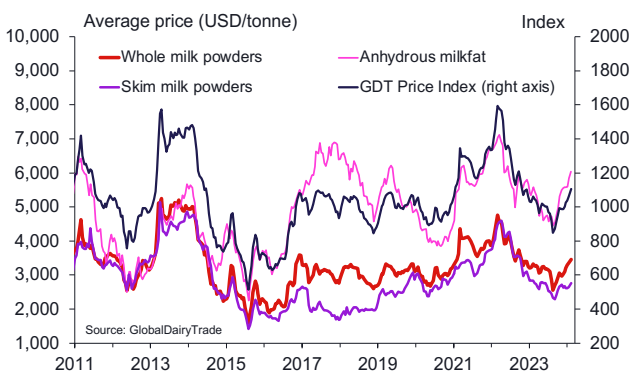
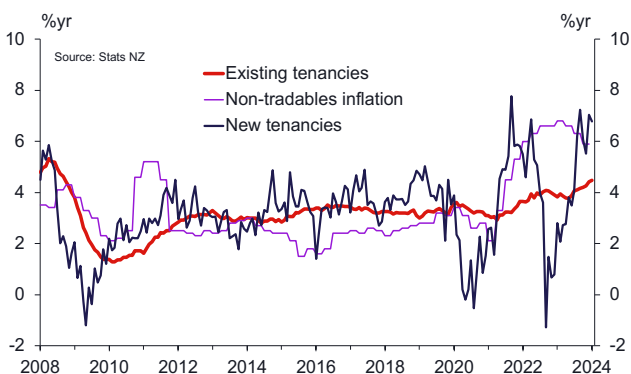


Figure 4: CPI new and existing rents vs non-tradables inflation



## Doves.

Figure 5: Economic momentum is far weaker than the RBNZ forecast

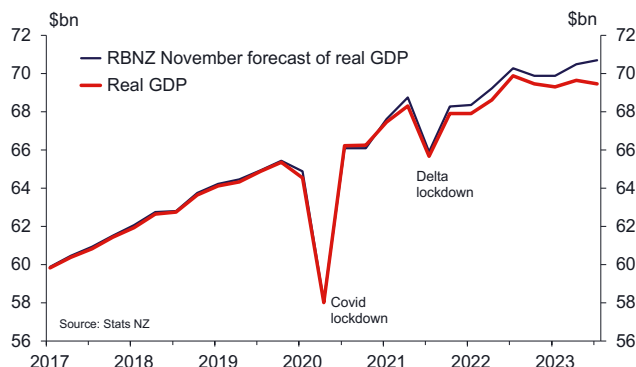


Figure 6: Inflation expectations are tracking back to target

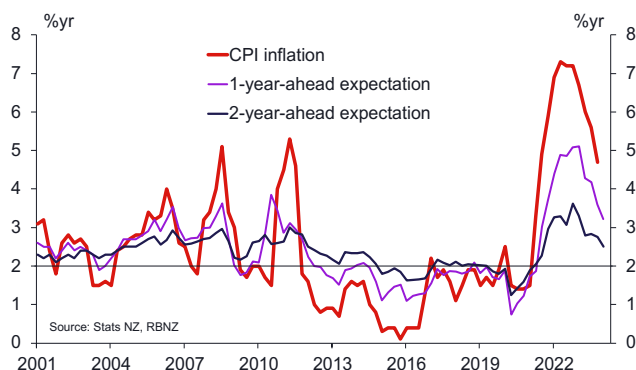


Figure 7: A balanced jobs market will see wage growth ease sharply

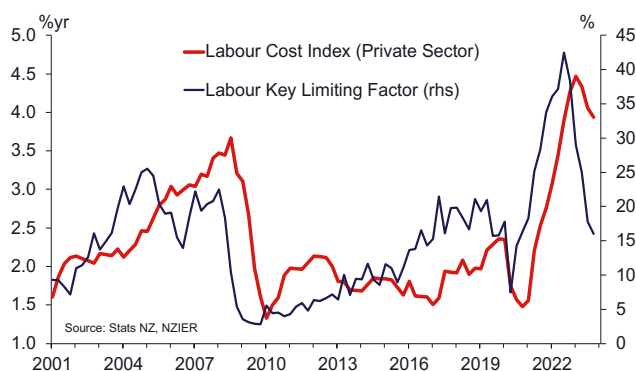
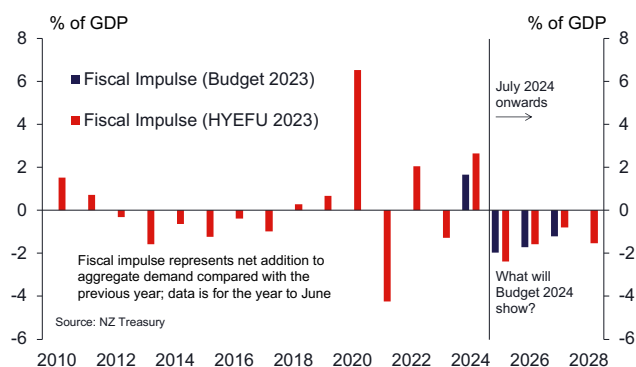


Figure 8: Fiscal policy may soon withdraw demand



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