Quarterly Economic Outlook

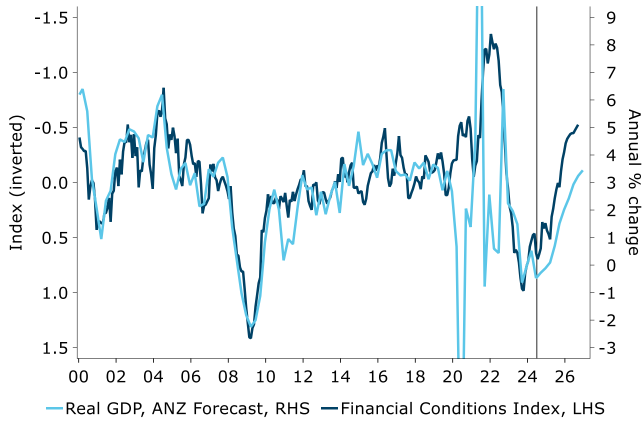
Finding neutral

ANZ

At a glance

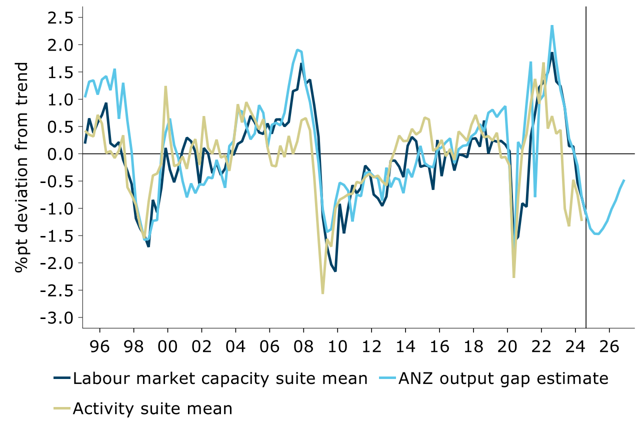
We now expect a faster recovery in activity…

Financial conditions have eased and the economy is already responding.



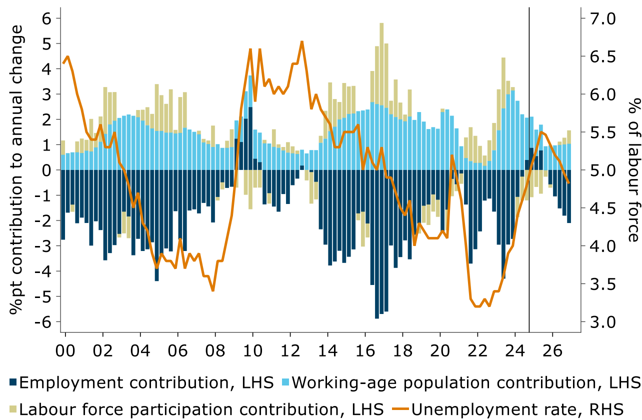
…from a weaker starting point.

The economy is operating with significant excess capacity.



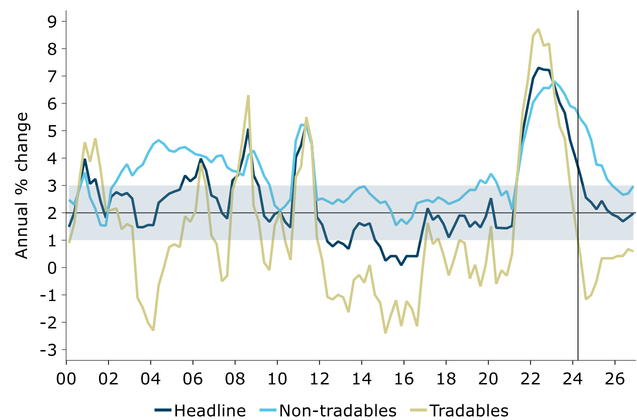
The labour market is expected to continue to weaken into 2025…

Labour demand continues to respond to the past slowdown.



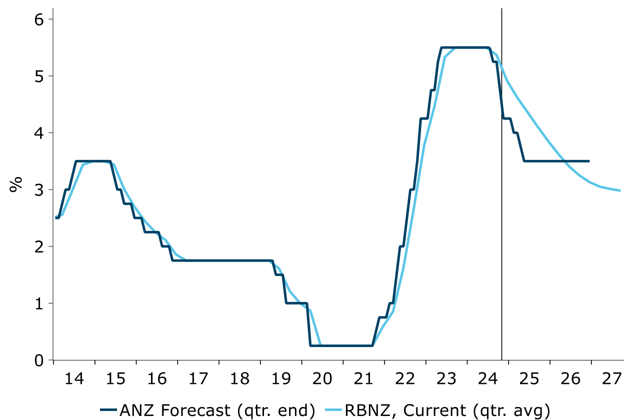
…while inflation remains around the 2% target midpoint.

Domestic inflation is expected to continue to ease, while the tradable disinflation tailwind fades.



We expect the OCR to fall to 3.5% by the middle of next year.

As the OCR moves closer to neutral, the RBNZ is expected to shift to a more gradual easing approach



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Source: Stats NZ, RBNZ, BusinessNZ, NZIER, Bloomberg, Macrobond, ANZ Research

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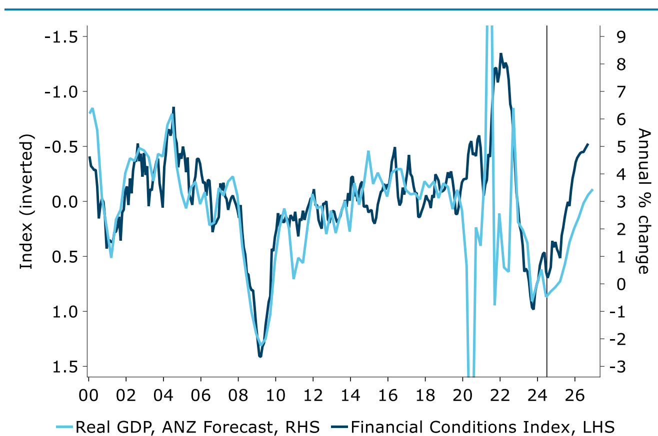
The big picture

Finding neutral

The RBNZ has started withdrawing monetary restriction. Parts of the economy are responding to that, but it will take time for easier monetary conditions to be reflected in hard economic outcomes. Business confidence has lifted sharply, but activity and employment indicators for the here and now, while off their lows, are still soft relative to history. Auction clearance rates suggest the housing market is about to **turn a corner, but there's still plenty of data to suggest** it is quite loose currently. Falling interest rates are expected to drive a recovery in economic growth towards trend, and an eventual improvement in labour **market conditions. But there's still a patch of soft** momentum to navigate in the near term, and things will remain patchy for some time. The RBNZ is not on a preset path, and the data flow will determine the pace and extent of easing. We remain comfortable with our current forecast for the OCR to reach 3.5% by mid-2025.

The economy remains soft, but interest rates are now falling quickly, paving the way for the recovery. Markets are obsessed with how far and how fast rates will fall (we are forecasting a follow-up 50bp cut in November, with 25s thereafter taking the OCR to 3.5%), but for most businesses and households, the big question is how quickly and vigorously the economy will respond. Lower interest rates, house price falls petering out, easier credit conditions, a softish NZD and more have all contributed to easing financial conditions that suggest better times ahead (figure 1).

Figure 1. ANZ Financial Conditions Index (lagged 9 months) vs GDP

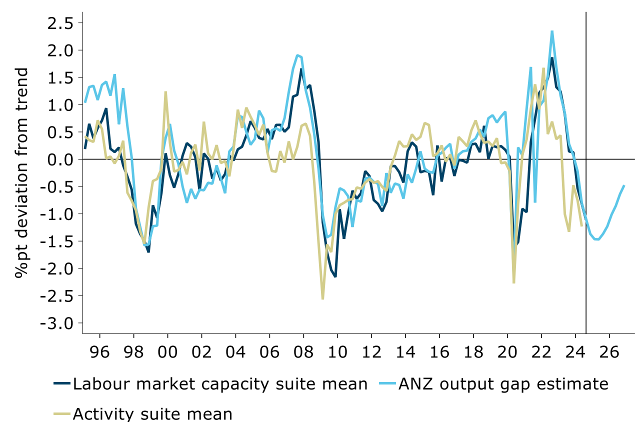


Source: Stats NZ, Macrobond, ANZ Research

For the RBNZ's part, current guidance is that the OCR is on a path towards neutral – ie the RBNZ feel confident enough in the inflation outlook to withdraw *monetary restriction*, but do not deem it necessary to *inject stimulus*. That could change of course. Should the economy and inflation pulse undershoot expectations, the RBNZ will not hesitate to take the OCR into stimulatory territory. However, given the **scope for "structurally higher" inflation going forward,** they will need to tread cautiously.

Our suite of capacity indicators (figure 2) makes the case that the cyclical position of the economy justifies a little stimulus (an OCR below neutral). However, **strong contributions to CPI inflation from 'non-**market**' sources such as council rates,** insurance, private health care, electricity (regulated increases in distribution charges from Q2 2025) are not set to dissipate any time soon, which means that for a given level of activity there is a risk that CPI inflation will continue to run hotter than it did over the decade prior to the pandemic. And if the housing market gets wind in its sails over 2025, housing-related components of the CPI could easily join in to see headline inflation settle above the 2% target midpoint over the medium term. In other words, the **"cyclical" case for OCR cuts is strong, but the "structural" reality is that the RBNZ needs to balance** risks on both sides. Getting the OCR back to neutral is looking like a relatively low-risk strategy, but there is still plenty of scope for the data to surprise our and **the RBNZ's forecasts –** on either side.

Figure 2. ANZ capacity suite



Source: Stats NZ, NZIER, RBNZ, Macrobond, ANZ Research

Another key uncertainty (related to some of the structural risks outlined previously) is where the neutral level of the OCR is and will settle over time. The neutral OCR is the interest rate that stabilises output growth and inflation in the medium term – ie it's where we could expect the OCR to be, were the economy in equilibrium and inflation stable at target. You can think of neutral as being the rate that brings balance between aggregate savings and investment demand, which themselves depend on all manner of things, including demographics, risk appetite, expectations for incomes and profits, technological change and adaptation, access to global capital

markets and trade, institutional arrangements, regulatory settings; the list goes on.

Gauging where the neutral level of the OCR is in real time (and forecasting it) is a significant challenge for policymakers. That said, the structural factors that underpin neutral are slow moving. The RBNZ's long-run neutral OCR estimate is currently 2.8%, but the RBNZ's own model suite ranges from 1.8% to 4.2%! Our neutral OCR assumption remains 3.5%, but our and the RBNZ's estimate will be influenced by how the economy responds to rate cuts. There's also a scenario where the economic cycle justifies a sub-neutral OCR to stabilise inflation at the 2% target midpoint in the near term, before structural factors see the OCR rise in the medium term.

So far, the economic response to the withdrawal of monetary restriction is looking pretty "textbook". High-frequency activity indicators have generally improved, and confidence has bounced following the falls in interest rates. The response in these data has reduced the risk of a protracted economic downturn, but it certainly hasn't gone away entirely. There's still a challenging period for the economy to navigate as the labour market continues to soften in the near term (given typical lags) and the impacts of lower interest rates take time to flow through.

Mortgage holders will roll onto lower rates faster than they rolled onto higher ones, but the impact on household cashflow is still relatively slow. Our Business Outlook survey shows confidence has spiked dramatically, but it's reasonable to think most firms will wait for the expected higher demand to manifest before taking on more staff or making an investment.

The housing market is the place to look for early impacts of the reduced cost of new debt, and there is evidence the vibe is shifting, with a marked lift in the proportion of houses successfully selling at auction.

As well as lower interest rates, economic tailwinds include easing credit conditions, higher dairy prices, and population growth – albeit the latter has slowed meaningfully as the labour market softens. Key headwinds are weak global growth (particularly China) and rising unemployment. This recession was caused by high interest rates, so lower rates are likely to be an effective cure, but not an instant one.

Meanwhile, fiscal policy continues to balance the long-overdue fiscal consolidation (after the last Government ran pro-cyclical fiscal policy that exacerbated the CPI inflation surge) against the need to deliver key Government services and investments (where an aging population and infrastructure deficit are set to keep the pressure on for the foreseeable future). Getting the books back into shape without broadening the tax base, while delivering public services and investment, won't be easy over the longer run. But the previous Government locked a lot of spending into baselines following the pandemic, meaning there could be scope for large reprioritisations as needs arise. Big picture: given the Government's commitment to fiscal consolidation, discretionary fiscal policy decisions represent a smaller upside inflation (and therefore interest rate) risk compared to the last Government's fiscal strategy. We expect the Government to reiterate its intention to live within the operating allowance profile set out at Budget in December's Half-Year Economic and Fiscal Update.

Globally, Tump's emphatic win will have implications for the global economy, particularly for economies that tend to run a trade surplus with the US (eg China, Europe, Mexico). But details of his policy agenda are lacking at this stage, making it difficult to quantify and incorporate into the outlook. But broadly speaking, it's likely that the indirect impacts of increased protectionism in the US (such as weaker demand outside of the US) will have a larger impact on NZ than the direct impacts. But that will also depend on how the NZD reacts and what policy makers among our largest trading partners (eg China) do to stabilise demand. There could be significant offsets for our exporters.

All in all, while the RBNZ is confident that CPI inflation risks are balanced, upside inflation risks haven't evaporated completely, and it is not yet clear that economic conditions warrant anything more than a sharp adjustment in monetary conditions towards neutral.

Table 1. Summary of key forecasts

Calendar Years	2020	2021	2022	2023	2024f	2025f	2026f
Real GDP[1] (annual average % change)	-1.4	5.7	2.4	0.7	-0.1	1.1	3.0
Unemployment Rate (sa; Dec qtr)	4.9	3.2	3.4	4.0	5.1	5.3	4.8
CPI Inflation (annual % change; Dec qtr)	1.4	5.9	7.2	4.7	2.1	2.3	1.9
Official Cash Rate (Dec qtr end)	0.25	0.75	4.25	5.50	4.25	3.50	3.50

[1] Production based

Source: Statistics NZ, REINZ, Bloomberg, ANZ Research

Forecasts finalised 18 November 2024. See page 8 for detailed forecast charts and this link to download tables

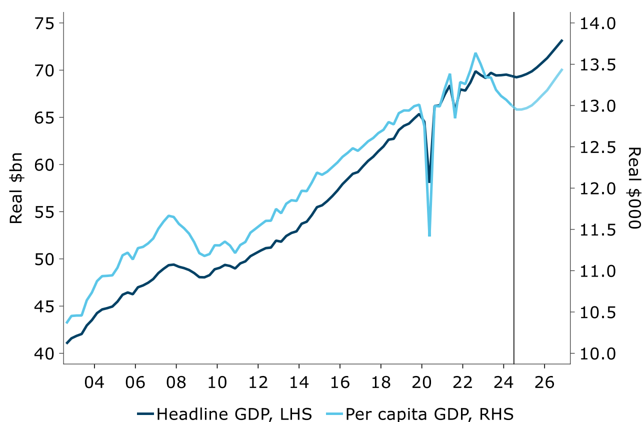
Our forecasts

A faster recovery is expected...

A faster withdrawal of monetary restriction by the RBNZ is expected to see economic activity recover faster than outlined in our previous edition. While economic conditions remain challenging here and now, and in fact we have revised our near-term GDP **forecast marginally lower, the RBNZ's signalled** preference to return to a neutral policy stance quickly has laid the path for a faster recovery from the second half of 2025.

Interest rate relief will take time to flow through, but emerging evidence suggests that the economy is responding. That said, significant uncertainty surrounding our forecast remains. While the drivers of economic momentum are shifting to the upside, including the recovery in the housing market, rising confidence and improving terms of trade, it remains uncertain how much damage has been done to the economy from the restrictive monetary conditions.

Figure 3. GDP and GDP per capita

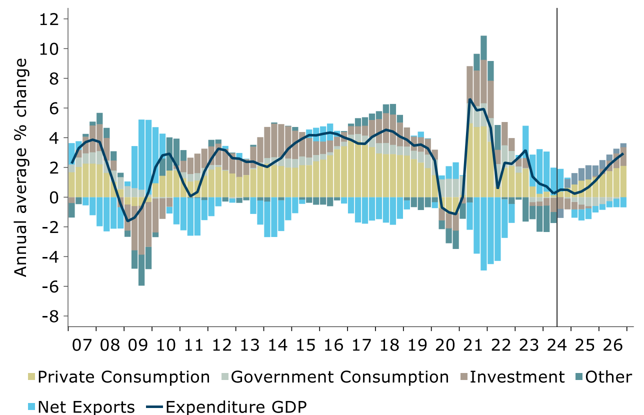


Source: Stats NZ, Macrobond, ANZ Research

We expect a largely stagnant economic performance over the second half of 2024 will be followed by a gradual recovery next year. The economy is expected to grow 1.1% over 2025 (previously 0.8%), and 3.0% over 2026 (previously 2.2%). The upgrade to activity reflects a stronger recovery in domestic demand, with the faster normalisation in policy settings driving a cyclical recovery in investment as firms make up for delayed investment activity, while consumption rises as debt-servicing costs fall and real incomes continue to recover from the erosion caused by high inflation.

Partially offsetting stronger domestic demand is waning support from net exports as import demand firms in line with broader economic activity, while the post-COVID recovery in services exports (chiefly international tourism) tapers. Merchandise export performance is expected to improve in the near term as favourable weather conditions and rising export prices support growth in volumes. However, in the medium term, land-use constraints are expected to continue to restrict growth in primary production and see export volume growth flatten off.

Figure 4. Contributions to GDP growth



Source: Stats NZ, Macrobond, ANZ Research

All up, while the outlook for activity is much improved, the economy will continue to navigate challenging conditions for some time yet. Risks to the outlook remain two-sided. On the one hand, high-frequency indicators have offered reassurance that the economy is responding to lower interest rates, though the extent of damage from past monetary restriction remains highly uncertain, with the ongoing deterioration in labour market conditions a potential handbrake on the recovery.

...with the labour market to follow with a lag

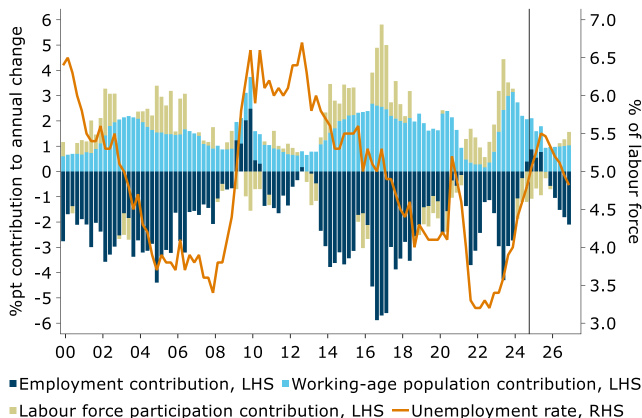
While economic activity is expected to gradually recover, labour market conditions are expected to continue to weaken into 2025 as the impacts of past monetary tightening continue to flow through. The unemployment rate is expected to peak at 5.5% in the middle of 2025 before a recovery in labour demand spurs a return to a better balance.

The adjustment in employment levels to past weakness in economic activity is expected to continue through the first half of 2025. While private sector employment is already firmly in contraction, growth in industries more closely tied to fiscal policy settings is providing a partial offset. However, as fiscal consolidation continues, support to employment growth from public demand is likely to fade.

On the supply side, fewer job opportunities are resulting in weaker labour force participation as discouraged worker effects play out, while labour supply growth is also slowing on the back of rapidly cooling net migration inflows as fewer migrants arrive and more kiwis look to opportunities offshore.

Our forecasts

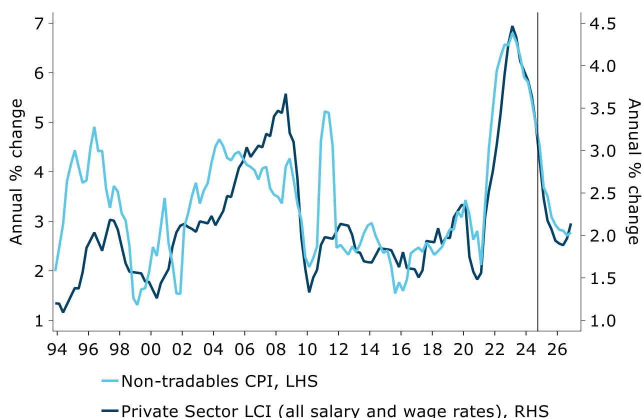
Figure 5. Unemployment rate decomposition



Source: Stats NZ, Macrobond, ANZ Research

As a result of weak labour demand, spare capacity continues to emerge in the labour market, driving the adjustment in wage growth to rates better aligned with stable inflation outcomes. Forward indicators of wage growth, such as in our Business Outlook survey, signal that this adjustment has occurred at pace. With inflation expectations having returned to levels consistent with headline inflation at 2%, this should provide a floor to the adjustment, despite still-growing spare labour market capacity. All up, the labour market no longer stands as a source of upside risk to domestic inflation, with attention now fixed on downside risks.

Figure 6. Wage and non-tradable inflation

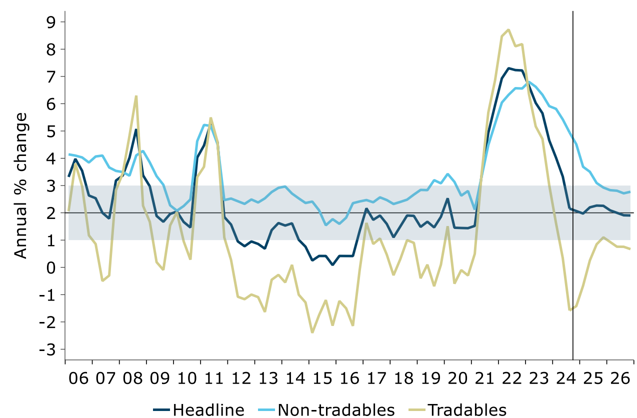


Source: Stats NZ, Macrobond, ANZ Research

… as inflation remains anchored near 2%

The Q3 CPI inflation data marked the return to the 1-3% target band for the first time since March 2021. And at 2.2%, annual inflation is within touching distance of the 2% target midpoint. Our expectation, absent shocks, is that inflation will remain around the 2% midpoint from here, as domestic disinflation progress continues, offsetting an expected normalisation in tradable inflation following the sharp adjustment over the past year. While tradable inflation has done a lot of the heavy lifting in returning inflation to target, the baton is likely to be passed to domestic drivers in 2025.

Figure 7. Inflation component forecast



Source: Stats NZ, Macrobond, ANZ Research

Risks to the domestic inflation outlook appear balanced in aggregate, though there remain some problematic components that are likely to remain robust. Administrative prices such as council rates, and electricity distribution charges continue to adjust to the past high-inflation environment and remain sources of upside risk, but those upside risks are being tempered by anticipated disinflation across market components as weaker economic activity and rising spare capacity restrict firms' pricing power.

Tradable inflation, as always, carries significant risk. The increasingly volatile global environment, rising barriers to trade amidst the return to protectionism, geopolitical risks and more frequent supply-side disruption are expected to see tradable inflation settle higher in the medium-term than the pre-COVID experience. However, structural challenges in China's economy due to the property sector downturn are resulting in deflationary conditions that could provide a meaningful offset.

While the threat of inflation shocks is heightened in a challenging global environment, the normalisation in inflation expectations provides the RBNZ flexibility to look through transitory inflation shocks. While there will be bumps along the road to 2%, the conditions are in place for a sustained return to a low-inflation environment.

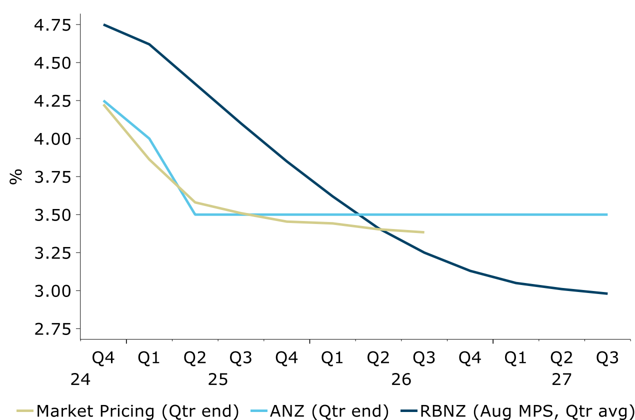
Short end rates have a little further to fall

As the OCR goes lower, it's expected to drag short-end interest rates down with it, with a more pronounced effect on the very short end (90-day bill rates), but less

Our forecasts

of an impact on rates like the 2yr swap rate. Markets are forward-looking by nature, and in situations like the one we're in now, where pending OCR cuts have been well telegraphed by the RBNZ, and are in most economists' forecasts, they are also baked into market pricing (figure 8). Very short-term rates like the 90-day rate only "look" 90 days into the future. They can't move too pre-emptively, and thus are expected to fall more gradually. However, the 2-year swap rate trades with reference to where markets think the OCR will average over the next 2 years (with minor adjustments for other factors like term and funding premiums), and since markets expect the OCR to be at 3.5% by mid-2025, they have already come down in anticipation of that. Accordingly, notwithstanding week-to-week volatility (as was seen around US elections), we don't expect them to fall significantly further.

Figure 8. Market expectations for the OCR and forecasts



Source: RBNZ, ICAP, Bloomberg, Macrobond, ANZ Research

With market expectations of where the OCR will bottom out similar to our own (3.5%), we see the risks around our forecasts as balanced. But that's not to say there are no risks. To the downside, if the RBNZ ends up needing to cut by more, which would ultimately force a downward adjustment in market expectations, the 2yr swap rate would likely fall further. But going the other way, if markets ultimately take the view that the OCR doesn't need go as low as 3.5%, or that it'll go to 3.5% and then need to rise again (perhaps in early 2026, as the economy responds to cuts), then the 2yr swap rate might not fall as far as we are forecasting, or even start rising a little. Nothing is on autopilot.

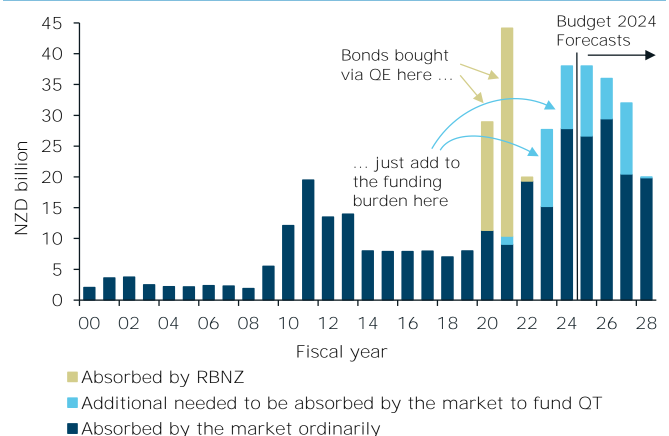
Long-term rates are rising alongside their US equivalents following US elections

In our last Quarterly, we wrote how we were expecting the NZ 10yr bond yield to fall from where it was at that time (around 4.2%) to around 4%, leading the OCR lower, before rising over the second half of 2025 as the RBNZ and Fed easing cycles ended and markets looked forward to economies responding to cuts.

In the weeks that followed, we did see the 10yr yield fall to around 4%, but it has since bounced sharply and sat at around 4.7% as we went to print. This move was almost entirely led by the US, where markets have moved to anticipate fewer and more gradual Fed cuts as the US economy has shown resilience, reinforcing the "soft landing" economic narrative. Markets have also moved to consider the consequences of President-elect Trump's proposed tariffs, and the prospect of more stimulatory fiscal policy and increased government bond issuance.

Looking ahead, we expect those factors to continue weighing on US and global bond market sentiment, and that's expected to keep upward pressure on NZ long end interest rates and bond yields too, steepening yield curves. New Zealand has a far more enviable position than the US in terms of the level of outstanding government debt (IMF data, calculated on an internationally comparable basis, puts New Zealand's public debt at 22% of GDP, compared with the US at around 99%). However, NZ fiscal surpluses aren't expected until 2028, and ongoing hefty bond issuance (influenced in part by quantitative tightening, or QT, as in figure 9) is expected to continue supporting higher-than-otherwise bond yields here.

Figure 9. The impact of QT on NZGB issuance that markets need to absorb



Source: NZDM, RBNZ, Bloomberg ANZ Research

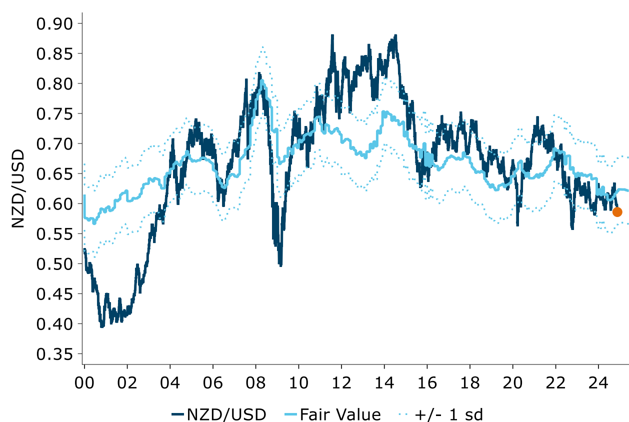
The NZD is forecast to appreciate, but US pro-growth policies pose downside risks

Our FX forecasts have not changed since last quarter: mild gradual NZD/USD appreciation to 0.62 by year end, and 0.63 by the end of 2025. These moves are expected to be supported by stronger commodity prices (particularly dairy) and gravitational pull back to fair value, which we see at 0.62 (figure 10).

Our forecasts

With the Australian economy doing better and the RBA easing cycle yet to kick off, we expect NZD/AUD to drift down to 0.899 by year end and to 0.887 by the end of 2025. Our forecasts have been calling for a move lower for some time, and while it has fallen less quickly than we anticipated, it has indeed fallen as the year has unfolded. That move has coincided **with Australia's** gradual move upward in rankings on our FX scorecard (figure 11), where it now ranks clear #1.

Figure 10. ANZ estimate of NZD fair value



Source: Bloomberg ANZ Research

Figure 11. ANZ global macro and financial FX scorecard

Category	NZD	AUD	USD	CAD	GBP	EUR
Annual GDP growth	-0.5%	1.0%	2.7%	1.3%	0.7%	0.9%
Annual CPI inflation	2.2%	2.8%	2.6%	1.6%	1.7%	2.0%
Policy rate (cash rate) *	4.75%	4.35%	4.65%	3.75%	4.70%	3.25%
2yr swap rate (spread to cash)	-0.84%	-0.17%	-0.55%	-0.71%	-0.18%	-0.98%
10yr bond yield #	4.70%	4.70%	4.48%	3.31%	4.52%	2.39%
Unemployment	4.8%	4.1%	4.1%	6.5%	4.3%	6.3%
C/A balance % GDP	-6.7%	-0.7%	-3.3%	-0.8%	-2.2%	2.5%
Budget balance % GDP ~	-2.4%	-0.5%	-6.5%	-1.5%	-3.6%	-3.1%
Govt net debt % GDP ^	22.4%	29.5%	98.8%	14.4%	91.6%	45.6%
Credit Rating (S&P) Δ	AA+	AAA	AA+	AAA	AA	AAA

Source: Bloomberg, IMF, Standard and Poor's, ANZ Research.

* USD rate is the Fed's Interest Rate on Reserve Balances; GBP rate is BOE SONIA rate; EUR rate is ECB Deposit Facility Rate.

EUR 10yr Bond Yield is the German Bund.

~ Budget Balances are Bloomberg consensus forecasts for the current calendar year; EUR figure is for Germany.

^ Net Debt figures are IMF forecast for General Government Net Debt for the current calendar year; EUR figure is for Germany.

Δ Credit ratings are Standard & Poor's long term foreign currency ratings; EUR rating is for Germany.

1st place (or #1) in each category shaded dark blue, 2nd place (or #2) light blue, 2nd last place orange, and last place shaded red.

Table 1: Forecasts (end of quarter)

FX Rates	Current	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
NZD/USD	0.586	0.62	0.62	0.62	0.63	0.63	0.64	0.64
NZD/AUD	0.906	0.90	0.89	0.89	0.89	0.89	0.89	0.89
NZD/EUR	0.556	0.56	0.55	0.54	0.54	0.53	0.54	0.54
NZD/JPY	90.3	91.8	89.3	88.0	88.2	85.7	87.0	87.0
NZD/GBP	0.464	0.48	0.47	0.46	0.46	0.46	0.47	0.47
NZ$ TWI	69.3	70.5	69.8	69.4	70.0	69.7	70.6	70.6
Interest Rates	**Current**	**Dec-24**	**Mar-25**	**Jun-25**	**Sep-25**	**Dec-25**	**Mar-26**	**Jun-26**
NZ OCR	4.75	4.25	4.00	3.50	3.50	3.50	3.50	3.50
NZ 90-day bill	4.45	4.23	3.73	3.65	3.65	3.65	3.65	3.65
NZ 2-yr swap	3.90	3.80	3.75	3.75	3.75	3.75	3.75	3.75
NZ 10-yr bond	4.67	4.75	5.00	5.10	5.10	5.20	5.20	5.20

Source: Bloomberg, ANZ Research

Forecast charts

Figure 1. Production GDP level (headline vs per capita)

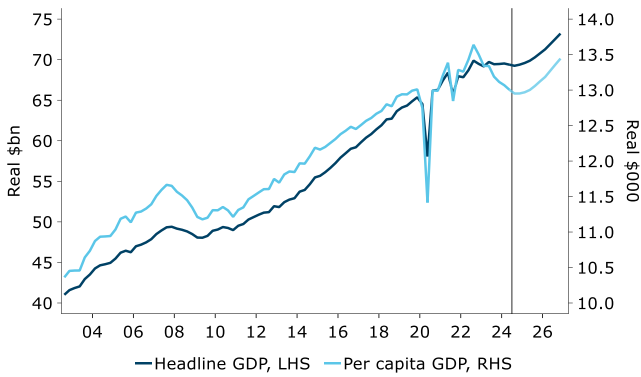


Figure 2. Production GDP growth

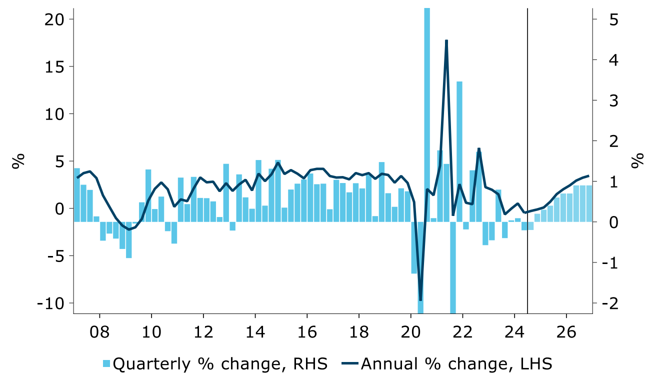


Figure 3. Contributions to GDP growth (detailed)

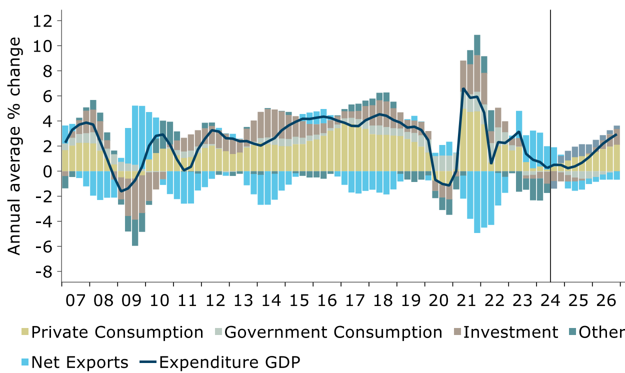


Figure 4. Real investment

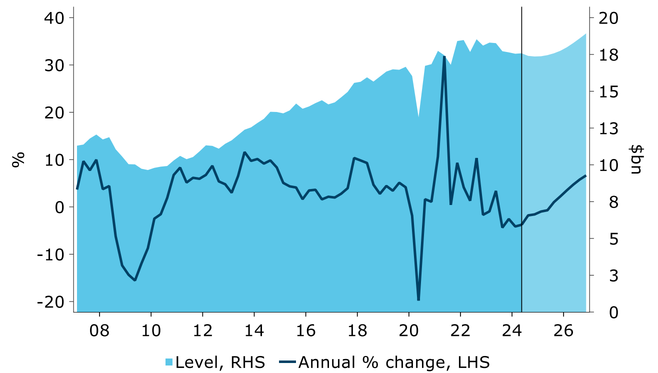


Figure 5. Real private consumption

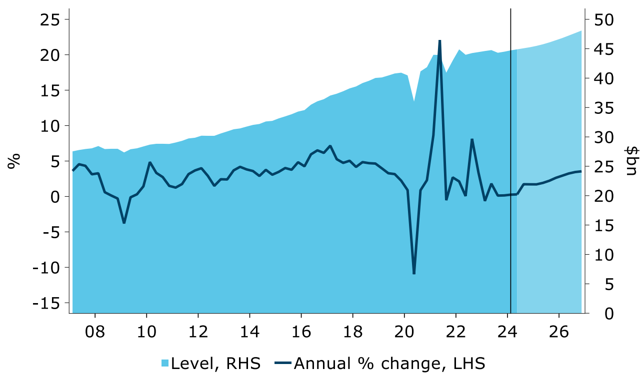


Figure 6. Real government consumption

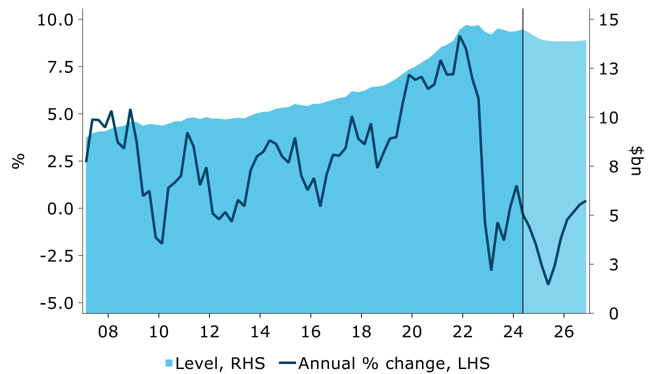


Figure 7. Real exports (goods and services)

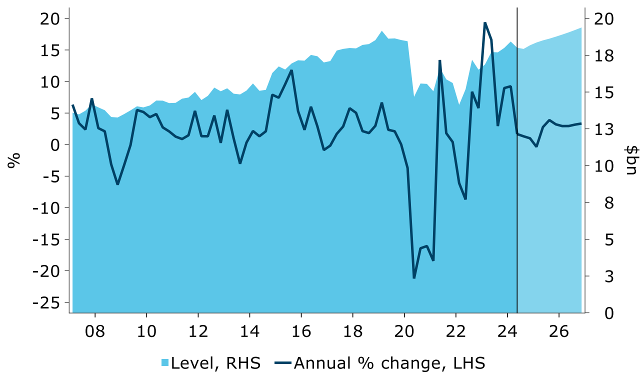
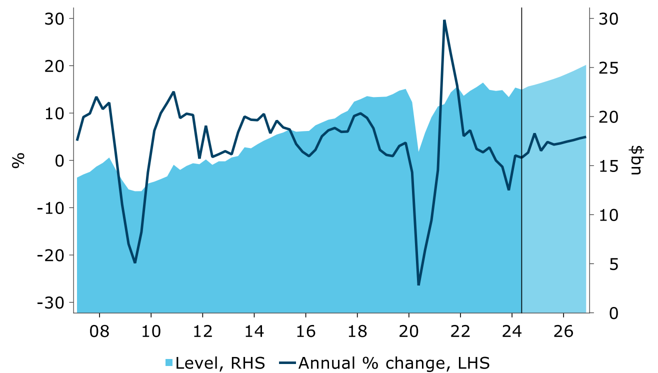


Figure 8. Real imports (goods and services)



Source: Stats NZ, Macrobond, ANZ Research

Forecast charts

Figure 9. Terms of trade

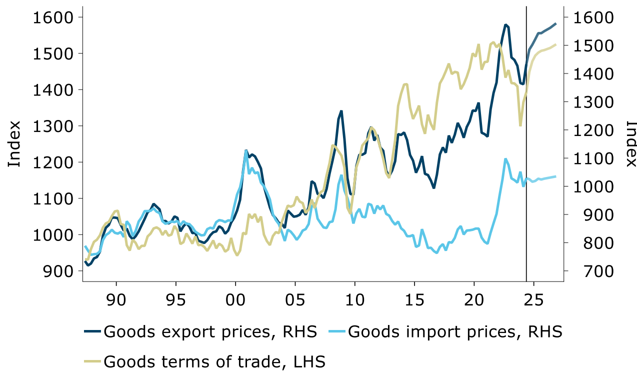


Figure 10. Current account balance

Figure 11. Output gap

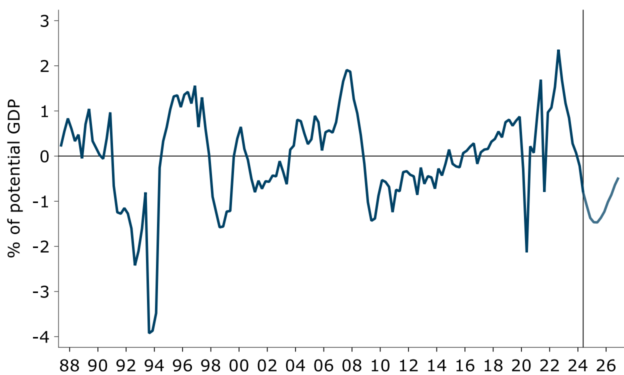


Figure 12. House prices (REINZ HPI)

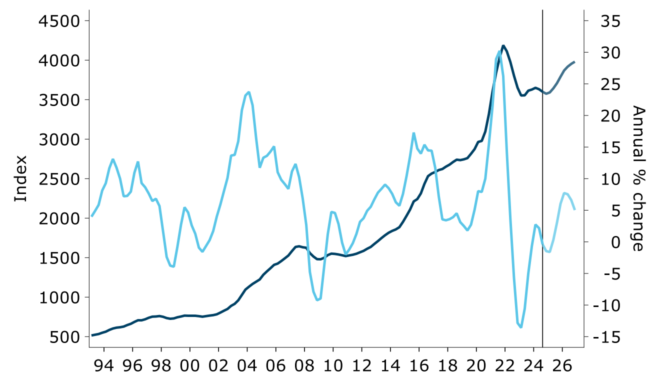


Figure 13. Annual migration

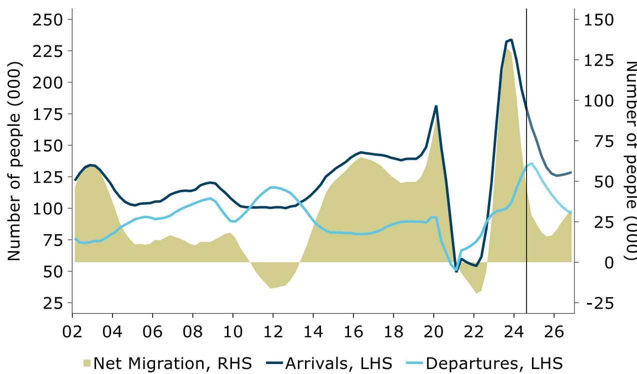


Figure 14. Resident population

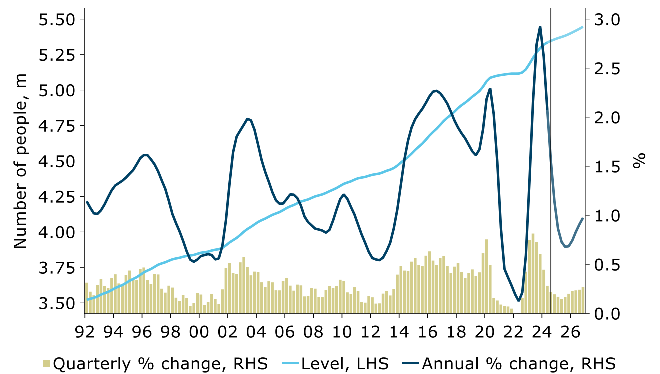
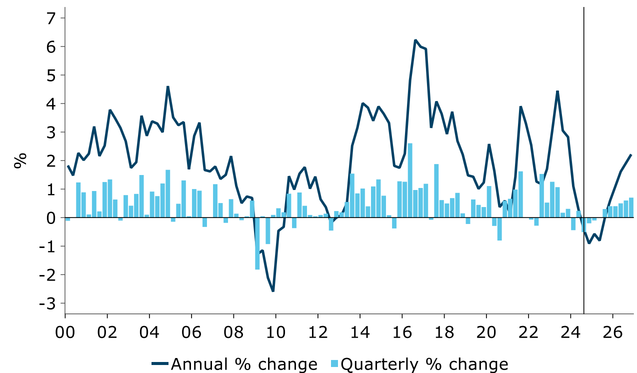


Figure 15. Participation and employment rate

Figure 16. Employment



Source: Stats NZ, REINZ, Macrobond, ANZ Research

Forecast charts

Figure 17. Unemployment rate decomposition

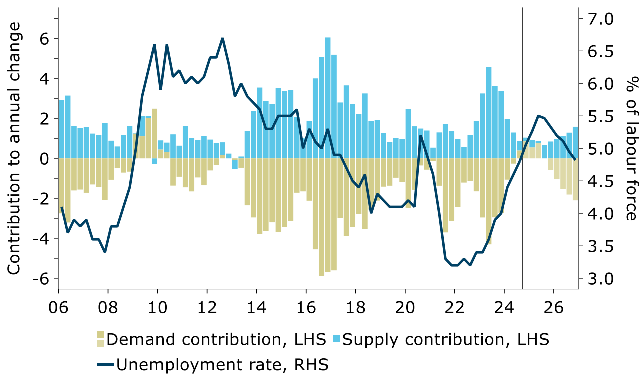


Figure 18. Wages and labour costs

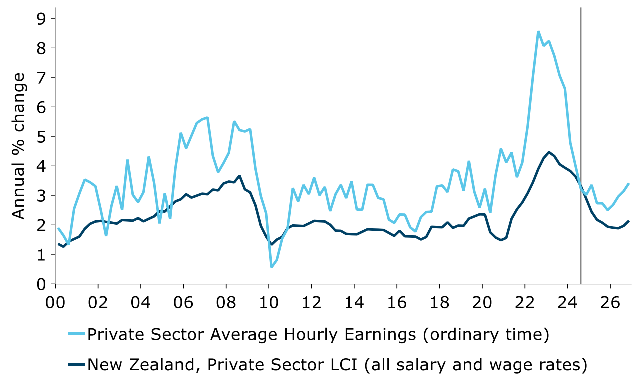


Figure 19. Inflation forecasts

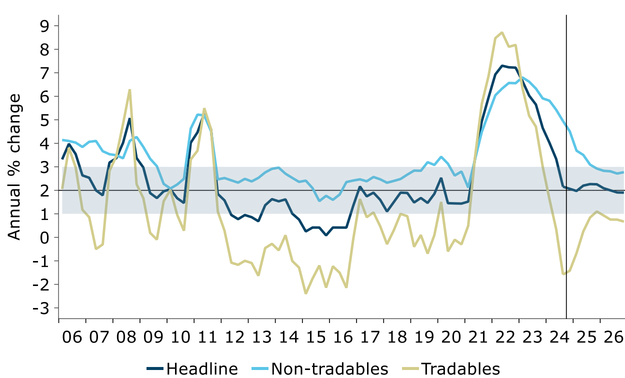


Figure 20. Headline inflation forecast decomposition

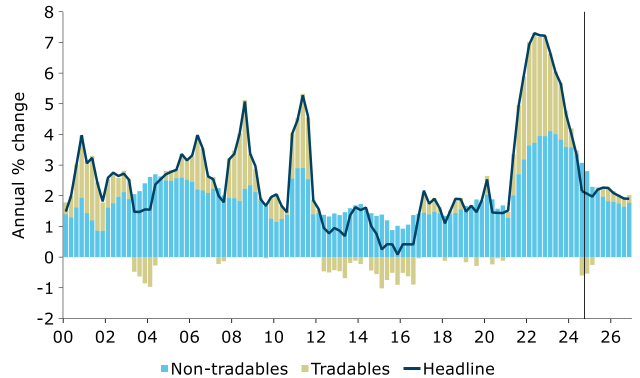


Figure 21. OCR and 90-day rate

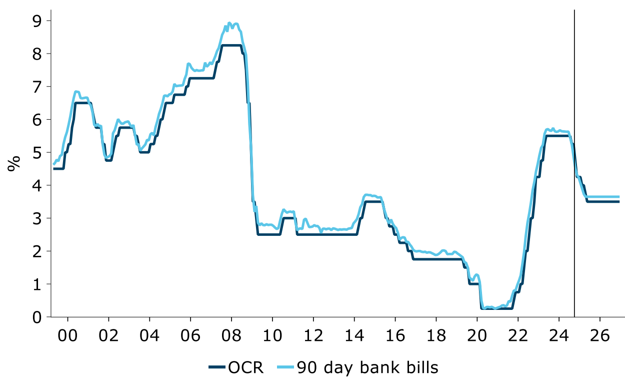


Figure 22. 2-year swap rate and 10-year bond yield

Figure 23. NZD against JPY and CNY, and TWI basis

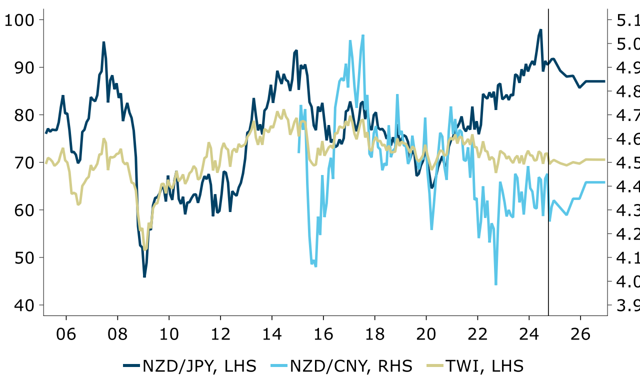
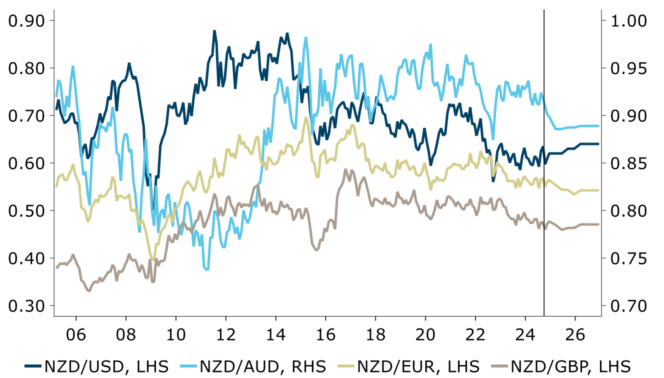


Figure 24. NZD against USD, AUD, EUR and GBP



Source: Stats NZ, Bloomberg, Macrobond, ANZ Research

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