ECONOMIC OVERVIEW

Nau mai haere mai ki Aotearoa – Welcome to New Zealand.

May 2023

Kelly Eckhold
Chief Economist
+64 9 348 9382

Michael Gordon
Senior Economist
+64 9 336 5670

Satish Ranchhod
Senior Economist
+64 9 336 5668

Nathan Penny
Senior Agri Economist
+64 9 348 9114

Paul Clark
Industry Economist
+64 9 336 5656

New Zealand economy	01
Global economy	04
Inflation and the RBNZ	06
Agricultural outlook	08
Exchange rates	09
Special topic: Migration	10
Economic and financial forecasts	11
The economy in six charts	12

Note from Kelly

The economy seems very close now to the turning point we have anticipated was coming for some time. The past few months have seen increasing signs that demand is cooling in response to the Reserve Bank's interest rate increases over the past 18 months. That gives us confidence that inflation can be brought down from its current lofty levels. Monetary policy is working.

The key questions now are how easy will it be to bring inflation back inside the 1% to 3% target range, and will the economy slow sufficiently to allow this to happen?

We take the view that getting inflation back to sustainable levels won't be easy and that more mahi is required to achieve this goal within a reasonable timeframe. As a result, we've revised up our forecast for the peak in the Official Cash Rate to 6%. Inflation has already been outside the target range almost two years, and our projections indicate it's going to take another 18 months to get inflation back within the band.

The economy likely won't slow as much as we feared a few months back. Net migration has rebounded faster than expected and population growth is set to rise to its highest level in decades. The world is back on the move after a few years of hunkering down, and New Zealand is one of the places where people want to come live and work. New entrants will bring valuable skills and experience to a labour market crying out for workers. But this valuable supply will also bring demand that will offset some of the impact rising interest rates are having.

None of this takes away from the point that the interest rate cycle is very mature and the peak in interest rates is near. The extra bit of work we think is required is very much in the vein of a stitch in time saves nine.

Kelly Eckhold
Chief Economist

Text finalised 12 May 2023 | ISSN 1176-1598 (Print) | ISSN 2253-2897 (Online) | For address changes contact: WNZResearch@westpac.co.nz

NEW ZEALAND ECONOMY

Eye of the storm.

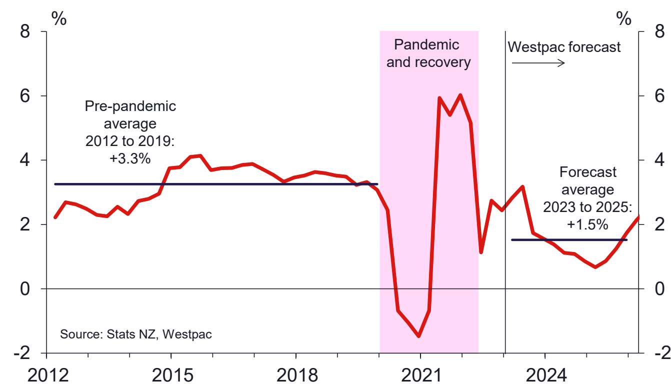
New Zealand is in for a period of subdued economic growth over the coming years, and conditions in the economy are set to be very uneven. Surging net migration and the recovering tourism industry are providing a floor under activity. However, increasingly tough financial conditions are squeezing households and will be a significant drag on overall demand.

The wind has come out of the New Zealand economy's sails. Several of the factors that boosted growth in recent years have now moderated or even reversed. Most significantly, a sharp rise in interest rates combined with large increases in household living costs is restraining domestic demand. At the same time, the pace of the rebound in international tourism has slowed after the initial surge in visitors when the borders reopened. And on top of that, parts of the economy have been grappling with the aftermath of the devastating storms in January and February.

We estimate that economic output fell by 0.8% over the December and March quarters combined. That might fit the label of a 'technical recession' (that is, two consecutive quarters of falling activity). However, we don't think this represents an actual recession in the New Zealand economy. The labour market remains strong and businesses are continuing to take on staff. In addition, much of the downturn in the March quarter reflects temporary disruptions caused by the recent storms.

Nevertheless, the slowdown in activity over the past few months does highlight that the ground beneath the economy has become increasingly soggy, with the sharp rise in interest rates over the past year now clearly weighing on demand. Going forward, we expect the rapid economic growth we saw in the wake of the Covid-lockdowns will now give way to an extended period of subdued growth.

Figure 1: GDP growth (annual average)



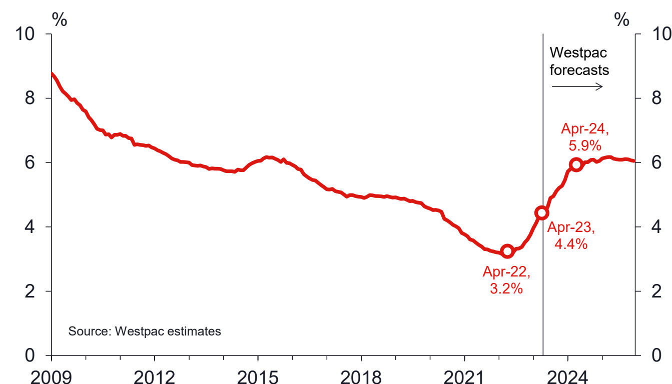
Household finances in the vice.

The major factor that is squeezing households' finances and weighing on economic growth is the large rise in debt servicing costs. In response to strong inflation pressures, the Reserve Bank has been hiking the Official Cash Rate at a rapid pace. And while widespread mortgage rate fixing did insulate many borrowers from the impact of those increases for a period, large numbers of mortgages have now rolled on to higher interest rates. In fact, accounting for the extent of interest rate fixing, we estimate that the average 'effective' mortgage rate that New Zealand borrowers are actually paying has increased by around 120 bps since early 2022.

Around 50% of all fixed rate mortgages will come up for repricing over the year ahead, and the average mortgage rate is set to rise by a further 150 bps by early 2024. That will see the average household's spending on interest costs increasing from around 5% of their disposable income in 2022 to 10% in 2024, and some borrowers will face much larger increases.

Higher interest rates along with rising living costs will drain a large amount of cash out of households' wallets. That means many households will be forced to wind back their spending over the coming year.

Figure 2: Effective mortgage rate*

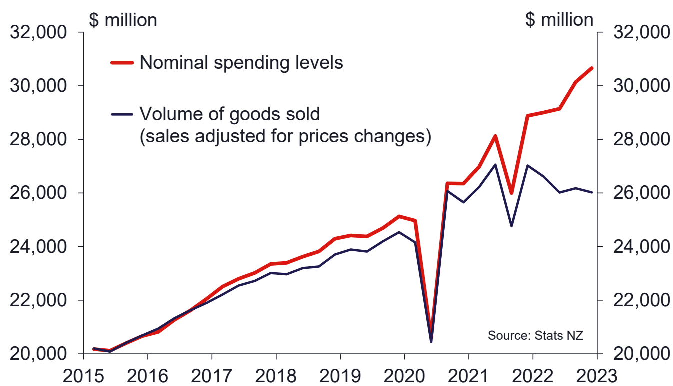


* The effective mortgage rate is an estimate of the average interest rate borrowers are paying on all outstanding mortgages. It adjusts for the fact that most mortgages are on fixed rates that are only periodically renegotiated, rather than paying the interest rates that are currently on offer.

While spending levels in the economy have continued to push higher in recent months, this mostly reflects the impact of price rises - households are having to splash out more cash, but are getting less bang for their buck. Even so, the resilience in retail spending has been notable, and highlights that the current strength of the labour market is helping to insulate many households from the other factors squeezing their finances. In fact, with high levels of economic activity and very low unemployment, average hourly earnings have risen by more than 7% over the past year, broadly keeping pace with the rise in living costs.

Eventually the labour market is also set to run out of steam as economic conditions more generally turn down. We expect the unemployment rate to rise from 3.4% currently to 5% by the start of 2025. While that's a relatively mild softening compared to previous downturns, it will still impact households.

Figure 3: Retail spending



Welcome to our shores.

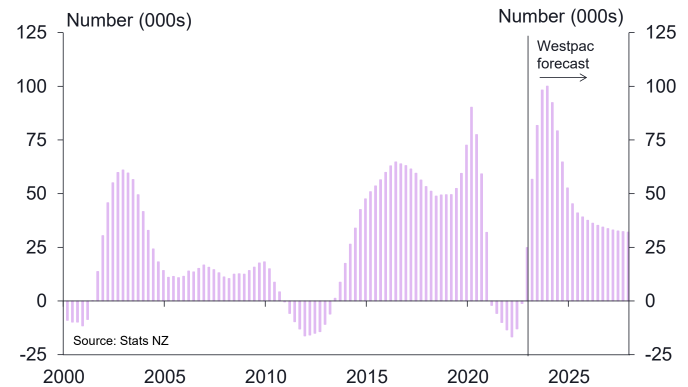
While the increasing pressure on households' finances will be a significant drag on economic activity, a few important factors will help to provide a floor under economic growth.

First is the rapid turnaround in net migration and population growth. Inflows of new migrants exceeded departures by 65,000 in the year to March. That compares to a net outflow of 20,000 people in the previous year. Importantly, as discussed in the *Special topic* in this report, New Zealand's strong labour market is continuing to attract more people to our shores. In fact, we expect that net migration will rise to an annual inflow of 100,000 people by the end of this year.

Households are being squeezed: living costs are charging higher, borrowing costs have risen sharply, and many have seen the value of their housing assets tumble.

That sharp rise in net migration will see population growth rising from just 0.5% at the end of 2022 to 2.4% by the close of this year. That would be the fastest rate of population growth New Zealand has seen in decades, and it signals a large increase in many businesses' demand base. The impact of this is likely to be most pronounced for those businesses selling fast moving consumer goods like groceries. However, it will also add to demand for a range of other consumer goods and services. That will be welcome news for many retailers in sectors like household furnishings who have been reporting softer sales in recent months.

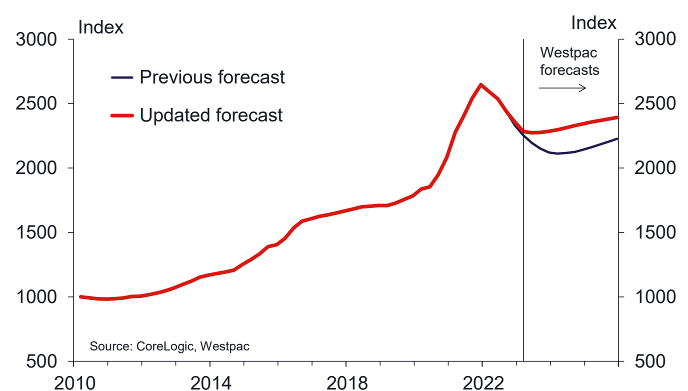
Figure 4: Net migration



The turnaround in population growth also signals increased demand for housing. As a result, the strong rise in housing rents that we've seen over the past year is set to continue well into 2024.

In addition, it's looking like a trough in the housing market is approaching faster than previously anticipated. Since mortgage rates began rising in 2021, house prices have fallen by an average of 17% across the nation. However, rising population growth along with lower longer-term mortgage rates are likely to provide a brake on those declines. We've revised up our forecasts for house price growth, and now expect that mid-2023 will be the bottom for the housing market. As interest rates are set to remain at contractionary levels for some time, we think the extent of the upswing should be limited – although this crucially also depends on the future path of migration.

Figure 5: House prices

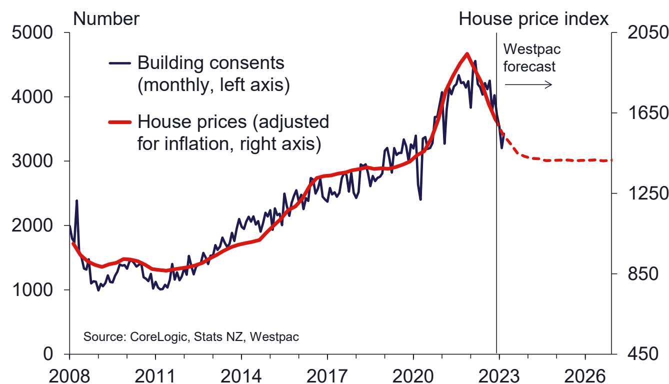


While housing market conditions are starting to stabilise, an upswing in home building activity still looks unlikely for some time yet due to ongoing financial pressures. In addition to higher interest rates and the large falls in house prices, construction firms have seen their operating costs rising by 13% over the past year. Against this backdrop, prospective

buyers are reluctant to purchase off the plans. We've also seen dwelling consent numbers falling 7% over the past year as developers have become increasingly hesitant to bring new projects to market.

Although population growth is set to outpace home building by a sizeable margin, those challenging financial conditions will continue to be a brake on home building. As a result, we expect that construction activity will trend down from its current high level over the next few years as the existing pipeline of projects is completed.

Figure 6: Dwelling consents and house prices

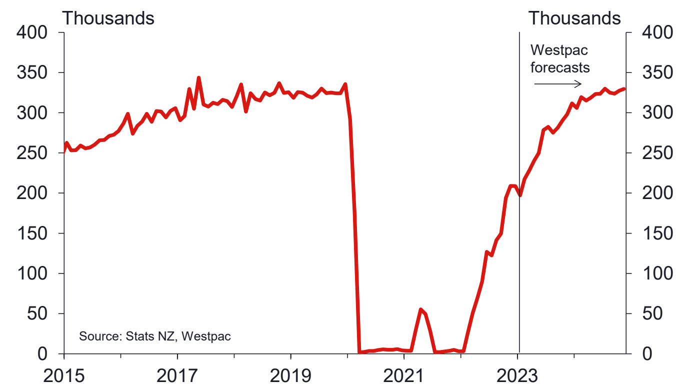


With population growth boosting demand across a range of sectors, inflation pressures in areas like the retail sector are likely to be stronger than would have otherwise been the case. But population increases don't just affect demand. With New Zealand's immigration policies tuned towards bringing in those of working age and with high skill levels, the rise in arrivals also signals a sizeable boost to the nation's 'human capital' – i.e. the size of our labour force and depth of our skills base. That will help to alleviate the shortages of skilled labour that many businesses have been struggling with, as well as the related upward pressure on wage rates. As a result, while higher migration will add to inflation in the near term, the impact on longer term inflation pressures will be much more limited due to the related lift in the economy's productive capacity.

The downturn in the housing market is coming to an end. However, with interest rates to remain high for some time yet, the scope for any upswing remains limited.

Firmer conditions in some of our key export markets are also helping to offset weaker demand elsewhere in the economy. As discussed in the *Agricultural outlook* section, prices for many of our commodity exports are likely to pick up as the Chinese economy rebounds and global agricultural supply remains subdued. Similarly, we expect to see a continuing rebound in tourism and hospitality exports. Visitor numbers rose rapidly over the past year as travel restrictions here and abroad were eased. And while we don't expect the same sort of rapid increases that we saw over 2022, the coming year is likely to see further increases in international visitor numbers from high spending markets like the US and China.

Figure 7: Monthly visitor arrivals, seasonally adjusted



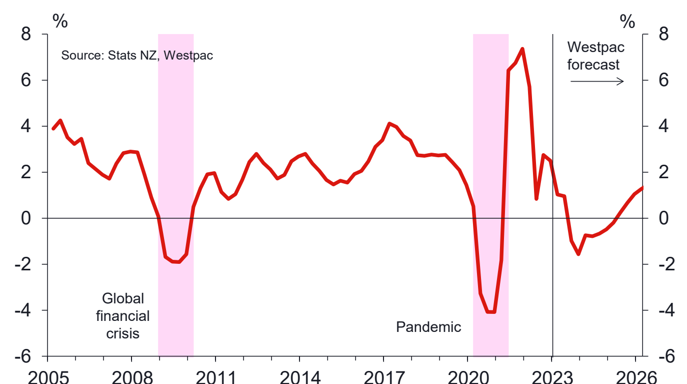
The uneven landscape.

Even with the boost to demand from factors such as the rise in net migration, we're still looking at an extended period of subdued growth. Furthermore, conditions are set to be very uneven across the economy.

For businesses, the rise in population growth signals a sizeable boost to demand. That will help to offset some of the challenges that many businesses have been grappling with, such as the mounting pressures on operating margins.

However, the boost to demand from high net migration is masking what will be a much tougher environment for many New Zealand households. In fact, on a per capita basis, household spending is set to go backwards over the coming years as the full brunt of high inflation and higher interest rates ripple through the economy. That means many New Zealanders could see their standard of living fall.

Figure 8: Per capita household spending (annual average growth)



The rise in net migration will help to alleviate labour shortages and will also boost demand.

GLOBAL ECONOMY

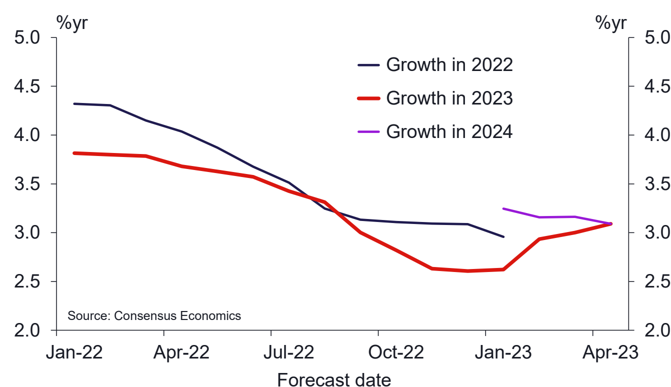
Work in progress.

Global inflation has eased from last year's highs, as some of the price shocks from previous years have waned. However, the services component of inflation remains stubbornly strong, reflecting tight labour markets and rising wage demands. Central banks have raised interest rates sharply, but the extent to which they have been successful in restraining activity and inflation pressures remains to be seen.

The current state of the world economy echoes New Zealand's situation in many respects. Central banks have raised their policy interest rates a long way in a short space of time to combat the post-Covid resurgence of inflation. There is a general sense that we've reached the peak in interest rates, although there are instances where more work may be needed. And there are certainly signs that monetary policy is getting some traction, but it remains to be seen whether things are cooling off enough to bring inflation all the way back to target.

Market forecasts of world growth have been steady in recent months, in contrast to the string of downgrades that we saw over the course of last year. Indeed, the overall picture for this year is now shaping up to be a little better than in 2022, mostly due to the unexpectedly rapid removal of Covid restrictions in China, the world's second-largest economy. OECD countries are still expected to see a slowdown this year, albeit down to sub-par growth rather than tipping into outright recession.

Figure 9: Market forecasts of world GDP growth



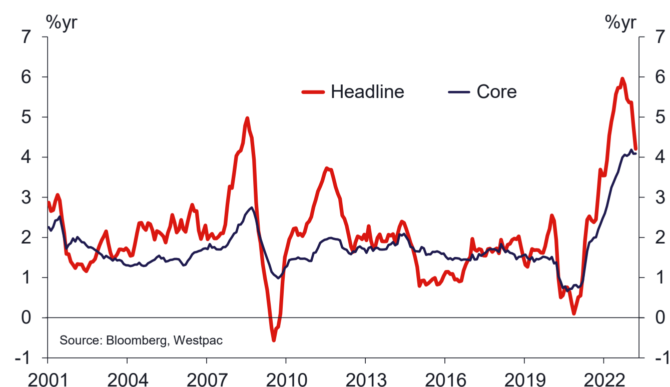
There are some clear headwinds to global growth this year. Monetary policy has been tightened significantly across most of the world to cool down economies that had become overstimulated and overheated in the wake of the Covid pandemic. This monetary tightening had also had the effect of exposing poor risk management and supervisory practices that had flourished in the era of low interest rates, most notably with several regional US banks running into distress this year. Surveys in the US and Europe show that lending standards have been tightened substantially in recent months.

On the inflation front, it's clear that the worst has now passed. Annual inflation rates in most regions have come off the peaks that they reached last year, although they remain far above central banks' target ranges.

Much of the easing in inflation to date reflects an unwinding of previous price shocks. As the Covid pandemic has eased, global supply chains have improved, and container shipping rates have receded all the way back to their pre-Covid levels. Similarly, the initial impacts from the invasion of Ukraine are now washing out – for instance, crude oil prices are down by about 30% from where they peaked a year ago. This easing in global price pressures is in turn helping to drive down the imported component of inflation in New Zealand.

However, these forces are unlikely to be enough to bring inflation all the way back to target. While headline inflation has come down, measures of core inflation (which typically exclude food and fuel) have remained stubbornly high. The strength in core inflation reflects a higher weighting on services, where price increases have been gaining momentum over the last year.

Figure 10: Annual inflation, trading partner average

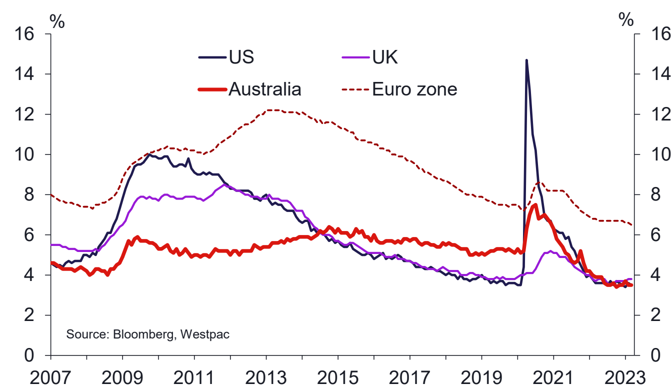


In turn, the strength in services inflation reflects the fact that labour makes up a high proportion of their costs. The inevitable conclusion is that for central banks to fully tame inflation, they will need to take the heat out of wage demands.

For central banks to fully tame inflation, they will need to take the heat out of wage demands.

To date, labour markets have been remarkably resilient. Rates of unemployment remain exceptionally low – in some cases at their lowest in several decades – and have held steady or even improved further over the last year, even as central banks have lifted interest rates sharply. Participation rates have continued to improve as well, as the strong demand for workers has brought more people back into the workforce.

Figure 11: Unemployment rates



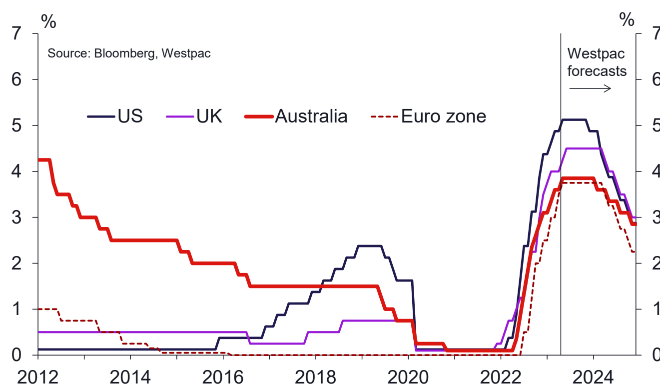
As the year progresses, we expect to see more evidence of a material slowdown in economic growth, with unemployment rates rising from their lows. This will allow central banks to start taking their foot off the brake, bringing interest rates back down to more normal levels. However, the pace and timing of this downshift will vary across regions, depending on local conditions.

The US may be the best-placed for a material easing in inflation in the year ahead. The accumulated effects of higher interest rates and tighter credit conditions are expected to lead to a marked slowdown in activity in the second half of this year. In addition, a well-anticipated easing in housing-related price pressures is helping to bring core inflation down. We expect that the US Federal Reserve will be in a position to start reducing its policy rate by the end of this year – although there are risks that easing takes longer to eventuate.

The European economy has fared better than expected, weathering the energy price shock that followed the Ukraine invasion surprisingly well. And in contrast to the US, services inflation still appears to be on the rise. Overall, there is more of a sense the European Central Bank has fallen behind in the fight against inflation, and the risks lean towards a need for further rate hikes this year.

The Reserve Bank of Australia has been a reluctant policy tightener in recent months, placing as much weight on the full employment part of its mandate as it has on inflation. That has left the RBA stretching the limits of compliance with its inflation target, with inflation not expected to fall back to 3% until 2025. We do expect a sharp slowdown in consumer spending this year as households are squeezed by higher mortgage rates. But the Australian economy remains buoyant in many other respects and, as in New Zealand, a surge in migrants is already giving the housing market a fresh lease of life.

Figure 12: Central bank policy rates



The themes seen in the OECD economies are largely absent across most of Asia, where inflation has tended to be more benign. The biggest exception of all is China, which has been operating to a different timetable. Having abandoned its Covid restrictions late last year, it is only now benefiting from an unleashing of pent-up demand, which has largely run its course now in other parts of the world.

This is not to say that the Chinese economy doesn't face its own set of challenges, both cyclical and structural. The Government has set a GDP growth target for this year of 5%, which would represent quite a modest rebound after a suppressed 2022. However, the March quarter figures suggest that the economy is already outstripping this pace, more akin to our forecast of 6.2% growth this year. And with inflation remaining relatively subdued in China, policymakers will not feel restrained in their ability to provide more stimulus where needed.

We think that central bank policy rates have peaked, though the near-term risks lean towards further hikes.

Consumers are leading China's recovery. Not only are the Covid-zero restraints now off, but unlike many Western economies, Chinese households are not being squeezed by rising living costs or higher mortgage rates. We have already seen a strong pickup in retail spending, and the appetite for overseas travel is gradually returning.

Residential investment, and the associated demand for labour and materials, is also likely to benefit in time. A pickup in house sales and prices points to renewed confidence among homebuyers. There is evidence that the pipeline of partially completed homes is being worked through, but it may be a while longer before the recovery in demand translates into new construction projects.

INFLATION AND THE RBNZ

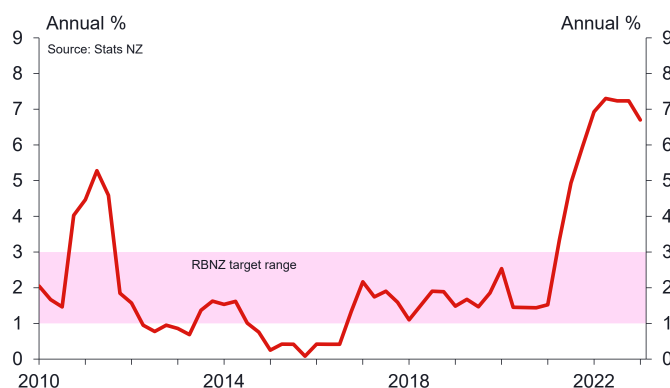
More mahi required.

Inflation is past its peak, but it will be a long ride back to the Reserve Bank's target. The past impact of supply-driven inflation is behind us leaving a hard rump of sticky demand-driven inflation. Monetary policy is working but an historic increase in migration looks set to add demand at an inconvenient time. More interest rate rises are required to finish the job.

Inflation is past its peak. Consumer prices rose by 1.2% in the March quarter. That saw the annual inflation rate dropping from 7.2% at the end of last year to 6.7% now. Annual inflation hasn't been this low since the end of 2021.

Importantly, inflation has now fallen well short of the RBNZ's forecasts for the past two quarters. The RBNZ forecast that annual inflation would rise to 7.3% in the March quarter.

Figure 13: Consumer price inflation



Despite the dip in headline inflation, it's too soon to celebrate victory over inflation. Indeed, underlying inflation pressures are still running hot. Businesses' operating costs are up 8% over the past year, and wage costs up by around 7% over the same period. Moreover, recent jobs growth points to ongoing strength in wage growth, rather than to any slowdown.

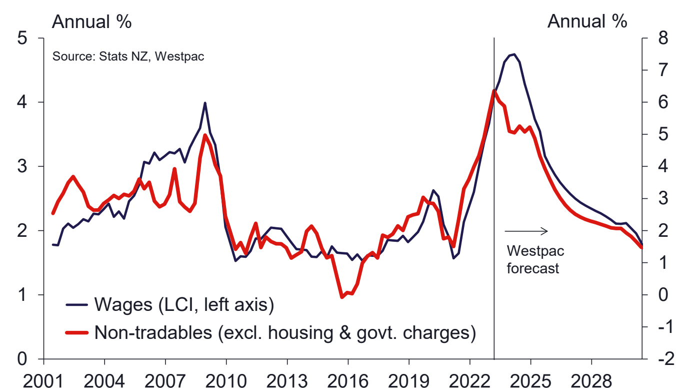
The impact of those strong cost pressures has been seen most clearly in the domestically oriented components of inflation (sometimes referred to as non-tradables). These components are continuing to rise at a rapid pace – up 1.7% in the March quarter and 6.8% over the past year.

Despite the dip in headline inflation, it's too soon to celebrate victory over inflation.

We can take some small comfort, however, from the fact that while price pressures remain strong, they aren't accelerating.

Measures of 'core' inflation, which smooth through the quarter-to-quarter volatility in prices, have stabilised around 6% and some measures are easing.

Figure 14: Non-tradables and wage inflation



Note: We have smoothed through the impact of the GST change in 2010.

Furthermore, it's also notable that the early part of 2023 saw widespread falls in the prices of many imported durable items, like furnishings and appliances, as well a further easing in the cost of purchasing a newly built home (which drove much of the rise in overall inflation over the past year). Those are both areas where we would expect to see price pressures soften following the sharp rise in interest rates over the past year.

The RBNZ.

The monetary policy cycle in New Zealand is getting to a mature late stage. The RBNZ has delivered 500 basis points of hikes already. That's taken interest rates into restrictive territory.

The RBNZ has no headroom for upside surprises to growth and inflation.

Since late 2022, the RBNZ has foreseen a need to move rates to the mid-5% level. We are seeing encouraging signs that higher interest rates are translating into weakening inflation pressures. All else equal, this could have meant that the RBNZ's

grand plan was coming together and that a prolonged period of unchanged interest rates could bring inflation back into the target range in a reasonable timeframe.

However, the RBNZ has no headroom for upside surprises to growth and inflation. And unfortunately, the surge in migration has the potential to disturb the grand plan.

This migration cycle is hard to assess in terms of its amplitude and duration. But based on what we can see now, it seems clear that New Zealand will see strong population growth that will add significantly to both the demand and supply for resources. The world is moving again post-Covid and countries like New Zealand are seeing people seek out opportunity and lifestyle benefits that have not been available for much of the last few years.

Better to finish the job now than to have to come back with stronger more painful measures later.

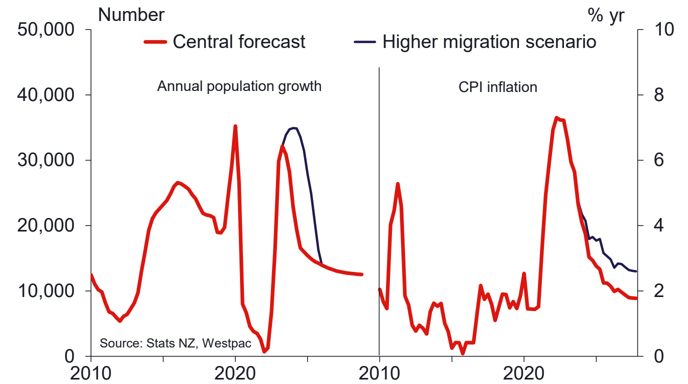
While demand and supply will balance out in the medium term, in the short term there will be more demand. That's at a time when the RBNZ's plan was for sub-trend growth to open up sufficient excess capacity to sustainably bring inflation down from the current very high levels. This marginal demand is likely to translate to more persistent inflation pressures and will delay the return of inflation to target.

Hence, we argue here that the tightening cycle is not yet over, and that more insurance is required to be sure of bringing inflation back into the target range. We see the OCR rising further to 6% by August and remaining there until mid-2024 when it should be clearer that inflation pressures have substantially moderated. By then CPI inflation should hopefully be closer to 4% and falling. For the Reserve Bank, the prospect of reaching the promised land of 3% inflation will be more than just a figment of an economic forecaster's wild imagination.

Figure 15: Official Cash Rate forecasts

As always, significant risks to this central outlook exist – but our sense is that these remain to the upside in terms of inflation persistence and hence interest rates. A key upside risk is the size and amplitude of the migration cycle we are now firmly within. We have included a reasonable assessment of what might be expected but if a greater and more protracted migration cycle eventuates then we would expect the net demand impact on the economy and inflation to be greater and more persistent. If inward migration triggers an early return to a strong housing market, then the resultant boost to consumption, investment and the labour market could really challenge the assumption that inflation expectations remain anchored to the 1-3% target range.

Figure 16: Scenario – net migration much stronger than expected



Downside risk scenarios can be contemplated – particularly with respect to the degree to which the tightening which has already occurred impacts domestic spending now we are firmly in the "sweet spot" of their impacts on the economy and inflation. But our sense is that the RBNZ would gratefully accept such surprises as gifts which would speed the return of inflation to target as opposed to raise significant concerns that tightenings are overdone, and policy reversals are necessary.

Better to finish the job now than to have to come back with stronger more painful measures later.

Financial market forecasts (end of quarter)

	CPI inflation	OCR	90-day bill	2 year swap	5 year swap
Jun-23	5.9	5.50	5.90	5.20	4.50
Sep-23	5.6	6.00	6.10	5.00	4.40
Dec-23	4.7	6.00	6.10	4.80	4.30
Mar-24	4.1	6.00	6.00	4.50	4.20
Jun-24	3.7	5.75	5.55	4.30	4.10
Sep-24	3.0	5.25	5.05	4.10	4.00
Dec-24	2.9	4.75	4.75	4.00	3.95
Mar-25	2.8	4.50	4.30	3.90	3.90
Jun-25	2.7	4.00	3.80	3.80	3.90
Sep-25	2.2	3.50	3.60	3.80	3.90

AGRICULTURAL OUTLOOK

2023: a year of two halves.

2023 has been a tough year so far for farmers and growers, punctuated by red-hot cost inflation, rising debt servicing costs, falling returns, and weather events. However, the second half of 2023 is shaping up better. Cost inflation is cooling rapidly, commodity prices are lifting, and interest rates are peaking. As such, we expect sector profitability will improve from here.

The squeeze has been on sector profit margins. Costs have spiked as inflation has run red hot. In the year to December 2022, rural cost inflation surged to 15.3% on an annual basis.

Falling incomes have also added to the squeeze. Prices received by farmers and growers have by and large declined, in some cases sharply. Farmgate lamb prices, for example, fell by around $2.70/kg or 28% between September 2022 and February this year. Production has also fallen, with the steepest falls in areas impacted by storms and other bad weather. Estimates suggest Cyclone Gabrielle has led to the loss of around half of the Hawke's Bay apple crop. While not nearly as steep, we expect dairy production to fall 0.6% over the season, compounding the decline in the milk price.

From here, we expect conditions to improve. First up, we expect rural cost inflation will descend rapidly from its red-hot current pace to around 4% and 2% by the end of 2023 and 2024, respectively. Notably, fertiliser and fuel prices have peaked and have further to fall. In addition, feed prices have plunged over recent months as wet weather has supercharged pastures around the country. Interest rates are also adding to the downward pressure. That is, while interest rates are not necessarily falling, they are not increasing at the same rapid pace as last year.

Meanwhile, commodity prices are turning the corner and that will ultimately lead farm and orchard gate prices higher.

Farmgate meat prices generally bottomed in January or February and have lifted steadily since then. Notably, these price lifts have come at a time of the year when prices normally fall. Global dairy prices have also turned the corner, albeit more recently and too late in the season to prevent us from stepping down our 2022/23 milk price forecast to $8.30/kg. The price rises do bode well for next season, however. Hence, we have maintained our bullish forecast of $10.00/kg.

Horticulture prices are also on the up. However, the catalyst for the rise is reduced crops following Cyclone Gabrielle and earlier weather events. On balance, we don't expect the higher prices will be enough to offset lower production. Lastly, we expect forestry prices to improve over the year and into next, however in the short term, prices may remain volatile.

We see two key factors boosting commodity prices over the coming year. Firstly, Chinese demand for our exports is rising as the Chinese economy accelerates following its reopening. The household sector is leading the way, and this bodes well for demand and the prices of our food exports. Secondly, global agricultural supply remains tight as producers battle red-hot cost inflation and, in some regions like the US, the lingering impacts of drought continue to crimp production.

The upshot is we expect farmer and grower margins will improve over the rest of the year and into 2024, translating into relatively healthy 2023/24 sector profits compared to 2022/23.

Commodity price monitor

Sector	Trend	Current level[1]	Next 6 months
Dairy	Global dairy prices have started to turn the corner. However, these rises have come too late in the season to prevent us from stepping down our 2022/23 milk price forecast to $8.30/kg. The price rises do bode well for next season. Hence, we have maintained our bullish forecast of $10.00/kg.	Average	↑
Beef	Farmgate beef prices have lifted gradually over recent months to around $5.80/kg. With US supply very tight and Chinese demand lifting further, we expect prices to head back over $6.00/kg over coming months and towards $7.00/kg by spring.	Below average	↑
Lamb/Mutton	Farmgate lamb prices have rebounded back above $7.00/kg. We expect further lifts in Chinese demand and relatively tight supply will lead prices towards $9.00/kg by spring.	Average	↑
Forestry	With the Chinese economy open and construction likely to pick up, we expect log prices to pick up over the year.	Low	↑
Horticulture	Cyclone Gabrielle has hit fruit and particularly apple production hard. The kiwifruit crop is also well down on last season's, although quality will be much improved. With fruit supply dropping, we expect fruit prices to spike higher.	Average	↑

1 New Zealand dollar prices adjusted for inflation, deviation from 10 year average.

EXCHANGE RATES

Pushing ahead.

The New Zealand dollar has made gains recently following the RBNZ's larger than expected 50 basis point OCR increase in April. Further gains are expected, with persistent US dollar weakness, favourable interest rate differentials and rising export revenues likely to add further support.

Since our last *Economic Overview* in February, the NZ/US exchange rate has been rangebound between $0.61 and $0.63 despite global volatility and growing financial stability concerns. However, following the RBNZ's hawkish April policy statement, the New Zealand dollar has since made gains against all its main trading partners.

The Kiwi has also been bolstered by US dollar weakness, which typically benefits higher risk and higher yielding currencies such as the New Zealand dollar more than the likes of the euro and the pound. The US dollar Index has fallen 4.7% since early March as inflation pressures have eased and expectations for rate hikes from the Federal Reserve have been wound back.

Over the remainder of this year, we expect the New Zealand dollar to strengthen further against the US dollar and most of our other trading partners.

A big part of that story will be continued US dollar weakness. As we look ahead to the end of 2023 and beyond, the downward trajectory of US inflation and easing monetary policy are likely to combine to increase downward pressure on the US dollar. Accordingly, we expect the New Zealand dollar to strengthen from US$0.63 currently to US$0.67 by the end of this year.

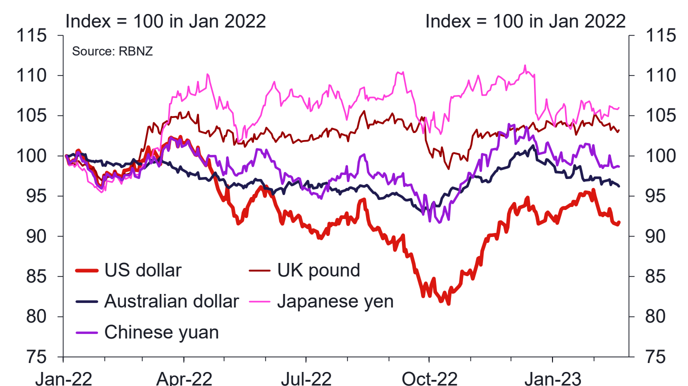
We also expect the New Zealand dollar to track higher against both the euro and pound. That reflects both a heightened sensitivity to US dollar weakness as well as the impact of favourable interest rate differentials i.e., relatively high New Zealand interest rates. Indeed, from an already high 5.25%, we expect the RBNZ to hike three more times to a peak of 6% by August.

New Zealand's economic fundamentals are also likely to support the currency, with ongoing tightness in the labour market continuing to suggest a relatively solid economy. The ongoing rebound in international tourism arrivals will also continue to support economic activity over the year. Meanwhile, the rebounding Chinese economy will provide further support to the New Zealand dollar as demand for and prices of our export commodities increase.

Given these conditions, we expect that the New Zealand dollar will edge higher over coming quarters, from EUR 0.57 currently to EUR 0.60 by the end of this year. Similarly, the Kiwi is expected to strengthen from GBP 0.50 to GBP 0.53 over the same timeframe.

We have a slightly different view for the Australian dollar. While we also expect it to benefit from ongoing US dollar weakness, we think it is even better positioned than the New Zealand dollar to benefit from the reopening of the Chinese economy. To that end, we see the New Zealand dollar easing against the Australian dollar, from AU$0.93 to AU$0.91 by year-end.

Figure 17: NZ dollar exchange rate vs major currencies



Exchange rate forecasts (end of quarter)

	NZD/ USD	NZD/ AUD	NZD/ EUR	NZD/ GBP	NZD/ JPY	TWI
Jun-23	0.64	0.93	0.58	0.51	84.5	71.5
Sep-23	0.66	0.92	0.59	0.53	85.8	72.5
Dec-23	0.67	0.91	0.60	0.53	85.8	72.7
Mar-24	0.68	0.90	0.60	0.54	85.7	72.5
Jun-24	0.68	0.89	0.59	0.53	85.1	71.7
Sep-24	0.68	0.89	0.59	0.53	84.4	71.2
Dec-24	0.68	0.88	0.59	0.53	84.3	71.0
Mar-25	0.68	0.89	0.58	0.53	83.6	71.0
Jun-25	0.68	0.89	0.58	0.53	83.0	70.9
Sep-25	0.68	0.90	0.58	0.52	82.3	70.8

SPECIAL TOPIC

Migration: Come one, come all.

Net migration has turned sharply positive again, as the reopening of the border has unleashed a pent-up demand to live and work in New Zealand. We now expect a record net inflow of 100,000 people this year. But the pool of potential arrivals is very large, and there are plausible scenarios where the balance could be much higher.

In our August 2022 *Economic Overview*, we wrote about the factors that would drive a return to net inward migration over 2023 as New Zealand reopened its international border. This was at a time when much of the discourse was around the potential for large outflows of New Zealanders, based on a pent-up demand for the 'overseas experience'. However, we noted that foreign arrivals have always been the dominant factor in the net migration balance, and that there was significant pent-up demand to move here as well.

Since then, the direction of our forecast has been proven correct, but the magnitude has been well beyond what anyone imagined. Net inflows reached more than 65,000 people in the year to March, from a net outflow of 20,000 in the previous year. And even this doesn't fully capture the extent of the turnaround: recent months have been running at a pace equivalent to 100,000 people per year.

As we predicted, overseas arrivals have been the biggest driver, and they have far exceeded the pace seen in the years before the pandemic. We're not the only country to experience this – Australia and Canada have also seen a surge in inflows, and even the US has been looking to play catch-up on visa issuance after a drop-off during the Covid restrictions in 2020.

We expect that these catch-up flows into New Zealand will continue for a while longer. We've upgraded our forecast to a net inflow of 100,000 people over 2023, adding almost 2% to New Zealand's population. This would be a stronger growth impulse than we've seen at the peaks of previous migration cycles.

Throughout this *Overview* we've detailed the impact that this migration surge is expected to have on the wider economy, and on policy settings. But we'd also emphasise that there's a wide range of possibilities around how this might play out, with large risks to both sides of our forecast.

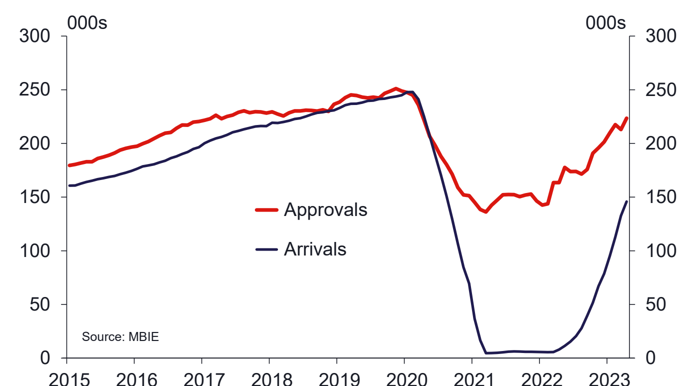
Firstly, the pool of potential arrivals is very large. For instance, since the border was closed in March 2020, approvals of work visas have exceeded arrivals by around 370,000. Now it's likely that many of these won't result in new arrivals – some of these visas will have expired, or they may be replacements for other types of visa. And no doubt many hopeful migrants will have made other plans in the meantime. But we note this number as an upper bound on what's possible – and it hints at outcomes that could be well north of our central view.

On the other hand, it's possible that migrant inflows could peter out after their initial burst, in the same way that outflows of New Zealanders have (while they remain relatively high, they seem to have peaked in the third quarter last year). Given what we've already seen to date, that would still amount to a larger than average inflow over the course of 2023, but the growth impulse could prove to be relatively short-lived.

There's also a great deal of uncertainty around how this rebound in migration will flow through to the wider economy. On one hand, an influx of workers may help to take the upward pressure out of wages – employers are certainly hoping this will be the case. But in other areas they are likely to add to already-strong demand, particularly in housing, where population growth is set to outstrip the pace of homebuilding in the year ahead.

This uncertain balance will also have important implications for monetary policy. The Reserve Bank has long regarded migration as an inflationary force on balance, adding more to demand than supply in the near term. Regardless of whether that proves to be the case this time, the RBNZ has little room to tolerate any upside surprises to the inflation outlook, and a continued surge in migrant inflows is likely to be met by policy action rather than waiting to observe its impact on inflation. For this reason, we now expect the Official Cash Rate to peak at 6% this year.

Figure 18: Working visas, annual sum



ECONOMIC AND FINANCIAL FORECASTS

New Zealand forecasts

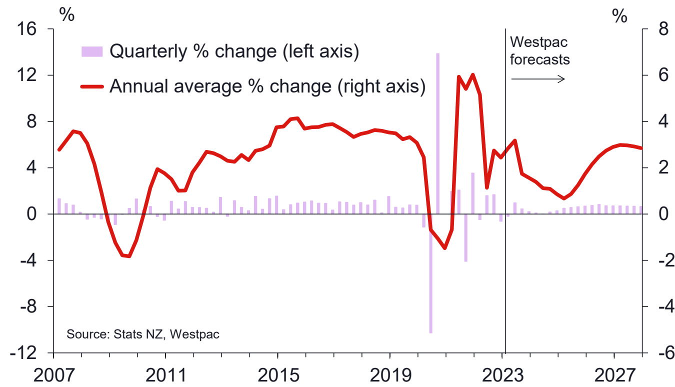
GDP components	Quarterly % change				Annual average % change			
	Mar-23	Jun-23	Sep-23	Dec-23	2021	2022	2023	2024
GDP (production)	-0.2	1.0	0.4	0.2	6.0	2.4	1.6	0.9
Private consumption	0.1	0.7	0.4	0.3	7.5	2.9	0.3	1.3
Government consumption	1.0	-0.2	-1.0	-0.6	8.2	4.5	-1.8	-0.7
Residential investment	1.1	0.6	-0.9	-2.5	8.0	0.4	0.6	-8.8
Business Investment	1.9	0.5	-0.3	-1.0	14.6	4.9	1.2	-2.8
Exports	2.6	3.2	2.4	1.6	-2.6	-1.0	13.3	6.4
Imports	4.8	-0.3	-0.1	0.2	15.1	4.4	6.4	0.7
Economic indicators	**Quarterly % change**				**Annual % change**			
	Mar-23	Jun-23	Sep-23	Dec-23	2021	2022	2023	2024
Consumer price index	1.2	1.0	1.9	0.5	5.9	7.2	4.7	2.9
Employment change	0.8	0.3	0.0	0.0	3.3	1.6	1.2	-0.3
Unemployment rate	3.4	3.5	3.7	3.9	3.2	3.4	3.9	4.9
Labour cost index (all sectors)	1.0	1.4	1.2	1.1	2.6	4.1	4.7	3.7
Current account balance (% of GDP)	-8.5	-8.4	-8.5	-7.8	-6.0	-8.9	-7.8	-4.8
Terms of trade	0.0	0.2	1.3	2.0	2.8	-3.9	3.5	2.7
House price index	-3.1	-0.4	0.1	0.4	27.1	-11.0	-3.0	2.5
Financial forecasts	**End of quarter**				**End of year**			
	Mar-23	Jun-23	Sep-23	Dec-23	2021	2022	2023	2024
90 day bank bill	4.99	5.90	6.10	6.10	0.81	4.26	6.10	4.75
2 year swap	5.11	5.20	5.00	4.80	2.08	5.09	4.80	4.00
5 year swap	4.50	4.50	4.40	4.30	2.46	4.66	4.30	3.95
10 year bond	4.27	4.20	4.15	4.10	2.39	4.30	4.10	3.70
TWI	71.3	71.5	72.5	72.7	74.3	70.8	72.7	71.0
NZD/USD	0.63	0.64	0.66	0.67	0.69	0.60	0.67	0.68
NZD/AUD	0.92	0.93	0.92	0.91	0.95	0.92	0.91	0.88
NZD/EUR	0.59	0.58	0.59	0.60	0.61	0.59	0.60	0.59
NZD/GBP	0.52	0.51	0.53	0.53	0.52	0.51	0.53	0.53

International economic forecasts

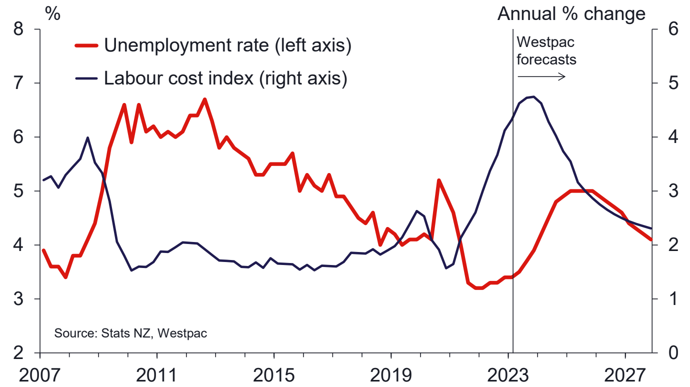
Real GDP (calendar years)	Annual average % change					
	2019	2020	2021	2022	2023	2024
Australia	1.9	-1.8	5.2	3.7	1.6	1.0
China	6.0	2.2	8.4	3.0	6.2	5.5
United States	2.3	-2.8	5.9	2.1	1.1	0.6
Japan	-0.4	-4.3	2.1	1.0	1.2	1.0
East Asia ex China	3.8	-2.3	4.3	4.5	4.1	4.4
India	3.9	-5.8	9.1	7.0	5.8	6.5
Euro Zone	1.6	-6.1	5.4	3.5	0.6	1.4
United Kingdom	1.6	-11.0	7.6	4.3	-0.2	1.2
NZ trading partners	3.5	-1.4	6.2	3.3	3.6	3.3
World	2.8	-2.8	6.3	3.3	3.0	3.1

THE ECONOMY IN SIX CHARTS

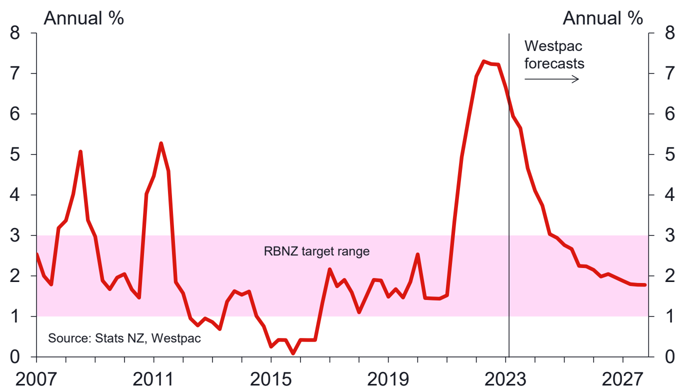
GDP growth



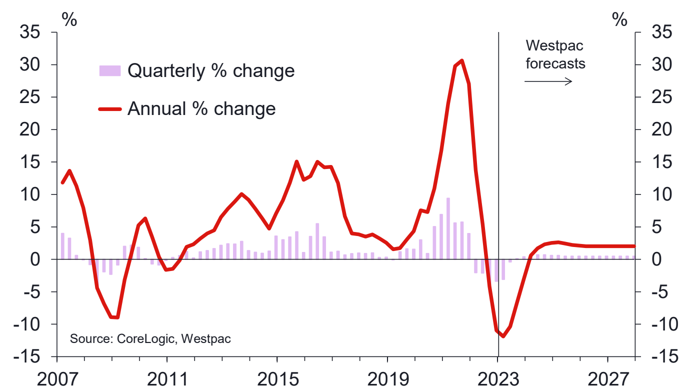
Employment and wage growth



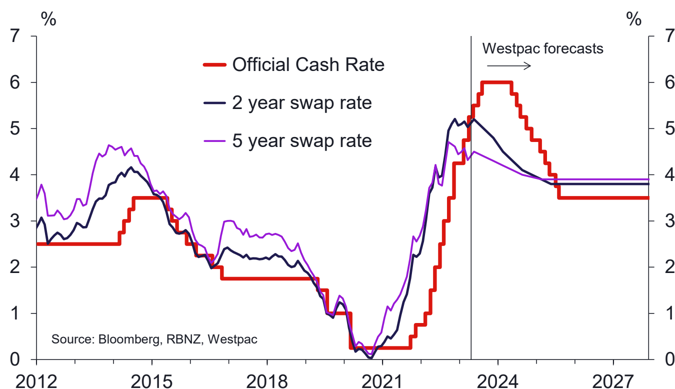
Consumer price inflation



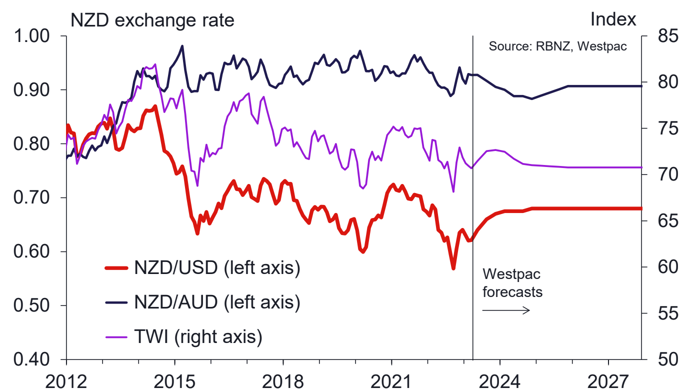
House prices



Official Cash Rate, 2 year swap and 5 year swap rates



Exchange rates



Contact the Westpac economics team

Kelly Eckhold, Chief Economist
+64 9 348 9382

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment recommendations disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;
(ii) physical separation of various Business/Support Units;
(iii) and well defined wall/cell crossing procedures;
(iv) a "need to know" policy;
(v) documented and well defined procedures for dealing with conflicts of interest;
(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

Westpac Banking Corporation.