WESTPAC WEEKLY ECONOMIC COMMENTARY

Double, or nothing?

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Harakeke/flax

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New Zealand recorded a 0.2% drop in GDP in the March quarter as the Omicron wave swept through the country. With recession risks already on people's minds, that inevitably sparked an interest in what the June quarter figures (to be released this Thursday) would hold. Would we see a second quarter of decline, meeting the 'technical' criteria for a recession? Or would it turn out to be nothing, simply a product of noisy data in an unusual environment?

With all the available data now to hand, it looks more likely that the March quarter drop was a big nothing – we estimate that GDP bounced by 1.6% in the June quarter. That's an upgrade from our initial forecast of a 1% rise, and is closer to the 1.8% increase that the Reserve Bank forecast in its most recent *Monetary Policy Statement*.

That said, the margin of uncertainty around our forecast – already quite wide throughout the pandemic – is particularly large this time. There were some big forces operating on the economy through the June quarter – not just the easing of the Omicron wave, but also the scaling back of the Covid response. And most importantly, the reopening of the border has seen the return of overseas tourists during what would normally have been the seasonal lull. We're expecting to see some big sectoral shifts in both directions, and it's not at all clear where the balance will lie.

Transport and accommodation were the obvious beneficiaries from the return of overseas tourists. The challenge has been in identifying what they did once they got here. They clearly weren't hitting the shops – retail spending was down more than 2% for the quarter. Instead, the gains will come through in sectors such as administrative services (which includes tour operators) and arts and recreation.

A number of sectors appear to have benefited from the easing of the Omicron wave over the June quarter, in particular the reduced degree of worker absences. We expect around a 4% lift in food manufacturing, helped by meatworks operating closer to full capacity, as well as improved growing conditions relative to previous quarters. Construction, non-food manufacturing and professional services are also expected to see an uptick to varying degrees.

Some of the sectoral details of GDP will need to be read with caution. The Marsden Point oil refinery was decommissioned in April and became an import-only facility. That means for GDP purposes its activities have been reclassified from manufacturing to wholesale and distribution. Without that effect, we'd be expecting to see a solid lift in non-food manufacturing, but a drop in wholesale trade, for the June quarter.

There are two areas where we expect to see a meaningful drag on GDP. The first is mining, with substantially lower oil and gas extraction during the quarter. That said, mining is a small sector (the decline knocks maybe 0.1% off total GDP growth for the quarter) and it doesn't tell us much about the health of the wider economy.

The second is healthcare. That, however, is more about returning to normal levels of activity. The Covid vaccination programme has largely wound down, as has PCR testing, with home tests taking over.

In New Zealand the production measure of GDP is generally considered more reliable, compared to the expenditure approach that's often favoured overseas. That's going to be particularly true for the June quarter figures. For one, the absence of overseas tourists until now has completely thrown off the usual seasonal patterns in services exports. Stats NZ also notes that there are issues with identifying how consumer spending is apportioned between tourists and New Zealand households, so that increased volatility has affected the household consumption figures as well. The production measure of GDP is much less affected by these issues.

A bounce in GDP in line with our forecasts would leave us with a picture of an economy that's still operating well above its sustainable potential. The Reserve Bank's task will be to close that gap in a timely manner in order to bring inflation pressures to heel, while also avoiding unnecessary volatility in the economy. We're already well down the path of higher interest rates, and we expect to see those have an increasing impact on activity in the months ahead.

But this process could take quite some time to play out, before we see the benefits of a return to low and stable inflation. So it's likely that some parts of the economy (such as the household sector) will have some pain to wear in the years ahead, even as other sectors such as tourism begin their recovery.

Q2 GDP forecast by production

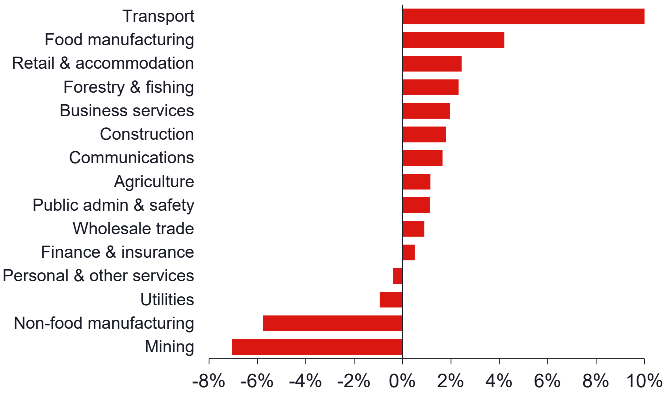

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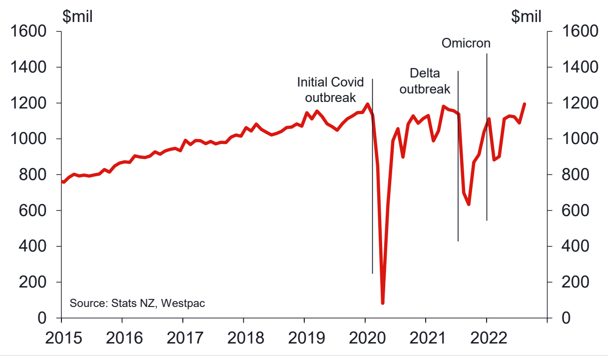
Chart of the week

Credit and debit card spending rose 0.7% in August, nearly all of which was related to a lift in hospitality. The reopening of our border to overseas visitors, and the easing in Covid cases locally, helped to lift hospitality spending back to around pre-pandemic levels (at least in dollar terms – like many sectors, it has seen a rise in prices in that time). Spending in other areas has effectively been flat, and in the case of durables such as household goods, it has fallen for the past three months.

Hospitality spending on electronic cards

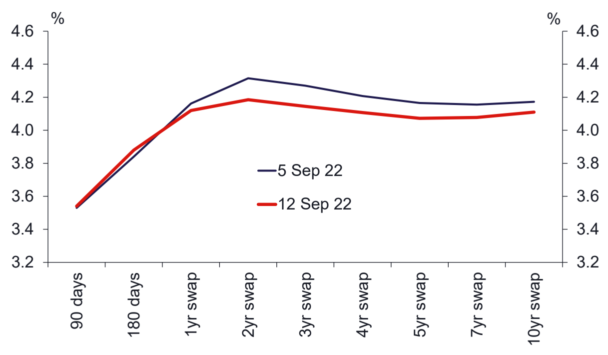


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 4% and to hold it there for the next couple of years, before reducing it to a more sustainable level in the following years. In contrast, wholesale interest rate markets are priced for a sustained higher level of the OCR for many years to come.

As a result, we believe that there is value in fixing for terms of up to two years. We would regard fixing for terms longer than this as expensive, but this option may suit those who want more certainty in their repayments.

NZ interest rates



The week ahead

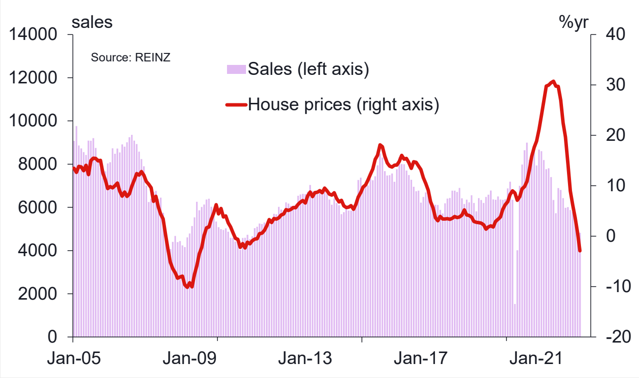
NZ Aug REINZ house sales and prices

Sep 13 (Due this week), Sales last: –3.1% m/m, –36.7% y/y
Prices last: –1.7% m/m, –2.9% y/y

The July housing market update from REINZ showed a further cooling in the housing market. Nationwide house prices are now down 8% from their peak in November 2021, and there have been particularly large falls in Auckland and Wellington. We've also seen the number of house sales continuing to drop, with monthly sales now at their lowest level since 2011 (barring the lockdown period in 2020).

We expect the August update will show that the softening in the housing market has continued. The low level of sales, increasing inventories of unsold homes, and a rise in the time to sell all point towards a further easing in sale prices. Mortgage rates did dip for a period in August. Even so, we expect the number of sales will remain low.

REINZ house prices and sales



NZ Q2 Current Account Balance, % of GDP

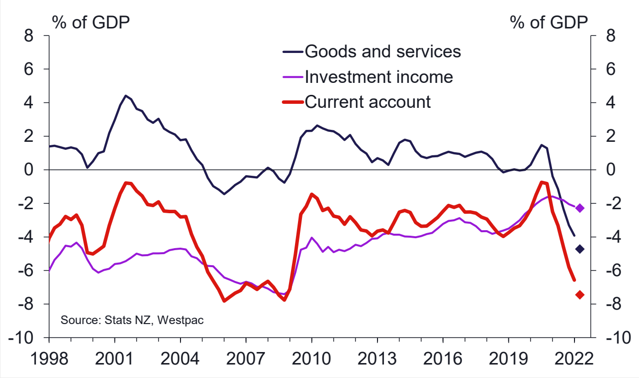
Sep 14, Last: –6.5%, Westpac: –7.5%

We expect the annual current account deficit to widen to 7.5% of GDP in the June quarter, from 6.5% in the March quarter.

The widening of the deficit beyond the average level of recent years essentially reflects the hot New Zealand economy since late 2020 – we have been, at least temporarily, living beyond our means.

However, we expect that 7.5% will represent the widest point for the current account deficit in this cycle. From here and as the economy slows, we expect the current account deficit to narrow to 6.7% by year end and to around 3.5% by December 2023.

NZ annual current account balance



NZ Q2 GDP

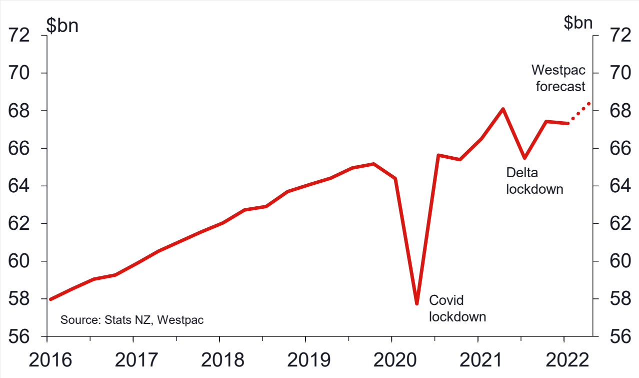
Sep 15, Last: –0.2%, WBC f/c: 1.6%, Mkt f/c: 1.0%

We expect a 1.6% rise in GDP for the June quarter. This follows a 0.2% drop in the March quarter as Omicron swept through the country.

The reopening of the border, and the resumption of overseas tourism, is expected to provide a significant boost to areas such as travel services, accommodation, and arts and recreation.

A result in line with our view would emphasise that the New Zealand economy remains far from recession. Indeed, the challenge is one of an economy that is running too hot.

NZ production-based GDP



The week ahead

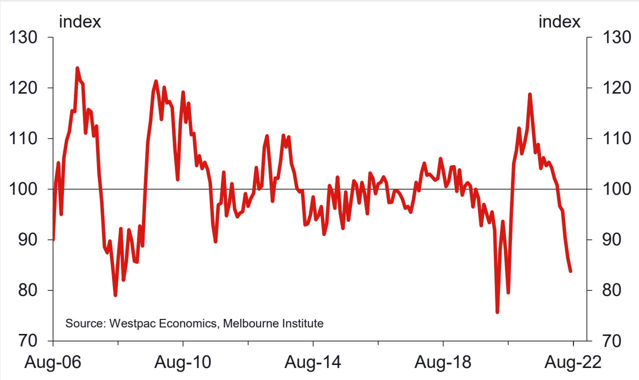
Aus Sep Westpac-MI Consumer Sentiment

Sep 13, Last: 81.2

Consumer Sentiment fell a further 3% to 81.2 in August, putting the Index on a par with the lows seen during COVID and the GFC but still well above those seen during the recession in the early 1990s. The Index has now seen a cumulative 22.9% fall from its peak in Nov last year.

September is shaping as another weak read, the RBA making a fourth 50bp interest rate rise in as many months. On top of this, equity markets have re-entreed correction mode, and price declines are becoming more pronounced and widespread in housing markets. More positively, the Q2 national accounts showed the economy sustaining gains through to mid-year, unemployment also remaining near historic lows and petrol prices continuing to retrace from recent highs. This is likely to be of little comfort though with overriding concerns about the shock from rapid rate rises likely to dominate.

Aus Consumer Sentiment Index



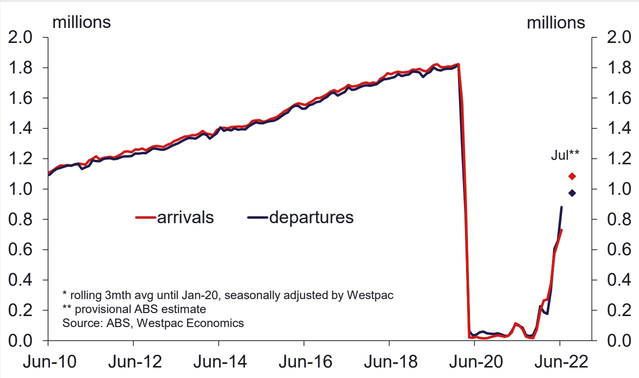
Aus Aug overseas arrivals and departures, prelim’

Sep 13, Arrivals, Last: 1083.2k
Sep 13, Departures, Last: 972.6k

A return to seasonal mid-year travel saw arrivals and departures post solid gains in July, lifting to 1083.2k and 972.6k respectively. The surge in June’s departures reflected Australians leaving for short-term trips, and July’s strength in arrivals marks their return, alongside a strong lift in short-term visitor arrivals.

For the August preliminary estimate, we expect the recovery in overseas travel to continue forging ahead. With arrivals and departures at 60% and 55% of their respective pre-pandemic levels, there is still plenty of capacity for growth.

Aus total overseas arrivals and departures



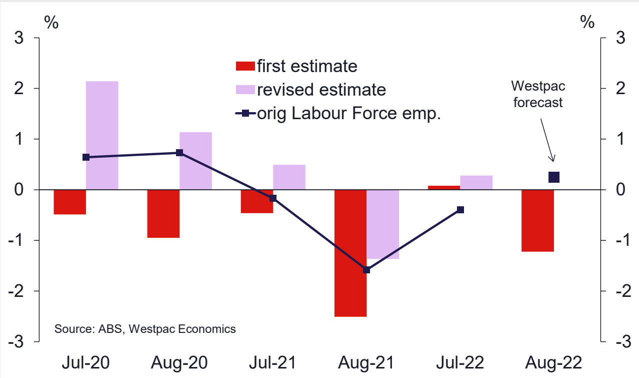
Aus Aug Labour Force Survey, employment ‘000

Sep 15, Last: –40.9k, WBC f/c: 110k
Mkt f/c: 37.5k, Range: 10k to 110k

Total employment surprised by falling 40.9k/0.3% in July and total hours worked fell in 0.8%. The ABS noted that the July Labour Force reference period coincided with winter school holidays, worker absences associated with various illnesses (including COVID), and further flooding events in NSW.

We are looking for a solid recovery from those events, but in comparing Labour Force reference periods, Weekly Payrolls fell -1.2% in the month to August, suggesting further weakness. However, post financial year Payrolls can be subject to significant revisions. As such we see the risk skewed to upside hence our solid +110k employment forecast.

Aus payroll revisions (Jul/Aug observations)



The week ahead

Aus Aug Labour Force Survey, unemployment %

Sep 15, Last: 3.4%, WBC f/c: 3.4%
Mkt f/c: 3.4%, Range: 3.2% to 3.6%

A decline in employment that is associated with less people being willing and/or able to work in the month would be reflected in a drop in participation which fell 0.3ppt in July to 66.4%, leading to a 61.2k decline in the labour force. As the decline in the labour force was larger than the decline in employment, the unemployment rate fell 0.1ppt to 3.4%; to 3.38% from 3.48% at two decimal points.

The decline in unemployment was matched by a decline in underemployment from 6.1% to 6.0%. Falling underemployment is unusual when hours worked contract but is consistent with the rise in part-time employment and further supply disruptions in July.

The fall in both underemployment and unemployment associated with falling employment and hours worked is a sign of seasonal volatility. Normally, you would expect unemployment and underemployment to rise with a fall in hours worked, suggesting many workers left the labour market in July. We expect them to return in August holding unemployment flat at 3.4%.

Aus Westpac employment indicators

US Aug CPI

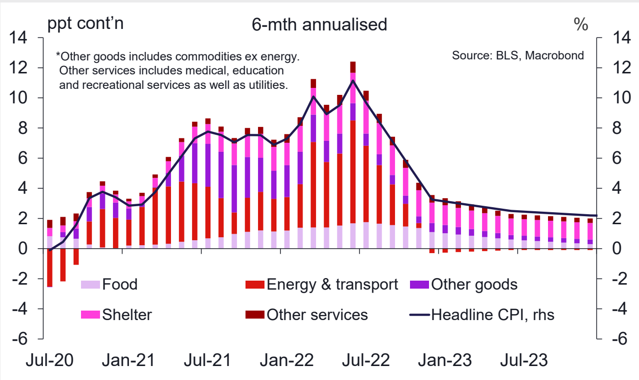
Sep 13, CPI mth chg, Last: 0.0%, Mkt f/c: –0.1%, WBC –0.2%

Coming a week ahead of the September FOMC meeting, this release looks set to decide whether the Committee will raise by 50bps or 75bps.

Headline inflation will be weighed down by the rapid decline in the oil price this month, so it is the core reading (ex energy and food) that will give a true read on the current pace of inflation and the risks ahead.

Arguably, with the economy having contracted through the first half, and household discretionary spending capacity under significant pressure, we are due a modest downside surprise. As such, we forecast +0.2% for core and -0.2% for headline. If achieved though, it should not be assumed that October and beyond will see repeats, with volatility likely to persist.

US CPI

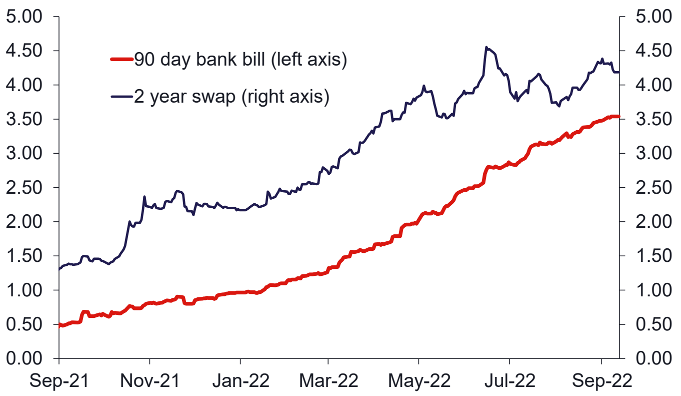


New Zealand forecasts

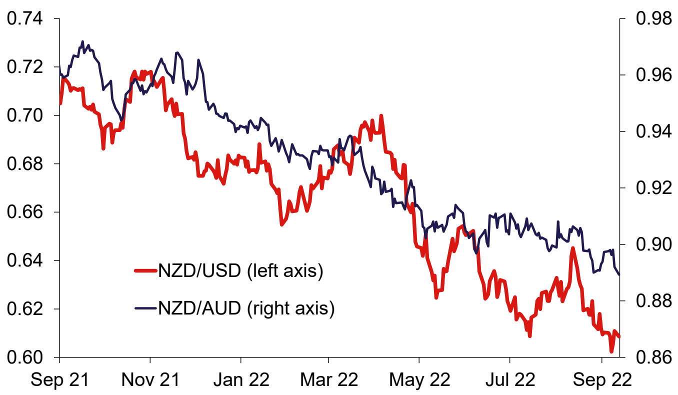
Economic forecasts	Quarterly				Annual			
	2022							
% change	Mar (a)	Jun	Sep	Dec	2020	2021	2022f	2023f
GDP (Production)	-0.2	1.6	0.4	0.6	-2.1	5.6	2.2	2.2
Employment	0.0	0.0	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.2	3.3	3.3	3.4	4.9	3.2	3.4	3.8
CPI	1.8	1.7	1.4	0.2	1.4	5.9	5.1	3.2
Current Account Balance % of GDP	-6.5	-7.6	-7.8	-7.4	-0.8	-5.8	-7.4	-4.6

Financial forecasts	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Cash	4.00	4.00	4.00	4.00	4.00	4.00	4.00
90 Day bill	4.10	4.10	4.10	4.10	4.10	4.10	3.80
2 Year Swap	3.90	3.80	3.70	3.50	3.30	3.10	2.80
5 Year Swap	3.70	3.60	3.50	3.35	3.20	3.05	2.90
10 Year Bond	3.50	3.40	3.30	3.15	3.00	2.95	2.90
NZD/USD	0.66	0.68	0.69	0.70	0.71	0.71	0.71
NZD/AUD	0.90	0.91	0.91	0.91	0.91	0.91	0.91
NZD/JPY	87.1	88.4	87.6	87.5	87.3	85.9	84.5
NZD/EUR	0.61	0.61	0.61	0.61	0.62	0.61	0.60
NZD/GBP	0.52	0.53	0.53	0.53	0.53	0.53	0.52
TWI	72.5	73.6	73.7	73.9	74.2	73.9	73.4

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 12 September 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.00%	3.00%	2.50%
30 Days	3.18%	3.04%	2.99%
60 Days	3.36%	3.25%	3.15%
90 Days	3.54%	3.47%	3.32%
2 Year Swap	4.19%	4.34%	3.96%
5 Year Swap	4.07%	4.16%	3.69%

NZ foreign currency mid-rates as at 12 September 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6086	0.6116	0.6368
NZD/EUR	0.6021	0.6125	0.6241
NZD/GBP	0.5223	0.5230	0.5266
NZD/JPY	86.70	84.71	84.92
NZD/AUD	0.8893	0.8909	0.9051
TWI	70.49	70.71	72.22

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	Jul net migration	-896	–	–	Still low, but starting to turn following opening of the border.
UK	Jul trade balance £mn	–11387	–	–	Deficit to remain wide on import strength.
Tue 13					
NZ	Aug REINZ house sales %yr	–36.7%	–	–	Expected this week. Sales to remain low...
	Aug REINZ house prices %yr	–2.9%	–	–	... with a further easing in prices expected.
	Aug food price index	2.1%	–	0.0%	Lower veg prices balanced against gains in other prices.
Aus	Sep Westpac-MI Consumer Sentiment	81.2	–	–	To be hit by a fourth 50bp rate hike in as many months.
	Aug NAB business survey	20	–	–	Conditions up 6pts in July. Any signs of cooling in August?
	Aug overseas arrivals, prelim '000s	1083.2k	–	–	Arrivals at 60% of pre-Covid levels on mid-year travel.
Eur	Sep ZEW survey of expectations	–54.9	–	–	Sunk to a series low; similar to other sentiment surveys.
UK	Jul ILO unemployment rate	3.8%	3.7%	–	Slack to become more visible into year-end.
US	Aug NFIB small business optimism	89.9	90.5	–	Consolidating near pandemic lows; outlook still gloomy.
	Aug CPI	0.0%	–0.1%	–0.2%	Core inflation the focus. 0.2%/0.3% necessary to quell fears.
Wed 14					
NZ	Q2 current account balance (% of GDP)	–6.5%	–	-7.5%	Deficit may be reaching its widest point.
Eur	Jul industrial production	0.7%	–0.7%	–	Buoyant through Q2, though supply issues linger.
UK	Aug CPI %yr	10.1%	10.4%	–	Energy inflation still a key risk.
US	Aug PPI	–0.5%	0.0%	–	Producer inflation cooling as supply issues ease.
Thu 15					
NZ	Q2 GDP	–0.2%	1.0%	1.6%	Post-lockdown bounce and return of international tourists.
Aus	Sep MI inflation expectations	5.9%	–	–	Will falling petrol prices have an impact on expectations?
	Aug employment	–40.9k	37.5k	110k	Employment bounces out of illness, holidays & flood induced...
	Aug unemployment rate	3.4%	3.4%	3.4%	... collapse while a lift in participation steadies unemployment.
Eur	Jul trade balance €bn	–30.8	–	–	Value of energy-related imports remains elevated.
US	Initial jobless claims	222k	–	–	Likely to remain at low levels for time being.
	Sep Fed Empire state index	–31.3	–15.5	–	Regional surveys have been highly volatile...
	Sep Phily Fed index	6.2	2.0	–	... and are increasingly varied across the nation.
	Aug retail sales	0.0%	0.0%	–	Inflation and rates clearly weighing on consumption.
	Aug import price index	–1.4%	–1.3%	–	Import prices are declining from elevated level.
	Aug industrial production	0.6%	0.2%	–	Businesses are working through supply issues...
	Jul business inventories	1.4%	0.6%	–	... and rebuilding inventories at a robust pace.
Fri 16					
NZ	Aug manufacturing PMI	52.7	–	–	Remains low, drags from rising costs and staff shortages.
Chn	Aug retail sales ytd %yr	–0.2%	0.2%	–	Consumption will be a key area of support into year-end.
	Aug fixed asset investment ytd %yr	5.7%	5.5%	–	Businesses are working through domestic virus disruptions...
	Aug industrial production ytd %yr	3.5%	3.6%	–	... as a weakening global economy weighs on trade.
Eur	Aug CPI %yr	9.1%	9.1%	–	Final estimate to provide detail on breadth and intensity.
UK	Aug retail sales	0.3%	–	–	Negative so far this year, highlighting pressure on HH's.
US	Sep Uni. of Michigan sentiment	58.2	59.3	–	Consumers still feeling the heat from inflation and rates.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.1	4.8	4.9	2.1
CPI inflation %yr	1.8	1.8	0.9	3.5	7.6	3.1
Unemployment rate %	5.0	5.2	6.8	4.7	3.0	4.2
Current account % of GDP	-2.1	0.7	2.6	3.5	1.6	-1.0
United States						
Real GDP %yr	2.9	2.3	-3.4	5.7	1.7	0.6
CPI inflation %yr	2.4	1.9	1.2	5.1	7.1	2.5
Unemployment rate %	3.9	3.7	8.1	5.4	3.7	4.1
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	-0.2	-4.5	1.6	1.7	1.7
Euro zone						
Real GDP %yr	1.8	1.6	-6.4	5.3	2.2	1.5
United Kingdom						
Real GDP %yr	1.7	1.7	-9.3	7.4	3.3	-1.0
China						
Real GDP %yr	6.8	6.0	2.2	8.1	3.5	7.0
East Asia ex China						
Real GDP %yr	4.5	3.8	-2.3	4.1	4.5	4.6
World						
Real GDP %yr	3.6	2.9	-3.1	6.1	3.0	3.4

Forecasts finalised 5 August 2022

Interest rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Australia							
Cash	2.35	3.10	3.35	3.35	3.35	3.35	3.10
90 Day BBSW	2.61	3.55	3.55	3.55	3.55	3.38	3.13
10 Year Bond	3.58	3.40	3.30	3.10	2.90	2.65	2.50
International							
Fed Funds	2.375	3.375	3.375	3.375	3.375	3.125	2.875
US 10 Year Bond	3.29	3.00	2.90	2.70	2.50	2.30	2.20

Exchange rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
AUD/USD	0.6825	0.73	0.75	0.76	0.77	0.78	0.78
USD/JPY	143.12	132	130	127	125	123	121
EUR/USD	1.0069	1.09	1.11	1.13	1.14	1.15	1.16
GBP/USD	1.1582	1.26	1.28	1.30	1.32	1.34	1.35
USD/CNY	6.9392	6.60	6.50	6.40	6.30	6.20	6.15
AUD/NZD	1.1176	1.11	1.10	1.10	1.10	1.10	1.10

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