

WESTPAC WEEKLY ECONOMIC COMMENTARY

The good, the bad, and the currency.

3 October 2022



Kōwhai

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We've revised up our forecast of how high the Official Cash Rate will need to go in the Reserve Bank's battle against inflation. We now expect a peak of 4.5%, compared to our previous forecast of 4%. We expect the RBNZ to reach this point with a 50 basis point hike at this Wednesday's policy review, followed by another 50 basis points at both the November and February reviews.

Recent developments in the New Zealand economy have been mixed, but on balance have pointed to ongoing resilience in activity. First up is GDP which grew by 1.7% in the June quarter. The main contributor to that growth was a surge across the services sectors, as New Zealand reopened its border to overseas tourists. That pace of growth is unlikely to be repeated, but it's a potent reminder that key parts of the economy are still in recovery mode, even as we see signs of cooling in the parts that had become overheated.

As we've moved through the back part of the year, the signs of cooling demand that the RBNZ has been looking for have started to emerge, and the household sector is bearing most of the brunt of the adjustment as we expected. House prices have continued to soften in the face of higher mortgage rates, and are now down around 9% from their peak last November. We've also seen a flattening off in nominal consumer spending (at a time that prices have been rising rapidly), and consumer confidence is languishing at low levels. Finally, the effective average mortgage rate paid by homeowners has continued to push higher, and is set to continue rising over the coming months.

But while some steam has come out of the economy, activity is still trucking along at a solid pace. That's been reflected in the latest PSI and PMI reports, which pointed to resilient demand and a lift in forward orders. Similarly, the labour market remains strong, with continued growth in filled jobs and job advertisements over recent months.

We've also seen positive developments in our export sectors. Prices for our commodity exports have held firm, with world dairy prices rising 7% over the past month alone. At the same time, international visitor arrivals have been climbing rapidly since the reopening of the borders.

The more significant developments for the monetary policy outlook have been on the global stage. With inflation boiling over around the world, policy rates in major economies have been charging higher in recent months. At the same time, geopolitical tensions, including the Ukraine war and an escalation in Russian rhetoric, are rippling through financial markets. And on top of those developments, the sustainability of the UK's longer term fiscal position has been thrown into question following the announcement of significant stimulus measures.

As a result, global investors have flocked to the perceived safe haven of the US dollar. That's come at the expense of currencies such as the New Zealand dollar in particular – we've fallen by more than 10% against the USD in recent weeks, and have lost ground to a lesser degree against others like the euro and the Australian dollar.

We had been forecasting the US dollar to ease back again over the next couple of years, as worldwide inflation rates passed their peaks and global markets became more comfortable that central banks were getting on top of the problem. However, that point is now looking more distant. So in addition to the lower starting point, we now expect a later and more subdued recovery in the New Zealand dollar. We expect the New Zealand dollar to remain below 0.60 against the USD through to the middle of next year, only rising to 0.67 by 2024.

A lower New Zealand dollar does come with some benefits to the economy, boosting our export earnings and providing some insulation from the headwinds to global growth. But it also means higher costs for imported consumer goods and production inputs, adding to inflation over the year or so ahead.

As a rule of thumb, a sustained 10% drop in the New Zealand dollar would add around 0.4% to the rate of inflation for the following year. This comes at a time when inflation is already expected to be outside the RBNZ's medium-term target range of 1-3% for an extended period.

The real issue, however, is the risk of second-round effects, as higher headline inflation can act as a catalyst for further price increases. The risk of that occurring is much greater when the economy is stretched thin, or if there is a large and persistent rise in inflation. And that's exactly what we're seeing now. In addition to businesses raising their prices to maintain margins, wage growth has risen sharply as workers have sought compensation for the large increases in the cost of living. Now, with a stronger outlook for consumer prices, that pressure on wages (and other operating costs) is likely to be even more intense.

Like the RBNZ, we had previously judged that an OCR of around 4% would be enough to bring inflation back to the target range within a medium-term horizon – but only barely. There was little room for the RBNZ to absorb any further upside surprises on inflation before it would have to revise its OCR track higher as well.

This week's decision won't include a new set of forecasts, so any change in the projected path for the OCR will have to be conveyed verbally. We expect the RBNZ to repeat its recent language that it will continue to tighten monetary policy "at pace", and may say that the Committee anticipates a higher OCR path than what was projected in the August statement.

Satish Ranchhod, Senior Economist

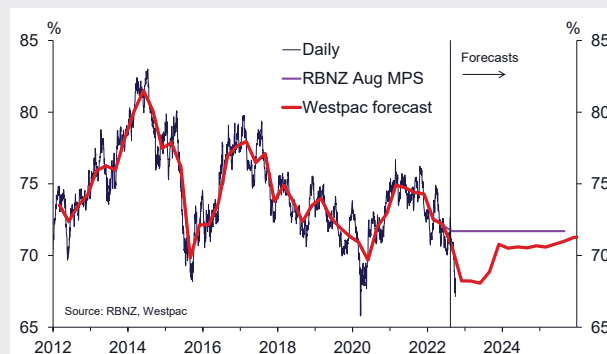
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Chart of the week

Since the time of the RBNZ's August policy statement, the New Zealand dollar has plunged, dropping to a level of 67.1 on a trade-weighted basis at the time of writing. There has been a particularly sharp fall relative to the US dollar, with the Kiwi dropping by more than 10% in recent weeks. The RBNZ's August forecasts assumed the NZ dollar TWI would track at 71.7 through to the end of this year. However, it is now faced with a currency that is more than 5% lower than it had expected.

NZD Trade Weighted Index

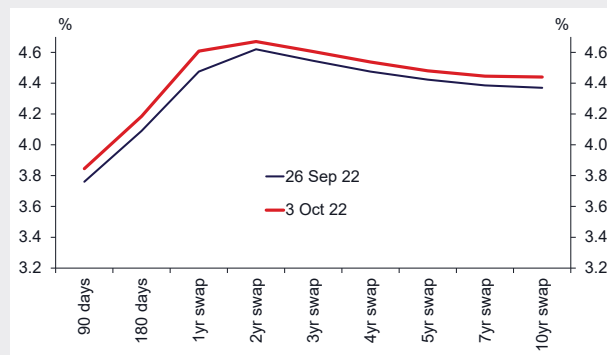


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 4.5% 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 Q3 NZIER Quarterly Survey of Business Opinion

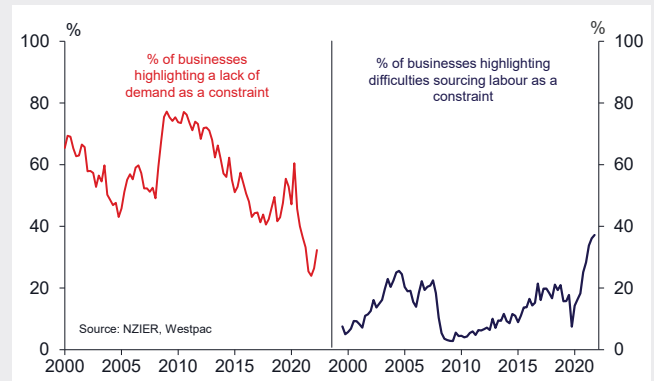
Oct 4, Domestic Trading Activity (past 3mths) last: -0.9

Despite a fall in economic confidence, the NZIER's June quarter survey of business opinion highlighted resilient economic conditions, along with continued strong inflation pressures.

We expect the September quarter survey will echo the mixed themes seen in other recent business surveys. Economic activity has been resilient. However, businesses are continuing to grapple with rising costs, especially for staff. That's seen profit margins eroded. Businesses also remain nervous about the economic outlook over the next few years.

The survey's various price and cost gauges are again expected to point to continued strong and widespread inflation pressures. That will be of interest for the RBNZ ahead of the upcoming policy decision.

Factors constraining business activity



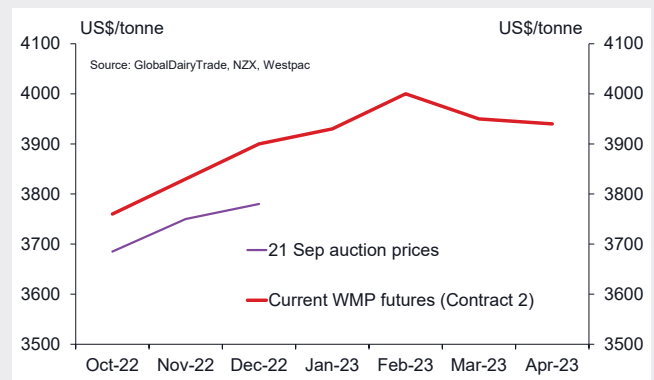
NZ GlobalDairyTrade auction

Oct 5, Last: 3.7%, Westpac: No change

We expect whole milk powder prices (WMP) to be unchanged at the upcoming auction. This follows a 3.7% price rise at the previous auction. Our pick is lower than the circa 2% lift that the futures market is pointing to.

Fundamentally, global dairy prices are being underpinned by very weak global dairy supply. However, at this auction we are erring on the side of caution as the surging US dollar has made dairy prices more expensive for most dairy buyers. In addition, we anticipate a degree of nervousness amongst buyers on the back of wider financial market volatility.

Whole milk powder prices



RBNZ Official Cash Rate review

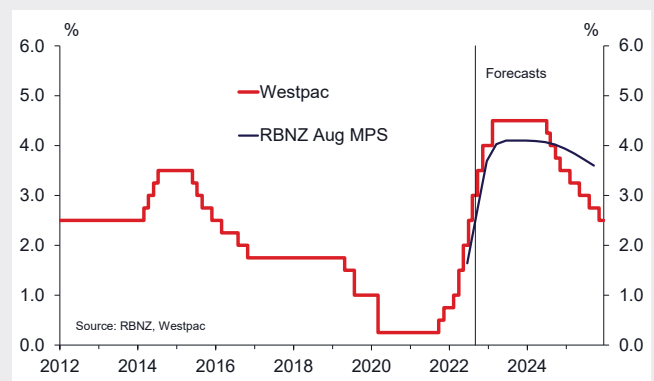
Oct 5, Last: 3.00%, Westpac: 3.50%, Market: 3.50%

We have revised up our forecast for the Official Cash Rate to a peak of 4.5% (previously 4%). We expect that to be achieved with three more 50 basis point hikes at the October, November and February reviews.

Recent developments point to the risks of stronger and more persistent inflation pressures than we anticipated. In particular, we now expect the New Zealand dollar to be lower for longer, adding to the pace of inflation in the year ahead. In an already-overheated economy – which is proving to be more resilient in the near term than we thought – the risks of second-round inflation pressures are greater.

At next week's review, we expect the RBNZ to repeat that the OCR will continue to rise "at pace", and to signal a higher peak for this cycle.

RBNZ Official Cash Rate



The week ahead

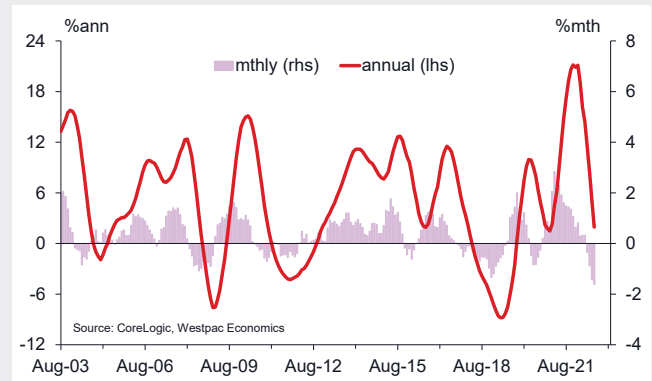
Aus Sep CoreLogic home value index

Oct 4, Last: -1.6%, WBC f/c: -1.4%

The housing market correction that began in May and accelerated through June-July continued to run at a rapid pace in August, the month registering a 1.6% decline across the major capital cities, for a cumulative decline of just over 4%. The RBA's aggressive interest rate tightening has been the main catalyst and accelerant, with price weakness spreading to most jurisdictions.

Its set to be a similar story for September with the RBA delivering a fourth consecutive 50bp rate increase at the start of the month. CoreLogic's daily measure points to a 1.4% fall in prices across the major capital cities, the detail showing a faster pace in Sydney and Brisbane, a more moderate decline in Melbourne and only small dips in Adelaide and Perth. Notably, September will also see the annual growth rate dip into negative for the first time.

Aus dwelling prices



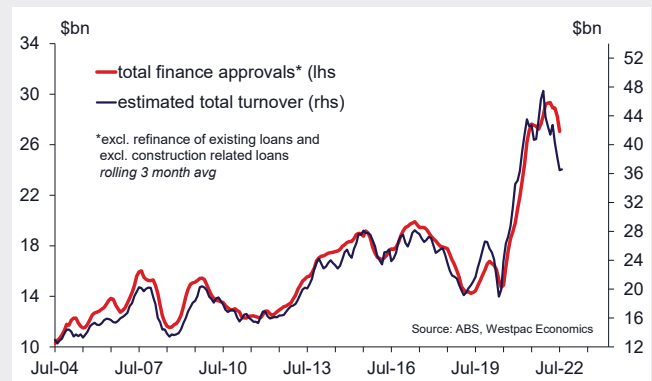
Aus Aug housing finance approvals

Oct 4, Last: -8.5%, WBC f/c: -2.5%
Mkt f/c: -4.0%, Range: -5.0% to 2.0%

Housing finance approvals fell sharply in July, an 8.5% drop following on from a 4.4% decline in June and bringing the series more in to line with the pull-back already evident in housing sales and prices.

Sales and prices continued to track lower through July-August, pointing to another decline in finance approvals in the August month. We expect the total value of new finance approvals to be down 2.5%. Owner occupiers may outpace investors this month given the outsized 11.2% drop the latter posted in July.

Aus new finance approvals vs value of sales



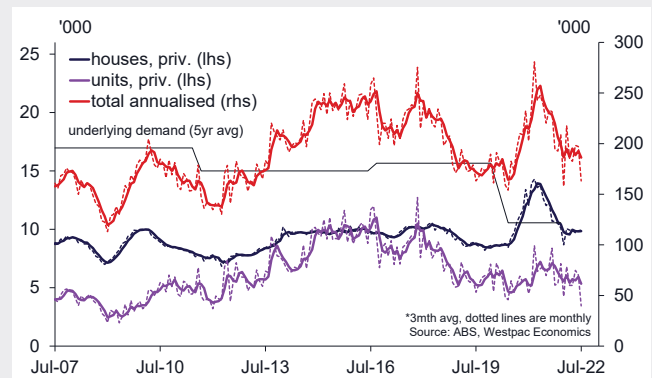
Aus Aug dwelling approvals

Oct 4, Last: -17.2%, WBC f/c: 2%
Mkt f/c: 9.0%, Range: 2.0% to 15.0%

Dwelling approvals slumped 17.2% in July led by an extreme fall in 'high rise' approvals. Despite this, approvals have held up better than expected in 2022, especially for detached houses where rate hikes, surging construction costs and pressures from a large backlog of unprofitable projects have yet to really dent new approvals.

We expect the impact of these negatives to become much clearer in coming months. However, the volatility of high rise approvals coming off a steep fall a month prior is likely to swamp these effects in August. On balance we expect to see a small 2% gain with a bounce in high rise largely negated by a sizeable fall in non high rise approvals – the first material decline for the latter in the cycle to date.

Aus dwelling approvals



The week ahead

Aus RBA policy decision

Oct 4, Last: 2.35%, WBC f/c: 2.85%

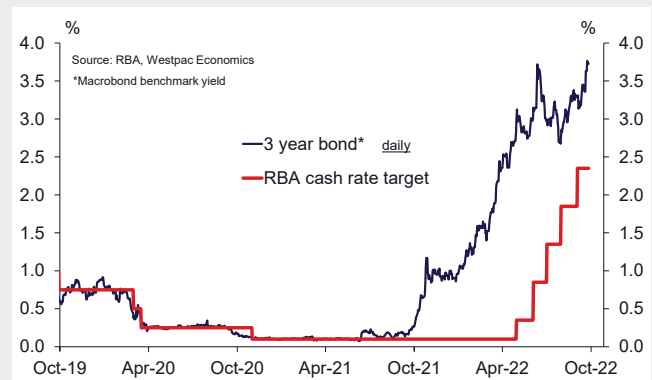
Mkt f/c: 2.85%, Range: 2.60% to 2.85%

At the October Board meeting, we anticipate that the RBA will lift the cash rate by 50bps – the fifth consecutive move of 50bps. That will take the cash rate to 2.85%, a touch on the high side of “neutral”. Moves beyond this point are likely to be more measured.

Globally and domestically, the inflation outlook is challenging, with risks that inflation expectations ratchet higher. In Australia, headline inflation is expected to climb to over 7% by year end, the labour market is the tightest in 50 years, and wages growth is accelerating, albeit from modest levels.

It is in this environment that the RBA is removing ultra easy monetary conditions and will shift to a contractionary stance. Westpac anticipates that the cash rate will peak at 3.60% in February 2023 – with further moves of 25bps at each of the three meeting from November to February.

RBA cash rate and 3 year bonds



Aus Aug trade balance, AUDbn

Oct 6, Last: 8.7, WBC f/c: 10.1

Mkt f/c: 10.1, Range: 16.5 to 7.0

Australia’s trade surplus shrunk to a still sizeable \$8.7bn in July, as export prices retreated on global recession concerns.

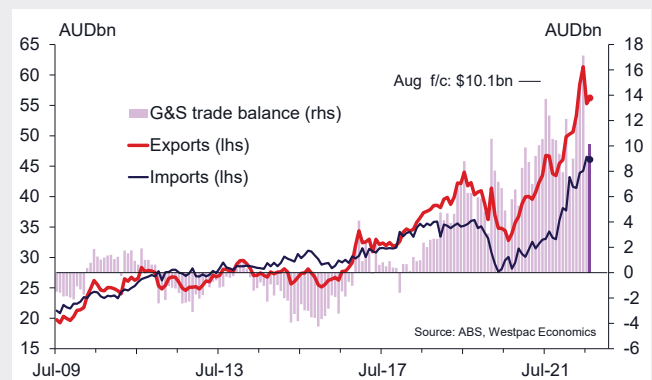
That was after the surplus ballooned to back-to-back fresh record highs of \$14.6bn and \$17.1bn in May and June – inflated by the spike in commodity prices in part triggered by the Ukraine war.

For August, we forecast the surplus to widen modestly, to \$10.1bn.

Export earnings are expected to lift by 1.7%, +\$0.9bn, after correcting 9.9% lower in July. The August lift is centred on a recovery of coal shipments after major flooding disruptions in NSW the month prior.

The import bill is expected to edge 1% lower, -\$0.5bn, led lower by global energy costs. That largely locks in July’s strong 5.2% rise in imports, with the uptrend in response to rising domestic demand.

Aus trade balance

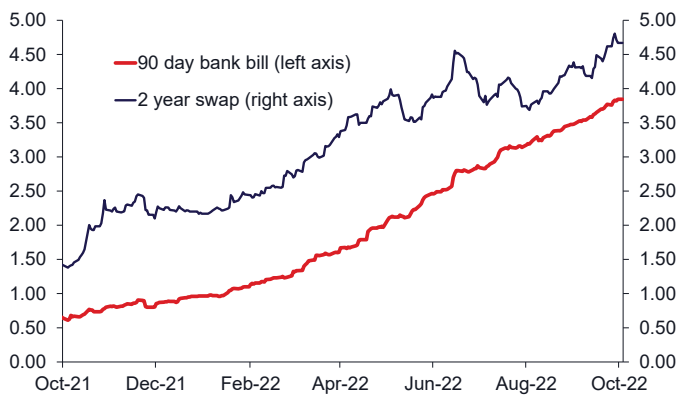


New Zealand forecasts

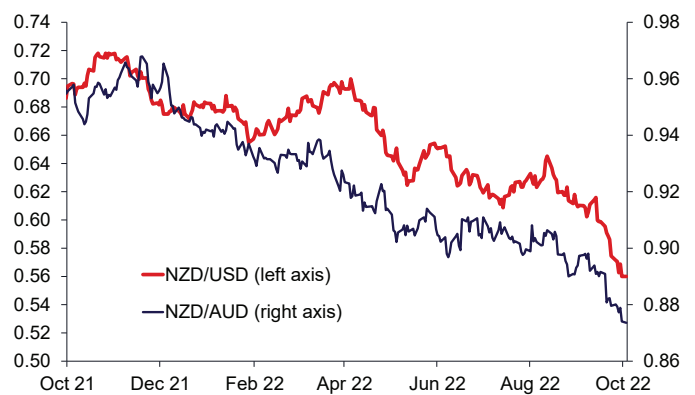
Economic forecasts	Quarterly				Annual			
	2022		2023		2020	2021	2022f	2023f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	1.7	0.4	0.6	0.6	-2.1	5.5	2.2	2.2
Employment	0.0	0.1	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	4.9	3.2	3.4	3.8
CPI	1.7	1.6	0.3	1.0	1.4	5.9	5.3	3.6
Current Account Balance % of GDP	-7.7	-7.7	-7.1	-6.0	-0.8	-6.0	-7.1	-4.4

Financial forecasts	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Cash	4.00	4.50	4.50	4.50	4.50	4.50	4.50
90 Day bill	4.30	4.60	4.60	4.60	4.60	4.60	4.40
2 Year Swap	4.70	4.60	4.40	4.20	3.95	3.65	3.35
5 Year Swap	4.50	4.30	4.10	3.90	3.65	3.40	3.20
10 Year Bond	4.30	4.10	4.00	3.80	3.60	3.40	3.25
NZD/USD	0.58	0.59	0.60	0.62	0.65	0.66	0.66
NZD/AUD	0.89	0.89	0.90	0.90	0.90	0.90	0.89
NZD/JPY	82.9	83.2	83.4	84.9	87.1	86.5	85.8
NZD/EUR	0.60	0.60	0.59	0.60	0.61	0.60	0.60
NZD/GBP	0.53	0.53	0.53	0.53	0.54	0.54	0.53
TWI	68.2	68.2	68.1	68.9	70.8	70.5	70.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 3 October 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.00%	3.00%	3.00%
30 Days	3.48%	3.33%	3.11%
60 Days	3.66%	3.51%	3.32%
90 Days	3.85%	3.70%	3.53%
2 Year Swap	4.67%	4.44%	4.32%
5 Year Swap	4.48%	4.22%	4.17%

NZ foreign currency mid-rates as at 3 October 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5600	0.5954	0.6101
NZD/EUR	0.5718	0.5958	0.6142
NZD/GBP	0.5016	0.5233	0.5301
NZD/JPY	81.03	85.41	85.72
NZD/AUD	0.8736	0.8909	0.8976
TWI	67.11	69.67	70.81

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 03					
Aus	Daylight saving time starts Oct 2	-	-	-	Clocks forward 1 hour (NSW, Vic, SA, Tas, ACT).
	Public holiday	-	-	-	Labour Day (NSW, SA, ACT).
	Sep MI inflation gauge %/yr	4.9%	-	-	Inflation well above RBA's target band.
Eur	Sep S&P Global manufacturing PMI	48.5	-	-	Final estimate.
UK	Sep S&P Global manufacturing PMI	48.5	-	-	Final estimate.
US	Sep S&P Global manufacturing PMI	51.8	51.8	-	Final estimate.
	Aug construction spending	-0.4%	-0.1%	-	Near-term weakening in demand weighing on construction.
	Sep ISM manufacturing	52.8	52.4	-	Mfg growth gradually slowing; risk of demand easing further.
	Fedspeak	-	-	-	Bostic and Williams.
Tue 04					
NZ	Q3 NZIER survey of business opinion	-0.9	-	-	Activity resilient, but continued cost pressures.
Aus	Sep CoreLogic home value index	-1.6%	-	-1.4%	Correction deepens, annual price growth set to turn negative...
	Aug housing finance	-8.5%	-4.0%	-2.5%	... finance activity tracking clearly lower in line with falling...
	Aug investor finance	-11.2%	-	-1.5%	... sales and prices. Investors coming off a big drop in Aug...
	Aug owner occupier finance	-7.0%	-	-3.5%	... but the cycle still mainly being driven by owner occupiers.
	Aug dwelling approvals	-17.2%	9.0%	2.0%	'Dead cat' bounce led by units. Detached houses to fall.
	Sep ANZ job ads	2.0%	-	-	Still at a very high level.
	RBA policy decision	2.35%	2.85%	2.85%	Fifth 50bp move - lifting rates to the hold side of neutral.
US	Aug factory orders	-1.0%	0.2%	-	Drag on capital investment...
	Aug durable goods orders	-0.2%	-	-	... extending into Q3.
	Aug JOLTS job openings	11239k	-	-	Job opening off peak but still strong.
	Fedspeak	-	-	-	Logan, Williams, Mester, Jefferson and Daly.
Wed 05					
NZ	GlobalDairyTrade (WMP)	3.7%	-	0.0%	Global dairy supply weak, but strong USD crimping prices.
	RBNZ policy decision	3.00%	3.50%	3.50%	Global developments adding to inflation pressures.
Eur	Sep S&P Global services PMI	48.9	-	-	Final estimate.
UK	Sep S&P Global services PMI	49.2	-	-	Final estimate.
US	Aug trade balance US\$bn	-70.7	-67.9	-	Decline in domestic demand weighing on imports.
	Sep S&P Global services PMI	49.2	-	-	S&P Global materially weaker than ISM...
	Sep ISM non-manufacturing	56.9	56.5	-	... pointing to clear downside risks for sector.
	Fedspeak	-	-	-	Bostic.
Thu 06					
NZ	Sep ANZ commodity prices	-3.3%	-	-	Dairy prices lifted over September.
Aus	Aug trade balance \$bn	8.7	10.1	10.1	Coal export shipments to recover from July floods.
Eur	Aug retail sales	0.3%	-	-	Negative so far this year; highlighting the pressure on HH's.
US	Initial jobless claims	193k	-	-	Likely to remain at low levels for time being.
	Fedspeak	-	-	-	Evans and Cook.
Fri 07					
Aus	RBA Financial Stability Review	-	-	-	Half yearly update.
Chn	Sep foreign reserves \$bn	3054.88	-	-	Authorities ready to employ measures for currency stability.
US	Sep non-farm payrolls	315k	250k	250k	Payrolls are at odds with many other indicators...
	Sep unemployment rate	3.7%	3.7%	3.7%	... but U/E likely to remain unchanged in near-term...
	Sep average hourly earnings %mth	0.3%	0.3%	0.3%	... putting off the next leg down in wage growth.
	Aug wholesale inventories	1.3%	-	-	Uncertain time for retailers and those that supply them.
	Aug consumer credit	23.811	25.000	-	High rates to weigh over coming year.
	Fedspeak	-	-	-	Waller, Mester, Williams.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.1	4.9	4.2	1.9
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	3.1	4.2
Current account % of GDP	-2.1	0.7	2.4	3.2	1.1	-1.0
United States						
Real GDP %yr	2.9	2.3	-3.4	5.7	1.7	0.5
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	4.4
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	2.9	0.5
United Kingdom						
Real GDP %yr	1.7	1.7	-9.3	7.4	3.4	-0.5
China						
Real GDP %yr	6.8	6.0	2.2	8.1	3.0	7.0
East Asia ex China						
Real GDP %yr	4.5	3.8	-2.3	4.1	4.5	4.5
World						
Real GDP %yr	3.6	2.9	-3.1	6.1	3.0	3.3

Forecasts finalised 14 September 2022

Interest rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Australia								
Cash	2.35	3.35	3.60	3.60	3.60	3.60	3.35	3.10
90 Day BBSW	3.06	3.80	3.80	3.80	3.80	3.63	3.38	3.13
10 Year Bond	3.95	3.75	3.50	3.40	3.20	3.00	2.80	2.70
International								
Fed Funds	3.125	4.375	4.625	4.625	4.625	4.625	4.375	3.875
US 10 Year Bond	3.79	3.60	3.40	3.30	3.10	2.90	2.70	2.60

Exchange rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
AUD/USD	0.6495	0.65	0.66	0.67	0.69	0.72	0.73	0.74
USD/JPY	144.70	143	141	139	137	134	132	130
EUR/USD	0.9810	0.97	0.99	1.02	1.04	1.07	1.09	1.10
GBP/USD	1.1118	1.10	1.12	1.14	1.17	1.20	1.22	1.24
USD/CNY	7.1217	7.00	6.80	6.60	6.40	6.30	6.20	6.15
AUD/NZD	1.1357	1.12	1.12	1.12	1.11	1.11	1.11	1.12

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