WESTPAC ECONOMIC BULLETIN

Hawkish and dovish considerations.

11 July 2023

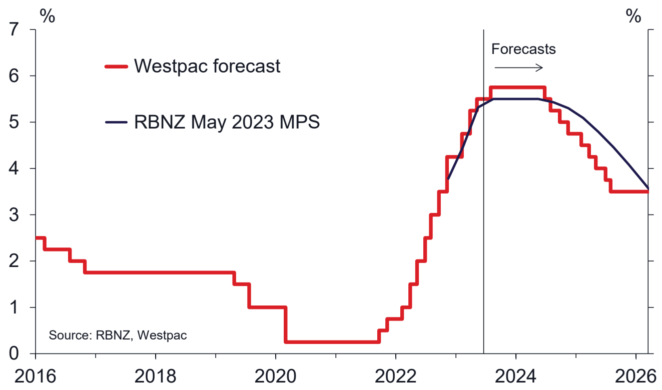
Westpac Economics Team
economics@westpac.co.nz
westpac.co.nz/economics

Kelly Eckhold, Chief Economist
+64 21 786 758 | @kellyenz
kelly.eckhold@westpac.co.nz

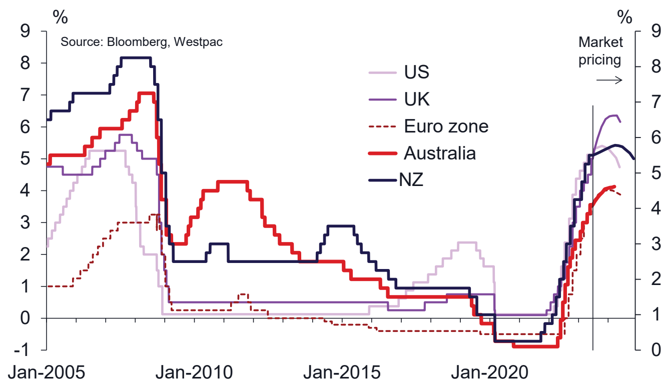
Hawks, doves, and kiwis.

We don't think tomorrow's monetary policy decision by the Reserve Bank will offer much in the way of firm guidance about the medium-term outlook for the economy and monetary policy. However, the Westpac Economics team has been considering how the outlook might evolve over the coming year or so. To help organise our thoughts and promote thought and debate, we have marshalled a range of hawkish and dovish considerations that, while not exhaustive, could influence the future direction of policy compared to the current baseline forecast. We don't weigh the various arguments to reach a conclusion, but we seek to raise with readers the issues we have been thinking about as we mull over the outlook in preparation for our updated Economic Outlook in early August. We invite feedback on the relevance of the perspectives we discuss here and any additional relevant viewpoints.

Official Cash Rate forecasts



Central bank policy rates



The Hawk's Eye View.

Potentially large boost to demand from migration.

- Migration surge to push population growth to a multi-decade high.
- Likely to boost domestic spending and the housing market, blunting the dampening impact of higher rates

Strong household income growth prevents significant disinflation.

- Strong employment growth and wage growth relative to productivity growth could underpin domestic demand.
- Labour market remains tight and employment elevated supporting household income growth.
- Retail demand holds up in nominal terms.
- Workers pursue real wage gains/protection (e.g., through multi-year wage agreements) and firms try to preserve margins and push cost increases through.
- Savings rates have risen since the pandemic, and households are ahead on mortgage repayments.

Output growth does not decline significantly due to bottoming confidence and population growth.

- Households and firms have weathered the worst and now anticipate rising asset prices and near peak interest rates.
- Public sector capex remains strong due to infrastructure needs, including replacing damage from this year's storms.

Risk of an exchange rate correction as global risk-free rates ratchet higher.

- Global risk-free interest rates are adjusting up to reflect a higher than pre-COVID norm in part reflecting persistent global inflation.
- NZ rates need to remain high to manage exchange rate risks from the elevated current account deficit. Related risk for imported inflation.

NZ interest rates are higher but not high.

- Higher interest rates have disproportionately affected upper quintile income households who have a lower propensity to consume.
- Other households have seen strong income growth (reflecting labour market shortages during COVID) and their wealth has not been reduced by falling asset prices.
- Aggregate demand proves resilient as non-mortgagees continue to spend.

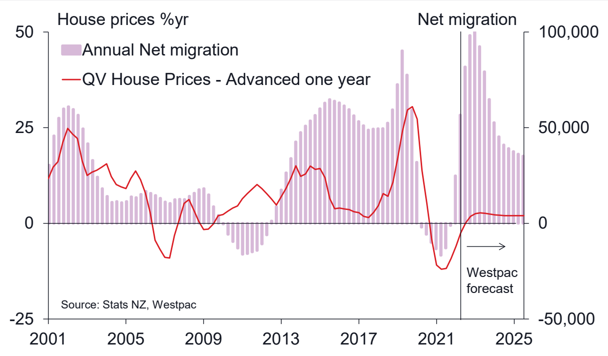
Tightness in the labour market doesn't ease sufficiently.

- The economy doesn't slow sufficiently compared to trend.
- The labour market remains tight and wage inflation remains robust, while firms' profits don't adjust sufficiently lower.
- Inflation is slow to decline requiring further tightening to become consistent with the inflation target.

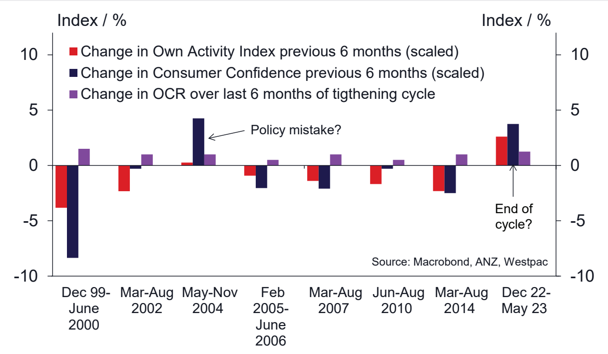
Inflation remains persistently high, resulting in high inflation expectations.

- RBNZ needs to pursue tighter policy to dislodge inflation.

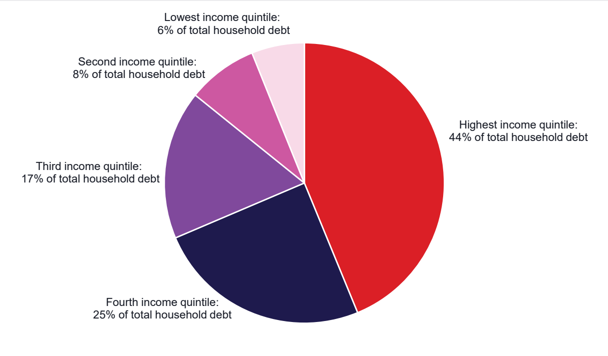
House prices and migration



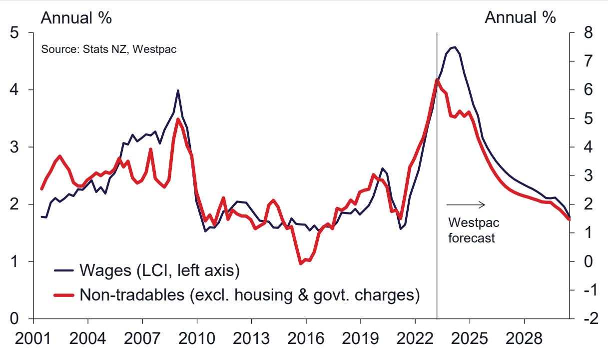
Confidence at the end of tightening cycles



Distribution of household debt by income quintiles



Wage growth and non-tradables inflation



The Dove's Tale.

Inflation dampening impact of migration flows.

- Migrant inflows will help reduce labour shortages and wage pressures.
- Business surveys highlighting an easing in labour market pressures.

Households are yet to feel the full impact of past rate hikes.

- Mortgage rate fixing has delayed the impact of rate increases. A sizeable rise in debt servicing costs will occur in 2023/24.
- The effective mortgage rate will rise above pre-Covid average levels, crimping household spending and homebuilding.

Downside risks for investment spending.

- Increased labour availability, a higher cost of capital and falling corporate profits might generate a sharper than forecast fall in business capex from historical high levels.
- Investment intentions in the QSBO have been negative for three consecutive quarters.

Downside risks for Chinese growth.

- Chinese households are overleveraged, asset prices are overvalued and weak.
- The Chinese authorities may be reluctant to inject liquidity into an already overleveraged financial sector.

Global stagflation scenario.

- Global inflation proves persistent requiring further policy tightening offshore.
- Downside risk for NZ export and commodity prices.

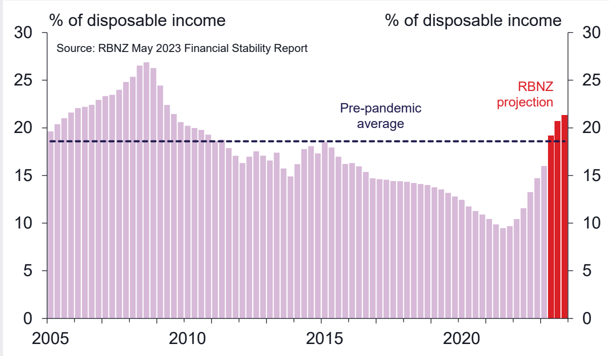
Wage increases prove to not be inflationary if profits take the hit.

- The labour share of the economic pie grows relative to profits which adjust lower as demand weakens. If total claims don't exceed income, then inflation remains contained.

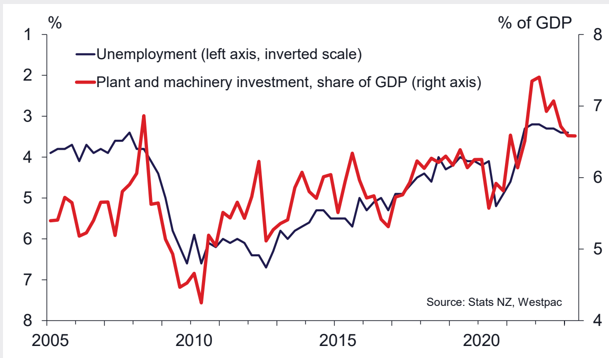
Core inflation proves less sticky than feared.

- Inflation expectations have already begun to decline, as the RBNZ credibility remains intact.
- Wage and prices adjust to inflation target-consistent levels quickly.

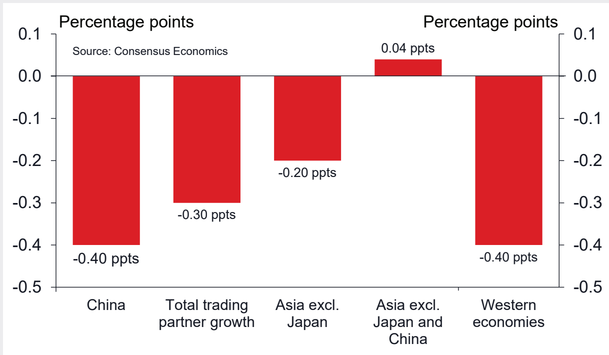
Spending on interest costs (households with mortgages)



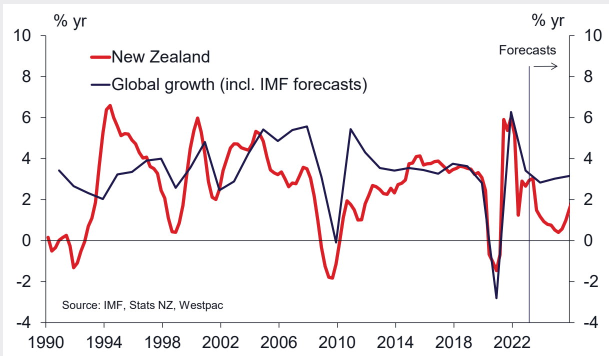
Business investment and unemployment



Change in *Consensus* forecasts for global growth over 2024



New Zealand and global economic growth



Contact the Westpac economics team

Kelly Eckhold, Chief Economist
+64 9 348 9382

Darren Gibbs, Senior Economist
+64 9 367 3368

Any questions email:
economics@westpac.co.nz

Michael Gordon, Senior Economist
+64 9 336 5670

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Satish Ranchhod, Senior Economist
+64 9 336 5668

Paul Clark, Industry Economist
+64 9 336 5656

Disclaimer