

WESTPAC WEEKLY ECONOMIC COMMENTARY

Waiting for the turn .

1 May 2023



Southern rātā

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With inflation now clearly past its highs, it looks likely that the May policy decision will mark the peak in the Reserve Bank's tightening cycle. But there are still a few things coming up in the weeks ahead that will keep the RBNZ on guard.

First up are the labour market surveys for the March quarter, which will be released on Wednesday. We expect the unemployment rate to hold steady at 3.4%, not quite at the record lows seen last year, but close to it. The labour market remains tight, with labour shortages still one of businesses' top concerns.

The monthly indicator of filled jobs shows that employment has been growing at a fairly steady pace over the last year, and if anything has picked up momentum in the last few months. That will be, at least in part, because there are more people around to hire. Since New Zealand reopened its border last year, net migration has rapidly switched from a modest net outflow to a strong net inflow. The bottom line, though, is that businesses are still firmly in hiring mode.

The RBNZ has emphasised that bringing inflation under control will most likely require engineering a recession, with a corresponding rise in unemployment. However, in its February Monetary Policy Statement forecasts, that didn't really come into play until the June quarter and beyond. For the March quarter, the RBNZ was expecting just a slight uptick in unemployment to 3.5%.

Hence, a flat outturn in line with our forecast probably wouldn't move the dial in terms of the May policy decision; we expect a further 25 basis point hike to 5.50%. But for the RBNZ to be satisfied that that's enough, it's going to need to see some evidence pretty soon that the labour market is losing steam.

What's more, the resurgence of workers from overseas will itself be on the RBNZ's radar. The RBNZ has typically regarded migration as a source of net demand, adding to inflation pressures. And migration has bounced back a lot faster and stronger than the RBNZ expected, enough to warrant a mention in the April OCR review. While we don't share that view – migrants add to both demand and supply, with the net impact on inflation unclear – it is nevertheless the RBNZ's interpretation that will play a role in upcoming policy reviews.

Wage growth is likely to have remained strong in the March quarter. That's largely because it tends to be the most lagging element of the economic cycle – we didn't really see it start to take off until early 2022, long after inflation had surged and the RBNZ had started raising interest rates. In a similar vein, we expect the Labour Cost Index (LCI) to accelerate to an annual pace of 4.4% this quarter, even with consumer price inflation now clearly past its peak.

The LCI is based on pay rates by role, rather than by worker. To get a better sense of what workers are actually getting in hand, we can look at the Quarterly Employment Survey (QES) measure of average hourly earnings, which captures the effects of people changing jobs or even industries in order to get a pay rise. While this measure is much choppier than the LCI from quarter to quarter, it shows that pay growth rose above 7% last year, broadly matching the rate of inflation. That demonstrates the challenge the RBNZ faces: inflation has now got into wages. Once that happens, it can be a long and painful process to remove it again.

The other key event ahead of the May Monetary Policy Statement is the Budget on 18 May. One of the big items in the Budget will be the cost of rebuilding after the flooding in late January and Cyclone Gabrielle in early February. Last week the Treasury estimated that the total cost of rebuilding could be between \$9bn and \$14.5bn, easily making it the second most expensive natural disaster in New Zealand's history (after the Christchurch earthquake).

A large share of that cost will be borne by the Government, reflecting the nature of much of the damage such as roads, bridges and water infrastructure. In a speech last week, Prime Minister Hipkins indicated that this will not be funded through new sources of revenue, but from a mix of additional borrowing and reprioritisation of existing spending plans.

The RBNZ has raised the cyclone recovery as an upside risk for inflation, as it will create an additional draw on the nation's resources over several years. Whether it does prove to be a significant inflationary force is up for debate, however. Infrastructure tends to be one of the less inflationary forms of government spending, and the fact that it will be partly funded from within the existing budget will reduce the net impact. Moreover, the experience of the Christchurch earthquake was that although construction costs did pick up substantially when the rebuild began, this didn't translate into a lift in inflation more generally.

Nevertheless, these perceived upside risks to inflation will keep the RBNZ on high alert, until it sees convincing evidence that the economy is cooling down and that inflation is coming under control. In that regard, market expectations for OCR cuts to begin by the end of this year are likely to be disappointed.

Michael Gordon, Senior Economist

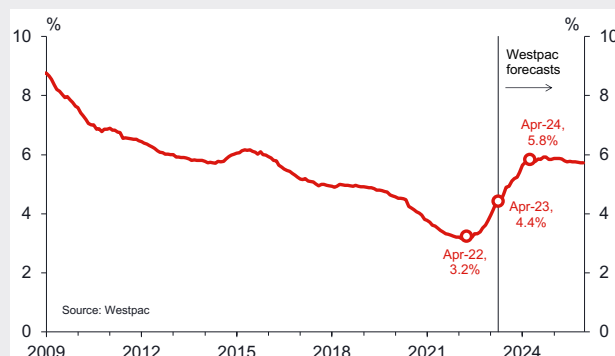
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Chart of the week

New Zealand is now firmly in the "sweet spot" for the transmission of the RBNZ's policy tightening to the economy. While mortgage rate fixing delayed the impact of OCR increases, large numbers of fixed mortgages have now repriced, with many households facing large increases in their debt servicing costs. The average interest rate on outstanding residential mortgages has risen by around 120 basis points since early 2022. We expect it will rise by a further 140 basis point over the year ahead as borrowers continue to roll off earlier low fixed rates.

Effective average mortgage rate

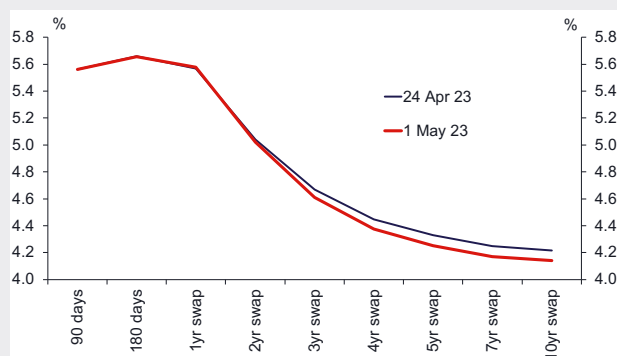


Fixed vs floating for mortgages

We expect the Official Cash Rate to reach a peak of 5.50% in May. As inflation pressures recede, we see scope for rate cuts in 2024 and 2025, although not as quickly as the market is pricing in.

As a result, we now see value in fixing for terms as long as three years. While there isn't a lot of difference between the expected cost of fixing for shorter vs longer periods, a longer period provides more certainty around the size of repayments. We would still regard fixing beyond three years as relatively expensive.

NZ interest rates



The week ahead

NZ GlobalDairyTrade auction, whole milk powder prices

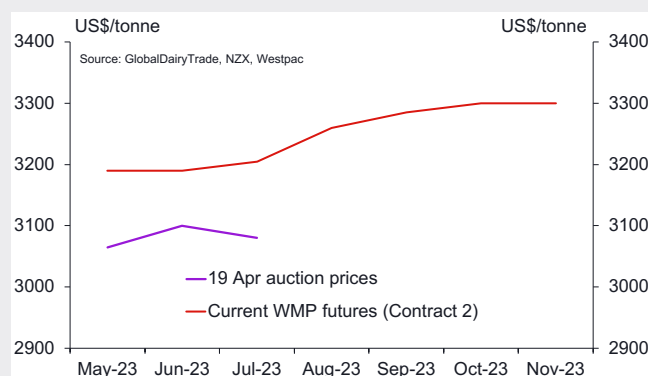
May 3, Last: +1.0%, Westpac: +2.0%

We expect whole milk powder prices (WMP) to lift by around 2% at the upcoming auction.

Our pick is halfway between the very modest lift at last week's mini (GDT pulse) auction and the strong 4% lift that the futures market is pointing to.

Over the year, we expect that rebounding Chinese dairy demand and very subdued global supply will lead global dairy prices higher.

Whole milk powder prices



NZ Q1 labour market surveys

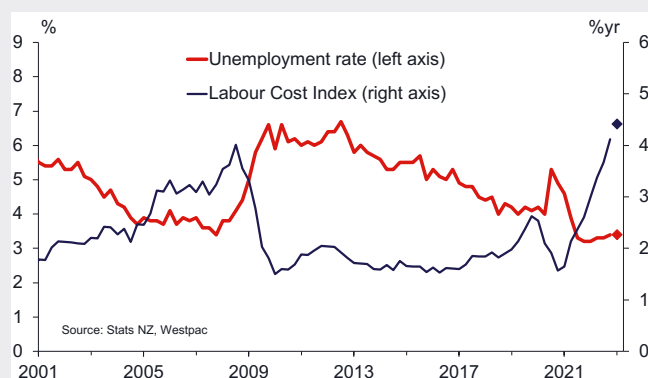
**May 3, Unemployment rate Last: 3.4%, Westpac f/c: 3.4%
Labour Cost Index Last: 1.1%, Westpac f/c: 1.1%**

We expect the unemployment rate to hold steady at 3.4% for the March quarter. Jobs growth has picked up momentum in recent months, in part because the return of migrants means there are more people around to hire. The overriding factor, though, is that businesses are still in hiring mode.

Wage growth typically lags the broader economic cycle. We expect a further acceleration in annual wage growth, even with consumer price inflation now clearly past its peak.

Our forecasts are similar to the RBNZ's for the March quarter, so on their own are unlikely to have a major impact on the May monetary policy decision. However, the RBNZ will need to see some evidence within the next few months that the labour market is losing steam, for it to be satisfied that interest rates have gone high enough.

NZ labour market indicators



NZ Mar building consents

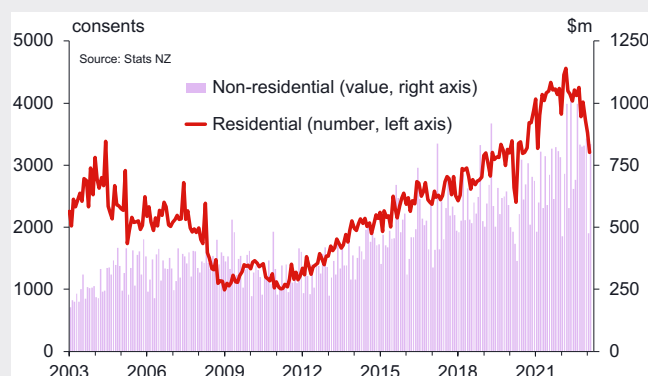
May 4, Last: -9.0%, Westpac f/c: +5.0%

We're forecasting a modest 5% bounce in consents in March. That follows the sharp decline in the choppy multi-unit consents category in recent months. However, the expected bounce would only reverse some of the recent drop in consent issuance.

Under the surface, tighter financial conditions mean that fewer new projects are coming to market. We expect the downturn will become increasingly pronounced over the months ahead.

In late January and early February New Zealand was struck by severe storms. Those events caused significant damage to homes in the upper and central North Island. The resulting repair work will moderate, but not completely offset, the broader slowing in homebuilding. We don't expect that repair work will have a large impact on consent numbers at this stage.

NZ building consents



The week ahead

Aus RBA policy decision

May 2, Last: 3.60%, Westpac f/c: 3.60%, Mkt f/c: 3.60%

At the May Board meeting, we anticipate that the RBA will keep the cash rate on hold at 3.60%. The Q1 CPI report delivered a downside surprise on underlying inflation, with the trimmed mean measure printing 1.2% (6.6%_{yr}), well below the market's expectation and our own. This was largely associated with a broad-based stepdown in the pace of goods inflation (9.5%_{yr} to 7.6%_{yr}).

While annual services inflation experienced another large rise, it was not enough to offset the disinflation amongst goods components, resulting in a further moderation in headline inflation from 7.8%_{yr} to 7.0%_{yr}. Relative to the RBA's February forecasts, the easing in annual headline inflation is running ahead of expectations. Hence, we believe the cash rate is currently at a level that will prove to be the peak for this tightening cycle.

Aus Mar retail trade

May 3, Last: 0.2%, Westpac f/c: 0.2%, Mkt f/c: 0.3%

Retail sales rose 0.2% in Feb but remain soft having only partially recovered from a steep 3.9% drop in Dec. The weakness shows through on a rolling 3mth basis with sales down 1.5% over Dec-Jan-Feb compared to Sep-Oct-Nov.

Our Westpac Card Tracker suggests the underlying trend in retail has stalled flat over Q1 as a whole. Another 0.2% gain in March would have nominal sales about flat for Q1 as a whole.

Note that the final March retail report, with full details including estimates of Q1 real retail sales, will be released on May 9. At this stage, a flat nominal result for the quarter and another solid rise in retail price is pointing to a sizeable contraction in sales volumes, in the range of -1%_{qtr}.

Aus trade balance

May 4, Last: 13.9, Westpac f/c: 13.6, Mkt f/c: 13.0

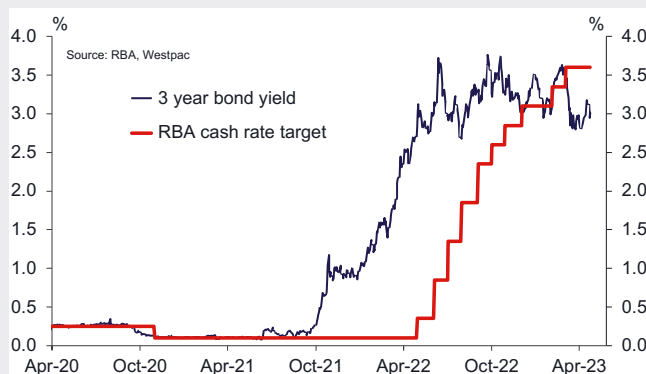
Australia continues to record a sizeable trade surplus each month, averaging \$11.7bn during 2022.

The 2023 year is off to a positive start, with outcomes of \$11.3bn and \$13.9bn for the opening two months. We anticipate the surplus will narrow a little in March, to a forecast \$13.6bn.

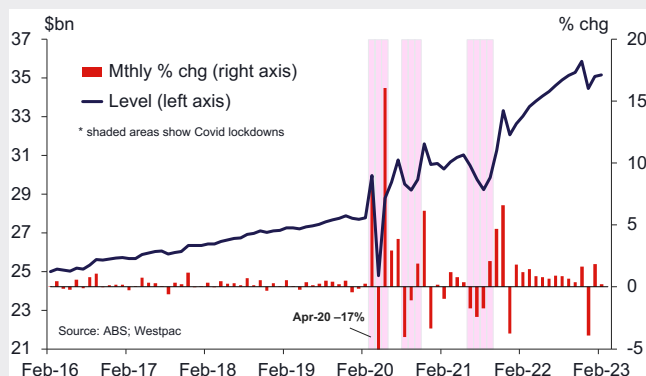
For the import bill, we have factored in a rise of 0.7%, +\$0.3bn. The rise is led by goods on higher prices associated with the weaker currency in the month (-3.3% vs USD, -2.6% TWI).

Export earnings are expected to be broadly flat, constrained by softer global commodity prices in the month (-1.3% in AUD terms). A small fall in goods exports is expected to be offset by a further lift in services, extending the upward trend as student and holiday visitor numbers continue to recover.

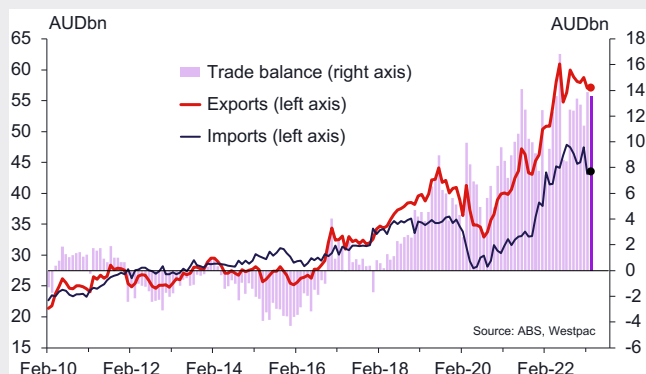
RBA cash rate and 3-year bond yields



Aus monthly retail sales



Aus trade balance



The week ahead

US May FOMC meeting

May 2-3, Last: 4.875%, Mkt f/c: 5.125%, Westpac f/c: 5.125%

Data received since the March meeting has consistently characterised the US economy as losing momentum but yet to stall. As a result, inflation risks have continued to recede only slowly.

Commentary from FOMC members ahead of the pre-meeting blackout consequently indicated a desire to take out a little more insurance before pausing. To us and the market, this points to one further hike in this cycle to a peak of 5.125%.

This last hike is unlikely to tighten financial conditions. Indeed, with risks around growth and the labour market growing, term interest rates and the US dollar are expected to weaken over coming months. By year-end, it is our expectation that the US will be in recession and inflation will no longer be the pre-eminent concern. Therefore, the first cut is now expected in December, with a further 200bps of easing to follow in 2024.

US Apr employment report

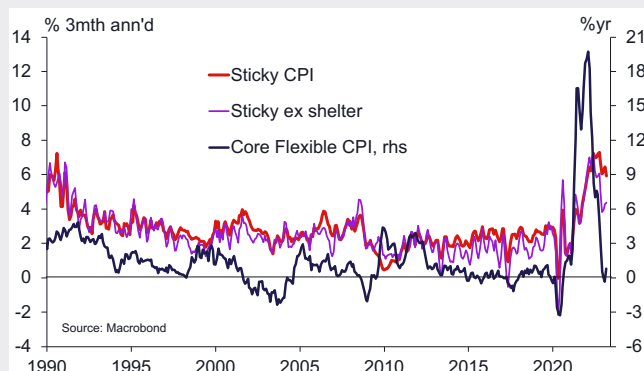
May 5, nonfarm payrolls Last: 236k, Mkt f/c: 175k, Westpac f/c: 150k
Unemployment rate Last: 3.5%, Mkt f/c: 3.6%, Westpac f/c: 3.6%

Over the past year, nonfarm payrolls and household employment have diverged, with payroll job creation averaging 345k but only 214k people entering employment every month according to the household survey. All the while, hours worked have edged down and hourly earnings lost momentum.

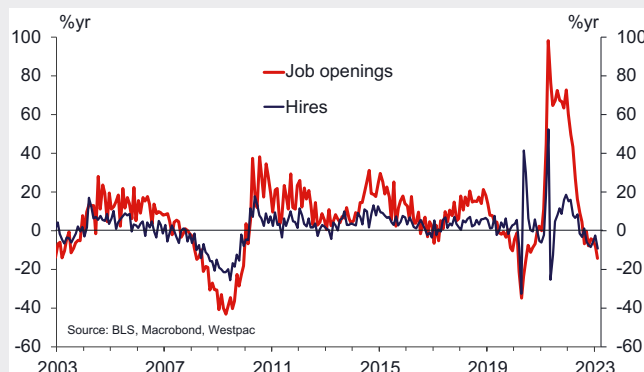
To be clear, the outcomes reported over the past year are certainly not weak. But they do point to a material reduction in growth in labour demand and a much reduced willingness to pay up for labour. Many of the business surveys are also now beginning to point to job creation stalling.

The need for a growing share of the population to hold multiple jobs also speaks to binding budget constraints amongst households, which also points to a challenging outlook for demand.

US inflation



US job openings

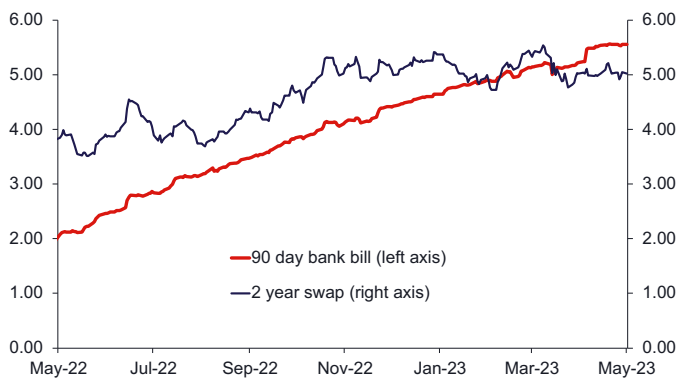


New Zealand forecasts

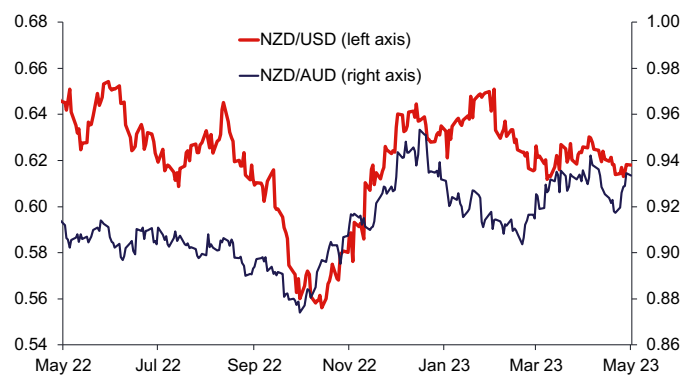
Economic forecasts	Quarterly				Annual			
	2022		2023		2021	2022	2023f	2024f
% change	Sep	Dec	Mar	Jun				
GDP (Production)	1.7	-0.6	0.2	0.2	6.0	2.4	1.1	-0.5
Employment	1.3	0.1	0.3	0.2	3.3	1.3	0.5	-0.3
Unemployment Rate % s.a.	3.3	3.4	3.4	3.6	3.2	3.4	4.0	5.1
CPI	2.2	1.4	1.2	1.0	5.9	7.2	4.5	2.7
Current Account Balance % of GDP	-8.5	-8.9	-8.5	-8.3	-6.0	-8.9	-6.7	-4.5

Financial forecasts	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Cash	5.50	5.50	5.50	5.50	5.25	4.75	4.25
90 Day bill	5.60	5.60	5.60	5.50	5.05	4.55	4.25
2 Year Swap	5.10	4.80	4.50	4.20	3.90	3.70	3.50
5 Year Swap	4.40	4.25	4.10	4.00	3.90	3.80	3.70
10 Year Bond	4.20	4.10	4.00	3.85	3.70	3.60	3.50
NZD/USD	0.64	0.66	0.67	0.68	0.68	0.68	0.68
NZD/AUD	0.93	0.92	0.91	0.90	0.89	0.89	0.88
NZD/JPY	83.2	85.1	85.8	85.7	85.1	84.4	84.3
NZD/EUR	0.58	0.59	0.60	0.60	0.59	0.59	0.59
NZD/GBP	0.52	0.53	0.54	0.54	0.53	0.53	0.53
TWI	71.4	72.5	72.7	72.5	71.7	71.1	71.0

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 1 May 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.25%	5.25%	4.75%
30 Days	5.41%	5.33%	5.09%
60 Days	5.49%	5.44%	5.17%
90 Days	5.56%	5.55%	5.24%
2 Year Swap	5.02%	5.09%	5.04%
5 Year Swap	4.25%	4.36%	4.37%

NZ foreign currency mid-rates as at 1 May 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6180	0.6197	0.6254
NZD/EUR	0.5601	0.5643	0.5753
NZD/GBP	0.4917	0.4995	0.5058
NZD/JPY	84.15	83.03	83.34
NZD/AUD	0.9334	0.9238	0.9297
TWI	70.61	70.45	71.51

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 01					
Aus	Apr CoreLogic home value index	0.8%	-	0.8%	Stabilisation now looking convincing.
	Apr MI inflation gauge	5.7%	-	-	Provides a general view of inflation risks.
	Apr ANZ job ads	-2.4%	-	-	Still elevated but gradually moving off peak.
US	Apr S&P Global manufacturing PMI	50.4	50.4	-	Some support from easing supply pressures...
	Apr ISM manufacturing	46.3	46.8	-	...but the outlook remains very challenging.
	Mar construction spending	-0.1%	0.2%	-	Softening demand weighing on construction.
Tue 02					
Aus	RBA policy decision	3.60%	3.60%	3.60%	Policy to remain on hold as inflation risks recede.
	RBA Governor Lowe	-	-	-	Speaking at the RBA Board Dinner in Perth, 9:20pm AEST.
Eur	Apr CPI %yr	6.9%	7.0%	-	Services inflation the focus.
UK	Apr Nationwide house prices	-0.8%	-0.6%	-	Price correction is firmly entrenched.
US	Mar JOLTS job openings	9931k	9725k	-	Starting to move lower after flattening for many months.
	Mar factory orders	-0.7%	1.3%	-	Weak new orders pointing to subdued capex outlook.
Wed 03					
NZ	GlobalDairyTrade auction (WMP)	1.0%	-	2.0%	Dairy prices lifting on better demand and subdued supply.
	RBNZ Financial Stability Report	-	-	-	Six-monthly review of the financial system's health.
	Q1 employment	0.1%	0.5%	0.8%	Hiring has picked up the pace as migrant workers return...
	Q1 unemployment rate	3.4%	3.5%	3.4%	...keeping the unemployment rate steady on balance.
	Q1 LCI wage inflation (pvte, ord. time)	1.1%	1.1%	1.1%	Wage growth still accelerating as it lags behind inflation.
Aus	Mar retail sales	0.2%	0.2%	0.2%	Nominal sales look to have stalled flat in Q1.
	RBA Assistant Governor (Economic)	-	-	-	Ellis speaking at CEDA Conference in Perth, 2:55pm AEST.
Eur	Mar unemployment rate	6.6%	6.6%	-	Labour market remains in robust health.
US	Apr S&P Global services PMI	53.7	53.7	-	Further weakness likely in coming months...
	Apr ISM non-manufacturing	51.2	51.8	-	...as growth slowdown materialises.
	FOMC policy decision, midpoint	4.875%	5.125%	5.125%	FOMC desires a little more insurance; first cut seen in Dec.
Thu 04					
NZ	Mar building consents	-9.0%	-	5.0%	Bounce in multi-unit consents, but longer term trend down.
	Apr ANZ commodity prices	1.3%	-	-	Dairy and meat prices lifted over the month.
Aus	Mar trade balance \$bn	13.9	13.0	13.6	Goods X down, lower commodity prices. M up on lower AUD.
Chn	Apr Caixin manufacturing PMI	50.0	50.4	-	Manufacturing is in robust health.
Eur	ECB policy decision, refi rate	3.50%	3.75%	3.75%	Downshift to 25bp hike likely; risk centred on April CPI.
US	Mar trade balance US\$bn	-70.5	-68.5	-	Deficit to gradually narrow as consumer demand softens.
	Initial jobless claims	230k	240k	-	Likely to remain at a low level versus history.
Fri 05					
Aus	RBA Statement on Monetary Policy	-	-	-	Forecast update.
	Mar housing finance	-0.9%	-0.3%	-0.3%	To corroborate the stabilisation being seen in other indicators.
Chn	Apr Caixin services PMI	57.8	57.3	-	Services exhibiting great strength post COVID-zero.
Eur	Mar retail sales	-0.8%	-0.2%	-	Inflation and rates clearly weighing on discretionary spending.
US	Apr non-farm payrolls	236k	180k	150k	Surveys pointing to continued downtrend in job creation...
	Apr unemployment rate	3.5%	3.6%	3.6%	...which will create uptrend in U/E rate in coming months.
	Apr average hourly earnings %mth	0.3%	0.3%	0.2%	Earnings growth to slowly recede back to average.
	Mar consumer credit \$bn	15.3	17.5	-	Demand for credit has been more subdued year-to-date.
	Fedspk	-	-	-	Bullard, Cook.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022f	2023f	2024f
Australia						
Real GDP %yr	1.9	-1.8	5.2	3.7	1.6	1.0
CPI inflation %yr	1.8	0.9	3.5	7.8	3.9	3.0
Unemployment rate %	5.2	6.8	4.7	3.5	4.5	5.0
Current account % of GDP	0.7	2.4	3.1	1.2	0.8	-0.1
United States						
Real GDP %yr	2.3	-3.4	5.7	2.1	0.9	0.7
CPI inflation %yr	1.9	1.2	7.2	6.4	2.5	2.0
Unemployment rate %	3.7	8.1	5.4	3.7	4.8	5.5
Current account % of GDP	-2.6	-2.5	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	-0.4	-4.6	1.7	1.6	1.3	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.2	3.5	0.6	1.4
United Kingdom						
Real GDP %yr	1.7	-9.3	7.4	4.0	-0.5	1.5
China						
Real GDP %yr	6.0	2.2	8.4	3.0	6.2	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.2	4.6	4.1	4.4
World						
Real GDP %yr	2.8	-3.0	6.0	3.3	3.0	3.1

Forecasts finalised 6 April 2023

Interest rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia								
Cash	3.60	3.60	3.60	3.60	3.35	3.10	2.85	2.60
90 Day BBSW	3.68	3.70	3.70	3.72	3.47	3.22	2.97	2.72
10 Year Bond	3.34	3.40	3.30	3.20	3.00	2.80	2.70	2.50
International								
Fed Funds	4.875	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.42	3.50	3.40	3.30	3.10	2.90	2.80	2.60

Exchange rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.662	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	136.18	130	129	128	127	126	125	124
EUR/USD	1.1031	1.10	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2567	1.23	1.24	1.25	1.26	1.27	1.28	1.29
USD/CNY	6.9184	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0714	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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