WESTPAC WEEKLY ECONOMIC COMMENTARY

RBNZ to leave the door open.

3 April 2023


Southern rātā

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We expect the Reserve Bank of New Zealand will raise the Official Cash Rate by 25 basis points at Wednesday's monetary policy review. The bigger question is what the central bank signals going forward. We expect the RBNZ will acknowledge recent downside developments, including the volatility in the global banking system. Even so, they will continue to emphasise the strength in inflation pressures and leave the door open for further hikes.

At the RBNZ's last policy review in February, the Monetary Policy Committee hiked the cash rate by 50bps to 4.75%. The MPC also indicated that it expected the cash rate would need to continue rising over the months ahead, with the OCR projected to peak at 5.50%.

In the weeks since the February policy statement, however, the economic landscape has become a lot rockier. Internationally, financial markets have been jolted by the collapse of several regional banks in the US and Credit Suisse Bank in Europe. The resulting concerns about the health of the global banking system and a potential tightening in credit conditions saw expectations for policy rates here and abroad pared back sharply.

While markets have calmed again, the nervousness surrounding the banking system hasn't completely dissipated. And although financial institutions in New Zealand remain in good health, the RBNZ will be keeping a close eye on developments offshore and the potential for a turn in global sentiment. If that were to occur, it would weigh on global growth. It would also make it harder and costlier for New Zealand to access funds from overseas.

Closer to home, there's been relatively limited economic news since the February policy decision. However, the one big piece of data that we've had was GDP, and that was a shocker. Economic output fell by 0.6% in the December quarter. That was a sharper decline than we and other analysts expected. The result was also well below the RBNZ's forecast for a 0.7% rise in activity over the quarter.

Importantly, it wasn't just the December quarter that has turned out softer than expected –estimates of activity through the middle part of 2022 were also revised down. Putting that altogether, it's turned out that GDP is running almost two percent below what the RBNZ was expecting in its February Monetary Policy Statement.

That still leaves us with a picture of an economy that is highly stretched, with elevated levels of demand and high levels of employment. Crucially, however, the economy is not nearly as stretched as the RBNZ thought. That matters for how much of a slowdown – and exactly how much further interest rates need to rise – to bring inflation back under control.

We estimate that the GDP surprise alone would knock about 50 basis points off the peak of the RBNZ's rates profile. That would still make a 25bp hike at the April review a reasonable prospect, but casts some doubt about the need for further moves. Consistent with those developments, we revised down our forecast for the peak in the cash rate to 5.00% a few weeks back.

However, since that time, we've had a speech from RBNZ Chief Economist Paul Conway which discussed how the RBNZ views the current state of inflation pressures. That speech – which was released following the weaker than expected GDP result and volatility in financial markets – remained hawkish. It made it clear that inflation is far too high and the RBNZ remains concerned about the risk that inflation remains strong for longer. Mr Conway went on to note that *"We are incredibly determined to get inflation and inflation expectations back to target."*

Given that very clear hawkish bias, we expect that this week's policy statement will continue to highlight the RBNZ's ongoing concerns about inflation. We also expect the RBNZ will leave the door open for further rate hikes.

How far the OCR ultimately rises will depend on how economic conditions play out over the coming months. For now, inflation remains red hot, with consumer prices up 7.2% over the past year and businesses operating costs up 8% over the same period.

But as we've noted previously, monetary policy acts with long lags. And while rates have been rising for more than 18 months now, much of the impact of that tightening still lies ahead of us. In fact, given the prevalence of mortgage rate fixing in the New Zealand market, most of the impact of rate hikes to date won't be felt until later part of this year.

However, the dampening impact of rate hikes is starting to become more obvious. House prices have already fallen 17% across the country since the start of the tightening cycle. In addition, conditions in the residential construction sector are turning down rapidly. While building activity remains elevated for now, monthly consent issuance has fallen 30% over the past year and many businesses that we've spoken to in the sector are reporting a sharp decline in forward orders. Similarly, we've heard a growing number of anecdotes of softening demand in the retail sector, especially among sellers of durable items like furnishings.

As the full impact of rate hikes is felt, we expect both economic activity and the labour market will weaken materially over the year ahead, and those conditions will see inflation easing back. But until the RBNZ gets clear confirmation that the economy is slowing, it will continue to emphasise the potential for further rate hikes. And regardless of where the OCR peaks in this cycle, interest rates will likely need to stay high for some time, until inflation is clearly back on a path towards the 1-3% target range.

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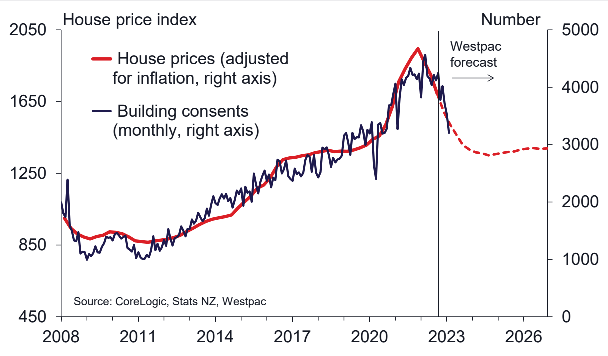
Chart of the week

The downtrend in residential consent issuance is deepening in the face of increasingly tough financial conditions. Build costs have skyrocketed over the past year. Interest rates have risen to their highest levels in more than a decade. And house prices have fallen by 17% across the country. Those factors mean that prospective buyers are reluctant to purchase off the plans. And developers are increasingly hesitant to bring new projects to market. While building activity is currently elevated, we're expecting a stark downturn over the year ahead.

Dwelling consents and House prices

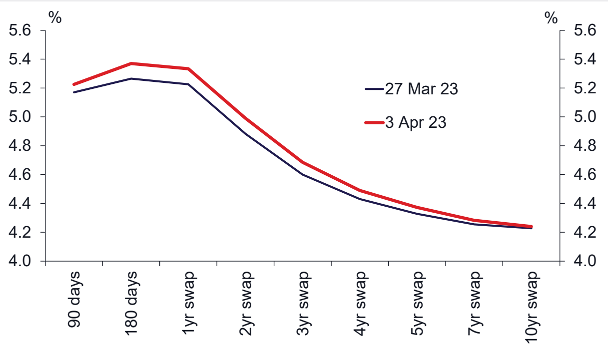


Fixed vs floating for mortgages

We expect the Official Cash Rate to rise to 5.00% at this week's interest rate review. As inflation pressures recede, we see scope for an extended series of rate cuts in 2024 and 2025, by more than that market is currently factoring in.

As a result, we believe that there is value in fixing for terms of up to one year. 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 Q1 NZIER Quarterly Survey of Business Opinion

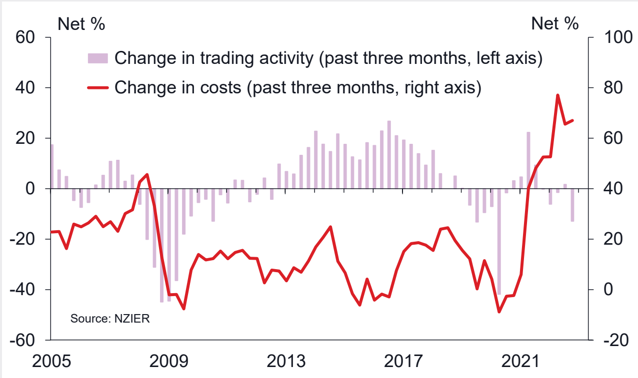
Apr 4, Domestic Trading Activity (past 3mths) Last: -12.9

At the end of last year, businesses reported that trading activity had started to soften, and some firms had seen a fall in forward orders. Even so, most businesses still reported ongoing pressure on operating costs and output prices.

We'll be watching the March survey for signs of a further softening in activity. Economic conditions have generally remained firm in recent weeks. However, we are hearing increasing anecdotes from businesses that demand is cooling. Those comments have mainly been centred on the construction sector but are becoming more widespread.

Against that backdrop, we'll also be keeping a close eye on the survey's cost and pricing gauges. While we don't expect further increases, any easing in inflation pressures is likely to be fairly modest at this stage.

NZIER Quarterly Survey of Business Opinion



NZ GlobalDairyTrade auction, whole milk powder prices

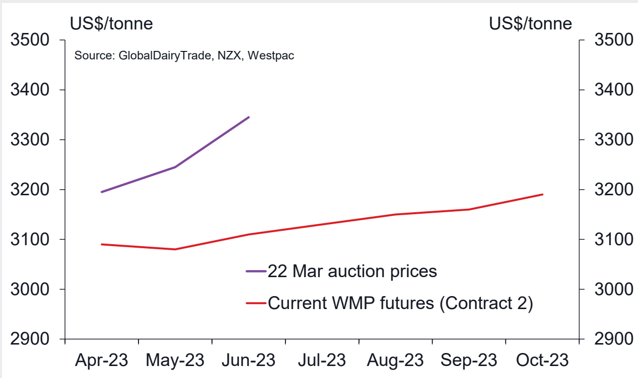
Apr 5, Last: -1.5%, Westpac: -3%

We expect whole milk powder prices (WMP) to fall by 3% at the upcoming auction. Our pick is similar to futures market pricing and last week's mini (GDT pulse) auction result.

Over the year, we expect that rebounding Chinese dairy demand and disruptions to New Zealand supply following recent storms will lead global dairy prices higher.

But for now, some key buyers are well-supplied and we anticipate that as they work through these stocks, prices will remain soft.

Whole milk powder prices



RBNZ Apr Monetary Policy Review

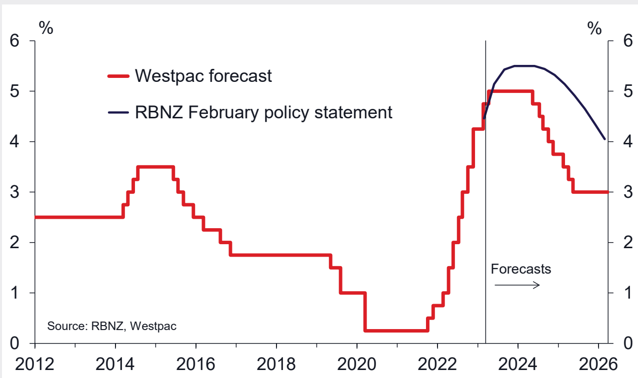
Apr 5, Last: 4.75%, Westpac f/c: 5.00%, Market f/c: 5.00%

We expect the Reserve Bank to lift the Official Cash Rate by 25 basis points to 5.00% next week.

Monetary policy has now moved into what the Reserve Bank considers to be 'contractionary' territory. But given the scale of the challenge, it will still be a long and uncomfortable wait until we see inflation back in the target range. And the anticipated slowing of the economy in response to higher interest rates lies largely in the realm of the forecasts; the actual data has stayed fairly robust so far.

For these reasons, the RBNZ is likely to continue to emphasise the potential for further rate hikes. The extent to which they actually deliver on that will depend on how the economy plays out in the coming months.

OCR forecasts



The week ahead

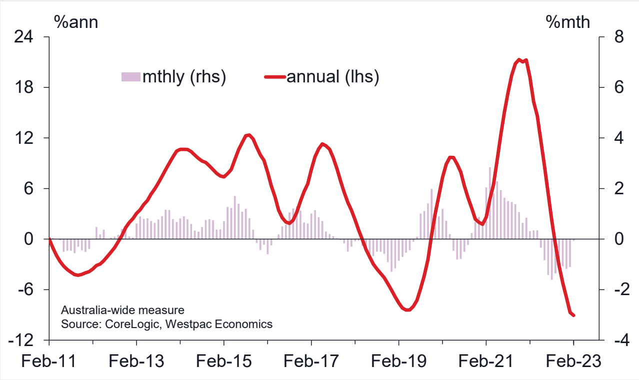
Aus Mar CoreLogic home value index

Apr 3, Last: -0.1%, WBC f/c: 0.7%

The CoreLogic home value index, covering the eight major capital cities, was surprisingly stable in Feb posting a slight -0.1%mth decline after seven straight months of falls in the 1-1.6% range. All major capital cities experienced a slowing in price declines in Feb, Sydney even managing to post a slight gain.

The CoreLogic daily index shows this stabilisation has given way to a positive gain in March, prices across the major capital cities tracking a 0.7% rise for the month led by an impressive 1.4% lift in Sydney. While there are some clear positives in the mix – a lift in migration inflows and super-tight rental vacancy rates – there are still good reasons to be wary of the price lift. Interest rates are weighing heavily on affordability and buyer sentiment, and have yet to peak, and the full impact of rate rises on wider economic activity has yet to emerge. Price gains are also coming off an exceptionally 'thin' market, sales and new listings around 2019 levels and the number of properties on market near 13yr lows.

Aus dwelling prices



Aus Feb housing finance approvals

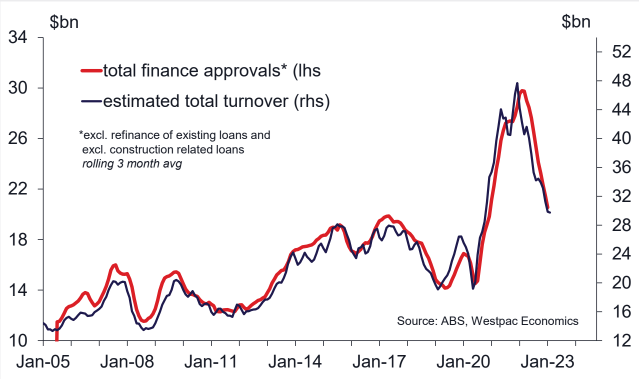
Apr 3, Last: -5.3%, WBC f/c: -1.0%
Mkt f/c: -1.8%, Range: -5.0% to +3.0%

Housing finance approvals recorded another sizeable decline in Jan, a 5.3% drop taking the total value of approvals 29.7% below their level at the start of last year. All major segments and states recorded falls.

The pace of monthly falls is likely to moderate significantly in Feb with the total value of turnover stabilising in early 2023. Prices were steady in Feb, the number of sales also lifting a touch through the first two months of the year.

The total value of new finance approvals is expected to show a 1% decline overall, with weak construction-related lending seeing a slightly bigger 1.2% decline for owner occupier loans compared to investors (-0.6%).

Aus new finance approvals and value of sales



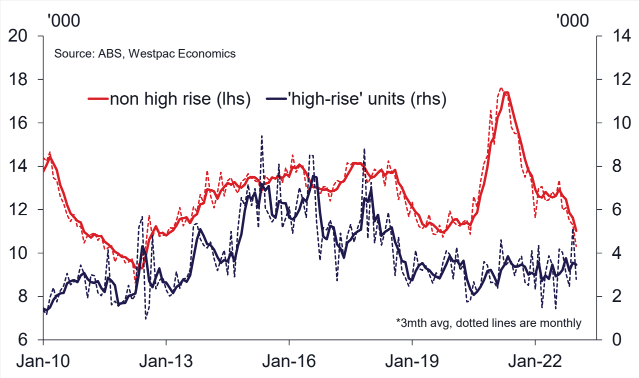
Aus Feb dwelling approvals

Apr 3, Last: -27.6%, WBC f/c: -2%
Mkt f/c: +10%, Range: -2% to +27%

Dwelling approvals posted a sharp decline in Jan, an unwinding spike in high rise approvals combining with a sharp fall in non-high rise segments – both moves likely amplified by seasonal adjustment over the summer low period.

Needless to say, the volatility over Dec-Jan makes the Feb update a difficult one to pick particularly with a significant underlying trend weakness also in the mix. HIA figures on new home sales suggest there are more declines to come for non high rise segments, despite a modest up-tick in Feb. High rise approvals also look to have returned to a more reasonable (i.e. weak) level in Jan. Assuming the latter holds steady, total approvals are likely to show a further moderate decline – we expect a 2% fall overall.

Aus dwelling approvals



The week ahead

Aus RBA poilcy decision

Apr 4, Last: 3.60%, WBC f/c: 3.60%
Mkt f/c: 3.60%, Range: 3.60% to 3.85%

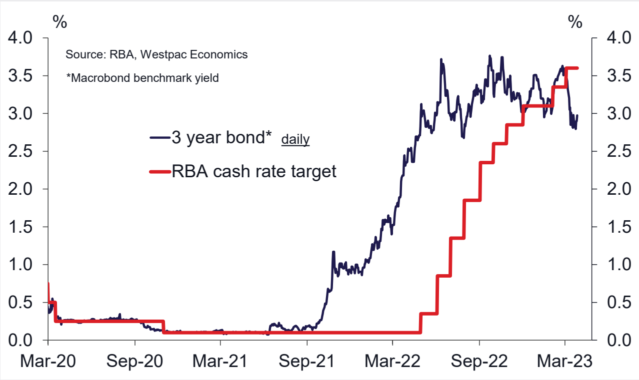
At the April Board meeting, Westpac anticipates that the RBA will keep the cash rate on hold at 3.60%.

In the minutes to the March meeting, the Board agreed to reconsider the case for a pause in April. Since then, the data flow, on balance, supports the case for such a move, particularly the drop in annual inflation (on the monthly indicator) and soft retail sales, however the labour market remains tight.

Additionally, the RBA's meeting schedule has largely avoided the intense periods of uncertainty around the global banking sector. With concerns on this front easing over the course of this week, the Board can remain cognisant of risks but focused on domestic developments.

That said, we do not expect a pause in April to mark the end of the tightening cycle. We continue to forecast one final 25bp rate hike will follow at the May Board meeting.

RBA cash rate and 3 year bonds



Aus Feb trade balance, $bn

Apr 6, Last: 11.7, WBC f/c: 12.6
Mkt f/c: 11.3, Range: 10.2 to 13.0

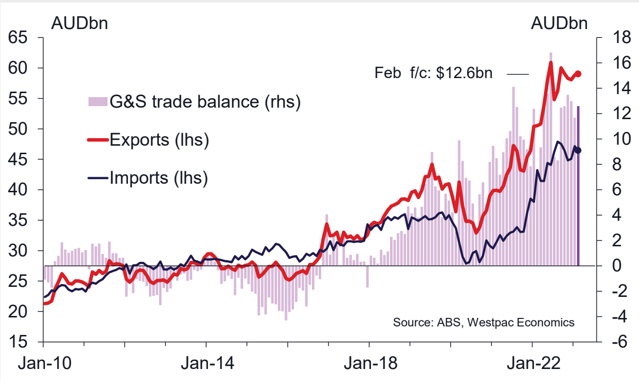
Australia continues to record a sizeable trade surplus each month – with a cumulative outcome of $140bn for 2022.

The 2023 year is off to a strong start with an $11.7bn surplus for January and an anticipated $12.6bn result for February – with the improvement to be driven by an expected pull-back in imports.

The import bill is forecast to narrow by -1.5%, down $0.7bn. Imports of transport goods leapt 29%, +$1.7bn, in January on a bunching of shipments ahead of Lunar New Year as supply disruptions eased. A partial reversal is likely in February.

Export earnings are expected to edge higher, up by 0.3%, $0.2bn, led by services. The upward trend in service exports (and service imports) continues after the reopening of the national border during the first half of 2022. Goods exports are expected to be little changed in the month, both volumes and prices.

Aus trade balance



US Mar employment report

Apr 7: payrolls, Last: 311k, Mkt f/c: 240k, WBC: 270k
Apr 7: U/e rate, Last: 3.6%, Mkt f/c: 3.6%, WBC: 3.6%

Non-farm payrolls continued to surprise to the upside in February, with 311k new jobs created in the month and only marginal revisions to the two months prior.

However, the trend in the household employment series is materially weaker, raising questions over the quality of jobs being created, and more importantly highlighting that many US consumers now need multiple jobs to fund their lives.

This constraint on discretionary capacity is unlikely to be offset by hourly wage gains which remain well below the pace of inflation and on a clear downtrend.

The labour market is becoming consistent with a low inflation environment, albeit slowly.

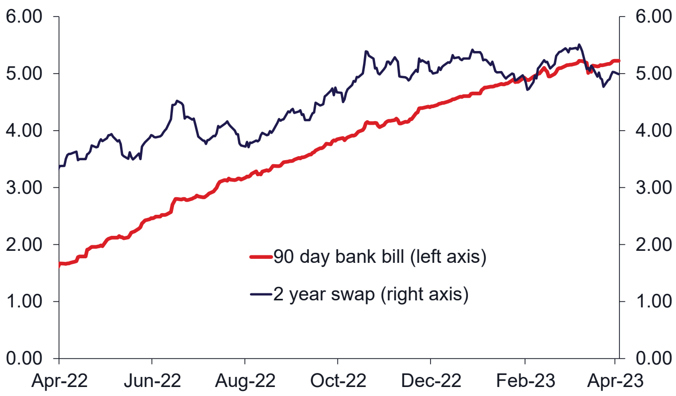
US job openings

New Zealand forecasts

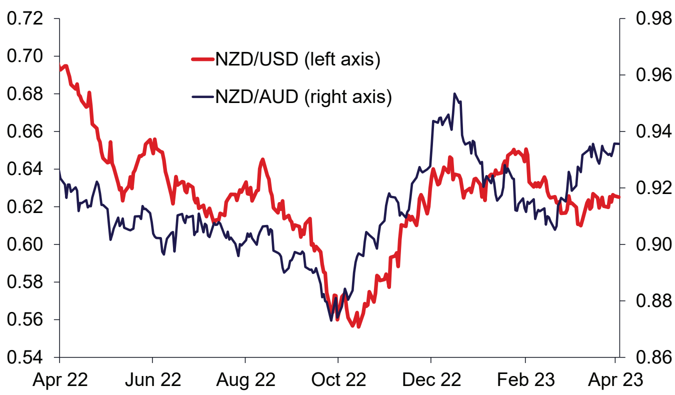
Economic forecasts	Quarterly				Annual			
	2022		2023					
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	1.7	-0.6	0.2	0.2	6.0	2.4	1.1	-0.5
Employment	1.3	0.1	0.3	0.2	3.3	1.3	0.5	-0.3
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	4.0	5.1
CPI	2.2	1.4	1.3	1.3	5.9	7.2	5.1	2.9
Current 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	5.00	5.00	5.00	5.00	4.75	4.25	3.75
90 Day bill	5.10	5.10	5.10	5.00	4.55	4.05	3.75
2 Year Swap	4.90	4.60	4.30	4.00	3.70	3.55	3.40
5 Year Swap	4.50	4.30	4.10	3.90	3.80	3.70	3.65
10 Year Bond	4.40	4.20	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	83.8	85.8	86.4	86.4	85.7	85.1	84.3
NZD/EUR	0.59	0.60	0.60	0.60	0.60	0.59	0.59
NZD/GBP	0.52	0.54	0.54	0.54	0.54	0.53	0.53
TWI	71.5	72.6	72.8	72.6	71.8	71.3	71.1

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 3 April 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.75%	4.75%	4.75%
30 Days	5.06%	4.94%	4.94%
60 Days	5.15%	5.01%	5.06%
90 Days	5.23%	5.13%	5.18%
2 Year Swap	4.99%	4.95%	5.45%
5 Year Swap	4.37%	4.39%	4.90%

NZ foreign currency mid-rates as at 3 April 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6251	0.6247	0.6197
NZD/EUR	0.5766	0.5825	0.5800
NZD/GBP	0.5070	0.5087	0.5153
NZD/JPY	83.34	82.03	84.21
NZD/AUD	0.9356	0.9297	0.9208
TWI	71.20	71.33	70.92

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 03					
Aus	Mar CoreLogic home value index	–0.1%	–	0.7%	Steady Feb followed by surprise Sydney-led rise in March.
	Feb dwelling approvals	–27.6%	10.0%	–2.0%	Choppy Dec-Jan conceals underlying down-trend.
	Feb housing finance	–5.3%	–1.8%	–1.0%	Pace of monthly falls likely to moderate significantly...
	Feb investor finance	–6.0%	–	–0.6%	... as prices and turnover volumes stabilise...
	Feb owner occupier finance	–4.9%	–	–1.2%	... weak construction-related activity to weigh on own-occ.
	Mar MI inflation gauge %yr	6.3%	–	–	Provides a general view of risk.
Chn	Mar Caixin manufacturing PMI	51.6	51.4	–	Continued strength on support from reopening.
Eur	Mar S&P Global manufacturing PMI	47.1	47.1	–	Final estimate.
UK	Mar S&P Global manufacturing PMI	48.0	–	–	Final estimate.
US	Mar S&P Global manufacturing PMI	49.3	–	–	Partial support from easing costs and supply pressures...
	Mar ISM manufacturing	47.7	47.5	–	... but the outlook remains challenging.
	Feb construction spending	–0.1%	0.0%	–	Softening demand weighing on construction.
Tue 04					
NZ	Q1 Qtly Survey of Business Opinion	–12.9	–	–	Trading conditions soft, inflation pressures elevated.
Aus	RBA policy decision	3.60%	3.60%	3.60%	Temporary pause before a final 25bp hike in May.
US	Feb factory orders	–1.6%	–0.5%	–	Weakness in new orders indicating...
	Feb durable goods orders	–1.0%	–	–	... a generally subdued capex outlook.
	Feb JOLTS job openings	10824k	–	–	Flattening trend reflects lasting strength in labour demand.
	Fedspeak	–	–	–	Mester.
Wed 05					
NZ	GlobalDairyTrade auction (WMP)	–1.5%	–	–3.0%	Buyers still working through existing stock piles.
	RBNZ policy decision	4.75%	5.00%	5.00%	RBNZ to leave the door open for further hikes.
Aus	RBA Governor Lowe	–	–	–	Address to National Press Club in Sydney.
Eur	Mar S&P Global services PMI	55.6	55.6	–	Final estimate.
UK	Mar S&P Global services PMI	52.8	–	–	Final estimate.
US	Feb trade balance $bn	–68.3	–68.5	–	Deficit should gradually narrow as consumer spend softens.
	Mar S&P Global services PMI	53.8	–	–	S&P has rebounded to be broadly in line with ISM...
	Mar ISM non-manufacturing	55.1	54.6	–	... with conditions in the service sector robust.
Thu 06					
NZ	Mar ANZ commodity prices	1.3%	–	–	Has been boosted by gains in meat and forestry prices.
Aus	Feb trade balance $bn	11.7	11.3	12.6	Imports a partial unwind of 29% spike in transport goods.
	RBA Financial Stability Review	–	–	–	Half-yearly update.
Chn	Mar Caixin services PMI	55.0	55.0	–	Continued strength, supported by reopening.
US	Initial jobless claims	198k	–	–	To remain at a relatively low level, at least for now.
	Fedspeak	–	–	–	Bullard.
Fri 07					
NZ/Aus	Good Friday	–	–	–	Public holiday, markets closed.
Chn	Mar foreign reserves $bn	3133	–	–	Little pressure on reserves.
US	Mar non-farm payrolls	311k	240k	270k	Divergence between payrolls and household employment...
	Mar unemployment rate	3.6%	3.6%	3.6%	... points to many needing multiple jobs to pay bills...
	Mar average hourly earnings %mth	0.2%	0.3%	0.3%	... and also raises questions over job quality and wage growth.

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	4.0	3.0
Unemployment rate %	5.2	6.8	4.7	3.5	4.6	5.1
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	1.0
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	1.5	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	4.2	4.3
World						
Real GDP %yr	2.8	-3.0	6.0	3.3	3.0	3.1

Forecasts finalised 10 March 2023

Interest rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia								
Cash	3.60	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.72	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.31	3.60	3.40	3.20	3.00	2.80	2.70	2.50
International								
Fed Funds	4.875	4.875	4.875	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.55	3.70	3.50	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	0.6719	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	132.73	131	130	129	128	127	126	124
EUR/USD	1.0908	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2401	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.8587	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0685	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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