

WESTPAC WEEKLY ECONOMIC COMMENTARY

Cooling, but not cracking.

3 July 2023



Southern rātā

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Recent indicators show that the previously red-hot labour market is cooling off a bit. That's to be expected in the wake of a sharp tightening in monetary policy over the last year and a half. But what remains to be seen is whether it's slowing by enough to be consistent with a return to low and stable inflation.

Firstly, the Westpac-McDermott Miller Employment Confidence Index shows that New Zealanders remain optimistic on balance about the state of the labour market, in contrast to the slump in consumer confidence over the last year or so. However, the index eased by 3.9 points to 105.6 in the June quarter, which was the lowest reading since June 2021.

The biggest contributor to the fall in confidence was perceptions about current job opportunities, down by 11 points to a net 14.6. This measure has traditionally given a good steer on the near-term direction of the unemployment rate (though less so since the Covid-19 shock). The latest reading is consistent with a modest rise in unemployment over the next couple of quarters, from its still-low current level of 3.4%.

Perceptions about the availability of jobs may reflect the fact that inflows of migrant workers have resumed in full force since New Zealand reopened its border last year. Migrants normally have a mixed impact on the labour market – filling in skill shortages in some areas, but also adding to the overall level of demand in the economy. But it appears that, at least for now, migrants are seen as adding more to the supply side

on balance, helping to address some of the distortions that had arisen during the border closure.

There does also seem to have been a genuine softening in the demand for workers, compared to what it once was. Online job advertisements fell by about 4% in May compared to April, and were down about 20% from the peaks they reached a year ago. These figures are not weak by any means – they're still running above their pre-Covid levels. But we've now unwound the surge in ads that we saw in 2021 and 2022, which reflected a high level of churn as employers scrambled to attract more workers from a largely static population.

The ANZ business opinion survey also suggests that businesses remain a little reticent about hiring. Overall confidence about their own prospects has actually improved in recent months, with the balance turning (slightly) positive in June for the first time in more than a year. But while conditions have been looking brighter on several fronts – cost pressures are easing, access to credit is improving, expected profits are rising – employment intentions remain slightly negative, and have hardly budged so far this year.

Finally, the weekly figures on Jobseeker Benefit recipients have clearly turned a corner. After steadily declining over 2021 and 2022, they have flattened off in recent months and are now a touch higher than they were a year ago. We need to be careful about how to interpret these figures – the criteria for receiving the benefit are quite different from the official definition of unemployment (a study by Stats NZ found that the overlap is only about one-third). So they're better used for identifying broad trends and turning points, rather than making specific forecasts.

On a more positive note, the Monthly Employment Indicator (MEI) showed a 0.2% rise in the number of filled jobs in May. The MEI is drawn from income tax data, making it quite a comprehensive record of the number of people in work, and far less prone to the volatility that we would see in a household or business survey. While the May increase was smaller than we've seen in previous months, it still points to a solid upward trend – up 3.7% on a year ago.

So where does that leave us in terms of a forecast for the unemployment rate? Technically it's possible to have both rising employment and rising unemployment, within a fast-growing population. However, even with migrant inflows helping to boost population growth, the rate of jobs growth seems to be outpacing that. The other possible avenue is if more people are being brought into the active labour force. However, the participation rate was already at an all-time high of 72% in the March quarter, and it's not clear where the scope lies to lift this rate even further.

We do expect a gradual rise in the unemployment rate over the rest of this year and beyond, as the economy continues to cool. However, the conditions for a substantial rise in unemployment don't appear to be in place just yet.

In its May *Monetary Policy Statement*, the Reserve Bank was projecting only a slight rise in the unemployment rate to 3.5% for the June quarter, but then a rapid rise to 4.1% in the September quarter and 4.6% by year-end. That's more akin to the pace of increase that we saw in 1998 or in 2009, when the New Zealand economy was deep into recession and employment was falling outright. It remains to be seen whether the gentler slowdown that we're currently facing will be enough to fully break the back of inflation.

On a related note, both household and business surveys show that inflation expectations for the year ahead have eased substantially from their highs. There are undoubtedly some easy gains to be made in terms of bringing the headline inflation rate down, with shipping costs easing and many commodity prices lower than they were a year ago. The real test will be whether the 'core' components of inflation come down as readily – these are proving to be surprisingly stubborn in many parts of the world.

Michael Gordon, Senior Economist

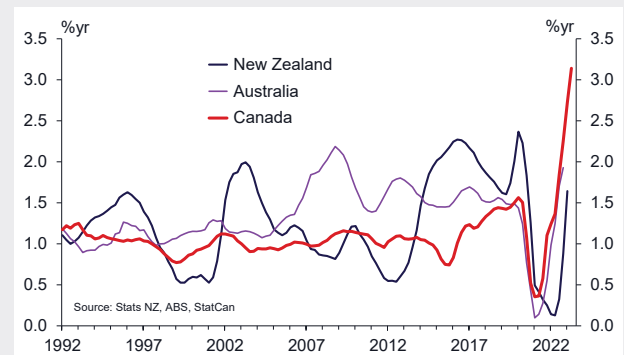
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Chart of the week

New Zealand is not alone in seeing a surge in migrant inflows, with countries such as Australia and the UK also recording above-average population growth rates this year. However, the standout has been Canada, which is actively pursuing a policy of attracting migrants in order to boost GDP. Its population has grown by more than 3% over the last year, almost triple the average of the last few decades. That makes Canada the one to watch in terms of the impact that a migration surge could have on labour shortages, wages and house prices.

Annual population growth

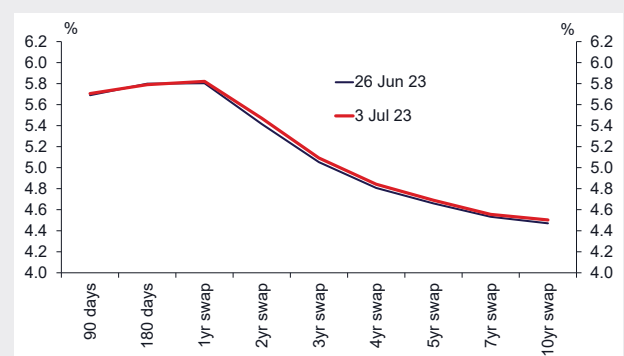


Fixed vs floating for mortgages

The RBNZ has signalled that it expects to hold the cash rate at its current level of 5.50% for an extended period. In contrast, financial markets are pricing in a much earlier start to interest rate cuts, from early next year. We see a risk that the OCR could go higher in the coming months, and that interest rate cuts could be some time away.

As a result, we see value in fixing for terms as long as three years. Rates for terms beyond three years are still relatively expensive, but would provide more certainty around the size of repayments.

NZ interest rates



The week ahead

NZ May building consents

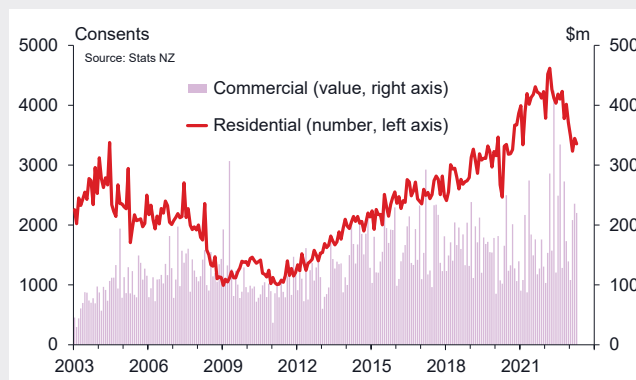
July 3, Last: -2.6%, Westpac f/c: +5.0%

The number of new dwelling consents fell 2.6% in April, with 3,400 consents issued over the month. That drop was spread across regions and building types.

We're forecasting a 5% bounce in consent numbers in May. Underpinning that rise is an expected recovery in some 'lumpy' categories, like apartments and retirement villages.

Despite the bounce expected in May, the longer-term trend in consent issuance remains to the downside, with tougher financial conditions (including higher interest rates) continuing to dampen new housing development.

NZ building consents



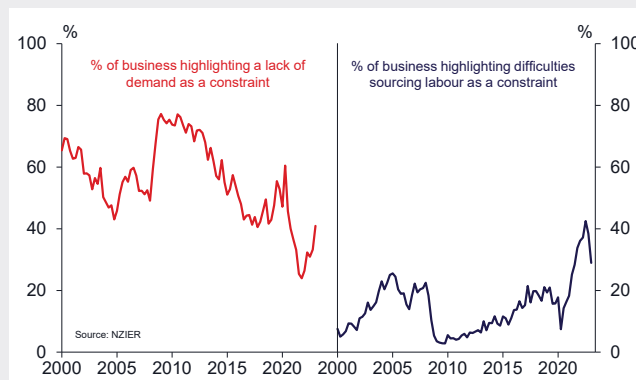
NZ Q2 NZIER Survey of Business Opinion

July 4, General business confidence, last: -61.3

The NZIER's survey of business conditions lifted in the early part of this year, but continued to point to tough trading conditions. Notably, gauges of trading activity remained low, while ongoing cost pressures have continued to eat away at margins.

We expect that the June confidence survey will highlight ongoing headwinds in the business sector, including continued pressure on margins and softening demand. However, some of the challenges that businesses have been dealing with over the past year, including shortages of staff, have now started to ease. As a result, although business sentiment is set to remain low in the June survey, it is likely to tick higher from the levels we saw at the start of the year.

Factors constraining business activity



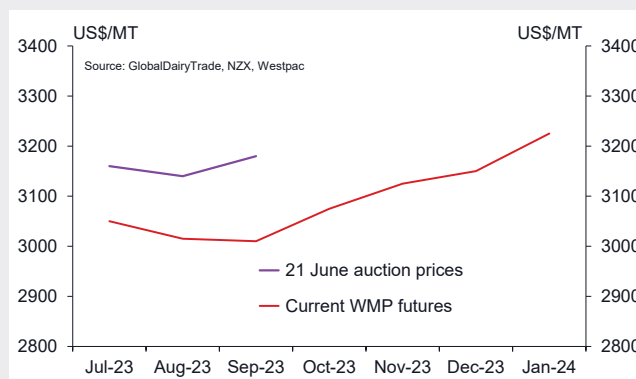
NZ GlobalDairyTrade auction, whole milk powder prices

Jul 5, Last: 0.0%, Westpac: -4.0%

We expect whole milk powder prices (WMP) to fall by 4% at the upcoming auction. If prices fall as expected, then this would continue the downward trend seen over recent months. Our pick is similar to the 3.7% drop that the futures market is pointing to as at Friday 30 June.

In the short term, we expect that very strong New Zealand dairy production over autumn and underwhelming Chinese dairy demand will continue to put downward pressure on prices. In the medium term, we expect that soft underlying global dairy production, and improving Chinese dairy demand will lift dairy prices.

Whole milk powder prices



The week ahead

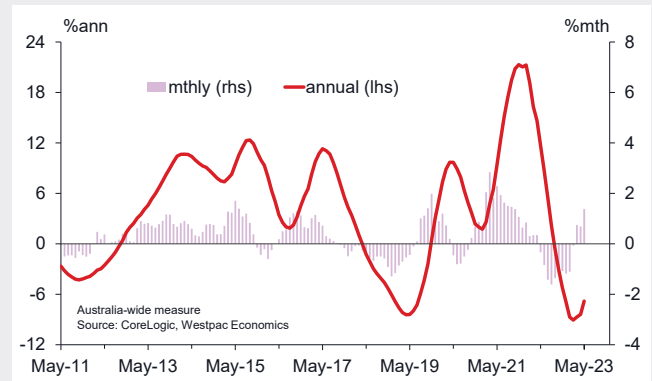
Aus Jun CoreLogic home value index

Jul 3, Last: 1.4%, WBC f/c: 1.4%

The CoreLogic home value index rose 1.4% in May, accelerating on the 0.7% gain in April and 0.8% gain in March. The 3% lift in the space of three months follows a sharp 9.4% drop over the previous nine months.

The CoreLogic daily index points to another robust gain in June, prices across the major capital cities tracking a 1.4% rise for the month. The recovery is unusual in the way it has been sustained despite high and rising mortgage interest rates. A feature of the lift to date is the 'thin' market conditions with both listings and turnover at decade lows. As such, an interesting aspect of the June update will be the extent to which we see a lift in turnover and a tightening in between demand and 'on-market' supply.

Aus dwelling prices



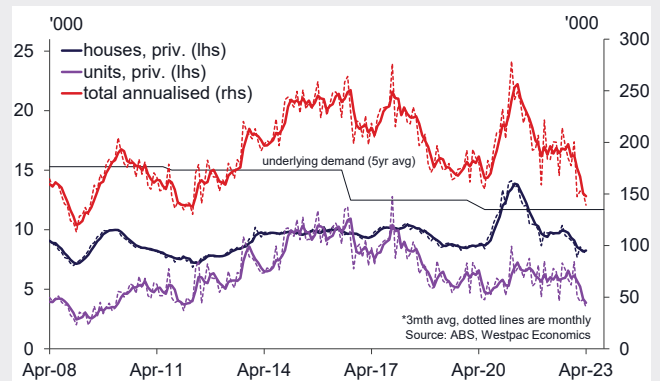
Aus May dwelling approvals

Jul 3, Last: -8.1%, WBC f/c: 3.0%
Mkt f/c: 4.0%, Range: -2.0% to 5.0%

Dwelling approvals fell sharply in April, the 8.1% drop in the month pointing to a significant broad-based down-trend that remains firmly intact. Weakness shows through more clearly on a rolling 3mth basis – a 2.8%qtr dip in the final quarter of 2022 giving way to a sharp 19.7%qtr drop in the first quarter of 2023 with the April update continuing to track in line with the weakening. In annualised terms, approvals are now tracking at just a 140k pace compared to a 187k pace at the end of 2022 and an eleven-year low.

Despite this weakness, a bounce in HIA new home sales through April-May suggests non high rise approvals should start to find a base through the middle of the year. High rise approvals are much harder to predict but are already at extreme lows – both further big falls and gains looking unlikely from here. On balance, a lift in non high rise should see total dwelling approvals up 3%*mth*, high rise activity again the main wild card.

Aus dwelling approvals



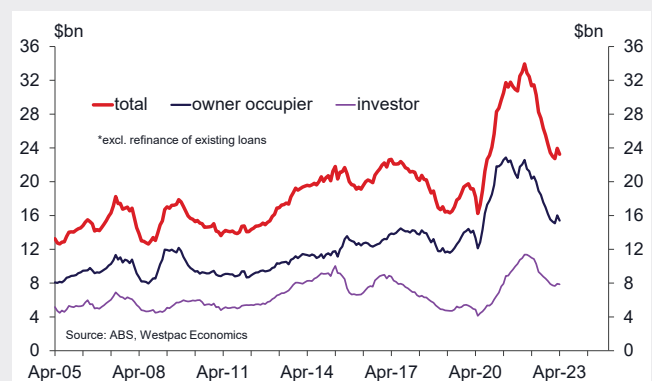
Aus May housing finance approvals

Jul 3, Last: -2.9%, WBC f/c: 4.0%
Mkt f/c: 1.7%, Range: -1.0% to 4.0%

Housing finance approvals posted a surprise 2.9% decline in April, after a robust 5.3% gain in March and despite the wider improvement in housing market conditions. We suspect the timing of Easter may have had a hand in the weak result. That said, some of the weakness around construction-related loans clearly reflects what was still a weak picture for dwelling approvals early in the year.

May should see a gain, reflecting both the firming in established markets and a stabilisation in construction-related loans. However, flat turnover and pressure on borrowing capacity will likely be restraints. On balance we expect to see the total value of loans rise 4%*mth* with similar gains across owner occupier and investor segments.

Aus new finance approvals by segment



The week ahead

Aus RBA policy decision

Jul 4, Last: 4.10%, WBC f/c: 4.35%

Mkt f/c: 4.10%, Range: 4.10% to 4.35%

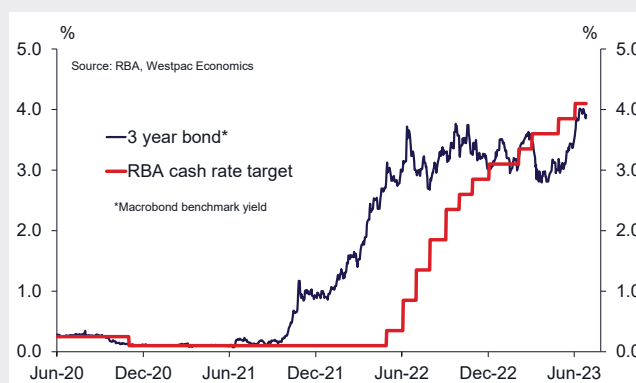
At the July Board meeting, Westpac anticipates that the RBA will raise the cash rate by 25bps to 4.35%.

Following a brief pause in April, the Board raised rates by 25bps in both May and June, citing concerns over the strength of domestic inflation indicators – particularly the stickiness of services inflation – and the risk of a slower return to the top of the 2-3% target range.

The recent data flow is reflective of these concerns: jobs growth is still exhibiting strength (+76k in May) and job vacancies are only gradually moderating from a historic high, together pointing to upside risk to services inflation. The Monthly CPI Indicator also reported that annual trimmed mean inflation held above 6% in May.

In our view, there is enough evidence to warrant a move in both July and August, raising the cash rate to a peak of 4.60%.

Aus RBA cash rate and 3 year bonds



Aus May trade balance, \$bn

Jul 6, Last: 11.2, WBC f/c: 11.0

Mkt f/c: 11.0, Range: 9.5 to 12.6

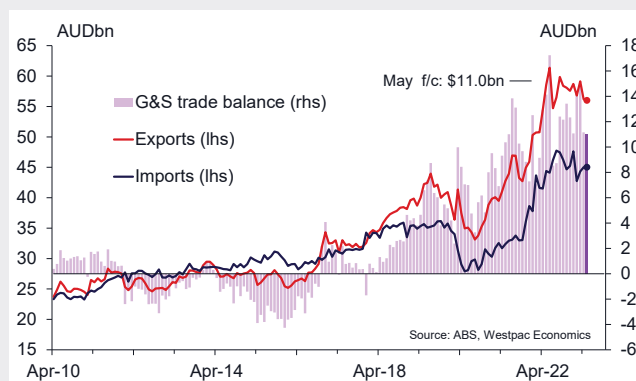
Australia's trade surplus narrowed in April, down from around record highs by \$3.7bn to still be a sizeable \$11.2bn. That move was driven by goods exports, which retreated by a hefty 7% (-\$3.6bn) on a combination of lower commodity prices and softer volumes.

For May, we anticipate that the trade surplus moved broadly sideways, edging lower by \$0.2bn to a forecast \$11.0bn.

Export earnings are expected to be resilient, down by only 0.3%, -\$0.2bn. That is despite a further sharp fall in commodity prices, down by -6.8% in the month after a -4.2% fall in April. Resource export volumes, which have been underwhelming, appear to have bounced off their lows (led by a rebound in coal, plus a lift in LNG shipments and potentially a rise in gold).

The import bill is factored in to be flat in the month, with downside pressure on fuel prices potentially offsetting higher volumes.

Aus trade balance



US June employment report

Jul 7: nonfarm payrolls, Last: 339k, Mkt f/c: 200k, WBC: 190k

Jul 7: u/e rate, Last: 3.7%, Mkt f/c: 3.6%, WBC: 3.6%

May saw a strong 339k increase in nonfarm payrolls plus an additional 93k in back revisions. In stark contrast, the household survey reported 310k less people employed in May than April, the unemployment rate rising 0.3ppts as a result to 3.7%.

Multiple job holders and the assumptions that go into the estimation of nonfarm payrolls will likely see a material divergence remain between the household survey and nonfarm payrolls, with the latter to correct back in line with household employment over the course of the recession forecast from late-2023.

Our below consensus expectation for nonfarm payrolls exists to signal we anticipate a downtrend to become established. Its marginal scale however highlights that, at present, the threat of a material deterioration in net job creation seems a way off.

US job openings have lost momentum

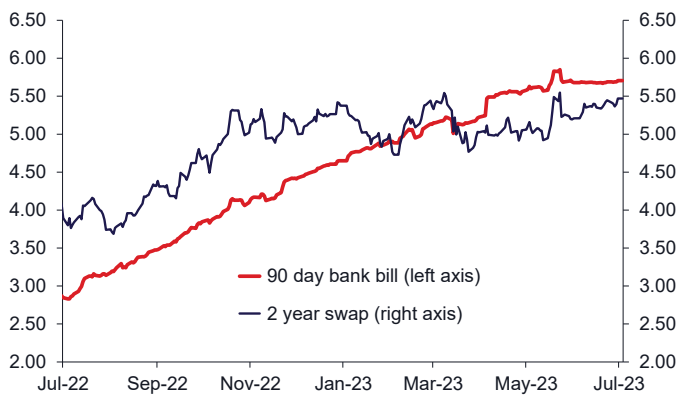


New Zealand forecasts

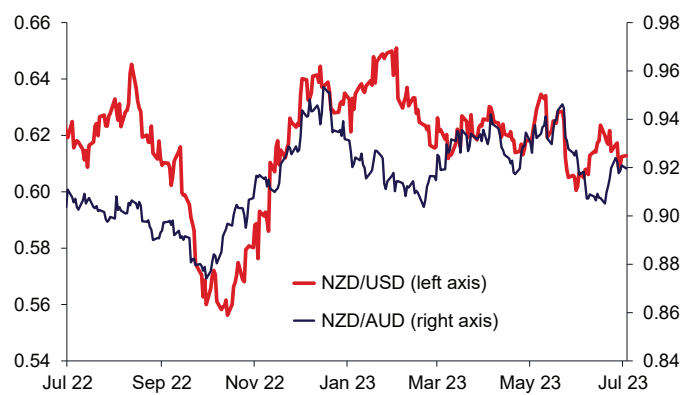
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.5	0.5	6.0	2.7	1.2	0.5
Employment	0.5	0.8	0.4	0.0	3.3	1.6	1.2	-0.4
Unemployment Rate % s.a.	3.4	3.4	3.5	3.7	3.2	3.4	3.9	4.9
CPI	1.4	1.2	1.0	1.9	5.9	7.2	4.7	2.9
Current Account Balance % of GDP	-9.0	-8.5	-8.2	-7.9	-6.0	-9.0	-6.8	-4.0

Financial forecasts	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Cash	5.75	5.75	5.75	5.75	5.25	4.75	4.50
90 Day bill	5.85	5.85	5.85	5.55	5.05	4.75	4.30
2 Year Swap	5.00	4.80	4.50	4.30	4.10	4.00	3.90
5 Year Swap	4.50	4.40	4.30	4.20	4.05	4.00	3.90
10 Year Bond	4.30	4.20	4.00	3.80	3.75	3.70	3.70
NZD/USD	0.62	0.62	0.63	0.64	0.65	0.66	0.66
NZD/AUD	0.90	0.90	0.89	0.89	0.89	0.88	0.88
NZD/JPY	85.6	84.3	84.4	84.5	84.2	84.5	83.5
NZD/EUR	0.56	0.56	0.56	0.57	0.57	0.57	0.57
NZD/GBP	0.49	0.49	0.49	0.50	0.50	0.51	0.51
TWI	70.3	69.8	70.0	70.3	70.4	70.8	70.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 3 July 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.61%	5.60%	5.60%
60 Days	5.66%	5.64%	5.65%
90 Days	5.71%	5.68%	5.68%
2 Year Swap	5.47%	5.34%	5.21%
5 Year Swap	4.69%	4.59%	4.44%

NZ foreign currency mid-rates as at 3 July 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6128	0.6199	0.6050
NZD/EUR	0.5616	0.5677	0.5658
NZD/GBP	0.4832	0.4840	0.4883
NZD/JPY	88.44	87.93	84.87
NZD/AUD	0.9196	0.9051	0.9183
TWI	71.28	71.23	70.16

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 03					
NZ	May building permits	-2.6%	-	5.0%	Bounce following recent softness, trend remains weak.
Aus	Jun CoreLogic home value index	1.4%	-	1.4%	Recovery unperturbed by RBA's latest rate rises.
	May dwelling approvals	-8.1%	4.0%	3.0%	Lifting a little after big falls in early 2023.
	May housing finance	-2.9%	1.7%	4.0%	Starting to stabilise as established market sees price gains...
	May owner occupier finance	-3.8%	-	4.0%	... and a modest lift in volumes, and construction-related...
	May investor finance	-0.9%	-	4.0%	... activity also moves off recent lows.
	Jun ANZ job ads	0.1%	-	-	Moderating slowly from a very elevated level.
	Jun MI inflation gauge %/yr	5.9%	-	-	Provides a general view of risks.
Chn	Jun Caixin manufacturing PMI	50.9	50.0	-	Reopening has provided mixed fortunes for manufacturing.
US	Jun ISM manufacturing	46.9	47.1	-	Manufacturing is feeling the weight of weaker demand.
	May construction spending	1.2%	0.4%	-	New capacity needed, but uncertainty a material headwind.
Global	Jun S&P Global manufacturing PMI	-	-	-	Final estimates for Japan, Eurozone, UK and US.
Tue 04					
NZ	Q2 NZIER Survey of Business Opinion	-61.3	-	-	Sentiment still weak, but starting to rise.
Aus	RBA policy decision	4.10%	4.10%	4.35%	Expected to hike but case for pause to be discussed.
US	Independence Day	-	-	-	Public holiday; markets closed.
Wed 05					
NZ	GlobalDairyTrade auction (WMP)	0.0%	-	-4.0%	Weaker prices to reflect sluggish Chinese demand.
	Jun ANZ commodity prices	0.3%	-	-	All main commodity prices were under pressure over June.
Chn	Jun Caixin services PMI	57.1	56.2	-	Services received most of the benefit post-reopening.
Eur	May PPI	-3.2%	-	-	Decelerating rapidly from historic peak.
US	May factory orders	0.4%	0.6%	-	Underlying demand for investment goods soft, as evinced...
	May durable goods orders	1.7%	-	-	... by core orders.
	FOMC June meeting minutes	-	-	-	Consensus opinion around June's 'skip' in focus.
	Fedspeak	-	-	-	Williams.
Global	Jun S&P Global services PMI	-	-	-	Final estimates for Japan, Eurozone, UK.
Thu 06					
Aus	May trade balance \$bn	11.2	11.0	11.0	Exports resilient, sharply lower prices offset by volume rebound.
Eur	May retail sales	0.0%	0.2%	-	Under pressure as discretionary spending capacity weakens.
US	May trade balance \$bn	-74.6	-68.3	-	Deficit to gradually narrow as consumer demand softens.
	Jun ISM non-manufacturing	50.3	51.2	-	Momentum in services has gradually waned..
	Jun S&P Global services PMI	54.1	-	-	... as downturn looms on horizon.
	Initial jobless claims	239k	-	-	Trending upwards; no signs of large-scale job shedding yet.
	May JOLTS job openings	10103k	-	-	Low response rate to survey raises questions re accuracy.
	Fedspeak	-	-	-	Logan.
Fri 07					
Chn	Jun foreign reserves US\$bn	3176.5	-	-	Little pressure on reserves.
US	Jun non-farm payrolls	339k	200k	190k	Payrolls likely to be last data point to show weakness.
	Jun unemployment rate	3.7%	3.6%	3.6%	HH survey points to a very marginal increase in slack.
	Jun average hourly earnings %/mth	0.3%	0.3%	0.3%	Current pace at top end of that consistent with 2% CPI.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	2023f	2024f
Australia						
Real GDP %oyr	1.9	-1.8	5.2	3.7	1.4	0.5
CPI inflation %oyr	1.8	0.9	3.5	7.8	4.2	3.2
Unemployment rate %	5.2	6.8	4.7	3.5	4.2	5.3
Current account % of GDP	0.7	2.4	3.1	1.2	0.8	0.4
United States						
Real GDP %oyr	2.3	-2.8	5.9	2.1	1.4	0.3
CPI inflation %oyr	1.9	1.2	7.2	6.4	2.5	2.0
Unemployment rate %	3.7	8.1	5.4	3.6	3.6	4.5
Current account % of GDP	-2.6	-2.5	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %oyr	-0.4	-4.3	2.1	1.1	1.2	1.0
Euro zone						
Real GDP %oyr	1.6	-6.1	5.4	3.5	0.6	1.2
United Kingdom						
Real GDP %oyr	1.6	-11.0	7.6	4.0	0.3	1.2
China						
Real GDP %oyr	6.0	2.2	8.4	3.0	6.0	5.5
East Asia ex China						
Real GDP %oyr	3.8	-2.3	4.3	4.5	3.9	4.4
World						
Real GDP %oyr	2.8	-2.8	6.3	3.4	3.1	3.0

Forecasts finalised 16 June 2023

Interest rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia							
Cash	4.10	4.60	4.60	4.60	4.35	4.10	3.85
90 Day BBSW	4.35	4.80	4.80	4.63	4.38	4.13	3.88
10 Year Bond	4.00	3.80	3.70	3.50	3.30	3.20	3.10
International							
Fed Funds	5.125	5.375	5.375	4.875	4.375	3.875	3.375
US 10 Year Bond	3.84	3.60	3.50	3.30	3.10	3.00	2.90

Exchange rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6632	0.69	0.69	0.71	0.72	0.73	0.74
USD/JPY	144.72	138	136	134	132	130	128
EUR/USD	1.0868	1.11	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2625	1.27	1.27	1.28	1.28	1.29	1.29
USD/CNY	7.2508	7.00	6.90	6.80	6.70	6.60	6.50
AUD/NZD	1.0881	1.11	1.11	1.13	1.13	1.12	1.12

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