

WESTPAC WEEKLY ECONOMIC COMMENTARY

From “Fast and Furious” to “Frozen” – RBNZ to keep the OCR on hold.

10 July 2023



Southern rātā

Westpac Economics Team

✉ economics@westpac.co.nz

🌐 westpac.co.nz/economics



In New Zealand, Wednesday’s RBNZ monetary policy review will be the focus for the market during a holiday-shortened week (the local market is closed on Friday for the Matariki holiday). That said, we expect the Reserve Bank to leave the OCR at 5.50% and the broad stance of policy as communicated in the post-meeting statement is also likely to be unchanged.

In the May *Monetary Policy Statement* the RBNZ gave the market a strong steer that it expected that no further increases in the OCR would be required during the present cycle and that now is the time to “watch, worry and wait”. Importantly, in signalling this ‘end of cycle’ stance, the RBNZ was also at pains to emphasize that there was no case to expect any cuts to the OCR for a good while yet. Indeed, the RBNZ’s forecasts indicated that the first easing in policy would need to wait until late next year.

The data flow since May will likely have given comfort to the RBNZ that its on-hold stance is appropriate – at least for now. The key piece of information was the release of March quarter GDP which pointed to a level of activity that came in close to Westpac’s own forecasts but weaker than the RBNZ had expected. Hence from the Reserve Bank’s perspective, the economy started the year in a slightly less overheated position than might have been feared when they produced their May *Statement*. Given the RBNZ’s previous strident on-hold stance, this data alone will probably be enough to convince it to keep the OCR steady this time around.

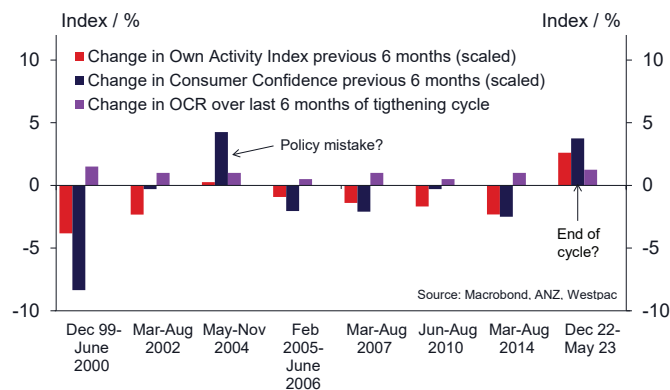
Other recent developments paint a mixed picture of the risks for future inflation and interest rates. Some downside risks for domestic inflation and interest rates are accumulating in the form of the weaker than expected bounce back of the Chinese economy, with implications for export demand (reflecting this, in June Westpac revised down its forecast of the farmgate milk price).

Many indicators of interest rate-sensitive domestic demand seem consistent with a cooling economy. For example, the sluggishness of retail sector is as one should expect given the interest rate increases that we have already seen. Overall household spending has continued to rise in nominal terms – in part due to spending by New Zealanders travelling abroad. However, new figures released last week indicated a decline in the buffer provided by household savings and a house price-driven reduction in household wealth, which might weigh on households’ willingness to spend going forward. Other information in the last week has pointed to an ongoing slowdown in construction – dwelling consents in May were 11% lower than a year earlier – and a growing shortfall of corporate tax compared with the Treasury’s expectations.

On the other side of the ledger, global central banks are generally finding inflation to be more resilient than anticipated and have upgraded their view of the likely peak in policy rates. The RBNZ will be aware of the risks of repeating the mistake of drawing the tightening cycle to an end too early and having to change tack should the economy and inflation prove more resilient. Some domestic indicators are consistent with lingering economic resilience. In particular, the labour market has not cracked yet – while migration has surged, jobs growth is still outstripping increases in the population. Consumer and business confidence looks to have found a base with the latter seeming quite strong if the top of the tightening cycle is really in place. The housing market has also found a bottom probably somewhat sooner than the RBNZ probably had factored in. Whilst measures of inflation expectations have fallen, the high proportion of firms reporting cost and selling price pressures remains concerning. Not surprisingly therefore, market pricing still reflects a risk of a further increase in the OCR this year (and Westpac retains its call for a 25-point increase in August).

It's likely – and in our view desirable – that the RBNZ will provide only a brief commentary to accompany this week's decision. Saying too much would raise the risk of misinterpretation and might lead markets to price in rate cuts or increases that the RBNZ won't want to endorse right now. The main message we might expect to see is that the future direction of interest rates is data-dependent, so as to leave room for the RBNZ to shift tack should upside (or downside) risks to the inflation profile accumulate. We think that this "data-dependent" message may have gotten a bit lost in the 'on-hold' messaging at the *May Statement*.

Confidence at the end of tightening cycles



Darren Gibbs, Senior Economist

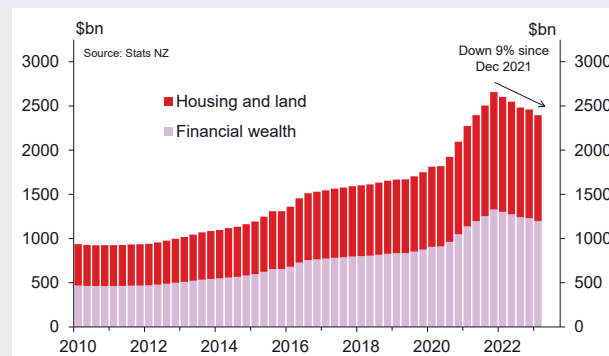
+64 9 367 3368

darren.gibbs@westpac.co.nz

Chart of the week

Household wealth levels fell by \$42bn in the first three months of the year and have fallen 9% since the end of 2021. That decline has mainly been due to the 17% fall in house prices since interest rates started rising in late 2021. That's a particular concern for those families who first entered the housing market in the past couple of years. Many of those families will now be looking at higher debt servicing costs, while the value of their homes has fallen since taking out a loan.

Household wealth

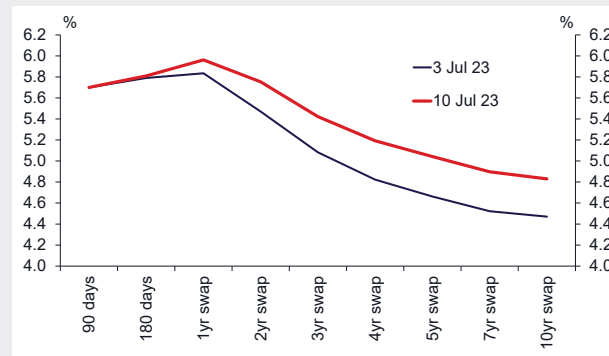


Fixed vs floating for mortgages

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

RBNZ Jul Monetary Policy Review

Jul 12, Last: 5.50%, Westpac f/c: 5.50%, Market f/c: 5.50%

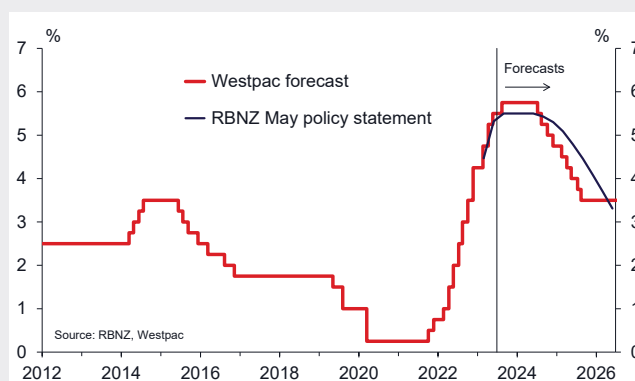
We expect the Reserve Bank to leave the Official Cash Rate unchanged at 5.50%.

In its May Monetary Policy Statement the RBNZ gave markets a strong steer that it expected that no further increases in the OCR would be required, and that now is the time to “watch, worry and wait”.

The data flow since May will likely have given comfort to the RBNZ that its on-hold stance is appropriate for now. The key piece of information was March quarter GDP, which showed that the economy started the year in a slightly less overheated position than believed.

The main message we might expect to see is that the future direction of interest rates is data-dependent, so as to leave room for the RBNZ to shift tack should upside (or downside) risks to the inflation profile accumulate. We think that this ‘data-dependent’ message may have gotten a bit lost in the on-hold messaging in May.

Official Cash Rate forecasts



NZ Jun REINZ house sales and prices

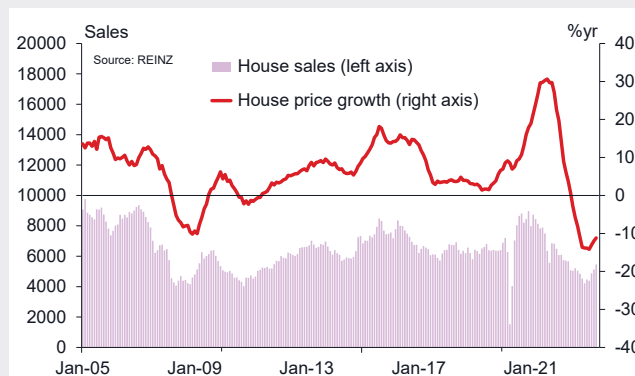
Jul 13 (tbc), Sales last: +2.5% m/m, -0.4% y/y
Prices last: +0.2% m/m, -11.2% y/y

The New Zealand housing market has been stabilising in recent months, as the forces that have weighed against the market over the past couple of years have started to turn.

House sales, while still well below average, are up about 30% from the lows that they reached at the end of last year. The REINZ house price index has flattened out and has even risen marginally in the last three months, after a cumulative 17% decline from late 2021 to early 2023.

The prospect of a peak in the interest rate cycle is likely to have brought some potential buyers off the sidelines. However, recent weeks have seen further increases in mortgage rates at the front end of the curve as funding costs have risen.

REINZ house prices and sales



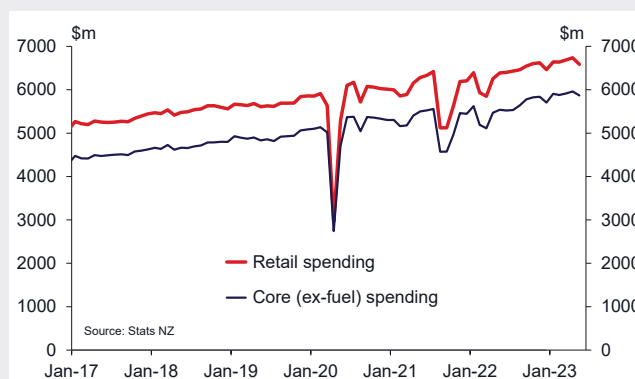
NZ Jun retail card spending

July 13, Last: -1.7%, Westpac f/c: +0.8%

Retail sales fell 1.7% in May. The weakness in spending was widespread, including sizeable falls in spending on household durables (like furnishings) and hospitality. Those falls highlight the mounting pressure on households’ finances, with continued increases in the cost of living and interest rates.

We’re forecasting a 0.8% rise in retail spending in June. However, much of that rise is due to a surge in fuel sales towards the end of the month as motorists rushed to avoid the rise in fuel taxes. Under the surface, we expect a modest 0.4% rise in core (ex-fuel) categories, with financial pressures continuing to dampen spending even as population growth surges.

NZ monthly retail card spending



The week ahead

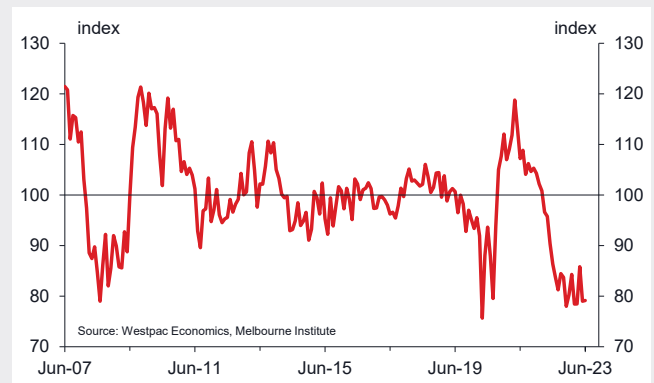
Aus Jul Westpac-MI Consumer Sentiment

Jul 11, Last: 79.2

Consumer sentiment rose 0.2% to 79.2 in June, holding around the very weak, recessionary levels seen since mid-2022. Rising interest rates and cost of living pressures continue to weigh heavily, June seeing a further rate rise from the RBA that came as a surprise for most commentators.

The RBA Board's decision to leave rates on hold in July should see some 'relief rally' lift in sentiment. Notably, responses over the June survey week showed a significant lift early on that unwound sharply following the RBA decision. Sentiment also posted a strong 9.4% gain back in April, the last time the RBA opted to pause the rate hike cycle. However, any gain in July will be tempered by the Bank's clear tightening bias. Other factors that may influence sentiment include: clearer signs that inflation has passed its peak in Australia; and a continued lift in dwelling prices.

Aus Consumer Sentiment Index



Aus Jun overseas arrivals and departures, preliminary

Jul 12, Arrivals, Last: 1300.1k

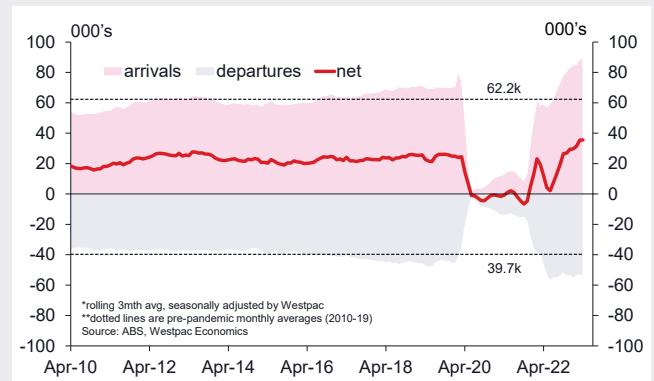
Jul 12, Departures, Last: 1366.7k

Following on from an unexpectedly strong pace of growth over the course of last year, the recovery in overseas arrivals and departures has begun to consolidate to a more manageable but still robust pace.

Permanent and long-term travel, which tends to be a better (albeit still limited) indicator of net migration flows, is continuing to exhibit strength, with net arrivals in this category tracking monthly gains of +35k/mth on a three-month average basis. The visa detail is also constructive, suggesting that the recovery in net overseas migration is continuing to track a strong pace.

Another dynamic that remains at play is the recovery in travel from China since their reopening from COVID-19. There is some evidence that momentum is beginning to gather, particular in longer-term categories of travel, but progress on this front is certainly lagging the broader recovery to date.

Aus permanent & long-term travel

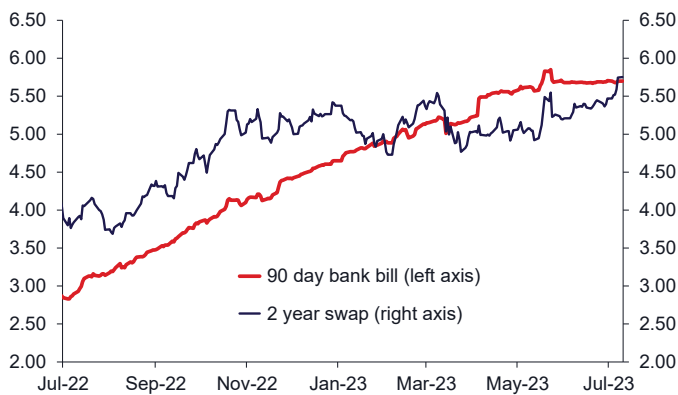


New Zealand forecasts

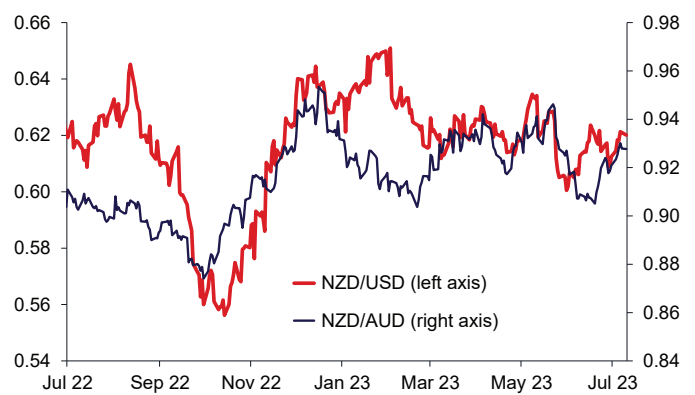
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.5	0.5	6.0	2.7	1.2	0.5
Employment	0.5	0.8	0.4	0.0	3.3	1.6	1.2	-0.4
Unemployment Rate % s.a.	3.4	3.4	3.5	3.7	3.2	3.4	3.9	4.9
CPI	1.4	1.2	1.0	1.9	5.9	7.2	4.7	2.9
Current 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 10 July 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.62%	5.60%	5.60%
60 Days	5.66%	5.65%	5.64%
90 Days	5.70%	5.69%	5.69%
2 Year Swap	5.75%	5.42%	5.37%
5 Year Swap	5.04%	4.66%	4.62%

NZ foreign currency mid-rates as at 10 July 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6201	0.6167	0.6143
NZD/EUR	0.5653	0.5656	0.5702
NZD/GBP	0.4832	0.4852	0.4884
NZD/JPY	88.25	88.24	85.51
NZD/AUD	0.9277	0.9240	0.9080
TWI	71.88	71.68	70.75

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
Chn	Jun CPI %yr	0.2%	0.2%	-	Managed prices and capacity limiting inflation.
	Jun PPI %yr	-4.6%	-5.0%	-	Producer prices coming off highs.
	Jun M2 money supply %yr	11.6%	11.2%	-	Looser financial conditions and liquidity...
	Jun new loans, CNYbn	1363	2250	-	... allowing better access to credit.
Eur	Jul Sentix investor confidence	-17	-	-	Investors aren't feeling good about outlook.
US	May wholesale inventories (final)	-0.1%	-0.1%	-	Inventories slide as firms become more uncertain.
	May consumer credit \$bn	23.0	20.5	-	High rates limit credit growth.
	Fedspeak	-	-	-	Barr, Daly, Mester, Bostic.
Tue 11					
Aus	Jul Westpac-MI Consumer Sentiment	79.2	-	-	RBA's July pause should see a 'relief rally' in sentiment.
	Jun NAB business survey	8	-	-	Downturn reportedly accelerated in May, conditions -7pts to +8.
Eur	Jul ZEW survey of expectations	-10	-	-	Outlook expectations to weaken.
UK	May ILO unemployment rate	3.8%	-	-	No clear signs of slack emerging yet.
US	Jun NFIB small business optimism	89.4	89.9	-	Tight conditions and uncertainty limiting optimism.
Wed 12					
NZ	May net migration	5785	-	-	Inflows still strong, but foreign departures jumped in April.
	RBNZ policy decision	5.50%	5.50%	5.50%	On hold for now, with future moves being data-dependent.
Aus	RBA Governor Lowe speech	-	-	-	"The Reserve Bank Review and Monetary Policy".
	Jun overseas arrivals, preliminary	1300.1k	-	-	China to provide further scope for recovery, in time.
US	Jun CPI	0.1%	0.3%	0.3%	Shelter keeping prices sticky.
	Fedspeak	-	-	-	Barkin, Kashkari, Bostic, Mester.
	Federal Reserve's Beige Book	-	-	-	Update on conditions across the 12 Fed districts.
Thu 13					
NZ	Jun manufacturing PMI	48.9	-	-	Activity and orders likely to remain subdued.
	Jun food price index	0.3%	-	1.6%	Continued shortages of some fresh produce.
	Jun retail card spending	-1.7%	-	0.8%	Boosted from fuel spending, core spending modest.
	Jun REINZ house sales %yr	-0.4%	-	-	Date TBC. House sales have picked up from their lows...
	Jun REINZ house prices %yr	-11.2%	-	-	... and prices appear to have stabilised in recent months.
Aus	Jul MI inflation expectations	5.2%	-	-	Expectations remain elevated but off recent highs.
Chn	Jun trade balance US\$bn	65.8	74.0	-	Pull-back in imports to widen surplus.
Eur	May industrial production	1.0%	-	-	Germany weighing down Euro Area industrial production.
UK	May monthly GDP	0.2%	-	-	Resilient consumers drive growth.
	May trade balance £bn	-1.5	-	-	Weaker exports to widen deficit.
US	Jun PPI	-0.3%	0.2%	-	Price growth weak coming off 2022 highs.
	Initial jobless claims	248k	-	-	Labour market indicators show little sign of slack.
Fri 14					
NZ	Matariki public holiday	-	-	-	Markets closed.
Eur	May trade balance €bn	-7.1	-	-	Weaker exports to see deficit widen.
US	Jun import price index	-0.6%	-0.1%	-	Rapidly decelerating from elevated level.
	Jul Uni. of Michigan sentiment	64.4	65.5	-	Inflation expectations the focus.
	Fedspeak	-	-	-	Waller.

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	1.6	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	0.8
China						
Real GDP %oyr	6.0	2.2	8.4	3.0	5.7	5.5
East Asia ex China						
Real GDP %oyr	3.8	-2.3	4.3	4.5	3.7	4.3
World						
Real GDP %oyr	2.8	-2.8	6.3	3.4	3.0	3.0

Forecasts finalised 7 July 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	4.28	4.80	4.80	4.63	4.38	4.13	3.88
10 Year Bond	4.22	3.90	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	4.03	3.70	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	0.6630	0.69	0.69	0.71	0.72	0.73	0.74
USD/JPY	143.95	140	138	136	133	130	128
EUR/USD	1.0891	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2743	1.27	1.27	1.28	1.28	1.29	1.29
USD/CNY	7.2490	7.10	7.00	6.80	6.70	6.60	6.50
AUD/NZD	1.0750	1.11	1.11	1.13	1.13	1.12	1.12

Contact the Westpac economics team

Kelly Eckhold, Chief Economist

+64 9 348 9382

Darren Gibbs, Senior Economist

+64 9 367 3368

Any questions email:

electronics@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

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