

# WESTPAC WEEKLY ECONOMIC COMMENTARY

## Steady as she goes!

14 August 2023



Southern rātā

### Westpac Economics Team

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Last week we released our quarterly Economic Overview.<sup>1</sup> The key theme was “the great rebalancing,” and we ask whether and how quickly it will occur? The economy is clearly slowing, as further demonstrated by last week’s soft retail spending and manufacturing PMI reports. However, the economy remains overstretched and inflation far too high. Twin deficits – external and fiscal – are in play, raising clear risks the required adjustments in economic conditions might be bumpy and prolonged.

Our baseline is that that further monetary policy action is needed to ensure the required adjustments come fast enough. But there are risks in both directions. On the upside, we continue to see the risk of only slow adjustments in economic activity and lingering ‘sticky’ inflation pressures, which could mean that the OCR needs to move even higher – perhaps even above 6%. But on the downside, the possibility of weaker Chinese demand could allow for a faster adjustment than we have factored in. But even then, local interest rates will likely remain higher than pre-pandemic levels.

This week the key event in the local diary is Wednesday’s RBNZ’s OCR decision and updated *Monetary Policy Statement*. As we wrote in our preview,<sup>2</sup> we are not expecting any fireworks, with the Bank likely to deliver the same “steady as she goes” message as was conveyed last month. Specifically, the OCR is almost certain to remain at 5.5% and the Bank

is very likely to retain its baseline projection that the rate cycle has peaked. Looking beyond this meeting, the Bank’s projection for the OCR will likely continue to indicate policy on hold until around the August 2024 meeting, before gradually moving lower thereafter. But it is probable – and certainly desirable – that the Bank will emphasise that policy is not on a predetermined path and that it will be closely monitoring the emerging data flow both here and abroad.

Economic developments since the July policy meeting – and since May when the RBNZ released its last set of forecasts – will likely be viewed as mixed, and so lead to only modest changes to the broad thrust of the Bank’s overall growth and inflation forecasts. That’s not to say there won’t be changes within the detail. For example, the RBNZ’s starting point for the level of excess capacity in the economy will be adjusted down to reflect that March quarter GDP was weaker than they expected.

<sup>1</sup> [westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2023/Other/Economic-Overview\\_QEO\\_report\\_10Aug23.pdf](https://westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2023/Other/Economic-Overview_QEO_report_10Aug23.pdf)

<sup>2</sup> [westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2023/Bulletins/Economic-Data\\_MPS-preview\\_bulletin\\_10Aug23.pdf](https://westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2023/Bulletins/Economic-Data_MPS-preview_bulletin_10Aug23.pdf)

However, indicators – including robust employment growth – point to a stronger June quarter than the Bank had projected, so the implications for the output gap will likely be a wash.

Recent external sector developments will have been a downside surprise for the RBNZ. Of particular significance has been ongoing weakness in China’s recovery and the related substantial downgrade to the outlook for commodity export prices (dairy, meat, logs for example), which will lower farm and business incomes. On the other hand, house prices have found a base sooner than the RBNZ expected and have even taken tentative steps higher. And while the headline CPI was in line with expectations, non-tradables inflation was higher than the RBNZ had forecast, and that will raise questions on how persistent price pressures will be in the next few quarters. The widespread nature of pricing pressures should see some short-term upward adjustment to the inflation outlook.

While the RBNZ’s baseline outlook may not have changed much, both upside and downside inflation risks have become more pronounced since the May Statement (as shown in this week’s *Chart of the week*).

On the downside the focus should be on the weakness in China and commodities markets, along with the related possibility of a steeper downturn in the economy and an earlier move lower in inflation. A May 2024 easing could come into focus in that scenario.

On the upside, greater persistence in domestic inflation, stronger house prices, and a slower adjustment in the labour market would confirm Westpac’s view that a hike in the OCR will be back on the table by the time of the RBNZ’s November OCR decision and *Statement*.

Ahead of the RBNZ’s meeting, there will be some interest in the REINZ housing report for July and migration data for June. In recent months house sales have moved decisively off their cycle lows and house prices have edged higher – developments that will no doubt have caught the attention of the RBNZ. Very strong net migrant inflows earlier this year have probably contributed to this uplift, so we will be interested to see whether the recent moderation in inflows has continued in June. On Wednesday the results of the latest GDT auction will likely be awaited with some trepidation, especially after the very sharp fall in whole milk powder prices at the last auction. Indeed, given the weakness in recent auction results, and following Fonterra’s own forecast revision, we have this week further revised down our forecast for the 2023/24 farmgate milk price to \$7.50/kg – a level that will likely leave many farmers in the red for the season. The June quarter business price indexes close out the week’s dataflow on Thursday. While not a big focus for markets, the producer price indexes might cast some light on the inflation pipeline.

**Kelly Eckhold**, Chief Economist

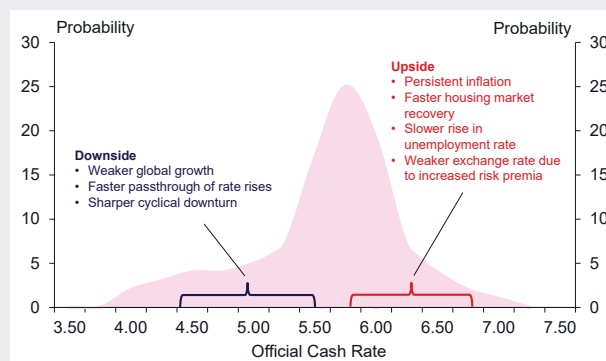
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## Chart of the week

The economy remains overstretched and inflation far too high – hence we see further policy action as needed to ensure the economy adjusts fast enough. But risks around that central view are significant in both directions for the OCR one year out. Twin deficits are in play raising clear risks the adjustment might be bumpy and prolonged. We still see the risks as towards slow adjustment, sticky inflation, and higher interest rates – perhaps even above 6%. But the impact on incomes of weaker Chinese demand could allow for a faster adjustment and some modest interest rate cuts over the next year. Policy and forecasts will need to be dictated by the data and not the calendar!

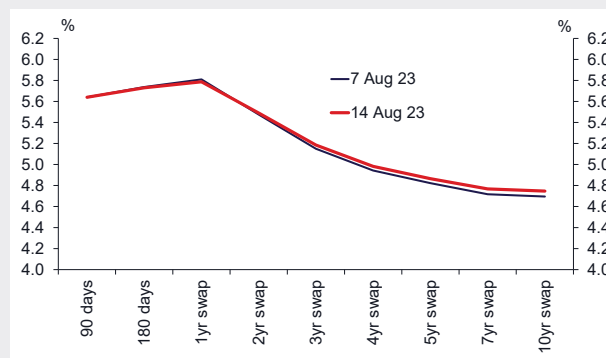
OCR risk scenarios - August 2024



## Fixed vs floating for mortgages

We think the current best value for borrowers is fixing for one year and rolling for this term. That is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms would be more suited to those who want certainty in their repayments.

NZ interest rates



# The week ahead

## NZ Jul REINZ house sales and prices

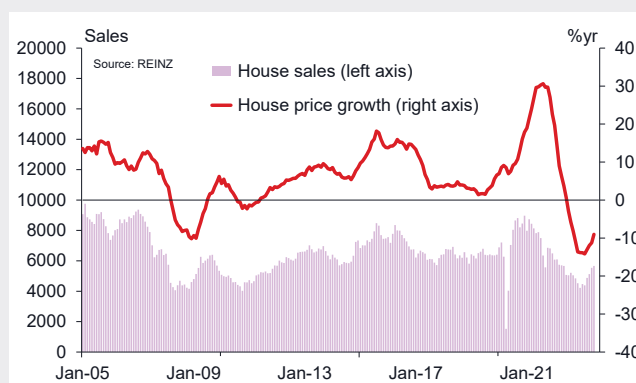
**Aug 15, Sales, Last: +2.2% m/m, 14.6% y/y**  
**Aug 15, Prices, Last: +1.2% m/m, -9.0% y/y**

This year, the New Zealand housing market has shown signs of recovery, likely supported by rapid migrant-driven population growth and a growing sense amongst buyers that interest rates are close to or at their peak.

House sales, while still well below average, are up about a third from last year's low-point. Prices have also moved higher in recent months, though they are still 15% below the peak.

Migrant inflows have slowed a little in recent months and mortgage rates have edged higher as funding costs have risen. Should the housing recovery gather pace regardless, this will doubtless raise eyebrows at the RBNZ.

REINZ house prices and sales



## NZ GlobalDairyTrade auction, whole milk powder prices

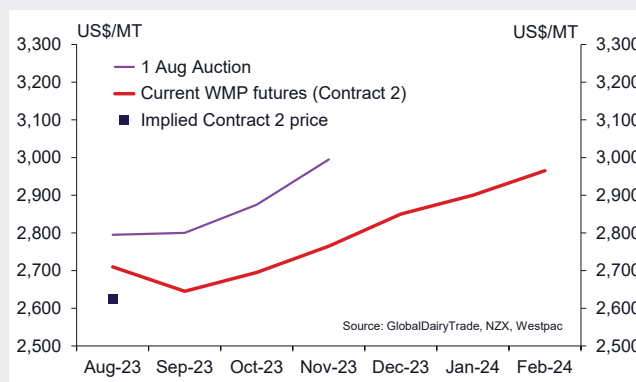
**Aug 16, Last: -8.0%, Westpac f/c: -5.0%**

We expect whole milk powder prices (WMP) to fall 5% at the upcoming auction. Prices slid 8% at the previous auction.

Notably, Fonterra has announced a 5.6% increase auction volumes on offer over the next year compared to what was previously signalled. This is a large amount for the market to absorb and thus is likely to put further downward pressure on prices.

This increase may partially reflect that New Zealand production was very strong in April and May and/or the release of previously held milk powder stocks. In addition, this sudden increase in auction volumes and likely impact on prices may explain Fonterra's larger than expected milk price forecast revision (to a \$7.00/kg midpoint) last week.

Whole milk powder prices



## NZ RBNZ Monetary Policy Statement

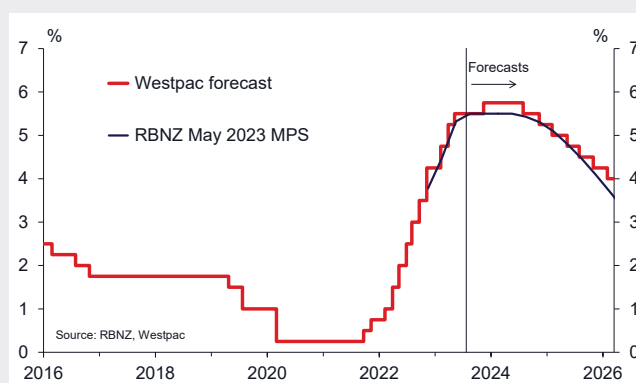
**Aug 16, Last: 5.50%, Westpac f/c: 5.50%, Market f/c: 5.50%**

The RBNZ will keep the OCR at 5.50% at its August policy meeting and retain its baseline forecast that the rate cycle has peaked. The Bank's forecast for the OCR should continue to indicate rates on hold until August 2024, falling slowly thereafter.

Economic developments will likely be viewed as broadly mixed and so will likely lead to only modest changes in the Bank's growth and inflation forecasts. Weaker than expected March quarter GDP and a softer outlook for the external sector are balanced against a firmer housing market and persistent domestic inflation pressures.

The Bank will likely emphasise that any future move in policy will depend on the emerging data flow at home and abroad.

Official Cash Rate forecasts



# The week ahead

## Aus Q2 Wage Price Index %qtr

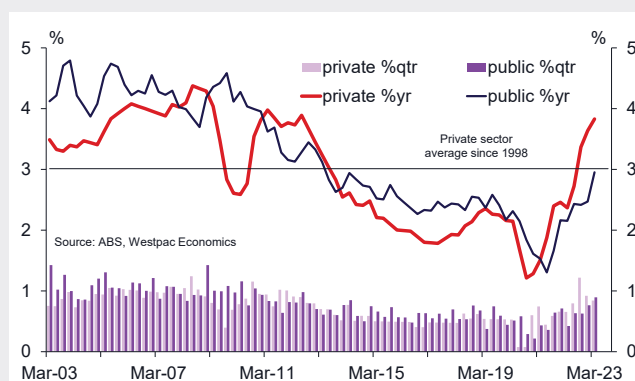
**Aug 15 Last: 0.8%, WBC f/c: 1.0%**  
**Mkt f/c: 0.9%, Range: 0.8% to 1.1%tr**

Wages lifted 0.8% in March, softer than the market's expectation for a 0.9% but spot on Westpac's 0.8% forecast. Wages continue to disappoint broader expectations and while private sector wage gains are moderating faster than we had anticipated, at least for now, the uptick in public sector wages means we can hold the forecast peak at 4.1%/yr.

However, that forecast implies a step up in the quarterly pace of wage inflation, and given an emerging moderation in private sector wages, more emphasis will be placed on public sector wage inflation, the emerging risks to that forecast now lie to the downside.

Westpac is forecasting a 1.0% rise in the June quarter taking the annual pace from 3.7% to 3.8%. June is a seasonally soft quarter with most wage rises being paid post June 30th, and most of the remainder occurring at the start of the year.

## Aus public vs. private wages



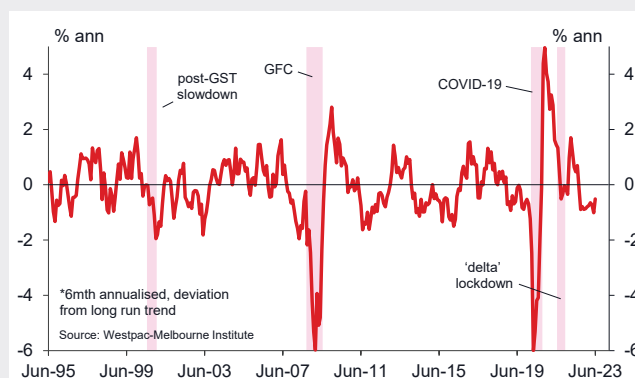
## Aus Jul Westpac-MI Leading Index

**Aug 16, Last: -0.51%**

The Leading Index lifted to -0.51% in June from -1.01% in May. Despite the improvement, the Index continue to send a weak signal on growth momentum, pointing to a below-trend pace continuing through the second half of 2023 and into early 2024.

The July read will include another mixed bag of component updates. On the plus-side, the ASX200 rose 2.9% and total hours worked increased slightly after big swings in previous months. But against this, commodity prices have fallen sharply again (-12.2% in AUD terms) and dwelling approvals have cycled a one-off high rise driven jump in May. Sentiment-based components have also been mixed, the Westpac-MI Consumer Expectations Index softening but the Westpac-MI Unemployment Expectations Index improving marginally. The mix is likely to leave another negative signal overall.

## Aus Westpac-MI Leading Index



## Aus Jul Labour Force – employment change ('000s)

**Aug 17, Last: 32.6k, WBC f/c: +25k**  
**Mkt f/c: +15k, Range: -20k to +45k**

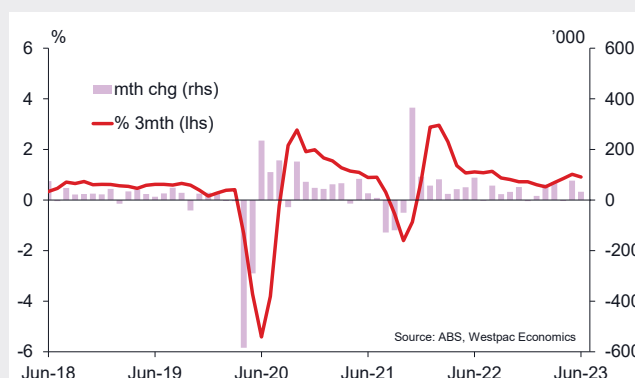
In June, employment lifted by 32.6k – slightly higher than Westpac's forecast (+25k) but well above the market median forecast (+15k).

We suspect there is scope for another robust read in July for two main reasons. Firstly, and more importantly, the data flow has not signalled any meaningful shift in tone around the current strength of labour demand, especially given the clear lack of moderation in job vacancies.

Secondly, work-hour restrictions for international students were reinstated on July 1 (from unlimited to 48hrs/fortnight). This poses an upside risk to jobs growth as employers may seek to replace the hours lost from the policy change with more workers. Admittedly, there is uncertainty around how this could present itself in the data.

Hence, we have erred on the side of caution and pencilled in +25k for employment. By all means, this is still a robust read that is reflective of current momentum, but we note the upside risk at hand.

## Aus employment growth



# The week ahead

## Aus Jul Labour Force – unemployment rate (%)

Aug 17, Last: 3.5%, WBC f/c: 3.5%

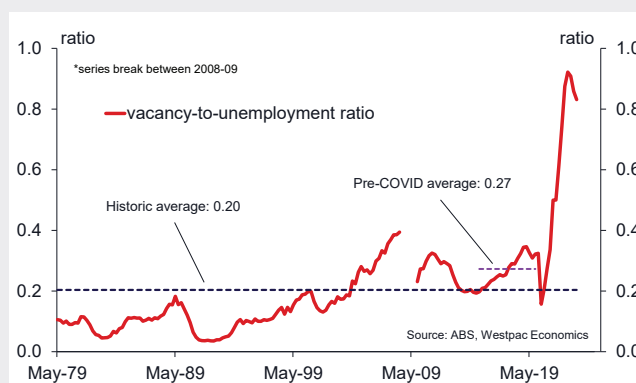
Mkt f/c: 3.6%, Range: 3.5% to 3.7%

In June, the participation rate edged slightly lower, from 66.9% to 66.8%, seeing the labour force grow by a solid 21.8k. However, jobs growth still managed to outperform, resulting in the unemployment rate holding firm near fifty-year lows, at 3.5%. In fact, June's print was only 0.04ppt above the cycle low from October 2022.

These results speak to the resilience of the labour market, supported by a lasting strength in labour demand – as evinced by a historically elevated level of job vacancies – amidst a surge in population growth. Hence, we have marked down our profile for the unemployment rate, which we now expect to print 3.8% by end-2023 and 4.7% by end-2024 (prior: 4.0% and 5.3% respectively).

For July, we expect the participation rate will be little changed, at 66.8%, resulting in the unemployment rate holding flat at 3.5%.

## Aus vacancy-to-unemployment ratio



## Aus Jul overseas arrivals and departures, preliminary

Aug 17, Arrivals, Last: 1358.5k

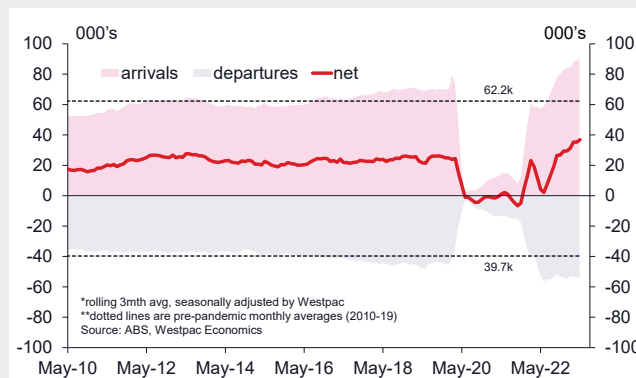
Aug 17, Departures, Last: 1563.7k

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 +37k/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

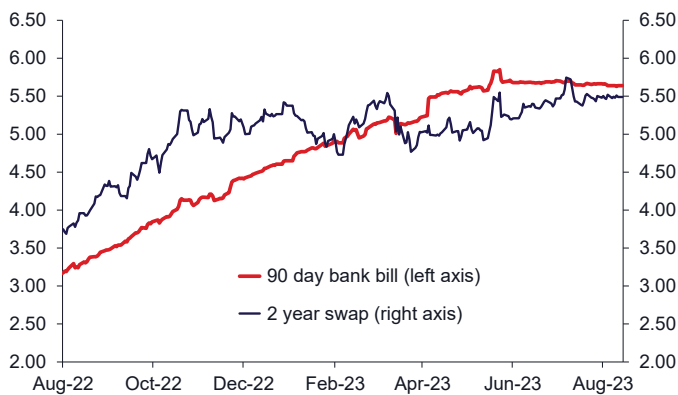


# New Zealand forecasts

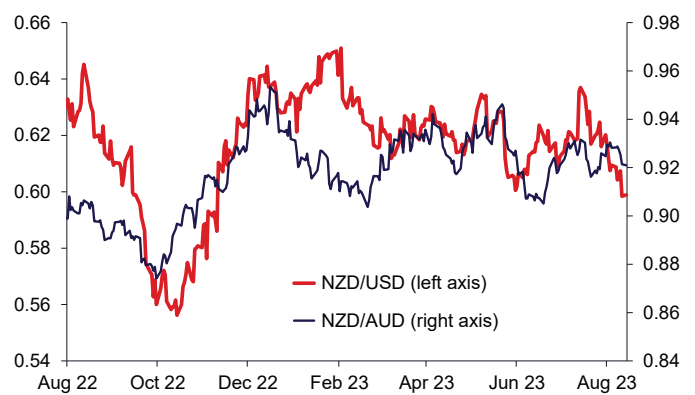
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.8	0.1	6.0	2.7	1.1	0.3
Employment	0.7	1.1	1.0	0.3	3.3	1.7	2.4	0.1
Unemployment Rate % s.a.	3.4	3.4	3.6	3.8	3.2	3.4	4.3	5.2
CPI	1.4	1.2	1.1	2.0	5.9	7.2	4.9	2.9
Current Account Balance % of GDP	-8.7	-8.2	-8.0	-8.2	-5.7	-8.7	-7.8	-6.0

Financial forecasts	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Cash	5.50	5.75	5.75	5.75	5.50	5.25	5.00
90 Day bill	5.70	5.85	5.85	5.85	5.60	5.35	5.10
2 Year Swap	5.64	5.49	5.29	5.06	4.81	4.58	4.37
5 Year Swap	4.84	4.74	4.62	4.51	4.41	4.31	4.23
10 Year Bond	4.50	4.45	4.30	4.15	4.05	3.95	3.85
NZD/USD	0.62	0.63	0.63	0.64	0.65	0.66	0.66
NZD/AUD	0.93	0.93	0.92	0.91	0.90	0.89	0.88
NZD/JPY	87.4	86.9	85.6	85.0	85.0	84.5	83.3
NZD/EUR	0.56	0.56	0.57	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	71.5	71.5	70.9	71.0	71.1	71.0	70.4

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 14 August 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.61%	5.62%	5.60%
60 Days	5.63%	5.64%	5.63%
90 Days	5.64%	5.67%	5.65%
2 Year Swap	5.49%	5.48%	5.39%
5 Year Swap	4.87%	4.76%	4.66%

NZ foreign currency mid-rates as at 14 August 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5989	0.6202	0.6338
NZD/EUR	0.5466	0.5619	0.5643
NZD/GBP	0.4715	0.4820	0.4846
NZD/JPY	86.74	88.22	87.56
NZD/AUD	0.9209	0.9247	0.9303
TWI	69.90	71.39	72.47

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 14</b>					
NZ	Jul BusinessNZ PSI	50.1	-	-	Has been trending lower since mid last year.
	Jun net migration	4939	-	-	Departures picked up sharply in May, lowering the net inflow.
<b>Tue 15</b>					
NZ	Jul REINZ house sales %yr	14.6%	-	-	The stabilisation of the housing market is set to continue...
	Jul REINZ house prices %yr	-9.0%	-	-	... with sales turning higher and prices flattening out.
Aus	Q2 wage price index	0.8%	0.9%	1.0%	Wage inflation has been surprisingly soft.
	RBA Minutes	-	-	-	More colour around the second consecutive policy pause.
Jpn	Q2 GDP	0.7%	0.7%	-	External demand likely to offset consumer's weakness.
	Jun industrial production	2.0%	-	-	Final estimate.
Chn	Jul retail sales ytd %yr	8.2%	7.6%	-	The lack of confidence is acting as a headwind to spending...
	Jul industrial production ytd %yr	3.8%	3.9%	-	... but as policy support comes online, momentum can shift...
	Jul fixed asset investment ytd %yr	3.8%	3.8%	-	... facilitating a sustained period of high-quality growth.
Eur	Aug ZEW survey of expectations	-12.2	-	-	Lingering pessimism as policy tightening ensues.
UK	Jun ILO unemployment rate	4.0%	4.0%	-	Wages growth holding up following prolonged tightness.
US	Jul retail sales	0.2%	0.4%	0.3%	Underlying downtrend in line with goods disinflation.
	Jul import price index	-0.2%	0.2%	-	Rapidly decelerating from an elevated level.
	Aug Fed Empire state index	1.1	-0.7	-	Reflective of subdued conditions for manufacturing.
	Jun business inventories	0.2%	0.2%	-	Accrual nearing stall speed as economy slows.
	Aug NAHB housing market index	56	56	-	Lack of supply aiding confidence boost.
	Fedspeak	-	-	-	Kashkari.
<b>Wed 16</b>					
NZ	GlobalDairyTrade auction	-8.0%	-	-5.0%	Down further on large increase in dairy auction volumes.
	RBNZ policy decision	5.50%	5.50%	5.50%	Another 'steady as she goes' message seems likely.
Aus	Jul Westpac-MI Leading Index	-0.51%	-	-	Pointing to below-trend growth carrying into early 2024.
Eur	Q2 GDP	0.3%	0.3%	-	No change is anticipated in the second estimate.
	Jun industrial production	0.2%	-0.6%	-	Likely to be positive in Q2, but only modestly so.
UK	Jul CPI %yr	7.9%	6.7%	-	Services prices remain strong, goods have scope to ease
US	Jul housing starts	-8.0%	0.4%	-	Struggling to gain momentum after start-of-year nadir...
	Jul building permits	-3.7%	1.6%	-	... risks around the pipeline to linger.
	Jul industrial production	-0.5%	0.4%	-	Regional surveys and PMIs not promising for production.
	FOMC July meeting minutes	-	-	-	Focus on consensus view around policy pause.
<b>Thu 17</b>					
NZ	Q2 PPI	0.3%	-	-	Pipeline inflation looks to be slowing.
Aus	Jul employment change	32.6k	15.0k	25.0k	Resilience in labour demand provides scope for further gains...
	Jul unemployment rate	3.5%	3.6%	3.5%	... allowing the unemployment rate to remain lower, for longer.
	Jul overseas arrivals (preliminary)	1358.5k	-	-	China to aid further in the recovery, in time.
Jpn	Jun machinery orders	-7.6%	3.5%	-	Broadly flat so far in Q3.
Eur	Jun trade balance €bn	-0.9	-	-	Export demand will remain a risk over foreseeable future.
US	Initial jobless claims	248k	-	-	Likely to remain near its lows, for now.
	Aug Philly Fed index	-13.5	-10.0	-	Reflective of subdued conditions for manufacturing.
	Jul leading index	-0.7%	-0.4%	-	Clearly pointing to downside risks for activity.
<b>Fri 18</b>					
Jpn	Jul CPI %yr	3.3%	3.3%	-	Tentative signs of core inflation cresting.
Eur	Jul CPI %yr	5.3%	5.3%	-	Final estimate to provide more colour around services.
UK	Aug GfK consumer sentiment	-30	-	-	Recovery flattening as interest rate concerns persist.
	Jul retail sales	0.7%	-	-	Up year-to-date, supported by income growth.

# International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	2023f	2024f
<b>Australia</b>						
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	3.2
Unemployment rate %	5.2	6.8	4.7	3.5	3.8	4.7
Current account % of GDP	0.7	2.4	3.1	1.2	1.0	0.3
<b>United States</b>						
Real GDP %yr	2.3	-2.8	5.9	2.1	1.8	0.4
CPI inflation %yr	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
<b>Japan</b>						
Real GDP %yr	-0.4	-4.3	2.1	1.1	1.4	1.0
<b>Euro zone</b>						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.2
<b>United Kingdom</b>						
Real GDP %yr	1.6	-11.0	7.6	4.0	0.3	0.5
<b>China</b>						
Real GDP %yr	6.0	2.2	8.4	3.0	5.2	5.5
<b>East Asia ex China</b>						
Real GDP %yr	3.8	-2.3	4.3	4.5	3.7	4.3
<b>World</b>						
Real GDP %yr	2.8	-2.8	6.3	3.4	3.0	3.0

Forecasts finalised 7 August 2023

Interest rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
<b>Australia</b>							
Cash	4.10	4.10	4.10	4.10	4.10	3.85	3.60
90 Day BBSW	4.18	4.30	4.30	4.30	4.22	3.97	3.72
10 Year Bond	4.12	3.75	3.55	3.45	3.30	3.25	3.20
<b>International</b>							
Fed Funds	5.375	5.375	5.375	5.125	4.625	4.125	3.625
US 10 Year Bond	4.11	3.80	3.60	3.40	3.20	3.10	3.00

Exchange rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6521	0.67	0.68	0.69	0.71	0.73	0.74
USD/JPY	144.72	140	138	135	132	130	128
EUR/USD	1.0989	1.11	1.12	1.12	1.13	1.14	1.15
GBP/USD	1.2684	1.28	1.28	1.29	1.29	1.30	1.30
USD/CNY	7.2276	7.10	7.00	6.80	6.70	6.60	6.50
AUD/NZD	1.0852	1.07	1.08	1.09	1.10	1.12	1.12



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