

WESTPAC WEEKLY ECONOMIC COMMENTARY

More slowing to go.

19 June 2023



Southern rātā

Westpac Economics Team

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Last week's GDP report showed that the New Zealand economy is steadily cooling down. That's entirely to be expected in the wake of more than 500 basis points of cash rate increases over the last two years. Indeed, it would be astonishing if we weren't seeing some braking effect on the economy by now. But the decline in GDP to date simply marks a pullback from what was an overheated starting point.

New Zealand's GDP dipped by 0.1% in the March quarter. That was in line with the average market forecast, but a little stronger than our pick of a 0.4% fall. However, downward revisions to previous quarters meant that annual growth was right in line with our forecast at 2.2%.

This was a second consecutive drop in GDP, following the 0.7% fall in the December 2022 quarter. Debating whether this constitutes a recession, 'technical' or otherwise, is fruitless at this point. The GDP figures will continue to be revised for years to come, and a negative outturn as small as this one (-0.06% before rounding) could easily change sign at some point in the future.

What's more, there is a clear direction to the revisions at the moment. With New Zealand's border reopened and international travel rebounding, Stats NZ has resumed regularly updating the seasonal adjustment factors that it applies to the GDP figures. These updates are having the effect of boosting growth rates in the December and March quarters – the usual peak in visitor arrivals – and reducing it in the June and

September quarters (see chart). The March 2023 quarter is ripe for an upward revision.

We find that the single best real-time gauge of how the economy is faring is the unemployment rate, which isn't subject to the same kinds of revisions as the GDP figures. What is this telling us right now? Unemployment was 3.4% in the March quarter, compared to a record low of 3.2% a year ago. That suggests that the economy is still running hot, but that it has turned a corner – much as you would expect after a long period of rising interest rates.

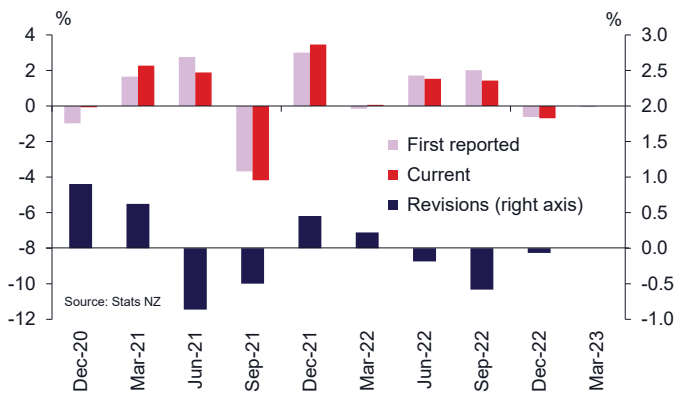
We get a similar signal from the current account balance, which was also released last week. The annual deficit narrowed to 8.5% of GDP in the March quarter, compared to the previous reading of 9% of GDP which was the largest deficit since the mid-1970s. The shift back from eye-wateringly high levels was a welcome one (although much of it appeared to be due to one-off items). However, the deficit remains unsustainably large by any reasonable measure, and it shows that demand in the economy continues to run well beyond our capacity to supply it.

We do expect the economy to continue to cool off, as a growing number of borrowers face the bite of higher interest rates. That won't necessarily result in an outright fall in GDP, as stronger migration-led population growth is likely to mask some of the decline. But it's likely to be a long period of adjustment before we can be confident that the inflation pressures in the economy have been tamed – neither we nor the RBNZ are forecasting inflation to be back within the 1-3% target range until the second half of next year. Any scope for OCR cuts looks to be some time away, and we still need to see tangible signs of a significant fall in non-tradables inflation in the quarters ahead.

The March quarter GDP result was below the 0.3% rise that the RBNZ had assumed in their May *Monetary Policy Statement*. That will no doubt leave the RBNZ comfortable with their decision to pause after a long series of interest rate hikes. Curiously, that stance is now putting them out of step with overseas central banks, who are growing more concerned about the potential for 'core' inflation to remain stubbornly high, and are stepping up their warnings about the need for further interest rate hikes.

The key things that we'll be watching from here are (1) the state of the labour market, (2) the degree to which the inflation rate slows over the course of this year, and (3) the potential for a rebound in the housing market. The May REINZ figures showed that house sales have picked up from their lows and that prices have stabilised after a cumulative decline of around 17% since late 2021. The rise in house prices and a surge in rents in Australia, following a similar rebound in net migration, may be a warning as to what could happen here.

Quarterly GDP growth before and after revisions



Michael Gordon, Senior Economist

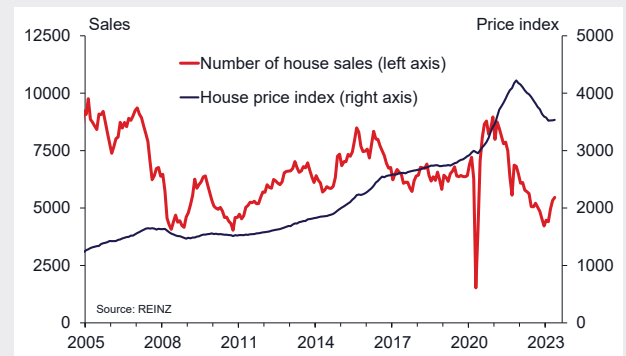
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Chart of the week

The latest update from REINZ signalled that the downturn in New Zealand's housing market has come to an end. While the level of sales remains low, they have risen in each of the past three months including a 2.5% increase in May (based on Westpac's adjustment for normal seasonal patterns). Similarly, there have been modest house price gains in each of the past three months. But while the housing market has found a base, interest rates are set to remain at contractionary levels for some time yet. That's likely to limit any material uplift in the housing market, at least in the near term.

REINZ house sales and house price index

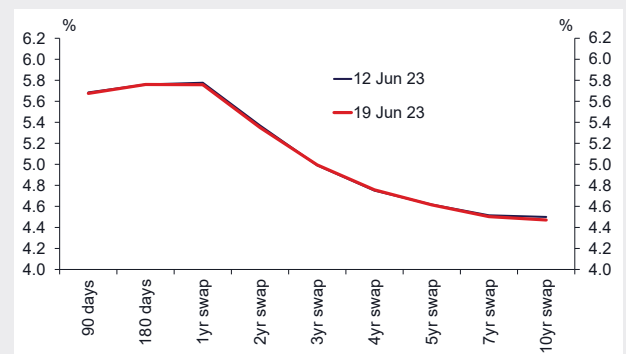


Fixed vs floating for mortgages

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

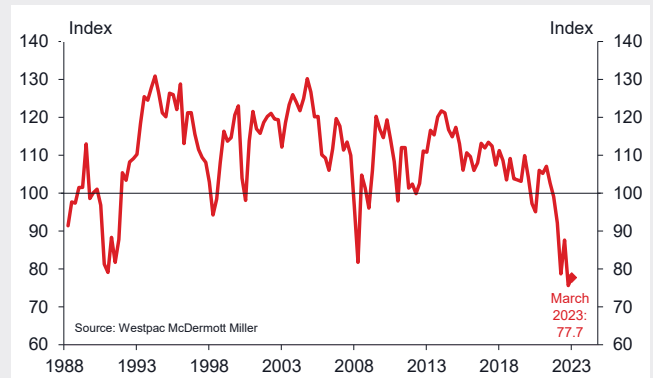
NZ Q2 Westpac McDermott Miller Consumer Confidence

Jun 20, Last: 77.7

Despite nudging higher at the time of our last survey, consumer confidence remained weak in the early part of this year. Households across the country have been grappling with skyrocketing living costs and higher mortgage rates. The downturn in the housing market over the past year will also have been a knock to many families' net worth.

Our latest survey was conducted in the first half of June. Recent weeks have seen signs of a softening in domestic demand as borrowing costs have risen and living costs have continued to rise. However, at the same time, there are increasing signs that the housing market is finding a base.

Consumer Confidence



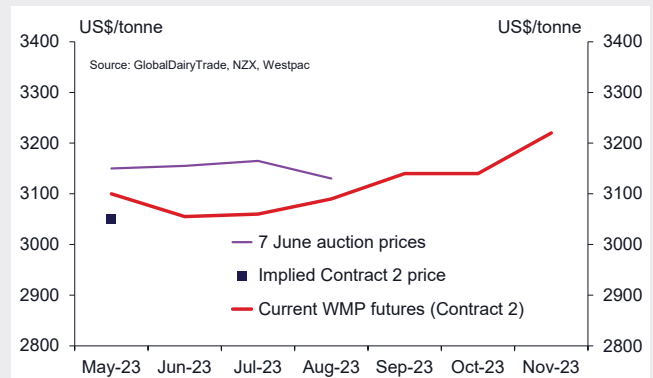
NZ GlobalDairyTrade auction, whole milk powder prices

Jun 21, Last: -3.0%, Westpac: -2.0%

We expect whole milk powder prices (WMP) to fall 2% at the upcoming auction. If prices fall as expected, then this would continue the slow downward trend seen over recent months. Our pick is similar to the 2% fall at last week's mini (GDT pulse) auction, although not as large as the circa 3% fall that the futures market is pointing to. We note that Fonterra has announced a reduction in auction volumes on offer and this has swayed us towards a slightly smaller price decrease.

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



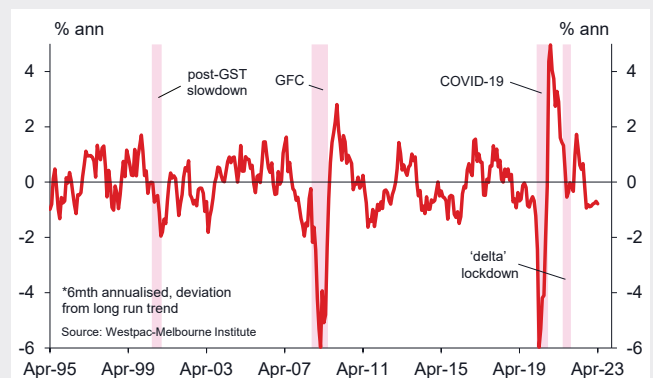
Aus May Westpac-MI Leading Index

Jun 21, Last: -0.78%

The Leading Index continued to send a weak signal in April, the six-month annualised growth rate dipping to -0.78%, marking a ninth successive below-trend read and suggesting that the slowdown that began late last year is set to extend through the second half of 2023 and into early 2024.

The May read will see another batch of weak component updates. The big negatives include: a 10% drop in commodity prices (in AUD terms); a further 8% decline in dwelling approvals; a 1.8% fall in total hours worked; and a 3% fall in the ASX200.

Aus Westpac-MI Leading Index

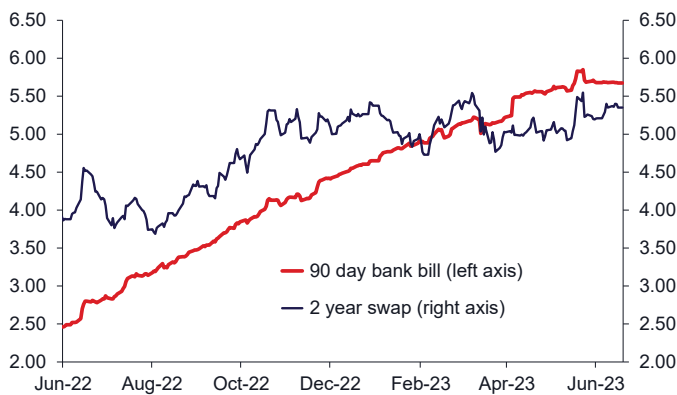


New Zealand forecasts

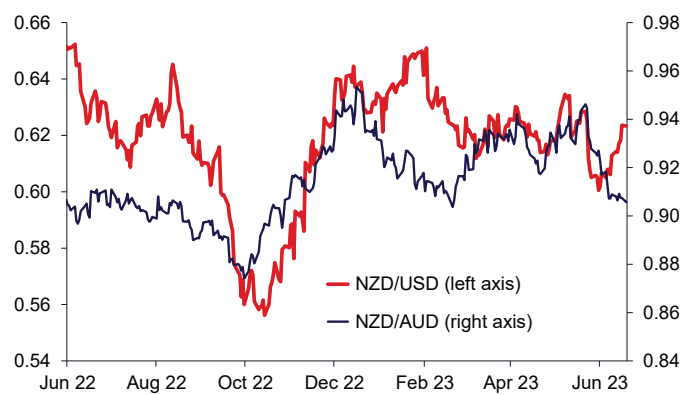
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.5	0.5	6.0	2.7	1.2	0.5
Employment	0.5	0.8	0.4	0.0	3.3	1.6	1.2	-0.4
Unemployment Rate % s.a.	3.4	3.4	3.5	3.7	3.2	3.4	3.9	4.9
CPI	1.4	1.2	1.0	1.9	5.9	7.2	4.7	2.9
Current 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 19 June 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.25%
30 Days	5.60%	5.60%	5.68%
60 Days	5.64%	5.65%	5.75%
90 Days	5.68%	5.68%	5.83%
2 Year Swap	5.35%	5.21%	5.44%
5 Year Swap	4.62%	4.44%	4.58%

NZ foreign currency mid-rates as at 19 June 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6233	0.6050	0.6285
NZD/EUR	0.5695	0.5658	0.5807
NZD/GBP	0.4860	0.4883	0.5048
NZD/JPY	88.32	84.87	86.71
NZD/AUD	0.9057	0.9183	0.9462
TWI	71.45	70.16	72.33

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 19					
NZ	May BusinessNZ PSI	49.8	-	-	Orders have fallen sharply recently.
US	Juneteenth	-	-	-	Public holiday; markets closed.
	Jun NAHB housing market index	50	51	-	Lack of inventory to drive optimism among builders.
Tue 20					
NZ	Q2 WBC-MM Consumer Confidence	77.7	-	-	Has been at low levels in recent months.
Aus	RBA minutes	-	-	-	More colour around the 25bp move.
	RBA Deputy Governor Bullock	-	-	-	Speaking at AI Group.
	RBA Assist' Governor (Fin Mkts) Kent	-	-	-	Panel participant at ISDA/AFMA Forum.
US	May housing starts	2.2%	-0.1%	-	Weakness to come as pipeline runs dry.
	May building permits	-1.4%	0.9%	-	Pessimism to provoke paltry permits.
	Fedspeak	-	-	-	Bullard, Williams.
Wed 21					
NZ	GlobalDairyTrade auction (WMP)	-3.0%	-	-2.0%	Down on strong NZ autumn supply and soft Chinese demand.
Aus	May Westpac-MI Leading Index	-0.78%	-	-	Pointing to an extended period of below-trend growth.
UK	May CPI %ytr	8.7%	8.5%	-	Strong base will decelerate growth but pressure remains.
US	Fedspeak	-	-	-	Powell before House Financial Services Panel; also Goolsbee.
Thu 22					
NZ	May trade balance \$mn	427	-	250	Underlying balance improving gradually as imports soften.
Eur	Jun consumer confidence	-17.4	-	-	Uptrend in confidence limited by rates and inflation.
UK	BoE policy decision	4.50%	4.75%	4.75%	Strong price and wages growth will necessitate a 25bp hike.
US	May Chicago Fed activity index	0.07	-	-	Seeping pessimism slowing activity...
	May leading index	-0.6%	-0.8%	-	... and creating downside risk.
	May existing home sales	-3.4%	-0.7%	-	Lack of inventory and affordability slowing sales.
	Initial jobless claims	262k	-	-	Volatility keeping pundits on toes over outlook.
	Jun Kansas City Fed index	-1	-	-	Blank backlogs bludgeon manufacturing.
	Fedspeak	-	-	-	Powell before Senate Panel; Waller, Bowman, Mester, Barkin.
Fri 23					
Eur	Jun HCOB manufacturing PMI	44.8	-	-	German weakness dragging on manufacturing sentiment...
	Jun HCOB services PMI	55.1	-	-	... services to follow soon enough.
UK	Jun GfK consumer sentiment	-27	-	-	Anticipation of a further rate hike to weigh in on sentiment.
	May retail sales	0.5%	-	-	Some weakness expected as demand declines.
	Jun S&P Global manufacturing PMI	47.1	-	-	Pessimism to remain in manufacturing while...
	Jun S&P Global services PMI	55.2	-	-	... services see a boost.
US	Jun S&P Global manufacturing PMI	48.4	48.5	-	The US is likely to experience similar outcomes...
	Jun S&P Global services PMI	54.9	54.0	-	... though risks for services greater.
	Fedspeak	-	-	-	Bullard, Mester.

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	4.30	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	3.73	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	0.6885	0.69	0.69	0.71	0.72	0.73	0.74
USD/JPY	140.63	138	136	134	132	130	128
EUR/USD	1.0943	1.11	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2786	1.27	1.27	1.28	1.28	1.29	1.29
USD/CNY	7.1311	7.00	6.90	6.80	6.70	6.60	6.50
AUD/NZD	1.1039	1.11	1.11	1.13	1.13	1.12	1.12

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