

# WESTPAC WEEKLY ECONOMIC COMMENTARY

## Frills and thrills.

22 May 2023



Southern rātā

### Westpac Economics Team

✉ [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

🌐 [westpac.co.nz/economics](http://westpac.co.nz/economics)



The 2023 Budget proved to be a lot more spendy than expected, capping off a dramatic week that has seen financial market pricing shift sharply towards the prospect of even more OCR hikes. This week's RBNZ statement will no doubt provide further excitement.

Last Tuesday we released our latest quarterly *Economic Overview*. The key update to our forecasts is that we now expect the Official Cash Rate to peak at 6% this year, from 5.5% previously. There is evidence that the tightening in monetary policy to date is getting traction, and inflation is now on the way down from its highs. But with some fresh upside risks emerging, we think that the Reserve Bank has a bit more work to do to ensure its success.

We still expect the economy to slow down significantly in the year ahead, as homeowners continue to roll on to higher mortgage rates. Higher interest rates, along with rising living costs, will be a drain on many households' budgets, forcing them to wind back their spending.

But in contrast to our previous forecasts, we don't expect to see the economy slip into outright recession. The key reason for this is the resurgence in migration inflows that we've seen since New Zealand reopened its international border last year. Net migration has risen to 65,000 people in the year to March, compared to a net outflow of 20,000 in the previous year. And the pace has accelerated significantly in the last few months.

We expect these flows to continue for a while longer – we now expect a net inflow of 100,000 people over the course of this year. With population growth expected to hit around 2.5% this year, it would be difficult to get the economy to shrink outright.

Admittedly, this combination of a slowing economy and surging migration is unusual. People move to where they see opportunity, so New Zealand typically sees strong inflows when the economy is doing well.

But the current migration surge is not being driven by the economic cycle. Instead, it's a product of the restrictions that were in place during the Covid pandemic. There's clearly a high degree of pent-up demand to live and work in New Zealand, which is now being unleashed. These inflows will eventually run their course, but it's quite uncertain where they will peak in the meantime.

Migration has complex effects on the economy, adding to both capacity and demand to varying degrees across different sectors. The key point here, though, is that the RBNZ regards migration as an inflationary force on balance. And with the RBNZ already stretching the limits of meeting its inflation target

over the ‘medium term’, it doesn’t have a lot of room to wait and see how the effects of how this migration surge play out.

Migration was one of the emerging risks to the inflation outlook that the RBNZ brought up in its April policy review. The other key risk was the fiscal stance. The prospect of a boost to fiscal spending has been on the cards for some time – not least because, as the Treasury has been pointing out, the existing spending allowances would not be enough to keep up with cost pressures in public services.

That risk has now materialised, with last week’s Budget revealing more than \$8bn of additional spending over five years. The operating balance is now expected to remain in deficit until the June 2026 fiscal year, and even the wafer-thin surpluses that are projected beyond that point could be at risk if the economy doesn’t live up to the Treasury’s optimistic growth forecasts in those later years.

This was a lot less conservative than the “no-frills” Budget that the Government had been signalling in the weeks prior. It’s difficult to translate this into what it might mean for the level of demand and inflation pressures in the economy, but it clearly adds to the pressure for a higher OCR peak than the RBNZ was previously looking at.

We expect the RBNZ to lift the OCR by another 25 basis points to 5.5% at next Wednesday’s *Monetary Policy Statement*, and to signal the likelihood of at least one further increase. Beyond that, the RBNZ will want to manage market expectations about the timing and extent of future rate cuts. The fight against inflation is one for the long haul, and they certainly won’t be thinking about taking their foot off the brake before the end of this year.

While our forecast of a 6% OCR peak emerged only a few days ago, market opinion has already swung strongly in that direction. Many of the other major forecasters are now looking for a peak of at least 5.75% this year, and interest rate markets are pricing in a peak of around 5.85% (and a reasonably high chance of a 50bp hike this week).

We don’t necessarily expect that the RBNZ will immediately snap to our view of a 6% peak. That will come down to the strength of the assumptions that it makes around the extent of the migration rebound, the inflationary impact of the Budget, and the emerging signs of life in the housing market. However, if they did lift their OCR projections to as high as 6% now, past behaviour suggests that they would be eager to get to that endpoint quickly – a 50 basis point hike this week is a real possibility.

**Michael Gordon, Senior Economist**

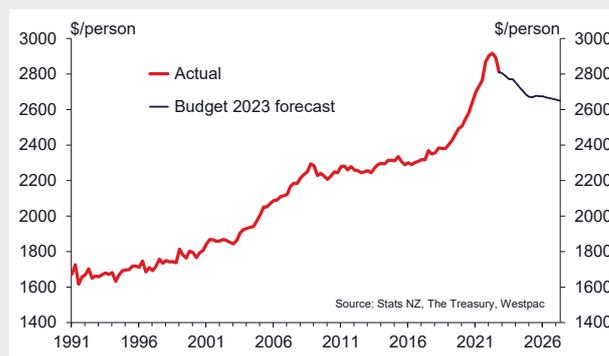
+64 9 336 5670

michael.gordon@westpac.co.nz

## Chart of the week

While the Budget projected a return to modest surpluses in later years, these forecasts assume a high degree of restraint in spending on government services in the years ahead. The Treasury itself notes that this projection “is a significant departure from previous trends, particularly given population growth will likely add to demand.” Indeed, using the Budget forecasts of net migration (which are substantially lower than our own), we estimate that this implies a 9% fall in government consumption per person, drawn out over five years.

Real government consumption per person

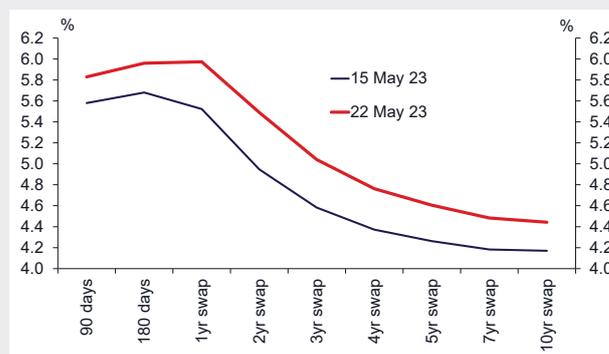


## Fixed vs floating for mortgages

We expect the Official Cash Rate to reach a peak of 6.00% in the coming months. Market pricing is also shifting in this direction, and if the Reserve Bank endorses this view in Wednesday’s *Monetary Policy Statement*, we would expect to see upward pressure on mortgage rates in the coming weeks.

As a result, we see value in fixing now 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 Q1 retail spending volumes

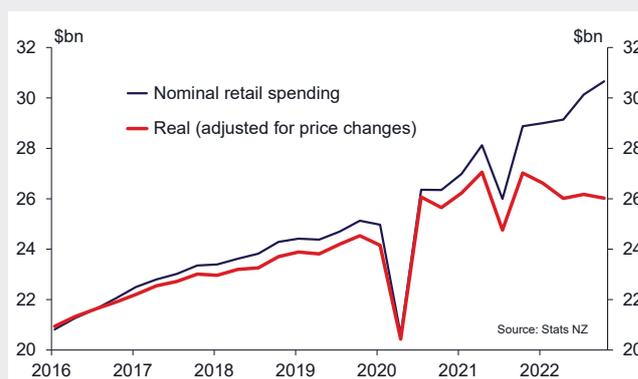
May 24, Last: -0.6%, Westpac f/c: -0.5%

Over the past year, nominal spending has continued to rise at a brisk pace. However, while households are splashing out more cash, the actual amount of goods we've been purchasing hasn't been rising. That's because large price rises have been eroding households' spending power.

We expect that the March quarter retail report will again highlight that financial pressures, including high inflation and rising interest rates, are squeezing households' purchasing power. We're forecasting a 0.5% drop in the volume of goods sold, even as nominal spending levels continue to push higher.

With prices for some durable items dropping back over the quarter, there is some upside risk to our forecast. However, that would still leave us with a picture of flat retail volumes over the past year.

## Retail spending



## RBNZ May Monetary Policy Statement

May 24, Last: 5.25%, Westpac f/c: 5.50%, Market f/c: 5.50%

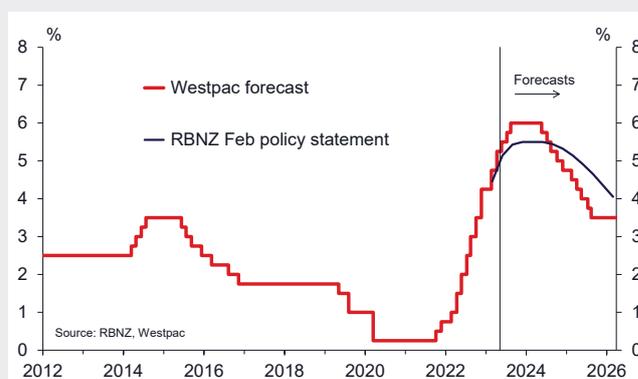
We expect the Reserve Bank to lift the OCR by 25 basis points to 5.5% this week.

Fiscal spending and a surge in migration suggests the need for a higher peak in interest rates than the RBNZ signalled in February.

While the RBNZ may not move immediately to our forecast of a 6% OCR peak, it will signal an openness to getting there. If it were to move into line with our forecast now, then the chance of a 50-point hike next week is high.

We expect an ongoing tightening bias to warn markets off pricing in rate reductions any time in the near future.

## Official Cash Rate forecasts



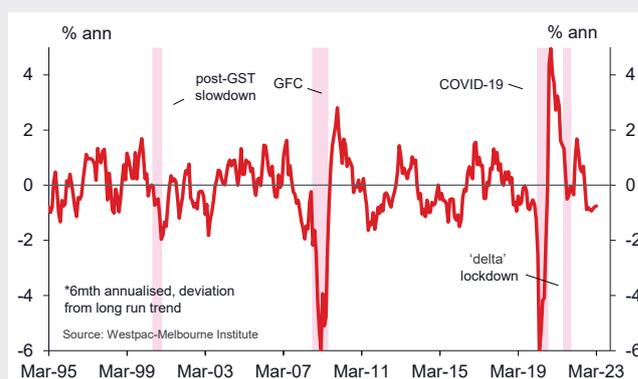
## Aus Apr Westpac-MI Leading Index

May 24, Last: -0.75%

The Leading Index continued to send a weak signal in March, the six-month annualised growth rate lifting only slightly to -0.75% in March from -0.79% in February. The Index continues to point to an extended period of below-trend growth.

The April report is likely to be a similar story. Component updates are again mixed, aggregate hours worked posting a solid 2.6% gain and slight improvements in equities and US industrial production occurring as consumer sentiment based measures retrace sharply and commodity prices fell about 5% in AUD terms.

## Aus Westpac-MI Leading Index



# The week ahead

## Aus Apr retail trade

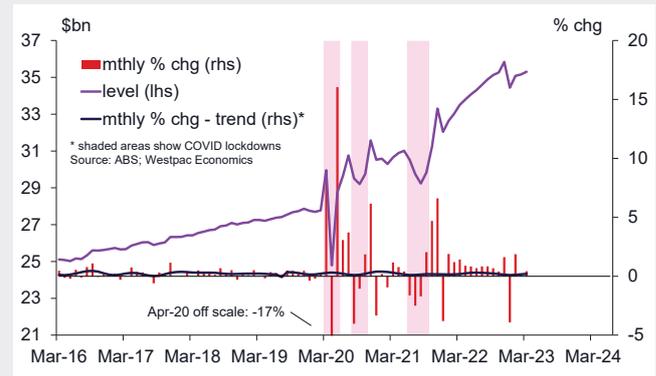
May 26, Last: 0.4%, WBC f/c: -0.2%  
Mkt f/c: 0.2%, Range: -0.2% to 0.6%

Retail sales posted a 0.4% rise in March but were still relatively soft, nominal sales holding flat for Q1 as a whole.

Our Westpac Card Tracker suggests retail segments had a mixed month in April, soft overall but with a brief lift in food segments around the Easter break. The official ABS retail estimates adjust for regular seasonal variations but can struggle with Easter due to shifts in the holiday timing and proximity to other holidays.

More generally, population gains and high inflation provide something of a base to growth in the dollar-value of sales. Judging the extent of this support against the extent of underlying weakness now showing through more clearly in the consumer sector remains tricky. On balance we expect April retail sales to show a slight 0.2% dip but there are risks to either side.

## Aus monthly retail sales



# New Zealand forecasts

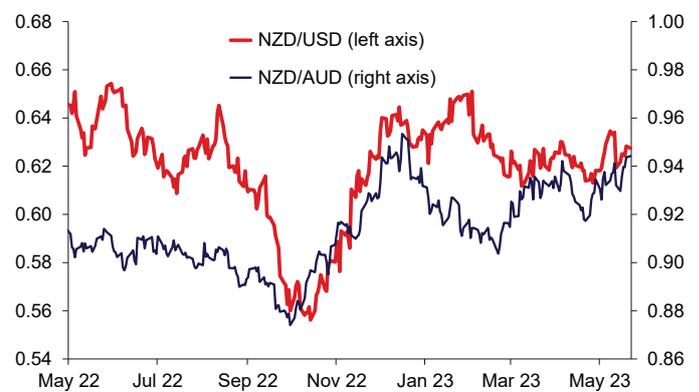
Economic forecasts	Quarterly				Annual			
	2022		2023		2021	2022	2023f	2024f
% change	Sep	Dec	Mar	Jun				
GDP (Production)	1.7	-0.6	-0.2	1.0	6.0	2.4	1.6	0.9
Employment	1.2	0.5	0.8	0.3	3.3	1.6	1.2	-0.3
Unemployment Rate % s.a.	3.3	3.4	3.4	3.5	3.2	3.4	3.9	4.9
CPI	2.2	1.4	1.2	1.0	5.9	7.2	4.7	2.9
Current Account Balance % of GDP	-8.5	-8.9	-8.5	-8.4	-6.0	-8.9	-7.8	-4.8

Financial forecasts	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Cash	5.50	6.00	6.00	6.00	5.75	5.25	4.75
90 Day bill	5.90	6.10	6.10	6.00	5.55	5.05	4.75
2 Year Swap	5.20	5.00	4.80	4.50	4.30	4.10	4.00
5 Year Swap	4.50	4.40	4.30	4.20	4.10	4.00	3.95
10 Year Bond	4.20	4.15	4.10	3.95	3.80	3.75	3.70
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	84.5	85.8	85.8	85.7	85.1	84.4	84.3
NZD/EUR	0.58	0.59	0.60	0.60	0.59	0.59	0.59
NZD/GBP	0.51	0.53	0.53	0.54	0.53	0.53	0.53
TWI	71.5	72.5	72.7	72.5	71.7	71.2	71.0

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 22 May 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.25%	5.25%	5.25%
30 Days	5.65%	5.50%	5.37%
60 Days	5.76%	5.56%	5.47%
90 Days	5.83%	5.62%	5.56%
2 Year Swap	5.49%	5.08%	5.04%
5 Year Swap	4.61%	4.30%	4.33%

NZ foreign currency mid-rates as at 22 May 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6275	0.6346	0.6143
NZD/EUR	0.5808	0.5744	0.5576
NZD/GBP	0.5043	0.5011	0.4935
NZD/JPY	86.63	85.69	82.67
NZD/AUD	0.9442	0.9340	0.9196
TWI	72.29	72.03	70.02

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 22</b>					
Eur	May consumer confidence	-17.5	-16.9	-	Confidence is resilient given cost-of-living and rates.
US	Fedspeak	-	-	-	Bullard, Bostic, Barkin.
<b>Tue 23</b>					
Aus	RBA Head of Domestic Mkts, Jacobs	-	-	-	Speaking at Fixed Income Forum, Tokyo.
Eur	May HCOB manufacturing PMI	45.8	46.0	-	Manufacturing under intense pressure as demand weakens...
	May HCOB services PMI	56.2	55.5	-	... tourism's recovery is key to services' outperformance.
UK	May S&P Global manufacturing PMI	47.8	-	-	The UK's own experience looks broadly in line with Europe...
	May S&P Global services PMI	55.9	-	-	... as manufacturing struggles while services advance.
US	May S&P Global manufacturing PMI	50.2	50.0	-	Improvements in manufacturing and services short-lived...
	May S&P Global services PMI	53.6	52.6	-	... as growth slowdown materialises upon rates impact.
	Apr new home sales	9.6%	-3.4%	-	Longer-term uptrend will come as supply comes online.
	May Richmond Fed index	-10	-	-	Regional investment detail pointing to subdued outlook.
	Fedspeak	-	-	-	Logan.
<b>Wed 24</b>					
NZ	Q1 real retail sales	-0.6%	-	-0.5%	Price rises continuing to weigh on spending.
	RBNZ policy decision	5.25%	5.50%	5.50%	Upward pressure on the OCR track from Budget, migration.
Aus	Apr Westpac-MI Leading Index	-0.75%	-	-	Pointing to an extended period of below-trend growth.
UK	Apr CPI %yr	10.1%	-	-	Moderation in food and discretionary services is key.
US	FOMC May meeting minutes	-	-	-	On hold or one more; consensus opinion critical to assess.
<b>Thu 25</b>					
US	Initial jobless claims	242k	-	-	Has lifted in recent weeks but still low versus history.
	Q1 GDP, annualised	1.1%	1.1%	-	No change anticipated in second estimate.
	Apr Chicago Fed activity index	-0.19	-	-	In line with broader evidence of weakening economy.
	Apr pending home sales	-5.2%	-	-	No indication of sustained improvement for now.
	May Kansas City Fed index	-10	-	-	Regional investment detail pointing to subdued outlook.
<b>Fri 26</b>					
NZ	May ANZ consumer confidence	79.3	-	-	Financial pressures continue to weigh on sentiment.
Aus	Apr retail sales	0.4%	0.2%	-0.2%	Consumer slowdown becoming clearer.
UK	Apr retail sales	-0.9%	-	-	Disposable income pressures weighing on retail spending.
US	Apr personal income	0.3%	0.4%	-	Slowing income growth and elevated inflation...
	Apr personal spending	0.0%	0.4%	-	... to keep pressure on household's spending capacity.
	Apr PCE deflator	0.1%	0.3%	-	Attention is centred on services inflation.
	Apr durable goods orders	3.2%	-1.0%	-	Weakness in core orders pointing to subdued demand.
	Apr wholesale inventories	0.0%	-	-	Inventories at risk given uncertainty over activity outlook.
	May Uni. of Michigan sentiment	57.7	57.7	-	Final estimate.
<b>Sat 27</b>					
Chn	Apr industrial profits ytd %yr	-21.4%	-	-	Profit growth will take time to recover from COVID-zero.

# International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022f	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	4.0	3.1
Unemployment rate %	5.2	6.8	4.7	3.5	4.5	5.0
Current account % of GDP	0.7	2.4	3.1	1.2	1.2	0.3
<b>United States</b>						
Real GDP %yr	2.3	-2.8	5.9	2.1	1.1	0.6
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
<b>Japan</b>						
Real GDP %yr	-0.4	-4.3	2.1	1.0	1.2	1.0
<b>Euro zone</b>						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.4
<b>United Kingdom</b>						
Real GDP %yr	1.6	-11.0	7.6	4.3	-0.2	1.2
<b>China</b>						
Real GDP %yr	6.0	2.2	8.4	3.0	6.2	5.5
<b>East Asia ex China</b>						
Real GDP %yr	3.8	-2.3	4.3	4.5	4.1	4.4
<b>World</b>						
Real GDP %yr	2.8	-2.8	6.3	3.3	3.0	3.1

Forecasts finalised 5 May 2023

Interest rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
<b>Australia</b>								
Cash	3.85	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.93	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.59	3.40	3.30	3.20	3.00	2.80	2.70	2.50
<b>International</b>								
Fed Funds	5.125	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.63	3.50	3.40	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	0.6644	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	138.19	132	130	128	127	126	125	124
EUR/USD	1.0783	1.11	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2416	1.25	1.25	1.26	1.26	1.27	1.28	1.29
USD/CNY	7.0323	6.75	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0632	1.08	1.09	1.10	1.11	1.13	1.13	1.13

# Contact the Westpac economics team

**Kelly Eckhold, Chief Economist**

+64 9 348 9382

**Michael Gordon, Senior Economist**

+64 9 336 5670

**Satish Ranchhod, Senior Economist**

+64 9 336 5668

**Nathan Penny, Senior Agri Economist**

+64 9 348 9114

**Paul Clark, Industry Economist**

+64 9 336 5656

**Any questions email:**

[economics@westpac.co.nz](mailto:economics@westpac.co.nz)

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- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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