WESTPAC WEEKLY ECONOMIC COMMENTARY

Some rough and some smooth.

25 September 2023

Southern rātā

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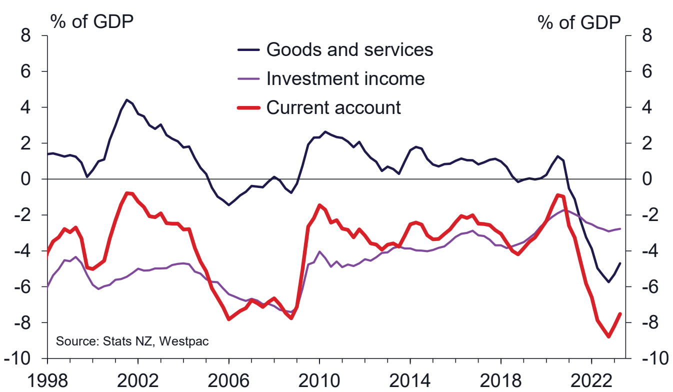
Last week was a bumper one for data in New Zealand. It also contained a few surprises – both positive and negative – that provided some insights about how the interest rate outlook may evolve in coming months.

Some positive news came in the form of the June quarter current account deficit, which showed a marked improvement to 7.5% of GDP. Revisions explained a good amount of the improvement, but it's good to see we have moved noticeably away from that cycle low point of 8.8% of GDP. Exports of services are picking up as tourism recovers, but imports remain high reflecting the still overheated domestic economy.

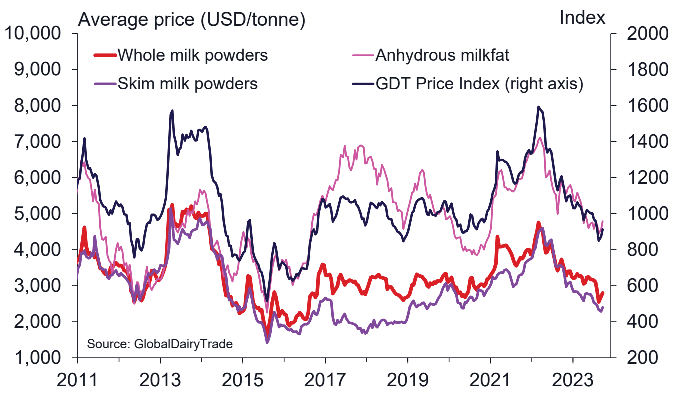
Annual current account balance



We expect some further improvement as the full impact of past monetary tightening brings the economy well off the boil. Even so, it's likely we are going to maintain a relatively high deficit for the foreseeable future given the current weak terms of trade and environmental constraints faced by commodity exports. Ratings agencies and foreign investors will be comforted by the improving trend in the current account, but also watchful at the level given the current weak fiscal position. Our note on risks to the exchange rate are relevant here also. We can't pat ourselves on the back on this one quite yet!

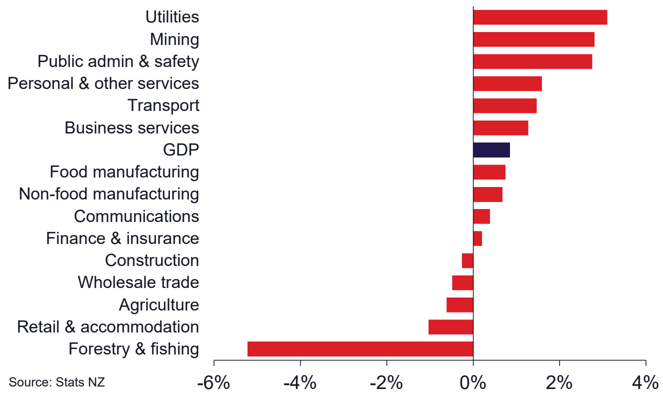
Last week also saw the second consecutive increase in dairy prices in the second of this month's GDT auctions. Two swallows don't make a summer, but it was certainly a relief to the agricultural sector to see another 4.6 % increase in average product prices. Prices for whole milk powder have now rebounded 10.4% from the lows, though they remain around 10% below their end-July levels. It was comforting to see increased participation by Chinese buyers and this outcome has helped balance the downside risks we were seeing to our $6.75 milk price forecast for the current season. However, it's important to keep in mind that the terms of trade is still down around 7% from its peak this cycle, so this year is not going to be a great one for commodities exporters and there will be a significant drag on incomes. Prices now appear broadly in line with the levels assumed by the RBNZ in their August *Statement* but remain a bit lower than we factored into our August *Overview* projections.

GlobalDairyTrade auction prices



The big-ticket item last week was the June quarter GDP report. This showed that the economy rebounded following two soft quarters. Indeed, GDP grew a sturdy 0.9% during the quarter and 1.8% over the year, which was considerably higher than market expectations (and even a touch over our own top of market 0.8%/1.5% call). Importantly, the outcome was also much stronger than the RBNZ's forecast of 0.5% growth in the quarter. The general picture showed few surprises in terms of the composition of growth. As we expected growth was driven by the service sector, including a strong lift in business services and government-related spending. Unfortunately, as we noted in our full review of the GDP report, even given the rebound in June there has been no growth in per capita terms over the past year.

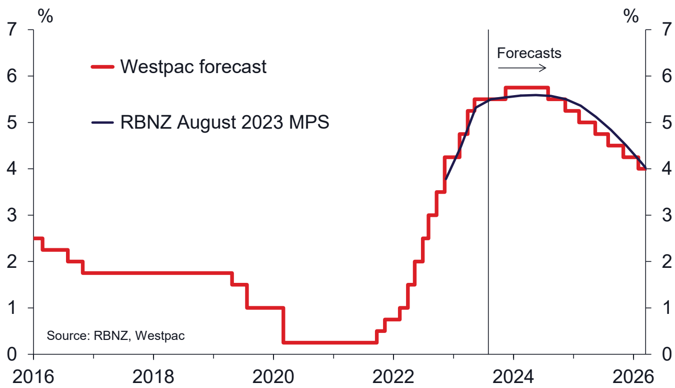
Q2 GDP quarterly change by industry



New Zealand's GDP data can be volatile at the best of times – even more so given the lingering impact of the pandemic and this year's storms. Looking through the noise, the economy is still slowing, but it's doing so from an even more overheated position than we had assumed. All else equal, that means it's going to take a bit longer to get the economy back to a position where disinflationary pressure is strong enough to get inflation back inside the 1-3% target range. There will be implications for the RBNZ's assessment of the output gap. The RBNZ estimated potential output growth of 0.8% for the June quarter, so there will be less disinflation pressure coming out of this GDP outcome.

However, it's important to put these signs of ongoing inflation pressures in perspective. At the time of the August MPS, the RBNZ's projections indicated that the Monetary Policy Committee saw only a 40% change of the OCR rising to 5.75% in the first half of 2024. We don't think that the data flow over the past week will have been strong enough to push the RBNZ's view into line with our own i.e., that the OCR will need rise to 5.75% at the November *Monetary Policy Statement*. Certainly, we see the risks of a tightening at the October *Monetary Policy Review* as still being modest: perhaps a 10-20% chance.

Official Cash Rate

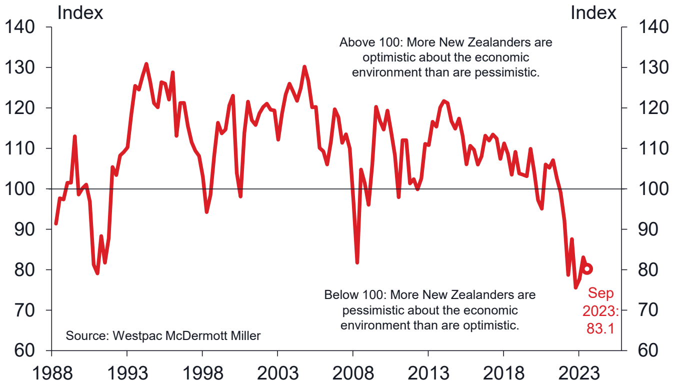


The RBNZ's Monetary Policy Committee is already acutely aware of the lingering inflation pressures in the economy. We expect they will be closely watching upcoming inflation-related indicators in October and November for a more definitive guide on whether quarterly inflation rates will step down significantly from the December quarter as forecast. Of particular importance will be the September quarter CPI, especially the various gauges of core inflation which are yet to show material signs of deceleration. Important also will be pricing indicators in upcoming business confidence surveys (the QSBO and ANZBO), as well as wages and employment indicators in the September quarter labour market report (due early November). The strength of wage growth will be crucial for determining how quickly services prices and non-tradables inflation will slow from their current elevated levels. We doubt the RBNZ will want to move ahead of seeing this important information (in their shoes, we wouldn't).

As noted above, we don't think there is much debate that growth is slowing and that it will be very flat (possibly even recessionary) in the second half of 2023. Last week the long running Westpac-McDermott Miller Consumer Confidence Survey confirmed that consumer confidence remains in the doldrums and households are keeping the purse strings tight. Cost of living pressures remain intense and interest costs for leveraged households are steadily increasing as past tightening impacts household budgets.

The issue is really about how fast the current red-hot inflation pressures will ease. Importantly, it looks like the risk on this front are becoming tilted towards more persistent price pressures, with the housing market turning up and population growth at historic high levels. Hence, the various gauges of wage and price pressures will be key to determining the RBNZ's monetary policy approach from here – is it higher or just longer?

Consumer confidence



This dilemma is also facing other central banks around the globe. Indeed, last week the Federal Reserve indicated that it now expects its policy rate to remain elevated for longer than had been forecast back in June. This essentially validated the market's repricing of the US interest rate curve over the past couple of months, which has seen the 10-year US Treasury yield rise to levels last seen in 2007. On that score, our international team have again revised up their forecast for US bond yields and that has flowed through to our forecast of the outlook for bond yields in New Zealand. For example, we now see the 10Y NZGB yield ending this year at around 5.2%, which is 35bps higher than forecast previously. While we see the 10-year yield declining to 4.65% by the end of next year, this is still 55bps higher than we had forecast previously.

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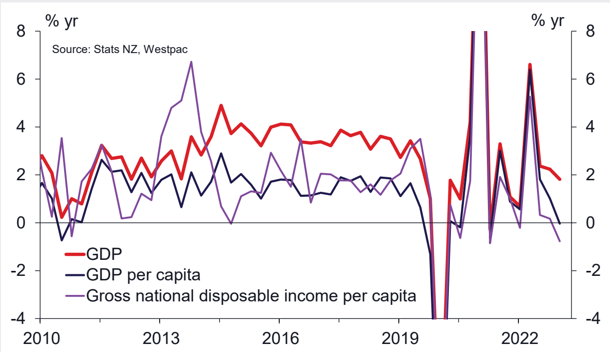
Chart of the week

Last week's GDP report indicated that the economy grew 1.8% in the year to June – below trend, but at face value certainly not weak. Yet as indicated by Westpac's consumer confidence index, household sentiment remains at deeply negative levels. How can this be?

One part of the explanation is that GDP growth over the past year owed entirely to a very high rate of population growth. In per capita terms, there was no growth at all over this period. Worse still, real gross national disposable income – which measures the real purchasing power of residents' disposable income – fell 0.8% on a per capita basis over the past year. This reflects a near 3% decline in the terms of trade. Looking ahead, on a per capita basis, GDP and disposable income is likely to fall further over the next year.

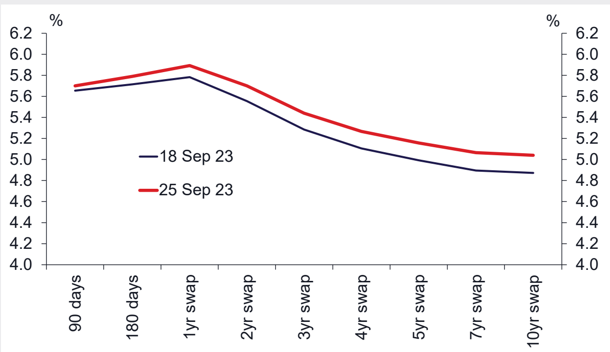
GDP measures



Fixed vs floating for mortgages

We think the current best value for borrowers is fixing for two years. 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

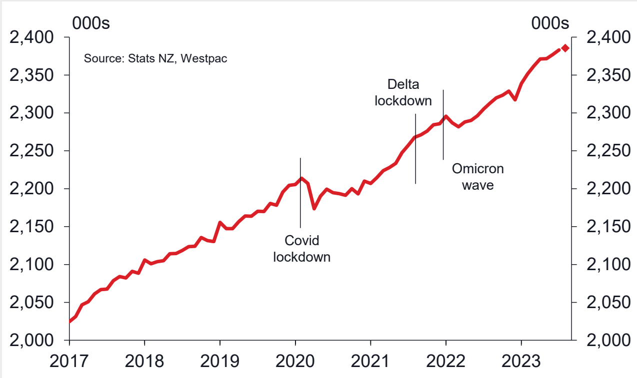
NZ August monthly employment indicator

Sep 28, Last: +0.3%, Westpac f/c: 0.1%

The monthly employment indicator is drawn from income tax data, making it a fairly comprehensive record of the number of people in work. And helpfully, while there are conceptual differences, it does a very good job of predicting the more widely followed quarterly household survey measure of employment.

Job growth was very robust over the first half of 2023, with a surge in migrant inflows allowing employers to fill longstanding vacancies. However, the weekly snapshots provided by Stats NZ suggest that the uptrend has slowed in recent months and so we expect only modest growth to be reported for August (insufficient to soak up growth in the labour force).

NZ monthly filled jobs



NZ Sep ANZBO business confidence

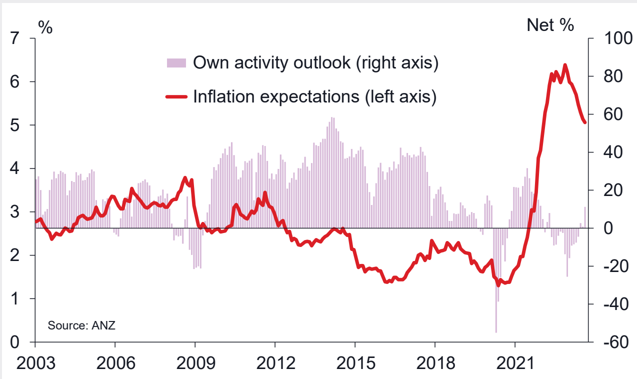
Sep 28, Last: –3.7

While still low, business confidence has been pushing higher in recent months, climbing to a two-year high in August. Businesses' expectations for their own trading activity has also been improving. That's despite the continued pressure on margins.

We'll be watching to see if the lift in business sentiment continues in September. Our recent discussions with businesses around the country did highlight softening demand, however conditions are mixed across sectors. Business confidence in New Zealand is also strongly influenced by political cycles, and the upcoming election could have a bearing on the survey results.

Recent surveys have pointed to easing, but still strong inflation pressures. However, the fall in the NZD and rise in oil prices will be adding to operating costs for many businesses.

Business confidence



Aus Aug Monthly CPI Indicator %yr

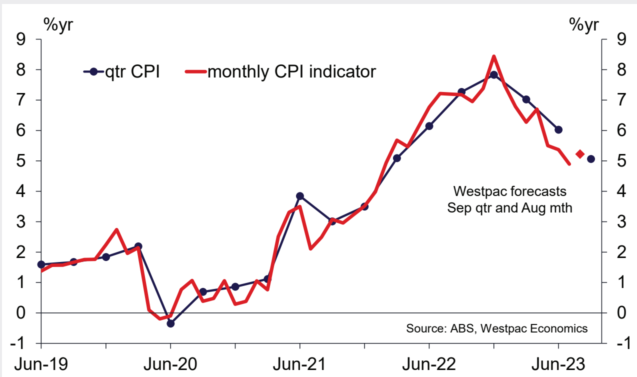
Sep 27 Last: 4.9%, WBC f/c: 5.2%
Mkt f/c: 5.2%, Range: 4.8% to 5.6%

The Monthly CPI Indicator lifted 0.3% in July to be up 4.9% in the year, a moderation from the 5.4%yr in June and the recent peak of 8.4%yr in December. The July print was softer than market expectations of 5.2% but close to our own forecast of 4.8%yr.

Readers would be aware that the Monthly Indicator is not a true monthly inflation measure, but rather the release of the data for the quarterly CPI as it becomes available. Much of the data is monthly, but a fair proportion is only available quarterly, and is released in the month of the quarter the survey is conducted, with a smaller proportion of annual data. As such incorporating the timing of these surveys in critical to understanding the monthly CPI.

Petrol prices rose close to 8% in August while diesel is up more than 12% so auto fuel will be a meaningful factor. August also sees a large range of quarterly services prices being surveyed ranging from hairdressing and motor vehicle maintenance to insurance.

Aus CPI Monthly Indicator vs. qtr CPI



The week ahead

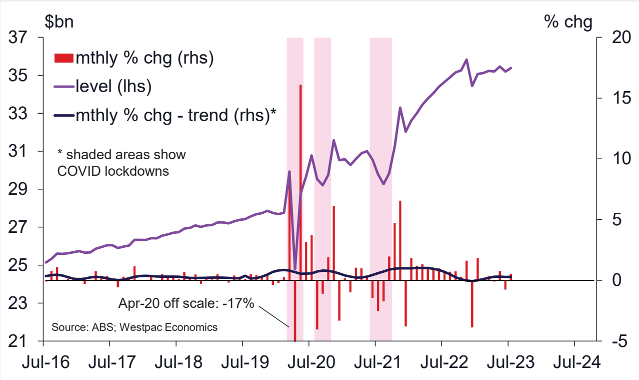
Aus Aug retail trade

Sep 28, Last: 0.5%, WBC f/c: 1.0%
Mkt f/c: 0.3%, Range: 0.0% to 1.0%

Retail sales rose by 0.5% in July, a slightly better month but still in line with a relatively flat underlying trend, nominal sales up just 0.5% on a three-month basis. Annual sales growth has slowed from 7.5% at the start of the year to 2.1%yr in July. With population growth running at 2.3%yr and price inflation in the retail space running at 5%yr, the result implies a large decline in the 3-3.5% range in real per capita terms.

Our Westpac Card Tracker suggests retail spending was firmer in August, led by a lift in activity in the hospitality sector relating to the FIFA Women's World Cup. We expect the official retail sales figures to show a relatively strong 1% gain for the August month, centred on cafes & restaurants. Activity is likely to soften again in September, reverting to what is still a weak underlying trend.

Aus monthly retail sales



Aus Q3 job vacancies (%qtr)

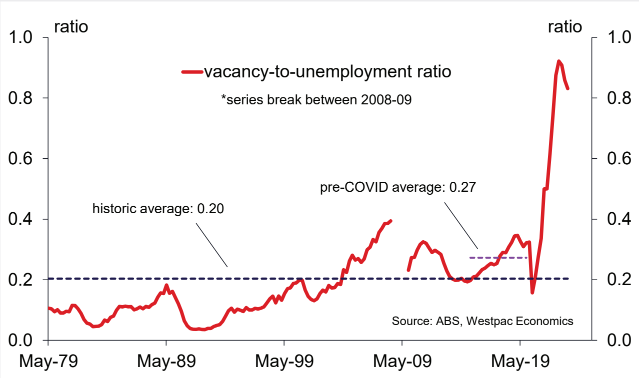
Sep 28, Last: –2.0%

Job vacancies moderated only slightly between February and May, down 9.0k (–2.0%). At 432k, job vacancies are only 10% below the peak observed over a year ago in May 2022 and almost twice the level observed before the pandemic. Highlighting the extreme tightness of the labour market, the vacancy-to-unemployment ratio was 0.82 as of May, well above the pre-pandemic average of 0.27.

For the Q3 (August) update, a larger decline in job vacancies is to be expected as positions continue to be filled and/or unfilled positions are removed. However, the mix between these dynamics is uncertain, creating difficulty in interpretation, particularly in the context of a moderation from a historically elevated level.

As an ad-hoc benchmark, the average rate required for vacancies to return to pre-COVID levels by end-2024 is –34k/qtr (–8%). A result in this realm would send a clear signal that labour demand is easing from a "red-hot" level. But, a print closer to May's observation would raise questions around how much longer this tightness can last.

Aus vacancy-to-unemployment ratio



Aus Aug private sector credit

Sep 29, Last: 0.3%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: 0.3% to 0.4%

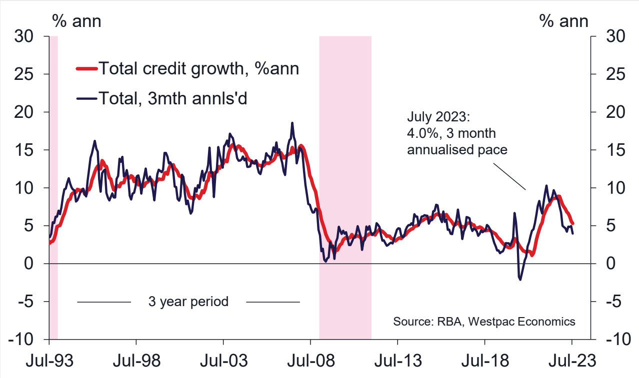
Private sector credit growth is subdued – a trend that is set to continue as interest rates remain elevated and with the economy on a sub-trend growth path.

Credit growth edged lower in June, down from 0.4% to 0.3% and then held at that 0.3% rate in July.

For August, we expect another 0.3% reading. That will see annual growth slow to 5.0% and the three month annualised pace slip from 4.0% to 3.6% – the softest since the start of 2021.

Housing credit growth has held steady at 0.3% each month for the period December to July. This is as the property market stabilises, with some lift in new lending and an offsetting rise in repayments. Business credit grew by 0.25% in June and July, a step down from a 0.5% average, reflecting the more downbeat economic backdrop.

Aus credit: growth pulse a subdued 4.0%

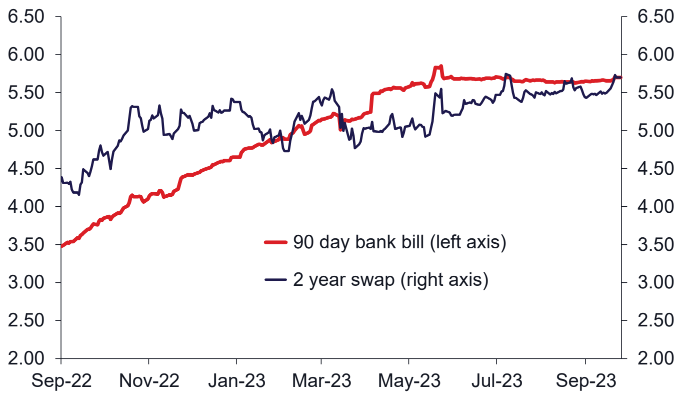


New Zealand forecasts

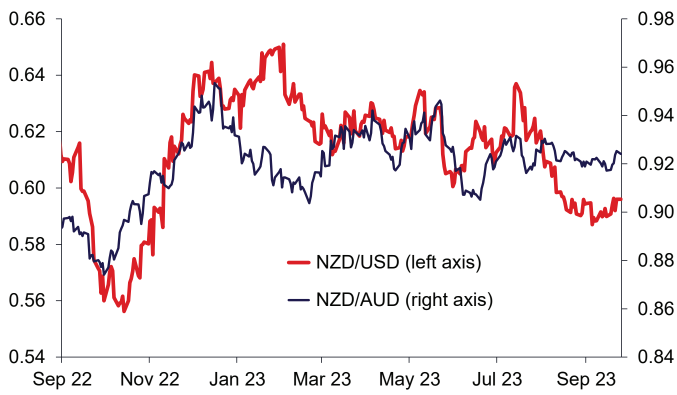
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.5	0.0	0.9	-0.1	6.0	2.7	1.3	0.4
Employment	0.7	1.1	1.0	0.3	3.3	1.7	2.3	0.0
Unemployment Rate % s.a.	3.4	3.4	3.6	3.8	3.2	3.4	4.3	5.2
CPI	1.4	1.2	1.1	2.0	5.9	7.2	4.9	2.9
Current Account Balance % of GDP	-8.8	-8.2	-7.5	-7.5	-5.8	-8.8	-7.0	-4.9

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	5.65	5.85	5.85	5.85	5.60	5.35	5.10
2 Year Swap	5.52	5.59	5.39	5.16	4.91	4.68	4.44
5 Year Swap	4.87	4.74	4.62	4.51	4.38	4.26	4.15
10 Year Bond	4.90	5.20	5.05	4.90	4.75	4.65	4.55
NZD/USD	0.59	0.61	0.61	0.62	0.62	0.62	0.63
NZD/AUD	0.92	0.92	0.92	0.91	0.90	0.89	0.88
NZD/JPY	85.6	87.8	87.2	86.4	85.6	84.9	83.4
NZD/EUR	0.55	0.55	0.55	0.55	0.55	0.55	0.55
NZD/GBP	0.46	0.48	0.48	0.48	0.48	0.48	0.48
TWI	69.1	70.3	69.9	69.4	68.9	68.6	68.2

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 25 September 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%	5.63%	5.62%
90 Days	5.70%	5.66%	5.64%
2 Year Swap	5.70%	5.52%	5.58%
5 Year Swap	5.16%	4.95%	4.99%

NZ foreign currency mid-rates as at 25 September 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5960	0.5915	0.5902
NZD/EUR	0.5593	0.5512	0.5459
NZD/GBP	0.4862	0.4726	0.4690
NZD/JPY	88.44	86.90	86.49
NZD/AUD	0.9241	0.9202	0.9209
TWI	70.21	69.78	69.56

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 25					
Aus	RBA Assist' Gov. Financial Systems	–	–	–	Jones; panel participant in financial technology conference.
US	Aug Chicago Fed activity index	0.12	–	–	Abating recession risks could see the index rise.
	Sep Dallas Fed index	–17.2	–15.7	–	Sentiment still low as new orders remain weak.
	Fedspeak	–	–	–	Kashkari.
Tue 26					
US	Jul FHFA house prices	0.3%	–	–	House prices are rising however...
	Jul S&P/CS home price index	0.92%	–	–	... growth will remain modest until rate cuts come through.
	Aug new home sales	4.4%	–2.0%	–	Builder discounts are assisting in the uptick of sales.
	Sep consumer confidence index	106.1	105.9	–	Confidence to receive support from extended pause.
	Sep Richmond Fed index	–7	–	–	Will give an indication of inflation pressures in the region.
Wed 27					
NZ	Q3 Westpac–MM employment conf	105.6	–	–	Labour market confidence softened in the June quarter.
Aus	Aug Monthly CPI Indicator %yr	4.9%	5.2%	5.4%	An important update on services inflation.
Chn	Aug industrial profits %yr	–6.7%	–	–	Weaker demand and stronger prices are squeezing profits.
US	Aug durable goods orders	–5.2%	–0.4%	–	Weakness to persist as global and local demand pulls back.
Thu 28					
NZ	Aug employment indicators	0.3%	–	0.1%	Weekly data suggest that job growth is beginning to slow
	Sep ANZ business confidence	–3.7	–	–	Confidence has picked up, but businesses still downbeat.
Aus	Aug retail sales	0.5%	0.3%	1.0%	'Matilda–mania' gives a brief reprieve from weak retail reads.
	Q3 job vacancies	–2.0%	–	–	Scope for a larger fall as vacant positions are filled/removed.
Eur	Sep consumer confidence	–	–	–	ECB's pause should help shore up confidence...
	Sep economic confidence	93.3	–	–	...in the economy but consumer optimism is some way off.
UK	Sep Nationwide house prices	–0.8%	–	–	Slower transmission of rate rises are limiting price falls.
US	Q2 GDP, annualised	2.1%	2.3%	–	Final estimate. Upward revisions expected.
	Aug pending home sales	0.9%	–	–	Lifting slowly but surely.
	Sep Kansas City Fed index	0	–	–	Low demand leading to weaker sentiment.
	Initial jobless claims	201k	–	–	To remain near lows, for now.
	FOMC Chair Powell speaking.	–	–	–	As well as FOMC's Goolsbee and Barkin.
Fri 29					
NZ	Sep ANZ consumer confidence	85.0	–	–	Set to remain low in the face of strong financial headwinds.
Aus	Aug private sector credit	0.3%	0.3%	0.3%	Subdued – with rates elevated, sub–trend economic growth.
Jpn	Sep Tokyo CPI %yr	2.9%	2.8%	–	Lower energy prices driving down CPI.
	Aug jobless rate	2.7%	2.6%	–	Unemployment returning to its pre–COVID rate.
	Aug industrial production	–1.8%	–0.8%	–	Weak export demand weighing on output.
Chn	Sep Caixin manufacturing PMI	51.0	50.2	–	Recent stimulus measures should support PMIs ahead...
	Sep Caixin services PMI	51.8	–	–	... but it is too soon to see the impact.
Eur	Sep CPI %yr	–	–	–	Energy prices coming down but transport a key risk.
UK	Q2 GDP	0.2%	–	–	Final estimate.
	Aug net mortgage lending £bn	0.2	–	–	Benign growth as high rates keep loans out of reach.
US	Aug personal income	0.2%	0.5%	–	Wages growth sustaining income gains as job growth slows...
	Aug personal spending	0.8%	0.4%	–	... allowing spending to continue rising.
	Aug PCE deflator	0.2%	0.5%	–	Likely to broadly match CPI outcome for month.
	Sep Chicago PMI	48.7	47.6	–	Reflective of soft manufacturing conditions
	Aug wholesale inventories	–0.2%	–	–	Businesses uncertain of demand, keeping less inventory.
	Sep Uni. of Michigan sentiment	67.7	–	–	Final estimate.
	Fedspeak	–	–	–	Williams.
Sat 30					
Chn	Sep NBS manufacturing PMI	49.7	–	–	Our best guide to employment momentum across industry...
	Sep NBS non–manufacturing PMI	51.0	–	–	... and services, the latter of which remains key for confidence.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	2023f	2024f
Australia						
Real GDP %yr	1.9	-1.8	5.2	3.7	1.9	1.2
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	3.0	1.1	1.2	0.5
United States						
Real GDP %yr	2.3	-2.8	5.9	2.1	2.2	1.4
CPI inflation %yr	1.9	1.2	7.2	6.4	2.7	2.2
Unemployment rate %	3.7	8.1	5.4	3.6	3.7	4.7
Current account % of GDP	-2.6	-2.5	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	-0.4	-4.3	2.1	1.1	1.6	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.2
United Kingdom						
Real GDP %yr	1.6	-11.0	7.6	4.0	0.3	0.5
China						
Real GDP %yr	6.0	2.2	8.4	3.0	5.0	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.3	4.5	3.5	4.2
World						
Real GDP %yr	2.8	-2.8	6.3	3.4	3.0	3.1

Forecasts finalised 13 Sep 2023

Interest rate forecasts	Latest	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Australia								
Cash	4.10	4.10	4.10	4.10	3.85	3.60	3.35	3.10
90 Day BBSW	4.15	4.30	4.30	4.22	3.97	3.72	3.47	3.22
10 Year Bond	4.36	4.35	4.20	4.00	3.90	3.80	3.70	3.60
International								
Fed Funds	5.375	5.375	5.125	4.875	4.625	4.375	4.125	3.875
US 10 Year Bond	4.49	4.50	4.35	4.20	4.10	4.00	3.90	3.80

Exchange rate forecasts	Latest	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
AUD/USD	0.6427	0.66	0.67	0.68	0.69	0.70	0.71	0.72
USD/JPY	148.03	144	142	140	138	136	133	130
EUR/USD	1.0655	1.10	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2285	1.27	1.28	1.29	1.30	1.30	1.30	1.30
USD/CNY	7.3015	7.15	7.00	6.90	6.80	6.70	6.60	6.50
AUD/NZD	1.0824	1.08	1.10	1.10	1.11	1.13	1.13	1.14

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