

WESTPAC WEEKLY ECONOMIC COMMENTARY

Household finances still in the vice.

26 June 2023



Southern rātā

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The mood among New Zealand households has remained gloomy in the face of mounting financial pressures. That ongoing pessimism reinforces our expectations for subdued household spending and economic growth over the months ahead.

While our Westpac McDermott Miller Consumer Confidence Index did rise 5.4 points in June, it currently sits at just 83.1. That's well below average and signals that the number of households who are feeling pessimistic about the economic landscape outweighs those who are optimistic by a wide margin. Consumer confidence has been lingering at extremely low levels for more than a year now, with confidence weak across all regions, age groups and income brackets.

This downbeat assessment of economic conditions is despite New Zealand's strong labour market. Unemployment is currently just 3.4% and disposable incomes have risen by 6.5% over the past year.

But even as earnings have pushed higher, the majority of households are reporting that their finances are being squeezed. In fact 43% of the households we spoke to in June told us that their financial position had deteriorated over the past year, while just 14% had seen an improvement.

That pressure on household finances is coming on two big fronts. First, living costs have been charging higher, with consumer prices up 6.7% over the past year. Notably, a big

chunk of that increase has been due to increases in the costs of necessities – housing and utility costs were up 7% in the year to March and food prices were up an eye watering 12% in the year to May. Those cost increases are hitting every family in the country in the pocket. They have been especially tough on those families who are on lower incomes, who tend to spend a larger share of their income on necessities.

The other big factor squeezing many households' finances has been the rise in mortgage rates. Interest rates have been on the rise for well over a year now. However, with around 90% of New Zealand mortgages on fixed rates, many borrowers were insulated from those increases for a period. But that picture has now changed. Large numbers of mortgages have now rolled on to higher interest rates. In fact, accounting for the extent of interest rate fixing, we estimate that the average 'effective' mortgage rate that New Zealand borrowers are actually paying has increased by around 120 bps since early 2022.

And there's more pain to come on this front. Around 50% of all fixed rate mortgages will come up for repricing over the year ahead, and the average mortgage rate is set to rise by a further 150 bps by early 2024. That will see the average household's

spending on interest costs increasing from around 5% of their disposable income in 2022 to 10% in 2024, and some borrowers will face much larger increases.

In the face of these powerful financial headwinds, overall spending levels in the economy have actually remained firm in recent months. However, that apparent resilience in the headline spending figures masks a much softer picture beneath the surface. Although nominal spending levels have been pushing higher, those gains are entirely due to the impact of price increases. The amount of goods that households have actually been taking home has been trending down for the past year.

Crucially, with financial headwinds continuing to mount, households are likely to continue to rein in their spending over the coming months. In fact, we expect that per capita household spending will fall by around 2% over 2023 and 2024 combined. Household spending accounts for around 60% of overall economic activity, and the retrenchment that is already in train will be a significant drag on economic growth.

But while there's no denying that many households are grappling with some big challenges, consumer confidence has actually picked up a bit from the record lows we saw at the end of last year. And looking ahead, there's reason to think that we could see a further rise over the coming months with some big shifts in the economic landscape already in train. Notably, the interest rate cycle is looking close to a peak. Consistent with that, we're already seeing signs that the housing market is finding a base, with both house sales and prices rising over the past few months. In addition, the high rates of inflation that have been eating away at households' spending power have started to moderate, and a further easing is on the cards over the coming year.

Furthermore, while mounting financial pressures will be tough for many households, the slowdown still looks like it will be manageable for the economy as a whole. On average, New Zealand households are entering the current downturn with their finances in good shape. In addition to a strong labour market, savings rates have picked up in recent years. At the same time, many households have taken advantage of the low interest rates in recent years to get ahead on their mortgage payments. And while interest costs are pushing higher, that's been a rise from extraordinarily low levels – mortgage rates are currently sitting around the averages we saw through the past decade.

Satish Ranchhod, Senior Economist

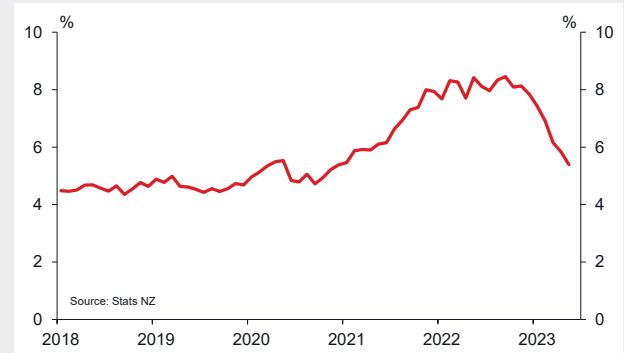
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Chart of the week

Global shipping costs have been falling over the past year. However, shipping costs for many New Zealand importers have been slow to decline as large amounts of global shipping capacity have been diverted to the US and other northern hemisphere markets. That picture is changing, with transport costs now also trending down here. While transport costs remain above pre-pandemic levels, the decline in recent months will help to dampen inflation in the prices of many imported consumer goods.

Freight and insurance (% of import costs)

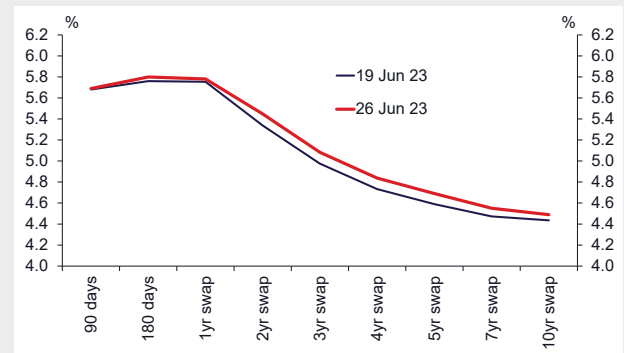


Fixed vs floating for mortgages

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

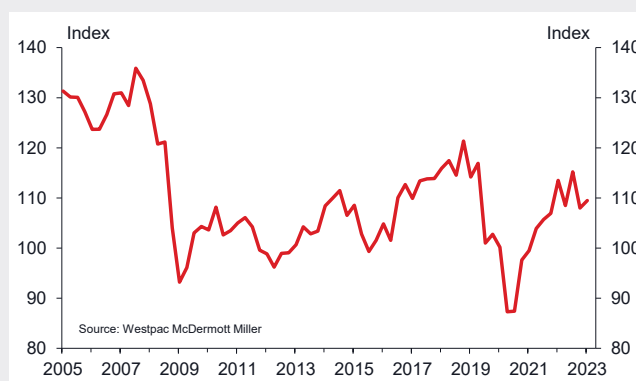
NZ Q2 Westpac McDermott Miller Employment Confidence Index

Jun 27, Last: 109.5

In contrast to the steep decline in consumer confidence, New Zealand households have stayed relatively positive about the state of the labour market. In particular, job opportunities have been seen as plentiful, reflecting a strong demand for workers and the low unemployment rate. However, perceptions about earnings growth remain subdued.

Our latest survey was conducted in the first half of June. Since the last survey, the unemployment rate has held steady at 3.4% and inflation has eased from its peak. Net inward migration has surged since the border was reopened last year, but it remains to be seen to what extent this will alleviate long-running labour shortages.

Employment Confidence Index



NZ May monthly employment indicator

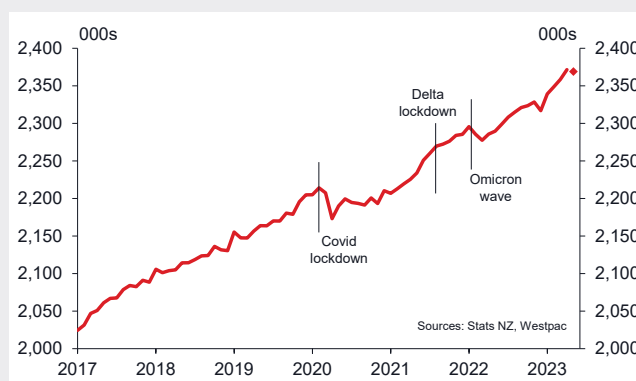
Jun 28, Last: +0.6%, Westpac f/c: -0.1%

The monthly employment indicator is drawn from income tax data. This makes it a fairly comprehensive record of the number of people in work, and helps to fill a gap in what is otherwise mostly quarterly data on the labour market.

Jobs growth has noticeably accelerated in 2023 so far. This is no doubt in part because there are more people around to hire – migrant inflows have surged as the reopening of the border has unleashed a pent-up demand to live and work here.

The weekly snapshots provided by Stats NZ suggest a slight decline in jobs in May compared to April. We view this as the jobs market taking a breather from the rapid growth in previous months, rather than a sign of emerging weakness. We still expect job numbers to be up 3.5% on the same time last year, well ahead of population growth even with the migration surge.

Monthly filled jobs



NZ Jun ANZBO business confidence

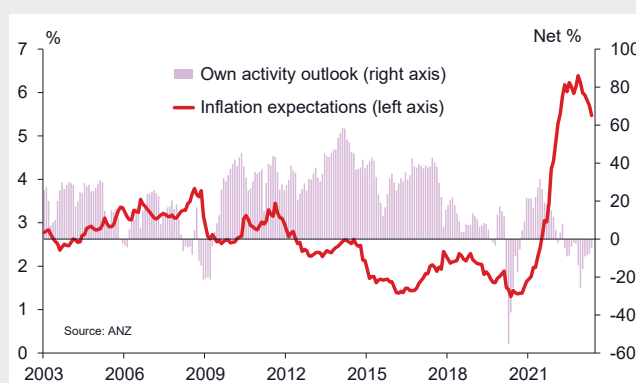
Jun 29, Last: -31.1

While off its lows, business confidence remained weak in May with the majority of firms expecting that trading conditions would weaken over the months ahead.

We expect that the June confidence survey will continue to highlight weakness in business sentiment. However, while trading conditions remain challenging, recent months have seen some encouraging developments for many businesses. Cost pressures have started to moderate. In addition, the recovery in net migration is helping to alleviate labour shortages and is adding to demand. Against that backdrop, some gauges of economic activity are starting to look less-dire.

The survey's cost and pricing gauges will be closely watched. While those continue to point to strong inflation pressures, they have been trending down for several months now. We expect that trend will continue in this month's survey.

Business confidence



The week ahead

Aus Q2 ACCI-Westpac business survey

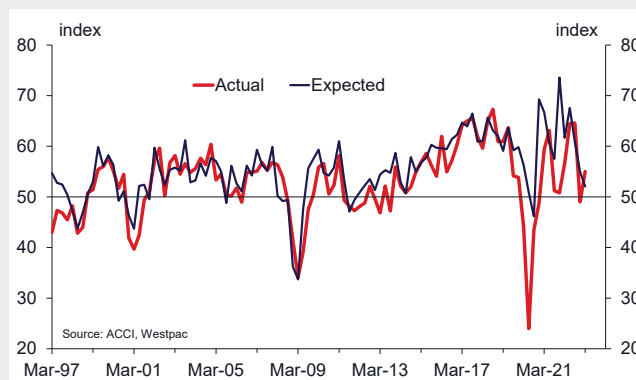
Jun 27, Last: 55.0

The ACCI-Westpac business survey for the June quarter, conducted through May into June, will provide a timely update on manufacturing and insights into economy wide trends.

Australia's manufacturing sector, having abruptly stalled in the final months of 2022, experienced a partial rebound in the March quarter. The survey reported similar growth in output and new orders and a modest increase in employment, reflecting a mild expansion in the context of a trend downturn.

However, the manufacturing sector continues to face a broad set of challenges. Labour and material shortages, in particular, have acted as a major drag on business activity. Additionally, input cost pressures remain intense and are flowing through (in part) to higher prices and squeezing margins.

Aus Westpac-ACCI Composite indexes (actual and expected, sa)



Aus May Monthly CPI Indicator %yr

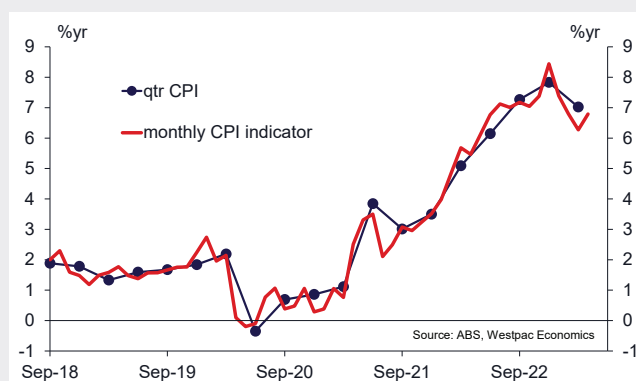
Jun 28, Last: 6.8%, WBC f/c: 6.1%
Mkt f/c: 6.0%, Range: 5.6% to 6.9%

The Monthly CPI Indicator gained 0.8%*mt*/6.8%*yr* in April. One of the main drivers of April's gain was a 2.9% increase in fuel prices, but the 7.2% rise in holiday travel and accommodation also acted as a key upside surprise, adding 0.17*ppt* on the Monthly Indicator.

The annual trimmed mean measure was also reinstated in April, and showed that underlying inflation lifted from 6.5%*yr* to 6.7%*yr*, highlighting inflation's lingering breadth.

For May, we are forecasting a 0.1%*mt*/6.1%*yr* increase, driven by: a 0.8% increase for food; 0.3% increase in clothing and footwear; 0.4% increase for housing; and a 0.5% increase in furnishings. Offsetting this, a 1.9% fall in transport (including a 7.6% fall in fuel) and 1.0% fall in recreation (including a 4.9% fall in holiday travel) are anticipated.

Aus CPI Monthly Indicator vs. qtr CPI



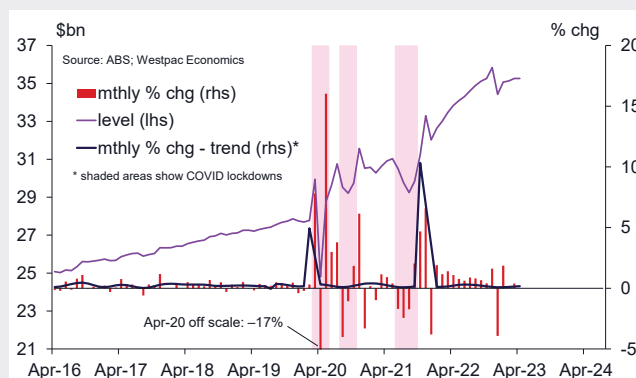
Aus May retail trade

Jun 29, Last: flat, WBC f/c: -0.2%
Mkt f/c: 0.1%, Range: -2.0% to 0.4%

Retail sales were flat in April following a 0.4% rise in March and 0.2% rise in Feb. The key message continues to be of a material slowing in momentum since late last year, centred on discretionary goods and reflecting rising cost of living and interest rate pressures.

The retail segment of our Westpac Card Tracker remained weak through April-May, with declines across all major segments (basic food, hospitality and non-food retail). We expect May retail sales to show a 0.2% decline, with downside risks in the mix.

Aus monthly retail sales

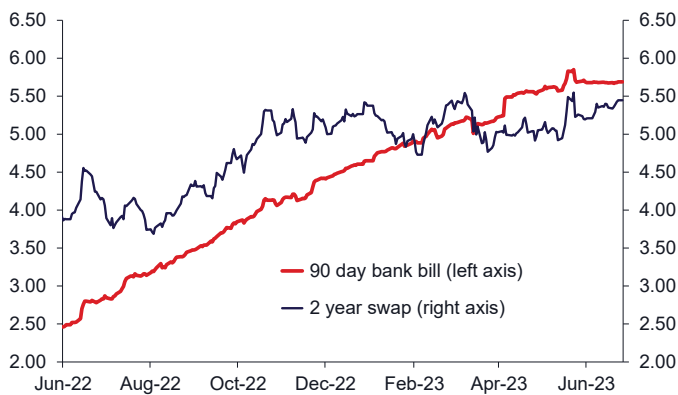


New Zealand forecasts

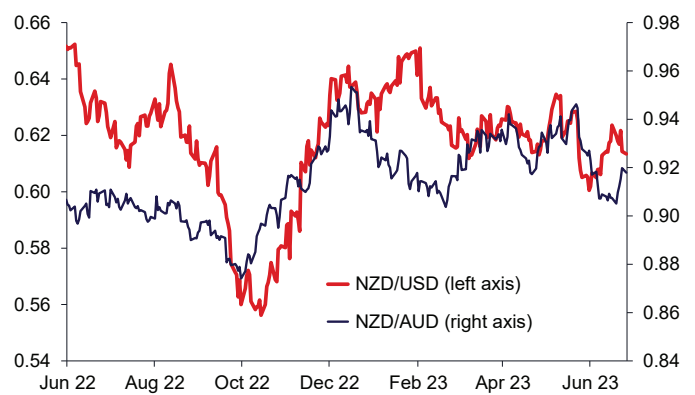
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.5	0.5	6.0	2.7	1.2	0.5
Employment	0.5	0.8	0.4	0.0	3.3	1.6	1.2	-0.4
Unemployment Rate % s.a.	3.4	3.4	3.5	3.7	3.2	3.4	3.9	4.9
CPI	1.4	1.2	1.0	1.9	5.9	7.2	4.7	2.9
Current 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 26 June 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.61%	5.60%	5.61%
60 Days	5.65%	5.64%	5.66%
90 Days	5.69%	5.69%	5.70%
2 Year Swap	5.45%	5.37%	5.24%
5 Year Swap	4.69%	4.62%	4.55%

NZ foreign currency mid-rates as at 26 June 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6134	0.6143	0.6058
NZD/EUR	0.5626	0.5702	0.5654
NZD/GBP	0.4830	0.4884	0.4907
NZD/JPY	88.19	85.51	84.98
NZD/AUD	0.9179	0.9080	0.9261
TWI	71.12	70.75	70.33

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 26					
US	Jun Dallas Fed index	-29.1	-	-	Weaker demand will be a drag on activity.
Tue 27					
NZ	Q2 Westpac employment confidence	109.5	-	-	Perceptions about jobs have been relatively upbeat.
Aus	Q2 ACCI-Westpac business survey	55.0	-	-	Manufacturers are under intense pressure from rising costs.
US	May durable goods orders	1.1%	-1.0%	-	Weaker business sentiment to dampen demand.
	Apr FHFA house prices	0.6%	-	-	Prices are finding their floor...
	Apr S&P/CS home price index	0.45%	-	-	... as inventories dry up and...
	May new home sales	4.1%	-3.0%	-	... owners take advantage of demand.
	Jun consumer confidence index	102.3	103.5	-	Teetering towards pessimism.
	Jun Richmond Fed index	-15	-	-	Manufacturing hit by demand and uncertainty.
Wed 28					
NZ	May employment indicator	0.6%	-	-0.1%	Taking a breather from recent strong growth.
Aus	May Monthly CPI Indicator %yr	6.8%	6.0%	6.1%	A 0.1%mtm forecast increase following a 0.8%mtm gain in April.
Chn	May industrial profits ytd %yr	-20.6%	-	-	Losses to continue as expenses go up
Eur	ECB's Annual Central Banking Forum	-	-	-	Policy panel with FOMC's Powell, ECB's Lagarde, BoE's Bailey.
UK	Jun Nationwide house prices	-0.1%	-	-	Higher rates to drive prices down further.
US	May wholesale inventories	-0.1%	-	-	Slowly stagnating as businesses hold back new orders.
Thu 29					
NZ	Jun ANZ business confidence	-31.1	-	-	Activity measures still low, price gauges easing from highs.
Aus	May retail sales	0.0%	0.1%	-0.2%	Consumer slowdown becoming clearer.
	Q2 job vacancies	-1.5%	-	-	Gradually easing from a historically elevated level.
Eur	Jun consumer confidence	-16.1	-	-	Sentiment down in the dumps for consumers...
	Jun economic confidence	96.5	-	-	... flowing through to increasingly miserable businesses.
UK	May net mortgage lending £bn	-1.4	-	-	Lending to taper as high rates ward off buyers.
US	Initial jobless claims	264k	-	-	Volatility keeping pundits on toes over outlook.
	Q1 GDP, annualised	1.3%	1.4%	-	Final estimate.
	May pending home sales	0.0%	-0.3%	-	Getting closer to a price floor.
	Fedspeak	-	-	-	Chair Powell at Bank of Spain. Bostic speaking too.
Fri 30					
NZ	Jun ANZ consumer confidence	79.2	-	-	Remains at weak levels.
Aus	May private sector credit	0.6%	0.4%	0.4%	Credit growth broadly stabilising at a subdued level.
Chn	Jun manufacturing PMI	48.8	48.9	-	Manufacturers are feeling down...
	Jun non-manufacturing PMI	54.5	53.7	-	... while the service industry continues to expand.
Eur	May unemployment rate	6.5%	6.5%	-	Plentiful jobs drive unemployment lower.
	Jun CPI %yr	6.1%	-	-	Services spending keeping inflation high.
UK	Q1 GDP	0.1%	-	-	Final estimate.
US	May personal income	0.4%	0.4%	-	Strong wages growth supporting incomes gains overall...
	May personal spending	0.8%	0.2%	-	... allowing spending momentum to hold up.
	May PCE deflator	0.4%	0.1%	0.1%	PCE outcomes likely to match CPI result...
	May core PCE deflator	0.4%	0.4%	0.4%	... though technical differences a marginal upside risk for core.
	Jun Chicago PMI	40.4	44.2	-	Business activity has waned in recent months.
	Jun Uni. of Michigan sentiment	63.9	63.9	-	Final estimate.

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	4.32	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	3.78	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	0.6708	0.69	0.69	0.71	0.72	0.73	0.74
USD/JPY	143.09	138	136	134	132	130	128
EUR/USD	1.0935	1.11	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2711	1.27	1.27	1.28	1.28	1.29	1.29
USD/CNY	7.1795	7.00	6.90	6.80	6.70	6.60	6.50
AUD/NZD	1.0912	1.11	1.11	1.13	1.13	1.12	1.12

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
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