WESTPAC WEEKLY ECONOMIC COMMENTARY

The long and bumpy road to balance.

28 August 2023

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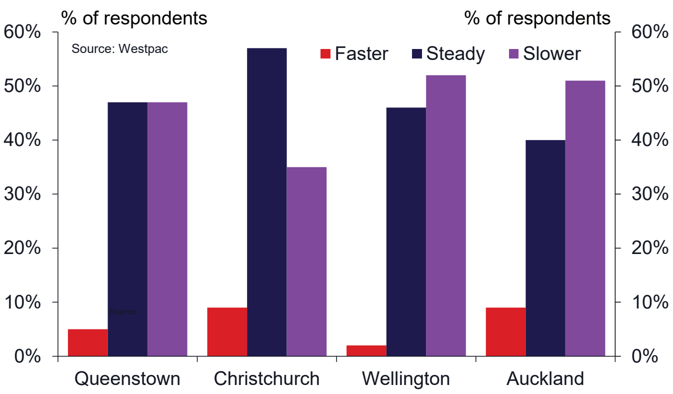
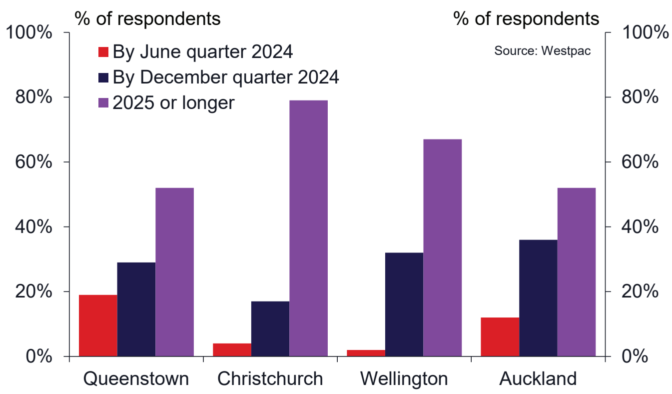
Last week I had the opportunity to spend time talking with customers around the country on the strength of the economy and the likely direction of growth, wages, inflation, and the exchange rate. The theme of the presentation I was giving was that of rebalancing and the path we see the economy taking in the years ahead. Customers seemed to agree that the economy was likely heading into a rough patch and that it would take time for some of the excesses built up in recent years to be worked off and dissipate.

What are your expectations for wage growth in the next year?



There were an interesting set of views around the outlook for wages and inflation. Our forecast embodies the idea that wage inflation has now peaked at relatively high levels and will soon weaken. This is a key factor that drives core inflation pressures down very significantly and quickly over the coming year such that overall inflation moves back inside the target range by the end of 2024. Customers seem more sceptical that the going will be so easy on this front. There was a consensus that wage growth will remain steady (at these current strong levels) or weaker. This could be a worrying sign of some ongoing persistence in wages growth, especially if workers try to recoup the real wage cuts received in recent years.

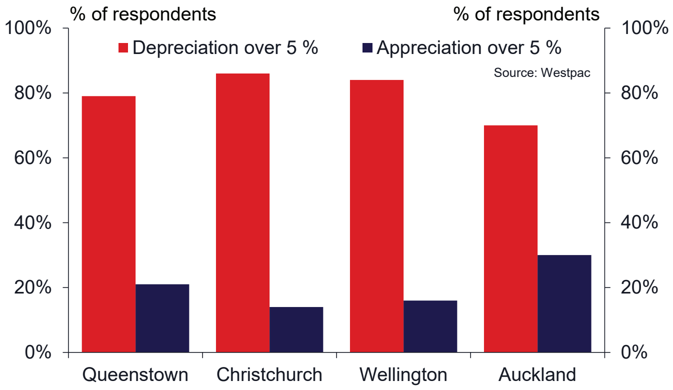
When will the annual CPI reach the RBNZ's target range?



The reality is that the labour market isn't weak enough yet to give confidence that wage growth is going to slow significantly. This perspective probably explains why the majority of customers believe inflation won't be back in the 1-3% target range until sometime in 2025. The RBNZ's view on the OCR hinges on their target being reached sooner than that.

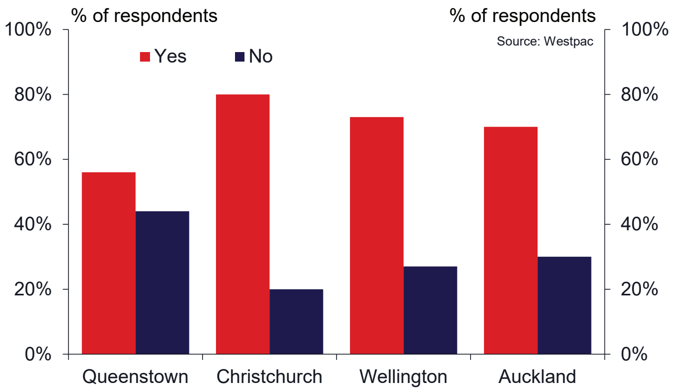
The theme of a bumpy path to rebalancing is certainly reflected in concerns around the exchange rate. Our analysis last week noted the government's books are likely headed more deeply in the red, with next month's fiscal update likely to lift this year's borrowing programme by around $6bn to $40bn. When combined with the large current account deficit, which seems set to decline only slowly considering recent declines in export commodity prices, raising exchange rate risks. Customers unsurprisingly perceive the risk distribution around the exchange rate as strongly skewed to significant depreciation.

What's the biggest risk for the NZD/USD exchange rate over the next year?



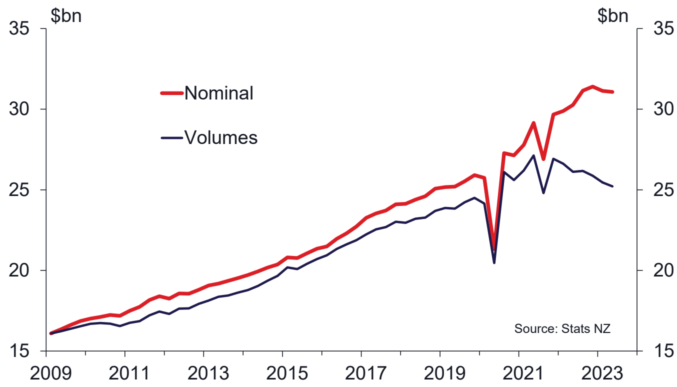
Finally, customers also see a decent chance that the economy will be in recession by the end of this year (unsurprisingly, customers in tourism-focused Queenstown were more positive). Certainly, this seems consistent with our forecasts, which are for flat growth and so an economy that is flirting with recession.

Do you expect the economy to be in recession by the end of 2023?



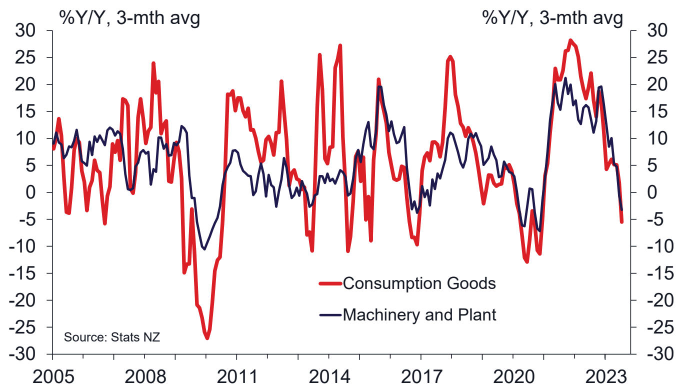
The domestic data flow over the past week certainly suggests that the RBNZ's monetary policy tightening may be gaining increasing purchase on the economy. Of note was an unexpectedly steep 1.0% decline in the volume of retail sales in the June quarter, with core sales (i.e., excluding vehicle and fuel sales) down an even steeper 1.8%. Nominal spending fell 0.2% following a 0.9% decline in the March quarter. This is a remarkable result considering ongoing growth in wages, very strong population growth and a recovering tourism sector. In the detail, we saw a pronounced decline in discretionary spending (especially hospitality) and in housing-related spending (especially hardware and construction materials).

Retail sales – values and volumes



While the poor retail spending report will contribute negatively to GDP growth in the June quarter, growth is still likely to be positive thanks to a large bounce in export volumes. However, this week's merchandise trade data hinted that this bounce could be short-lived, with exports receipts slumping by a seasonally adjusted 10% in July (albeit lower commodity prices undoubtedly explain some of this decline). Moreover, import values again pointed to weakening domestic demand, with imports of consumption goods declining 6.5% from year-earlier levels, and imports of plant and equipment falling more than 12%. The ANZ's "Truckometer" also continued the run of weak July data, with the Heavy Traffic Index – which has the best correlation with GDP growth – falling 3% during the month.

Imports – consumer and capital goods



Looking ahead, this week's data flow kicks off today with the monthly employment indicator. Filled jobs have trended higher over the first half of this year, but weekly data suggests that this trend may have halted in July. Wednesday's building consents report may point to a small decline in dwelling consent issuance in July, but the downtrend does appear to have flattened in recent months in line with the recovery in other housing indicators. On Thursday, the ANZ's Business Outlook Survey could prove a mixed bag for markets. The recent steep decline in dairy export prices and general concerns about the Chinese economy may have interrupted this year's recovery in business sentiment. However, the recent rise in petrol prices may also have halted this year's decline in pricing indicators and inflation expectations. Meanwhile, we will be interested to see whether growth in private sector credit has slowed further in July. Finally, on Friday, the ANZ's consumer confidence index is likely to point to still moribund levels of sentiment in August.

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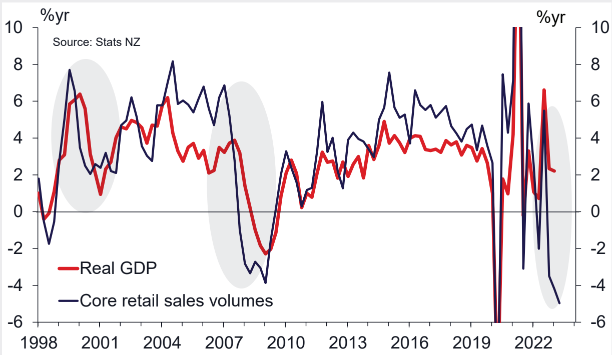
Chart of the week

In the June quarter, the volume of core retail spending was 5% lower than a year earlier. This was a much steeper decline than we and the market had expected. Moreover, it is steeper than that which occurred during the GFC recession. This very soft result, despite rapid population growth and a recovering tourism sector, confirms that monetary policy is bearing down on domestic demand.

In our recent Economics Overview, we noted that the economy is flirting with recession. We are cognisant that in past cycles, a steep decline in retail spending has been a precursor of broader weakness in the economy. Therefore, we will be watching high frequency data closely in coming months to see whether a deeper downturn might be taking hold.

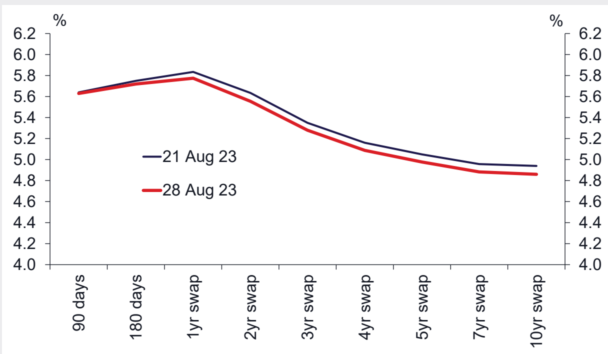
Core retail sales volumes and GDP growth



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

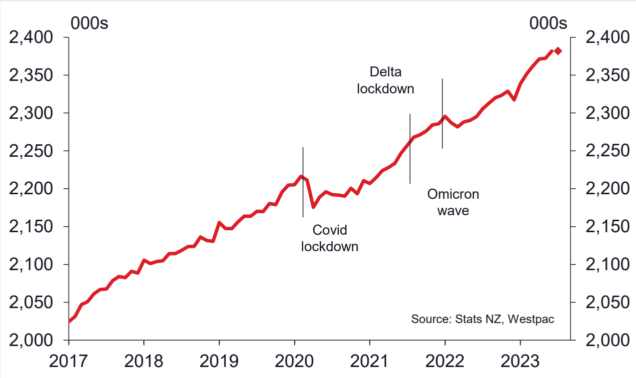
NZ Jul monthly employment indicator

Aug 28, Last: +0.4%, Westpac f/c: 0.0%

The monthly employment indicator is drawn from income tax data, making it a fairly comprehensive record of the number of people in work. This fills a gap in what is otherwise mostly quarterly data on the labour market. And helpfully, while there are conceptually differences, the monthly employment indicator does a very good job of predicting the household survey measure of employment.

Job growth remained 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 – together with a decline in job vacancies – suggests that this uptrend may have halted in July.

Monthly filled jobs



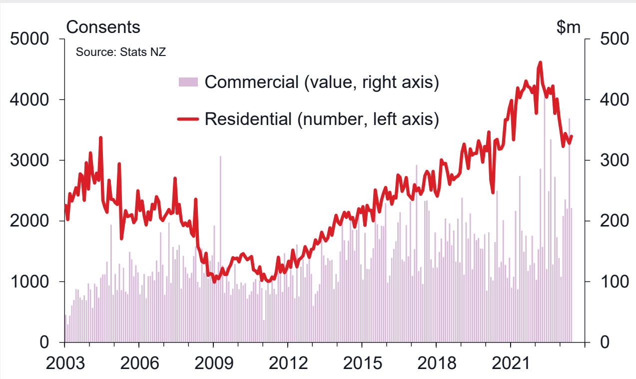
NZ Jul building consents

Aug 30, Last: +3.5%, Westpac f/c: –2.0%

After falling sharply last year, the downturn in dwelling consent issuance looks like it has now flattened off. Since the start of this year, monthly consent issuance has running at around 3,400 per month. We expect that it will remain close to that level in the July figures.

The flattening off in consent issuance coincides with the stabilisation in the housing market in recent months. That's a key influence on developers' willingness to bring new projects to market. With interest rates at contractionary levels, we think the upside for consents is limited in the near term, and there is some chance of a further easing.

Building consents



NZ Aug ANZBO business confidence

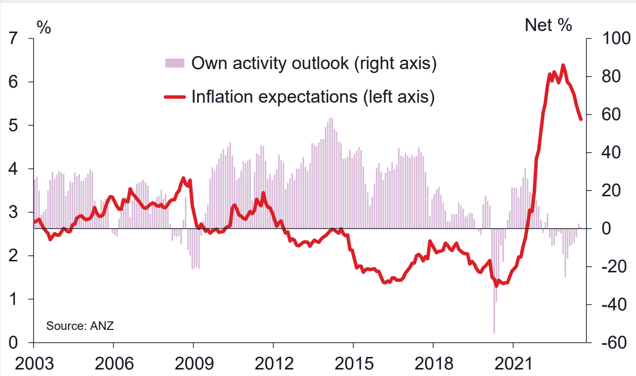
Aug 31, Last: –13.1

While business confidence improved further in July, it remained low, with respondents remaining cautious about prospects for trading conditions over the months ahead.

We expect that the August confidence survey will continue to highlight weakness in business sentiment, although with variation among sectors. Since the last survey, further declines in key export commodity prices and weaker than expected Chinese demand will have provided an additional challenge to some businesses that are already facing high borrowing costs and other headwinds.

The survey's cost and pricing gauges will also be closely watched. While these have continued to point to strong inflation pressures, they have been trending down for several months now. However, the recent uplift in fuel prices might halt that trend, at least in this month's survey.

Business confidence



The week ahead

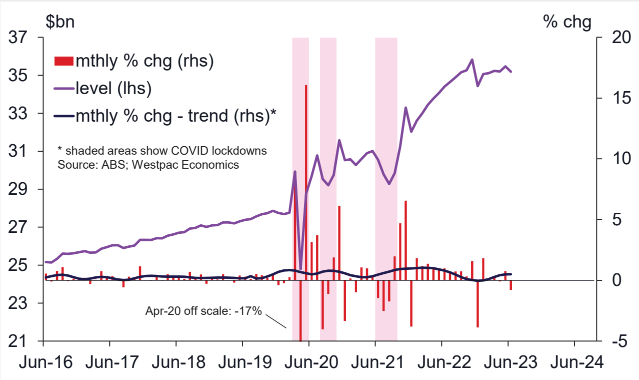
Aus Jul retail trade

Aug 28, Last: –0.8%, WBC f/c: 0.4%
Mkt f/c: 0.2%, Range: –0.3% to 0.6%

Retail sales weakened in June, a 0.8% fall unwinding a 0.8% gain in May to leave sales flat over the two months, the choppy profile partly reflecting the timing of sales events. Annual sales growth slowed to 2.3%yr.

Our Westpac Card Tracker suggests retail spending was a little firmer in July, bearing in mind that this and the retail sales measure include price-driven changes. Note also that population growth alone is running at 0.2%mth. As such, even if sales hold flat in real (i.e. inflation-adjusted) per capita terms, total nominal sales would be up about 0.4%mth. We expect that to be broadly the story in July, with a 0.4% rise for the month.

Aus monthly retail sales



Aus Jul Monthly CPI Indicator %yr

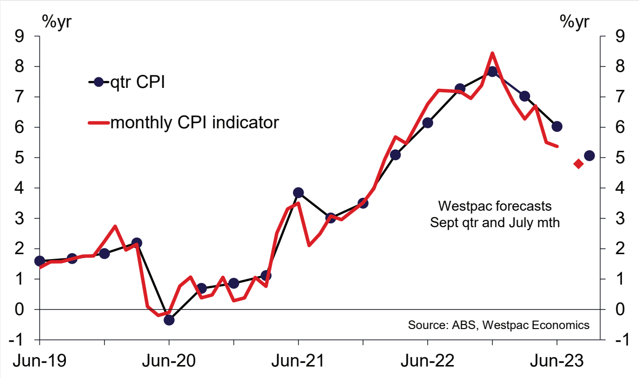
Aug 30 Last: 5.4%, WBC f/c: 4.8%
Mkt f/c: 5.2%, Range: 4.7% to 5.9%

The Monthly CPI Indicator lifted 0.7% in June to be up 5.4%yr, a moderation from the 5.5%yr in May and 6.7%yr in April. The June print was softer than anticipated with the reported annual pace moderating significantly faster than the quarterly CPI which reported growth of 6.0% in the year to the June quarter.

The Monthly Indicator is not a true monthly inflation measure but rather the release of the data from the quarterly CPI as it becomes available. A lot of the data is monthly but a fair proportion is only available quarterly (and appears in the month of the quarter the survey is conducted) while a smaller proportion is annual.

Electricity presents a key risk this quarter both in terms of the impact of state energy rebates and the timing of bill increases. The ABS recently introduced a monthly electricity price series for the CPI but it only goes back to September 2017 so we don't have a good handle on the monthly seasonality of electricity price changes.

Aus CPI monthly indicator vs. qtr CPI



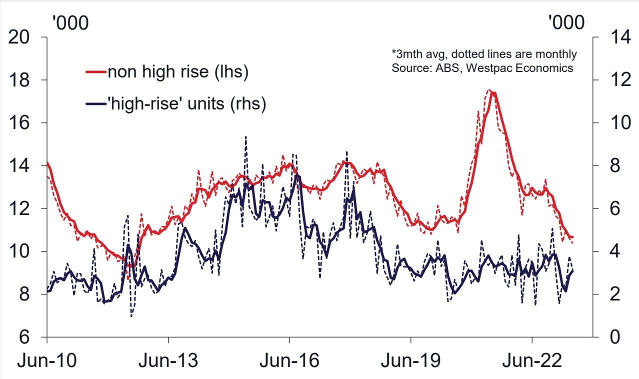
Aus Jul dwelling approvals

Aug 30, Last: –7.7%, WBC f/c: –1.0%
Mkt f/c: –1.0%, Range: –21.0% to 8.0%

Dwelling approvals fell 7.7% in June, partially unwinding a 20% apartment-driven jump in May. Apartment approvals on retraced part of the May spike, a big fall back in NSW offset by gains in Vic and Qld. Notably, ex high rise approvals were soft, down about 1.7%mth, having shown a marginal 3.3%mth gain in May. That suggests underlying conditions are still weak, particularly given recent gains in high rise approvals are very unlikely to be part of a sustained lift.

HIA new home sales weakened through June-July, the recovery momentum evident in previous months fading somewhat. With July still likely to see some unwind in high rise approvals that points to a small decline in approvals overall, we expect in the order of a 1% fall for the month.

Aus dwelling approvals



The week ahead

Aus Q2 construction work

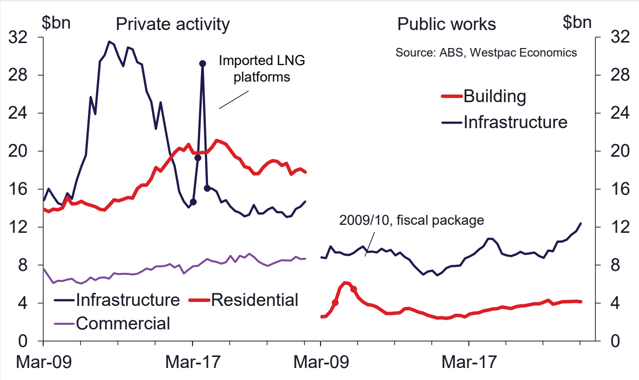
Aug 30, Last: 1.8%, WBC f/c: 1.5%
Mkt f/c: 1.0%, Range: –1.5% to 1.5%

Construction activity, led by business and public works, has trended higher from mid-2022, with ongoing positive momentum. Current strength in part reflects earlier delays to project starts and work due to COVID-19, bad weather and shortages. More fundamentally, the capital stock needs to expand as the population increases.

Work increased by 3.9%, 1.0% and 1.8% in the past three quarters, and we anticipate a 1.5% rise for 2023 Q2. That lifts annual growth to 8.4%, a five-year high.

Public works grew by 11.4% over the past three quarters and has considerable further upside given a sizeable pipeline (notably transport infrastructure projects). Private business construction work rose 8% over the past three quarters and also has further upside. Housing, by contrast, is mixed. Renovations are in a downturn, off a high level. New residential building still has further upside, near-term, given a backlog of work caused by COVID delays, cost pressures, and other disruptions.

Aus construction work by segment



Aus Est 3 2023/24 capex plans, $bn

Aug 31, Last: 2023/24 Est 2 $137.6bn

In 2022/23, capex spending likely rose by about 15%, potentially including volumes up by around 5% and prices 9% higher.

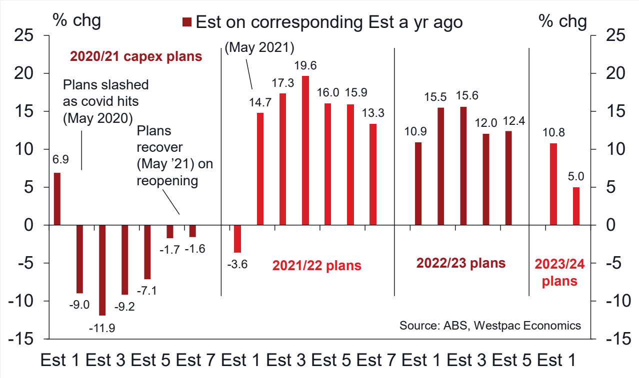
For 2023/24, we expect divergent capex trends, equipment down and B&S up, while capex inflation will likely halve (on our figures).

We forecast total business investment (national accounts estimate) to rise by 5.5% in 2023/24 (nominal), with volumes up a timid 1%.

Est 2 for 2023/24 printed $137.6bn, some 5% above Est 2 a year ago (with the price/volume split an unknown). On our calculations, Est 2 implies a 5.3% rise for the 2023/24 year.

Est 3 may possibly print around $156bn, some 5.5% above Est 3 a year ago and, on our calculations, still imply capex will be 5.3% higher in 2023/24. CAUTION: the upgrade between Est 2 and Est 3 is, on average, the largest between any of the estimates, at 13%. With such large and variable movements (particularly for non-mining equipment) there is significant scope for surprises.

Aus capex plans



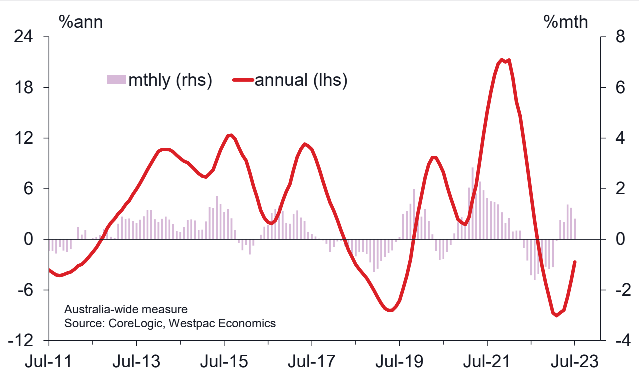
Aus Aug CoreLogic home value index

Sep 1, Last: 0.8%, WBC f/c: 1.0%

The CoreLogic home value index rose 0.8% in July, a slight moderation on the 1.2% and 1.4% gains in June and May respectively, and more in line with the milder 0.7-0.8% gains in April and March. Prices are now up 5% from their Feb low, reversing just over half of the 9.7% decline over the previous ten months. The annual pace of price declines moderated to –2.7%yr.

The CoreLogic daily index suggests price growth quickened again in August, the major capital city index tracking a 1% gain for the full month. All cities look to have posted solid gains in the month.

Aus dwelling prices



The week ahead

US Aug employment report

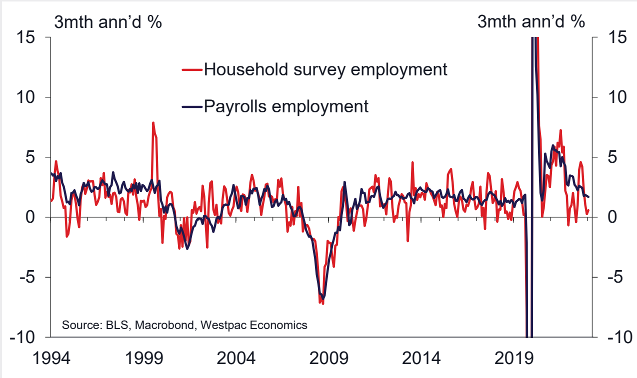
Sep 1, nonfarm payrolls, Last: 187k, Mkt f/c: 168k, WBC: 190k
Sep 1, unemployment rate, Last: 3.5%, Mkt f/c: 3.5%, WBC: 3.6%

The US labour market continues to slowly lose momentum, allowing demand to fall into line with supply, reducing pressure on wages and inflation.

We expect this trend to continue at a similar pace in coming months, though an acceleration in the downtrend via back revisions or a sudden jolt lower in payrolls is a risk.

On a multi-month view, household employment is likely to show a greater degree of weakness and see the unemployment rate edge higher towards 4.0%. Hourly earnings growth should also moderate with a delay. For households, as long as the downtrend in inflation persists, softer nominal wage growth should be of little concern.

US job growth

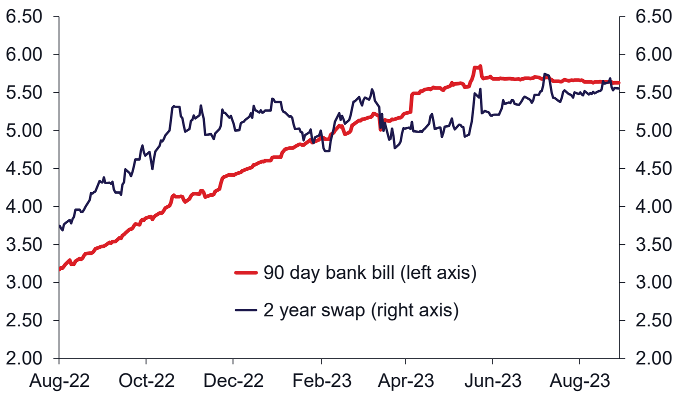


New Zealand forecasts

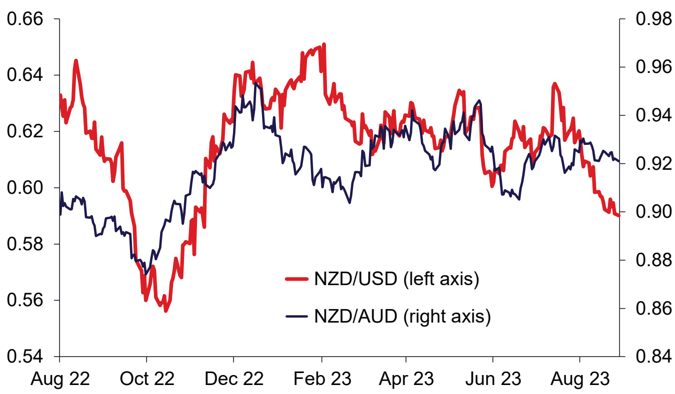
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.8	0.1	6.0	2.7	1.1	0.3
Employment	0.7	1.1	1.0	0.3	3.3	1.7	2.4	0.1
Unemployment Rate % s.a.	3.4	3.4	3.6	3.8	3.2	3.4	4.3	5.2
CPI	1.4	1.2	1.1	2.0	5.9	7.2	4.9	2.9
Current 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 28 August 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.60%	5.61%	5.62%
60 Days	5.62%	5.63%	5.64%
90 Days	5.63%	5.64%	5.67%
2 Year Swap	5.56%	5.52%	5.48%
5 Year Swap	4.98%	4.91%	4.76%

NZ foreign currency mid-rates as at 28 August 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5901	0.5986	0.6202
NZD/EUR	0.5465	0.5469	0.5619
NZD/GBP	0.4688	0.4713	0.4820
NZD/JPY	86.40	86.80	88.22
NZD/AUD	0.9210	0.9211	0.9247
TWI	69.49	70.04	71.39

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
NZ	Jul Monthly Employment Indicator	0.4%	–	0.0%	Weekly indicators suggest that the uptrend has halted
Aus	Jul retail sales	–0.8%	0.2%	0.4%	Slightly better month but flat in real, per capita terms.
UK	Aug Nationwide house prices	–0.2%	–	–	Sustained recovery unlikely anytime soon.
US	Aug Dallas Fed index	–20.0	–	–	Regional surveys pointing to subdued mfg outlook.
	Fedspeak	–	–	–	Barr.
Tue 29					
Aus	RBA Dep. Governor Bullock speaking	–	–	–	"Climate Change and Central Banks", Canberra.
Jpn	Jul jobless rate	2.5%	2.5%	–	Labour demand robust amidst post-pandemic normalisation.
US	Jun FHFA house prices	0.7%	–	–	Price gains unlikely to abate in the near-term but are...
	Jun S&P/CS home price index	0.99%	1.00%	–	... nevertheless fragile, as buyers compete for limited supply.
	Jul JOLTS job openings	9582k	–	–	Still tracking a gradual downtrend from historic highs.
	Aug consumer confidence index	117.0	116.6	–	Up-tick centred on labour market optimism.
	Fedspeak	–	–	–	Barr.
Wed 30					
NZ	Jul building permits	3.5%	–	–2.0%	Consent levels have found a floor in recent months.
Aus	Jul Monthly CPI Indicator %yr	5.4%	5.2%	4.8%	Electricity prices are a big unknown due to the state rebates.
	Jul dwelling approvals	–7.7%	–1.0%	–1.0%	Continued unwind of May high rise spike, flat ex. high-rise.
	Q2 construction work done	1.8%	1.0%	1.5%	Upward trend, led by business & public works. Housing mixed.
Eur	Aug consumer confidence	–16.0	–	–	Uptrend has few legs to stand on given rates and inflation...
	Aug economic confidence	94.5	–	–	... are seeing broader economic sentiment continue to sour.
UK	Jul net mortgage lending £bn	0.1	–	–	Lending has effectively stalled with rates near their peak.
US	Aug ADP employment change	324k	200k	–	Often at odds with BLS data.
	Q2 GDP, annualised	2.4%	2.4%	–	No change anticipated in the second estimate.
	Jul wholesale inventories	–0.5%	–	–	Foreshadowing a further softening in production.
	Jul pending home sales	0.3%	–0.5%	–	Near-term recovery fragile given supply constraints.
Thu 31					
NZ	Aug ANZ business confidence	–13.1	–	–	Lower dairy prices might halt the recent uptrend in sentiment
Aus	Q2 private capital expenditure	2.4%	1.0%	2.0%	Boost from tax incentives, which expired on 30 June 2023.
	Est 3 2023/24 capex plans, $bn	137.6	–	–	Est 2: 5% above Est 2 a year ago.
	Jul private sector credit	0.2%	0.3%	0.3%	June weakness looked to be a little overstated.
Jpn	Jul industrial production	2.4%	–1.3%	–	Holding up for now, but global slowdown clouds the outlook.
Chn	Aug manufacturing PMI	49.3	49.2	–	Our best guide to employment momentum across industry...
	Aug non-manufacturing PMI	51.5	51.3	–	... and services. Services job growth key for confidence.
Eur	Aug CPI %yr	5.3%	5.0%	–	Stickiness in services is impeding core's deceleration...
	Jul unemployment rate	6.4%	6.4%	–	... just as unemployment reaches a new historic low.
US	Jul personal income	0.3%	0.3%	0.3%	Wages growth sustaining income gains as job growth slows...
	Jul personal spending	0.5%	0.7%	0.6%	... allowing spending to continue ticking higher.
	Jul PCE deflator	0.2%	0.2%	0.2%	Likely to broadly match CPI outcome for month.
	Initial jobless claims	230k	–	–	To remain near its lows, for now.
	Aug Chicago PMI	42.8	44.1	–	Reflective of soft manufacturing conditions
	Fedspeak	–	–	–	Bostic.
Fri 01					
NZ	Aug ANZ consumer confidence	83.7	–	–	Little reason to expect a lift from historically low levels
Aus	Aug CoreLogic home value index	0.8%	–	1.0%	Upturn continues to gain traction. Sales vols also likely up.
	Jul housing finance	–1.0%	–0.5%	1.2%	Should reconnect with clear underlying up-trend...
	Jul owner occupier finance	–2.8%	–	0.5%	... but soft construction-related activity a drag for own-occ...
	Jul investor finance	2.6%	–	2.5%	... investor activity leading the gains.
Chn	Aug Caixin manufacturing PMI	49.2	49.2	–	An highly uncertain time for small manufacturing firms.
US	Aug nonfarm payrolls	187k	168k	190k	Job growth continues to decelerate, slowly balancing...
	Aug unemployment rate	3.5%	3.5%	3.6%	... demand with supply...
	Aug average hourly earnings %mth	0.4%	0.3%	0.3%	... and taking the pressure off wages.
	Aug ISM manufacturing	46.4	46.9	–	US manufacturers face considerable headwinds.
	Jul construction spending	0.5%	0.5%	–	Non-residential construction has a long pipeline of work.
	Fedspeak	–	–	–	Bostic, Mester.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	2023f	2024f
Australia						
Real GDP %yr	1.9	-1.8	5.2	3.7	1.6	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
United States						
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
Japan						
Real GDP %yr	-0.4	-4.3	2.1	1.1	1.4	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	5.2	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.3	4.5	3.7	4.3
World						
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
Australia							
Cash	4.10	4.10	4.10	4.10	4.10	3.85	3.60
90 Day BBSW	4.13	4.30	4.30	4.30	4.22	3.97	3.72
10 Year Bond	4.17	3.75	3.55	3.45	3.30	3.25	3.20
International							
Fed Funds	5.375	5.375	5.375	5.125	4.625	4.125	3.625
US 10 Year Bond	4.25	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	0.6406	0.67	0.68	0.69	0.71	0.73	0.74
USD/JPY	146.07	140	138	135	132	130	128
EUR/USD	1.0783	1.11	1.12	1.12	1.13	1.14	1.15
GBP/USD	1.2566	1.28	1.28	1.29	1.29	1.30	1.30
USD/CNY	7.2872	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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