WESTPAC WEEKLY ECONOMIC COMMENTARY

Mission accomplished? Yeah… nah.

29 May 2023

Southern rātā

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While the Reserve Bank of New Zealand delivered the expected increase in the Official Cash Rate at its May meeting, the central bank's assessment of economic conditions was much more dovish than we expected. We continue to expect that the cash rate will need to rise further to bring inflation back to target. However, given the tone of the RBNZ's policy outlook, we have revised down our forecast for the peak in the cash rate to 5.75% (from 6.00% previously).

As expected, the Reserve Bank of New Zealand hiked the Official Cash Rate by 25bps at their May policy meeting, taking the cash rate to 5.50%. However, in contrast to our own and market expectations for a hawkish tilt from the central bank, the tone of the RBNZ's policy assessment was surprisingly dovish. Most notably, the RBNZ continues to assume that a peak cash rate of 5.50%, if held for long enough, would be sufficient to bring inflation back to target.

In contrast, we think that the cash rate will need to rise further from here, especially given the boost to demand from the current surge in migration. However, given the RBNZ's dovish stance, we have revised down our forecast for the OCR. We now expect that the OCR will rise to a peak of 5.75% (down from 6.00% previously) with that final 25bp rise coming in August.

Digging into the details of the RBNZ's policy assessment, the central bank is conscious of the same factors that we have been highlighting, most notably the squeeze on households' purchasing power from higher living costs and increases in interest rates. However, while we agree that those tighter financial conditions will be a significant drag on demand, we think the RBNZ may be overestimating just how much demand will soften. In fact, if we look at the RBNZ's assumption for per-capita spending growth, the central bank expects that rate hikes to date will see spending dropping even more sharply than during the 2008/09 Global Financial Crisis.

Even though there will be a good deal of belt tightening from households over the coming months, we're not as pessimistic as the RBNZ is on this front. A key reason for this is the state of the labour market – employment levels remain high, and rising wages are helping to support household spending. And although we do expect the labour market will cool over time, we expect that the downturn will be more modest than the RBNZ has assumed (especially if the RBNZ stays on hold, as their forecasts imply).

On top of this, the current surge in migration inflows signals a material upside risk to the RBNZ's forecasts. The RBNZ's migration forecasts are actually quite similar to our own. But the big question is what this means for the balance of demand

and supply conditions in the economy. And to be fair, the RBNZ acknowledged there is some uncertainty around how those pressures will evolve. However, we think that the surge in net migration will ultimately result in stronger inflation pressures than the central bank expects.

Notably, the RBNZ seems to be putting a lot of weight on the idea that migration will ease the labour shortages that have plagued the country for the last few years. They note that job advertisements have fallen substantially from their mid-2022 highs, as New Zealand's border was reopened and the surge in migrants began.

However, job ads are not weak by any means. Although they have come down, they're still substantially above pre-Covid levels. The demand for workers remains strong and, as the March quarter labour force survey showed, employment is still outstripping population growth.

The RBNZ has also downplayed the impact of migration on the housing market. Housing is the part of the economy where migration is most obviously a net inflationary force as the supply of new homes is relatively unresponsive to population changes (at least in the near term). This pressure on house prices occurs regardless of whether migrants are buying or renting, since somebody has to own the houses that they rent.

Putting this altogether, it's likely that domestic demand and inflation pressures will prove stronger than the RBNZ expects. However, it will take some time – likely not until late this year – before the strength of those pressures becomes obvious. The key area to watch will be the housing market. The RBNZ is forecasting a further 3.5% fall in house prices over the next year before they bottom out. However, the most recent REINZ sales figures hint that the turn in the market may have already arrived. The upturn in house prices in Australia – which has seen a similar resurgence in net migration – should serve as a warning for what might come next here.

A complicating factor is that, even with the RBNZ's lower OCR forecast, inflation is still set to fall sharply over the next few months. That's because some of the very large cost increases that we saw in the wake of the pandemic (many of which were due to temporary supply side disruptions) are now dropping out of the annual inflation figures. That will pull headline inflation down from close to 7% currently to around 4.5% by the end of this year. But underlying that is a picture of more persistent domestic inflation pressures. And if the RBNZ doesn't take the OCR higher from here, it's likely that those domestic inflation pressures will linger, meaning interest rates will also likely need to remain higher for longer.

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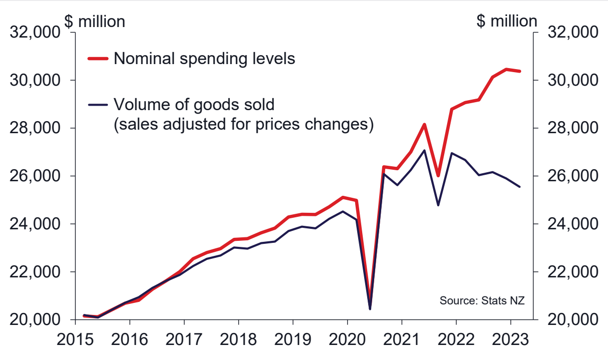
Chart of the week

Over the past year, nominal retail spending levels have increased by 4.7%. However, that masks significant and growing pressure on households' finances. In fact, while households are splashing out more cash, the actual amount of goods they've taken home has fallen 4.1% over the past 12 months. The fact that nominal spending levels have held up in the face of mounting price pressures is notable, pointing towards resilience in spending appetites. However, we expect that the pressure on households' finances will become increasingly stark over the year ahead.

Retail spending

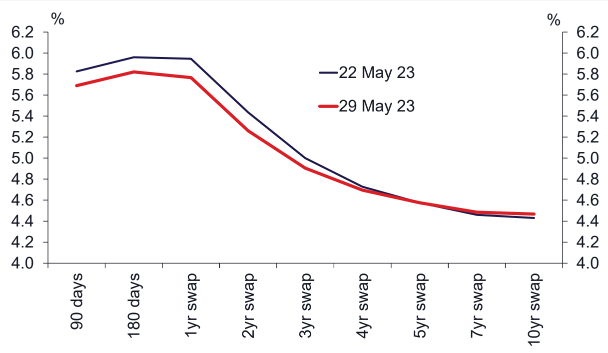


Fixed vs floating for mortgages

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 Apr monthly employment indicator

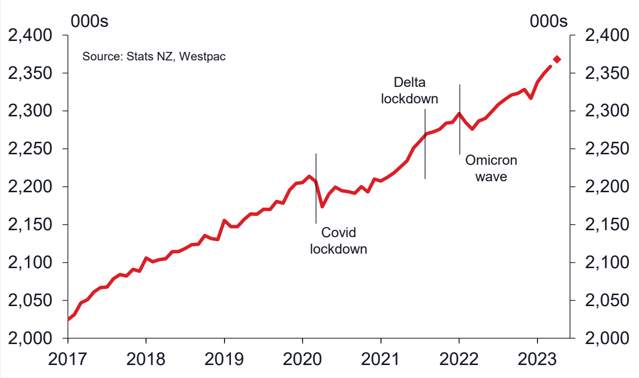
May 29, Last: 0.4%, Westpac f/c: 0.4%

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.

The pace of employment growth has actually picked up in recent months. 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 continuation of this solid pace of growth. We expect a 0.4% rise in jobs in April, matching the increase in March.

NZ monthly filled jobs



NZ Apr building consents

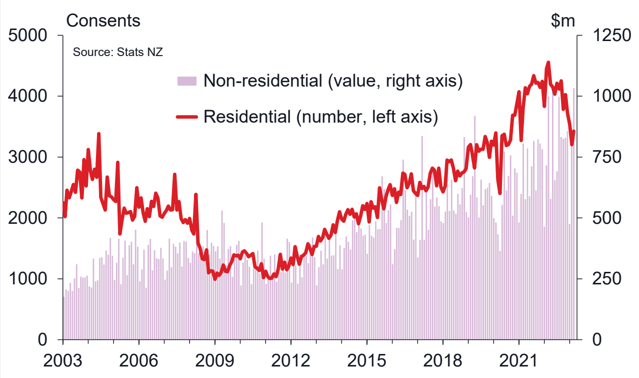
May 30, Last: +7.0%, Westpac f/c: –10.0%

The number of new dwelling consents rose 7% in March, with 3,400 new dwellings consented over the month. Underlying March's rise in overall consent numbers was a large rise in multi-unit consent numbers (like apartments and townhouses), the bulk of which were in Auckland.

We're forecasting a 10% drop in consents in April. In part, that large drop is a normalisation following last month's spike in multi-unit consents.

More generally, the past year has seen a sharp rise in borrowing costs, falls in house prices and large increases in build costs. The related fall in demand has meant that developers are bringing fewer new projects to market. We expect the downturn will become increasingly pronounced over the months ahead.

NZ building consents



NZ May ANZBO business confidence

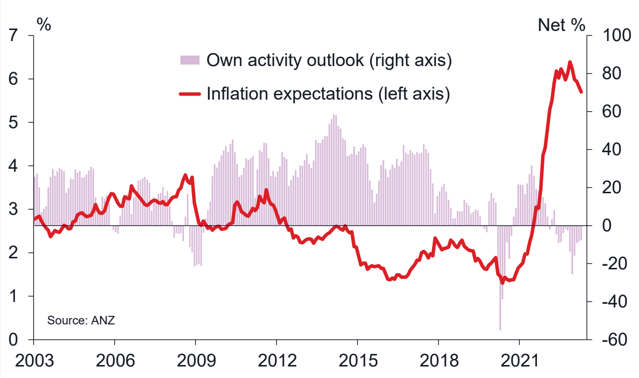
May 31, Last: –43.8

The April business survey continued to point to a slowdown in economic activity. It also continued to highlight strong inflation pressures. However, with earlier interest rate increases rippling through the economy and activity losing steam, the survey's gauges of inflation pressures have been easing back.

We expect that the May confidence survey will again highlight weakness in business sentiment. However, it is a mixed picture across the economy – while retailers and those in the construction sector are reporting softer conditions, businesses in service sectors like hospitality are reporting firmer activity (supported in part by the ongoing recovery in international tourism).

The survey's cost and pricing gauges will be closely watched. While those gauges have softened in recent months, they continue to point to strong inflation pressures.

NZ business confidence



The week ahead

NZ Q1 building work put in place

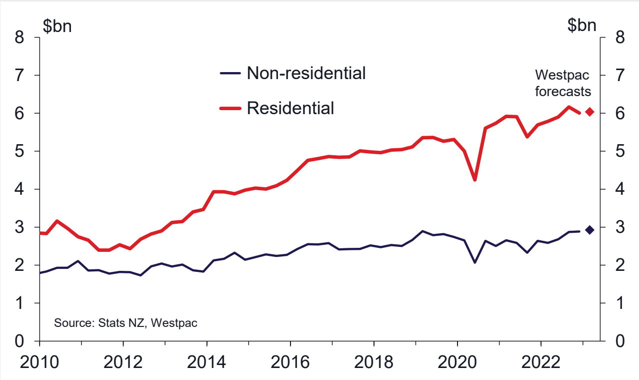
Jun 2, Last: –1.6%, Westpac: +0.8%

While still elevated, the amount of building work put in place fell by 1.6% in the December quarter. That fall was due to a 2.6% fall in residential activity. In contrast, non-residential building activity rose by 0.4% over the quarter.

We're forecasting a 0.8% rise in construction activity in the March quarter with gains in both residential and non-residential activity.

We expect that construction activity will remain elevated in the near-term, with a large number of projects already in the works. However, with increasingly tough financial conditions, we expect that construction activity will trend down over the coming years as the current backlog of projects is cleared and not replaced by new builds.

NZ real building work put in place



Aus Apr Monthly CPI Indicator %yr

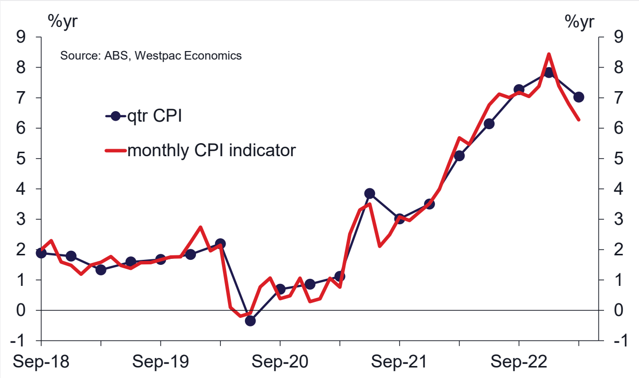
May 31 Last: 6.3%, WBC f/c: 6.5%
Mkt f/c: 6.4%, Range: 6.1% to 6.6%

The Monthly CPI Indicator gained 0.6% in March. This increase was due to a 0.4% increase in food of which the standouts being a 1.1% increase in fresh fruit & vegetables, 1.8% increase in dairy products while meat & seafood prices fell 0.2%. Also worth noting was the most 0.2% gain in clothing & footwear, the seasonal 2.6% jump in health costs and 2.2% fall in auto fuel prices.

In March housing costs lifted 0.8% driven by a 0.5% increase in rents, 0.2% increase in dwelling prices and a small 0.2% fall in electricity prices due to state government rebates.

For April we are forecasting a 0.5% increase composed of a 0.3% increase in food, 0.8% increase in clothing & footwear, a 0.5% increase in housing, 1% increase in furnishings and a 1.2% increase in transport costs with a 3.6% increase in auto fuel.

Aus CPI Monthly Indicator vs. qtr CPI



US Apr employment report

Jun 2: nonfarm payrolls,
Last: 253k, Mkt f/c: 180k, WBC: 150k
Jun 2: unemployment rate,
Last: 3.4%, Mkt f/c: 3.5%, WBC: 3.5%

In recent months, indicators of the US labour market have continued to show a slow deceleration in momentum, albeit with considerable volatility month-to-month and on first and second estimates. We expect this downtrend to remain in place through the remainder of 2023 and into 2024 as the US economy enters recession.

As slack builds, wage growth will take another leg lower, reducing inflation risks but also putting activity at risk of a deeper contraction. How the consumer adapts to this deterioration and the degree to which businesses perceive the weakness as transitory or permanent will determine how long this contraction will run for and the strength of the recovery to follow.

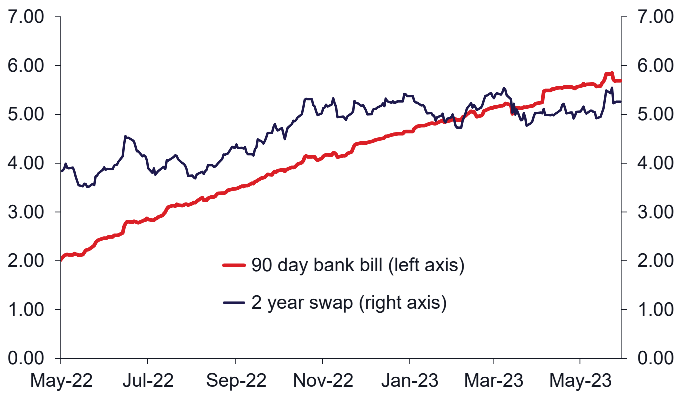
US job openings

New Zealand forecasts

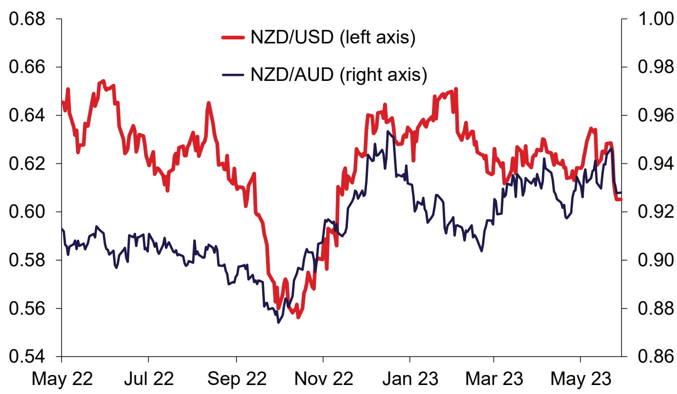
Economic forecasts	Quarterly				Annual			
	2022		2023					
% change	Sep	Dec	Mar	Jun	2021	2022	2023f	2024f
GDP (Production)	1.7	-0.6	-0.2	1.0	6.0	2.4	1.6	0.9
Employment	1.2	0.5	0.8	0.4	3.3	1.6	1.2	-0.4
Unemployment Rate % s.a.	3.3	3.4	3.4	3.5	3.2	3.4	3.9	4.9
CPI	2.2	1.4	1.2	1.0	5.9	7.2	4.6	2.9
Current 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	5.75	5.75	5.75	5.75	5.25	4.75
90 Day bill	5.70	5.85	5.85	5.85	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 29 May 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.25%	5.25%
30 Days	5.60%	5.51%	5.42%
60 Days	5.63%	5.55%	5.50%
90 Days	5.69%	5.58%	5.58%
2 Year Swap	5.26%	4.95%	5.06%
5 Year Swap	4.58%	4.26%	4.29%

NZ foreign currency mid-rates as at 29 May 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6052	0.6217	0.6181
NZD/EUR	0.5643	0.5715	0.5614
NZD/GBP	0.4901	0.4971	0.4932
NZD/JPY	85.07	84.63	84.47
NZD/AUD	0.9280	0.9297	0.9305
TWI	70.27	71.14	70.59

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
NZ	Apr employment indicator	0.4%	–	0.4%	Growth picking up, fuelled by migrant arrivals.
UK	May Nationwide house prices	0.5%	–	–	Fundamentals point to ongoing correction.
Tue 30					
NZ	Apr building permits	7.0%	–	–10.0%	Multi-unit numbers to fall after last month's spike higher.
Aus	Apr dwelling approvals	–0.1%	2.0%	2.0%	Up-tick but coming from a very low level.
Eur	May consumer confidence	–17.4	–	–	Recovery in consumer confidence stalling...
	May economic confidence	99.3	99.0	–	... as cost-of-living pressures bite.
US	Mar FHFA house prices	0.5%	0.3%	–	Limited supply to keep price growth going despite...
	Mar S&P/CS home price index	0.1%	0.0%	–	... contractionary policy and softening labour market.
	May consumer confidence index	101.3	99.9	–	Health of the labour market critical to confidence.
	May Dallas Fed index	–23.4	–19.5	–	Businesses under pressure across the nation.
	Fedspeak	–	–	–	Barkin.
Wed 31					
NZ	May ANZ business confidence	–43.8	–	–	Activity subdued. Cost pressures easing from high levels.
Aus	RBA Governor Lowe	–	–	–	Appearing before Senate in Canberra.
	Apr CPI Monthly Indicator %yr	6.3%	6.4%	6.5%	A 0.5%mth increase following on from a 0.6% gain in March.
	Q1 construction work done	–0.4%	0.7%	1.2%	Higher on public works and private infrastructure.
	Apr private sector credit	0.3%	0.3%	0.3%	Monthly growth steady of late as housing stabilises.
Chn	May manufacturing PMI	49.2	49.5	–	Volatility likely in coming months as economy adjusts to...
	May non-manufacturing PMI	56.4	55.2	–	... re-opening and the deterioration in developed economies.
US	May Chicago PMI	48.6	47.5	–	Businesses under pressure across the nation.
	Apr JOLTS job openings	9590k	–	–	Job openings and hiring continues to weaken.
	Federal Reserve Beige Book	–	–	–	Update on conditions across the 12 Fed districts.
	Fedspeak	–	–	–	Collins & Bowman. Harker, Jefferson.
Thu 01					
Aus	May CoreLogic home value index	0.7%	–	1.4%	Lift strengthening and broadening but on very low volumes.
	Q1 private new capital expenditure	2.2%	1.0%	1.0%	Gains likely across both equipment and Building & Structures.
	2023/24 capex plans Est 2, $bn	129.7	–	–	Clouded outlook in face of slowing economy.
Chn	May Caixin manufacturing PMI	49.5	49.5	–	Export-orientated industries adjusting to shifts in demand.
Eur	May CPI %yr	7.0%	6.4%	–	Energy driving headline descent; underlying remains sticky.
	Apr unemployment rate	6.5%	6.5%	–	Labour market remains in robust health.
	May HCOB manufacturing PMI	44.6	–	–	Final estimate.
UK	May S&P Global manufacturing PMI	46.9	–	–	Final estimate.
	Apr net mortgage lending £bn	0.0	–	–	Cost-of-living and rates major headwinds for housing.
US	May ADP employment change	296k	160k	–	Businesses continue to slow hiring amid uncertainty.
	Initial jobless claims	229k	–	–	Job shedding negligible as firms hold on to staff.
	Apr construction spending	0.3%	0.2%	–	New capacity needed but uncertainty to remain high.
	May S&P Global manufacturing PMI	48.5	–	–	Small and medium sized businesses under pressure...
	May ISM manufacturing	47.1	47.0	–	... big business well positioned for downturn, but pressure on.
	Fedspeak	–	–	–	Harker.
Fri 02					
NZ	Q1 terms of trade	1.8%	–	0.0%	Likely flat result masks falls in both import and export prices.
	Q1 building work put in place	–1.6%	–	0.8%	Still elevated, modest gains expected across segments.
Aus	Apr housing finance	4.9%	2.0%	3.0%	Lifting off lows, consistent with wider market firming...
	Apr owner occupier finance	5.5%	–	3.5%	... surprisingly strong owner occupier gain in March...
	Apr investor finance	3.7%	–	2.0%	... with investor activity lagging a little.
US	May non-farm payrolls	253k	180k	150k	Revisions are creating volatility, but downtrend is clear.
	May unemployment rate	3.4%	3.5%	3.5%	Unemployment will slowly tick higher in coming months...
	May average hourly earnings %mth	0.5%	0.3%	0.3%	... and, as it does, wage growth will take the next leg lower.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022f	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	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
United States						
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
Japan						
Real GDP %yr	-0.4	-4.3	2.1	1.0	1.2	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.4
United Kingdom						
Real GDP %yr	1.6	-11.0	7.6	4.3	-0.2	1.2
China						
Real GDP %yr	6.0	2.2	8.4	3.0	6.2	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.3	4.5	4.1	4.4
World						
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
Australia								
Cash	3.85	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.95	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.73	3.40	3.30	3.20	3.00	2.80	2.70	2.50
International								
Fed Funds	5.125	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.80	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	0.6523	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	139.68	132	130	128	127	126	125	124
EUR/USD	1.0729	1.11	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2340	1.25	1.25	1.26	1.26	1.27	1.28	1.29
USD/CNY	7.0522	6.75	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0735	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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