

WESTPAC WEEKLY ECONOMIC COMMENTARY

It's raining, it's pouring.

7 February 2023



Southern rātā

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The heavy rainfall in Auckland and parts of the upper North Island has left many people with a major recovery job in the months ahead. While we don't think this will meaningfully alter the outlook for the wider economy, there will be some effects to watch for in the upcoming data.

It's still early days in terms of gauging the scale of the damage, and we'll review our numbers as we go. Based on what has been reported so far, we estimate that it could be in the range of \$500m, and potentially higher.

This makes it New Zealand's most expensive weather-related event by quite some margin. However, it's well short of the cost of repairs that followed the 2010-11 Canterbury earthquakes, which came in at around \$40bn (spread over many years). Repairs following the 2016 Kaikoura earthquake cost around \$2bn.

To put these numbers in perspective, nationwide building activity (including infrastructure) is currently running at over \$50bn a year. Moreover, the industry is already stretched to capacity, especially in the residential building sector. This is a major contrast with the Canterbury earthquake rebuild, when the industry was starting from a depressed state in the wake of the GFC recession.

As a result, we suspect that flood recovery work won't end up being much of a boost to building activity – rather, we may see some projects delayed or shelved while the repair work takes priority. The additional pressure is instead likely to be

channelled into prices. There were signs that construction cost inflation was starting to slow at the end of 2022, but it may now take longer to recede.

We are also likely to see food price inflation hold up for longer. Vegetable growers were already contending with poor growing conditions that saw prices rise by 23% over 2022, and this year's flooding has caused major damage to some crops in the Auckland region.

Both of these effects should be temporary, as the repair work is completed and as the new growing season begins. They are not a source of sustained inflation that might warrant a response from the central bank. However, they will require some patience to look through as they feed into the inflation data over the coming months.

Delayed downturn

The additional work created by the flood recovery doesn't detract from the broader issues that the homebuilding industry faces. The level of activity remains very high for now, but the

financial incentives for housing development have turned a lot less attractive. Interest rates have risen sharply, building costs are rising rapidly, and existing house prices have fallen. This is leading to hesitancy among both developers and purchasers. As a result, we expect to see building consents easing back from their current elevated levels over the next few years.

That doesn't mean that a crash in construction activity is imminent. Indeed, over the past year, the number of new consented projects has risen much faster than actual construction activity. As a result, there still is a substantial existing pipeline of planned work. The construction sector is continuing to grapple with stretched capacity and shortages of skilled staff. Those conditions are acting as a handbrake on the pace of building activity. We expect an easing in construction activity over the next few years as fewer new projects come to market. But that is likely to be a gradual easing from high levels.

Even a gradual downturn will prove challenging for some operators. As our [recent report](#) notes, the homebuilding industry is dominated by small players, often weakly capitalised and with little oversight of their finances. Even in the best of times, construction firms account for an outsized proportion of business failures. Those that can tightly control their costs and diversify their sources of income will be best placed to ride out the downleg of the cycle.

Turning point

Last week's employment figures for the December quarter were close to what was expected by market forecasters and the Reserve Bank, if anything fractionally on the softer side. The labour market is still very tight, but there are signs that we've passed the very peak.

The unemployment rate rose slightly to 3.4%. That's still close to its recent record low of 3.2%, and it's held around these levels for the last year and a half – as good a sign as any that the economy has effectively reached full employment. Labour shortages remain top of the list of businesses' concerns, although the number of job vacancies has receded from its highs in recent months.

The greater story will be around what happens in the year ahead, as higher interest rates increasingly weigh on people's spending, and in turn what that does to the demand for workers. We're expecting the unemployment rate to rise over the next couple of years to a peak of 4.8% – not that high compared to history, but consistent with a much lower rate of wage and price inflation than we have today.

Market forecasts and pricing now seem to have converged around a 50 basis point increase in the OCR at this month's review, reaching a peak of 5.25% within the next few months. That matches the call that we made last week after the inflation figures. We're also seeing some of the popular one- and two-year fixed mortgage rates being trimmed, reflecting the slightly lower expected peak in the OCR for this cycle.

Michael Gordon, Acting Chief Economist

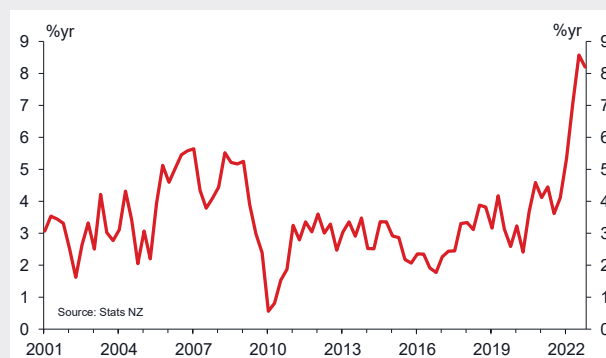
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Chart of the week

Wage growth is typically a lagging element of the economic cycle, and that has proven to be the case this time – despite the mounting evidence of a tight labour market and rising inflation pressures over 2021, wage growth didn't really start to pick up until 2022. But now that it has taken off, wage growth has charged higher, with average hourly earnings rising by 8.2% over the past year. While some of the steam is now coming out of the economy, we suspect that wage growth has a few quarters to go before it reaches its peak. That in turn means that consumer price inflation is likely to stay stubbornly above the RBNZ's target in the year ahead.

Average hourly earnings growth (private sector)

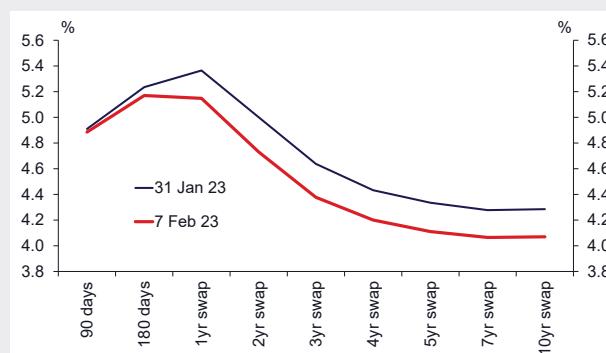


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.25% in the early part of this year, a move that has also been factored into wholesale interest rates. However, we see more scope for reducing the OCR over the longer term as inflation pressures recede.

As a result, we believe that there is value in fixing for terms of up to two years. We would still regard fixing for terms longer than this as expensive, but this option may suit those who want more certainty in their repayments.

NZ interest rates



The week ahead

NZ GlobalDairyTrade auction, whole milk powder prices

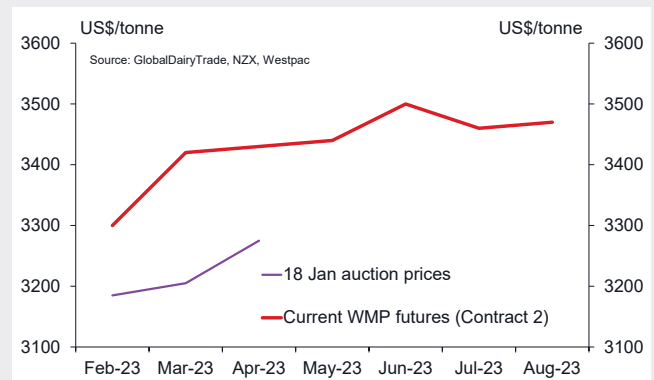
Feb 8, Last: +0.1%, Westpac: +5.0%

We expect whole milk powder prices (WMP) to jump 5% at the upcoming auction. This follows essentially no price change at the previous auction.

Our pick is similar to futures market pricing (as at 12pm Friday 3 February).

The rapid easing of Covid restrictions in China is likely to boost global demand and thus lift dairy prices.

Whole milk powder prices



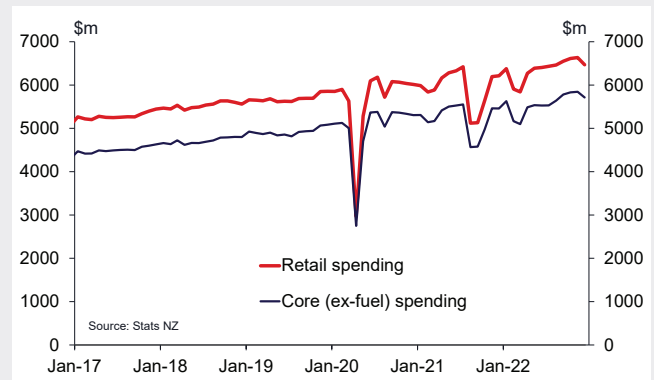
NZ Jan retail card spending

Feb 10, Last: -2.5%, Westpac: +1.0%

Retail spending fell by 2.5% in December with declines across a range of discretionary spending categories. That fall was particularly notable as for most of 2022, households were continuing to dial up their spending on discretionary items despite large price increases. Spending was also boosted by the return of international tourists to our shores. However, with increases in inflation and interest rates, the pressure on households' finances has been growing. And it now looks like spending appetites are starting to falter.

We're forecasting a 1% rise in spending in January, underpinned by the sharp rise in food prices and a partial recovery in durables spending after last month's sharp fall. However, the recent flooding in Auckland over the holiday weekend will be a drag on spending.

NZ retail card spending



Aus Q4 real retail sales

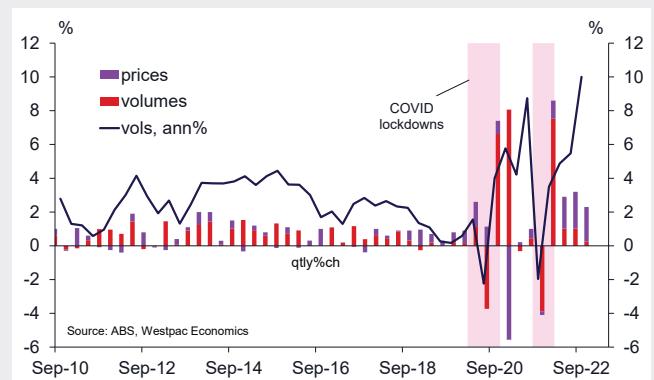
Feb 6, Last: 0.2%, WBC f/c: -0.3%

Mkt f/c: -0.5%, Range: -0.1% to -0.9%

Real retail sales slowed materially in Q3, rising just 0.2%qtr after back to back gains of 1% gain in Q1 and Q2. The main dynamic was around a sharp spike in retail prices eroding purchasing power with the 2.5%qtr gain in nominal spend comparable to the 2.5-3% gains in the previous two quarters.

Preliminary estimates show nominal sales slowed abruptly in Q4 with a sharp fall in the final month leaving sales up just 0.9%qtr. The Q4 CPI showed prices continued to rise at a rapid pace, albeit with more of that pressures starting to emanate from 'non-retail' segments (slower gains in food prices a particularly important component given food accounts for about half of retail sales). Overall we expect retail prices to have risen by about 1.2%qtr, pointing to a 0.3% dip in real retail sales 'volumes'. Note that wider measures of spending suggest this weakness in retail has been largely offset by a surge in non-retail spend, services in particular.

Aus quarterly retail volumes and prices



The week ahead

Aus Dec trade balance, AUDbn

Feb 7, Last: 13.2, WBC f/c: 13.5

Mkt f/c: 12.4, Range: 11.5 to 15.0

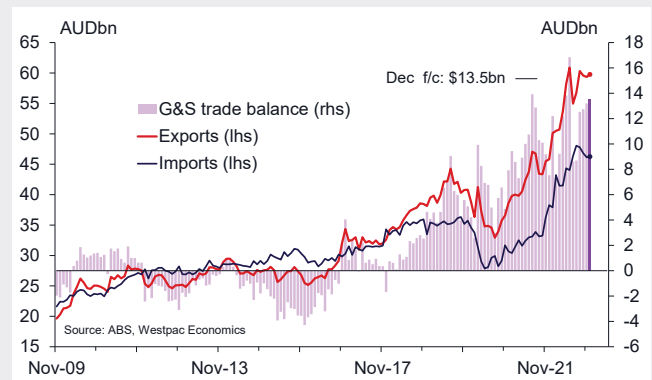
Australia's trade surplus remains sizeable with commodity prices still elevated (albeit the terms of trade is down a little from the June quarter record high).

The surplus printed at \$13.2bn for November - only the fourth occasion the surplus has exceeded the \$13bn mark. We expect the surplus to edge higher in December, rising to \$13.5bn.

The import bill is forecast to be little changed, up by 0.2%, +\$0.1bn. Lower prices (falling oil and freight costs) broadly offset a rise in overseas travel and a potential modest lift in goods volumes.

Export earnings are forecast to rise modestly, up 0.7%, +\$0.4bn. Coal shipments rebounding from flood disruptions, gold lifting off a low base and rising tourism numbers are all positives. Fuel exports likely fell on lower global oil prices, while metal ores (dominated by iron ore, including lithium) may ease from November's record high with softer volumes more than outweighing the higher iron ore price.

Aus trade balance



Aus RBA policy decision

Feb 7, Last: 3.10%, WBC f/c: 3.35%

Mkt f/c: 3.35%, Range: 3.10% to 3.35%

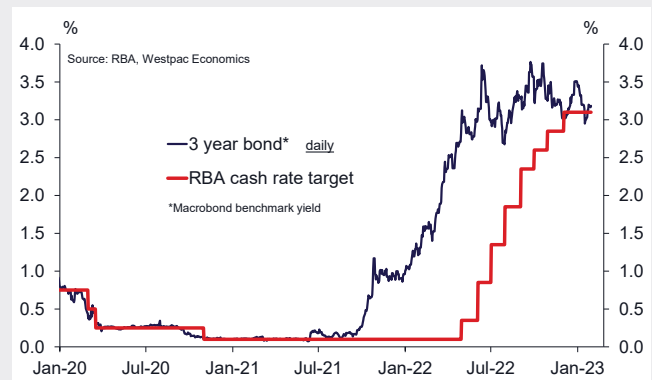
At the February Board meeting, Westpac anticipates that the RBA will lift the cash rate by 25bps, to 3.35%. The RBA, in responding to a significant inflation challenge and the tightest labour market in 50 years, has quickly raised interest rates.

Rates have lifted from a record low of 0.1% in May 2022, with moves at each monthly Board meeting, including 50bp hikes for the four meetings July to September. The RBA slowed the pace of tightening at the October meeting, back to 25bp increments, with policy arguably moving into the contractionary zone.

The Q4 CPI report revealed that annual trimmed mean (underlying) inflation reached 6.9%, significantly higher than the RBA's November forecast for 6.5%. Inflation is still clearly too high, and more work needs to be done in our view.

The RBA will also release its Feb Statement on Monetary Policy on Feb 9 including updated forecasts.

RBA cash rate and 3 year bonds

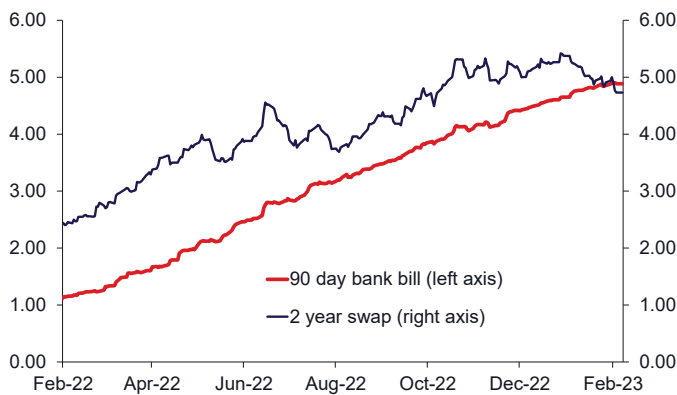


New Zealand forecasts

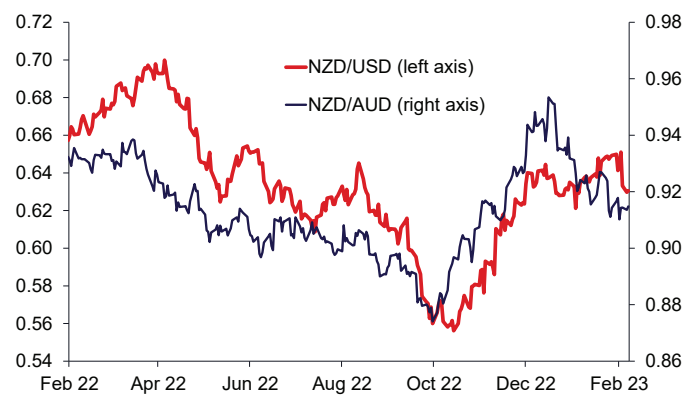
| Economic forecasts | Quarterly | | | | Annual | | | |
|----------------------------------|-----------|------|------|------|--------|-------|-------|-------|
| | 2022 | | 2023 | | 2021 | 2022f | 2023f | 2024f |
| % change | Sep | Dec | Mar | Jun | | | | |
| GDP (Production) | 2.0 | 0.5 | 0.4 | 0.0 | 6.1 | 2.9 | 2.2 | 0.0 |
| Employment | 1.3 | 0.1 | 0.0 | 0.0 | 3.3 | 1.3 | 0.1 | -0.1 |
| Unemployment Rate % s.a. | 3.3 | 3.4 | 3.5 | 3.6 | 3.2 | 3.4 | 3.9 | 4.8 |
| CPI | 2.2 | 1.4 | 1.4 | 1.0 | 5.9 | 7.2 | 4.7 | 2.4 |
| Current Account Balance % of GDP | -7.9 | -7.3 | -5.9 | -5.2 | -6.0 | -7.3 | -4.4 | -3.4 |

| Financial forecasts | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 |
|---------------------|--------|--------|--------|--------|--------|--------|--------|
| Cash | 4.75 | 5.25 | 5.25 | 5.25 | 5.00 | 4.50 | 4.00 |
| 90 Day bill | 5.25 | 5.35 | 5.35 | 5.25 | 4.80 | 4.30 | 3.80 |
| 2 Year Swap | 4.80 | 4.60 | 4.30 | 4.00 | 3.80 | 3.60 | 3.45 |
| 5 Year Swap | 4.20 | 4.10 | 4.00 | 3.90 | 3.80 | 3.70 | 3.65 |
| 10 Year Bond | 4.00 | 3.90 | 3.85 | 3.80 | 3.70 | 3.60 | 3.55 |
| NZD/USD | 0.64 | 0.65 | 0.66 | 0.67 | 0.68 | 0.68 | 0.68 |
| NZD/AUD | 0.93 | 0.93 | 0.92 | 0.91 | 0.90 | 0.89 | 0.89 |
| NZD/JPY | 87.0 | 87.8 | 88.4 | 88.4 | 87.8 | 86.4 | 85.1 |
| NZD/EUR | 0.60 | 0.61 | 0.61 | 0.60 | 0.60 | 0.60 | 0.59 |
| NZD/GBP | 0.52 | 0.53 | 0.54 | 0.54 | 0.54 | 0.54 | 0.53 |
| TWI | 73.3 | 73.6 | 73.2 | 73.2 | 73.0 | 72.4 | 71.9 |

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 7 February 2023

| Interest rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| Cash | 4.25% | 4.25% | 4.25% |
| 30 Days | 4.54% | 4.46% | 4.32% |
| 60 Days | 4.73% | 4.68% | 4.55% |
| 90 Days | 4.89% | 4.88% | 4.77% |
| 2 Year Swap | 4.73% | 5.02% | 5.19% |
| 5 Year Swap | 4.11% | 4.35% | 4.56% |

NZ foreign currency mid-rates as at 7 February 2023

| Exchange rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| NZD/USD | 0.6305 | 0.6489 | 0.6383 |
| NZD/EUR | 0.5873 | 0.5973 | 0.5945 |
| NZD/GBP | 0.5238 | 0.5268 | 0.5244 |
| NZD/JPY | 83.51 | 84.45 | 84.24 |
| NZD/AUD | 0.9148 | 0.9238 | 0.9258 |
| TWI | 71.12 | 72.54 | 71.94 |

Data calendar

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---------------|-----------------------------------|--------|---------------|------------------|--|
| Mon 06 | | | | | |
| NZ | Waitangi Day public holiday | - | - | - | Markets closed. |
| Aus | Jan MI inflation gauge | 5.9% | - | - | It leads the monthly CPI but provides a general view of risk. |
| | Q4 real retail sales | 0.2% | -0.5% | -0.3% | Price gains to outstrip nominal spend with declining volumes. |
| Eur | Feb Sentix investor confidence | -17.5 | - | - | Robust economy should support gains hence. |
| | Dec retail sales | 0.8% | - | - | Consumer impacted by high inflation; but jobs secure. |
| Tue 07 | | | | | |
| NZ | Jan ANZ commodity prices | -0.1% | - | - | Meat prices falling on earlier weakness in Chinese demand. |
| Aus | Dec trade balance \$bn | 13.2 | 12.4 | 13.5 | Another sizeable surplus expected. |
| | RBA policy decision | 3.10% | 3.35% | 3.35% | Tightening cycle continues, responding to inflation challenge. |
| Chn | Jan foreign reserves \$bn | 3127.7 | 3154.0 | - | Little pressure on reserves. |
| US | Dec trade balance \$bn | -61.5 | -68.5 | - | Deficit should narrow as consumer demand weakens. |
| | Fedspeak | - | - | - | Chair Powell to speak. Barr too. |
| Wed 08 | | | | | |
| NZ | GlobalDairyTrade auction (WMP) | 0.1% | - | 5.0% | Easing Chinese Covid restrictions boosting dairy prices. |
| US | Dec consumer credit \$bn | 27.96 | 25.00 | - | Demand for credit likely to continue to decline. |
| | Dec wholesale inventories | 0.1% | 0.1% | - | Volatile times ahead. |
| | Fedspeak | - | - | - | Williams, Cook, Barr, Bostic, Kashkari and Waller. |
| Thu 09 | | | | | |
| Aus | Dec weekly payrolls %mth | 0.7% | - | - | Will the summer holiday collapse be larger than usual? |
| Chn | Jan M2 money supply %yr | 11.8% | 11.6% | - | Credit will remain freely available... |
| | Jan new loans, CNYbn | 1398 | 4000 | - | ... as authorities support recovery. |
| US | Initial jobless claims | 183k | - | - | To remain at low level for time being. |
| Fri 10 | | | | | |
| NZ | Jan manufacturing PMI | 47.2 | - | - | Set to remain weak, new orders contracting. |
| | Jan card spending | -2.5% | - | 1.0% | Boosted by higher food prices and some lift in durables. |
| Aus | RBA Statement on Monetary Policy | - | - | - | Forecast update. |
| Chn | Jan CPI %yr | 1.8% | 2.3% | - | Inflation to remain a benign force for consumers... |
| | Jan PPI %yr | -0.7% | -0.5% | - | ... and likely also for most businesses. |
| | Q4 current account balance US\$bn | 144.3 | - | - | Trade surplus showing resilience as Asia gives support. |
| UK | Dec trade balance £bn | -1802 | - | - | Weaker consumer should narrow deficit in 2023. |
| | Q4 GDP | -0.3% | - | - | A lengthy recession is beginning. |
| US | Feb Uni. of Michigan sentiment | 64.9 | - | - | A base is beginning to form. |
| | Jan monthly budget statement \$bn | -85.0 | - | - | Budget figures in focus as debt ceiling looms (again). |
| | Fedspeak | - | - | - | Waller and Harker. |

International forecasts

| Economic Forecasts (Calendar Years) | 2019 | 2020 | 2021 | 2022f | 2023f | 2024f |
|-------------------------------------|------|------|------|-------|-------|-------|
| Australia | | | | | | |
| Real GDP %yr | 1.9 | -1.8 | 5.2 | 3.6 | 1.8 | 1.2 |
| CPI inflation %yr | 1.8 | 0.9 | 3.5 | 7.5 | 3.9 | 3.0 |
| Unemployment rate % | 5.2 | 6.8 | 4.7 | 3.3 | 4.6 | 5.1 |
| Current account % of GDP | 0.7 | 2.4 | 3.1 | 0.5 | -1.0 | -1.5 |
| United States | | | | | | |
| Real GDP %yr | 2.3 | -3.4 | 5.7 | 2.0 | 0.5 | 1.3 |
| CPI inflation %yr | 1.9 | 1.2 | 5.1 | 7.4 | 2.3 | 2.1 |
| 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 | -4.6 | 1.7 | 1.6 | 1.5 | 1.0 |
| Euro zone | | | | | | |
| Real GDP %yr | 1.6 | -6.1 | 5.2 | 3.2 | 0.4 | 1.5 |
| United Kingdom | | | | | | |
| Real GDP %yr | 1.7 | -9.3 | 7.4 | 4.0 | -0.7 | 1.5 |
| China | | | | | | |
| Real GDP %yr | 6.0 | 2.2 | 8.1 | 3.5 | 6.0 | 5.5 |
| East Asia ex China | | | | | | |
| Real GDP %yr | 3.8 | -2.3 | 4.2 | 4.5 | 4.3 | 4.4 |
| World | | | | | | |
| Real GDP %yr | 2.8 | -3.0 | 6.0 | 3.3 | 2.9 | 3.2 |

Forecasts finalised 12 December 2022

| Interest rate forecasts | Latest | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Australia | | | | | | | | | |
| Cash | 3.10 | 3.60 | 3.85 | 3.85 | 3.85 | 3.60 | 3.35 | 3.10 | 2.85 |
| 90 Day BBSW | 3.34 | 3.97 | 4.05 | 4.05 | 3.97 | 3.72 | 3.47 | 3.22 | 2.97 |
| 10 Year Bond | 3.38 | 3.45 | 3.30 | 3.10 | 2.90 | 2.70 | 2.55 | 2.50 | 2.50 |
| International | | | | | | | | | |
| Fed Funds | 4.625 | 4.875 | 4.875 | 4.875 | 4.875 | 4.375 | 3.875 | 3.375 | 2.875 |
| US 10 Year Bond | 3.37 | 3.40 | 3.30 | 3.20 | 3.10 | 2.90 | 2.70 | 2.60 | 2.50 |

| Exchange rate forecasts | Latest | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| AUD/USD | 0.7060 | 0.69 | 0.70 | 0.72 | 0.74 | 0.75 | 0.76 | 0.76 | 0.77 |
| USD/JPY | 128.58 | 136 | 135 | 134 | 132 | 130 | 128 | 126 | 124 |
| EUR/USD | 1.0894 | 1.06 | 1.07 | 1.09 | 1.11 | 1.12 | 1.13 | 1.14 | 1.15 |
| GBP/USD | 1.2212 | 1.22 | 1.22 | 1.23 | 1.24 | 1.25 | 1.26 | 1.27 | 1.28 |
| USD/CNY | 6.7440 | 6.90 | 6.80 | 6.60 | 6.50 | 6.40 | 6.30 | 6.20 | 6.10 |
| AUD/NZD | 1.0910 | 1.08 | 1.08 | 1.09 | 1.10 | 1.11 | 1.13 | 1.13 | 1.13 |

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