WESTPAC WEEKLY ECONOMIC COMMENTARY

Another 50 points, and even more to come.

10 October 2022

Kōwhai

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As expected, the Reserve Bank of New Zealand raised the Official Cash Rate by 50 bp at its October policy review. That was the fifth 50 bp move in a row and took the cash rate to a seven year high of 3.50%. The RBNZ also repeated that it would continue moving "at pace" until it's satisfied that interest rates are high enough to bring inflation back to target.

The October statement didn't give any direct indication of where exactly the RBNZ now thinks the peak in the cash rate will be. That's understandable: October's policy review didn't include a full set of new forecasts, and it's not really desirable for the RBNZ to be drawing conclusions about work that hasn't been done yet.

However, the record of the meeting was unusually explicit in one respect, noting that the Committee had debated between a 50 or a 75 bp hike this time. The latter was argued on a 'stitch in time' basis: a larger increase now could reduce the need for a higher peak in the OCR cycle overall. This is the same reasoning that was applied when the RBNZ switched up from 25 to 50 bp moves earlier this year. So this was effectively a 'hawkish' shift in the RBNZ's thinking, without being too precise about the scale of it.

The RBNZ's comments strongly suggest that they now expect a higher peak in the OCR than they did before. In the August Monetary Policy Statement, the RBNZ projected a peak of just over 4% by the second half of next year. If that was still the peak that they had in mind, then moving to 3.75% at the October review would have done very little in terms of trimming the amount of tightening they ultimately need to do. Stepping up the pace of rate hikes – or even discussing it – makes more sense in an environment where the RBNZ is quite some distance from where it thinks it needs to be.

A key point to take from the October statement is that the RBNZ is firmly focused on setting monetary policy for local conditions. The statement was filled with references to strong demand, constrained capacity, labour shortages, and elevated core inflation. There was much less emphasis on overseas conditions, or – surprisingly to us – the sharply lower exchange rate over recent weeks.

Looking at local developments since the RBNZ's previous policy statement in August, we have seen some signs that the economy is starting to lose steam. Most notably, the housing market has continued to cool, with prices now down 9% since their peak in November. We've also seen a flattening off in nominal spending at the same time that prices and earnings have been rising rapidly.

However, while signs of a slowdown are taking shape, overall economic activity has continued to run hot. That's been seen most clearly in the labour market with continued strength in filled jobs, high levels of staff turnover, and a rise in job advertisements. We're also continuing to hear reports of strong increases in wage rates.

Looking at economic conditions more generally, the latest NZIER survey of business opinion has seen businesses continuing to report firm levels of demand and ongoing pressure on operating capacity. Businesses are also continuing to report significant pressure on operating costs, with very large numbers passing those increases into their output prices.

With activity remaining resilient and inflation pressures still red hot, we recently revised up our forecast peak in the current cash rate cycle to 4.50% (up from 4.00% previously). We expect that to be achieved with 50 bp increases at both the November and February policy meetings.

Given the extend of the price and cost pressures rippling through the economy, there have been questions about whether even a 4.50% cash rate will be enough to tame the inflation dragon. Those concerns have been reinforced by the resilience in activity over the past year as the OCR has continued to push higher. However, there are a couple things to keep in mind on this front.

First, a sizeable chunk of the cost pressures that we've been grappling with have been due to global disruptions that occurred as a result of the pandemic. That includes interruptions to global manufacturing and distribution networks, as well as increases in the prices of commodities like oil. Some of those pressures are continuing today, with the prices for many imported consumer goods and production inputs lingering above their pre-pandemic levels. Even so, we're not seeing the same sort of very large increases that we did over the past year. And in the case of global oil and shipping costs, there have been sizeable falls in recent months.

Second, and importantly for domestic monetary policy, is that the full impact of interest rate increases to date has yet to be felt by many households. Around 90% of New Zealand mortgages are on fixed rates. That's meant many borrowers have been insulated from the impact of rate increases thus far. But that picture is now changing, with around half of all mortgages coming up for repricing over the coming 12 months. In many cases, borrowers will face refixing at rates that are 2% to 3% higher than the rates they are currently on. That signals a significant squeeze on many households' disposable incomes, and the related easing in demand will go a long way to dampen the domestic inflation pressures the RBNZ is grappling with.

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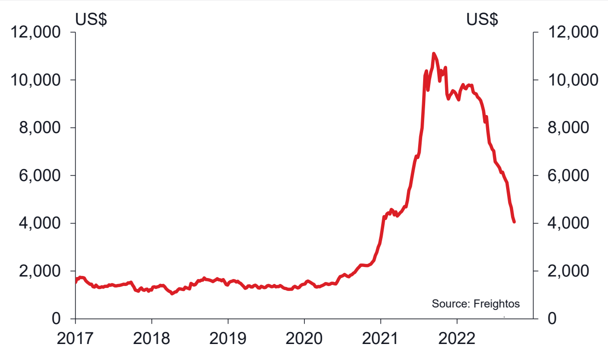
Chart of the week

Global shipping rates are still well above the levels we saw prior to the pandemic. However, they have been dropping rapidly in recent months, falling by around 60% since the start of this year. It will take some time before the full impact of those falls is felt on shop shelves here in New Zealand. Nevertheless, this does signal an easing in import costs and reduced pressure on consumer prices over the coming months.

Freightos container rate index

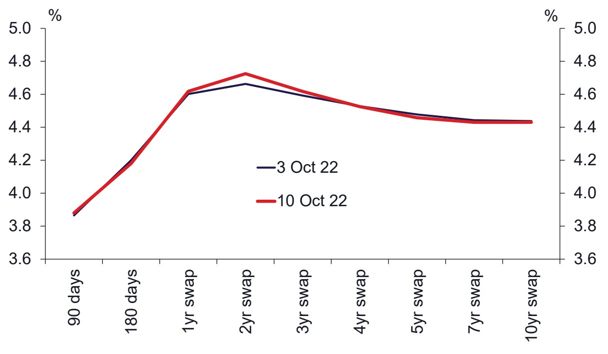


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 4.5% and to hold it there for the next couple of years, before reducing it to a more sustainable level in the following years. In contrast, wholesale interest rate markets are priced for a sustained higher level of the OCR for many years to come.

As a result, we believe that there is value in fixing for terms of up to two years. We would 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 Sep retail card spending

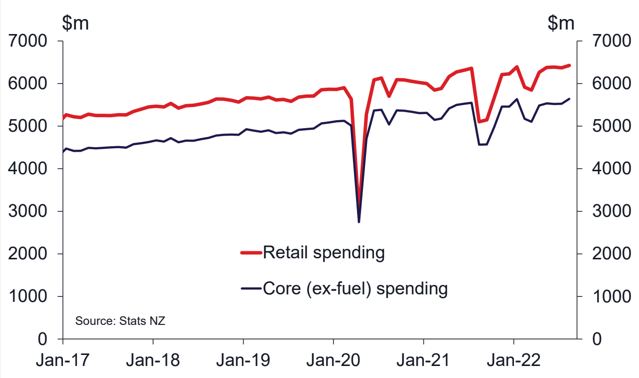
Oct 11, Last: +0.9% Westpac: +0.4%

Following a 0.9% rise in August, we're forecasting a 0.4% rise in retail spending in September.

There are two key areas to watch. First is spending on durables which has fallen for the past three months, and we expect it will continue to moderate in September. Spending on durables is being dampened by the rise in interest rates and the related cooling in the housing market.

The other area to watch is hospitality spending, which has been trending higher since the borders reopened. We've also seen New Zealanders shifting their spending away from durables and towards services like dining out. We'll be looking to see if that trend has continued, or if the rise in interest rates is starting to drag on spending in this area also.

NZ retail card spending



NZ Sep REINZ house sales and prices

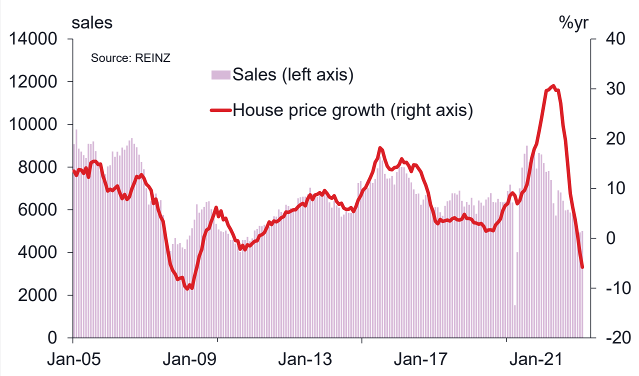
Oct 13 (TBC), Sales last: +1.4% m/m, -18.3% y/y
Prices last: -1.4% m/m, -5.8% y/y

There are some tentative signs that the downturn in the New Zealand housing market is flattening out. Sales have been flat to slightly higher in the last couple of months, albeit still at very low levels. The stock of unsold homes on the market is also beginning to stabilise.

This should not be taken as a sign of demand returning, though. Rather, the flow of new listings is slowing, as vendors accept that they won't get the prices they would like. In time this will help to stem the downward pressure on sale prices, but it doesn't point to an upturn any time soon.

Indeed, house values remain under pressure as fixed-term mortgage rates continue to creep higher. Further RBNZ rate hikes are being priced in for the coming months.

REINZ house prices and sales



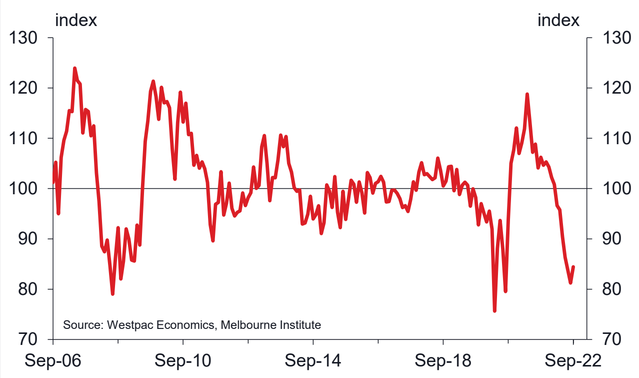
Aus Sep Westpac-MI Consumer Sentiment

Oct 11, Last: 84.4

Consumer Sentiment seemed to find something of a base through Q3, rising 3.9% to 84.4 in the September month, the first increase since November. That said, the Index remains at very weak levels – readings in the 80-85 range only seen heading into major disruptions such as the Covid pandemic, the GFC or the recessions in the early 1990s and early 1980s. Labour market conditions appear to be providing a modicum of support – reads below 80 have only been seen when unemployment has been rising sharply.

The October update may see more consolidation. Most notably, the RBA slowed the pace of policy tightening, opting for a 25bp rate hike after four consecutive 50bp increases – which may be viewed as a positive sign that official rates are nearing a peak. But running against this is more volatility on global financial markets (S&P500 down 6.8% and AUD off 3.4¢ US since the Sep survey); a continued correction in housing markets; and the end of the temporary halving in fuel excise tax that has seen pump prices jump nearly 20¢/litre.

Aus Consumer Sentiment Index



The week ahead

Aus Sep overseas arrivals and departures, prelim

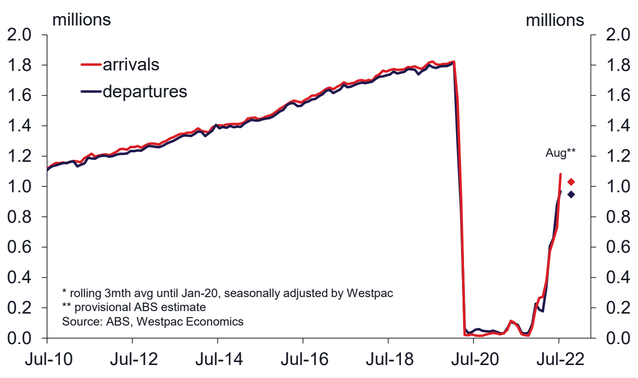
Oct 11, Arrivals, Last: 1029.2k
Oct 11, Departures, Last: 947.0k

While the patterns of overseas travel are beginning to return to more typical seasonal trends, the robust underlying strength of the recovery continues to be clearly evident. Indeed, in August, arrivals and departures slipped only slightly in original terms, down -52.4k and -21.5k respectively – a favourable outcome against typical seasonality seen during this period.

For the September preliminary estimate, we expect this to remain the case. With arrivals and departures at 60% and 55% of their respective pre-pandemic levels, there is still plenty of capacity for growth before the year-end travel season.

There will also be a keen focus on the visa detail. Visa grant rates have already begun to improve after more resources were put towards processing the backlog. It will be interesting to gauge how visa arrivals will respond, especially among temporary workers given the current tightness of Australia's labour market.

Aus total overseas arrivals and departures

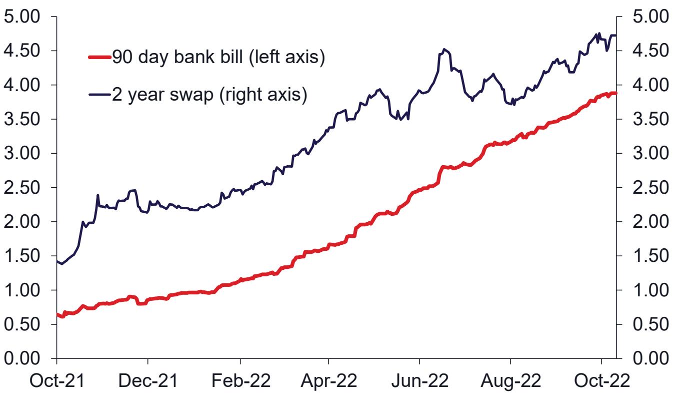


New Zealand forecasts

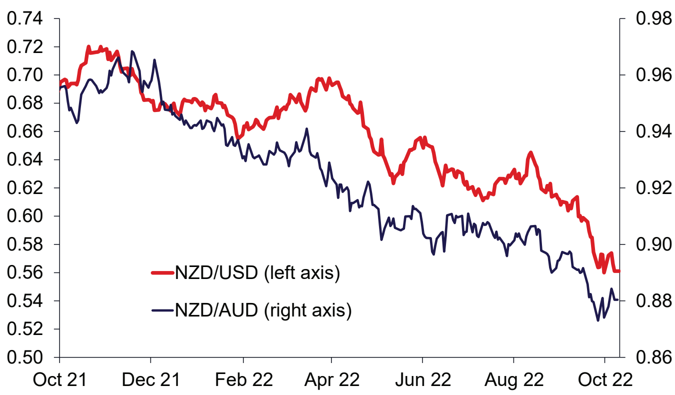
Economic forecasts	Quarterly				Annual			
	2022			2023				
% change	Jun (a)	Sep	Dec	Mar	2020	2021	2022f	2023f
GDP (Production)	1.7	0.4	0.6	0.6	-2.1	5.5	2.2	2.2
Employment	0.0	0.1	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	4.9	3.2	3.4	3.8
CPI	1.7	1.6	0.3	1.0	1.4	5.9	5.3	3.6
Current Account Balance % of GDP	-7.7	-7.7	-7.1	-6.0	-0.8	-6.0	-7.1	-4.4

Financial forecasts	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Cash	4.00	4.50	4.50	4.50	4.50	4.50	4.50
90 Day bill	4.30	4.60	4.60	4.60	4.60	4.60	4.40
2 Year Swap	4.70	4.60	4.40	4.20	3.95	3.65	3.35
5 Year Swap	4.50	4.30	4.10	3.90	3.65	3.40	3.20
10 Year Bond	4.30	4.10	4.00	3.80	3.60	3.40	3.25
NZD/USD	0.58	0.59	0.60	0.62	0.65	0.66	0.66
NZD/AUD	0.89	0.89	0.90	0.90	0.90	0.90	0.89
NZD/JPY	82.9	83.2	83.4	84.9	87.1	86.5	85.8
NZD/EUR	0.59	0.60	0.59	0.60	0.61	0.60	0.60
NZD/GBP	0.51	0.52	0.53	0.53	0.54	0.54	0.53
TWI	68.3	68.5	68.4	69.1	71.0	70.7	70.8

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 10 October 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.00%	3.00%
30 Days	3.54%	3.39%	3.21%
60 Days	3.71%	3.58%	3.40%
90 Days	3.88%	3.76%	3.58%
2 Year Swap	4.73%	4.70%	4.19%
5 Year Swap	4.46%	4.53%	4.07%

NZ foreign currency mid-rates as at 10 October 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5611	0.5637	0.6137
NZD/EUR	0.5756	0.5865	0.6062
NZD/GBP	0.5056	0.5274	0.5253
NZD/JPY	81.53	81.58	87.66
NZD/AUD	0.8804	0.8730	0.8910
TWI	67.15	68.36	71.08

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
Eur	Oct Sentix investor confidence	-31.8	-33.0	–	Dreary outlook offering little support to confidence.
US	Columbus Day	–	–	–	Federal holiday. Stock market open, bonds closed.
	Fedspeak	–	–	–	Evans and Brainard.
Tue 11					
NZ	Sep retail card spending	0.9%	–	0.4%	Durables spending softening, while hospitality picks up.
Aus	Oct WBC-MI Consumer Sentiment	84.4	–	–	Consolidated at weak levels, ahead of RBA's Oct 25bps move.
	Sep NAB business survey	20	–	–	August, conditions elevated. September, any signs of slowing?
	Sep overseas arrivals, prelim '000s	1029.2	–	–	Net temporary work visa arrivals starting to pick-up.
UK	Aug ILO unemployment rate	3.6%	3.7%	–	Slack to become more visible into year-end.
US	Sep NFIB small business optimism	91.8	91.8	–	Consolidating near pandemic lows; outlook remains gloomy.
	Fedspeak	–	–	–	Mester.
Wed 12					
NZ	Aug net migration	-376	–	–	Balance is starting to improve as the border has reopened.
Aus	RBA Assistant Governor Economic	–	–	–	Luci Ellis speaking, Investment conference, Sydney.
Eur	Aug industrial production	-2.3%	1.3%	–	Tough start to Q3, weakening demand a risk into year-end.
UK	Aug trade balance £bn	-7793	–	–	Deficit likely to remain at strong levels given import values.
US	Sep PPI	-0.1%	0.2%	–	Producer inflation cooling as supply issues ease.
	FOMC September meeting minutes	–	–	–	Focus is on discussions of path for policy in 2022/23.
	Fedspeak	–	–	–	Kashkari and Barr.
Thu 13					
NZ	Sep REINZ house sales %yr	-18.3%	–	–	Expected date. Signs that sales are levelling out...
	Sep REINZ house price index %yr	-5.8%	–	–	... but prices likely still have further to adjust downward.
	Sep food price index	1.1%	–	-0.3%	Seasonal drop in vegetable prices.
Aus	Oct MI inflation expectations	5.4%	–	–	Elevated and well above target band, mirroring actual inflation.
US	Sep CPI	0.1%	0.2%	–	Close attention on core inflation given August's surprise.
	Initial jobless claims	219k	–	–	Likely to remain at low levels for time being.
	Fedspeak	–	–	–	Bowman.
Fri 14					
NZ	Sep manufacturing PMI	54.9	–	–	Production and orders have been holding firm.
Chn	Sep PPI %yr	2.3%	1.1%	–	Upstream price pressures to decelerate further...
	Sep CPI %yr	2.5%	2.8%	–	... while consumer inflation remains relatively benign.
	Sep trade balance USDbn	79.39	81.20	–	Weaker global economy a risk for trade into year-end.
Eur	Aug trade balance €bn	-40.3	–	–	Energy-related import values still elevated.
US	Sep retail sales	0.3%	0.2%	–	Inflation and rates clearly weighing on consumption.
	Sep import price index	-1.0%	-1.1%	–	Import prices are declining from elevated levels.
	Aug business inventories	0.6%	0.9%	–	Businesses rebuilding inventory at robust pace.
	Oct Uni. of Michigan sentiment	58.6	58.8	–	Consumers still feeling the heat from inflation and rates.
	Fedspeak	–	–	–	Cook.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.1	4.9	4.2	1.9
CPI inflation %yr	1.8	1.8	0.9	3.5	7.5	3.8
Unemployment rate %	5.0	5.2	6.8	4.7	3.1	4.3
Current account % of GDP	-2.1	0.7	2.4	3.2	1.1	-1.0
United States						
Real GDP %yr	2.9	2.3	-3.4	5.7	1.6	0.4
CPI inflation %yr	2.4	1.9	1.2	5.1	7.1	2.5
Unemployment rate %	3.9	3.7	8.1	5.4	3.7	4.7
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	-0.2	-4.5	1.6	1.7	1.7
Euro zone						
Real GDP %yr	1.8	1.6	-6.4	5.3	2.9	0.5
United Kingdom						
Real GDP %yr	1.7	1.7	-9.3	7.4	3.4	-0.5
China						
Real GDP %yr	6.8	6.0	2.2	8.1	3.0	7.0
East Asia ex China						
Real GDP %yr	4.5	3.8	-2.3	4.1	4.5	4.5
World						
Real GDP %yr	3.6	2.9	-3.1	6.1	3.0	3.3

Forecasts finalised 7 October 2022

Interest rate forecasts	Latest	Dec–22	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
Australia								
Cash	2.60	3.35	3.60	3.60	3.60	3.60	3.35	3.10
90 Day BBSW	2.87	3.80	3.80	3.80	3.80	3.63	3.38	3.13
10 Year Bond	3.85	3.70	3.50	3.40	3.20	3.00	2.80	2.70
International								
Fed Funds	3.125	4.375	4.625	4.625	4.625	4.625	4.375	3.875
US 10 Year Bond	3.82	3.60	3.40	3.30	3.10	2.90	2.70	2.60

Exchange rate forecasts	Latest	Dec–22	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
AUD/USD	0.6414	0.65	0.66	0.67	0.69	0.72	0.73	0.74
USD/JPY	145.03	143	141	139	137	134	132	130
EUR/USD	0.9794	0.99	0.99	1.02	1.04	1.07	1.09	1.10
GBP/USD	1.1168	1.14	1.14	1.14	1.17	1.20	1.22	1.24
USD/CNY	7.1139	7.00	6.80	6.60	6.40	6.30	6.20	6.15
AUD/NZD	1.1327	1.12	1.12	1.12	1.11	1.11	1.11	1.12

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