WESTPAC WEEKLY ECONOMIC COMMENTARY

Even less bang for your buck.

17 October 2022

Kōwhai

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This week's Consumers Price Index is set to reveal another big rise in prices. We're forecasting a 1.8% increase in the CPI over the three months to September. While that would see the annual inflation rate slipping from 7.3% last quarter to 6.9%, we're still looking at a picture of consumer prices that are continuing to charge higher.

The September quarter inflation result (due for release on Tuesday) will be boosted by the seasonal rise in vegetable prices, along with the annual increases in local council rates and alcohol taxes. But underlying the large price rises in those specific areas, we're also continuing to see widespread inflation pressures rippling through all corners of the economy.

In part, that broad-based strength in inflation is due to continued pressure on businesses' operating costs. Notably, recent months have seen wage costs rocketing higher as businesses have struggled to attract and retain staff.

Those elevated cost pressures have been compounded by the continued firmness in demand. That's been seen most clearly in the construction sector, with building activity charging higher over the past year. However, strong demand has also seen growing pressures on operating capacity, namely a severe shortage of workers, in other parts of the economy, especially in service sector industries like hospitality.

That firmness in demand and the related pressures on operating costs will also be reflected in the range of core inflation measures that Stats NZ and the RBNZ will publish along with the CPI. Those measures track the underlying trend in prices, and we expect they will continue to run well above the RBNZ's 1% to 3% target band.

Up the elevator, down the stairs – inflation is past its peak.

While the economy is continuing to be buffeted by powerful inflation headwinds, the annual inflation rate is actually expected to soften in the September quarter. That easing is mainly due to swings in petrol prices, which rose rapidly over 2021 and early 2022 as the global economy emerged from the pandemic and the demand for fuel picked up again.

While prices at the pump remain well above the levels we saw prior to the pandemic, they have dropped in recent months. In addition, the very large petrol price increases that we saw last year are now dropping out of the annual CPI calculation. Nevertheless, this still leaves us with annual inflation that is running close to a multi-decade high, signalling ongoing pressure on households' spending power.

September quarter inflation result to reinforce the RBNZ's hawkish bias.

Our forecast for September quarter inflation is higher than the RBNZ's latest published forecast for a 1.4% rise. However, the RBNZ's forecast was finalised in August, and since that time, market opinion has generally shifted towards a higher OCR peak than the 4.1% that the RBNZ was projecting. The hawkish tone of its October policy review, which highlighted that the Committee had discussed a larger 75 basis point hike, suggests that the RBNZ is already braced for stronger inflation pressures in the near term.

Recent weeks have seen financial markets pricing in the likelihood of large Official Cash Rate increases continuing into the new year. A result in line with our forecasts would strengthen the case for those moves.

The great rebalancing.

As higher interest rates dampen domestic demand, the economy is rebalancing. The opening of our borders, high export commodity prices and the weak New Zealand dollar are adding to the effect.

On the travel front, tourists are flooding back to our shores. From a standing start in March, August tourist arrivals are now back to around 40% of pre-Covid (2019) levels. And for Australian arrivals, the bounceback has been even more impressive, with August arrivals touching three-quarters of their pre-Covid levels. Anyone who has been in Queenstown recently will have noticed this.

Looking to the peak tourist season over the summer months, we expect the surge to continue. Notably, over this period we expect tourists from longer-haul markets, such as Europe and North America, to return en masse as well. Indeed, the announcements and subsequent commencement of routes such as Auckland to New York by a number of airlines suggests that they're well aware of the level of demand.

The pandemic years aside, tourism has been a cornerstone of our export earnings. We estimate that tourism's pre-Covid net contribution to the economy (the earnings from tourists visiting New Zealand less the amount that New Zealanders spend overseas) was around 2.5% of GDP. We expect the balance to return to around this magnitude over coming years.

The return of tourists to our shores is thus a shot in the arm for the economy, and comes at a time when other parts of the economy like the household sector are slowing. It's a big part of the reason why we expect the overall economy to grow slowly in the next couple of years rather than tipping into outright recession. The other key reason is strong export commodity prices, reinforced by the weak New Zealand dollar.

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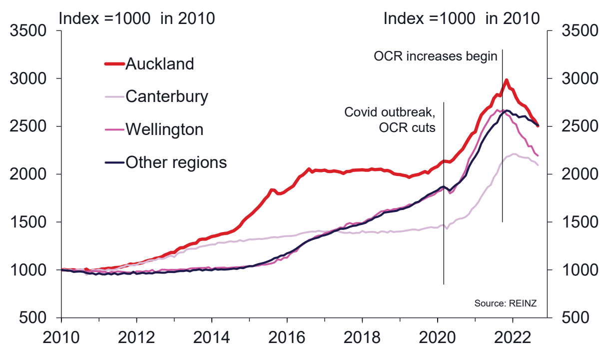
Chart of the week

The housing market has continued to slow as mortgage rates have pushed higher, with prices around the country now down by an average of 11% since their peak in November last year. However, there have been some notable differences across the motu. The biggest price falls have been in Auckland (down 16% from last year's peak) and Wellington (down 18%). House prices have also come off their peaks in other regions, but to a much smaller degree.

House prices by region

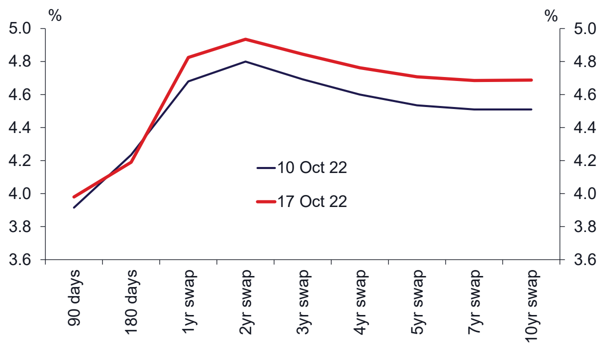


Fixed vs floating for mortgages

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 Q3 Consumer price inflation

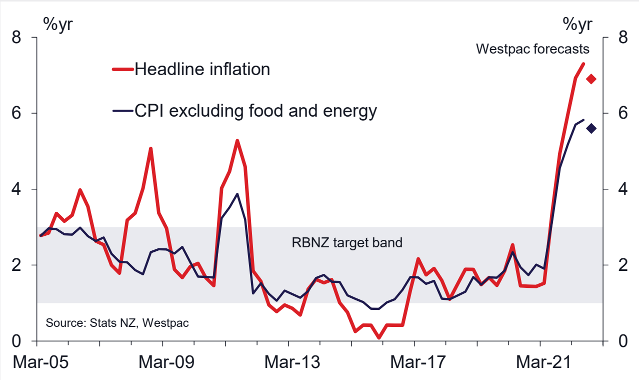
Oct 18, Qtly. – Last: +1.7%, Westpac: +1.8%, Market f/c: +1.5%
Annual – Last: +7.3%, Westpac: +6.9%, Market f/c: +6.6%

We estimate that consumer prices rose by 1.8% in the September quarter. While that would see the annual inflation rate slipping from 7.3% last quarter to 6.9%, we're still left with a picture of rapid increases in consumer prices.

The September quarter saw large increases in food prices and housing related costs. Those increases were only partially offset by the easing in fuel prices. Measures of core inflation are expected to remain elevated reflecting the strong and widespread price pressures rippling through the economy.

Our forecast is higher than the RBNZ's last published forecast. A result in line with our forecast would reinforce the recent rise in market pricing for the OCR.

NZ Consumer Price Inflation



NZ GlobalDairyTrade auction, whole milk powder prices

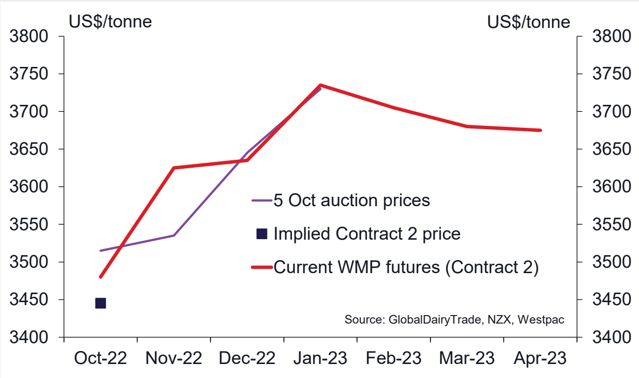
October 19, Last: –4.0%, Westpac: –2.0%

We expect whole milk powder prices (WMP) to fall by around 2% at the upcoming auction. This follows a 4.0% price slide at the previous auction.

Our pick is slightly lower than the circa 1% fall that the futures market is pointing to.

Fundamentally, global dairy prices are being underpinned by very weak global dairy supply. However, the surging US dollar has made dairy prices more expensive for most dairy buyers. In addition, we anticipate a degree of continued nervousness amongst buyers on the back of wider financial market volatility.

Whole milk powder prices



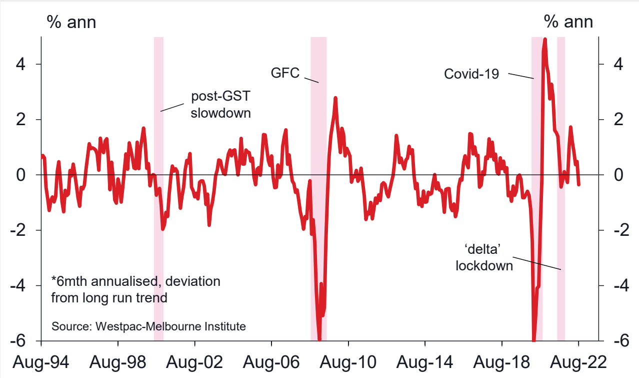
Aus Sep Westpac–MI Leading Index

Oct 19, Last: –0.36%

The six-month annualised growth rate fell to –0.36% in August, down from +0.49% in July. This was the first negative print since the start of the year and the weakest since the delta lockdown in 2021 points – indicating a material loss in momentum to a below-trend pace.

The September read looks set to further entrench the weakening signal. It will include some very weak component updates: commodity prices down steeply (-15.8% in AUD terms); the ASX200 down sharply as well (-7.3%); and sentiment based components also weakening further (the Westpac-MI Consumer Expectations Index off another -2.1% and the Westpac-MI Unemployment Expectations Index off by 11.7%). This will be partially offset by a rebound in the volatile dwelling approvals component and continued gains in hours worked but the net result looks likely to see a further move into negative.

Aus Westpac-MI Leading Index



The week ahead

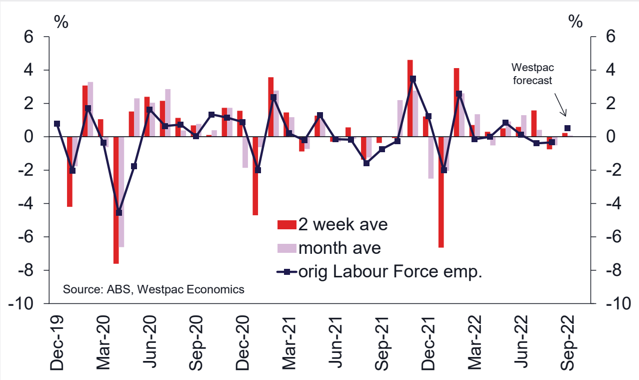
Aus September Labour Force - employment ‘000

Oct 20, Last: 33.5k, WBC f/c: 25k
Mkt f/c: 25k, Range: 13.5k to 45k

In August, the 33.k rise in employment was close to the market estimate of +37.5k but well under Westpac’s +110k. Where did we go wrong? Underestimating the impact of the ongoing Covid outbreak and other illness. The ABS noted that the number of people working reduced hours due to being sick/illness increased 11k to 761k in August 2022, which is around double the number typically seen at the end of winter.

So why not go for a bounce in September to make up for the large July loss (-41k in July)? August employment was 8k below the June level. Weekly Payrolls point to a very mild bounce, and while there is likely to be some upward revision, it suggests we can’t be confident in a strong bounce. Job ads and job vacancies have started to soften, from a high level, while our business surveys Job Indicator has levelled out. Unemployment expectations did ease in September but they jumped 11% in October pointing to weakness in the labour market though September.

Aus payrolls vs labour force employment



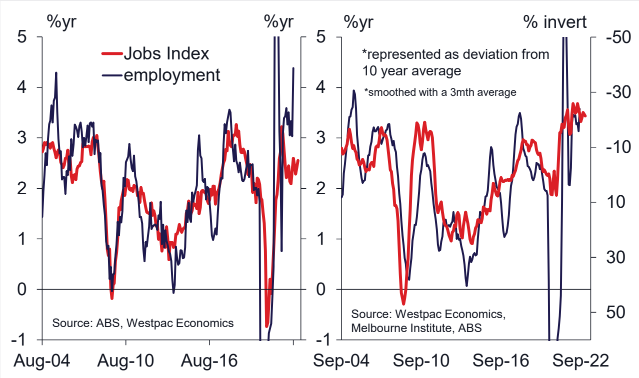
Aus September Labour Force - unemployment %

Oct 20, Last: 3.5%, WBC f/c: 3.4%
Mkt f/c: 3.5%, Range: 3.4% to 3.6%

In August the labour force lifted 47.5k, greater than the gain in employment, so as well as lifting the participation rate to 66.6% the number of unemployed rose 14.0k and the unemployment rate gained 0.1ppt to 3.5% (at two decimal points from 3.38% to 3.46%). The participation rate is now 0.1ppt off the June 2022 record high of 66.8% while unemployment is still down from 4.2% at the start of this year.

The larger than usual number of people not working due to illness does not just effect employment and hours worked but it also has an impact on the availability of labour, and hence, the labour force. As ongoing illnesses are likely to be a factor behind the soft September Weekly Payrolls update we expect it to have an impact on the labour force as well. We expect the labour force to lift just 17k holding the participation rate flat at 66.6% while the unemployment rate will round down to 3.4% from a rounded up 3.5%.

Aus Westpac employment indicators



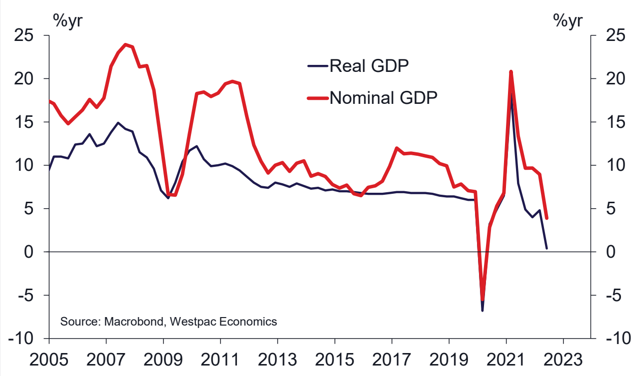
China Q3 GDP

Oct 18, %yr, Last: 0.4%yr, Mkt f/c: 3.5%, WBC 2.9%

Covid-zero restrictions and ongoing weakness in the housing construction sector hit activity hard in Q2, with a GDP decline of 2.6% recorded. In Q3, partial data points to a robust rebound in consumption and a broadening up-trend for investment. While our expectation is a little lower than consensus, it is more a matter of timing than the strength of the rebound, with Q4 to experience similar growth to Q3 in our view.

Into year end, the risks to the China outlook that are known are Covid-zero, which will only slowly recede as a headwind at some stage, and how long it will take for housing to reset. The more unknown risk is trade which has provided material support over the past year, but ahead will come under pressure as Western economies stall and/or enter recession. Growth in Asian economies will provide an offset, but likely only a partial one.

China GDP

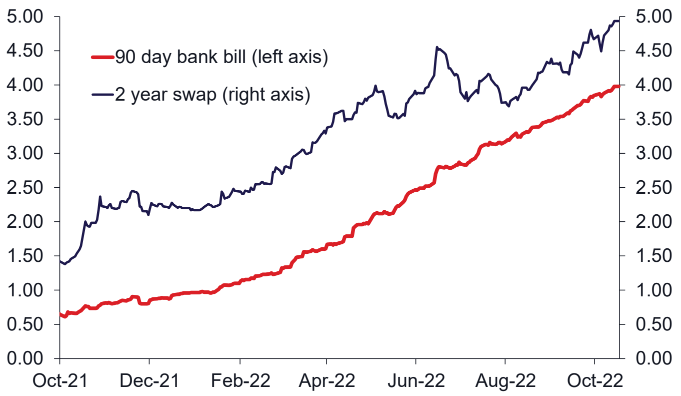


New Zealand forecasts

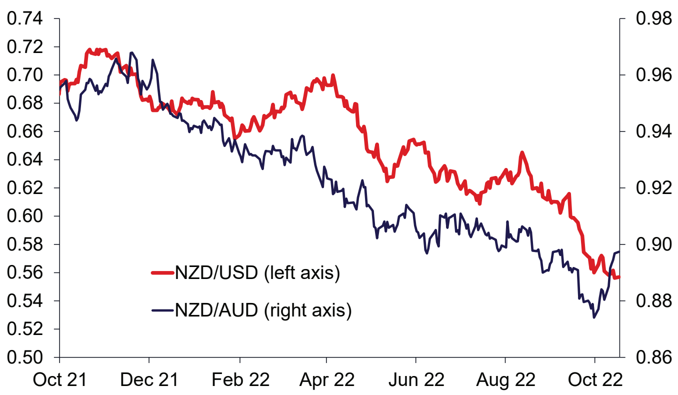
Economic forecasts	Quarterly				Annual			
	2022			2023				
% change	Jun (a)	Sep	Dec	Mar	2020	2021	2022f	2023f
GDP (Production)	1.7	0.4	0.6	0.6	-2.1	5.5	2.2	2.2
Employment	0.0	0.1	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	4.9	3.2	3.4	3.8
CPI	1.7	1.8	0.5	1.2	1.4	5.9	5.9	4.0
Current 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 17 October 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.00%	3.00%
30 Days	3.54%	3.51%	3.33%
60 Days	3.76%	3.69%	3.51%
90 Days	3.98%	3.87%	3.70%
2 Year Swap	4.94%	4.72%	4.44%
5 Year Swap	4.71%	4.54%	4.22%

NZ foreign currency mid-rates as at 17 October 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5569	0.5657	0.5954
NZD/EUR	0.5720	0.5784	0.5958
NZD/GBP	0.4940	0.5052	0.5233
NZD/JPY	82.65	82.12	85.41
NZD/AUD	0.8974	0.8771	0.8909
TWI	67.28	67.54	69.67

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 17					
NZ	Sep BusinessNZ PSI	58.6	–	–	Ongoing resilience despite interest rate rises.
UK	Oct Rightmove house prices	0.7%	–	–	More declines to come as policy tightening continues.
US	Oct Fed Empire state index	–1.5	–1.0	–	Regional surveys showing weakness.
Tue 18					
NZ	Q3 CPI	1.7%	1.5%	1.8%	Boosted by large increases in food and housing costs...
	Q3 CPI %yr	7.3%	6.6%	6.9%	... annual inflation is past its peak, but still running hot.
Aus	RBA minutes	–	–	–	Key insights into the surprise 25bp rate hike decision.
	RBA Deputy Governor	–	–	–	Bullock, speaking to AFIA.
Chn	Q3 GDP %yr	0.4%	3.5%	2.9%	Activity to rebound; COVID-zero a lingering risk.
	Sep retail sales ytd %yr	0.5%	1.0%	–	Consumption will be a key support moving into 2023.
	Sep fixed asset investment ytd %yr	5.8%	6.0%	–	Businesses are working through domestic virus disruptions...
	Sep industrial production ytd %yr	3.6%	3.7%	–	... while weakening global demands looms for trade.
Eur	Oct ZEW survey of expectations	–60.7	–	–	Collapsed to a series low.
US	Sep industrial production	–0.2%	–0.1%	–	Weakness in domestic and global demand a key risk.
	Oct NAHB housing market index	46	44	–	Housing market under significant and lasting pressure.
	Fedspeak	–	–	–	Bostic.
Wed 19					
Aus	Sep Westpac-MI Leading Index	–0.4%	–	–	Slowdown to below trend pace likely to deepen.
NZ	GlobalDairyTrade auction (WMP)	–4.0%	–	–2.0%	Dairy prices likely to fall again at this auction.
Eur	Sep CPI %yr	10.0%	–	–	Final estimate to provide detail on breadth and intensity.
UK	Sep CPI %yr	9.9%	–	–	Energy inflation a key risk moving into year-end.
US	Sep housing starts	12.2%	–5.6%	–	Demand is being hit hard by rising interest rates...
	Sep building permits	–10.0%	0.5%	–	... while input availability continues to limit construction.
	Federal Reserve's Beige book	–	–	–	To provide an update on conditions across the regions.
	Fedspeak	–	–	–	Kashkari.
Thu 20					
Aus	Sep employment	33.5k	25k	25k	Employment was held back in Aug but absent sick workers...
	Sep unemployment rate	3.5%	3.5%	3.4%	... with Payrolls suggesting this effect continued into Sep.
US	Initial jobless claims	228k	–	–	Likely to remain at low levels for time being.
	Oct Phily Fed index	–9.9	–4.5	–	Regional surveys showing weakness.
	Sep existing home sales	–0.4%	–2.2%	–	Declines set to continue given further tightening from FOMC.
	Sep leading index	–0.3%	–0.3%	–	Growth outlook clearly deteriorating.
	Fedspeak	–	–	–	Evans, Bullard, Jefferson, Cook, Bowman.
Fri 21					
NZ	Sep trade balance $mn	–2447	–	–2450	Import values strong on weak NZD and high oil price.
Eur	Oct consumer confidence	–28.8	–	–	Collapsed to a series low.
UK	Oct GfK consumer sentiment	–49	–	–	Collapsed to a series low.
	Sep retail sales	–1.6%	–	–	Negative so far this year, highlighting pressure on HH's.
US	Fedspeak	–	–	–	Williams.

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	3.10	3.60	3.60	3.60	3.60	3.35	3.10
90 Day BBSW	2.93	3.80	3.80	3.80	3.80	3.63	3.38	3.13
10 Year Bond	4.00	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	3.92	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	0.6329	0.65	0.66	0.67	0.69	0.72	0.73	0.74
USD/JPY	147.30	143	141	139	137	134	132	130
EUR/USD	0.9796	0.99	0.99	1.02	1.04	1.07	1.09	1.10
GBP/USD	1.1335	1.14	1.14	1.14	1.17	1.20	1.22	1.24
USD/CNY	7.1733	7.00	6.80	6.60	6.40	6.30	6.20	6.15
AUD/NZD	1.1167	1.12	1.12	1.12	1.11	1.11	1.11	1.12

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