

WESTPAC WEEKLY ECONOMIC COMMENTARY

That's not a recession...

20 June 2022



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Covid disruptions featured heavily in New Zealand's March quarter GDP figures, which came in a little lower than expected. But this masks the broader story that the economy is running hot, and that demand needs to be reined in to better match the economy's capacity. We doubt that the Reserve Bank will be too concerned at finding itself on a quicker path of adjustment, although the implication would be a lower peak in the Official Cash Rate than what the RBNZ has projected.

The 0.2% drop in GDP for the March quarter was close to our expectation of a flat result. As the Omicron wave reached its peak, people stayed away from retail spaces out of caution, and the surge in infections meant that worker absenteeism proved to be a major headache for many businesses.

We noted in our preview that: "A flat forecast does mean there's a good chance that GDP could go backwards for the quarter. But that wouldn't tell us anything about the prospects of a recession this year." Even with a slight pullback in activity in the last quarter, there is every indication that the economy is running too hot, not too cold. The unemployment rate is at a record low, job vacancies are soaring to new highs, and the most common complaint we hear (apart from rising prices) is that people are feeling overworked and burnt out. If this is a recession, it's the weirdest recession that I've ever seen.

An issue with talking about recession risks is that we need to be careful with what that term means. "Two consecutive quarters of negative growth" is not the definition of a recession,

but rather a rule of thumb for identification. This point is that economic data is noisy, and in any given quarter we might see a drop in GDP just by chance. So we should wait for a second negative result before jumping to conclusions.

That is particularly true these days, as Covid disruptions have made activity even more variable than usual. Indeed, this wasn't the first negative GDP print that we've seen in this cycle. After the initial lockdown ended in 2020, GDP surged by 13.7% in the September quarter, followed by a 0.4% drop in the December quarter. That fall was a combination of catch-up activity petering out, and the seasonal factors failing to keep up with the fact that there were no overseas tourists during what would have been the peak period. Both of those factors appear to have played a role in the latest quarter as well.

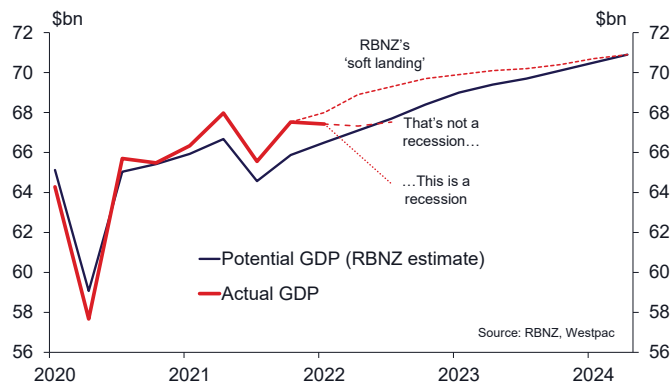
We've pencilled in a 1% rise in GDP for the June quarter. Fewer Omicron disruptions and the gradual reopening of the border will provide a more supportive environment for growth over that period. More broadly though, we're expecting modest

growth in the economy over the rest of this year, with a fairly subdued outlook for consumer spending as it bears the brunt of rising interest rates and falling house prices.

That transition to a softer growth path is a necessary part of the Reserve Bank's fight against inflation. The RBNZ had previously estimated that the economy was running about 2% above its non-inflationary potential – that is, demand exceeded our ability to meet it without pushing up prices. The challenge now is to realign demand and supply in a way that brings inflation under control, without imposing unnecessary pain on businesses and consumers.

Given that the economy's potential itself is likely to rise over time, that leaves a few options for the path of adjustment. The first path – the one projected by the RBNZ, and probably still the consensus view – is a period of low but still positive growth in activity over the next few years, while the economy's capacity catches up. The risk of this approach is that it may not be enough to anchor inflation at the 2% target. Indeed, on the RBNZ's forecasts the economy would be running above its non-inflationary potential for almost four years before the gap closes.

Potential paths of adjustment



Another – hypothetical – path of adjustment would be a faster closing of the gap over a few quarters rather than a few years. That might involve two consecutive quarters of falling GDP, but that wouldn't really be in the spirit of what we call a 'recession'. A genuine recession would mean a sharper drop in activity to below its potential, with a meaningful rise in unemployment and a rapid drop-off in domestic wage and price pressures.

The latest GDP figures suggest we could be on the way to a faster realignment than what the RBNZ was forecasting. We suspect that the RBNZ would be quite happy with that, as long as it continues in a controlled manner. The consequence of this is that the RBNZ wouldn't need to raise the Official Cash Rate as high as the 4% peak that it was projecting in May, but that's fine too – ultimately the RBNZ wants to be vindicated on inflation, not on interest rates. Our forecast remains for a peak cash rate of 3.5% by the end of this year.

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Chart of the week

Online job advertisements rose by 5% in May, and are now about 50% above their pre-Covid levels. There were gains across the board, but the biggest rise was in hospitality and tourism – up 10% for the month, and nearly double what they were six months ago – as the sector has geared up for the border reopening.

Online job advertisements, seasonally adjusted

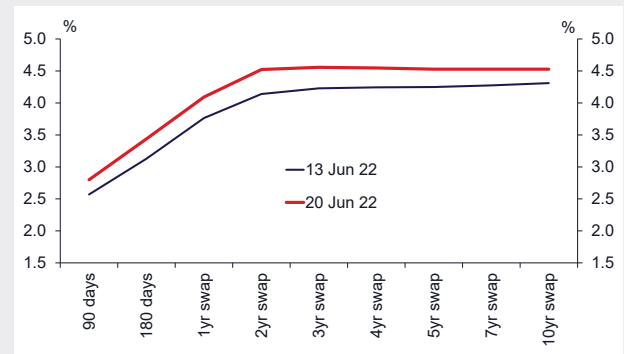


Fixed vs floating for mortgages

Wholesale interest rates remain above our forecast of a 3.5% peak in the Official Cash Rate this year. That suggests to us that there is no cost advantage to fixing for longer terms.

While a one-year mortgage rate is likely to rise further in the year ahead, fixing and rolling for this term 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

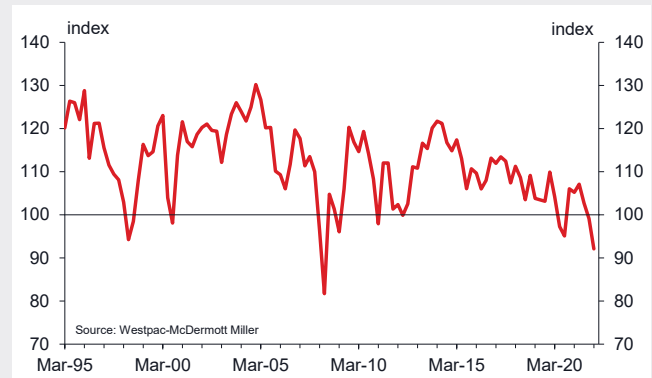
NZ Q2 Westpac McDermott Miller Consumer Confidence

Jun 21, Last: 92.1

Consumer confidence continued to lose ground in March, dropping to its lowest level since the Global Financial Crisis. That growing pessimism around the economic landscape reflected households' increasing concern around their financial positions as consumer prices and mortgage rates have pushed higher. Disruptions stemming from the Omicron outbreak will also have weighed on confidence.

Our latest survey was conducted in the early part of June. While concerns about Covid have been receding, households have continued to grapple with increasingly powerful economic headwinds. That includes ongoing cost of living rises and increases in mortgage rates. The housing market has also continued to cool.

Westpac-McDermott Miller consumer confidence



NZ GlobalDairyTrade auction, whole milk powder prices

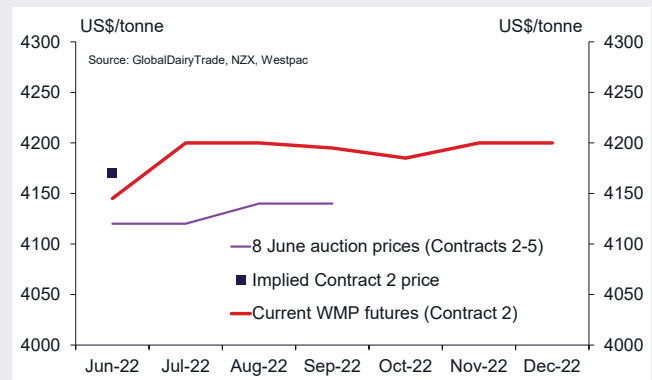
Jun 22, Last: 5.7%, Westpac: +1%

We expect whole milk powder prices (WMP) to lift by around 1% at the upcoming auction. Prices rebounded strongly at the last auction and we expect the market to cement these price gains.

Easing Covid restrictions in China and the associated return in dairy demand should continue to underpin prices at this auction.

Looking over coming months, we anticipate that very weak global supply combined with rebounding Chinese demand should help keep prices at very elevated levels.

Whole milk powder prices



Aus Q2 ACCI-Westpac business survey

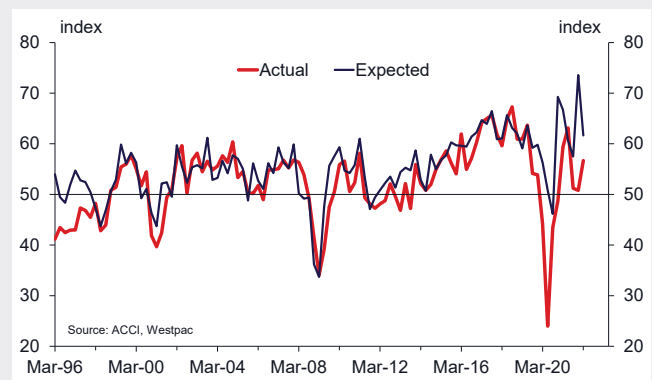
Jun 21, Last: 56.7

The ACCI-Westpac business survey for the June quarter, conducted through May into June, will provide a timely update on manufacturing and insights into economy wide trends.

Manufacturing output stalled over the second half of 2021, and the presence of omicron and weather related disruptions tempered the growth rebound in the opening quarter of 2022. The reopening - which will be a key dynamic into the June and September quarters - will continue to facilitate a lift in activity. It is the pace of this recovery which is of keen interest.

The survey also highlights that the manufacturing sector is facing a broad set of challenges. Supply headwinds surrounding labour and material shortages are acting as a handbrake to growth. Also, soaring input costs are flowing through (in part) to higher prices and squeezing margins. Of interest, how will these pressures impact the rebound in growth through mid-2022?

Aus Westpac-ACCI Composite indexes (actual and expected, sa)



The week ahead

Aus Apr Westpac-MI Leading Index

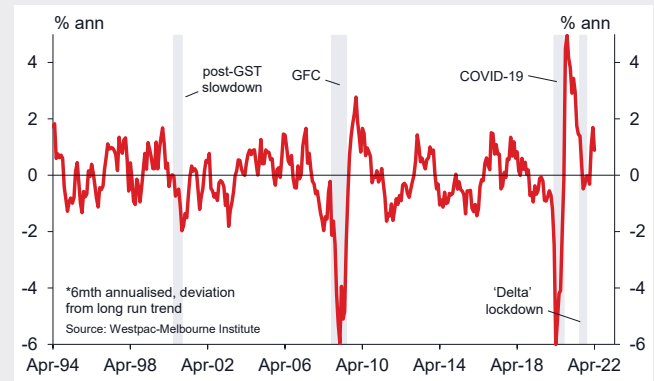
Jun 22, Last: 0.88%

The six-month annualised growth rate slowed to 0.88% in April but remained consistent with above trend growth momentum in 2022.

The May update is likely to see some further moderation with more soft monthly updates for several components, including: the ASX200; the Westpac-MI Consumer Expectations Index; and dwelling approvals.

Other components have been more mixed with commodity prices also holding up relatively well, up 1% in AUD terms in May and likely to post a solid gain for June.

Aus Westpac-MI Leading Index

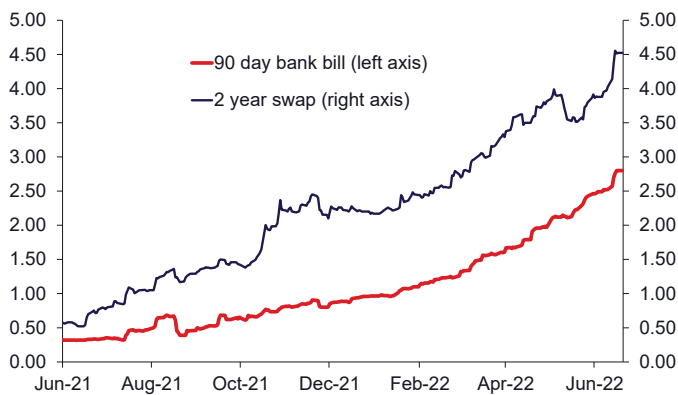


New Zealand forecasts

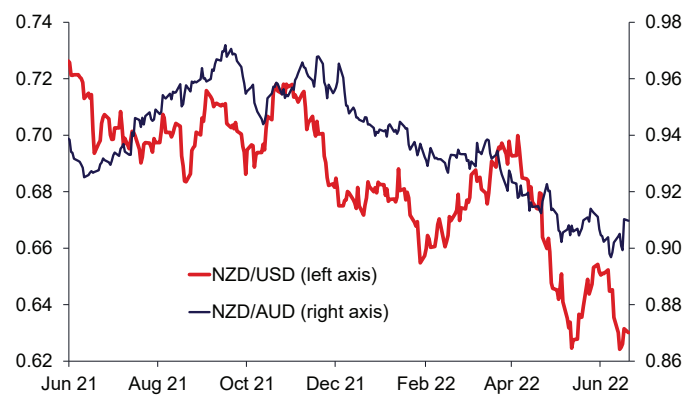
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Mar (a)	Jun	Sep	Dec	2020	2021	2022f	2023f
GDP (Production)	-0.2	1.0	0.7	1.2	-2.1	5.6	2.1	3.3
Employment	0.1	0.2	0.2	0.2	0.6	3.5	0.8	0.9
Unemployment Rate % s.a.	3.2	3.1	3.0	3.0	4.9	3.2	3.0	3.3
CPI	1.8	1.1	1.2	0.4	1.4	5.9	4.5	2.7
Current Account Balance % of GDP	-6.5	-7.5	-7.8	-7.5	-0.8	-5.8	-7.5	-6.1

Financial forecasts	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Cash	3.00	3.50	3.50	3.50	3.50	3.50	3.50
90 Day bill	3.40	3.60	3.60	3.60	3.60	3.60	3.60
2 Year Swap	4.50	4.30	4.10	3.80	3.50	3.20	2.90
5 Year Swap	4.60	4.40	4.10	3.80	3.55	3.30	3.05
10 Year Bond	4.30	4.10	3.70	3.40	3.20	3.00	2.90
NZD/USD	0.65	0.68	0.70	0.71	0.72	0.72	0.72
NZD/AUD	0.90	0.91	0.91	0.91	0.91	0.90	0.90
NZD/JPY	85.8	87.7	88.9	88.0	87.2	87.1	86.4
NZD/EUR	0.61	0.62	0.63	0.63	0.63	0.63	0.62
NZD/GBP	0.52	0.54	0.55	0.55	0.54	0.54	0.53
TWI	71.6	73.3	74.4	74.7	74.5	74.7	74.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 20 June 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	2.00%	2.00%	1.50%
30 Days	2.23%	2.03%	1.97%
60 Days	2.52%	2.26%	2.13%
90 Days	2.80%	2.49%	2.29%
2 Year Swap	4.52%	3.88%	3.58%
5 Year Swap	4.53%	3.94%	3.64%

NZ foreign currency mid-rates as at 20 June 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6301	0.6523	0.6490
NZD/EUR	0.6011	0.6080	0.6079
NZD/GBP	0.5154	0.5195	0.5158
NZD/JPY	85.01	85.21	82.77
NZD/AUD	0.9097	0.9039	0.9109
TWI	71.16	72.36	71.98

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
NZ	May BusinessNZ PSI	51.4	-	-	Activity gauges low, but firming. Headwinds still evident.
UK	Jun Rightmove house prices	2.1%	-	-	Demand to soften as rate hikes take full effect.
US	Federal holiday – Juneteenth.	-	-	-	Markets closed.
	Fedspeak	-	-	-	Bullard.
Tue 21					
NZ	Q2 Westpac-MM consumer confidence	92.1	-	-	Economic headwinds have continued to mount.
Aus	Q2 ACCI-Westpac business survey	56.7	-	-	Activity accelerates on reopening. Significant supply headwinds.
	RBA media release	-	-	-	Review of the Yield Target.
	RBA Governor Lowe speaking	-	-	-	Economic Outlook & Monetary Policy.
	RBA minutes	-	-	-	Colour around June 50bps hike, and risks to outlook.
US	May Chicago Fed activity index	0.47	-	-	Labour and cost concerns remain at the fore.
	May existing home sales	-2.4%	-3.7%	-	Limited inventory and rising rates are slowing sales activity.
	Fedspeak	-	-	-	Mester and Barkin.
Wed 22					
NZ	GlobalDairyTrade auction prices (WMP)	5.7%	-	1.0%	Dairy prices to rise as Chinese Covid restrictions ease further.
	May trade balance \$mn	584	-	500	Dairy price strength shading similar oil price strength.
Aus	May Westpac-MI Leading Index	0.88%	-	-	Consistent with above trend growth. Partials softened in May.
Eur	Jun consumer confidence	-21.1	-	-	Inflation pressuring capacity, spending and sentiment.
UK	May CPI	2.5%	0.7%	-	Energy inflation remains the key driver.
US	Fedspeak	-	-	-	Chair Powell before Senate Panel. Evans, Harker Barkin.
Thu 23					
NZ	Q2 Westpac-MM employment conf.	113.5	-	-	Jobs plentiful, watching for evidence of higher pay.
Eur	Jun S&P Global manufacturing PMI	54.6	53.7	-	Supply and cost pressures are the key concerns...
	Jun S&P Global services PMI	56.1	55.5	-	... for European manufacturing and services.
UK	Jun S&P Global manufacturing PMI	54.6	-	-	Similar risks are present in the UK...
	Jun S&P Global services PMI	53.4	-	-	... with a sharp slowdown in activity on its way.
US	Jun S&P Global manufacturing PMI	57.0	56.3	-	The US is weathering these headwinds...
	Jun S&P Global services PMI	53.4	53.7	-	... although price pressures are an ongoing risk.
	Initial jobless claims	229k	-	-	To remain at a low level.
	Jun Kansas City Fed index	23	-	-	Manufacturing outlook is positive but fragile.
	Fed Chair Powell	-	-	-	Appearing before House Panel.
Fri 24					
NZ	Matariki public holiday	-	-	-	Markets closed.
Aus	RBA Governor Lowe	-	-	-	Panel, Central banks & inflation, Zurich.
Chn	Q1 current account balance	89.5	-	-	Final estimate; holding at a healthy surplus in Q1.
UK	Jun GfK consumer sentiment	-40	-	-	At weakest level in series history that dates back to 1980.
	May retail sales	1.4%	-0.6%	-	Cost-of-living pressures to weigh on spending.
US	Jun Uni. of Michigan sentiment	50.2	50.2	-	Final; confidence has collapsed amid historic inflation.
	May new home sales	-16.6%	0.7%	-	Construction under pressure from rising rates and costs.
	Fedspeak	-	-	-	Bullard and Daly.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.1	4.8	4.5	2.7
CPI inflation %yr	1.8	1.8	0.9	3.5	6.6	3.0
Unemployment rate %	5.0	5.2	6.8	4.7	3.2	3.5
Current account % of GDP	-2.1	0.7	2.6	3.5	1.4	-1.3
United States						
Real GDP %yr	3.0	2.2	-3.4	5.7	2.5	1.6
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	3.6	4.0
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	0.3	-4.8	1.8	1.7	1.8
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	2.2	1.5
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	7.2	3.7	0.0
China						
Real GDP %yr	6.7	5.8	2.3	8.1	5.3	5.5
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	4.2	4.5	4.6
World						
Real GDP %yr	3.6	2.8	-3.3	5.5	3.4	3.3

Forecasts finalised 10 June 2022

Interest rate forecasts	Latest	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Australia								
Cash	0.85	1.60	2.10	2.35	2.35	2.35	2.35	2.35
90 Day BBSW	1.80	2.05	2.47	2.55	2.55	2.55	2.55	2.55
10 Year Bond	4.11	4.10	3.80	3.40	3.00	2.70	2.50	2.35
International								
Fed Funds	1.625	2.875	3.375	3.375	3.375	3.375	3.125	2.875
US 10 Year Bond	3.24	3.50	3.30	3.00	2.70	2.50	2.30	2.20

Exchange rate forecasts	Latest	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
AUD/USD	0.7016	0.72	0.75	0.77	0.78	0.79	0.80	0.80
USD/JPY	134.25	133	131	129	127	125	123	121
EUR/USD	1.0519	1.08	1.10	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2287	1.25	1.27	1.28	1.30	1.32	1.34	1.35
USD/CNY	6.7042	6.50	6.35	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.1085	1.11	1.10	1.10	1.10	1.10	1.11	1.11

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