WESTPAC WEEKLY ECONOMIC COMMENTARY

The elephant is still in the room.

21 March 2022

Kākābeak/ngutukākā

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The New Zealand economy expanded by 3% in the December quarter last year. That meant the economy clawed back most of the 3.6% decline seen in the September quarter when the Delta outbreak pushed us into lockdown. Prior to that time, activity had been running hot.

The December quarter result provides us with clues as to how the economy operates under the various Covid lockdown settings. Indeed, the result suggests that anything short of a Level 4 lockdown is just not that limiting for many parts of the economy.

It might therefore be tempting to dismiss this data as backward-looking, with the economy facing a new set of challenges already in 2022: the Omicron variant, the Russia-Ukraine conflict, growing inflation worries and falling house prices. But it's important to know where we're starting from to understand where we might be heading.

In this case, the December quarter GDP data gives us a mixed picture of the economy's recovery. In some sectors, particularly those related to the production of physical goods, the post-lockdown rebound is already more or less complete – limiting the scope for growth going forward. However, in service sectors like hospitality, the recovery still awaits Covid developments.

Similarly, the fact that the 3% lift was above the Reserve Bank's forecast of a 2.3% rise (prepared in February, without the benefit of more recent data that pointed to a stronger result) doesn't put another tick in the box for an even higher peak in the OCR. The Reserve Bank's assumption was that both actual and potential output would be held back by Covid restrictions over the December quarter, with the economy still running 2% above its non-inflationary speed limit. What the GDP numbers suggest to us is that there was less restraint on the economy's potential than first thought.

Turning to 2022, the year has gotten off to a patchy start. Indeed, the data flow over the next few months is likely to be messy in a way that New Zealand hasn't seen so far in this pandemic. Moreover, the weakness in activity will be due to behavioural changes in the face of Omicron rather than government-imposed restraints (see for instance the 7.6% drop in card spending in February).

However, the overseas experience also suggests that activity will pick up quickly again once people feel that the Omicron wave has passed its worst. And the gradual return of overseas tourists will provide an additional source of demand later this year and beyond.

On the tourism front, the Government announced that the border will be opened to tourists sooner than it had previously signalled. Starting from 12 April, Australians will be able to travel to New Zealand isolation-free, and then from 1 May, vaccinated travellers from visa-waiver countries – such as the large tourist markets of the UK, US, Japan, Germany, Korea and Singapore, and those with valid visitor visas – will be able to arrive.

This earlier opening of the border will be a welcome boost for the tourism sector, and a shot in the arm for the broader economy. Visitor numbers are likely to be well below pre-pandemic levels for some time to come, but even going from nothing to something will have a meaningful impact on the outlook for GDP growth this year.

Meanwhile, exports more broadly remain strong, at least on a values basis. Global dairy and meat prices are at or near record highs and many farmers are seeing record high profits. These profits are spilling over into economic activity in the regions, with the rural land market heating up for example. And with the export price outlook strong for the remainder of the year, we expect agricultural, if not regional, activity to remain strong through 2022.

The other sector that continues to fire is construction. 48,000 new dwelling consents were issued over the past year. And despite rising costs and shortages of labour and raw materials, we expect construction activity to remain at elevated levels over this year and next.

But the elephant in the room remains inflation. High inflation is already putting the squeeze on both households' spending power and businesses' margins.

The Government has attempted to ease the pain, at least on the fuel front. Excise duties on petrol have been reduced by 25 cents a litre, road user charges on diesel vehicles will be reduced by an equivalent amount, and public transport fares will be halved. This was described as a temporary measure and will be reviewed after three months. We estimate that this will take 0.6-0.7 percentage points off the inflation rate in the June quarter.

However, this doesn't really alter the medium-term picture. For one thing, if these measures are genuinely temporary, then as they're removed they will boost the inflation rate through next year, delaying the date at which inflation returns within the Reserve Bank's 1-3% target band.

Moreover, inflation pressures are widespread, and while international forces have been a major contributor, there's much more to it than oil prices. That means the pressure will remain on the RBNZ to demonstrate that it will do what's needed to bring inflation pressures to heel over the medium term. And that will mean dampening domestic demand to bring it back into line with the economy's capacity.

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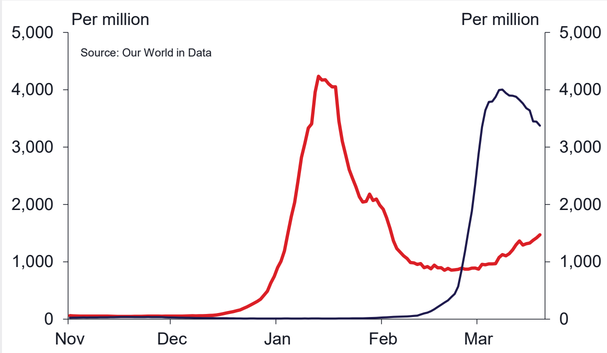
Chart of the week

As New Zealand's Covid case numbers pass their peak, Australia's experience provides a reminder of what the 'new normal' of living with Omicron involves: daily case numbers still far in excess of what previous variants were capable of producing, ongoing bouts of worker absenteeism, and continued demands on the healthcare system.

Confirmed Covid cases per capita (7-day average)

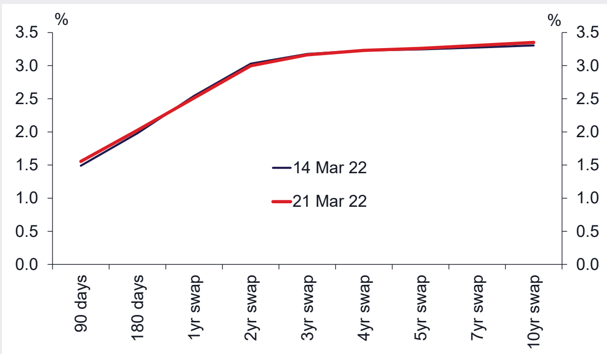


Fixed vs floating for mortgages

Wholesale interest rates are now largely in line with our forecast of a 3% cash rate by mid-2023. That suggests there is no longer an advantage to fixing for longer terms.

While the one-year mortgage rate is likely to rise further in the next couple of years, fixing and rolling for this term is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms are more suited to those who want certainty in their repayments.

NZ interest rates



The week ahead

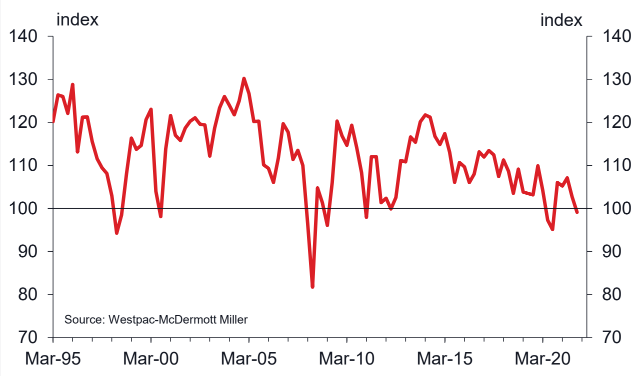
NZ Q1 Westpac McDermott Miller Consumer Confidence

Mar 22, Last: 99.1

Consumer confidence took another step down in December as the economy grappled with the combination of Delta-related health restrictions, rising mortgage rates and increases in consumer prices.

Since the time of our previous survey, there has been a wave of negative headlines. Notably, Covid infections have spiked as Omicron has spread, and there have been related disruptions to economic activity and the labour market. At the same time, the conflict in Ukraine has escalated, and the resulting rise in oil prices has compounded the existing pressure on consumer prices and households' spending power. On top of those developments, the housing market has continued to cool as mortgage rates have pushed higher.

Westpac-McDermott Miller consumer confidence

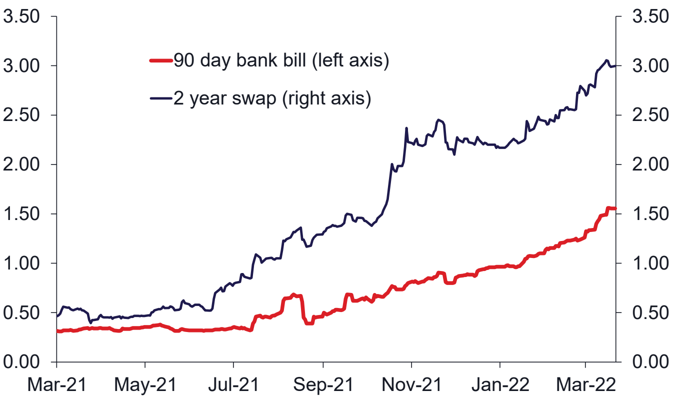


New Zealand forecasts

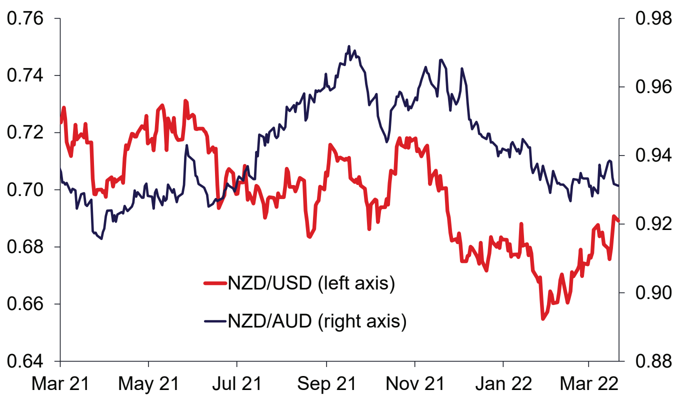
Economic forecasts	Quarterly				Annual			
	2021		2022					
% change	Sep (a)	Dec(a)	Mar	Jun	2020	2021f	2022f	2023f
GDP (Production)	-3.6	3.0	0.3	0.7	-2.1	5.6	3.4	4.8
Employment	1.9	0.1	0.5	0.1	0.6	3.7	0.9	1.0
Unemployment Rate % s.a.	3.3	3.2	3.1	3.0	4.9	3.2	3.0	3.3
CPI	2.2	1.4	1.7	0.9	1.4	5.9	4.0	2.7
Current Account Balance % of GDP	-4.4	-5.6	-5.8	-6.5	-0.8	-5.6	-6.1	-5.5

Financial forecasts	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	1.50	2.00	2.25	2.50	2.75	3.00	3.00
90 Day bill	1.90	2.20	2.45	2.70	2.95	3.10	3.10
2 Year Swap	2.90	3.00	3.05	3.05	3.05	3.00	2.90
5 Year Swap	3.10	3.15	3.20	3.20	3.20	3.15	3.10
10 Year Bond	2.95	3.05	3.10	3.10	3.10	3.10	3.05
NZD/USD	0.68	0.70	0.71	0.72	0.72	0.73	0.73
NZD/AUD	0.93	0.93	0.93	0.93	0.92	0.92	0.91
NZD/JPY	79.2	81.9	83.8	84.4	85.7	86.3	86.9
NZD/EUR	0.62	0.63	0.63	0.63	0.63	0.63	0.63
NZD/GBP	0.51	0.52	0.53	0.53	0.53	0.53	0.54
TWI	72.8	74.4	74.9	74.9	74.8	75.1	75.3

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 21 March 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	0.75%
30 Days	1.17%	1.05%	1.06%
60 Days	1.37%	1.20%	1.16%
90 Days	1.56%	1.34%	1.24%
2 Year Swap	3.00%	2.78%	2.55%
5 Year Swap	3.26%	3.01%	2.88%

NZ foreign currency mid-rates as at 21 March 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6892	0.6877	0.6722
NZD/EUR	0.6230	0.6348	0.5919
NZD/GBP	0.5231	0.5228	0.4932
NZD/JPY	82.06	79.13	77.21
NZD/AUD	0.9312	0.9290	0.9329
TWI	74.14	73.87	71.90

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 21					
NZ	Feb trade balance $mn	–1082	–	–50	Run of deficits to continue as import strength is ongoing.
UK	Mar Rightmove house prices	2.3	–	–	Rising mortgage rates set to cool demand over 2022.
US	Feb Chicago Fed activity index	0.69	–	–	Will provide a timely update on activity in the region.
	Fedspeak	–	–	–	Chair Powell and Bostic to speak at NABE conference.
Tue 22					
NZ	Q1 Westpac–MM consumer confidence	99.1	–	–	Headwinds in the household sector have continued to mount.
Aus	RBA Governor speaking	–	–	–	Appearance at Walkleys, 12pm AEDT, no Q&A.
US	Mar Richmond Fed index	1	2	–	Sourcing labour remains a challenge.
	Fedspeak	–	–	–	Wuerffel, Williams and Daly.
Wed 23					
Eur	Mar consumer confidence	–8.8	–	–	Russia–Ukraine and elevated prices are headwinds.
UK	Feb CPI	–0.1%	–	–	Energy inflation remains a key driver.
US	Feb new home sales	–4.5%	1.8%	–	Easing supply issues a positive; rising rates a headwind.
	Fedspeak	–	–	–	Chair Powell, Mester and Daly.
Thu 24					
NZ	Q1 Westpac–MM employment conf.	106.9	–	–	Job opportunities high but earnings growth subdued to date.
Eur	Mar Markit manufacturing PMI	58.2	56.0	–	Covid-19 restrictions are easing across the bloc ...
	Mar Markit services PMI	55.5	55.0	–	... supporting growth; Russia-Ukraine & supply headwinds.
UK	Mar Markit services PMI	60.5	–	–	Renewed strength in services post omicron...
	Mar Markit manufacturing PMI	58.0	–	–	... robust demand and catch-up work supports manufacturing.
US	Feb durable goods orders	1.6%	–0.6%	–	Volatility in transportation segment; strong otherwise.
	Initial jobless claims	214k	–	–	To remain at a low level for foreseeable future.
	Mar Markit manufacturing PMI	57.3	55.0	–	Growth across manufacturing ...
	Mar Markit services PMI	56.5	56.0	–	... and services holding at a robust pace.
	Mar Kansas City Fed index	29	–	–	Manufacturing outlook remains very strong for the region.
	Fedspeak	–	–	–	Bullard, Kashkari, Waller and Bostic.
Fri 25					
Chn	Q4 current account balance	119.4	–	–	Final estimate; X'pt strength has surplus nearing 2008 peak.
Eur	Feb M3 money supply %yr	6.4	–	–	Credit data also due. Liquidity ample for economy.
UK	Mar GfK consumer sentiment	–26	–	–	... are weighing on business and consumer sentiment.
	Feb retail sales	1.9%	–	–	Weak purchasing power may squeeze discretionary spending.
US	Feb pending home sales	–5.7%	1.0%	–	Demand is strong but should cool with higher rates over '22.
	Mar Uni. of Michigan sentiment	59.7	59.7	–	Inflation worries amid Russia–Ukraine a heavy weight.
	Fedspeak	–	–	–	Daly, Waller, Williams and Barkin.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.2	4.7	5.2	3.9
CPI inflation %yr	1.8	1.8	0.9	3.5	4.1	2.3
Unemployment rate %	5.0	5.2	6.8	4.7	3.8	3.9
Current account % of GDP	-2.1	0.7	2.6	3.5	4.1	-1.5
United States						
Real GDP %yr	3.0	2.2	-3.5	5.7	3.2	2.3
CPI inflation %yr	2.4	1.9	1.3	7.1	4.0	2.3
Unemployment rate %	3.9	3.7	8.1	5.4	3.6	3.3
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	2.4	1.3
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	3.2	2.1
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	7.3	3.7	2.0
China						
Real GDP %yr	6.7	5.8	2.3	8.1	5.7	5.6
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	4.2	4.7	4.6
World						
Real GDP %yr	3.6	2.8	-3.3	5.5	4.0	3.5

Forecasts finalised 11 March 2022

Interest rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Australia								
Cash	0.10	0.10	0.25	0.50	0.75	1.00	1.25	1.50
90 Day BBSW	0.15	0.20	0.35	0.60	0.95	1.20	1.45	1.70
10 Year Bond	2.51	2.40	2.40	2.50	2.50	2.40	2.30	2.20
International								
Fed Funds	0.125	0.875	1.125	1.375	1.625	1.875	1.875	1.875
US 10 Year Bond	2.14	2.10	2.20	2.30	2.30	2.30	2.30	2.20

Exchange rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7371	0.73	0.75	0.76	0.77	0.78	0.79	0.80
USD/JPY	118.75	117	117	118	118	119	119	119
EUR/USD	1.1077	1.10	1.11	1.12	1.13	1.14	1.15	1.15
GBP/USD	1.3153	1.33	1.34	1.35	1.36	1.37	1.37	1.36
USD/CNY	6.3589	6.30	6.30	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.0718	1.07	1.07	1.07	1.08	1.08	1.09	1.10

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