

WESTPAC WEEKLY ECONOMIC COMMENTARY

Four of a kind.

22 August 2022



Harakeke/flax

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The RBNZ has delivered a fourth consecutive 50bp rate hike, and the accompanying policy statement fully endorsed Westpac's forecast for two additional 50bp hikes by the end of this year. Inflation pressures have been bubbling over and the RBNZ is set to continue with its 'go hard and early' approach over the course of this year. However, there are signs that demand is already starting to cool and a slowdown in growth is on the cards over the coming months. That will likely see the RBNZ shifting to an on-hold stance from the end of this year.

As expected, the Reserve Bank of New Zealand raised the Official Cash Rate by 50bps at its August policy meeting. That was the fourth consecutive 50bp rise and took the cash rate from 2.50% to 3.00%, its highest level in seven years.

An August rate hike had been well telegraphed. Consequently, the main focus was on what the RBNZ signalled going forward. On this front, the RBNZ's published projections and the accompanying commentary fully endorsed Westpac's forecast for two additional 50bp moves and a 4.00% peak in the cash rate by the end of this year.

The RBNZ's updated forecasts now show the cash rate peaking at 4.1% (up from 3.9% in their previous projection) with the cash rate also rising at a slightly faster pace than previously assumed. Underlying that higher projection for the cash rate was a hawkish assessment of recent economic developments, with the policy statement highlighting the tightness in the labour market and strength of domestic inflation pressures. Consistent with the hawkish assessment, the minutes from

the August meeting noted that the Monetary Policy Committee agreed to bring forward the timing of OCR hikes. In addition, the Committee noted that "maintaining the recent pace of tightening remains the best means by which to meet their Remit." All of that is in line with our forecasts for continued large increases in the cash rate over the remainder of this year.

The RBNZ's updated projections did leave open the possibility that the size of rate increases could slow to 25bps by the end of this year, and that rate hikes could continue into next year. There certainly are some big question marks surrounding the longer-term outlook, including the strength of domestic demand and the state of the global economy. And a more measured pace of rate hikes would give the central bank time to take stock of whether the last few increases really will be required.

However, while the RBNZ has that flexibility if needed, we think they will continue with their current 'go hard and early' approach of 50bp moves. The strength of inflation has

surprised the RBNZ and analysts alike, and it's set to remain above the RBNZ's target band for at least the next year. That is a big concern. Such a protracted period of strong price growth risks expectations of high inflation becoming embedded into households and businesses' behaviour. And that could result in serious long-term damage to the economy, including the risk of a wage-price spiral and the erosion of households' purchasing power. To offset those risks, the RBNZ is more likely to frontload rate increases to get the inflation genie back in its bottle.

Reinforcing the case for continued large rate moves is the uncertainty about where the 'neutral' level of the cash rate is. The neutral cash rate is the level of the OCR that is neither accommodative nor restrictive. When the OCR is above neutral, interest rates will tend to be a drag on demand. Conversely, when the OCR is below neutral (as it has been through much of the pandemic) the low level of interest rates will boost spending and activity. Right now, with domestic demand running hot and inflation bubbling over, the RBNZ is desperate to ensure that the cash rate has moved above neutral and into tight territory to cool the economy down.

Even in normal times, there are wide bounds of uncertainty around where exactly the neutral rate sits. And right now, we are a long way from normal. The neutral level of the cash rate in New Zealand is usually thought to be around 2%. However, the RBNZ has flagged the possibility that at the current time that level could be higher than usual (meaning that more policy tightening could be required). Given that uncertainty, the RBNZ are likely to continue with large and rapid rate hikes to ensure that the cash rate is having the intended dampening impact.

While we're forecasting rapid rate increases in the near term, there are signs that demand is already starting to cool and a slowdown in growth is on the cards over the coming months. As we've previously highlighted, the impact of rate increases to date has been blunted by mortgage rate fixing. However, a large number of mortgages will come up for repricing at substantially higher rates over the coming months. The related pressure on households' budgets will squeeze demand and help to bring inflation pressures to heel over the coming years. That will likely see the RBNZ shifting to an on-hold stance from the end of this year, capping the rise in the OCR at 4%.

Satish Ranchhod, Senior Economist

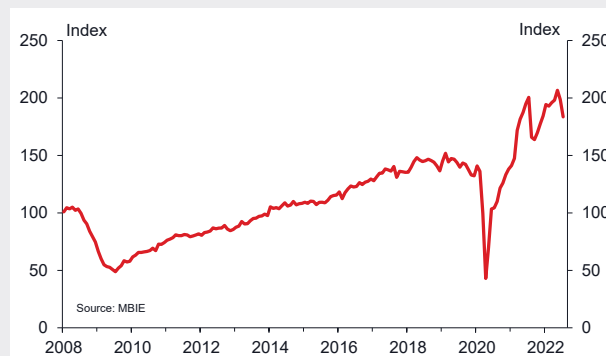
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Chart of the week

Job advertisements were down substantially for a second straight month in July. There were falls across all regions and industries. The labour market remains tight, with job openings still quite some way above pre-Covid levels. However, that unsatisfied (excess) demand for workers is starting to be reined in. With signs that demand in the economy is starting to cool, we'll be watching to see if this trend continues. That would have an important bearing on wage and inflation pressures.

Online job advertisements, seasonally adjusted

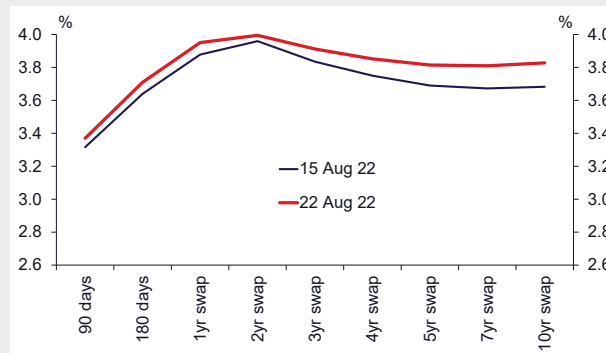


Fixed vs floating for mortgages

The Reserve Bank expects to lift the Official Cash Rate to a peak of around 4% in the coming months, and to hold it around there for some time. Wholesale interest rates are priced for a similar profile over the near term, but we think they're too hasty in pricing a fall in the OCR from 2023.

As a result, we believe that there is value in fixing for terms out 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 Q2 retail spending (volumes)

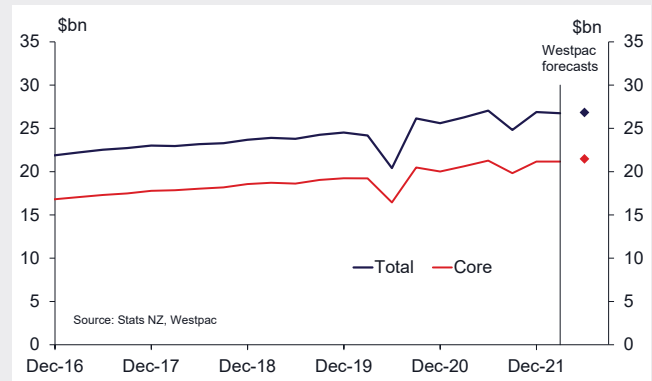
Aug 25, Last: -0.5%, Westpac f/c: +0.3%

The volume of goods sold fell 0.5% in the March quarter. However, that was a fairly small reversal following the solid 8% rise in the December quarter and left spending at firm levels.

We're forecasting a muted 0.3% rise in spending volumes in the June quarter. That's mainly related to a rise in hospitality spending following the relaxation of health restrictions earlier in the year. Spending in most other categories has remained steady.

The volume of goods sold has effectively been flat through 2022 to date. However, nominal spending has continued to trend higher due to the rise in consumer prices. We expect that the erosion of households' spending power (along with the rise in interest rates) will be an increasing drag on spending through the back half of the year.

NZ retail spending volumes

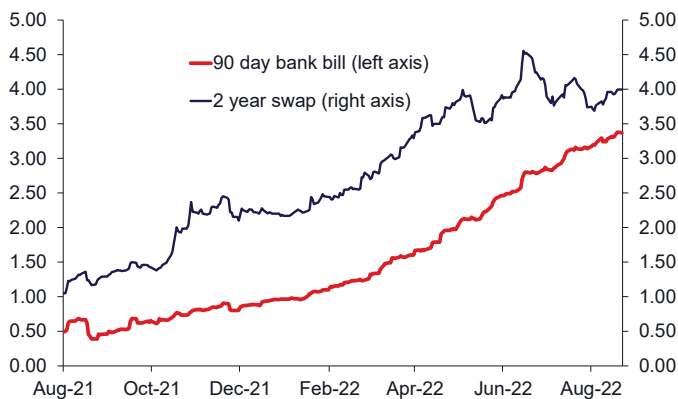


New Zealand forecasts

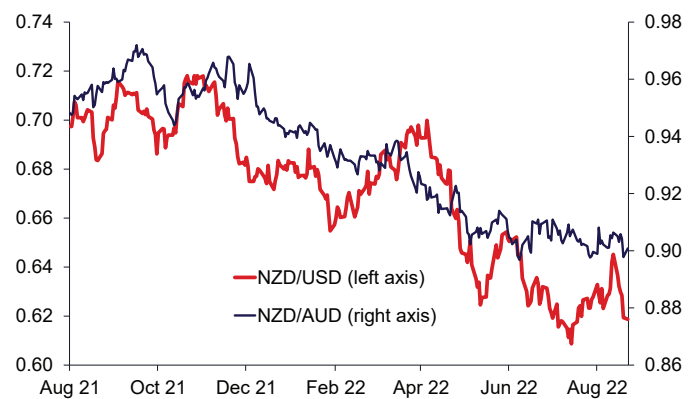
| Economic forecasts | Quarterly | | | | Annual | | | |
|----------------------------------|-----------|------|------|------|--------|------|-------|-------|
| | 2022 | | | | 2020 | 2021 | 2022f | 2023f |
| % change | Mar (a) | Jun | Sep | Dec | | | | |
| GDP (Production) | -0.2 | 1.0 | 0.4 | 0.6 | -2.1 | 5.6 | 1.8 | 2.0 |
| Employment | 0.0 | 0.0 | 0.1 | 0.1 | 0.6 | 3.4 | 0.2 | 0.8 |
| Unemployment Rate % s.a. | 3.2 | 3.3 | 3.3 | 3.4 | 4.9 | 3.2 | 3.4 | 3.8 |
| CPI | 1.8 | 1.7 | 1.4 | 0.2 | 1.4 | 5.9 | 5.1 | 3.2 |
| Current Account Balance % of GDP | -6.5 | -7.6 | -7.8 | -7.4 | -0.8 | -5.8 | -7.4 | -4.6 |

| Financial forecasts | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
|---------------------|--------|--------|--------|--------|--------|--------|--------|
| Cash | 3.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| 90 Day bill | 3.70 | 4.10 | 4.10 | 4.10 | 4.10 | 4.10 | 4.10 |
| 2 Year Swap | 3.90 | 3.90 | 3.80 | 3.70 | 3.50 | 3.30 | 3.10 |
| 5 Year Swap | 3.70 | 3.70 | 3.60 | 3.50 | 3.35 | 3.20 | 3.05 |
| 10 Year Bond | 3.40 | 3.50 | 3.40 | 3.30 | 3.15 | 3.00 | 2.95 |
| NZD/USD | 0.64 | 0.66 | 0.68 | 0.69 | 0.70 | 0.71 | 0.71 |
| NZD/AUD | 0.90 | 0.90 | 0.91 | 0.91 | 0.91 | 0.91 | 0.91 |
| NZD/JPY | 84.5 | 87.1 | 88.4 | 87.6 | 87.5 | 87.3 | 85.9 |
| NZD/EUR | 0.61 | 0.61 | 0.61 | 0.61 | 0.61 | 0.62 | 0.61 |
| NZD/GBP | 0.52 | 0.52 | 0.53 | 0.53 | 0.53 | 0.53 | 0.53 |
| TWI | 71.6 | 72.5 | 73.6 | 73.7 | 73.9 | 74.2 | 73.9 |

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 22 August 2022

| Interest rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| Cash | 3.00% | 2.50% | 2.50% |
| 30 Days | 3.04% | 2.94% | 2.74% |
| 60 Days | 3.21% | 3.12% | 2.94% |
| 90 Days | 3.37% | 3.30% | 3.13% |
| 2 Year Swap | 4.00% | 3.83% | 4.00% |
| 5 Year Swap | 3.82% | 3.56% | 3.82% |

NZ foreign currency mid-rates as at 22 August 2022

| Exchange rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| NZD/USD | 0.6187 | 0.6284 | 0.6272 |
| NZD/EUR | 0.6170 | 0.6166 | 0.6128 |
| NZD/GBP | 0.5232 | 0.5192 | 0.5203 |
| NZD/JPY | 84.74 | 84.75 | 85.57 |
| NZD/AUD | 0.9008 | 0.9010 | 0.9016 |
| TWI | 70.39 | 71.40 | 71.35 |

Data calendar

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---------------|---------------------------------------|-------|---------------|------------------|--|
| Mon 22 | | | | | |
| US | Jul Chicago Fed activity index | -0.19 | - | - | Regional surveys very volatile of late. |
| Tue 23 | | | | | |
| Eur | Aug S&P Global manufacturing PMI | 49.8 | 49.3 | - | Manufacturing tipping into contraction... |
| | Aug S&P Global services PMI | 51.2 | 50.5 | - | ... services growth feeling pressure from cooling demand. |
| | Aug consumer confidence | -27 | -28 | - | Inflation pressuring capacity, spending and sentiment. |
| UK | Aug S&P Global manufacturing PMI | 52.1 | - | - | Manufacturing output has hit a 24-month low... |
| | Aug S&P Global services PMI | 52.6 | - | - | ... services equally under pressure from rampant inflation. |
| US | Aug S&P Global manufacturing PMI | 52.2 | 52.0 | - | S&P PMIs point to much weaker conditions than ISMs... |
| | Aug S&P Global services PMI | 47.3 | 50.2 | - | ... potentially implying larger effect on small/mid sized firms. |
| | Aug Richmond Fed index | 0 | - | - | Regional surveys very volatile of late. |
| | Jul new home sales | -8.1% | -1.7% | - | Housing sector under significant and lasting pressure. |
| Wed 24 | | | | | |
| Aus | RBA Head of Domestic Markets speaking | - | - | - | Climate Change Risks in the Financial System, Sydney. |
| US | Jul durable goods orders | 2.0% | 0.6% | - | Investment partials point to material deterioration in spend. |
| | Jul pending home sales | -8.6% | -2.5% | - | Housing sector under significant and lasting pressure. |
| | Fedspeak | - | - | - | Kashkari. |
| Thu 25 | | | | | |
| NZ | Q2 real retail sales | -0.5% | 1.7% | 0.3% | Restrained volumes growth as prices charge higher. |
| US | Q2 GDP | -0.9% | -0.9% | - | Q2's weak consumer a big risk for outlook. |
| | Initial jobless claims | 250k | - | - | Likely to remain low versus history. |
| | Aug Kansas City Fed index | 13 | - | - | Regional surveys very volatile of late. |
| Fri 26 | | | | | |
| NZ | Aug ANZ consumer confidence | 81.9 | - | - | Confidence low in the face of high inflation and rate rises. |
| US | Jul wholesale inventories | 1.8% | - | - | Unwanted inventory accrual a risk given end demand. |
| | Jul personal income | 0.6% | 0.6% | - | Real income will remain under pressure until inflation... |
| | Jul personal spending | 1.1% | 0.3% | - | ... comes back to more normal levels in 2023... |
| | Jul PCE deflator | 1.0% | 0.1% | - | ... consumption will remain at risk until it does. |
| | Aug Uni. of Michigan sentiment | 55.1 | 55.1 | - | Consumption to remain weak into 2023. |
| | Jackson Hole Symposium | - | - | - | 25-27 August. Chair Powell to speak on the 26th. |

International forecasts

| Economic Forecasts (Calendar Years) | 2018 | 2019 | 2020 | 2021 | 2022f | 2023f |
|-------------------------------------|------|------|------|------|-------|-------|
| Australia | | | | | | |
| Real GDP %yr | 2.8 | 2.0 | -2.1 | 4.8 | 4.9 | 2.1 |
| CPI inflation %yr | 1.8 | 1.8 | 0.9 | 3.5 | 7.6 | 3.1 |
| Unemployment rate % | 5.0 | 5.2 | 6.8 | 4.7 | 3.0 | 4.2 |
| Current account % of GDP | -2.1 | 0.7 | 2.6 | 3.5 | 1.6 | -1.0 |
| United States | | | | | | |
| Real GDP %yr | 2.9 | 2.3 | -3.4 | 5.7 | 1.7 | 0.6 |
| 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 | 3.7 | 4.1 |
| 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 | 2.2 | 1.5 |
| United Kingdom | | | | | | |
| Real GDP %yr | 1.7 | 1.7 | -9.3 | 7.4 | 3.3 | -1.0 |
| China | | | | | | |
| Real GDP %yr | 6.8 | 6.0 | 2.2 | 8.1 | 3.5 | 7.0 |
| East Asia ex China | | | | | | |
| Real GDP %yr | 4.5 | 3.8 | -2.3 | 4.1 | 4.5 | 4.6 |
| World | | | | | | |
| Real GDP %yr | 3.6 | 2.9 | -3.1 | 6.1 | 3.0 | 3.4 |

Forecasts finalised 5 August 2022

| Interest rate forecasts | Latest | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Australia | | | | | | | | |
| Cash | 1.85 | 2.35 | 3.10 | 3.35 | 3.35 | 3.35 | 3.35 | 3.10 |
| 90 Day BBSW | 2.33 | 3.05 | 3.55 | 3.55 | 3.55 | 3.55 | 3.38 | 3.13 |
| 10 Year Bond | 3.40 | 3.20 | 3.40 | 3.30 | 3.10 | 2.90 | 2.65 | 2.50 |
| International | | | | | | | | |
| Fed Funds | 2.375 | 2.875 | 3.375 | 3.375 | 3.375 | 3.375 | 3.125 | 2.875 |
| US 10 Year Bond | 2.90 | 2.80 | 3.00 | 2.90 | 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 | 0.6912 | 0.71 | 0.73 | 0.75 | 0.76 | 0.77 | 0.78 | 0.78 |
| USD/JPY | 136.12 | 132 | 132 | 130 | 127 | 125 | 123 | 121 |
| EUR/USD | 1.0081 | 1.05 | 1.09 | 1.11 | 1.13 | 1.14 | 1.15 | 1.16 |
| GBP/USD | 1.1918 | 1.23 | 1.26 | 1.28 | 1.30 | 1.32 | 1.34 | 1.35 |
| USD/CNY | 6.8059 | 6.70 | 6.60 | 6.50 | 6.40 | 6.30 | 6.20 | 6.15 |
| AUD/NZD | 1.1081 | 1.11 | 1.11 | 1.10 | 1.10 | 1.10 | 1.10 | 1.10 |

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