

WESTPAC WEEKLY ECONOMIC COMMENTARY

Households feeling the pinch.

27 September 2022



Harakeke/flax

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The pressures in the household sector are becoming more pronounced and a slowdown in demand is on the cards. However, that's balanced against firmer conditions in our tourism and agricultural sectors. At the same time, the global backdrop is becoming increasingly rocky with the NZ dollar plunging in recent weeks.

Signs of cooling in the household sector have been mounting. Our September Westpac-McDermott Miller survey showed that economic confidence among New Zealand households is languishing at the sorts of lows that we saw during the recession in the early 1990s and during the 2008/09 Global Financial Crisis.

Households' finances are being squeezed. House prices have fallen sharply over the past year, with nationwide prices dropping around 9% since November. We've also had interest rates pushing higher. And on top of that, we've seen big increases in living costs, including large rises in the prices for food, fuel and housing.

On all of those fronts, there is more pain to come. Inflation is set to remain at high levels over the remainder of this year. In addition, the RBNZ is likely to continue with large increases in the cash rate, with 50 basis point increases on the cards at both the October and November meetings.

The pressure on households' finances is already weighing on spending appetites. Retail spending has flattened off in recent months, with purchases of durable items like furnishings going

backwards. And with the pressure on household budgets continuing to mount, we expect that there will be more softness as we go into the Christmas shopping period.

But while the household sector is clearly losing steam, conditions in other parts of the economy have been faring better.

In the business sector, the latest PSI and PMI reports point to resilient demand and a lift in forward orders. That resilience has been broad-based across industries, and there has been a notable firming in conditions in the hospitality sector after some very tough years.

There's no denying that conditions in the hospitality sector remain challenging. However, recent months have seen a sharp rise in international tourist numbers. Since the reopening of our borders, total visitor numbers have now risen to around 40% of their pre-pandemic levels, with visitor numbers from Australia having already retraced 75% of their 2019 levels. It will take time for international visitor numbers to fully retrace their previous peak. Even so, the recovery to date has been an important boost to confidence in the hospitality sector, and numbers are set to continue climbing over the months ahead.

We're also continuing to see strong returns for our commodity exports. Notably, Fonterra recently announced a record milk price payout for the 2021/22 season of \$9.30/kg, which points to record on-farm profits. Looking to the coming season, the milk price outlook for the 2022/23 season remains strong, with whole milk powder prices rising 7% over the past month alone.

The firmness in our export industries will be an important buffer for economic conditions over the coming months. Nevertheless, we still think that a slowdown in growth is on the cards. Interest rates are continuing to push higher, and as they flow through the economy they will be an increasing drag on demand over the coming months.

In addition to higher interest rates, businesses are grappling with a number of other challenges. First is the tightness in the labour market and related difficulties sourcing staff. That's constraining activity and has also resulted in large increases in labour costs for many businesses as they compete to attract and retain staff.

Businesses' operating costs more generally have also been rising at a rapid pace, climbing by around 10% over the past year. We expect to see ongoing pressures on operating costs over the coming months. Those increases are squeezing businesses profit margins despite the resilience of demand to date.

Importantly, with signs that domestic demand is cooling, many businesses are likely to find that they have less scope to pass on cost increases into output prices than they had over the past year.

In addition to changing conditions onshore, the global backdrop is becoming increasingly rocky and the downside risks for growth have been growing. Central banks around the globe, including the US Federal Reserve, have been rapidly tightening policy settings to lean against bubbling inflation pressures. At the same time, geopolitical tensions, including those related to the conflict in Ukraine, are rippling through commodity and financial markets. That's adding to the headwinds for growth.

The rapid changes in the global backdrop have seen the New Zealand dollar plunge in recent weeks. Relative to the US dollar, the Kiwi has fallen 13% since its peak in August, dropping to a low of around 56.3c at the time of writing. In light of recent developments, we have lowered our forecast for the NZ dollar by year's end from US 63 cents to US 58 cents. We still expect the New Zealand dollar to lift against the US dollar in 2023, but have lowered our forecast for the end of 2023 from US 68 cents to US 65 cents.

That sharp fall in the New Zealand dollar will help to boost our export earnings, providing some insulation from the global headwinds that threaten to buffet the New Zealand economy. However, it also signals higher costs for imports and ongoing pressure on households' finances.

Satish Ranchhod, Senior Economist

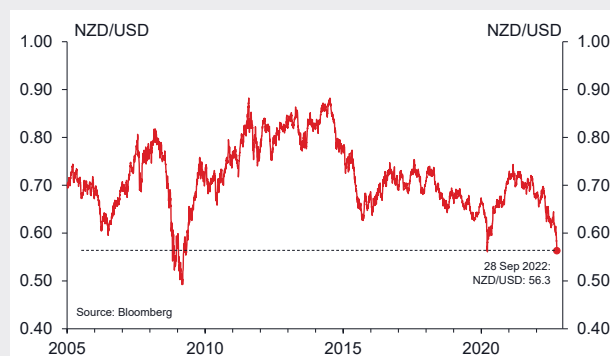
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Chart of the week

Investors around the globe have grown increasingly nervous about recession risks as central banks continue to rapidly raise policy rates in response to strong inflation pressures. That nervousness about the economic outlook has been exacerbated by geopolitical events, including the conflict in Ukraine. The resulting safe-haven demand has seen the US dollar rising sharply. Conversely, the New Zealand dollar has plunged and is now at the sorts of lows we saw during the Covid lockdown in 2020 and in 2009 during the depths of the financial crisis.

New Zealand dollar

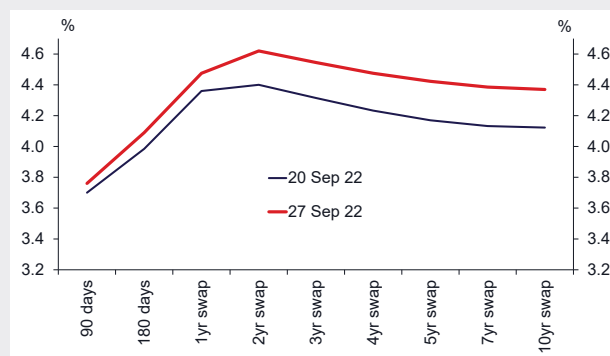


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 4% 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

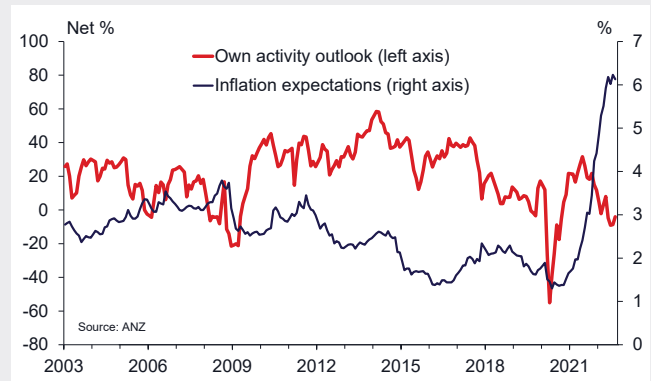
NZ Sep ANZBO business confidence

Sep 29, Last: -47.8

Business confidence nudged higher for a second month in August. Nevertheless, New Zealand businesses remain deeply pessimistic about the economic outlook. Businesses have been grappling with shortages of staff, strong cost pressures, and the rise in interest rates. We expect those factors will continue to weigh on confidence in the September survey.

The survey's cost and pricing gauges will again be worth keeping a close eye on. While still elevated, both the number of businesses who expect costs to rise over the coming months and the number who are planning on raising their prices eased back in August. If those trends continue in September, it will reinforce our expectation that the peak in inflation has passed.

NZ business confidence



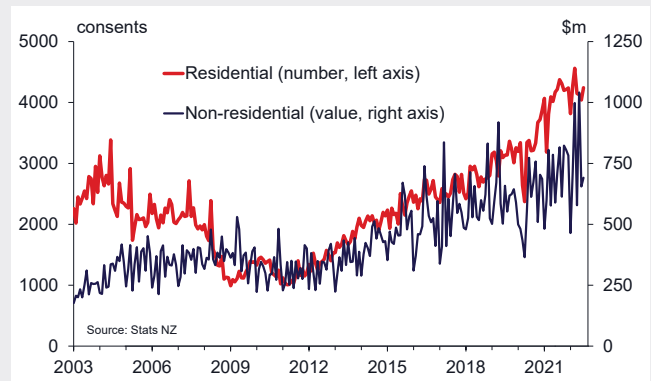
NZ Aug residential building consents

Sep 30, Last: +5.0%, Westpac f/c: Flat

We expect that dwelling consent issuance will remain broadly steady in August, with consent numbers still running at firm levels. Monthly consent issuance has effectively been tracking sideways for around a year now. While there has been some month-to-month volatility associated with 'lumpy' categories like retirement villages, consents have failed to rise meaningfully above 4,200/month for any sustained period.

Material and labour shortages have been a break on the pace of building. At the same time costs have been rising, while house prices have been declining. Over time, those factors will weigh on construction activity. But for now, the slowdown looks like it will be gradual.

NZ building consents



Aus Aug retail sales

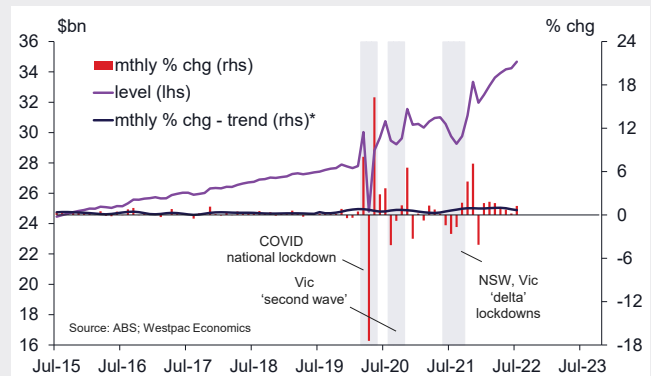
Sep 28, Last: 1.3%, WBC f/c: 0.0%

Mkt f/c: 0.4%, Range: 0.0% to 0.9%

Retail sales surprised to the upside in July, posting a 1.3% gain despite RBA rate rises, cost of living pressures and a sharp slide in consumer sentiment. The result likely reflects a mix of delayed impacts from these negatives, still positive reopening dynamics, the cushioning effect of large financial buffers accumulated during the pandemic, and higher retail prices, which cushion the effect of slower volumes on nominal sales. Certainly there was little in the detail to suggest the result was a 'rogue'.

The August update should show more signs of moderation, although again, judging the net impact of rate rise effects and these other factors is difficult. On balance, card activity suggests retail activity is 'cresting' with August expected to show a flat outcome in the month.

Aus monthly retail sales



The week ahead

Aus Q3 ACCI-Westpac business survey

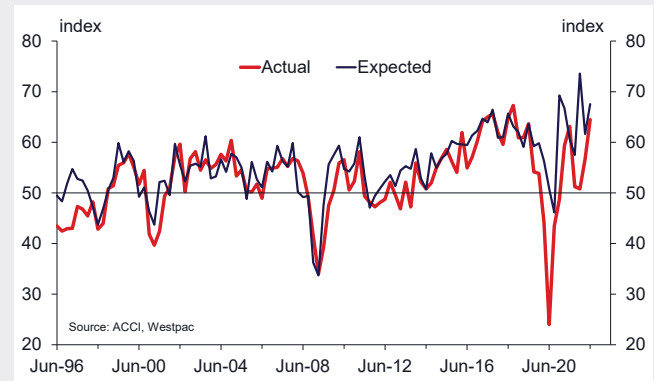
Sep 29, Last: 64.5

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

Momentum in the manufacturing sector started to build in Q2, after being affected by omicron and weather-related disruptions in Q1. The reopening - which will be a key dynamic in the September quarter - should 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.

Aus Westpac-ACCI Composite indexes



Aus Aug private sector credit

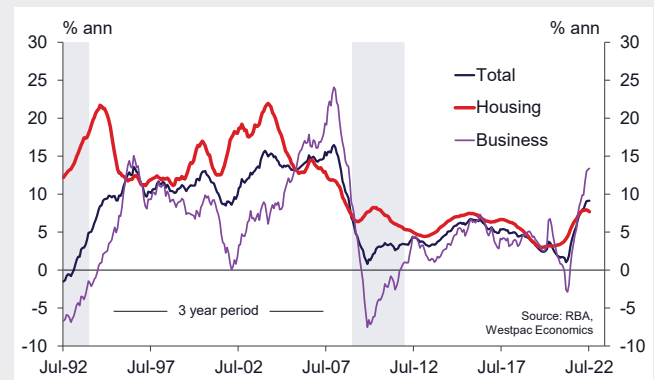
Sep 30, Last: 0.7%, WBC f/c: 0.6%
Mkt f/c: 0.6%, Range: 0.5% to 0.7%

Annual credit growth climbed to a brisk 9.1% in May and held there in June and July. That is the fastest annual pace since October 2008, albeit well below the end 2007 peak of 16.5%. Businesses and households responded to very expansionary policy settings - stimulus which is now being wound back.

The June quarter 2022 was a stand-out, as the economy experienced a burst of activity on the reopening from earlier covid disruptions. Credit grew at an 11.1% annualised pace in the quarter, including an unsustainable 20% annualised pace for businesses - housing grew at a mere 7.5% pace.

In July, the monthly rate of credit growth edged down to 0.74%, from 0.9%, and we expect a 0.6% outcome for August - with the slowing led by housing. The housing market has been hit by the RBA's rapid fire interest rate hikes - new lending fell by -4.4% in June and then slumped -8.5% in July.

Aus private sector credit growth

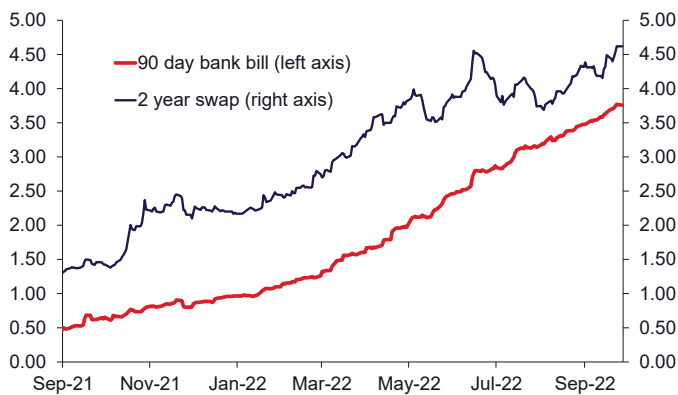


New Zealand forecasts

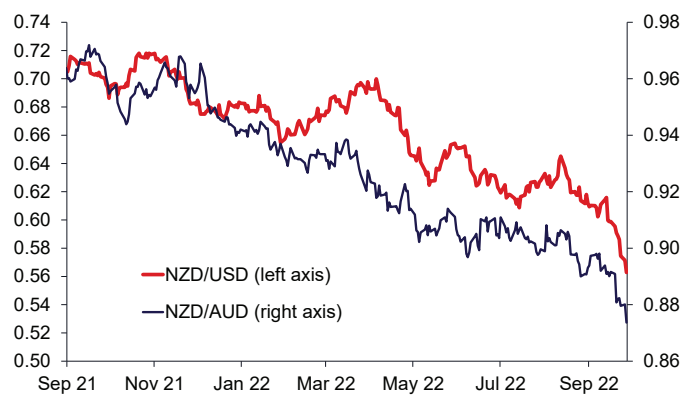
Economic forecasts	Quarterly				Annual			
	2022		2023		2020	2021	2022f	2023f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	1.7	0.4	0.6	0.6	-2.1	5.5	2.2	2.2
Employment	0.0	0.1	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	4.9	3.2	3.4	3.8
CPI	1.7	1.6	0.3	1.0	1.4	5.9	5.3	3.6
Current 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	4.00	4.00	4.00	4.00	4.00	4.00
90 Day bill	4.10	4.10	4.10	4.10	4.10	4.10	3.80
2 Year Swap	4.10	4.00	3.80	3.60	3.40	3.20	2.95
5 Year Swap	4.10	4.00	3.90	3.70	3.50	3.30	3.15
10 Year Bond	4.00	3.80	3.70	3.60	3.45	3.30	3.20
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	0.60	0.60	0.59	0.60	0.61	0.60	0.60
NZD/GBP	0.53	0.53	0.53	0.53	0.54	0.54	0.53
TWI	68.2	68.2	68.1	68.9	70.8	70.5	70.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 27 September 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.00%	3.00%	3.00%
30 Days	3.39%	3.22%	3.06%
60 Days	3.58%	3.40%	3.26%
90 Days	3.76%	3.58%	3.48%
2 Year Swap	4.62%	4.16%	4.32%
5 Year Swap	4.42%	4.02%	4.14%

NZ foreign currency mid-rates as at 27 September 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5629	0.6159	0.6180
NZD/EUR	0.5861	0.6051	0.6161
NZD/GBP	0.5283	0.5251	0.5275
NZD/JPY	81.47	87.52	85.44
NZD/AUD	0.8737	0.8909	0.8907
TWI	67.49	70.97	71.10

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 26					
US	Aug Chicago Fed activity index	0.27	-	-	Regional surveys are mixed...
	Sep Dallas Fed index	-12.9	-8.0	-	... but the outlook is fragile.
	Fedspeak	-	-	-	Collins, Bostic, Logan, Mester.
Tue 27					
NZ	RBNZ Governor Orr speaking	-	-	-	Talking on policy and the outlook (no published notes).
Chn	Aug industrial profits %yr	0.8%	-	-	Profits under pressure; likely to remain so into year-end.
US	Aug durable goods orders	-0.1%	-0.1%	-	Investment spending clearly subdued.
	Jul FHFA house prices	0.1%	0.0%	-	Set to see further slowing...
	Jul S&P/CS home price index	0.44%	0.25%	-	... as rate hikes take effect
	Sep consumer confidence index	103.2	104.5	-	Confidence starting to consolidate; similar to Uni of Michigan.
	Sep Richmond Fed index	-8	-10	-	Volatile of late; further weakening into year-end likely.
	Aug new home sales	-12.6%	-2.2%	-	Housing market under significant and lasting pressure.
	Fedspeak	-	-	-	Chair Powell on digital currencies; Evans and Bullard too.
Wed 28					
Aus	Aug retail sales	1.3%	0.4%	0.0%	Likely to see a 'cresting' of retail spending.
UK	Sep Nationwide house prices	0.8%	-	-	Annual growth cooling as rate hikes impact.
US	Aug wholesale inventories	0.6%	0.4%	-	Unwanted inventory accrual a risk given end demand.
	Aug pending home sales	-1.0%	-0.5%	-	Housing market under significant and lasting pressure.
	Fedspeak	-	-	-	Daly, Bostic, Bullard, Evans.
Thu 29					
NZ	Sep ANZ business confidence	-47.8	-	-	Sentiment and activity to remain subdued, costs elevated.
	RBNZ Governor Orr	-	-	-	BIS panel discussion on the 'Future of Central Banking'.
Aus	Q3 ACCI-Westpac business survey	64.5	-	-	Manufacturing, a strong expansion, on the reopening burst.
	Q3 job vacancies (ABS measure)	13.8%	-	-	At very elevated levels - at a time of labour shortages.
	Jul, Aug monthly CPI indicator	-	-	-	A media release of monthly CPI; it is not a full data release.
Eur	Sep economic confidence	97.6	96.0	-	The highly uncertain outlook has left...
	Sep consumer confidence	-28.8	-	-	... consumer confidence at record lows.
UK	Aug net mortgage lending £bn	5.1	-	-	Rising rates and the slowing economy to weigh on lending.
US	Initial jobless claims	213k	-	-	Likely to remain at low levels for time being.
	Q2 GDP, annualised	-0.6%	-0.6%	-0.6%	Final estimate to confirm component detail.
	Fedspeak	-	-	-	Bullard, Mester, Daly.
Fri 30					
NZ	Sep ANZ consumer confidence	85.4	-	-	Off its recent lows, but still very weak.
	Aug building permits	5.0%	-	0.0%	Weaker financial incentives weighing on new developments.
Aus	Aug private sector credit	0.7%	0.6%	0.6%	Emerging signs of a slowing in Q3, as RBA rapidly raises rates.
Chn	Sep manufacturing PMI	49.4	49.4	-	Ongoing virus risks are limiting mfg activity...
	Sep non-manufacturing PMI	52.6	52.6	-	... and slowing momentum in services.
	Sep Caixin manufacturing PMI	49.5	-	-	Close to official estimate; small/mid-sized firms equally weak.
	Q2 current account balance US\$bn	80.2	-	-	Final estimate; surplus to narrow into year-end on demand.
Eur	Aug unemployment rate	6.6%	6.6%	-	Holding at record lows.
	Sep CPI %yr	9.1%	9.7%	-	80% of CPI basket running above the ECB's 2.0%yr target.
UK	Q2 GDP, final	-0.1%	-	-	Extent of HH consumption weakness is the key concern.
US	Aug personal income	0.2%	0.3%	-	Real income will remain under pressure while...
	Aug personal spending	0.1%	0.2%	-	... inflation puts consumption at risk.
	Aug PCE deflator	-0.1%	0.1%	-	August core CPI upside surprise...
	Aug core PCE deflator	0.1%	0.5%	-	... to also appear in PCE.
	Sep Chicago PMI	52.2	51.8	-	Broad-based weakening in conditions evident.
	Sep Uni. of Michigan sentiment	59.5	59.5	-	Final estimate.
	Fedspeak	-	-	-	Brainard and 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	7.6	3.1
Unemployment rate %	5.0	5.2	6.8	4.7	3.1	4.2
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	1.7	0.5
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	4.4
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 14 September 2022

Interest rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Australia								
Cash	2.35	3.35	3.60	3.60	3.60	3.60	3.35	3.10
90 Day BBSW	2.91	3.80	3.80	3.80	3.80	3.63	3.38	3.13
10 Year Bond	3.92	3.75	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	3.71	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	0.6616	0.65	0.66	0.67	0.69	0.72	0.73	0.74
USD/JPY	142.23	143	141	139	137	134	132	130
EUR/USD	0.9826	0.97	0.99	1.02	1.04	1.07	1.09	1.10
GBP/USD	1.1232	1.10	1.12	1.14	1.17	1.20	1.22	1.24
USD/CNY	7.1003	7.00	6.80	6.60	6.40	6.30	6.20	6.15
AUD/NZD	1.1353	1.12	1.12	1.12	1.11	1.11	1.11	1.12

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