

WESTPAC WEEKLY ECONOMIC COMMENTARY

Strange days.

28 March 2022



Kākābeak/ngutukākā

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Our latest household confidence surveys found that New Zealanders are increasingly concerned about the state of their own finances and the wider economy, but are more positive about the state of the labour market. That's an unusual combination, and it reflects the unusual economic conditions we find ourselves in.

The Westpac McDermott Miller consumer confidence index fell by 7 points to 92.1 in the March quarter. That takes the index even lower than it was during the Covid lockdown in 2020. Households have become even more pessimistic on both their own finances and the economic outlook for the years ahead, and are more apprehensive about making major purchases.

That pessimism extended to concerns about their regional economies, with all but one region recording a drop in confidence for the quarter. The progress of the Omicron outbreak was probably more of a factor for some regions than others, and the agriculture-focused regions fared relatively better, buoyed by strong export commodity prices. But the extent of the drop in confidence suggests that the factors behind it were universal.

But despite that pessimism about the broader economic backdrop, households have actually been growing increasingly confident about the state of the labour market. Households noted the increasing number of jobs available, with employers desperate to find workers. A growing number of them also reported a lift in their earnings over the last year, though that measure is still running below its pre-pandemic levels.

The common theme in these survey responses is inflation. The cost of living has been rising rapidly, and even though a tight labour market means that workers are in a strong position to negotiate pay increases, many people feel like they're struggling to get ahead.

Once again, this highlights the challenge that lies ahead for the Reserve Bank. The inflation rate has risen to a three-decade high, and is expected to remain above the target range for at least the rest of this year. And while much of the rise in prices has been due to external factors beyond the central bank's control, people are increasingly looking to bake this into their future wage and price setting.

The inflation targeting framework has served the economy well over the years. Indeed, one of its great successes has been that most of the time we just don't need to think about inflation in our day-to-day business.

But that framework is centred around dealing with demand-driven inflation pressures. What we're experiencing now is a combination of both homegrown inflation pressures and a range of cost shocks from overseas, with the risk that the latter

can feed back into the former.

There are no easy answers about how central banks should deal with this. For instance, a jump in oil prices acts like a tax on activity, adding to inflation in the short term but weighing on demand elsewhere in the economy. Raising interest rates to counter the near-term rise in inflation would come at the expense of even weaker activity, and it's not clear that this would be welfare-enhancing.

On the other hand, our history shows that appeasement doesn't work either. Running looser monetary policy, to soften the impact of rising living costs, just increases the risk that high inflation becomes entrenched over time.

It would seem that the answer for the central bank is to not jump in either direction. Indeed, in the past the RBNZ has assessed that the impact of oil prices on monetary policy settings is zero. (Oil is an example of a pure cost shock, as New Zealand imports all of the oil that it consumes; higher prices for our export commodities are more obviously a plus for interest rates.)

But this only holds true if the economy is starting from a balanced position. In this case, we're starting with an economy that was already running hot, in part due to the substantial policy stimulus in response to the Covid shock. An overheating economy increases the risk that wage- and price-setting becomes unanchored from the RBNZ's inflation target.

So the need to keep inflation expectations in check means that higher interest rates are required, and that early action is better. In this respect the RBNZ is relatively well positioned, having started lifting the Official Cash Rate last year. In contrast, some of its international peers are only just getting this process under way – the US Federal Reserve increased its policy rate for the first time this month, and the first move from the Reserve Bank of Australia still looks to be several months away.

That distinction appears to have been lost on financial markets, however. Growing expectations that the Fed will raise interest rates faster – spurred on by comments by some Committee members about 50 basis point moves – have seen US interest rates rise sharply in recent weeks, and New Zealand rates have been marked higher in tandem. We'd argue that markets are now overpricing the likely extent of OCR hikes over the next couple of years.

If we're right about that though, what would prompt the market to correct? We think it will come down to the evidence that monetary policy is already getting enough traction – cooling down the housing market, and ultimately slowing consumer demand to more sustainable levels.

We're already seeing the evidence on that first part, with house prices falling by 3% over the last three months. We expect further declines as the higher level of mortgage rates continues to do its work, and we're forecasting house prices to drop by around 10% in total over the next two years.

Michael Gordon, Acting Chief Economist

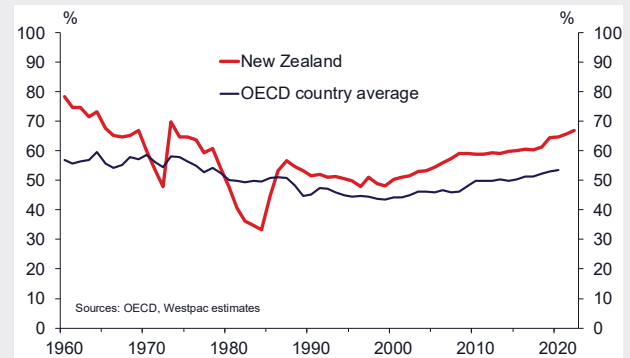
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Chart of the week

From the 1st of April the minimum wage will increase by 6% to \$21.20 per hour, broadly keeping pace with inflation over the last year. New Zealand's minimum wage has typically been more generous compared to the average OECD country, except in the 1970s and early 1980s when high generalised inflation eroded its real value between reviews.

Minimum wage as a % of the median wage

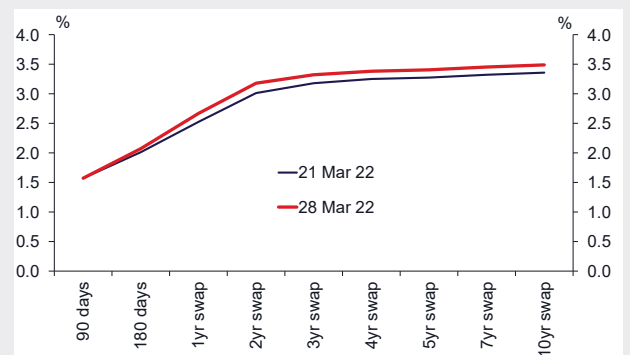


Fixed vs floating for mortgages

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 Feb residential building consents

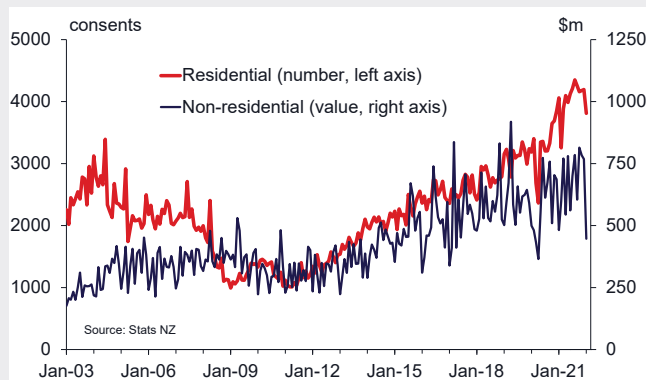
Mar 30, Last: -9.2%, Westpac f/c: +10.0%

Consent issuance dropped 9% in January. That decline was concentrated in the more volatile medium density categories following a few months of very strong issuance last year.

We're forecasting a 10% rise in issuance in February, reflecting a reversal of last month's drop in multi-unit consents. That would take consent issuance back around the very strong levels we've seen since the middle of last year.

We expect consent issuance and home building will remain strong for some time yet. However, the housing market has been cooling in recent months. Over time, that is likely to weigh on the number of new projects that come to market.

NZ building consents



NZ Mar ANZBO business confidence

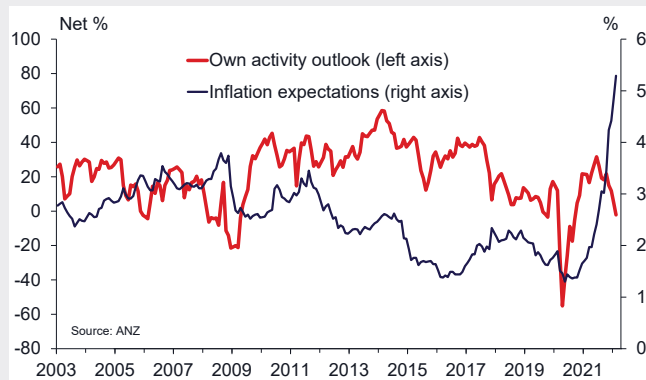
Mar 30, Last: -51.8

Business confidence nose dived in the early part of the year. That drop was not unexpected. In addition to surging Omicron infections, businesses are grappling with a range of headwinds including shortages of staff and materials, as well as the strong rise in inflation pressures.

We expect confidence will remain weak in the March survey. Recent weeks have seen a rapid rise in Omicron infections, as well as the invasion of Ukraine.

We also expect price and inflation gauges will remain high, especially given the sharp rise in fuel costs in recent weeks.

NZ business confidence



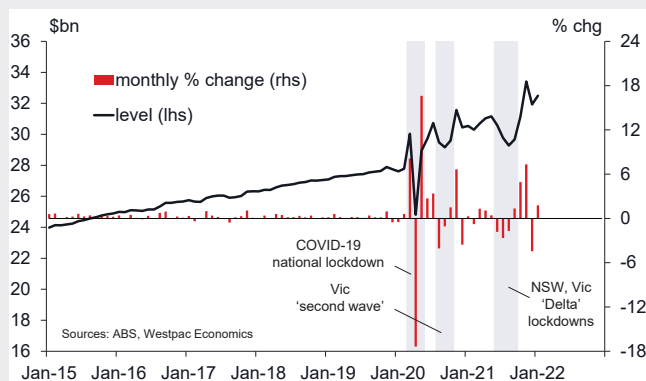
Aus Feb retail trade

Mar 29, Last: 1.8%, WBC f/c: 1.5%
Mkt f/c: 0.9%, Range: 0.0% to 1.5%

Retail posted a surprisingly robust 1.8% gain in Jan with omicron-related drags fairly minimal in the month - only two storetypes recorded outright sales declines and some exposed segments holding up much better than expected. Recall that retail was also coming off a relatively strong Dec with the post-delta reopening driving a 7.6% lift vs Sep, with the Dec month suggesting some of this 'catch-up' spend was starting to run off.

Our **Westpac Card Tracker** was much softer in Jan but rebounded strongly in Feb, flooding events in Qld and NSW only taking a little of the gloss off. We suspect some of the difference between the card data and official retail sales may be down to the allocation of weekly data to different months. On that basis, we expect Feb to show another relatively strong 1.5% gain, bringing the two measures more in line on a two month basis. Note that some of the gain will be due to rising prices rather than volumes.

Aus monthly retail sales



The week ahead

Aus 2022 Federal Budget, \$bn

Mar 29, Last, 2021/22: -77.7 (est), 2022/23 WBC f/c: -76.9

The budget deficit profile will be lowered in the Federal Budget benefiting from a stronger economy. Commodity prices are higher than anticipated in MYEFO, boosting national income. We estimate a potential budget windfall of \$78bn across the four years to 2024/25.

The policy focus in this budget shifts from boosting demand to supporting supply, with the unemployment rate this year to be at the lowest level since 1974. We've allowed for \$20bn of new spending, including: a cost of living package; and supply measures, to lift labour force participation and increase productivity.

On our figures, the budget deficit estimate for 2021/22 is lowered to \$77.7bn from \$99.2bn in MYEFO, a \$21.5bn improvement (after including \$7.5bn in new spending). The 2022/23 deficit is trimmed by \$22bn (after \$6bn in spending) to \$76.9bn, -3.3% of GDP.

For additional detail, see our Budget Preview from March 21.

Aus Federal budget, \$bn

	2021/22	2022/23	2023/24	2024/25
Budget deficit, MYEFO	-99.2	-98.9	-84.5	-57.5
% of GDP	-4.5	-4.4	-3.6	-2.3
Stronger economy boost	29.0	28.0	11.0	10.0
Cost of new policy	-7.5	-6.0	-3.0	-3.5
Budget deficit, Budget	-77.7	-76.9	-76.5	-51.0
% of GDP	-3.4	-3.3	-2.7	-2.0
Gross debt, MYEFO	919	1,017	1,110	1,189
% of GDP	41.8	45.6	47.7	48.6
Gross debt, Budget	898	974	1,059	1,131
% of GDP	40.8	43.7	45.5	46.3

Sources: Budget papers, Westpac Economics forecasts

Aus Feb dwelling approvals

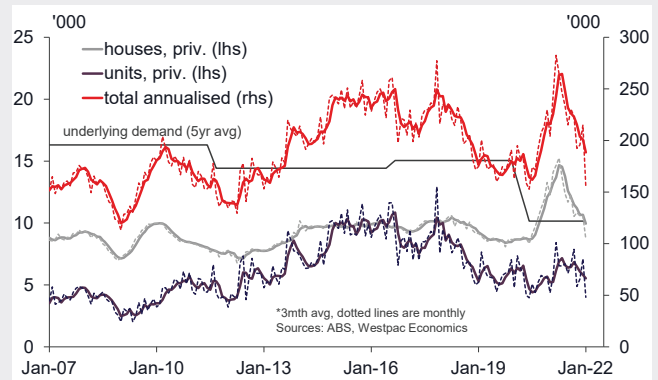
xMar 31, Last: -27.9%, WBC f/c: 20%
Mkt f/c: 10%, Range: -25.3% to 50.0%

Dwelling approvals posted a surprise slump in Jan, recording a 27.9% drop that was both steep and broad-based. The falls almost certainly reflect COVID disruptions around the start of the year, 'amplified' by seasonal adjustments. Jan housing data always needs to be read with caution and that looks to be even more the case this year.

Feb is almost certain to see a very large reversal. A full reversal to Dec levels would see approvals jump nearly 40% in the month. However, the Dec read was flattered by a big post-delta rebound in high rise units. A more muted rebound to something closer to Oct-Nov levels seems more likely but would still see an impressive gain in the order of +20%.

Clearly this excessive monthly noise makes it next to impossible to pick out ongoing trends - it will take a few more monthly updates to get a confident read on momentum.

Aus dwelling approvals



US Mar employment report

Apr 1, nonfarm payrolls, Last: 678k, WBC f/c: 500k, Mkt f/c: 450k; Apr 1, unemployment rate, Last: 3.8%, WBC f/c: 3.7%, Mkt f/c: 3.7%

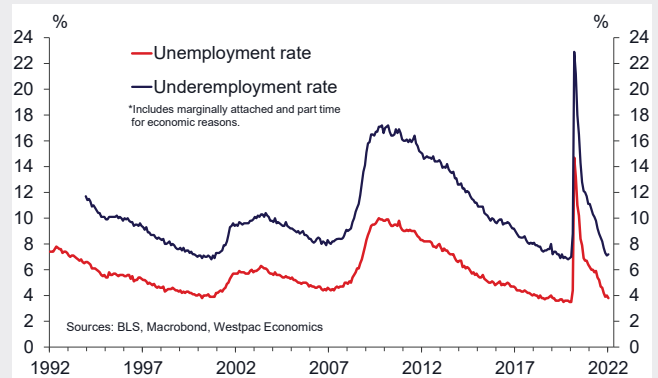
The US economy continues to produce jobs at a rapid rate, the average monthly gain over the past six months coming in circa 580k. In March, we expect a similar result of 500k.

For now, it seems that risks remain to the upside, with participation's intermittent move higher allowing labour supply to more fully meet demand.

As a result, while in March we expect an unchanged participation rate, even if it does lift, the unemployment rate is still likely to move lower to 3.7%.

Hourly earnings have surprised to the downside the past two months and so are due for a robust gain in March. Still, real wages growth will continue to decline.

US 'maximum employment achieved

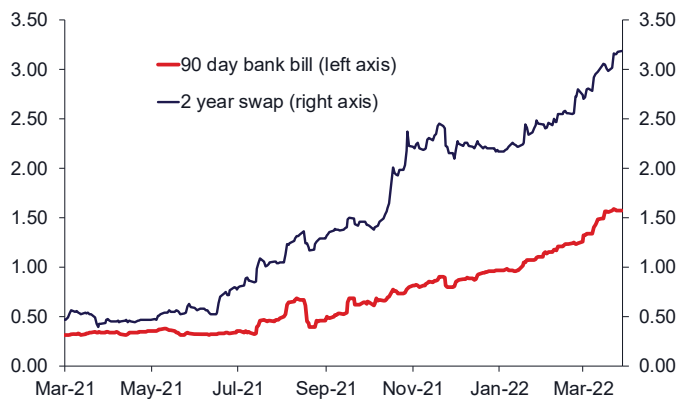


New Zealand forecasts

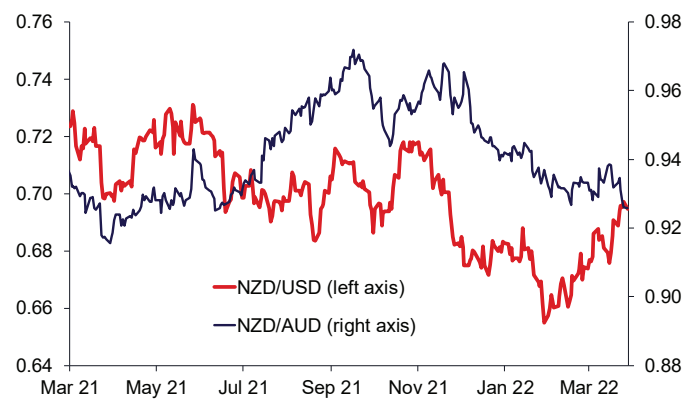
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Dec (a)	Mar	Jun	Sep	2020	2021	2022f	2023f
GDP (Production)	3.0	0.3	0.7	2.3	-2.1	5.6	3.4	4.8
Employment	0.1	0.5	0.2	0.1	0.6	3.7	0.9	1.0
Unemployment Rate % s.a.	3.2	3.1	3.0	3.0	4.9	3.2	3.0	3.3
CPI	1.4	1.7	0.9	1.1	1.4	5.9	4.0	2.7
Current Account Balance % of GDP	-5.6	-5.8	-6.5	-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	3.30	3.30	3.25	3.20	3.15	3.10	3.00
5 Year Swap	3.45	3.45	3.40	3.35	3.30	3.25	3.15
10 Year Bond	3.40	3.40	3.20	3.15	3.10	3.05	3.00
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 28 March 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.05%	1.04%
60 Days	1.39%	1.27%	1.15%
90 Days	1.57%	1.49%	1.26%
2 Year Swap	3.19%	3.03%	2.75%
5 Year Swap	3.41%	3.25%	2.99%

NZ foreign currency mid-rates as at 28 March 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6948	0.6795	0.6739
NZD/EUR	0.6323	0.6199	0.6001
NZD/GBP	0.5273	0.5211	0.5025
NZD/JPY	84.75	80.21	77.87
NZD/AUD	0.9259	0.9380	0.9333
TWI	74.75	73.51	72.22

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
UK	Mar Nationwide house prices	1.70%	-	-	Rising mortgage rates set to cool demand over 2022.
US	Feb wholesale inventories	0.80%	1.20%	-	Stocks are being replenished at a robust pace.
	Mar Dallas Fed index	14	10	-	Will provide a timely update on manufacturing in Texas.
Tue 29					
Aus	Feb retail sales	1.80%	0.90%	1.50%	Jan up better than expected. Weather, price effects in Feb.
	2022/23 Federal Budget, \$bn	-77.7(e)	-	-76.9	Stronger economy delivers budget windfall ahead of election.
UK	Feb net mortgage lending £bn	5.9	-	-	Softer lending patterns to eventuate with higher rates.
US	Jan FHFA house prices	1.20%	1.30%	-	Soft inventory and eager buyers ...
	Jan S&P/CS home price index	1.46%	1.50%	-	... to drive house price growth before rate hikes take effect.
	Mar consumer confidence index	110.5	107.8	-	Inflation concerns to dampen confidence.
	Feb JOLTS job openings	11263k	11000k	-	Pointing to extraordinary demand for workers.
	Fedspeak	-	-	-	Harker.
Wed 30					
NZ	Feb building permits	-9.2%	-	10.00%	Rebound after last month's fall in multi-unit numbers.
	Mar ANZ business confidence	-51.8	-	-	Business confidence and conditions to remain subdued.
Eur	Mar economic confidence	114	110	-	Russia-Ukraine conflict and inflation set to...
	Mar consumer confidence	-18.7	-	-	... weigh heavily on European confidence.
US	Mar ADP employment change	475k	413k	-	Jobs growth recovering to strong levels after omicron decline.
	Q4 GDP	7.00%	7.10%	-	Small upward revision anticipated in final estimate.
	Fedspeak	-	-	-	Bostic and Barkin.
Thu 31					
Aus	Feb dwelling approvals	-27.9%	10%	20%	Omicron created extreme volatility at start of the year.
	Feb private sector credit	0.60%	0.60%	0.60%	Jan 7.6% yr, strongest since 2008 – boost from policy stimulus.
Jpn	Feb industrial production	-0.8%	0.80%	-	Volatility remains as supply issues are worked through.
Chn	Mar manufacturing PMI	50.2	50	-	COVID-19 disruptions are ongoing concerns...
	Mar non-manufacturing PMI	51.6	50.7	-	... but underlying strength of the economy is clear.
Eur	Feb unemployment rate	6.80%	6.70%	-	Tight labour market laying foundation for wages growth.
UK	Q4 GDP	1.00%	-	-	Economy in robust health; fit to handle rate hikes over 2022.
US	Feb personal income	0.00%	0.50%	-	Weakening purchasing power is a concern...
	Feb personal spending	2.10%	0.50%	-	... strength in services necessary for above trend GDP g'th.
	Feb PCE deflator	0.60%	0.60%	-	PCE inflation has reached a 40-year high...
	Feb core PCE deflator	0.50%	0.40%	-	... price pressures will only slowly abate through 2022.
	Initial jobless claims	187k	-	-	Set to remain very low for foreseeable future.
	Mar Chicago PMI	56.3	57.1	-	Supply issues are an ongoing concern.
	Fedspeak	-	-	-	Williams.
Fri 01					
Aus	Mar CoreLogic home value index	0.30%	-	0.30%	Gains stalled in Syd, Melb, but still strong in some cities.
	Feb housing finance	2.60%	1.50%	2.50%	Market showing a clear moderation since late 2021 ...
	Feb owner occupier finance	1.00%	-	1.00%	... centred on owner occupiers, first time buyers especially ...
	Feb investor finance	6.10%	-	5.50%	... but with investors still showing good momentum
NZ	Mar ANZ consumer confidence	81.7	-	-	Confidence low, high inflation is a big concern.
Jpn	Q1 Tankan large manufacturers index	18	12	-	Commodity prices and supply issues to weigh on sentiment.
	Mar Nikkei manufacturing PMI	53.2	-	-	Final estimate for the month.
Chn	Mar Caixin China PMI	50.4	50	-	Mfg to work through COVID-19 with authorities' support.
Eur	Mar Markit manufacturing PMI	57	-	-	Final estimate for the month.
	Mar CPI %yr	5.80%	6.30%	-	Energy inflation expected to come through strongly.
UK	Mar Markit manufacturing PMI	55.5	-	-	Final estimate for the month.
US	Mar non-farm payrolls	678k	450k	500k	Employment gains to continue at healthy pace...
	Mar unemployment rate	3.80%	3.70%	3.70%	... pushing unemployment rate lower...
	Mar average hourly earnings %mth	0.00%	0.40%	0.30%	... and supporting robust wages growth.
	Mar Markit manufacturing PMI	58.5	-	-	Final estimate for the month.
	Feb construction spending	1.30%	1.00%	-	Spending supported by strength in home building.
	Mar ISM manufacturing	58.6	58.3	-	Manufacturing is growing at a strong pace.

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	0.75	1.00	1.25	1.50	1.75
90 Day BBSW	0.20	0.20	0.35	0.85	1.20	1.45	1.70	1.95
10 Year Bond	2.80	2.90	2.80	2.50	2.40	2.25	2.10	2.10
International								
Fed Funds	0.375	1.375	1.875	2.375	2.375	2.375	2.375	2.375
US 10 Year Bond	2.37	2.60	2.60	2.30	2.20	2.15	2.10	2.10

Exchange rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7517	0.73	0.75	0.76	0.77	0.78	0.79	0.80
USD/JPY	121.83	122	121	121	120	120	119	119
EUR/USD	1.1026	1.10	1.11	1.12	1.13	1.14	1.15	1.15
GBP/USD	1.3201	1.33	1.34	1.35	1.36	1.37	1.37	1.36
USD/CNY	6.362	6.30	6.30	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.0786	1.07	1.07	1.07	1.08	1.08	1.09	1.10

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