WESTPAC WEEKLY ECONOMIC COMMENTARY

Feeling the pinch.

29 August 2022


Harakeke/flax

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Clear signs are emerging that the heat is coming out of the economy. The housing market slowdown has been in train for a while, but signs are now also clearly visible in other parts of the economy like the labour market and the retail sector. If anything, these signs have appeared ahead of schedule and point to monetary policy having its intended impact.

To get on top of inflation, the Reserve Bank needs to cool the overheated economy, and it does this via increases in the cash rate. Generally, this mechanism works by cooling the most interest rate sensitive parts of the economy first, like the housing market. As the housing market cools, this then usually translates to lower household spending as household confidence wanes on the back of falling house prices or slower house price growth. Homeowners' also feel the pinch from higher mortgage payments. Combined, these effects then reduce demand in the economy and allow the economy's productive capacity to catch up. As this process plays out, inflation begins to cool.

There are now clear signs that household demand is softening along with the other signs of a cooling economy. Retail sales volumes fell for the second quarter in a row, with volumes plunging 2.3% over the June quarter. That makes it a circa 3% fall so far over the year.

At first glance, it appears that surging prices are the likely culprit for the slump in retail sales. Recall that inflation surged 1.8% and 1.7% over the March and June quarters, respectively, with consumer prices up an eye-watering 7.3% for the year. Interestingly, wages have also been rising at a brisk pace in recent months, so higher prices are likely to explain some, but not all, of the weakness in spending.

We think the other culprits in play are higher mortgage rates and waning household confidence. More homeowners are now seeing their mortgage payments lift as they roll off low fixed mortgage rates. In some cases, the jump in mortgage rates has been as big as three percentage points. Those higher mortgage payments clearly reduce household disposable incomes in these cases.

Household confidence has also been very weak over recent months. In addition to surging inflation and higher interest rates, household sentiment has turned down in line with the slump in the housing market. Indeed, house prices peaked in late 2021 and have since tumbled by over 8%. From here we expect prices to fall further, with a total decline of 15% expected by the end of 2023.

The key drivers of the slump in retail sales are also consistent with the weak household confidence picture. Purchases of durable items like furniture and electronic goods plummeted 8% and 6%, respectively, over the June quarter. Spending in these same categories charged higher over 2020 and 2021 on the back of the surging housing market and associated lift in household confidence. Households also diverted spending from overseas travel to household durable goods over that period, adding to the lift in spending.

The slowdown in household spending doesn't come as a surprise. Indeed, we have been factoring such a slowdown into our forecasts for quite some time. However, the fact that the slowdown has arrived this early does come as somewhat of a surprise.

From here, we expect the slowdown to continue. For retailers, the outlook particularly heading into Christmas points to a soggy festive season spending wise. That said, there will be some exceptions for retail sectors and regions that will be able to welcome an increasing number of overseas tourists heading into summer.

The softer than anticipated retail spending result signals downside risk to our forecasts for a 1.0% rise in June quarter GDP. More importantly, it also signals significant downside risk to the RBNZ's forecast for 1.8% growth. In its recent policy statement, the RBNZ highlighted the strength in inflation and need for further OCR increases. However, in our view the RBNZ gave little credence to the signs of softening demand that have been emerging.

The weak June quarter retail spending result further reinforces our expectation that the OCR will peak at 4% by the end of this year. That's in contrast to the RBNZ's projections, which highlighted the risk of both a higher peak in the cash rate, as well as the possibility of OCR increases spilling over into 2023.

Real time indicators of pricing pressures support our view that inflation has now peaked (at 7.3%) and will fall from here. We expect it to reach 5.1% by the end of the year, 3.2% by the end of 2023, before returning within the RBNZ's target range of between 1% and 3% by mid-2024.

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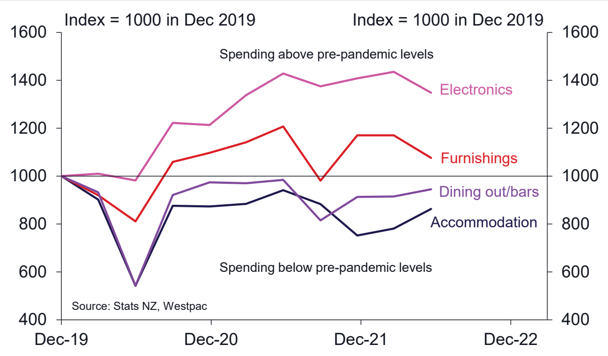
Chart of the week

The great spending switch is unwinding. During the various Covid lockdowns and while the borders were closed, households switched a large chunk of spending from services to goods. Purchases like home office equipment, home entertainment and gym equipment surged. Now that we can move around more freely, households have begun to switch their spending back to services. From here, we expect households to lift spending on dining out, entertainment and travel, heading gradually back towards, if not above, their pre-pandemic levels.

Retail spending trends

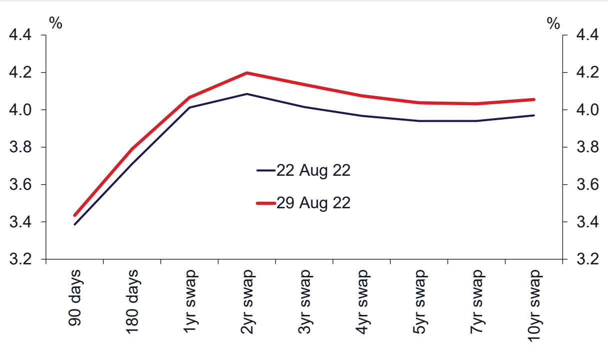


Fixed vs floating for mortgages

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. We agree with this outlook, and wholesale interest rates are also priced for a similar profile over the next couple of years.

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 Jul monthly employment indicator

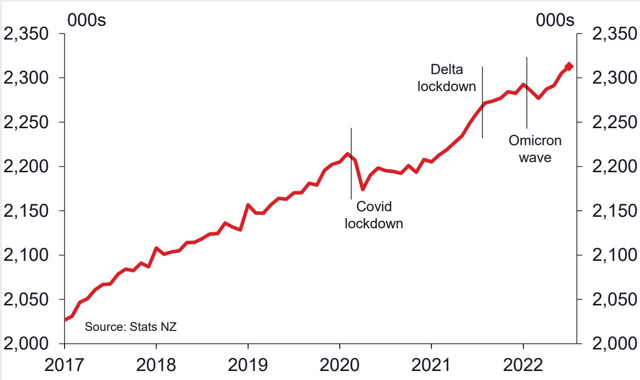
Aug 29, Last: 0.6%, Westpac f/c: 0.3%

The monthly employment indicator, a measure drawn from tax data, showed a strong 0.6% rise in the number of filled jobs in June. Employment has now fully recovered from the Omicron disruptions earlier this year, and continues to set new highs.

The weekly snapshots of the data suggest another solid rise in filled jobs for July. However, the annual pace of growth is slowing.

This indicator will be of particular interest to the Reserve Bank, given their heightened concerns about labour market tightness as a source of ongoing inflation pressures.

NZ monthly filled jobs



NZ Jul residential building consents

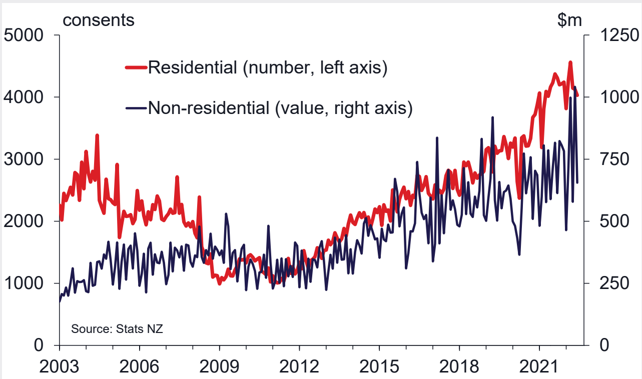
Aug 31, Last: -2.3%, Westpac f/c: Flat

The number of dwelling consents issued fell by 2.3% in June. That drop was mainly due to a pullback in medium-density consent numbers (i.e. townhouses and apartments) after their earlier sharp rise. However, there was also greater than expected softness in stand-alone home numbers.

We expect that overall consent numbers will remain broadly steady in August, with consent numbers still running at firm levels.

While still elevated, consent issuance has been softening in recent months. We expect that trend will continue – if not become more pronounced – over the remainder of this year. The combination of labour shortages, rising costs, and a slowing housing market all point to a pullback in the number of new developments coming to market.

NZ building consents



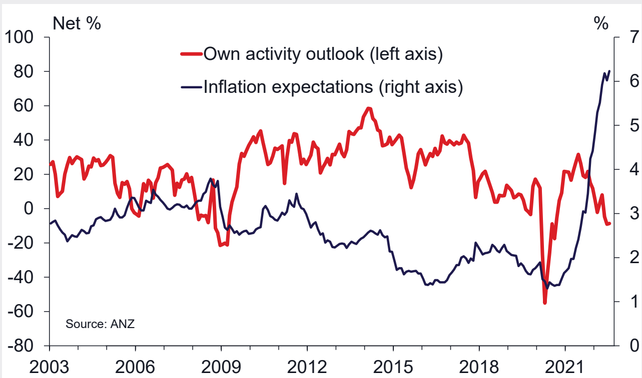
NZ Aug ANZBO business confidence

Aug 31, Last: -56.7

The July business survey highlighted the ongoing weakness in business confidence. Businesses have been under the pump, grappling with the combination of staff shortages, strong cost pressures, falling demand and the rise in interest rates. We expect those factors will leave confidence at low levels in the August survey.

The survey's cost and pricing gauges will again be worth keeping a close eye on. While still elevated, the number of businesses who reported that they expect operating costs and output prices to rise over the coming months remained broadly unchanged in the last survey. If that continues in August, it will reinforce our expectation that the peak in inflation has passed.

NZ business confidence



The week ahead

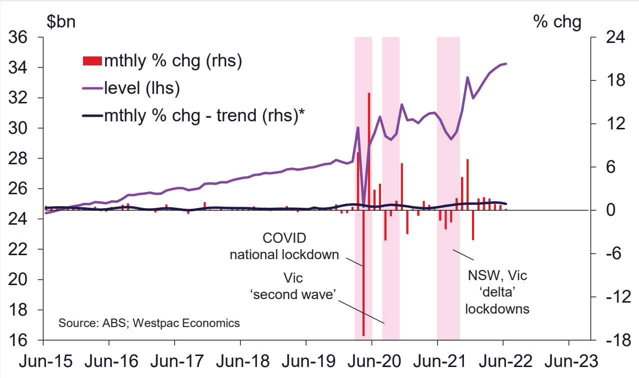
Aus Jul retail trade

Aug 29, Last: 0.2%, WBC f/c: –0.1%
Mkt f/c: 0.3%, Range: –1.5% to 1.0%

Retail sales rose 0.2% in June, the softest monthly gain since the start of the year. This likely reflects a decline in the underlying volume of sales in the month given the pace of retail price inflation over the quarter (+2.1%qtr, a +0.7% monthly pace). Even with the slowing momentum, sales are still at a high level, up 12%yr.

July looks to have been another lacklustre month for retailers. While the continued reopening rebound, and the associated return to more normal spending and saving patterns, is driving gains in wider spending, this is also seeing a shift in the spending mix away from retail towards non-retail segments such as tourism and travel. Meanwhile, retail may also be seeing more impact from rising costs, interest rate hikes and the slump in consumer confidence. On balance, we expect nominal sales to dip 0.1% in the July month.

Aus monthly retail sales



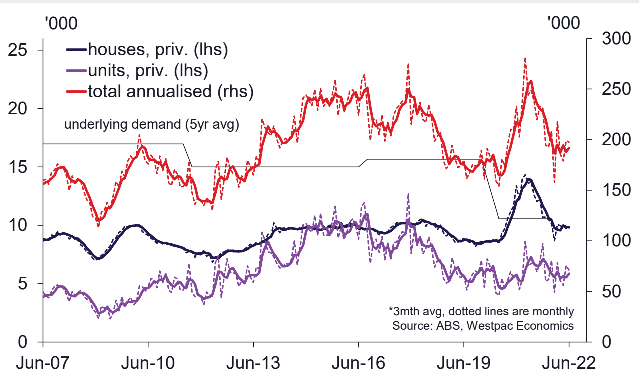
Aus Jul dwelling approvals

Aug 30, Last: –0.7%, WBC f/c: –5%
Mkt f/c: –3%, Range: –10% to 3%

Dwelling approvals were surprisingly resilient in June, posting a slight 0.7% dip to be up 2.4% for Q2 as a whole – that's despite a marked deterioration in the wider housing market, a sharp rise in building costs and widely publicised stresses amongst developers, many sitting on a large backlog of committed 'fixed-price' projects that are now unprofitable. The June segment detail still points to an underlying down-trend, but a much milder one than might be expected given the backdrop.

It still looks like just a matter of time before downward pressures show though in approvals. Notably, new home sales dropped sharply in the month of July, although this series has not been a great guide to dwelling approvals over the last year. Overall, we expect dwelling approvals to show a more meaningful 5% decline in July with further falls to come and risks pitched to the downside.

Aus dwelling approvals



Aus Q2 construction work

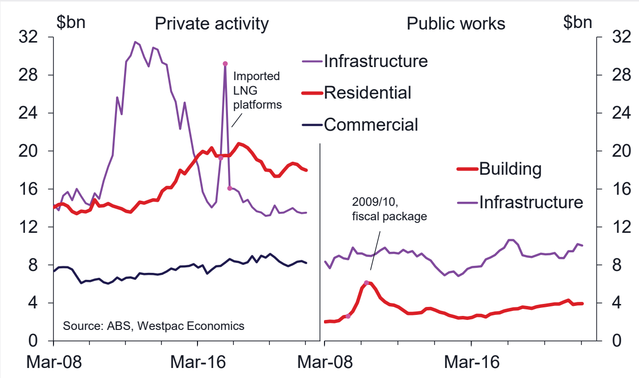
Aug 31, Last: –0.9%, WBC f/c: 3.0%
Mkt f/c: 0.7%, Range: –2.0% to 3.0%

Construction activity contracted over the past 3 quarters, with outcomes of: -1.3%; +0.6%; and then -0.9% for 2022 Q1. It was a challenging time. The delta outbreak and the omicron wave resulted in increased workplace absences. As well, a La Nina delivered wet weather and flooding along the east coast.

Move forward to the June quarter 2022, conditions improved with fewer disruptions. We expect construction work to bounce by 3%. The Q2 rebound will likely be lead by NSW and Qld, coming off weather related Q1 falls of -1.6% and -4.4%, respectively.

There is a sizeable pipeline of construction work across housing and public works, as well as commercial building, which emerged in response to earlier substantial policy stimulus. So much so the sector is experiencing significant supply headwinds (labour and material shortages), which is restricting activity.

Aus construction work by segment



The week ahead

Aus Jul private sector credit

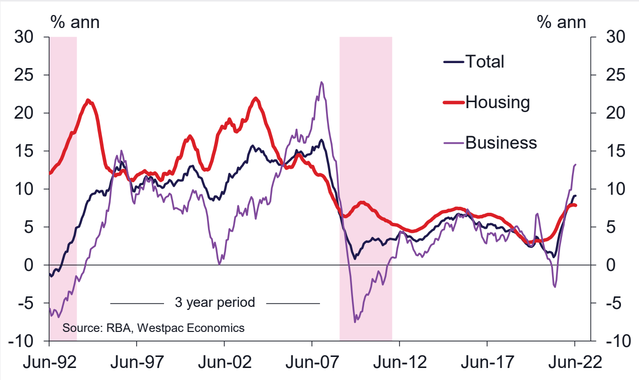
Aug 31, Last: 0.9%, WBC f/c: 0.7%
Mkt f/c: 0.7%, Range: 0.3% to 0.8%r

Credit grew by a brisk 9.1% over the year to June, the fastest pace since October 2008, albeit well below the 2007 peak of 16.5%. Businesses and households alike responded to very expansionary policy settings - stimulus which is now being wound back.

The June quarter was a stand-out, with total credit posting gains of 0.9% for each of the three months - a 3 month annualised pace of 11%. These result were boosted by oversized gains for business, at about 1.5% a month, an unsustainable 20% annualised pace. This is further evidence that the June quarter experienced a burst of activity, benefiting from fewer disruptions.

For July, we anticipate a 0.7% increase - a robust outcome, but a step down from the Q2 results, likely led by business. Going forward, the impact of recent RBA rate hikes will become more apparent, with housing - and then in turn business - set to cool.

Aus credit growth



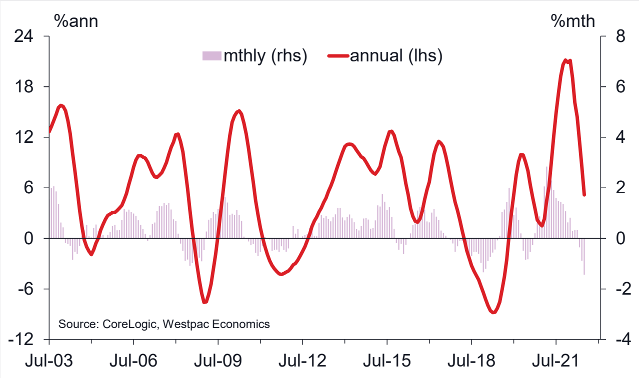
Aus Aug CoreLogic home value index

Sep 1, Last: –1.4%, WBC f/c: –1.5%

The wider housing market tipped over into correction in May (–0.4%mth), with price declines accelerating in June (–0.9%mth) and again in July (–1.4%mth), turnover also off sharply from the highs at the start of the year. The RBA's tightening cycle, which began with a 25bp rate rise in May and saw big 50bp moves in June and July, has been the clear catalyst turning the market.

Aug saw the RBA deliver a fourth successive hike, and a third successive 50bp move, further entrenching the market correction. CoreLogic's daily measure points to a 1.5% fall in prices nationally for the month, with another 2%+ fall in Sydney, and Melbourne and Brisbane both seeing consistent, albeit slightly milder, monthly price declines.

Aus dwelling prices



Aus Jul housing finance approvals

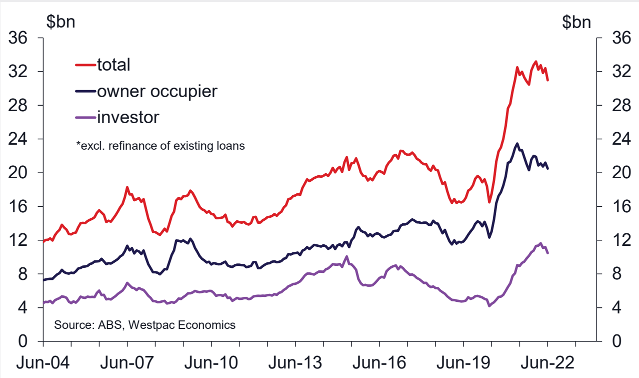
Sep 1, Last: –4.4%, WBC f/c: –4.0%
Mkt f/c: –3.6%, Range: –6.0% to –1.0%

After a couple of false starts, housing finance approvals finally showed a decisive move lower in June, falling 4.4% to be down 6.7% since the start of the year.

While this is broadly consistent with the wider market downturn, finance approvals are still lagging the moves in turnover and prices, the total value of sales down over 15% since the start of the year.

This suggests there are more substantial declines still to come through. We expect July approvals to show another 4% fall with risks to the downside.

Aus new finance approvals by segment



The week ahead

Aus Q2 private business capex

Sep 1, Last: –0.3%, WBC f/c: 4.0%
Mkt f/c: 1.0%, Range: –1.3% to 4.0%

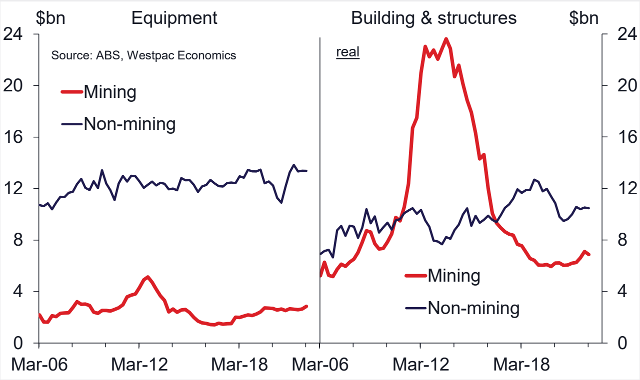
Businesses were upbeat and boosting investment spending early in 2021 - a trend that was interrupted by delta, omicron and wet weather/flooding associated with a La Nina.

In the year to June 2021, capex spending grew by 11.4%. That reversed an 11.4% decline over the previous year, a fall at the outset of the pandemic. Over the 3 quarters since mid-2021, capex spending was choppy, up a tepid 0.8%.

The June quarter 2022 ushered in a burst of activity, supported by earlier stimulus and enabled by fewer disruptions. Associated with this, capex spending strength is likely - up a forecast 4%.

Gains are expected in equipment, a forecast 5%, responding to limited spare capacity, underlying strength in demand and generous tax incentives. Building & structures capex spend also likely lifted, up a forecast 3.5%, across both building work and infrastructure.

Aus private business capex



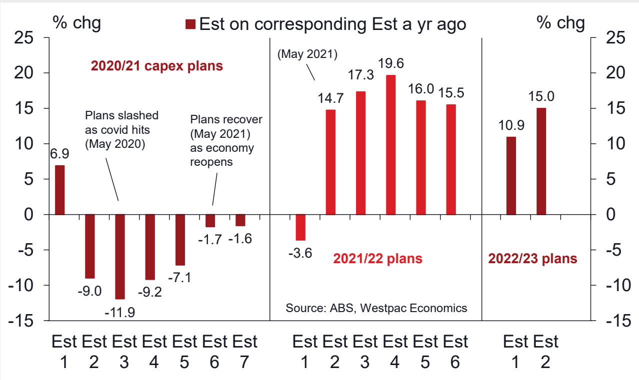
Aus 2022/23 capex plans

Sep 1, Last: Est 2 $130.5bn

We estimate that capex spending will lift by 10% in 2022/23. The 2nd estimate of plans printed at $130.5, some 15% above the 2nd estimate a year earlier. This is broadly based, across mining and non-mining, and across equipment and building & structures. This nominal measure includes the impact of rising costs - inflation exceeded 6% over the past four quarters.

Est 3, surveyed in July and August, will likely confirm capex strength, consistent with positive fundamentals and the confidence provided by fewer disruptions - as well as the impact of higher costs. An Est 3 print of around $146bn is feasible. This represents a 12% upgrade on Est 2, in line with the historic average.

Aus capex plans



US Aug employment report

Sep 2, payrolls, Last: 528k, WBC f/c: 250k, Mkt f/c: 300k
Sep 2, unemployment rate, Last: 3.5%, WBC f/c: 3.5%, Mkt f/c: 3.5%

Nonfarm payrolls surprised to the upside in July, with 528k new jobs reported for the month and 28k added to May and June. Household survey employment growth meanwhile remained weak.

Come August, we again expect a materially softer outcome for nonfarm payrolls, while recognising that risks remain to the upside. The latter is principally because an individual can have two or more payroll jobs and the BLS continue to assume new businesses are being created every month and hire immediately despite the decline in activity and confidence through H1 2022.

For the next few months, the unemployment rate can hold around 3.5%; but from the end of the year, it is likely to begin to trend higher as employment growth slows and participation rises as households seek relief from the loss of real spending capacity.

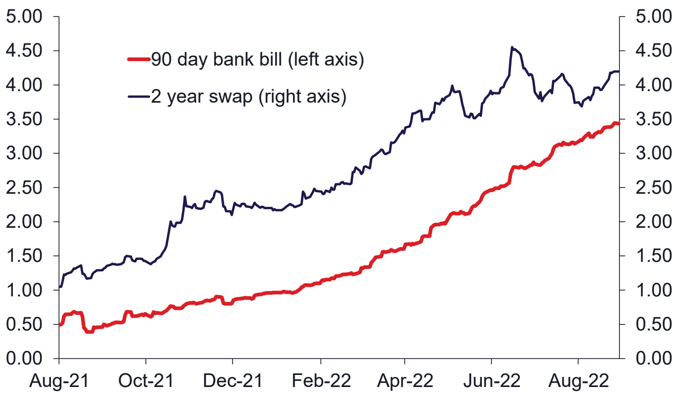
US labour market

New Zealand forecasts

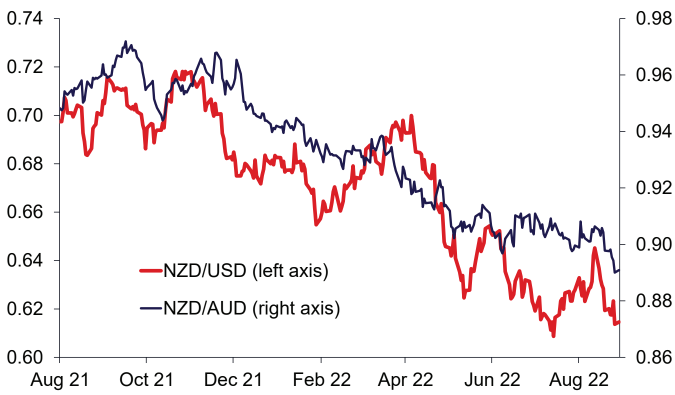
Economic forecasts	Quarterly				Annual			
	2022							
% change	Mar (a)	Jun	Sep	Dec	2020	2021	2022f	2023f
GDP (Production)	-0.2	1.0	0.4	0.6	-2.1	5.6	1.8	2.0
Employment	0.0	0.0	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.2	3.3	3.3	3.4	4.9	3.2	3.4	3.8
CPI	1.8	1.7	1.4	0.2	1.4	5.9	5.1	3.2
Current 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 29 August 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.00%	2.50%	2.50%
30 Days	3.04%	2.99%	2.83%
60 Days	3.24%	3.15%	3.00%
90 Days	3.44%	3.32%	3.18%
2 Year Swap	4.20%	3.96%	3.75%
5 Year Swap	4.04%	3.69%	3.57%

NZ foreign currency mid-rates as at 29 August 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6146	0.6368	0.6329
NZD/EUR	0.6159	0.6241	0.6174
NZD/GBP	0.5229	0.5266	0.5170
NZD/JPY	84.57	84.92	83.70
NZD/AUD	0.8909	0.9051	0.8989
TWI	70.72	72.22	71.67

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
NZ	Jul monthly employment indicator	0.6%	–	0.3%	Another solid month, but annual growth rate is easing.
Aus	Jul retail sales	0.2%	0.3%	–0.1%	Benefiting less from reopening, hit harder by cost & rate rises.
US	Aug Dallas Fed index	–22.6	–12.2	–	Regional surveys have been volatile of late.
	Fedspeak	–	–	–	Brainard.
Tue 30					
Aus	Jul dwelling approvals	–0.7%	–3.0%	–5.0%	Likely to show a clearer weakening.
Eur	Aug economic confidence	99.0	97.8	–	The highly uncertain outlook...
	Aug consumer confidence	–24.9	–	–	... has sunk consumer confidence to record lows.
UK	Jul net mortgage lending £bn	5.3	5.3	–	Rising rates and the slowing economy to weigh on lending.
US	Jun FHFA house prices	1.4%	0.8%	–	Price momentum is clearly slowing...
	Jun S&P/CS home price index	1.32%	0.75%	–	... as rate hikes take effect.
	Aug consumer confidence index	95.7	97.4	–	Inflation concerns to the fore; job uncertainty to grow.
	Jul JOLTS job openings	10698k	10300k	–	Job openings off peak; hiring rate also softening.
	Fedspeak	–	–	–	Barkin and Williams.
Wed 31					
NZ	Jul building permits	–2.3%	–	0.0%	Issuance has flattened off, set to trend down over time.
	Aug ANZ business confidence	–56.7	–	–	Sentiment and activity to remain subdued, costs elevated.
Aus	Q2 construction work	–0.9%	0.7%	3.0%	Rebound on fewer disruptions, supported by large work pipeline.
	Jul private sector credit	0.9%	0.7%	0.7%	Step down from brisk Q2 pace, led by business.
Chn	Aug manufacturing PMI	49.0	49.2	–	COVID-zero risks increasingly a concern for HH's more...
	Aug non-manufacturing PMI	53.8	52.2	–	... than manufacturers; power uncertainty also a risk.
Eur	Aug CPI %yr	8.9%	8.8%	–	Roughly three-quarters of CPI basket running at >2.5%yr.
US	Aug Chicago PMI	52.1	53.1	–	Weakening new orders growth mirroring other surveys.
	Fedspeak	–	–	–	Mester.
Thu 01					
Aus	Aug CoreLogic home value index	–1.4%	–	–1.5%	Correction deepening and broadening.
	Jul housing finance	–4.4%	–3.6%	–4.0%	Lagging the wider housing market downturn...
	Jul investor finance	–6.3%	–	–4.0%	... but should show another decisive move lower...
	Jul owner occupier finance	–3.3%	–	–4.0%	... all segments impacted by interest rate rises.
	Q2 private new capital expenditure	–0.3%	1.0%	4.0%	Strength associated with burst of activity on fewer disruptions.
	Est 3 2022/23 capex plans, AUDbn	130.5	–	–	Upbeat. Est 2 at $130.5bn, some 15% above Est 2 a year ago.
Chn	Aug Caixin manufacturing PMI	50.4	50.1	–	A better guide on small and medium-sized manufacturers.
Eur	Aug S&P Global manufacturing PMI	49.7	49.7	–	Final estimate.
	Jul unemployment rate	6.6%	6.6%	–	Holding at record lows.
UK	Aug S&P Global manufacturing PMI	46.0	–	–	Final estimate.
US	Q2 productivity	–4.6%	–4.6%	–	Final estimate.
	Initial jobless claims	243k	–	–	Slowly lifting from historic lows.
	Aug S&P Global manufacturing PMI	51.3	–	–	Final estimate.
	Jul construction spending	–1.1%	–0.1%	–	Home building to provide medium-term support.
	Aug ISM manufacturing	52.8	52.1	–	ISMs still strong; at odds with S&P Global measures.
	Fedspeak	–	–	–	Bostic.
Fri 02					
NZ	Q2 terms of trade	0.5%	–	–3.8%	Imported energy prices peaked over the quarter.
US	Aug non-farm payrolls	528k	300k	250k	Payrolls at odds with many other indicators of the labour...
	Aug unemployment rate	3.5%	3.5%	3.5%	... market which are already weakening.
	Aug average hourly earnings %mth	0.5%	0.4%	0.4%	Employers to gain greater say in wage setting hence.
	Jul factory orders	2.0%	0.2%	–	Q2 investment partials have indicated...
	Jul durable goods orders	0.0%	–	–	... a material softening in capital investment.

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	2.41	3.05	3.55	3.55	3.55	3.55	3.38	3.13
10 Year Bond	3.58	3.40	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	3.04	3.00	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	0.6965	0.71	0.73	0.75	0.76	0.77	0.78	0.78
USD/JPY	136.73	132	132	130	127	125	123	121
EUR/USD	0.9972	1.05	1.09	1.11	1.13	1.14	1.15	1.16
GBP/USD	1.1826	1.23	1.26	1.28	1.30	1.32	1.34	1.35
USD/CNY	6.8553	6.70	6.60	6.50	6.40	6.30	6.20	6.15
AUD/NZD	1.1227	1.11	1.11	1.10	1.10	1.10	1.10	1.10

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