

WESTPAC WEEKLY ECONOMIC COMMENTARY


Businesses buffeted by rising costs and staff shortages.


4 April 2022



Mount Cook buttercup

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It's been a rocky few months for many New Zealand businesses, and confidence about the economic outlook has fallen to low levels. Key among the challenges that businesses are grappling with has been the sharp rise in operating costs which is squeezing margins. There are also changes afoot on the migration front, and difficulties sourcing staff are likely to continue for some time yet.

New Zealand businesses are grappling with a number of big challenges. First up is the ongoing Omicron outbreak. On this front, we're seeing encouraging signs that case numbers have peaked. In addition, the Government is continuing to gradually ease Covid related health restrictions. Even so, many businesses are still struggling with subdued demand. Nervousness about the health situation has seen many households choosing not to go out to hospitality or entertainment venues. That's seen foot traffic in major urban centres drop sharply, while spending on hospitality and entertainment has remained below the levels we saw prior to last year's Delta outbreak despite a less restrictive operating environment.

Australia's experience with Omicron provides a useful comparison for New Zealand. Like us, Australia saw a period of weak spending as Omicron numbers flared. However, case numbers dropped back fairly quickly, and spending recovered at the same time. We'll be watching to see if that's the case in here also.

Next week will also see the resumption of quarantine free travel between New Zealand and Australia, with travel between

other countries set to open up later in the year. While it will take some time for tourist numbers to get back to the levels we saw prior to the pandemic, we expect numbers will rise fairly quickly (as we saw during last year's short-lived trans-Tasman bubble). That will be a big boost for confidence in our hospitality sector.

Looking at demand conditions more generally, we are seeing some encouraging signs. In the construction sector, there is a large and growing pipeline of planned projects with nearly 50,000 new dwellings consented over the past year, as well as a number of industrial and infrastructure projects in the works. Prices for our key commodity exports have also held firm, boosting incomes in many rural regions. And on top of that, we're seeing resilience in spending on durable household items like furnishings.

Putting this altogether leaves us with a mixed (rather than weak) picture for demand in the early part of 2022. But even in sectors where demand has held up, businesses are being confronted by a range of challenges. The most significant of these has been a sharp rise in operating costs, with input costs

up 8% over the past year. That's in large part related to the continuing disruptions to global and domestic supply chains. There have also been large increases in transport costs. Those developments are squeezing margins in businesses across the economy.

One of the other key challenges that businesses are grappling with are shortages of labour, with businesses struggling to attract and retain staff. That's adding to the pressures on wages, with average hourly earnings rising by 3.8% over the past year. With unemployment already at a record low and set to drop even further, we're forecasting a sharp rise in wage growth over the coming year.

Difficulties sourcing labour have been exacerbated by the closure of our borders. For the past two years, that's cut off a key source of skilled workers that many employers previously relied on.

With the borders opening up, we expect to see new arrivals pushing higher over the coming year. However, at least in the near-term, we're also likely to see a rise in departures, as many young New Zealanders who have put off OEs start to travel again. That means that net migration is likely to remain low or negative for some time yet.

However, what could have a longer lasting impact on the labour market are immigration policy changes. Even before the pandemic, the Government had signalled its plans to tighten entry requirements for new arrivals based around skill levels. That aimed to support job opportunities and skills development among existing New Zealand residents. Now, with the borders reopening, those plans are set to be gradually rolled out over the coming year.

This change in migration policy could have a significant impact. In fact, as the current backlog of people waiting to enter and leave the country clears, we expect that net migration will settle at around 30,000 people per annum. That's a big step down from the rates of 50,000 to 60,000 that we saw in the years leading up to the pandemic.

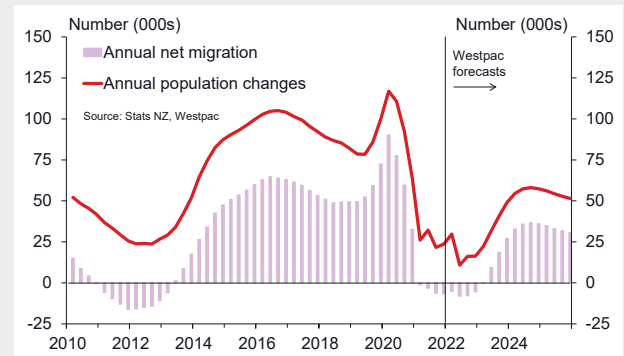
For the labour market, these policy changes and the expected lower pace of migration will reduce the pool of available workers with a related lift in wage pressures. However, with a targeted tightening of migration settings, the impacts will be varied across sectors. In particular, we're likely to see fewer lower-skilled workers arriving over the coming years, which will be particularly important in areas like retail.

In contrast, the policy changes are likely to have a smaller impact on the availability of skilled labour. Nevertheless, with the global environment improving, many businesses will still find it tough to attract highly skilled staff. Furthermore, while developing the skills base of New Zealand workers is a laudable aim, retaining those workers is likely to be a challenge, with talented New Zealanders having always looked for opportunities abroad.

Chart of the week

With immigration policy set to be tightened, we're forecasting that population growth will drop from the rates of close to 2% per annum that we saw before the pandemic to around 1% per annum in the middle of the decade. For many businesses, that will moderate an 'easy' source of demand growth that they have enjoyed in recent years.

Population growth and net migration

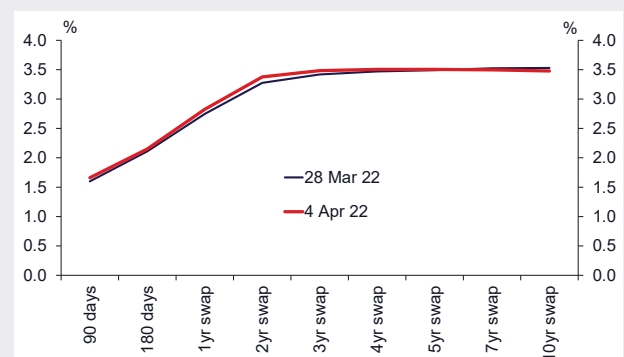


Fixed vs floating for mortgages

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



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The week ahead

NZ GlobalDairyTrade auction, whole milk powder prices

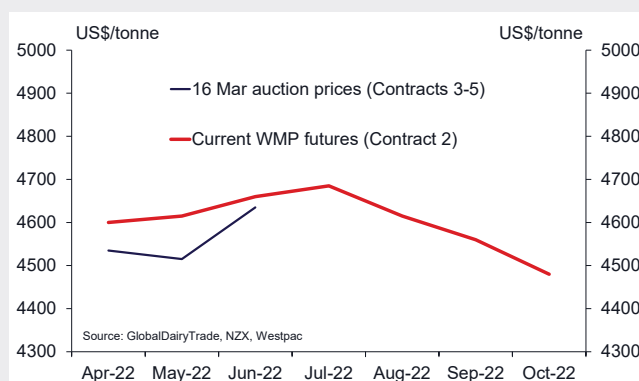
Apr 6, Last: -2.1%, Westpac: No change

We expect whole milk powder prices (WMP) to be largely unchanged at the upcoming dairy auction. Prices cooled a little at the last auction, falling 2.1%. Nonetheless, prices remain very high, having lifted 20% since the start of the year.

Our pick is slightly more modest than futures market pricing, where a lift of around 1% is expected.

While the impact of the Russia-Ukraine conflict is putting upward pressure on global dairy prices, the Omicron outbreak in China and the subsequent impact on dairy demand is countering this pressure.

Whole milk powder prices



Aus RBA policy decision

Apr 5, Last: 0.1%, WBC f/c: 0.1%

Mkt f/c: 0.1%, Range: 0.1% to 0.1% oil trade

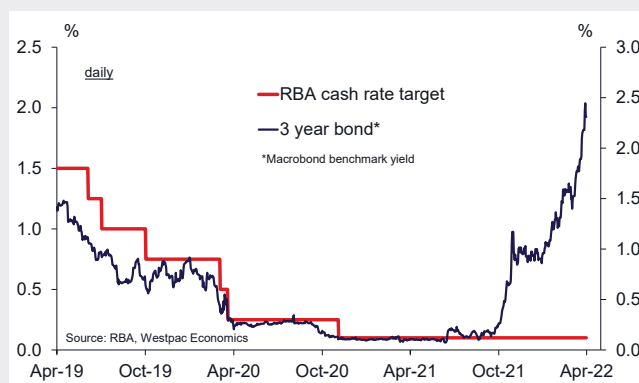
RBA Board meetings are particularly interesting with the prospect that the RBA will lift rates this year, for the first time since November 2010.

At this meeting, the cash rate will be held at the record low of 0.1%. The focus will be on any shift in language in the decision statement. Westpac expects the tightening cycle to begin this August.

Inflation is now back in the target band and the unemployment rate, at 4.0%, will soon move below 4% for the first time since 1974. However, the RBA has stated that it will not lift rates until inflation is "sustainably" within the target band - which requires a lift in wages growth from current relatively modest levels.

We anticipate that by August, with the benefit of additional information on inflation, wages and unemployment, the case will be made for the tightening cycle to commence.

RBA cash rate and 3 year bonds



Aus Feb trade balance, \$bn

Apr 7, Last: 12.9, WBC f/c: 13.2

Mkt f/c: 12.1, Range: 10.5 to 13.5

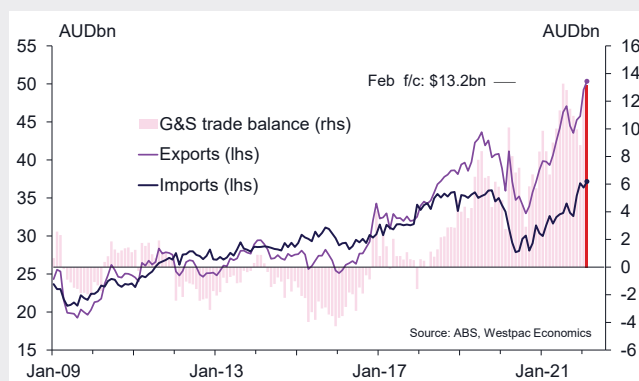
Australia's trade surplus jumped by \$4.1bn in January, nearing a record high - with commodity prices finding a second wind, boosting export earnings.

For February, we anticipate a \$13.2bn trade surplus, up a touch from \$12.9bn last month, and within a whisker of the \$13.3bn peak last July.

Export earnings surged 7.6% in January (+\$3.5bn), led by metal ores (+\$1.9bn). Exports are expected to push higher still in February, +2.2%, up \$1.1bn. Coal and LNG likely advanced, on higher prices and volumes. Iron ore is expected to ease a little despite higher prices, with shipments soft in the month.

Imports dipped in January, -1.6%, after a 13% jump over the previous two months associated with the post delta reopening. For February, a resumption of the uptrend is expected, +2.2%, +\$0.8bn, on higher volumes and rising prices.

Australia's trade balance

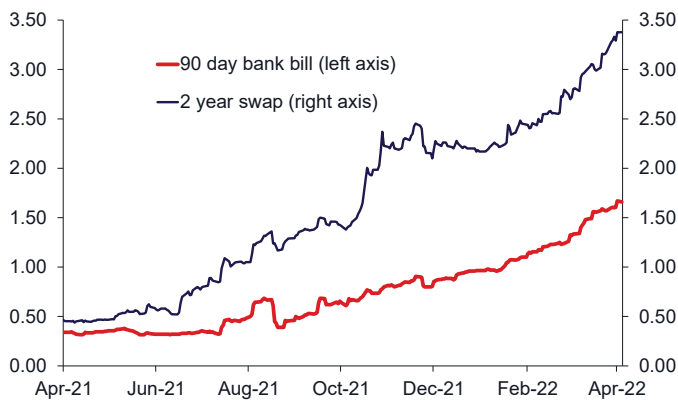


New Zealand forecasts

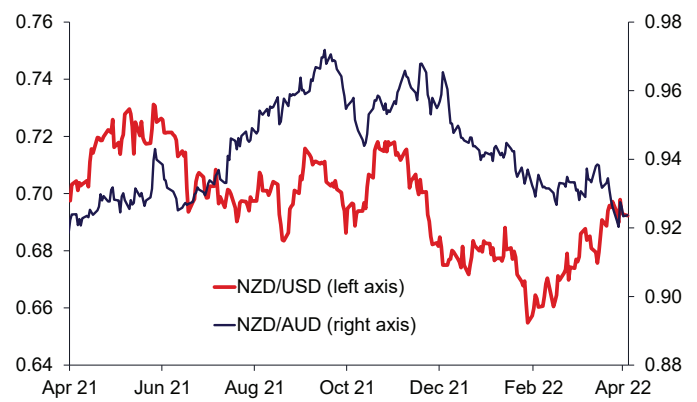
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Dec (a)	Mar	Jun	Sep	2020	2021	2022f	2023f
GDP (Production)	3.0	0.3	0.7	2.3	-2.1	5.6	3.4	4.8
Employment	0.1	0.5	0.2	0.1	0.6	3.7	0.9	1.0
Unemployment Rate % s.a.	3.2	3.1	3.0	3.0	4.9	3.2	3.0	3.3
CPI	1.4	1.7	0.9	1.1	1.4	5.9	4.0	2.7
Current 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	0.69	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	80.4	81.9	83.8	84.4	85.7	86.3	86.9
NZD/EUR	0.63	0.63	0.63	0.63	0.63	0.63	0.63
NZD/GBP	0.52	0.52	0.53	0.53	0.53	0.53	0.54
TWI	73.7	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 4 April 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.33%	1.17%	1.05%
60 Days	1.50%	1.37%	1.20%
90 Days	1.66%	1.57%	1.34%
2 Year Swap	3.38%	3.02%	2.78%
5 Year Swap	3.51%	3.28%	3.01%

NZ foreign currency mid-rates as at 4 April 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6923	0.6887	0.6877
NZD/EUR	0.6272	0.6235	0.6348
NZD/GBP	0.5280	0.5243	0.5228
NZD/JPY	84.89	82.11	79.13
NZD/AUD	0.9237	0.9331	0.9290
TWI	74.39	74.12	73.87

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
Aus	Mar MI inflation gauge	3.5%	-	-	Material inflation pressures have increased in 2022.
	Mar ANZ job ads	8.4%	-	-	Job ads up strongly; evidence of a tight labour market.
Eur	Apr Sentix investor confidence	-7	-	-	Russia-Ukraine and inflation remain as headwinds.
US	Feb factory orders	1.4%	-0.6%	-	Capital investment should gain over 2022...
	Feb durable goods orders	-2.2%	-2.2%	-	... as inventories reset and growth continues.
Tue 05					
Aus	RBA policy decision	0.10%	0.10%	0.10%	Policy unchanged. Any shift in language key focus.
Eur	Mar Markit services PMI	54.8	-	-	Final estimate for the month.
UK	Mar Markit services PMI	61.0	-	-	Final estimate for the month.
US	Feb trade balance US\$bn	-89.7	-88.6	-	Deficit to remain wide on demand and inventory rebuild.
	Mar Markit service PMI	58.9	58.9	-	Final estimate for the month.
	Mar ISM non-manufacturing	56.5	58.6	-	Growth in services is holding at a robust pace.
	Fedspeak	-	-	-	Brainard.
Wed 06					
NZ	GlobalDairyTrade auction prices (WMP)	-2.1%	-	0.0%	China's Omicron outbreak countering Ukraine conflict impact.
	Mar ANZ commodity prices	3.9%	-	-	Another tick up expected following earlier dairy gains.
Chn	Mar Caixin China PMI services	50.2	49.8	-	Weak demand and high input costs have slowed growth.
US	FOMC March meeting minutes	-	-	-	Focus on discussions of the path for rates in 2022.
	Fedspeak	-	-	-	Harker.
Thu 07					
Aus	Feb trade balance \$bn	12.9	12.1	13.2	Exports up, coal & LNG. Imports higher, volumes & prices.
Chn	Mar foreign reserves \$bn	3213.83	-	-	Little need for authorities to be active in market in 2022.
Eur	Feb retail sales	0.2%	-	-	Spending outlook is dampened by inflation risks.
US	Initial jobless claims	202k	-	-	Set to remain at a very low level.
	Feb consumer credit	6.838	16.850	-	Robust demand for credit as pandemic savings worked down.
	Fedspeak	-	-	-	Bullard, Bostic and Evans.
Fri 08					
Aus	RBA	-	-	-	Financial Stability Review, half yearly update.
US	Feb wholesale inventories	2.1%	-	-	Final estimate; restocking at a robust pace.
Sat 09					
Chn	Mar new loans, CNYbn	1230.0	-	-	Authorities are committed to ensuring credit...
	Mar M2 money supply %yr	9.2%	-	-	... and liquidity remain ample as demand builds in 2022.

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	0.23	0.20	0.35	0.85	1.20	1.45	1.70	1.95
10 Year Bond	2.85	3.00	3.00	2.60	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	0.7489	0.74	0.75	0.76	0.77	0.78	0.79	0.80
USD/JPY	121.93	122	121	121	120	120	119	119
EUR/USD	1.1067	1.10	1.11	1.12	1.13	1.14	1.15	1.15
GBP/USD	1.3142	1.33	1.34	1.35	1.36	1.37	1.37	1.36
USD/CNY	6.3400	6.30	6.30	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.0804	1.07	1.07	1.07	1.08	1.08	1.09	1.10

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