WESTPAC WEEKLY ECONOMIC COMMENTARY

Talk of the town.

5 December 2022


Southern rātā

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Over the past few weeks, we've been talking to businesses across the country. Those we spoke to did point to some looming dark clouds on the economic horizon. Even so, the feedback we received on current economic conditions was generally very upbeat, with most of the businesses we spoke to reporting that demand had remained firm in recent months.

That resilience in activity has also been seen in recent economic data. For instance, the latest update on retail spending showed that nominal spending levels have continued to charge higher, with a 2.5% rise in the September quarter alone.

Much of the rise in spending that we've seen over the past year has been due to price rises. In fact, the actual amount of goods we're purchasing has remained fairly steady since early 2021 (in other words, while households are splashing out more cash, we're actually getting a lot less bang for our buck). But even in the face of those large price rises, we're still seeing resilience in spending appetites. Notably, discretionary spending – which is more likely to be affected by changes in prices and households' finances – has continued to climb.

Businesses in our services sector have also been reporting solid trading conditions, with the Performance of Services Index pointing to a strong lift in sales over recent months. A particular bright spot has been the hospitality sector, with operators in the sector reporting a resurgence in demand. That's in part due to the welcome return of international tourists to our shores after a long absence. At the same time, we're also seeing New Zealanders dialling up their spending on hospitality and other leisure activities.

One area where things are looking more mixed is the construction sector. Building levels picked up strongly in the wake of the pandemic, and there is still a large pipeline of planned projects (especially in Auckland and Canterbury). However, as we've highlighted before, financial conditions in the construction sector have become a lot tougher. Operating and financing costs have risen sharply over the past year. And at the same time, house prices are tumbling in many parts of the country. Builders, as well as those supplying into the industry, have told us that those conditions are weighing on demand, with forward orders dropping off. We've also seen dwelling consent numbers starting to ease back in many parts of the country. We expect those conditions will see the level of building activity peeling back through the latter part of next year.

On balance, although there are some areas where demand is cooling, the overall level of economic activity looks set to remain elevated through the final part of 2022. But while conditions are holding firm for now, businesses have highlighted some big concerns about the economic landscape as they look to the new year.

First is the state of the labour market, with nearly every business we spoke to reporting significant difficulties finding staff. Many of them also noted the low level of migration has been a major factor contributing to those difficulties.

The other big concern that is worrying many businesses is the ongoing rise in interest rates. As seen in the latest Business Outlook survey, a net 14% of businesses now expect trading conditions will weaken over the coming year. Expectations for trading activity have only been this low twice in the past two decades - first during the 2008/09 Global Financial Crisis, and then again during the initial Covid lockdown.

The large interest rate increases over the past year have been gradually rippling through the economy. To date, their impact has been seen most clearly in the housing market, with prices down 12% from their peak in November 2021 and sales at their lowest level since 2011 (barring the 2020 lockdown). Even so, overall demand in the economy has actually proven to be resilient to interest rate hikes thus far.

We expect those conditions will change dramatically over the coming year. More than half of all mortgages will come up for re-fixing in the next twelve months, and many borrowers will face large increases in their debt servicing costs. We expect that the resulting squeeze on household finances will result in outright falls in household spending through 2023. That also signals related softness in businesses' investment spending.

With those mounting concerns about the strength of demand over the coming year, we're starting to see a change in businesses' pricing behaviour. Over the past year, businesses' operating costs have been rising rapidly, climbing by an average of 9% across the economy in the year to September. And while that has resulted in pressure on margins, much of the rise in operating costs has actually passed through to higher consumer prices.

However, the latest business confidence survey signalled that businesses are finding it tougher to pass on cost increases. While the vast majority of businesses expect their operating costs will continue to rise over the coming year, the numbers who expect to raise their output prices has been dropping back. That signals ongoing pressure on margins over the months ahead.

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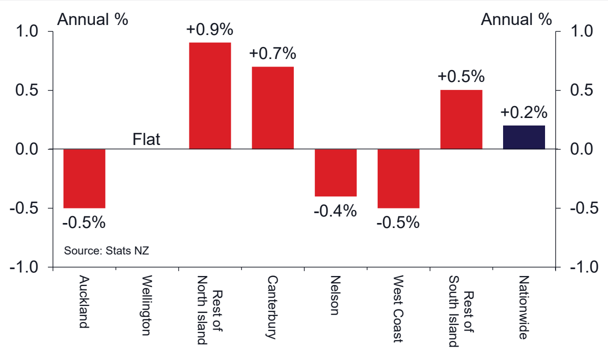
Chart of the week

With a drop off in net migration since the start of the pandemic, population growth has fallen to just 0.2% over the past year. That's a far cry from the rates of around 2% per annum that we saw over much of the past decade. However, population trends have been very different across the country. While most regions have continued to see modest increases, Auckland, Nelson and the West Coast have all seen their populations shrinking by around 0.5% over the past year.

Regional population growth

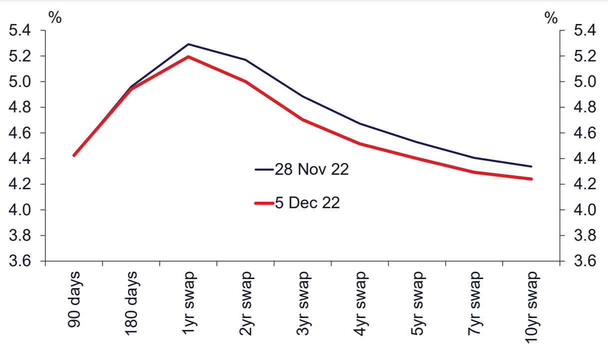


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.5% by early next year, a move that has also been factored into wholesale interest rates. However, we see more scope for reducing the OCR over the longer term as inflation pressures recede.

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 Q3 building work put in place

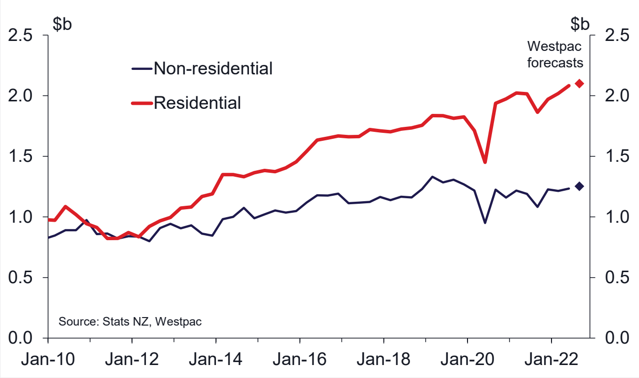
Dec 6, Last: +2.6%, Westpac: +1.1%

Total construction activity rose by 2.6% in the June quarter. Underlying that increase was a 3.2% lift in residential work, as well as a 1.6% increase in non-residential construction.

We're forecasting a further 1.1% rise in construction activity in the September quarter with modest gains in both residential and non-residential activity. While there is a large amount of work in the pipeline, shortages of labour and difficulties sourcing materials continue to act as a handbrake on the pace of building.

We expect that construction activity will remain elevated for some time yet, with a large number of planned projects. However, the financial conditions in the building sector are changing, and activity is set to moderate over the year ahead.

NZ real building work put in place



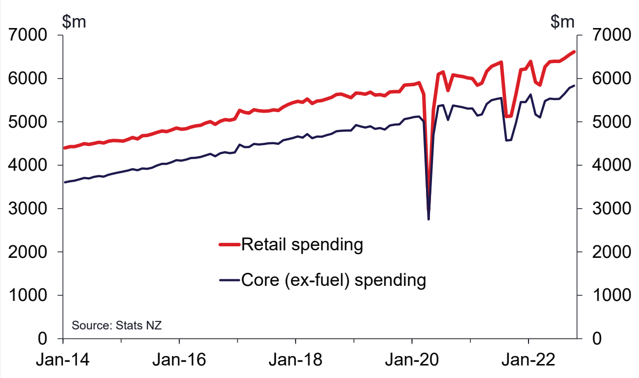
NZ Nov retail card spending

Dec 9, Last: +1.0%, Westpac: +0.6%

Spending levels rose by 1.0% in October. The continued firmness in spending appetites seen in recent months is notable given the sharp rise in interest rates and increases in consumer prices. Despite those headwinds, New Zealanders have not dialled back their discretionary spending (though there has been a change in the mix of spending away from goods and towards services).

We're forecasting a 0.6% rise in spending levels in November. New Zealanders have been increasing their spending on hospitality activities, like dining out. Spending is also being boosted by the return of international tourists. On top of those developments, November also saw the usual proliferation of Black Friday/Cyber Monday sales.

NZ retail card spending



Aus Q3 company profits

Dec 5, Last: 7.6%, WBC f/c: -4.5%
Mkt f/c: -1.8%, Range: -4.5% to +4.0%r t

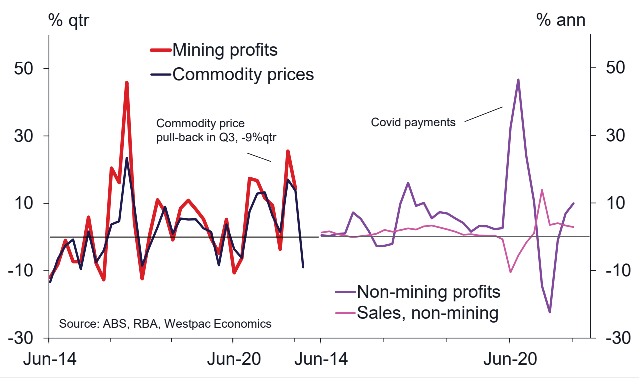
Company profits likely took a backward step in the September quarter, a forecast -4.5%, after surging 28.5% over the past year.

Global commodity prices retreated in Q3 on global recession fears, declining from recent highs. In AUD terms, commodity prices fell 9% in the quarter, following a Q2 result of +17.5%qtr, +49.6%yr. That will see mining profits move lower, following a +14.3%qtr, +51.3%yr for Q2.

Non-mining profits (ex finance) posted a Q2 result of +2.5%qtr, +12.8%yr. The upward trend likely extended into Q3, and is associated with rising demand on the economic reopening.

Note, the Business Indicators (BI) survey is on an accounting basis and in Q3 will likely book a sizeable loss from a reduction in the value of inventories. Our -4.5% forecast attempts to make an allowance for this. Expressed differently, we expect National Accounts profits for Q3 to be less negative than the BI survey reading.

Aus company profits



The week ahead

Aus Q3 inventories

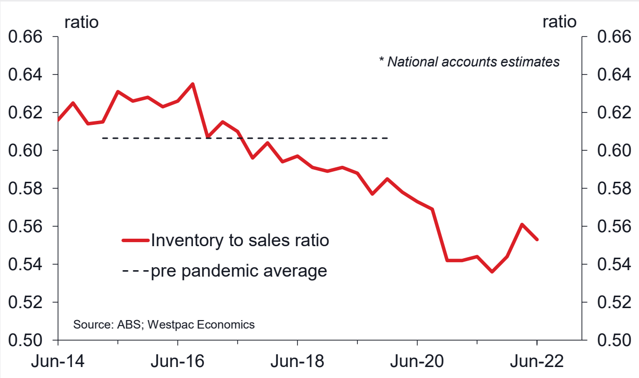
Dec 5, Last: 0.3%, WBC f/c: 1.4% (0.4ppts impact)
Mkt f/c: 1.0%, Range: -0.3% to +2.0%r

An inventory rebuild was underway in the final quarter of 2021 and the opening quarter of 2022, with gains of 1.6% and 3.6%, associated with the reopening from the delta lockdowns and rising imports. That rebuild stalled in the June quarter, with inventory levels up only 0.3%, in part due to disruptions to the supply of goods imports.

In the September quarter, the inventory rebuild appears to have resumed. We anticipate a rise of around of 1.4%, +$2.5bn, which would have inventories add around 0.4ppts to activity.

Of note, goods imports posted a sizeable rise in the quarter (+4%, +$3.7bn) albeit that is well below the March quarter goods import surge (+9%, +$7.75bn), which was associated with that large jump in inventories (+3.6%, +$6.2bn).

Aus inventories



Aus Q3 current account, $bn

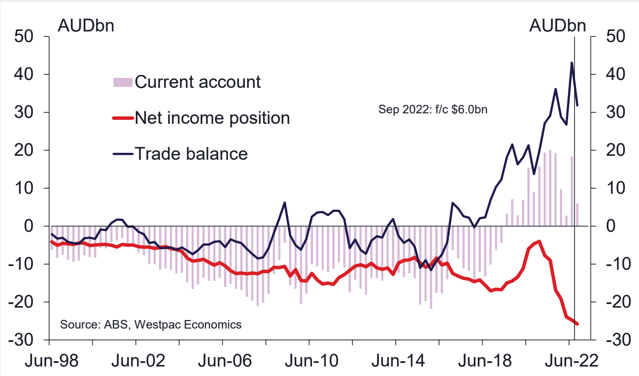
Dec 6, Last: 18.3, WBC f/c: 6.0
Mkt f/c: 6.2, Range: 5.5 to 17.5

The trade surplus ballooned to $43bn in the June quarter, boosted by a record high terms of trade in part due to the Ukraine war.

In the September quarter, the trade surplus narrowed to around $31.8bn, we estimate, trimmed by a pull-back in global commodity prices and a surge in import volumes. The terms of trade likely moderated by around 6% in the quarter.

The net income deficit (NID) widened to $24.8bn in Q2, 3.9% of GDP, more in line with levels prevailing in 2018 (as a share of the economy) and after temporarily narrowing to historic lows in 2020. Another sizeable deficit is in prospect, we've factored in $25.8bn.

Aus current account



Aus Q3 net exports, ppts cont'n

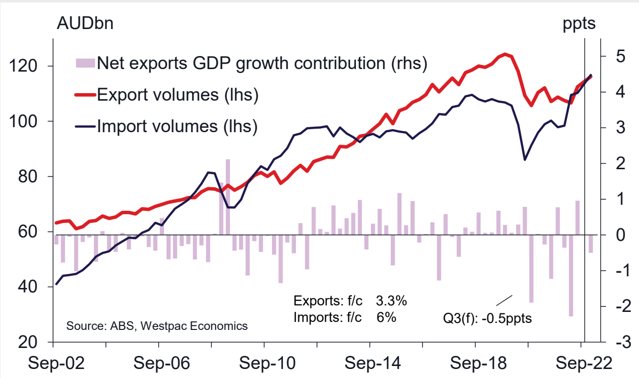
Dec 6, Last: +1.0, WBC f/c: -0.5
Mkt f/c: -0.5, Range: -1.3 to 0.0

For the September quarter, net exports are expected to be a material negative, subtracting -0.5ppts from activity – partially reversing a sizeable 1.0ppt positive contribution in June.

Import volumes grew by around 6% in the quarter we estimate, including goods +4% (on robust demand and improved supply) and services +16% (increased holiday travel abroad).

Export volumes grew by around 3.3% in the quarter, we estimate, with goods up by around 2% (led by rural goods) and services +10% (international holiday makers and students returning).

Aus net exports



The week ahead

Aus RBA policy decision

Dec 6, Last: 2.85%, WBC f/c: 3.10%
Mkt f/c: 3.10%, Range: 3.00% to 3.10%

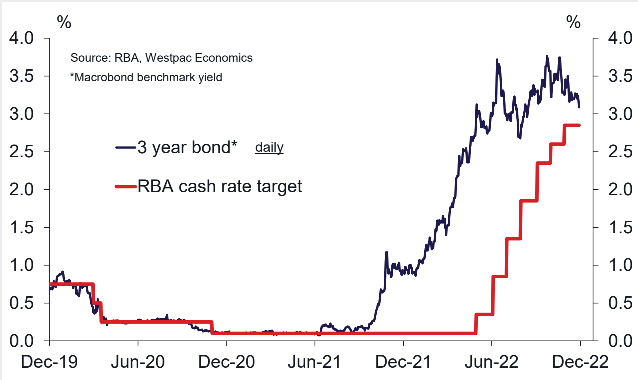
At the December Board meeting, Westpac anticipates that the RBA will lift the cash rate by 25bps, to 3.10%.

The RBA, in responding to a significant inflation challenge and the tightest labour market in 50 years, has quickly raised interest rates.

Rates have lifted from a record low of 0.1% at the start of May, with moves at each monthly Board meeting, including 50bps hikes for the four meetings July to September. The RBA slowed the pace of tightening at the October meeting, back to 25bp increments, with that policy arguably moving into the contractionary zone.

Inflation is still too high and more work needs to be done in our view. Annual headline inflation is expected to hit the 8% mark in the December quarter and to still be above the 2-3 target band at the end of 2023 (at about 4%, we expect).

RBA cash rate and 3 year bonds



Aus Q3 GDP

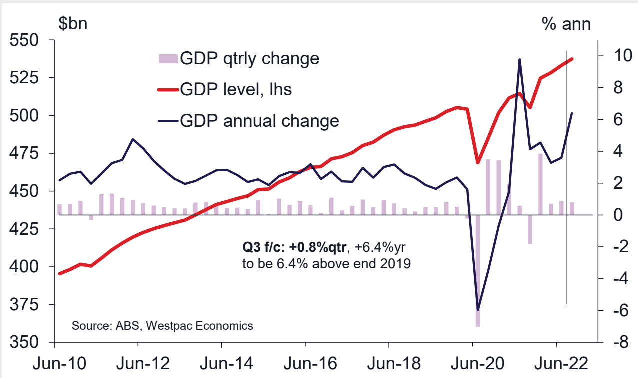
Dec 7, Last: 0.9%, WBC f/c: 0.8%
Mkt f/c: 0.7%, Range: 0.1% to 0.8%

Australia's economic expansion remains robust for now, with tailwinds from earlier policy stimulus and the reopening effect from the delta lockdowns of 2021. This is ahead of the full adverse impacts of sharply higher interest rates.

Output growth is a forecast 0.8%qtr, 6.4%yr for the September quarter. The arithmetic is: domestic demand +0.9% and -0.1ppts on balance from net exports (-0.5ppts) and inventories (+0.4ppts).

Consumer spending grew by a forecast 1.0%, led by services and motor vehicles. That's a slowing from the very brisk 2.2% gains in Q1 and Q2 when the reopening effect was greatest and with high inflation hitting retail. Business investment rose by a forecast 1.3%, construction work rebounding and outweighing a dip in equipment spending. Public demand likely returned to growth, a forecast 0.8%, while home building was flat (on a retreat in renovation work).

Aus GDP



Aus Oct trade balance, $bn

Dec 8, Last: 12.4, WBC f/c: 12.1
Mkt f/c: 12.1, Range: 8.0 to 15.0

Australia's trade surplus remains sizeable, albeit down from the June record high of $17.6bn when commodity prices were at their highs. A $12.4bn surplus printed for September, including a 7.0% rebound in export earnings in the month and broadly steady imports, +0.4%.

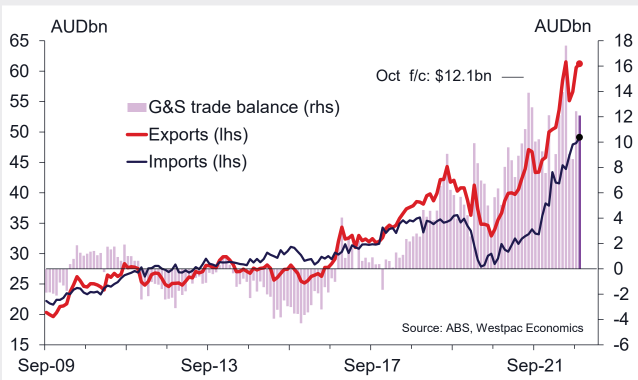
For October, we expect the surplus to remain elevated at $12.1bn.

The Australian dollar was sharply weaker in the month, down 5% against the US dollar and 3% on a TWI basis, thereby boosting prices for exports and imports.

We've factored in a 2% rise in the import bill for the month, +$1.0bn, on a combination of higher prices and the upward trend in volumes.

For exports, we expect a 1% rise, $0.6bn, led by LNG, while lower coal shipments on flooding disruptions are a headwind.

Aus trade balance

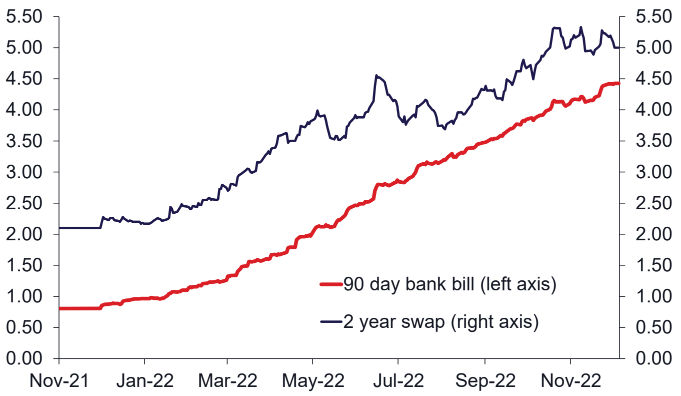


New Zealand forecasts

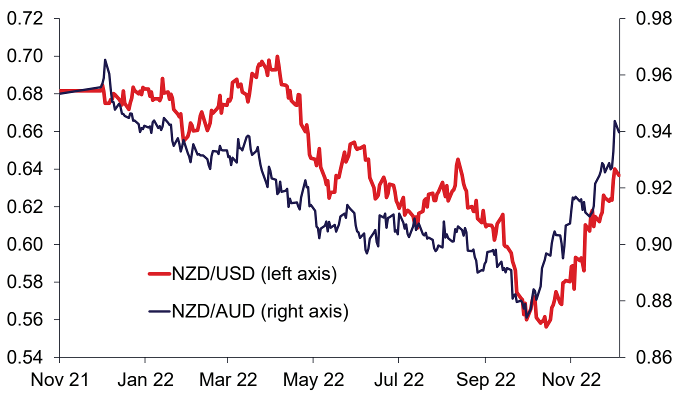
Economic forecasts	Quarterly				Annual			
	2022			2023				
% change	Jun (a)	Sep	Dec	Mar	2020	2021	2022f	2023f
GDP (Production)	1.7	0.4	0.4	0.9	-2.1	5.5	2.2	1.9
Employment	0.0	1.3	0.1	0.1	0.6	3.3	1.3	0.5
Unemployment Rate % s.a.	3.3	3.3	3.3	3.4	4.9	3.2	3.3	3.8
CPI	1.7	2.2	0.8	1.2	1.4	5.9	6.5	3.9
Current Account Balance % of GDP	-7.7	-8.0	-7.5	-6.4	-0.8	-6.0	-7.5	-4.7

Financial forecasts	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Cash	5.00	5.50	5.50	5.50	5.25	4.75
90 Day bill	5.50	5.60	5.60	5.50	5.05	4.55
2 Year Swap	5.20	5.00	4.80	4.50	4.20	3.90
5 Year Swap	4.60	4.50	4.35	4.20	4.05	3.90
10 Year Bond	4.30	4.20	4.10	4.00	3.80	3.70
NZD/USD	0.64	0.65	0.66	0.67	0.68	0.68
NZD/AUD	0.93	0.93	0.92	0.91	0.90	0.89
NZD/JPY	87.0	87.1	87.1	87.1	86.4	85.1
NZD/EUR	0.61	0.61	0.61	0.60	0.60	0.60
NZD/GBP	0.53	0.53	0.54	0.54	0.54	0.54
TWI	73.6	73.4	73.1	73.0	72.8	72.2

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 5 December 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	3.50%	3.50%
30 Days	4.32%	4.16%	3.92%
60 Days	4.37%	4.20%	4.05%
90 Days	4.43%	4.23%	4.17%
2 Year Swap	5.00%	5.02%	5.20%
5 Year Swap	4.40%	4.53%	4.88%

NZ foreign currency mid-rates as at 5 December 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6367	0.6121	0.5914
NZD/EUR	0.6046	0.5978	0.5925
NZD/GBP	0.5187	0.5179	0.5164
NZD/JPY	85.56	86.71	86.76
NZD/AUD	0.9397	0.9244	0.9153
TWI	73.41	71.93	70.65

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 05					
NZ	Nov ANZ commodity prices	–3.4%	–	–5.0%	Falling meat, dairy prices in November.
Aus	Q3 company profits	7.6%	–1.8%	–4.5%	Mining profits off highs as commodity prices pull-back.
	Q3 inventories	0.3%	1.0%	1.4%	Rebuild resumes after pause in Q2, aided by higher imports.
	Nov MI inflation gauge %yr	5.2%	–	–	To date has been an inconsistent lead to ABS CPI measures.
	Nov ANZ job ads	–0.5%	–	–	Still at a very high level even though it has eased a bit.
Chn	Nov Caixin services PMI	48.4	48.0	–	Ongoing virus disruptions will continue to impact for now.
Eur	Nov S&P Global services PMI	48.6	–	–	Final estimate.
	Dec Sentix investor confidence	–30.9	–	–	Confidence is beginning to consolidate.
	Oct retail sales	0.4%	–	–	Negative so far this year; weakness is broadly-based.
UK	Nov S&P Global services PMI	48.8	–	–	Final estimate.
US	Nov S&P Global services PMI	46.1	46.1	–	S&P Global materially weaker than ISM...
	Nov ISM non-manufacturing	54.4	53.5	–	... pointing to clear downside risks for the sector.
	Oct factory orders	0.3%	0.7%	–	Capital investment subdued through Q3.
Tue 06					
NZ	Q3 building work put in place	2.6%	–	1.1%	Continued gains in residential and non-residential work.
Aus	Q3 current account balance $bn	18.3	6.2	6.0	Trade surplus narrows after record high in Q2.
	Q3 net exports, ppts cont'n	1.0	–0.5	–0.5	Import strength outstrips lift in exports.
	Q3 public demand	0.0%	–	0.8%	Return to growth after rare flat quarter.
	RBA policy decision	2.85%	3.10%	3.10%	Tightening cycle continues, responding to inflation challenge.
US	Oct trade balance US$bn	–73.3	–77.0	–	Import prices and demand are easing.
Wed 07					
NZ	GlobalDairyTrade auction (WMP)	2.4%	–	0.0%	Futures prices broadly flat since the last auction.
Aus	Q3 GDP	0.9%	0.7%	0.8%	Domestic demand growth remains robust.
Chn	Nov foreign reserves USDbn	3052	–	–	Authorities focused on stability on trade-weighted basis.
	Nov trade balance USDbn	85.2	78.1	–	Asia a key support, but developed world demand still a risk.
Eur	Q3 GDP	0.2%	–	–	Final estimate.
US	Q3 productivity	0.3%	0.3%	–	Final estimate.
Thu 08					
Aus	Oct trade balance $bn	12.4	12.1	12.1	Another sizeable surplus, supported by LNG export revenue.
	RBA Assist' Governor, Financial Syst	–	–	–	Jones speaking at FIRN Conference.
US	Oct consumer credit	25.0	26.5	–	High rates to weigh over coming year.
	Initial jobless claims	225k	–	–	To remain at relatively low levels for now.
Fri 09					
NZ	Nov retail card spending	1.0%	–	0.6%	Domestic demand holding firm, tourist spending on the rise.
Chn	Nov PPI %yr	–1.3%	–1.4%	–	Upstream price pressures are continuing to decelerate...
	Nov CPI %yr	2.1%	1.6%	–	... as consumer inflation remains little-changed.
	Nov new loans, CNYbn	615.2	1225.0	–	Credit gains to continue...
	Nov M2 money supply %yr	11.8%	11.6%	–	... on authorities encouragement.
US	Nov PPI	0.2%	0.2%	–	Annual producer inflation is easing from record highs.
	Oct wholesale inventories	0.8%	–	–	Final estimate.
	Dec Uni. of Michigan sentiment	56.8	56.8	–	Pressure from inflation and rates still dominates.

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	7.9	4.1
Unemployment rate %	5.0	5.2	6.8	4.7	3.3	4.5
Current account % of GDP	-2.1	0.7	2.4	3.2	1.3	-0.9
United States						
Real GDP %yr	2.9	2.3	-3.4	5.7	1.9	0.4
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	4.8
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	-0.4	-4.6	1.7	1.7	1.5
Euro zone						
Real GDP %yr	1.8	1.6	-6.1	5.2	3.2	0.4
United Kingdom						
Real GDP %yr	1.7	1.7	-9.3	7.4	3.6	-0.2
China						
Real GDP %yr	6.8	6.0	2.2	8.1	3.5	6.0
East Asia ex China						
Real GDP %yr	4.5	3.8	-2.3	4.2	4.5	4.4
World						
Real GDP %yr	3.6	2.8	-3.0	6.0	3.2	3.0

Forecasts finalised 4 November 2022

Interest rate forecasts	Latest	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
Australia							
Cash	2.85	3.60	3.85	3.85	3.85	3.60	3.35
90 Day BBSW	3.06	3.97	4.05	4.05	3.97	3.72	3.47
10 Year Bond	3.39	3.80	3.60	3.40	3.20	3.00	2.90
International							
Fed Funds	3.875	4.625	4.625	4.625	4.625	4.375	3.875
US 10 Year Bond	3.54	4.00	3.80	3.60	3.40	3.10	2.90

Exchange rate forecasts	Latest	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
AUD/USD	0.6812	0.69	0.70	0.72	0.74	0.75	0.76
USD/JPY	135.07	138	136	134	132	130	128
EUR/USD	1.0523	1.05	1.07	1.09	1.11	1.12	1.13
GBP/USD	1.2245	1.21	1.22	1.23	1.24	1.25	1.26
USD/CNY	7.0528	7.00	6.80	6.60	6.50	6.40	6.30
AUD/NZD	1.0682	1.08	1.08	1.09	1.10	1.11	1.13

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