WESTPAC WEEKLY ECONOMIC COMMENTARY

Power to the workers.

7 November 2022

Kōwhai

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New Zealand's labour market remains extremely tight. Unemployment remains very low and wage growth is picking up sharply, emphasising that our inflation problem is increasingly a home-grown one.

The unemployment rate remained at 3.3% in the September quarter, close to the record low of 3.2% that it set in December and March. On the face of it, that was a little weaker than the drop to 3.2% that we and the market were forecasting.

What wasn't a surprise was that jobs growth actually regained some momentum. Indeed, that turned out even stronger than we expected – employment was up 1.3% for the quarter, following three straight quarters of zero growth.

However, that growth was quite narrowly focused on one group. Employment among 15-19 year olds rose by 8% in just one quarter, and the participation rate for this group rose to its highest since 2007. We also saw a strong rise in the number of people working while studying, and a rebound in the share of part-time workers.

A lift in youth employment is certainly not unwelcome. But it highlights how few avenues that employers have left to find new workers. Students working part-time may well help to fill the gaps in areas like hospitality, which have suffered from the absence of the migrant and working-holiday visa crowds in the last couple of years. But labour shortages are a feature across all sectors, all regions, and all skill levels. More often than not, finding the people with the right skills will mean luring them away from another employer.

The result is that the strong demand for workers is largely being channelled into pay rates rather than employment. The Labour Cost Index (LCI) rose by 1.1% in the September quarter, lifting the annual rate to 3.7%, the highest since 2008. Private sector labour costs are running hotter than the public sector, up 3.9% vs 3.1% for the year. The unadjusted analytical measure of the LCI, which excludes pay rises related to promotion or experiences, is running stronger than this, up 5.3% on a year ago (and 5.6% for the private sector).

The Quarterly Employment Survey (QES) measure of average hourly earnings is even stronger again. Private sector pay rates were up 2.6% for the quarter, lifting the annual rate to 8.5% – exceeding the previous high of 7.7% in 1990, which is as far back as the survey goes. We should take this result with a small grain of salt, as it can be quite variable from quarter to quarter. But it is clear that not only is the QES measure outpacing the LCI, but the gap between the two is widening.

Why is this happening? One reason could be due to job title inflation. The LCI measures pay rates by job role. But some employers are having to hire or promote people into more senior positions – with higher salary ranges – in order to be able to pay what's needed to attract or retain them. This may be an attractive option for employers, because it's easier to scale this back than to reduce pay rates once the economy does cool down.

So the question of which wage measure to focus on is really horses for courses. If you're interested in wage growth on a like-for-like basis, the headline LCI is best. If you're thinking about the overall pressure for pay rises that an individual firm is facing – including the pressure to promote – use the analytical LCI. And if you want to gauge what workers are actually getting in hand (before tax, and hence bracket creep), the QES is the best measure, as it also captures the effects of people moving into higher-paying jobs or industries.

The QES measure suggests that the average worker is starting to claw back some of the rise in the cost of living, which until recently hadn't been the case. That broadly matches how the Covid pandemic has played out. At first it was largely a productivity shock to the economy, as supply chains gummed up and worker absences increased. In these conditions, we would expect real (inflation-adjusted) wages to fall. But we're hearing much less from firms about supply chain issues these days; the overwhelming issue now is labour shortages. And that is a recipe for rising real wages.

The Reserve Bank was already braced for some very strong wage growth over the coming quarters, but last week's results either matched or exceeded those forecasts. That reinforces that the RBNZ faces a significant challenge in bringing inflation under control. There's a clear risk of a self-perpetuating upward spiral in wages and prices, in the absence of the circuit-breaker that higher interest rates provide. Any thoughts of the monetary policy cycle being 'mature' or 'well advanced' need to be put into the context of the scale of the RBNZ's task.

We continue to expect a 75 basis point increase in the OCR at the 23 November policy review. It seems that 50 or 75 points are likely to be the options on the table, as was the case in the October review. What tips us towards a larger move this time is the strong readings on inflation and wages in the last few weeks, as well as the unusual three-month gap until the next scheduled policy review in February.

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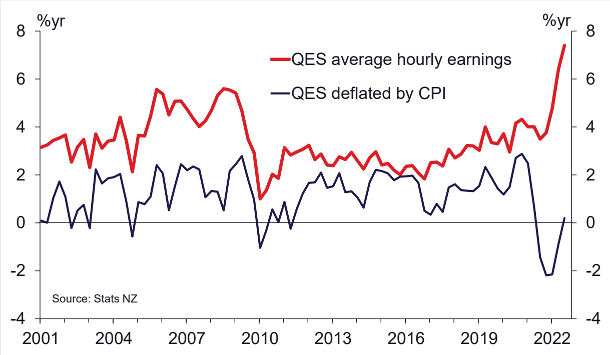
Chart of the week

The average worker took a substantial hit in 2021, as the cost of living surged and wage growth failed to match it. This year has been a different story – wages have surged to more or less match the rate of inflation, though they haven't clawed back the ground that was lost last year. We expected real (inflation-adjusted) wage growth to pick up further in the year ahead, largely due to the headline inflation rate receding from its highs.

Nominal and real wage growth

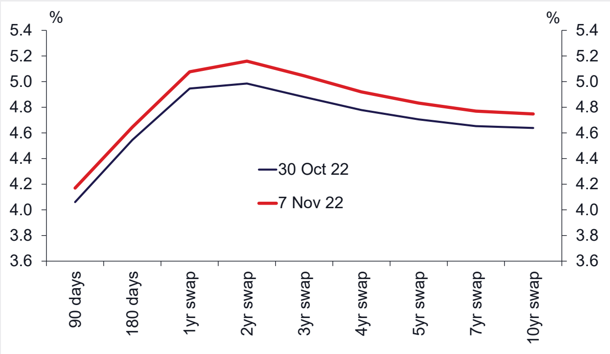


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5% 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

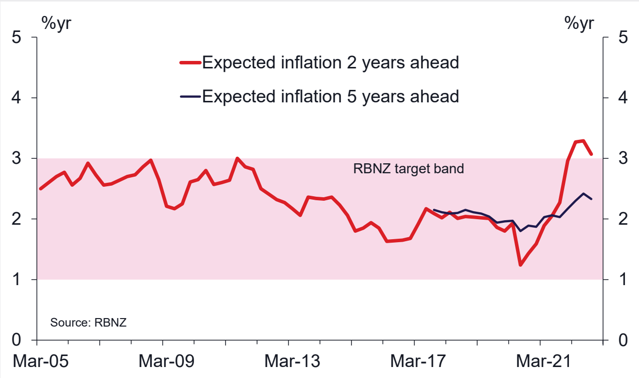
NZ Q4 RBNZ survey of expectations

Nov 8, Two-year ahead inflation expectations, Last: 3.07%

The risk of a wage-price spiral is a significant concern for the RBNZ given the current strong and widespread inflation pressures. Key to this is whether inflation expectations remain well anchored.

The November survey is likely to show that expectations for inflation remain elevated at both short and longer-term horizons. Importantly, there is a risk that inflation expectations over longer horizons (two or more years ahead) could push upwards. Despite interest rate increases over the past year, we are not seeing signs that inflation pressures are abating. In fact, recent labour market data signals that those pressures have become more intense. Consistent with that, forecasts for inflation have been revised upwards in recent weeks.

RBNZ survey of expectations



NZ Oct retail card spending

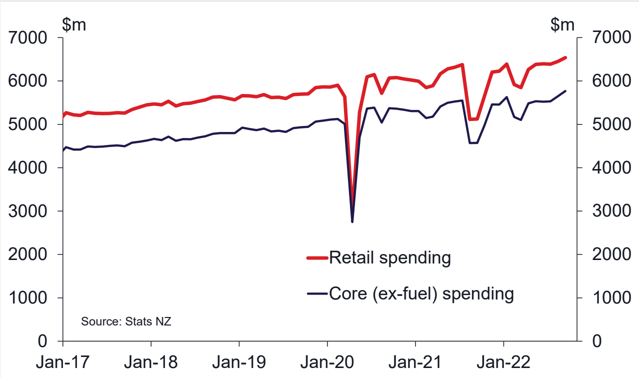
Nov 9, Last: +1.4%, Westpac: +0.2%

Retail spending was stronger than expected in September. In large part, that was a result of increased spending in the hospitality sector, which has been boosted by the reopening of the borders and the return of international visitors.

We're forecasting that spending levels will rise modestly in October. Spending is being supported by the last of the Government's temporary 'Cost of living' payments to households. We've also seen continued gains in the hospitality sector and a fall in petrol prices.

Providing some offset to the aforementioned tailwinds, rising consumer prices and higher interest rates are eroding households' spending power. That's been a particular drag on durables spending. We expect the dampening impact of those factors will become increasingly pronounced over the year ahead.

NZ retail card spending



NZ Oct REINZ house sales and prices

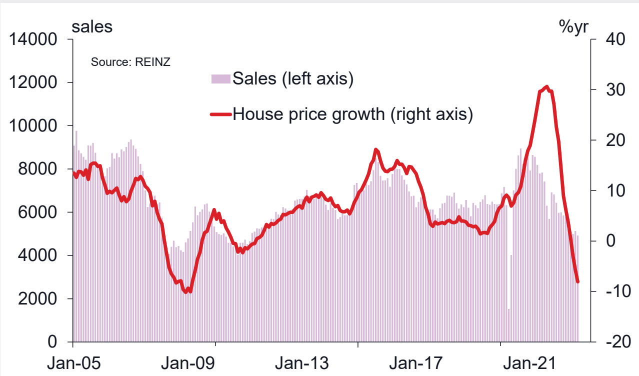
Nov 11 (TBC), Sales last: -4.1% m/m, -10.9% y/y
Prices last: -1.6% m/m, -8.1% y/y

The correction in New Zealand's housing market continues at pace, with prices down by 11% since last November. That has only taken them back to where they were in April last year, highlighting the ferocity of the price rise over 2020 and 2021.

Higher interest rates have been the key driver of the correction, and they point to further price declines to come. Fixed-term mortgage rates eased slightly in August and September, but rebounded to reach new highs in October.

There are signs of house sales flattening out in recent months, albeit at very low levels. The supply of unsold homes on the market also looks to be stabilising, though this is largely due to a drop in new listings, as falling prices have kept potential sellers away from the market.

REINZ house prices and sales



The week ahead

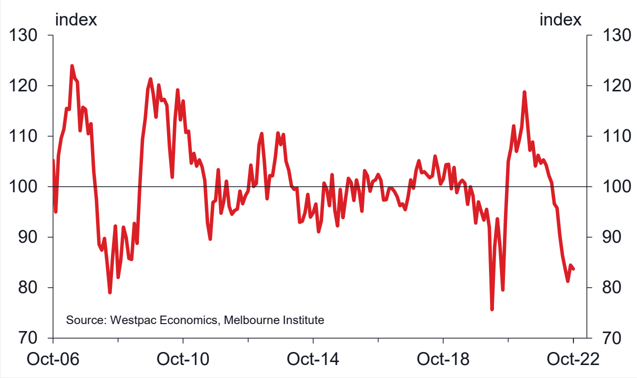
Aus Nov Westpac-MI Consumer Sentiment

Nov 8, Last: 83.7

Consumer Sentiment edged 0.9% lower in Oct to remain near historical lows at 83.7 – sustained lower readings in the past only ever seen in the depths of recession. The most striking aspect of the Oct survey though was a sharp turnaround in responses over the course of the survey week, the RBA's surprise move – raising rates by 25bps instead of a widely expected 50bp increase – preventing what would otherwise have been an extremely weak Oct read, sentiment across the 'post-RBA' sample actually up 5% vs Sep.

Its unclear if that 'mini-rally' will carry into Nov. While the RBA opted for another 25bp rate increase at its Nov meeting, this time the move was in line with consensus expectations. Meanwhile the inflation challenge is looking more formidable with the Q3 CPI showing a bigger and broader price lift, the Budget forecasts highlighting a very large prospective rise in retail electricity costs and the RBA now forecasting headline inflation to only slow back to 4.75% in 2023.

Aus Consumer Sentiment Index

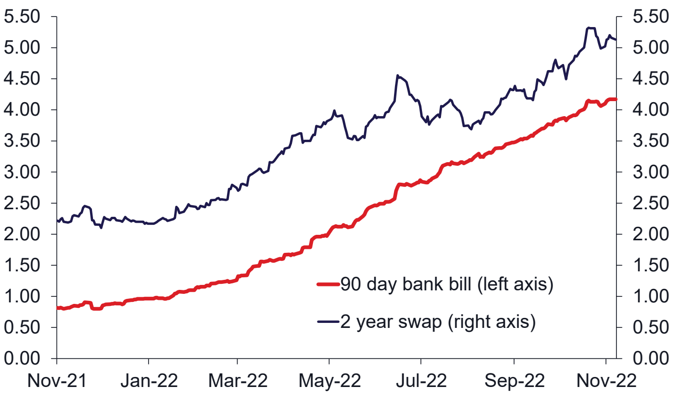


New Zealand forecasts

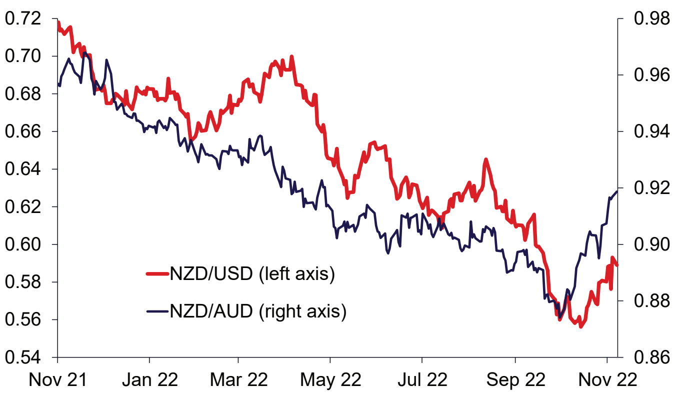
Economic forecasts	Quarterly				Annual			
	2022			2023				
% change	Jun (a)	Sep	Dec	Mar	2020	2021	2022f	2023f
GDP (Production)	1.7	0.4	0.6	0.6	-2.1	5.5	2.2	2.2
Employment	0.0	1.3	0.1	0.1	0.6	3.3	1.4	0.8
Unemployment Rate % s.a.	3.3	3.3	3.3	3.5	4.9	3.2	3.3	3.8
CPI	1.7	2.2	0.5	1.3	1.4	5.9	6.2	4.1
Current 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	4.25	4.75	5.00	5.00	5.00	5.00	5.00
90 Day bill	4.55	5.00	5.10	5.10	5.10	5.10	4.80
2 Year Swap	5.00	4.90	4.80	4.60	4.40	4.15	3.90
5 Year Swap	4.70	4.60	4.50	4.35	4.20	4.05	3.90
10 Year Bond	4.50	4.50	4.30	4.20	4.00	3.80	3.70
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	85.3	85.6	85.8	86.8	88.4	87.1	85.8
NZD/EUR	0.58	0.58	0.59	0.60	0.61	0.60	0.60
NZD/GBP	0.51	0.52	0.52	0.53	0.54	0.54	0.53
TWI	68.3	68.5	68.4	69.2	71.1	70.8	70.8

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 7 November 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.89%	3.63%	3.54%
60 Days	4.03%	3.88%	3.73%
90 Days	4.17%	4.13%	3.92%
2 Year Swap	5.16%	5.31%	4.80%
5 Year Swap	4.83%	5.07%	4.54%

NZ foreign currency mid-rates as at 7 November 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5888	0.5688	0.5582
NZD/EUR	0.5924	0.5791	0.5759
NZD/GBP	0.5205	0.5032	0.5053
NZD/JPY	86.59	84.97	81.24
NZD/AUD	0.9182	0.9032	0.8851
TWI	70.43	68.70	67.07

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 07					
Aus	Oct ANZ job ads	–0.5%	–	–	Still at a very high level.
Chn	Oct foreign reserves USDbn	3028.96	3029.50	–	Authorities focused on stability on trade-weighted basis.
	Oct trade balance USDbn	87.7	96.0	–	Weaker global economy a risk to trade into year-end.
Eur	Nov Sentix investor confidence	–38.3	–	–	Collapsed confidence undermines Europe's resilience to date.
Tue 08					
NZ	Q4 RBNZ inflation expectations (2yrs)	3.1%	–	–	Set to remain elevated.
Aus	Nov WBC–MI Consumer Sentiment	83.7	–	–	Mini-rally post Oct 25bp rate hike. Will this feature again?
	Oct NAB business survey	25	–	–	Sep, conditions up & elevated at +25. Oct, any signs of slowing?
Eur	Sep retail sales	–0.3%	–	–	Negative so far this year; broadly-based across the region.
US	Sep consumer credit	32.2	32.0	–	High rates to weigh over the coming year.
	Oct NFIB small business optimism	92.1	91.5	–	Consolidating but fragile given uncertainties.
	Fedspeak	–	–	–	Collins, Mester, Barkin.
Wed 09					
NZ	Oct card spending	1.4%	–	0.2%	Lift in tourist spending offsetting higher borrowing costs.
Aus	RBA Deputy Governor Bullock	–	–	–	Speaking on the economic outlook at ABE, Sydney.
Chn	Oct PPI %yr	0.9%	–1.6%	–	Upstream price pressures continue to decelerate...
	Oct CPI %yr	2.8%	2.4%	–	... while consumer inflation remains relatively benign.
	Oct new loans, CNYbn	2473.8	800.0	–	Credit gains to continue...
	Oct M2 money supply %yr	12.1%	12.0%	–	... on authorities' encouragement.
US	Sep wholesale inventories	0.8%	0.8%	–	Final estimate.
	Fedspeak	–	–	–	Williams, Barkin.
Thu 10					
NZ	RBNZ review of policy implementation	–	–	–	Assessment of policy decisions over the past five years.
Aus	Nov MI inflation expectations	5.4%	–	–	Elevated and well above target band, mirroring actual inflation.
US	Oct CPI	0.4%	0.7%	0.7%	Close attention on momentum in core; critical update.
	Initial jobless claims	217k	–	–	Likely to remain at low levels, at least for time being.
	Fedspeak	–	–	–	Waller, Logan, Mester, George.
Fri 11					
NZ	Oct manufacturing PMI	52.0	–	–	Continues to point to moderate activity.
	Oct food price index	0.4%	–	–0.4%	Seasonal fall in vegetable prices.
	Oct REINZ house sales %yr	–10.9%	–	–	Signs of sales flattening out, albeit at low levels.
	Oct REINZ house prices %yr	–8.1%	–	–	Rising interest rates point to further price declines to come.
UK	Q3 GDP	0.2%	–	–	Sustained period of negative growth ahead.
	Sep trade balance £bn	–7080	–	–	Deficit to remain wide for now.
US	Nov Uni. of Michigan sentiment	59.9	59.6	–	Consumers still feeling the heat from inflation and rates.

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	Dec–22	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
Australia								
Cash	2.85	3.10	3.60	3.85	3.85	3.85	3.60	3.35
90 Day BBSW	3.06	3.55	3.97	4.05	4.05	3.97	3.72	3.47
10 Year Bond	3.90	3.80	3.80	3.60	3.40	3.20	3.00	2.90
International								
Fed Funds	3.875	4.375	4.625	4.625	4.625	4.625	4.375	3.875
US 10 Year Bond	4.15	4.00	4.00	3.80	3.60	3.40	3.10	2.90

Exchange rate forecasts	Latest	Dec–22	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
AUD/USD	0.6289	0.65	0.66	0.67	0.69	0.72	0.73	0.74
USD/JPY	148.17	147	145	143	140	136	133	130
EUR/USD	0.9750	1.00	1.01	1.02	1.04	1.07	1.09	1.10
GBP/USD	1.1162	1.13	1.14	1.16	1.18	1.20	1.22	1.24
USD/CNY	7.3019	7.20	7.00	6.80	6.60	6.50	6.40	6.30
AUD/NZD	1.0899	1.12	1.12	1.12	1.11	1.11	1.11	1.12

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