WESTPAC WEEKLY ECONOMIC COMMENTARY

From 'squeeze' to 'crush' – New Zealand forecast update.

12 December 2022

Southern rātā

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We've downgraded our forecasts for the New Zealand economy in response to the ongoing increases in the Official Cash Rate. Discretionary spending will be squeezed a lot harder in 2023 than it has been in 2022, as increasing numbers of mortgages come up for refixing at substantially higher interest rates. As a result, although economic activity has remained firm in recent months, we now expect GDP growth to stall over the coming year, with a small contraction in activity over late 2023 and early 2024.

We have revised down our forecasts for economic activity in response to the continued tightening in financial conditions. We expect that economic growth will drop to stall speed over the coming year, with the economy briefly slipping into a recession in late 2023 / early 2024 as the full brunt of interest rate hikes ripple through the economy. The projected recession is not expected to be deep - we're 'only' forecasting a decline of 0.3%. More importantly, however, we expect a protracted period of weak demand through mid-2023 to mid-2024, with economic growth falling well below trend. That weakness in economic conditions will result in unemployment rising from 3.3% currently to around 4.8% over the coming years.

The reason for the projected slowdown in economic growth has been the continued rise in borrowing costs. With inflation running red hot, the Reserve Bank has been hiking the Official Cash Rate (OCR) at a rapid pace. The cash rate has already risen by 400 basis points since October of last year.

Those large increases in the OCR have seen a marked downturn in the housing market. Nationwide house prices have now fallen by an average of 12% from their peak in 2021, and house sales are at their lowest levels since 2010 (barring the lockdown period in 2020). New Zealander's hold a large amount of their wealth in owner occupied or investor housing, and the fall in prices now in train has taken a sizeable bite out of many households' net worth.

But despite that, overall household spending has continued to trend higher a year after the interest rate tightening cycle began. Crucially, we have not seen any signs that domestic inflation pressures are cooling. In fact, measures of core inflation have continued to push higher.

A key reason for that resilience in demand is that around 90% of New Zealand mortgages are actually on fixed rates. Many borrowers locked in very low interest rates in the early stages of the pandemic. That has shielded them – and their spending power – from interest rate increases to date.

However, as we've been at pains to highlight, the situation for many New Zealand borrowers is going to become much tougher. Around half of all mortgages will come up for repricing over the coming year, and borrowers will face refixing at rates that are significantly higher than those they are currently on.

Notably, since the RBNZ's last policy meeting in November – when they delivered a jumbo sized 75bp hike and signalled that further large interest rate hikes are on the cards – mortgage rates have taken another step higher. As a result, borrowers who go to refix their mortgage now could see the interest rate on their loan rising by upwards of 3.5%. That's signals an even larger drag on demand than we had previously anticipated. We're now forecasting outright falls in per-capita spending over 2023.

Household spending accounts for around 60% of total economic activity, and the expected fall in demand will drive a broader downturn in economic activity, including capital spending by businesses. As activity weakens, we're likely to see unemployment trending higher, which will further compound the pressure on some households' finances.

That slowdown in domestic demand and the labour market is actually what is needed – and what the RBNZ has been trying to engineer – to dampen the inflation pressures that have been boiling over in every corner of the economy. Even so, we don't expect inflation will be back inside the RBNZ's target band until mid-2024.

Half-Year Update 2022 Preview: A rock and a hard place.

With a weaker growth outlook and surging wage inflation, the Government is facing a tricky balance maintaining the level of public services while not exacerbating wage and inflation pressures. On balance, we expect the Government to prioritise maintaining services over the risks that increased spending will exacerbate inflation.

That means we expect an increase in the spending allowances for coming Budgets. Notably for Budget 2023 we expect a circa $1.5bn to be added to the operating allowance versus what was already allocated at Budget 2022. We also expect smaller additions of circa $1bn for Budgets 2024, 2025 and 2026.

Alongside the additional spending, we expect an aggressive programme of spending re-prioritisation to free up spending to maintain key public services like health. An additional reason for this delicate balancing is that the Government will want to stay as close as possible to its previously stated operating balance target. Accordingly, we expect the books to show a surplus in the later years, but for it to be small and within the magnitude of error and the Government could potentially push out the year that it returns to surplus by a year. In contrast and given the strong starting point, we expect the Government's debt track to remain within its stated targets i.e. comfortably below the 30% net debt ceiling.

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Table of the week

A key focus for financial markets in this week's HYEFU will be the details of the Government's bond programme. Overall, we expect an increase of $20bn over the four-year forecast period relative to Budget 2022. This increase in part reflects the increase in spending allowances. It also includes an allowance for the funding of Kāinga Ora's activities (in November the Government announced that Kāinga Ora will now borrow from the Crown's New Zealand Debt Management office, rather than private sources).

New Zealand Government bond programme, $bn (June year)

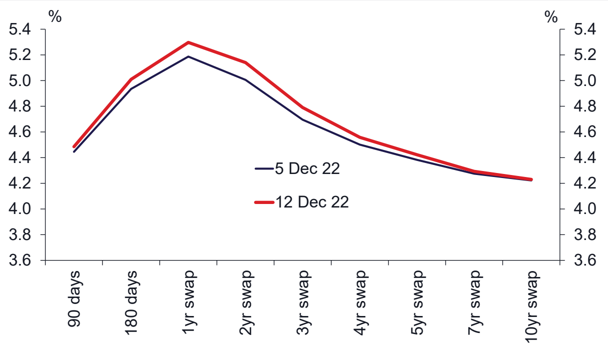
	2023	2024	2025	2026	2027	4-year total to 2026
Half-Year Update	**25**	**30**	**30**	**25**	**20**	**110**
Budget 2022	25	25	25	15	-	90
Change	0	+5	+5	+10	-	+20

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 Nov REINZ house sales and prices

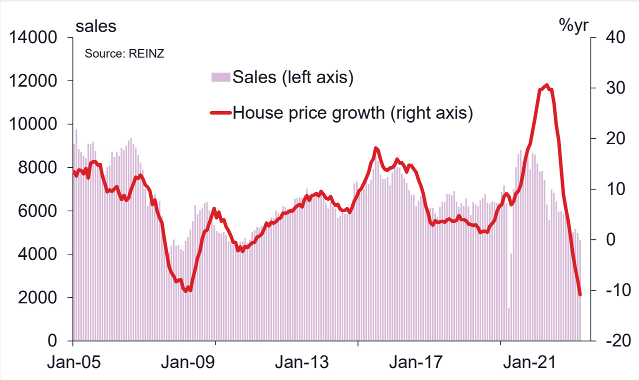
Dec 13, Sales last: –6.4% m/m, –34.7% y/y
Prices last: –1.1% m/m, –10.9% y/y

The downturn in the New Zealand housing market continued in October. Sales dropped to an eleven-year low and we continued to see widespread price declines.

We expect the November sales report will show that the downturn has continued to deepen. Mortgage rates have taken another step higher, and that will further dampen sales and prices.

At the same time, the stock of unsold homes is dropping back. Vendors are increasingly accepting that they won't get the prices they would like and are instead stepping back from the market. However, we don't think that will do much to stem the fall in prices in the near term as the RBNZ is expected to continue hiking the cash rate at a rapid pace.

REINZ house prices and sales



NZ Q3 Current Account Balance, % of GDP

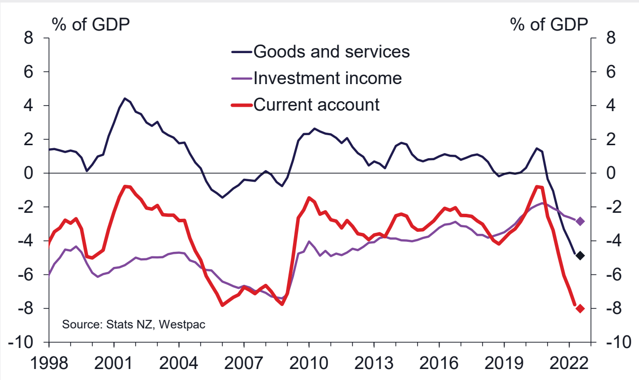
Dec 14, Last: –7.8%, Westpac: –8.0%

We expect the annual current account deficit to widen to 8.0% of GDP in the September quarter, from 7.8% in the June quarter.

The widening of the deficit beyond the average level of recent years essentially reflects the hot New Zealand economy since late 2020 – we have been, at least temporarily, living beyond our means.

However, we expect that 8.0% will represent the widest point for the current account deficit in this cycle. From here and as the economy slows, we expect the current account to narrow to 7.3% by year end and to around 4.3% by December 2023.

NZ annual current account balance



NZ Half Year Economic and Fiscal Update

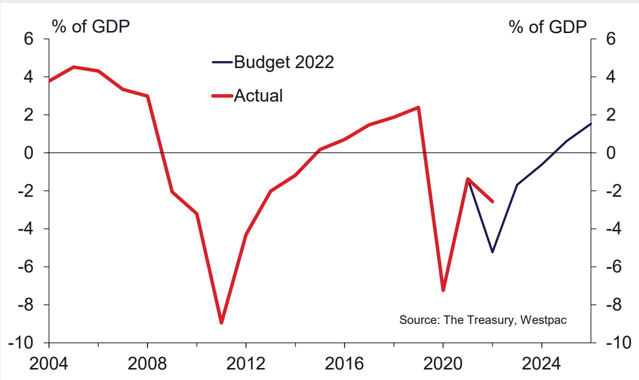
Dec 14

With a weaker growth outlook and surging wage inflation, the Government is facing a tricky balance maintaining the level of public services while not exacerbating wage and inflation pressures.

As a result, we expect some increase in spending allowances for upcoming Budgets, alongside an aggressive programme of spending re-prioritisation to free up spending to maintain key public services like health. We also expect the books to show a surplus in the later years, but for it to be small and/or the Government could potentially push out the year that it returns to surplus by a year. In contrast, we expect the Government's debt track to remain within its stated targets.

Market interest will be on the size of the bond programme. Overall, we expect an increase of $20bn over the four-year forecast period relative to Budget 2022.

Operating balance (OBEGAL) as a % of GDP



The week ahead

NZ Q3 GDP

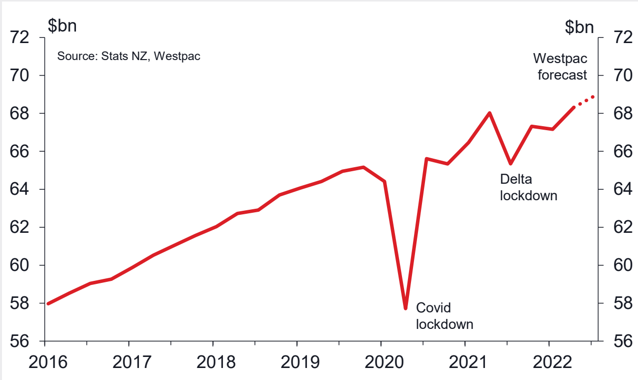
Dec 15, Last: 1.7%, WBC f/c: 0.9%, Mkt f/c: 0.9%

We expect a 0.9% rise in GDP for the September quarter. That follows a 1.7% surge in the June quarter, as the reopening of the border to international tourists gave a boost to areas such as transport, accommodation and recreational activities.

The September quarter is likely to see a similar lift in these areas, though not at the same rate of increase given the higher starting point this time. We also expect to see strong gains in construction and food manufacturing.

Our pick is similar to the Reserve Bank's forecast of a 0.8% rise. While the RBNZ's statements about engineering a recession have caught many people's attention, that's more of a story for mid-2023 onward – they still expect the economy to retain its momentum in the near term as the travel recovery continues.

NZ production-based GDP



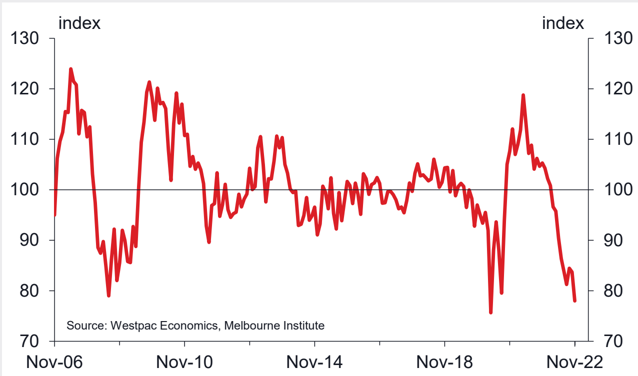
Aus Dec Westpac-MI Consumer Sentiment

Dec 13, Last: 78

Consumer Sentiment fell to fresh cycle lows in Nov, dropping a further 6.9% to just 78. A continued surge in inflation; a relatively poorly received Federal Budget; and a further 25bp rate rise from the RBA with a clear signal of more to come all weighed heavily on consumer confidence in the month. There was also a notable deterioration in expectations for unemployment, which had held at relatively upbeat levels through the year to date.

Dec may see the gloom lift slightly, a milder than expected Oct CPI inflation indicator possibly easing some inflation fears. However, the pressure from rate rises will clearly continue, the RBA delivering another 25bp hike at its Dec meeting and warning that it expects to increase rates further over the period ahead.

Aus Consumer Sentiment Index



Aus Nov Labour Force - employment '000

Dec 15, Last: 32.2k, WBC f/c: 27k
Mkt f/c: 17k, Range: 0k to 45k

Total employment lifted 32.2k in October following a 3.8k contraction in September (revised from +0.9k). It was a strong update even though holidays, sickness and floods continue to hold back the recovery in employment.

Further highlighting the strength of the September update, seasonally adjusted hours worked increased by 2.3%, stronger than the growth in employment (0.2%). This stronger growth in hours partly reflected fewer people than usual taking leave during October.

While labour market indicators from both business and household surveys, along with job ads, have eased a bit over the past few months they remain at very robust levels consistent with at least sound employment growth. And the November update from Weekly Payrolls suggests jobs growth bounce back in the month. Our forecast 27k rise in employment should hold the three month average increase around 20k.

Aus Westpac employment indicators

The week ahead

Aus Nov Labour Force - unemployment rate %

Dec 15, Last: 3.4%, WBC f/c: 3.3%
Mkt f/c: 3.4%, Range: 3.3% to 3.5%

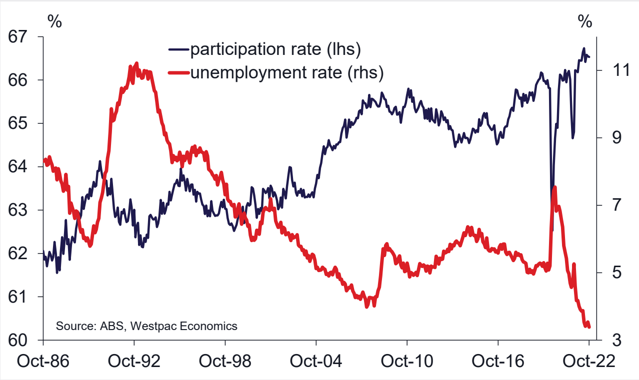
Participation was flat at 65.5% (at two decimal places it fell from 65.55% to 65.53) which nevertheless is still only just under the historical high of 66.7%. Due to the moderation in participation there was a smaller 11.7k gain in the labour force resulting in a 20.6k drop in those unemployed with the unemployment rate falling 0.1ppt to 3.4%.

At 3.4% the unemployment rate is the lowest since November 1974.

There continues to be a pickup in the growth of the working age population which lifted from 0.6%yr last December to 1.2%yr in October. Prior to Covid annual growth in the working age population peaked at 1.7%yr in 2018/2019 due to robust immigration.

Holding participation at 66.5% and the rate of growth in the working age population steady this should see a 17k increase in the labour force in October. As such, our 27k forecast increase in employment will be enough to take the unemployment rate down to 3.3%.

Aus unemployment rate



US Dec FOMC meeting

Dec 14-15, Last: 3.875%, Mkt f/c: 4.375%, WBC 4.375%

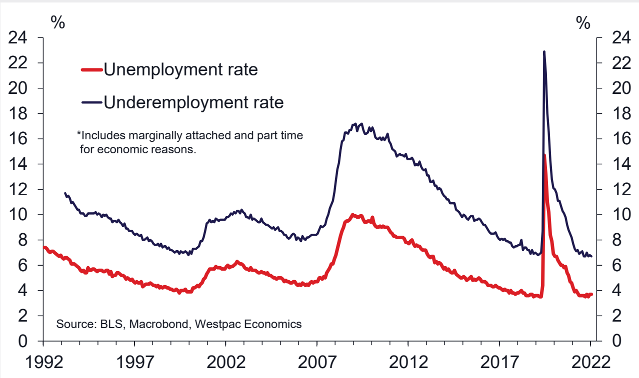
Recent data have given the FOMC enough confidence in their tightening to date and the risks related to inflation to slow the pace of rate hikes from 75bps to 50bps at the December meeting. A further moderation is likely to come at the January/February meeting, to 25bps per move.

That said, the rhetoric from Chair Powell at the post-meeting press conference and the overall tone of the Committee's forecasts will remain hawkish, with the FOMC committed to doing what is necessary to bring inflation back to target without delay.

With financial conditions having eased materially and nonfarm payrolls yet to show a sustained increase in labour market slack, we now see the rate hike cycle extending to 4.875% at March.

However, by that time, a much weaker labour market and stalled economy will call for an end to hikes, with cuts to come in 2024.

US labour market

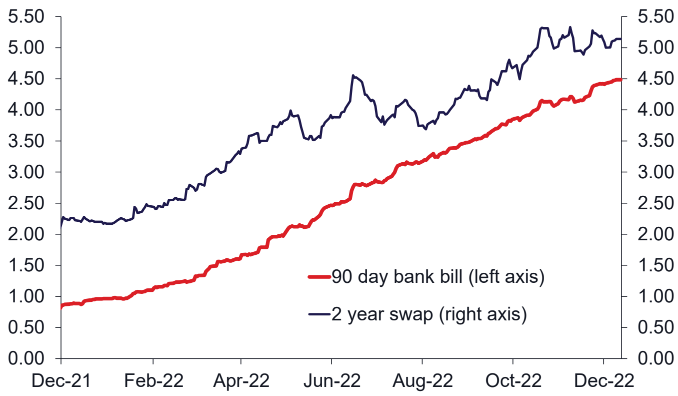


New Zealand forecasts

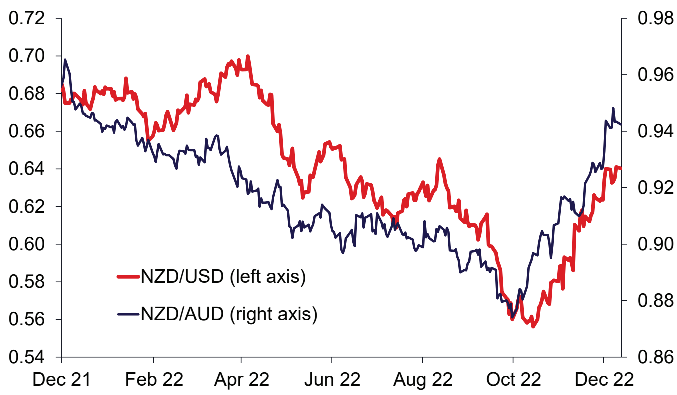
Economic forecasts	Quarterly				Annual			
	2022			2023				
% change	Jun (a)	Sep	Dec	Mar	2020	2021	2022f	2023f
GDP (Production)	1.7	0.9	0.5	0.4	-2.1	5.5	2.5	1.7
Employment	0.0	1.3	0.1	0.1	0.6	3.3	1.3	0.1
Unemployment Rate % s.a.	3.3	3.3	3.3	3.4	4.9	3.2	3.3	3.9
CPI	1.7	2.2	1.1	1.5	1.4	5.9	6.9	4.3
Current Account Balance % of GDP	-7.7	-8.0	-7.4	-6.2	-0.8	-6.0	-7.4	-4.6

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	5.00	4.90	4.70	4.50	4.20	3.90
5 Year Swap	4.40	4.35	4.25	4.15	4.05	3.90
10 Year Bond	4.00	3.95	3.90	3.80	3.70	3.60
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 12 December 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	4.25%	3.50%
30 Days	4.32%	4.32%	4.02%
60 Days	4.41%	4.37%	4.08%
90 Days	4.49%	4.42%	4.15%
2 Year Swap	5.14%	5.17%	4.95%
5 Year Swap	4.42%	4.53%	4.62%

NZ foreign currency mid-rates as at 12 December 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6403	0.6229	0.6071
NZD/EUR	0.6083	0.5948	0.5898
NZD/GBP	0.5226	0.5154	0.5162
NZD/JPY	87.48	85.84	85.34
NZD/AUD	0.9424	0.9288	0.9099
TWI	73.51	72.65	70.82

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	Oct net migration	2176	–	–	Pickup in migrant workers is outpacing NZer departures.
UK	Dec Rightmove house prices	–1.1%	–	–	More declines to come as policy tightening ensues.
	Oct trade balance £bn	–3135	–3300	–	Imports declining amid numerous headwinds facing HH's.
Tue 13					
NZ	Nov REINZ house sales %yr	–34.7%	–	–	Recent further rises in mortgage rates...
	Nov REINZ house prices %yr	–10.9%	–	–	... will likely keep buyers away and prices down.
	Nov food price index	0.8%	–	–0.3%	Smaller seasonal drop than usual, annual growth high.
Aus	Dec WBC–MI Consumer Sentiment	78	–	–	Descended to new extreme cycle lows in Nov.
	Nov NAB business survey	22	–	–	Conditions still elevated in October, but confidence evaporated.
Eur	Dec ZEW survey of expectations	–38.7	–	–	Has bounced off historic lows but still very weak.
UK	Oct ILO unemployment rate	3.6%	3.7%	–	Slack to emerge more clearly into year-end.
US	Nov NFIB small business optimism	91.3	90.8	–	Consolidating but fragile given uncertainties.
	Nov CPI	0.4%	0.3%	0.3%	Close attention paid to composition of core CPI.
Wed 14					
NZ	Q3 current account % of GDP	–7.8%	–8.0%	–8.0%	Hefty import bill due to rising world prices, transport costs.
	Half-Year Economic and Fiscal Update	–	–	–	High inflation making it costlier to maintain public services.
Aus	RBA Governor Lowe	–	–	–	Keynote address at AusNetPay Summit.
Eur	Oct industrial production	0.9%	–1.3%	–	Support from easing supply issues but outlook is gloomy.
UK	Nov CPI	11.1%	10.9%	–	Annual core inflation looks to be flattening.
US	Nov import price index	–0.2%	–0.5%	–	Import prices continuing to decline from elevated levels.
	FOMC policy decision, midpoint	3.875%	4.375%	4.375%	FOMC to throttle back rate hike pace, but remain hawkish.
Thu 15					
NZ	Q3 GDP	1.7%	0.9%	0.9%	Return of overseas tourists has provided fresh momentum.
Aus	Dec MI inflation expectations	6.0%	–	–	Falling petrol prices should help ease inflation expectations.
	Nov Labour Force employment, '000	32.2	17.0	27.0	Leading indicators moderated but remain at robust levels...
	Nov Labour Force unemployment	3.4%	3.4%	3.3%	... hinting of strong employment & falling unemployment.
Chn	Nov retail sales ytd %yr	0.6%	0.5%	–	Consumption is key to growth in 2023.
	Nov fixed asset investment ytd %yr	5.8%	5.6%	–	Policy is providing lasting support for investment...
	Nov industrial production ytd %yr	4.0%	4.0%	–	... but the global outlook remains a clear headwind.
Eur	ECB policy decision, refi rate	2.00%	2.50%	2.50%	Moderation from +75bp to +50bp widely expected.
UK	BoE policy decision	3.00%	3.50%	3.50%	BoE tightening cycle will likely run further into 2023.
US	Nov retail sales	1.3%	0.0%	–	Inflation and rates to weigh more heavily on consumption.
	Dec Fed Empire state index	4.5	–1.0	–	Regional surveys have...
	Dec Phily Fed index	–19.4	–10.0	–	... shown weakness of late.
	Initial jobless claims	230k	–	–	To remain at relatively low levels for now.
	Nov industrial production	–0.1%	0.2%	–	Weakness in domestic and global demand a key risk.
	Oct business inventories	0.4%	0.4%	–	Pace of inventory accrual beginning to slow.
Fri 16					
NZ	Nov manufacturing PMI	49.3	–	–	Manuf conditions, including orders, have been cooling.
Eur	Dec S&P Global manufacturing PMI	47.1	–	–	Broad-based weakening in demand beginning to take hold...
	Dec S&P Global services PMI	48.5	–	–	... leaving mfg and services in a very fragile state.
	Oct trade balance €bn	–37.7	–	–	Deficit to remain very wide for the foreseeable future.
	Nov CPI	10.0%	–	–	Final estimate.
UK	Dec GfK consumer sentiment	–44	–42	–	Consumer confidence remains historically weak...
	Nov retail sales	0.6%	0.4%	–	... leading many households to limit their spending.
	Dec S&P Global manufacturing PMI	46.5	–	–	Elevated costs and softening demand...
	Dec S&P Global services PMI	48.8	–	–	... are weighing heavily on both mfg and services.
US	Dec S&P Global manufacturing PMI	47.7	47.9	–	Similar themes are present in the US though the ISMs...
	Dec S&P Global services PMI	46.2	46.5	–	... suggest larger firms are managing headwinds better.

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	3.10	3.60	3.85	3.85	3.85	3.60	3.35
90 Day BBSW	3.13	3.97	4.05	4.05	3.97	3.72	3.47
10 Year Bond	3.29	3.20	3.10	3.00	2.90	2.80	2.70
International							
Fed Funds	3.875	4.875	4.875	4.875	4.875	4.375	3.875
US 10 Year Bond	3.46	3.40	3.30	3.20	3.10	2.90	2.70

Exchange rate forecasts	Latest	Mar–23	Jun–23	Sep–23	Dec–23	Mar–24	Jun–24
AUD/USD	0.6787	0.69	0.70	0.72	0.74	0.75	0.76
USD/JPY	135.93	138	136	134	132	130	128
EUR/USD	1.0579	1.05	1.07	1.09	1.11	1.12	1.13
GBP/USD	1.2272	1.21	1.22	1.23	1.24	1.25	1.26
USD/CNY	6.9620	7.00	6.80	6.60	6.50	6.40	6.30
AUD/NZD	1.0603	1.08	1.08	1.09	1.10	1.11	1.13

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