WESTPAC WEEKLY ECONOMIC COMMENTARY

It won't happen overnight...

28 November 2022

Kōwhai

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The Reserve Bank delivered a jumbo sized 75 basis point rise in the Official Cash Rate at its November meeting. The central bank also signalled that the cash rate is likely to rise much higher in the months ahead. We have revised up our forecast for the OCR and now expect a peak of 5.50% in early 2023. For New Zealand households, that signals big increases in borrowing costs. And as those higher interest rates ripple through the economy, we're likely to see growth slowing and unemployment rising.

We have revised our forecast for the Official Cash Rate higher. We now expect a 75 basis point rise in February, and a further 50 basis point rise in April (previously we had expected increases of 50bp and 25bp respectively at those meetings). Those increases would take the OCR to a peak of 5.50% – its highest level since 2008.

Behind that change in our OCR forecast has been ongoing strength in inflation, and a related hawkish lurch from the RBNZ. The central bank delivered a 75 basis point rise in the Official Cash Rate at its November policy meeting. That was the largest ever increase in a single meeting, and it follows a series of large increases in the cash rate over the past year. In fact, the cash rate has now risen by a total of 400 basis points since the tightening cycle began in October last year.

And the RBNZ isn't slowing down. It has signalled that further large increases in the cash rate are coming in short order. From here, the central bank is projecting the cash rate to peak at 5.50%. That's a significant upgrade from the peak of 4.1% they had expected back in August.

Prices are charging higher in nearly every corner of the economy, with the Consumers Price Index rising by 7.2% in the year to September. That was a much larger increase than the Reserve Bank had expected. Importantly, the drivers of inflation have changed over time. Price rises were initially related to supply disruptions and increases in import costs in the wake of the pandemic. However, it's domestic factors that are now driving much of the strength in inflation that we're seeing. That includes the strength of domestic demand. It also includes the tightly stretched labour market, with wage costs rising rapidly as businesses have struggled to attract and retain workers.

Crucially for the RBNZ, households and businesses increasingly expect that inflation will remain elevated despite the rise in interest rates. And that is a big worry for the central bank. Expectations, especially over longer horizons, are a key influence on how businesses adjust prices and wages, and their recent rise means that the current inflation cycle could be even more protracted. Indeed, we are already seeing signs of a wage-price spiral emerging. Average hourly earnings rose by 7.4% over the past year with the very low level of unemployment giving workers greater bargaining power. And the strength of activity means that businesses have been willing to pay (and pass on) those higher labour costs.

Interest rate increases to date have started to weigh on domestic activity. That's been seen most clearly in the housing market, with sales dropping to low levels and prices down an average of 12% from their peak in November 2021. Nevertheless, overall economic activity remains elevated. In fact, the latest retail spending figures have shown that households are not winding back their spending despite mounting financial pressures. Instead, nominal spending levels were up another 2.5% in the three months to September. In addition, core inflation measures (which track the underlying trend in prices) have continued to push higher despite rate increases over the past year.

To get the inflation genie back in the bottle, it's clear that demand needs to soften. In fact, the RBNZ is forecasting that a recession will be needed, and is projecting falls in economic activity from mid-2023 to early 2024, along with a related rise in unemployment.

But we think a note of caution is needed here. Although inflation has been resilient to interest rate increases thus far, there should be no mistake – monetary policy is still effective. However, it takes time for interest rate changes to affect demand and inflation. To borrow a phrase, it won't happen overnight, but it will happen.

A key reason for that is because the vast majority of New Zealand mortgages are on fixed interest rates, which has shielded them from interest rate increases to date. Many borrowers are still on the very low rates that were on offer during the early stages of the pandemic.

That picture will change dramatically over the coming year. Over the next 12 months, more than half of mortgages will come up for repricing, and many borrowers will face interest rate rises of 2% or more. That will certainly pull down spending and employment. And it could also see the current strength in domestic inflation dissipate more quickly than the RBNZ expects.

Consistent with that, we now expect OCR cuts to begin in early 2024, six months earlier than we did previously. Those rate cuts are both earlier and faster than what the RBNZ is projecting.

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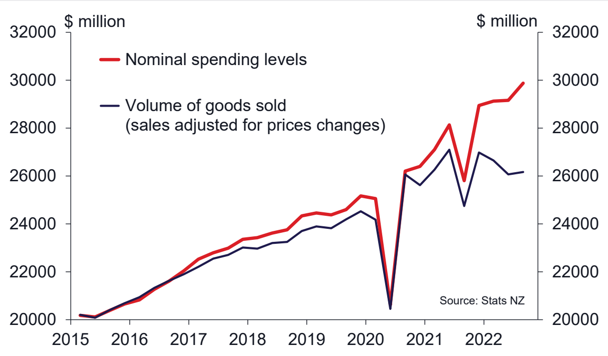
Chart of the week

Despite the large increases in prices and interest rates over the past year, households have not been reining in their spending. In fact, nominal spending levels rose 2.5% in the September quarter alone. However, while households are splashing out more cash, the actual amount of goods we've been purchasing hasn't really been rising. Taking a look back over the past couple of years, the volume of goods that households are purchasing has actually remained steady since early 2021. In essence, the post-Covid splurge in purchases has come to a halt.

Retail spending

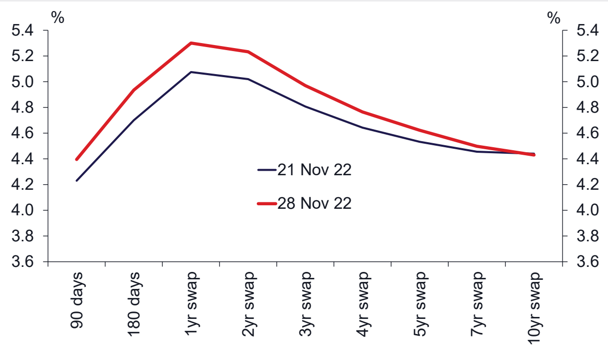


Fixed vs floating for mortgages

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 Oct monthly employment indicator

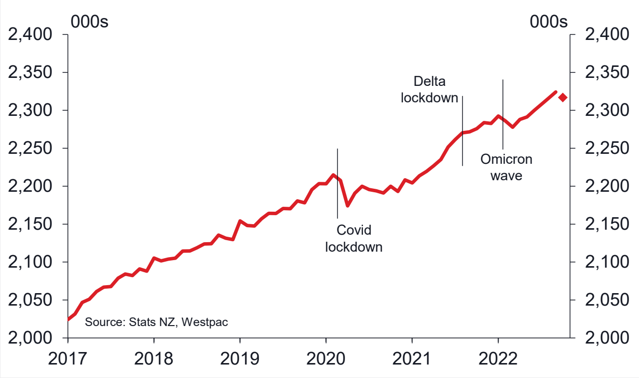
Nov 28, Last: 0.4%, Westpac f/c: -0.3%

The monthly employment indicator reports the number of filled jobs, drawn from income tax data. This measure has recorded some solid gains in previous months, rising by 1% over the September quarter as a whole.

The indicator also highlights that around 40% of the growth in employment over the last year has been among teenagers – one of the few remaining areas where there is scope to bring people into the workforce. However, this is not a viable source of labour for many industries.

The weekly snapshots of the data suggest a modest easing in jobs in October, although that's in the context of a strong run of growth recently. Employment growth is still outstripping growth in the labour force on an annual basis.

NZ monthly filled jobs



NZ Oct residential building consents

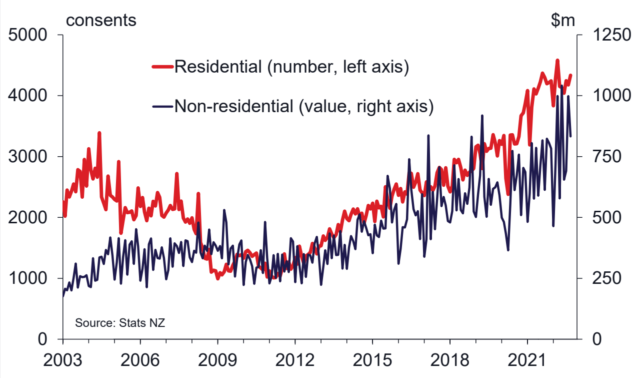
Nov 30, Last: +3.8%, Westpac f/c: -5.0%

Dwelling consent issuance rose by 3.8% In September. That stronger than expected increase was mainly due to the large number of apartment consents issued over the month. Looking at the underlying trend in consent numbers, issuance remains around record highs supported by the large number of medium density developments (like apartments and townhouses).

We are forecasting a 5% decline in consent numbers in October. That's mainly due to an easing in the 'lumpy' apartments category after last month's surge. But even with that decline, the level of consents is expected to remain elevated.

Looking further ahead, we expect that less favourable financial conditions for both purchasers and developers will see consent issuance trend down over the year ahead.

NZ building consents



NZ Nov ANZBO business confidence

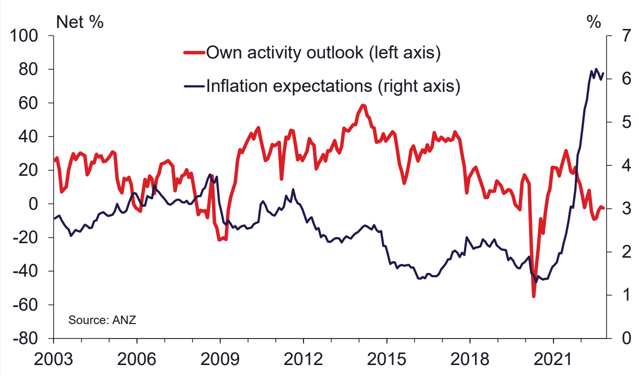
Nov 30, Last: -42.7

Business confidence dropped further into pessimistic territory in October. Although activity levels in the economy have held up, businesses are grappling with a range of challenges, including rising interest costs and ongoing shortages of staff. At the same time, operating costs have been charging higher, squeezing margins for many firms.

Confidence is set to remain low in the November survey. Labour market pressures and operating costs have continued to push higher. There is also growing concern about the outlook for activity as interest rates continue to rise.

Despite softening in recent months, the survey's price and cost gauges have remained elevated. We expect that pattern will be repeated in the November survey, consistent with our forecast for only a gradual easing in the current high rate of inflation.

NZ business confidence



The week ahead

Aus Oct retail trade

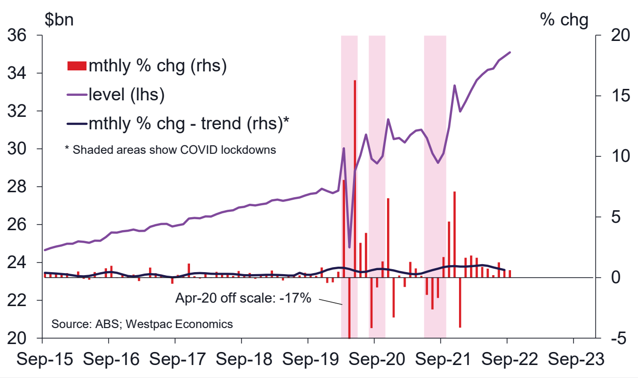
Nov 28, Last: 0.6%, WBC f/c: 0.2%
Mkt f/c: 0.5%, Range: 0.0% to 0.9%r

Retail sales posted 0.6% gains in Sep and Aug, most of which looks to have been on higher prices with underlying volumes about flat. Rising interest rates may be having some small dampening effect as well with the Sep month showing notable declines in the value of sales for household goods and department stores despite likely higher prices.

The Oct update should start to show a clearer impact from interest rate rises although available evidence suggests this continues to be mild. Our Westpac Card Tracker Index held up reasonably well through the month, albeit with retail components showing some signs of softening. Retail responses to private sector business surveys were also a touch softer but still very positive overall.

On balance, we expect nominal sales to post 0.2% gain in the month, implying a small outright decline in underlying sales volumes.

Aus monthly retail sales



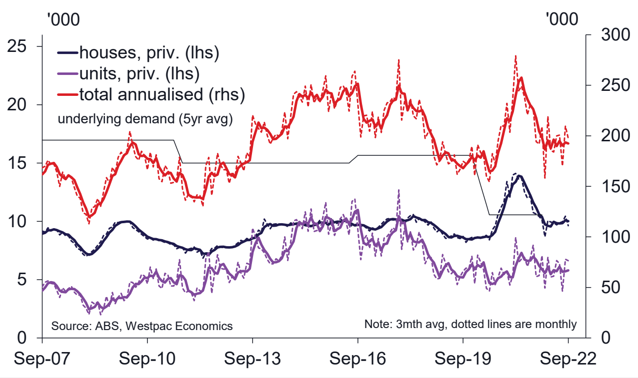
Aus Oct dwelling approvals

Nov 30, Last: -5.8%, WBC f/c: -5.0%
Mkt f/c: -2.0%, Range: -6.0% to 3.0%

Dwelling approvals posted a 5.8% decline in Sep, following a string of upside surprises through most of 2022. The detail suggests approvals are starting to reflect the numerous headwinds at play – including sharp rises in interest rates and building costs, and the wider housing market downturn – with a notable decline in private detached houses.

October is likely to show a clearer cyclical shift. We expect approvals to post another 5% decline with risks again to the downside.

Aus dwelling approvals



Aus Oct Monthly CPI Indicator %yr

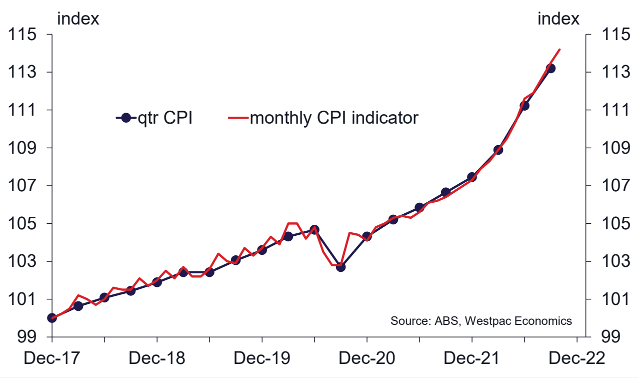
Nov 30, Last: 7.3%, WBC f/c: 7.3%
Mkt f/c: 7.6%, Range: 7.1% to 8.3%

The monthly indicator has proven to be reliable leading indicator for the quarterly CPI. Through the September quarter the monthly indicator lifted 0.6% in July, 0.2% in August and 0.6% in September taking the annual pace from 6.7% at June to 7.3% in September. The quarterly CPI was up 7.3% in the year to September.

Considering the partial indicators we have, and making reference to the timing of the surveys for the various components of the CPI, Westpac is forecasting the Monthly Indicator to lift 0.6% in October holding the annual rate flat at 7.3%. We are nearing the peak in the annual pace of inflation but given the timing of the various surveys we don't expect to see it until December.

From there we expect to moderate as we move through 2023 with the usual monthly volatility.

Aus CPI monthly indicator vs. qtr CPI



The week ahead

Aus Q3 construction work

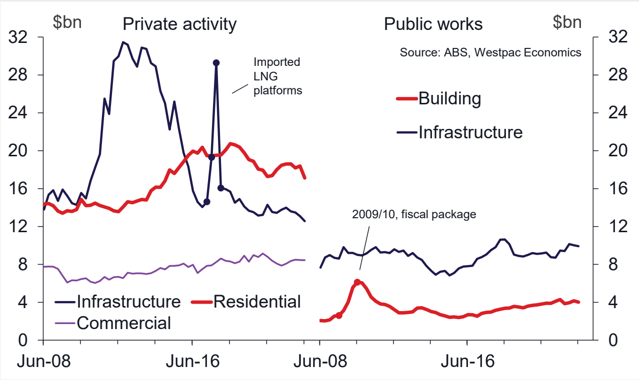
Nov 30, Last: -3.8%, WBC f/c: 2.0%
Mkt f/c: 2.0%, Range: -1.8% to 5.0%

Construction work contracted in 3 of the past 4 quarters, including a 3.8% drop in June, despite a sizeable pipeline of work. Inclement weather associated with the La Nina has caused significant delays, compounded by labour and material shortages.

For the September quarter, given the ongoing headwinds, we anticipate only a partial rebound from that sizeable 3.8% decline in June – at a forecast +2%, which would still leave the level of activity below that a year ago (-1.3%) and below that in mid-2021 (-2.4%).

That June quarter fall included declines across each of the states, as well as declines across segments – notable was a sharp drop in private detached home building, of -13.9%. If there is confirmation of a September quarter partial recovery in work, we envisage that it will be relatively broadly based across the segments with gains in housing, business construction and public works.

Aus construction work by segment



Aus Oct private sector credit

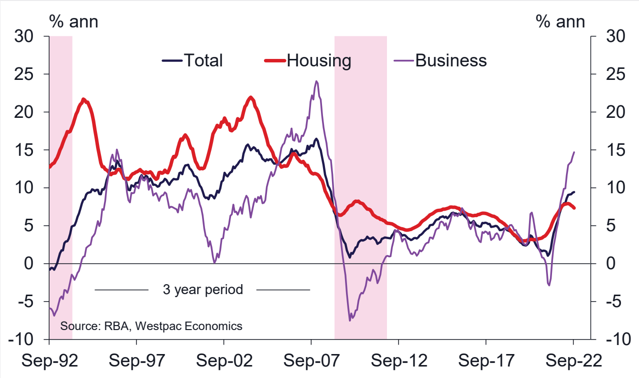
Nov 30, Last: 0.7%, WBC f/c: 0.6%
Mkt f/c: 0.6%, Range: 0.5% to 0.8%

There is an emerging gradual slowing in the monthly pace of credit growth – as rapidly rising interest rates reduce the borrowing capacity of households.

This comes after a period of strong growth, as households and businesses responded to earlier policy stimulus. Over the year to September, credit grew by 9.4%, the fastest annual pace since 2008. The September outcome included 7.3%yr for residential, flat for personal and 14.7%yr for business lending.

Monthly credit growth has eased from 0.9% throughout the June quarter to 0.8% for July and August, then a 0.7% result for September. We anticipate that credit growth will edge down to 0.6% in October, led by housing, as well as some easing in the recent rapid pace of business lending. New lending for housing is in retreat, contracting by 24% over the past 8 months to September, including a 22% fall over the past 4 months.

Aus annual credit growth



Aus Nov CoreLogic home value index

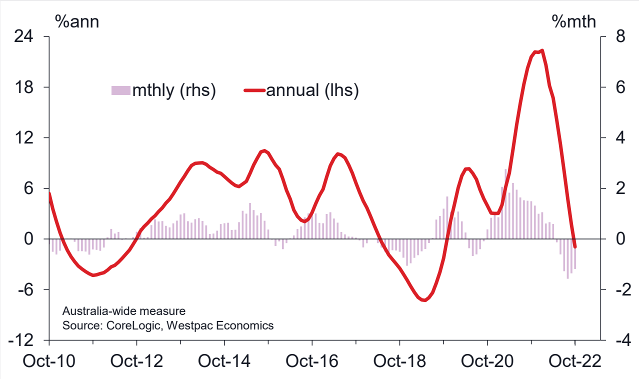
Dec 1, Last: -1.1%, WBC f/c: -1.0%

The housing market correction that began in May ran at a rapid pace through the second half of 2022. Prices fell 1.1% in October, a slight moderation on the 1.4-1.6%/mth declines in Q3 but still a rapid rate overall.

November is set to see a repeat with the daily index pointing to another 1.0% decline for the month. This will take annual growth to -5.4%yr with a 7.5% fall since April.

While the slightly milder monthly pace and marginal improvement in auction markets suggest the correction is moderating, stabilisation still looks a long way off, especially with more rate rises on the way.

Aus dwelling prices

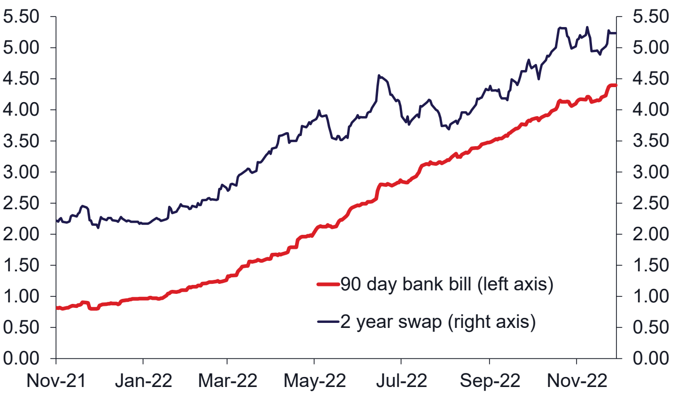


New Zealand forecasts

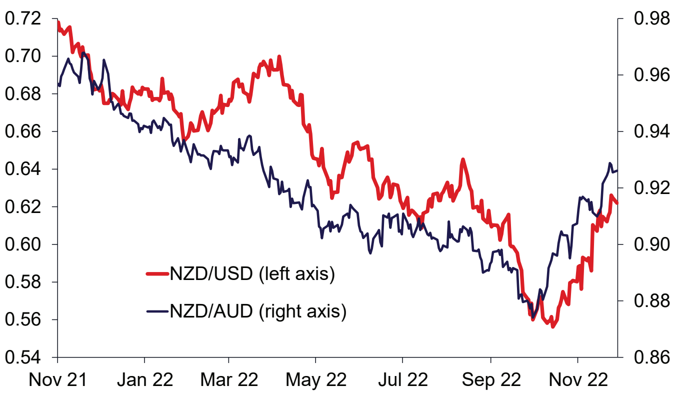
Economic forecasts	Quarterly				Annual			
	2022			2023				
% change	Jun (a)	Sep	Dec	Mar	2020	2021	2022f	2023f
GDP (Production)	1.7	0.4	0.4	0.9	-2.1	5.5	2.2	1.9
Employment	0.0	1.3	0.1	0.1	0.6	3.3	1.3	0.5
Unemployment Rate % s.a.	3.3	3.3	3.3	3.4	4.9	3.2	3.3	3.8
CPI	1.7	2.2	0.8	1.2	1.4	5.9	6.5	3.9
Current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

Financial forecasts	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Cash	4.25	5.00	5.50	5.50	5.50	5.25	4.75
90 Day bill	4.60	5.50	5.60	5.60	5.50	5.05	4.55
2 Year Swap	5.30	5.20	5.00	4.80	4.50	4.20	3.90
5 Year Swap	4.70	4.60	4.50	4.35	4.20	4.05	3.90
10 Year Bond	4.30	4.30	4.20	4.10	4.00	3.80	3.70
NZD/USD	0.63	0.64	0.65	0.66	0.67	0.68	0.68
NZD/AUD	0.93	0.93	0.93	0.92	0.91	0.90	0.89
NZD/JPY	86.9	87.0	87.1	87.1	87.1	86.4	85.1
NZD/EUR	0.61	0.61	0.61	0.61	0.60	0.60	0.60
NZD/GBP	0.53	0.53	0.53	0.54	0.54	0.54	0.54
TWI	73.5	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 28 November 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	3.50%	3.50%
30 Days	4.32%	4.02%	3.79%
60 Days	4.36%	4.08%	3.95%
90 Days	4.40%	4.15%	4.10%
2 Year Swap	5.23%	4.95%	5.02%
5 Year Swap	4.62%	4.62%	4.70%

NZ foreign currency mid-rates as at 28 November 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6220	0.6071	0.5802
NZD/EUR	0.5990	0.5898	0.5842
NZD/GBP	0.5150	0.5162	0.5027
NZD/JPY	86.60	85.34	86.24
NZD/AUD	0.9261	0.9099	0.9074
TWI	72.62	70.82	69.81

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
NZ	Oct employment indicators	0.4%	–	–0.3%	Easing after some solid gains in recent months.
Aus	RBA Governor Lowe	–	–	–	Appearing before Senate Economics Committee.
	Oct retail sales	0.6%	0.5%	0.2%	Rate rises starting to impact?
UK	Nov Nationwide house prices	–0.9%	–	–	Due this week. Housing market correction clearly deepening.
US	Nov Dallas Fed index	–19.4	–23.0	–	Regional surveys broadly showing weakness.
	Fedspeak	–	–	–	Williams and Bullard.
Tue 29					
Eur	Nov economic confidence	92.5	–	–	Broader economic sentiment continues to deteriorate...
	Nov consumer confidence	–23.9	–	–	... though consumer confidence is consolidating at low levels.
US	Sep FHFA house prices	–0.7%	–1.2%	–	Correction deepening amid broad-based price declines...
	Sep S&P/CS home price index	–1.32%	–1.15%	–	... cumulative rate hikes to date will continue to impact.
	Nov consumer confidence index	102.5	100.0	–	Inflation and rates are weighing heavily on households.
Wed 30					
NZ	Oct building permits	3.8%	–	–5.0%	Pullback in medium density consents after last month's surge.
	Nov ANZ business confidence	–42.7	–	–	Activity gauges to remain low, price gauges elevated.
Aus	Oct dwelling approvals	–5.8%	–2.0%	–5.0%	Surprisingly steady through Q3 but set to fall.
	Oct CPI Monthly Indicator %yr	7.3%	7.6%	7.3%	The Monthly Indicator is a reliable leading indicator for...
	Oct CPI MI trimmed mean %yr	5.4%	–	–	... the quarterly CPI. It is yet to show signs of peaking.
	Q3 construction work done	–3.8%	2.0%	2.0%	Only a partial rebound, constrained by ongoing headwinds.
	Oct private sector credit	0.7%	0.6%	0.6%	Emerging gradual slowing as higher interest rates impact.
	RBA Head of Domestic Markets	–	–	–	Kearns speaking at Securitisation conference.
Chn	Nov manufacturing PMI	49.2	49.0	–	Policy initiatives will support mfg and services in time...
	Nov non-manufacturing PMI	48.7	48.0	–	... but virus and global demand risks loom for now.
Eur	Nov CPI %yr	10.7%	–	–	Breadth of inflation pulse of increased concern.
US	Oct wholesale inventories	0.6%	0.5%	–	Unwarranted inventory accrual a risk given end demand.
	Q3 GDP, annualised	2.6%	2.7%	–	Very small revision anticipated in second estimate for Q3.
	Nov Chicago PMI	45.2	47.0	–	Pointing to clear downside risk for business conditions.
	Oct pending home sales	–10.2%	–5.2%	–	Weakness in sales volumes set to persist.
	Oct JOLTS job openings	10717k	10325k	–	Gradually falling from historic peak.
	Federal Reserve Beige book	–	–	–	To provide an update on conditions across the 12 Fed districts.
	Fedspeak	–	–	–	Chair Powell on economy and labour market. Bowman, Cook.
Thu 01					
Aus	Nov CoreLogic home value index	–1.1%	–	–1.0%	Price declines still look firmly entrenched.
	Q3 private new capital expenditure	–0.3%	1.4%	1.6%	Upward trend in equipment, partial rebound in B&S.
Chn	Nov Caixin manufacturing PMI	49.2	48.9	–	Under pressure from virus risks and weakening global demand.
Eur	Nov S&P Global manufacturing PMI	47.3	–	–	Final estimate.
	Oct unemployment rate	6.6%	–	–	Slack will begin to emerge more clearly in 2023.
UK	Nov S&P Global manufacturing PMI	46.2	–	–	Final estimate.
US	Oct personal income	0.4%	0.4%	–	Real incomes remain under pressure from inflation...
	Oct personal spending	0.6%	0.8%	–	... putting consumption at risk of weakness.
	Oct PCE deflator	0.3%	0.4%	–	FOMC is paying close attention to core PCE inflation...
	Oct core PCE deflator	0.5%	0.3%	–	... as they plan to step down the pace of rate hikes.
	Nov S&P Global manufacturing PMI	47.6	–	–	Manufacturing activity clearly remains in a fragile state...
	Nov ISM manufacturing	50.2	49.8	–	... S&P indicating that small/mid-sized firms are under pressure.
	Oct construction spending	0.2%	–0.2%	–	Softening demand clearly weighing on construction.
	Initial jobless claims	240k	–	–	To remain at relatively low levels for now.
	Fedspeak	–	–	–	Logan and Bowman.
Fri 02					
NZ	Q3 terms of trade	–2.4%	–	0.5%	Improved export prices balanced out the rising import bill.
Aus	Oct housing finance	–8.2%	–2.1%	–3.5%	Stabilising turnover suggests a slower pace of decline...
	Oct owner occupier finance	–9.3%	–	–4.5%	... for finance associated with purchase of established...
	Oct investor finance	–6.0%	–	–2.0%	... dwellings but construction-related looks to be down sharply.
	RBA Governor Lowe	–	–	–	Panel participant at Bank of Thailand conference.
US	Nov non-farm payrolls	261k	200k	180k	Payrolls increasingly at odds with other indicators...
	Nov unemployment rate	3.7%	3.7%	3.8%	... but U/E likely to remain little changed in near-term...
	Nov average hourly earnings %mth	0.4%	0.3%	0.3%	... supporting robust wage growth, for now.
	Fedspeak	–	–	–	Barr and Evans.

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	3.10	3.55	3.97	4.05	4.05	3.97	3.72	3.47
10 Year Bond	3.54	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	3.69	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	0.6767	0.68	0.69	0.70	0.72	0.74	0.75	0.76
USD/JPY	138.68	140	138	136	134	132	130	128
EUR/USD	1.0412	1.04	1.05	1.07	1.09	1.11	1.12	1.13
GBP/USD	1.2103	1.20	1.21	1.22	1.23	1.24	1.25	1.26
USD/CNY	7.1628	7.20	7.00	6.80	6.60	6.50	6.40	6.30
AUD/NZD	1.0810	1.08	1.08	1.08	1.09	1.10	1.11	1.13

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