WESTPAC WEEKLY ECONOMIC COMMENTARY

Weathering the storm.

6 March 2023

Southern rātā

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Our latest Economic Overview details the storm that's brewing for the New Zealand economy in the year ahead, as households absorb a significant rise in mortgage rates. We now expect the economy to slip into a moderate recession from late-2023 through to mid-2024.

Despite rising interest rates and a weaker housing market, household spending has actually remained firm in recent months. That's in part due to the strong growth in incomes, with average hourly earnings rising by 7.2% over the past year. Savings levels have also increased since the start of the pandemic, which has provided many households with a buffer from some of the other headwinds they are now facing.

Most mortgage lending in New Zealand is on fixed rates, typically for terms of one to two years. That's shielded many homeowners from the tightening of monetary policy so far. Indeed, while the Official Cash Rate has been rising since October 2021, we estimate that the effective average mortgage rate paid by borrowers didn't bottom out until mid-2022, at around 3.2%.

That average rate has since risen to around 3.8% today, as some mortgages have come up for refixing at higher interest rates than before. Over the coming year, the effective mortgage rate is set to rise sharply as increasing numbers of borrowers roll off earlier low interest rates and refix at the higher rates now on offer. We estimate that the effective average mortgage rate will have risen to 5.3% by the end of this year.

This rapid rise in debt servicing costs will take a big bite out of many households' disposable incomes. Household spending accounts for around 60% of total economic activity, and the expected weakening in demand will drive a broader slowdown in economic growth over the coming years.

We now expect GDP growth to slow sharply this year, with the economy contracting by 1% from late 2023 through to mid-2024. This would be a moderately-sized recession by the standards of history: much less severe than the 2008-09 recession during the Global Financial Crisis, but comparable to the one in 1997-98 during the Asian Financial Crisis. Both of these recessions were also preceded by a rapid tightening of monetary policy in New Zealand.

While consumer spending is likely to bear the brunt of the downturn, there are some forces that will help to soften the economic blow. The first is the rebound in international travel now that New Zealand has reopened its border. Overseas visitor numbers have already retraced around two-thirds of their pre-pandemic levels, contributing much of the 4% surge in GDP growth over the June and September quarters last year.

The second factor is the unexpectedly abrupt end to China's Covid-zero policies. For much of last year, tight Covid restrictions crimped consumer demand for many of our exports as households were confined to their homes for long periods of time. As people take advantage of their new-found freedoms, we expect consumer demand to lift and for our export prices to follow.

The devastation caused by Cyclone Gabrielle has complicated the outlook for the economy in the years ahead. In the near term there's likely to be a hit to activity, with people displaced from their homes and businesses forced to shut down. As we saw with the Canterbury earthquakes in 2010-11, cleaning up and repairs will also boost measured activity in the short term. However, a key point of difference is that the earthquakes did not substantially affect our exporting capacity, whereas the cyclone has led to a significant loss of agricultural output that won't be recovered.

We're also likely to see some upward pressure on prices this year, particularly for food prices where crops were wiped out. Some of those price rises may prove to be temporary, but they will mean an even longer wait until the rate of inflation comes back down to a more acceptable level.

Looking further ahead, repairs and reconstruction will add to activity and create a draw on the nation's resources over several years. At this stage there's a great deal of uncertainty around the magnitude of this job, though it's likely to be in the several billions of dollars. There are also some big decisions still to be made about what will be rebuilt and how.

At the margin, the rebuild could mean more inflation pressure and higher interest rates than otherwise. Yet we should be careful about making too much of this. Right from the start, the Canterbury earthquakes were recognised as something that would stretch the economy's capacity, potentially requiring tighter monetary policy. And indeed, while there was a significant amount of pressure on construction costs, overall inflation remained stubbornly on the low side of the Reserve Bank's target range throughout the rebuild period. The lesson from the Canterbury rebuild is that while an event like this might mean higher interest rates than otherwise, the "otherwise" is far more important and far more uncertain.

Of course, today's conditions are quite different from 2011 – we're starting out with an economy that is already overheated. But if the economy slips into recession as we expect, it will be running substantially below full capacity by the time the cyclone rebuild is in full swing. Hence, our view remains that inflation is on track to return to target over the medium term. And given the inherent lags in monetary policy, the RBNZ will need to be nimble in determining when to take its foot off the brake.

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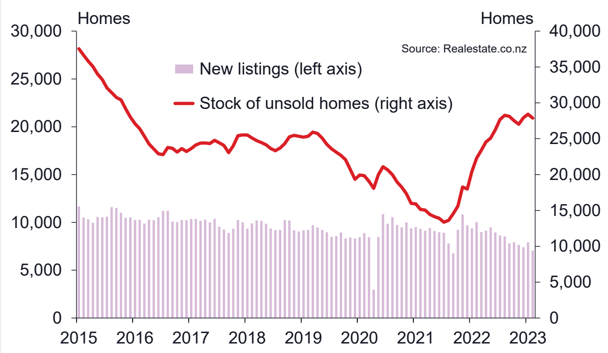
Chart of the week

New Zealand's real estate market remains in hibernation. The latest figures from realestate.co.nz show that the number of homes on the market has risen substantially since late 2021. That rise hasn't been due to a flood of listings hitting the market, but rather a sharp drop-off in sales as rising mortgage rates have sapped buyers' interest. New listings have actually slowed in this time – just not as much as sales – as more owners have chosen not to sell into a falling market.

Real estate listings, seasonally adjusted

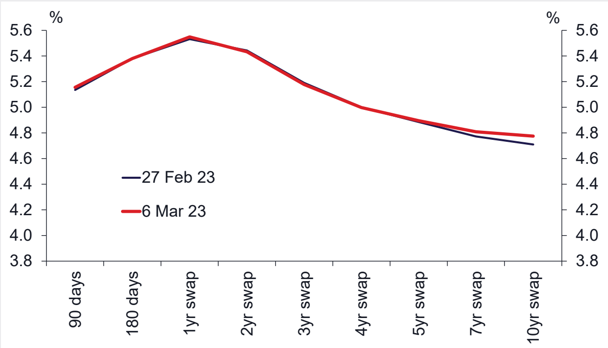


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.50% in the first half of this 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 still 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 building work put in place

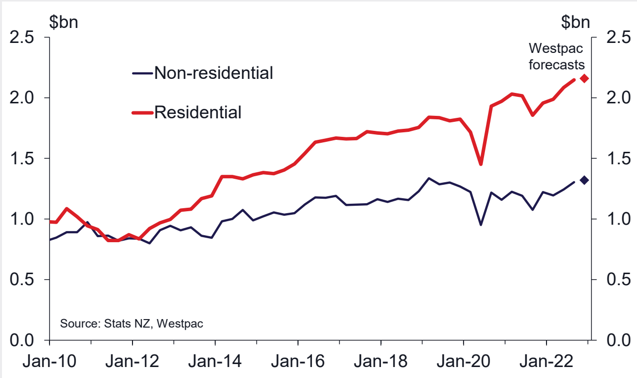
Mar 6, Last: +3.8%, Westpac: +1.0%

Construction activity has been running hot, with the amount of building work put in place rising by 3.8% in the September quarter. Strength in activity has been widespread across regions, with building levels particularly strong in Auckland and Wellington.

We're forecasting a further 1.0% rise in construction activity in the December quarter with gains in both residential and non-residential activity.

We expect that construction activity will remain elevated in the near term, with a large number of projects already in the works. However, with increasingly tough financial conditions, we expect that construction activity will trend down over the coming years as the current backlog of projects is cleared.

NZ real building work put in place



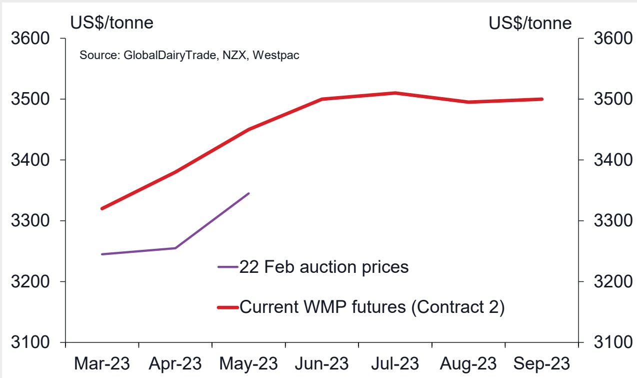
NZ GlobalDairyTrade auction, whole milk powder prices

Mar 8, Last: -2.0%, Westpac: +1.0%

We expect whole milk powder prices (WMP) to post a small 1% rise at the upcoming auction. Our pick is marginally lower than the circa 2% rise that the futures market is priced for.

Over the first half of this year, we expect that rebounding Chinese dairy demand and disruptions to New Zealand supply following recent storms will lead global dairy prices higher.

Whole milk powder prices



NZ Feb retail card spending

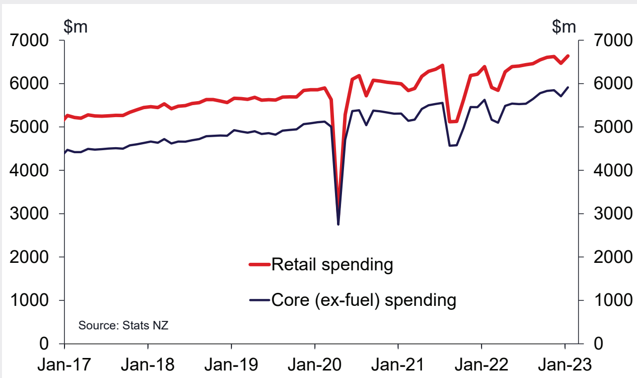
Mar 9, Last: +2.6%

Household spending appetites have been resilient in the face of growing financial pressures. Retail spending rebounded in January, rising by 2.6%. That followed softer-than-usual spending in December and took spending back to the firm levels we had seen in previous months.

Cyclone Gabrielle struck in mid-February, resulting in significant disruptions to household and business activity through large parts of the North Island. That was compounded by the damage to transport and communications networks. Notably, the damage to communications networks also resulted in widespread disruptions to payment networks.

It's hard to pin down exactly how large the resulting disruptions will be. However, we are likely to see a sharp fall in retail spending in February with a bounce back in March.

NZ retail card spending



The week ahead

Aus Jan trade balance, AUDbn

Mar 7, Last: 12.2, WBC f/c: 12.5
Mkt f/c: 12.25, Range: 11.5 to 13.0

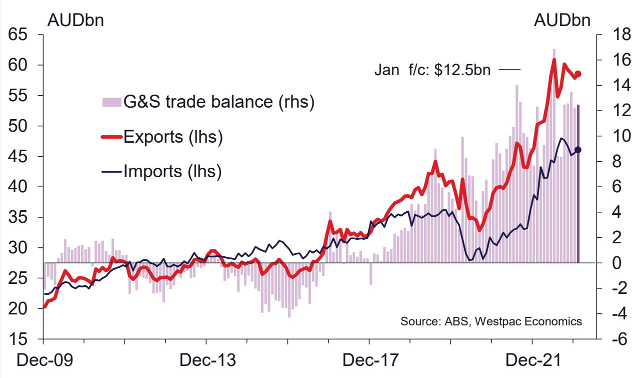
Australia's trade account will begin the 2023 year with another sizeable surplus as global commodity prices remain elevated, albeit down from the peaks of mid-2022.

The surplus printed $12.2bn for December and averaged $11.3bn over the 18 months from July 2021 (prior to 2021, the largest surplus was $9.9bn). For January, we anticipate a surplus of $12.5bn.

Export earnings are forecast to rise by 1.2%, +$0.7bn, supported by a rise in commodity prices and the ongoing recovery in service exports post the national border reopening. Goods volumes were likely mixed (LNG up and gold possibly higher on Lunar New Year but LNG shipments lower and coal down on renewed disruptions).

Imports are forecast to rise by around 1%, +$0.4bn. Service imports likely posted another strong rise, as more of us holiday abroad, and goods volumes are trending higher. However, the AUD moved higher, placing downward pressure on prices.

Aus trade balance



Aus RBA policy decision

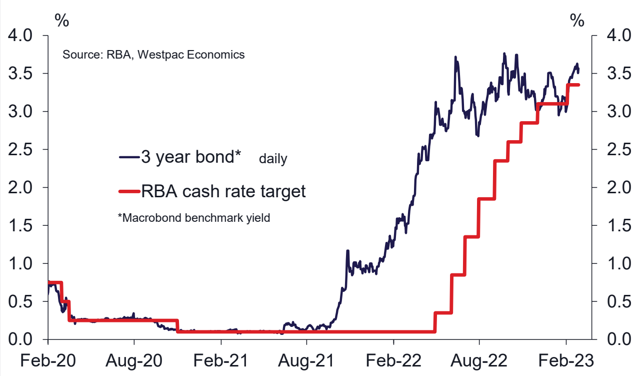
Mar 7, Last: 3.35%, WBC f/c: 3.60%
Mkt f/c: 3.60%, Range: 3.60% to 3.60%

At the March Board meeting, Westpac anticipates that the RBA will lift the cash rate by 25bps, to 3.60%. The RBA, in responding to a significant inflation challenge and a tight labour market, has quickly raised interest rates.

Rates have lifted from a record low of 0.1% in May 2022, with moves at each monthly Board meeting, including 50bp hikes for the four meetings from July to September. The RBA slowed the pace of tightening in October, back to 25bp increments, with policy moving into the contractionary zone.

This week, the Q4 GDP report revealed a weak consumer, impacted by the rising cost of living and elevated interest costs despite strong nominal wage gains and a further reduction in the savings rate. The Board will be mindful of these signals but will remain focussed on its task of ensuring a return to the inflation target zone of 2-3%.

RBA cash rate and 3 year bonds



US Feb employment report

Mar 10: nonfarm payrolls, Last: 517k, Mkt f/c: 215k, WBC: 180k
Mar 10: U/e rate, Last: 3.4%, Mkt f/c: 3.4%, WBC: 3.4%

The strength of the January nonfarm payrolls report shocked markets. Even taking the average of the three months to January, the pace of job creation still stood at 3.5 times the 100k believed necessary to balance demand and supply.

Curiously though, average hourly earnings growth was benign at 0.3% and the unemployment rate just 0.1ppt lower.

It is impossible therefore to overstate the significance of the February report. The state of the economy and statistics argue for a snap back below 200k in the month and likely some downward revisions to the prior two periods. A stronger outcome is likely to unnerve the market and result in interest rate expectations rising to new highs.

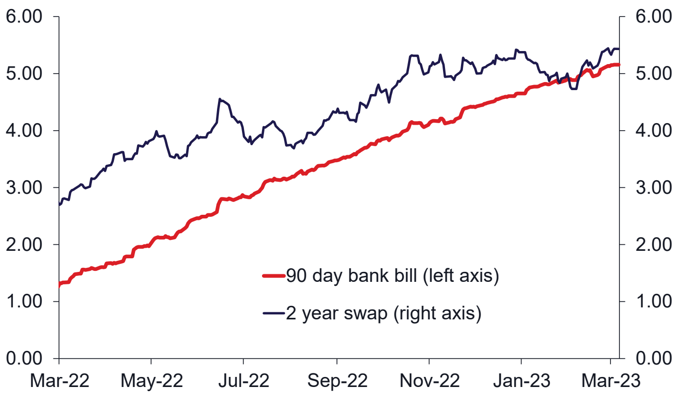
US employment

New Zealand forecasts

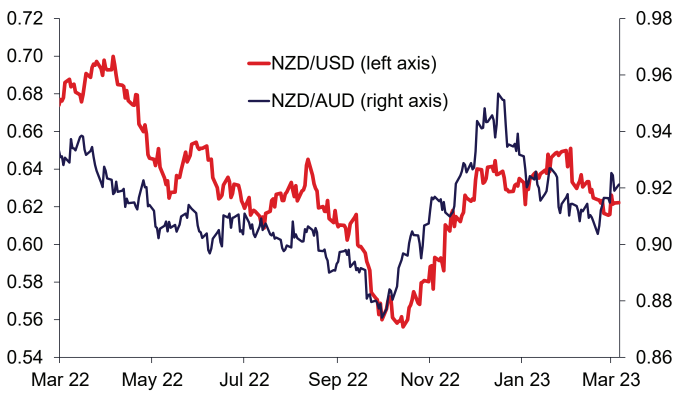
Economic forecasts	Quarterly				Annual			
	2022		2023					
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	2.0	0.3	-0.2	0.2	6.1	2.8	1.7	-0.5
Employment	1.3	0.1	0.3	0.2	3.3	1.3	0.5	-0.3
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	4.0	5.1
CPI	2.2	1.4	1.3	1.3	5.9	7.2	5.1	2.9
Current Account Balance % of GDP	-7.9	-7.6	-6.8	-6.5	-6.0	-7.6	-5.8	-4.5

Financial forecasts	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Cash	4.75	5.50	5.50	5.50	5.25	4.75	4.25
90 Day bill	5.40	5.60	5.60	5.50	5.05	4.55	4.05
2 Year Swap	5.30	5.10	4.80	4.40	4.10	3.80	3.60
5 Year Swap	4.80	4.60	4.40	4.20	4.00	3.80	3.70
10 Year Bond	4.60	4.50	4.20	4.00	3.85	3.70	3.60
NZD/USD	0.64	0.65	0.66	0.67	0.68	0.68	0.68
NZD/AUD	0.91	0.92	0.92	0.91	0.90	0.89	0.89
NZD/JPY	84.5	85.2	85.8	86.4	86.4	85.7	85.1
NZD/EUR	0.59	0.60	0.60	0.60	0.60	0.60	0.59
NZD/GBP	0.53	0.53	0.54	0.54	0.54	0.54	0.53
TWI	71.7	72.3	72.6	72.8	72.6	71.8	71.3

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 6 March 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.75%	4.25%	4.25%
30 Days	4.88%	4.71%	4.54%
60 Days	5.03%	4.86%	4.73%
90 Days	5.16%	4.98%	4.89%
2 Year Swap	5.43%	5.14%	4.73%
5 Year Swap	4.90%	4.56%	4.11%

NZ foreign currency mid-rates as at 6 March 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6222	0.6237	0.6297
NZD/EUR	0.5855	0.5836	0.5849
NZD/GBP	0.5168	0.5185	0.5235
NZD/JPY	84.58	83.64	83.26
NZD/AUD	0.9212	0.9037	0.9136
TWI	71.20	70.83	70.97

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 06					
NZ	Q4 building work put in place	3.8%	–	1.0%	Residential and commercial work continuing to rise.
	Feb ANZ commodity prices	–1.0%	–	1.0%	Meat prices lifted in Feb, dairy prices flat.
Aus	Feb MI inflation gauge %yr	6.4%	–	–	Provides a general view of risk.
Eur	Mar Sentix investor confidence	–8.0	–	–	Broader conditions supportive of sentiment...
	Jan retail sales	–2.7%	–	–	... but high inflation still impacting consumers.
US	Jan factory orders	1.8%	–1.5%	–	Investment outlook generally subdued.
Tue 07					
Aus	Jan trade balance $bn	12.2	12.25	12.5	Another sizeable surplus. Commodity prices higher.
	RBA policy decision	3.35%	3.60%	3.60%	Taming inflation remains the focus.
Chn	Feb foreign reserves $bn	3184	–	–	Little pressure on reserves.
US	Jan wholesale inventories	–0.4%	–	–	Final estimate.
	FOMC Chair Powell	–	–	–	Appearance before Senate Banking Panel.
Wed 08					
NZ	GlobalDairyTrade auction (WMP)	–2.0%	–	1.0%	Rebounding Chinese demand expected to support prices.
Aus	RBA Governor Lowe	–	–	–	Speaking at the AFR Business Summit, Sydney.
Eur	Q4 GDP	0.1%	0.1%	–	Final estimate.
US	Jan consumer credit $bn	11.6	22.5	–	Demand for credit likely to continue.
	Feb ADP employment change	106k	200k	–	Slowing in labour market momentum...
	Jan JOLTS job openings	11012k	–	–	... critical to the outlook for interest rates.
	Jan trade balance US$bn	–67.4	–69.0	–	Deficit should narrow as consumer demand weakens.
	FOMC Chair Powell	–	–	–	Appearance before House Financial Service Committee.
Thu 09					
NZ	Feb card spending	3.3%	–	–	Likely to be pulled down by February's cyclone.
Chn	Feb CPI %yr	2.1%	2.0%	–	Inflation to remain a benign force for consumers...
	Feb PPI %yr	–0.8%	–1.4%	–	... and likely also for most businesses.
	Feb M2 money supply %yr	12.6%	12.4%	–	Credit will remain freely available...
	Feb new loans, CNYbn	4900	1500	–	... as authorities support recovery.
US	Initial jobless claims	190k	–	–	To remain at a relatively low level for now.
	Fedspeak	–	–	–	Barr.
Fri 10					
NZ	Feb manufacturing PMI	50.8	–	–	Mounting financial headwinds weighing on activity.
UK	Jan trade balance £bn	–7150	–	–	Weak consumer should narrow deficit in 2023.
US	Feb non-farm payrolls	517k	215k	180k	Payrolls growth is set to snap back after Jan's burst...
	Feb unemployment rate	3.4%	3.4%	3.4%	... but remain above the 100k/mth 'neutral' pace...
	Feb average hourly earnings %mth	0.3%	0.3%	0.3%	... a stronger result will pose upside risk to rates outlook.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022f	2023f	2024f
Australia						
Real GDP %yr	1.9	-1.8	5.2	3.6	1.8	1.2
CPI inflation %yr	1.8	0.9	3.5	7.8	3.9	3.1
Unemployment rate %	5.2	6.8	4.7	3.5	4.6	5.1
Current account % of GDP	0.7	2.4	3.1	0.5	-1.0	-1.5
United States						
Real GDP %yr	2.3	-3.4	5.7	2.1	0.9	1.0
CPI inflation %yr	1.9	1.2	5.1	7.4	2.3	2.1
Unemployment rate %	3.7	8.1	5.4	3.7	4.8	5.5
Current account % of GDP	-2.6	-2.5	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	-0.4	-4.6	1.7	1.6	1.5	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.2	3.5	0.6	1.4
United Kingdom						
Real GDP %yr	1.7	-9.3	7.4	4.0	-0.5	1.5
China						
Real GDP %yr	6.0	2.2	8.4	3.0	6.2	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.2	4.6	4.2	4.3
World						
Real GDP %yr	2.8	-3.0	6.0	3.3	3.0	3.1

Forecasts finalised 14 February 2023

Interest rate forecasts	Latest	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia									
Cash	3.35	4.10	4.10	4.10	3.85	3.60	3.35	3.10	3.10
90 Day BBSW	3.63	4.30	4.30	4.22	3.97	3.72	3.47	3.22	3.22
10 Year Bond	3.89	3.75	3.45	3.25	3.00	2.80	2.70	2.50	2.50
International									
Fed Funds	4.625	5.375	5.375	5.375	4.875	4.375	3.875	3.375	3.375
US 10 Year Bond	4.05	3.80	3.50	3.30	3.10	2.90	2.80	2.60	2.60

Exchange rate forecasts	Latest	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6739	0.71	0.72	0.74	0.75	0.76	0.76	0.77	0.77
USD/JPY	136.70	131	130	129	128	127	126	125	125
EUR/USD	1.0605	1.09	1.10	1.11	1.12	1.13	1.14	1.15	1.15
GBP/USD	1.1964	1.22	1.23	1.24	1.25	1.26	1.27	1.28	1.28
USD/CNY	6.9073	6.70	6.60	6.50	6.40	6.30	6.20	6.10	6.10
AUD/NZD	1.0831	1.09	1.09	1.10	1.11	1.13	1.13	1.13	1.13

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