WESTPAC WEEKLY ECONOMIC COMMENTARY

Missing the trifecta.

8 May 2023

Southern rātā

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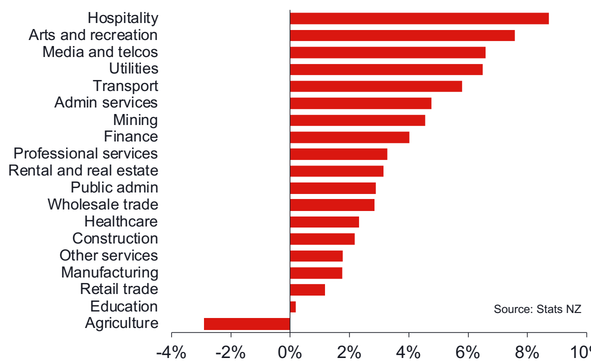
The monetary policy cycle in New Zealand is well advanced, and we are getting closer to a long-awaited turning point where the fruits of the RBNZ's efforts to restrain demand and inflation pressures should be becoming apparent. That's why last week's March quarter labour market report was closely watched by us and, we daresay, the RBNZ. The labour market has tended to give a clearer and timelier picture on the underlying state of the economy than GDP has in the post-Covid environment.

The labour market report didn't disappoint, highlighting that the economy is still running hot. The unemployment rate remained very low at 3.4%, in line with Westpac's forecasts. Employment growth was robust at 0.8% for the quarter – again close to our expectations. And labour market participation rose to a new high of 72%.

Both supply and demand factors contributed to the strong March quarter labour results and are important for assessing where the economy is heading. On the supply side, an historic surge in migration has driven strong growth in the supply of available workers, with an inflow of 52,000 new long-term migrants over the past year. That's driven a 0.5% increase in the working age population, adding critical supply to a labour starved economy.

On the demand side, businesses have long been crying out for staff. And now, with new workers flowing into the country, hiring has picked up. However, there are some big differences across sectors. While demand for labour is slackening in some more interest rate sensitive sectors such as construction, the tourism centric sectors gladly accepted the new supply of workers. On balance, this still leaves us with a picture of a highly stretched labour market.

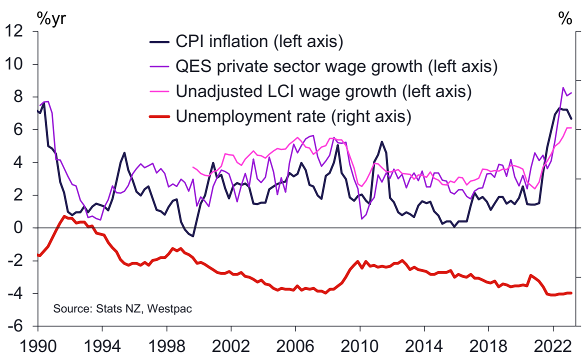
Filled jobs by sector, annual change



Putting this altogether, it seems unlikely that the fall in GDP seen in the December quarter marked an early start to recession. There are also scant signs that the labour market is turning down. Consequently, the RBNZ's forecast for a recession to begin as early as the June quarter this year is looking increasingly doubtful.

Wages are also continuing to rise rapidly, with average hourly earnings in the private sector up 8% over the past year. That continued firmness in wage growth, despite signs of cooling in some parts of the economy, isn't really a surprise – wage growth tends to lag changes in the labour market and economy more broadly, and we didn't expect that it would be slowing at this point. Even so, this is a key concern for the RBNZ who want to see a decline in underlying inflation pressures. But at the current time, with consumer prices rising rapidly and the labour market stretched tight, wage growth is set to remain elevated for some time yet. Inflation is at the centre of ongoing wage negotiations and probably will be for a while.

Labour market and inflation indicators



All this boils down to cementing in a 25bp hike in the OCR at the May policy meeting. The RBNZ foreshadowed such a move back in February and emphasised its likelihood in April when they delivered a larger than expected 50bp hike. There could even be some upside risks beyond then depending on how quickly things come off. The wild card is what migration does for activity and inflation pressures.

But let's not get too pessimistic. The RBNZ is now a fair way through the tightening cycle, and we are definitely seeing demand in some interest sensitive sectors starting to struggle. For instance, last week's building consents data look very consistent with the downturn in construction we have been expecting for a while.

We felt that the RBNZ needed three horses to come in over April and May to make the case to stop at 5.25%. Coming in first was the March quarter CPI which, while still strong, was much less worrying than the RBNZ had feared. Next, the Government has talked positively about delivering a "no-frills" budget, suggesting that fiscal policy might not be as much of a driver of demand pressures over the coming years. But while those first two horses made it to the finishing line, the firm labour market looks like it broke the RBNZ's trifecta. Consequently, that last 25 points is necessary insurance – and let's hope that will be it for a year or so.

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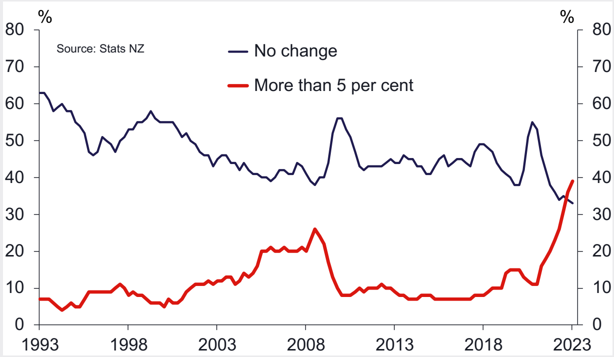
Chart of the week

With continued tightness in the labour market, wage increases have become increasingly widespread. Over the past year, two thirds of all wage and salary rates recorded a rise. And those wage increases haven't just been widespread – they've also been large. In the year to March, nearly 40% of all wage rates rose by more than 5%. Both the need to retain staff and adjustments for the increases in household living costs were major contributors to those increases.

Distribution of changes in pay rates

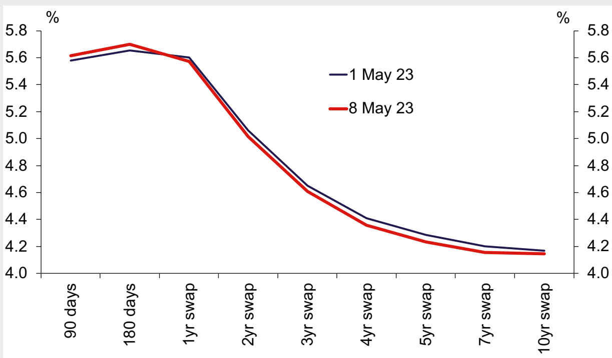


Fixed vs floating for mortgages

We expect the Official Cash Rate to reach a peak of 5.50% in May. As inflation pressures recede, we see scope for rate cuts in 2024 and 2025, although not as quickly as the market is pricing in.

As a result, we now see value in fixing for terms as long as three years. While there isn't a lot of difference between the expected cost of fixing for shorter vs longer periods, a longer period provides more certainty around the size of repayments. We would still regard fixing beyond three years as relatively expensive.

NZ interest rates



The week ahead

NZ Apr retail card spending

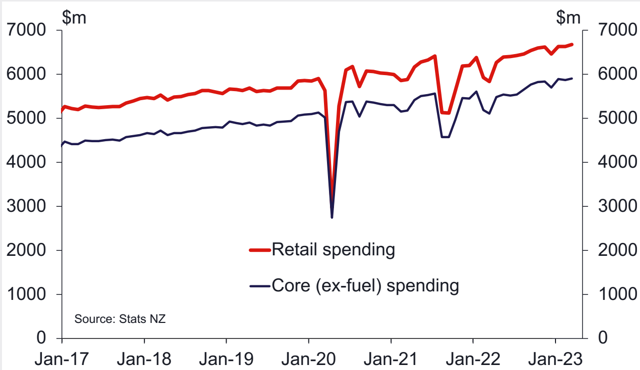
May 9, Last: +0.7%, Westpac f/c: +0.5%

Recent months have seen a rotation in spending appetites. Following strong gains over the past year, spending on durable items and apparel has been flattening off. That's been balanced against increased spending in areas like hospitality. That latter trend reflects both a switch in New Zealanders' spending preferences, as well as the rise in international visitor numbers.

We're forecasting a modest 0.5% rise in retail spending in April. Underlying that, we're expecting to see further softness in durables spending but ongoing gains in the hospitality sector.

Much of the forecast rise in spending is related to continued increases in output prices, which are eroding households' spending power.

NZ retail card spending



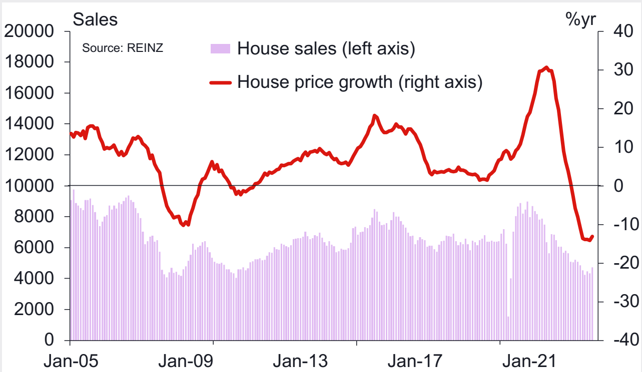
NZ Apr REINZ house sales and prices

May 11 (tbc), Sales last: +9% m/m, -15% y/y
Prices last: 0% m/m, -13.1% y/y

The New Zealand housing market has remained soft in the early part of this year, although there are some signs that the downturn is nearing its end. Sales have picked up from their rock-bottom lows, the supply of homes on the market is easing, and the rate of decline in prices appears to be slowing, although it has been choppy from month to month.

With monetary policy now approaching the end of the tightening cycle, fixed-term mortgage rates are likely at or near their peaks, and have even fallen for some longer terms. We think that house prices still have a little further to go to adjust to the higher level of interest rates, but the 17% fall that we've seen to date is broadly in line with the correction that we've been forecasting for the past two years.

REINZ house prices and sales



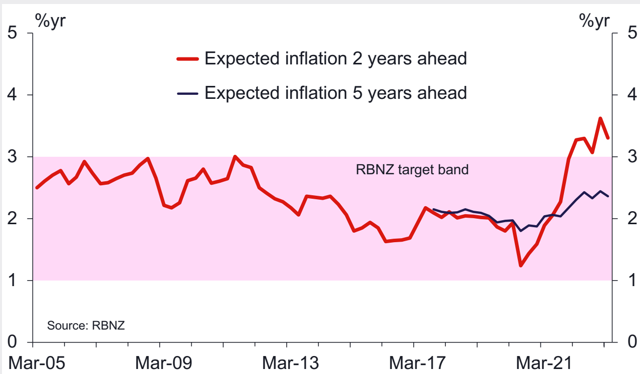
NZ Q2 RBNZ Survey of Expectations

May 12, Two-year ahead inflation expectations Last: 3.30%

The RBNZ's latest Survey of Expectations signalled that although expectations for inflation remain elevated, they are not continuing to creep higher. The closely watched two-year ahead measure took a step down, falling from 3.6% to 3.3%. Similarly, expectations for inflation 5 years ahead pushed down slightly.

The latest survey comes in the wake of the softer-than-expected March quarter inflation result and mounting signs that the economy is losing steam. Against this backdrop, expectations for inflation are likely to have softened further. However, the extent of any decline is likely to be modest. While cost pressures have softened, they remain strong. Furthermore, the labour market remains highly stretched, with wage costs continuing to rise at a brisk pace.

RBNZ survey of expectations



The week ahead

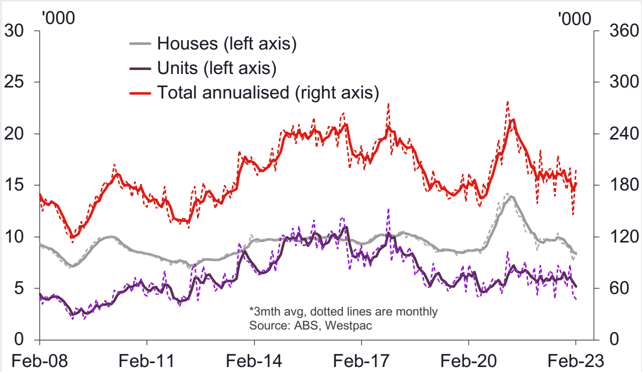
Aus Mar dwelling approvals

May 8, Last: 4.0%, Westpac f/c: 1.0%, Market f/c: 3.0%

Feb saw a 4% lift in dwelling approvals, but coming off a sharp decline in the previous month and a surge in December. Looking through the choppy monthly profile, year-on-year figures still show a clear slowdown with approvals down over 30%yr. Some of the volatility may be due to processing delays due to workforce disruptions from unusually high rates of leave early in the year.

HIA new home sales continued to weaken in March, suggesting the underlying downtrend in non-high rise approvals remains intact. However high rise approvals are coming off an extreme low in Feb and are very likely to post a sizeable bounce. On balance we expect this to see another small net gain in total approvals, up 1% in the March month but with large risks either side.

Aus dwelling approvals



Aus Q1 real retail sales

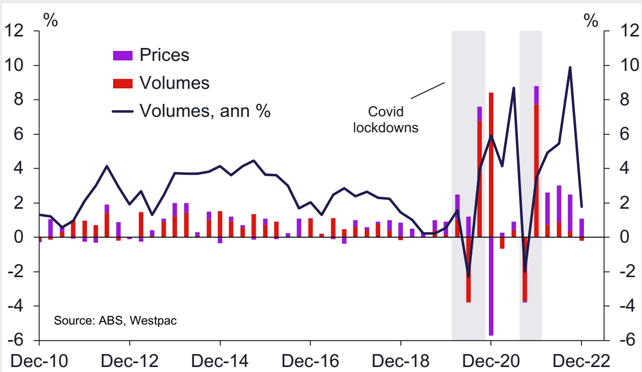
May 9, Last: –0.2%, Westpac f/c: –1.0%, Market f/c: –0.5%

Real retail sales declined 0.2% in Q4, with a nominal gain of 0.9% more than offset by a 1.1% rise in retail prices.

Preliminary estimates show nominal sales stalled flat in Q1. Meanwhile the CPI detail suggests retail prices continued to rise, up about 1% overall with basic food prices up 1.6%qtr.

That in turn points to a sizeable 1%qtr contraction in real retail sales, which would mark the largest quarterly decline in volumes since the 1990 recession, outside of the temporary disruptions seen during Covid and the GST introduction.

Aus quarterly retail volumes and prices



Aus Federal Budget

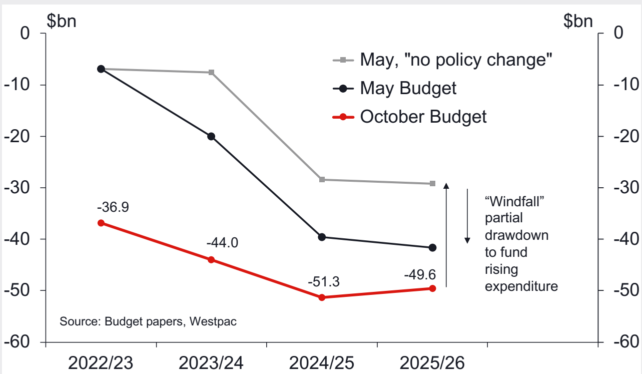
May 9

The 2023 Budget is set against the backdrop of high inflation and sharply higher interest rates, which is placing considerable pressure on household incomes. The Budget will attempt to deliver some relief for the most vulnerable households, balanced against the need for restraint in terms of the impact of fiscal policy on the economy.

The Federal budget profile has improved relative to that in the October Budget – with national income stronger than official forecasts and given ongoing labour market strength.

On our figuring, the budget deficit for the four years to 2025/26 has improved by $110bn due to the stronger economy. Some of this will be deployed to meet the cost of net new spending, as well as the escalating cost of existing programs – the scale and dimensions of these forces is unclear. We speculate that together they may reach $36bn.

Aus Budget deficit profile

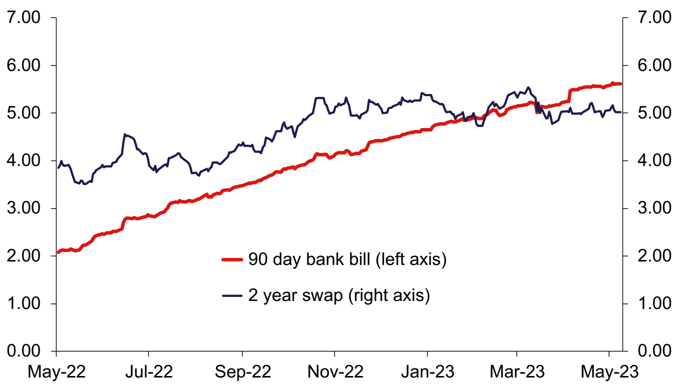


New Zealand forecasts

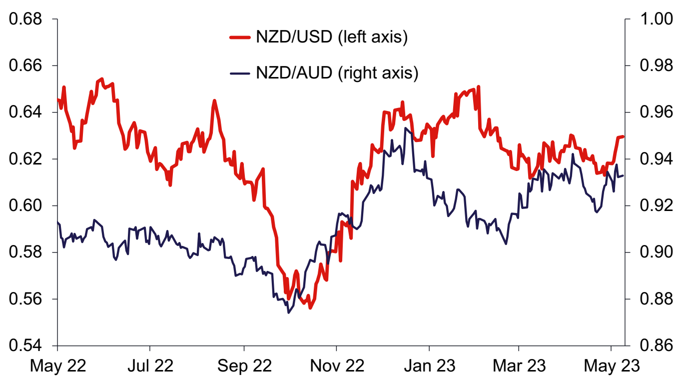
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.6	0.2	0.2	0.2	6.0	2.4	1.1	-0.5
Employment	0.5	0.8	0.3	0.0	3.3	1.3	1.0	-0.3
Unemployment Rate % s.a.	3.4	3.4	3.5	3.7	3.2	3.4	4.0	5.1
CPI	1.4	1.2	1.0	1.7	5.9	7.2	4.5	2.7
Current Account Balance % of GDP	-8.9	-8.5	-8.1	-7.6	-6.0	-8.9	-6.7	-4.5

Financial forecasts	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Cash	5.50	5.50	5.50	5.50	5.25	4.75	4.25
90 Day bill	5.60	5.60	5.60	5.50	5.05	4.55	4.25
2 Year Swap	5.10	4.80	4.50	4.20	3.90	3.70	3.50
5 Year Swap	4.40	4.25	4.10	4.00	3.90	3.80	3.70
10 Year Bond	4.20	4.10	4.00	3.85	3.70	3.60	3.50
NZD/USD	0.64	0.66	0.67	0.68	0.68	0.68	0.68
NZD/AUD	0.93	0.92	0.91	0.90	0.89	0.89	0.88
NZD/JPY	84.5	85.8	85.8	85.7	85.1	84.4	84.3
NZD/EUR	0.58	0.59	0.60	0.60	0.59	0.59	0.59
NZD/GBP	0.51	0.53	0.53	0.54	0.53	0.53	0.53
TWI	71.5	72.5	72.7	72.5	71.7	71.2	71.0

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 8 May 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.25%	5.25%	5.25%
30 Days	5.49%	5.37%	5.33%
60 Days	5.55%	5.47%	5.41%
90 Days	5.62%	5.56%	5.49%
2 Year Swap	5.02%	5.04%	4.98%
5 Year Swap	4.24%	4.33%	4.24%

NZ foreign currency mid-rates as at 8 May 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6296	0.6143	0.6244
NZD/EUR	0.5706	0.5576	0.5725
NZD/GBP	0.4986	0.4935	0.5024
NZD/JPY	84.89	82.67	82.61
NZD/AUD	0.9330	0.9196	0.9362
TWI	71.53	70.02	70.96

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 08					
Aus	Mar dwelling approvals	4.0%	3.0%	1.0%	Volatility clouding underlying downtrend.
	Apr NAB business survey	16	–	–	Conditions trend moderation. Confidence fragile.
Eur	May Sentix investor confidence	–8.7	–	–	Up–trend limited by lingering uncertainties.
Tue 09					
NZ	Apr retail card spending	0.7%	–	0.5%	Continued rotation towards hospitality spending.
Aus	Q1 real retail sales	–0.2%	–0.5%	–1.0%	Shaping up as a big quarterly decline.
	Federal Budget	–	–	–	Improved budget position, but challenges remain, see textbox.
Jpn	Mar household spending	1.6%	0.9%	–	Likely to remain subdued over 2023.
Chn	Apr trade balance US$bn	88.2	74.3	–	Intra–regional trade supportive to longer–term outlook.
	M2 money supply %yr	12.7%	12.5%	–	Credit will remain freely available...
	Apr new loans, CNYbn	3890	1375	–	...as authorities support growth.
US	Apr NFIB small business optimism	90.1	89.7	–	Emerging evidence of post–SVB credit tightening.
	Fedspeak	–	–	–	Jefferson, Williams.
Wed 10					
US	Apr CPI	0.1%	0.4%	0.3%	Shelter and discretionary services critical.
	Apr monthly budget statement	–378.1	–	–	Budget figures in focus as debt ceiling looms.
Thu 11					
NZ	Apr food price index	0.8%	–	0.5%	Prices firm, boosted by minimum wage increase.
	Apr REINZ house sales %yr	–15.0%	–	–	Date TBC. Sales are tentatively picking up...
	Apr REINZ house prices %yr	–13.1%	–	–	...suggesting that prices may be nearing their trough.
Aus	May MI inflation expectations	4.6%	–	–	Expectations are easing from an elevated level.
Jpn	Mar current account balance ¥bn	2197	2865	–	Weaker ¥ and narrowing trade deficit to support.
Chn	Apr CPI %yr	0.7%	0.3%	–	Inflation to remain a benign force...
	Apr PPI %yr	–2.5%	–3.2%	–	...for consumers and most businesses.
UK	Q1 GDP	0.1%	–	–	2023 growth outlook weak.
	BoE policy decision	4.25%	4.50%	4.50%	One final 25bp rate hike to ensure inflation's downtrend.
	Mar trade balance £bn	–4805	–	–	Weak consumer should narrow deficit over this year.
US	US Initial jobless claims	242k	–	–	Likely to remain at a low level versus history.
	Apr PPI	–0.5%	0.3%	–	Decelerating quickly from a historic peak.
	Fedspeak	–	–	–	Waller.
Fri 12					
NZ	Apr manufacturing PMI	48.1	–	–	Conditions set to remain weak.
	Mar net migration	11655	–	–	Foreign arrivals have surged since border re–opening.
	Q2 RBNZ inflation expectations	3.3%	–	–	Likely to soften, but only modestly.
Chn	Q1 current account balance USDbn	103.1	–	–	Surplus near historic highs prior to COVID–zero reopening.
US	Apr import price index	–0.6%	0.3%	–	Falling energy costs driving a sharp deceleration.
	May Uni. of Michigan sentiment	63.5	63.0	–	Forward looking gauges providing downbeat view on outlook.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	2023f	2024f
Australia						
Real GDP %yr	1.9	-1.8	5.2	3.7	1.6	1.0
CPI inflation %yr	1.8	0.9	3.5	7.8	4.0	3.1
Unemployment rate %	5.2	6.8	4.7	3.5	4.5	5.0
Current account % of GDP	0.7	2.4	3.1	1.2	1.2	0.3
United States						
Real GDP %yr	2.3	-2.8	5.9	2.1	1.1	0.6
CPI inflation %yr	1.9	1.2	7.2	6.4	2.5	2.0
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	-4.3	2.1	1.0	1.2	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.4
United Kingdom						
Real GDP %yr	1.6	-11.0	7.6	4.3	-0.2	1.2
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	4.3	4.5	4.1	4.4
World						
Real GDP %yr	2.8	-2.8	6.3	3.3	3.0	3.1

Forecasts finalised 5 May 2023

Interest rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia								
Cash	3.85	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.87	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.32	3.40	3.30	3.20	3.00	2.80	2.70	2.50
International								
Fed Funds	5.125	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.44	3.50	3.40	3.30	3.10	2.90	2.80	2.60

Exchange rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6748	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	134.83	132	130	128	127	126	125	124
EUR/USD	101.34	1.11	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2627	1.25	1.25	1.26	1.26	1.27	1.28	1.29
USD/CNY	6.9094	6.75	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0718	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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