

WESTPAC WEEKLY ECONOMIC COMMENTARY

Cyclone Gabrielle buffets the north.

13 February 2023



Southern rātā

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As the week begins, New Zealand is grappling with another severe weather event. The effects of cyclone Gabrielle have been especially heavy in the upper North Island, where many families and businesses are still dealing with the effects of January's floods.

With the cyclone still making its way across the country, it's too early to put a price tag on the cost of these events. However, the combined impact of the floods and cyclone have already resulted in significant damage to housing and other assets, and have caused disruptions to economic activity. The cost of January's floods was already estimated to be upwards of \$500 mil.

While the next few days will see disruptions to economic activity, over the coming months there will be increases in spending associated with the replacement of damaged items and repairs to property. With the construction sector already stretched, those repairs could take an extended period to complete. Some existing planned work could be delayed to make way for essential repairs.

There will be some cost increases in the wake of these events, with most of that related to construction. The RBNZ is able to look through temporary price rises associated with events like floods or storms. However, it's harder for them to do that in the event of a protracted boost to prices. At the current time, with inflation already running red hot, we expect another large 50bp hike from the RBNZ next week.

Open for business.

China is back open for business. And this is a welcome development for New Zealand Inc. Similarly, the reopening of our border last year and the subsequent rebound in the tourism industry continues to provide a significant boost to our economy. Together these developments will help offset some (but not all) of the weakness in the domestic economy that we expect to see later this year.

China is the key market for our main exports, and we expect the Chinese economy's growth to double to 6% over calendar 2023 (from around 3% growth over 2022). In turn, we expect that to lift demand for our food exports and similarly to take our food export prices higher.

Last week, we had the first sign that this dynamic is starting to play out. Global dairy prices posted a solid lift at last week's auction, with overall prices lifting 3.2%. Before the auction, global dairy prices had been on a steady downward path, dropping by around a third from the peak back in March 2022. Within the overall price lift, milk fat prices led the way, with butter prices jumping by 6.6%. This jump is the clearest

evidence that the price rebound stems from the lifting of China's Covid Zero policy. Indeed, Chinese consumers are now largely free to move about and return to restaurants, cafes and bakeries. And those are just the places that use large amounts of butter.

In contrast, the price signals in New Zealand's meat markets are less clear. Farmgate prices have bottomed rather than lifted so far this year, albeit that is somewhat against the normal seasonal trend where prices would normally fall through the summer and autumn.

That said, there is some hint that a broader upward move in prices is underway. Lamb flap prices, a product popular in China, have lifted over recent weeks. We expect mutton and lamb prices to soon start ticking higher over coming months too. Similarly, beef prices are likely to strengthen as Chinese demand lifts as well as on the back of a tightening in beef supply.

New Zealand's tourism sector is also making the most of being back open for business. We estimate that tourist numbers are back at around two-thirds of the pre-Covid level. Notably, it's tourists from markets like the US that have exceeded our expectations. In fact, the number of US tourist arrivals have effectively doubled each month from September through to November, noting that the spring months precede the normal summer surge. We expect this rebound to continue, with Delta Airlines recently announcing the opening of a new Los Angeles-Auckland route later this year.

Tourism operators will now also be able to welcome Chinese visitors back into the mix. Pre-Covid, China was New Zealand's second-largest tourist market. And based on the patterns of recovery in other markets, we expect a swift recovery in Chinese tourist arrivals over the course of this year. Interestingly, Chinese airlines kept their fleets flying during the pandemic, meaning there are few barriers at the Chinese end to tourists returning to our shores.

Finally, the education sector is also set to rebound much sooner than expected. The Chinese government has mandated that students must study in-person (as opposed to online) for their overseas qualifications to be recognised. This requirement, as well as university and polytech semesters getting under way soon means that Chinese students are likely to arrive en masse over the year, if not the next month or so. Export education was a significant earner for New Zealand pre-Covid, accounting for around 5% of New Zealand's total goods and services export values back in 2019.

All up, this paints a relatively positive picture for New Zealand's trade sector and puts it in stark contrast with the likely weakening in the domestic economy over the year. Recall that we anticipate that as interest rates increasingly bite on households and their spending, the economy will dip into recession in the second half of 2023 and early 2024. However, we do foresee a relatively shallow recession, with the strength in the New Zealand trade sector partially offsetting weakness elsewhere in the economy.

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Chart of the week

The Government has announced that the minimum wage will rise by \$1.50 to \$22.70 from 1 April 2023. That's a large rise of 7% and follows similarly large increases in recent years. However, after we account for the rapid increases in consumer prices in recent years, the 'real' purchasing power of the minimum wage has remained effectively unchanged since mid-2021. While a higher minimum wage will add to some businesses' costs of production, that's definitely not the only reason why wage bills have been rising. With strong demand over the past year, businesses have been raising wages to attract workers, with private sector average hourly earnings rising by 8% over 2022.

Minimum wage changes

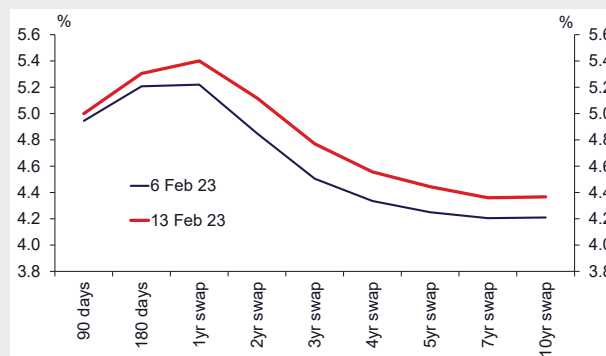


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.25% in the early part 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

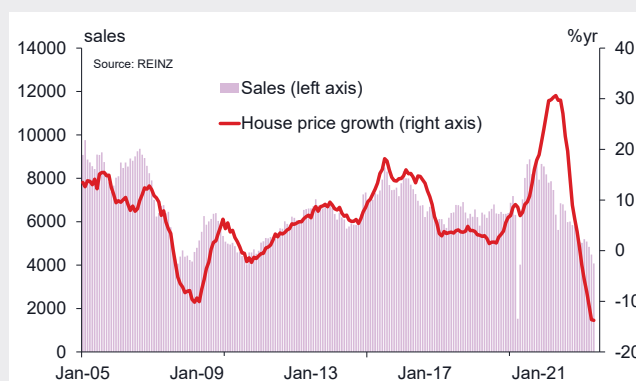
NZ Jan REINZ house sales and prices

Feb 14 (tbc), Sales last: -9.2% m/m, -39% y/y
Prices last: -1.3% m/m, -13.7% y/y

The New Zealand housing market progressively cooled over 2022, as rising mortgage rates reduced buyer appetite. Nationwide house prices have now fallen by 15% from their peak, taking them back to where they were in early 2021.

While it seems likely that fixed-term mortgage rates have now reached their peak, the housing market is still adjusting to these conditions. Low turnover and listings, as property owners hold back rather than selling at a loss, are contributing to the slow pace of correction. We expect a further 8% decline in sale prices over 2023.

REINZ house prices and sales



NZ Q1 RBNZ survey of expectations

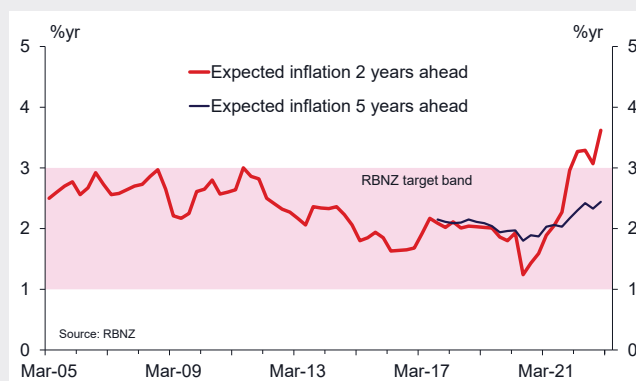
Feb 14, Two-year ahead inflation expectations, Last: 3.62%

The risk of an enduring wage-price spiral is a key concern for the RBNZ. Central to this is the level of inflation expectations, which have risen sharply over the past year. That includes a rise at the longer-term horizons that are of more concern for monetary policy.

The February survey is likely to show that expectations for inflation remain elevated at both short and longer-term horizons. However, with inflation remaining steady over the past six months (albeit at very high levels) and mounting headwinds for domestic activity, we do not expect a further rise in expectations in the latest survey.

Note that the latest survey came in the wake of the recent flooding in Auckland, which could tilt the results to the upside.

RBNZ survey of expectations



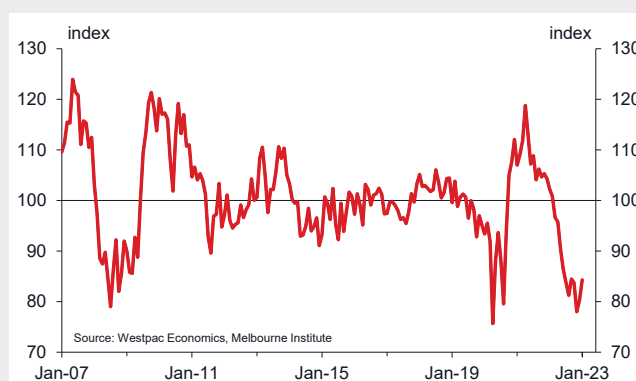
Aus Feb Westpac-MI Consumer Sentiment

Feb 14, Last: 84.3

Consumer Sentiment rose 5% between Dec and Jan, likely reflecting the break in the RBA's sequence of rate rises over the Christmas period, although this was due to the Bank Board having no scheduled meeting rather than a choice to leave rates on hold. At 84.3, the Index remains at extreme lows by historical standards – weaker reads only ever seen during the depths of recessions.

Unfortunately, Feb is likely to see this 'mini-rally' unwind with the RBA resuming rate hikes at its first meeting of the year and giving a strong indication that more increases can be expected in coming months. There also looks to have been little let-up on the inflation front as well with domestic price pressures becoming more evident.

Aus Consumer Sentiment Index



The week ahead

Aus Jan Labour Force - employment chg, '000

Feb 16, Last: -14.6k, WBC f/c: 15k
Mkt f/c: 20k, Range: -5k to 45k

It looks as though illness-related disruptions remained a key drag on jobs growth and hours worked heading into year-end. It was therefore surprising to see a lower proportion of employed people taking annual leave (6.1% in December 2021 vs. 6.7% pre-pandemic December average) given this has been the first 'disruption-free' summer break since the onset of the pandemic.

The January update will provide more insight into how these forces are impacting the labour market. We suspect that illness-related absences and a 'catch-up' in summer leave will result in an employment print slightly below trend, as opposed to another outright decline. Hence, we have pencilled in a 15k rise in employment.

Aus labour force



Aus Jan Labour Force - unemployment rate %

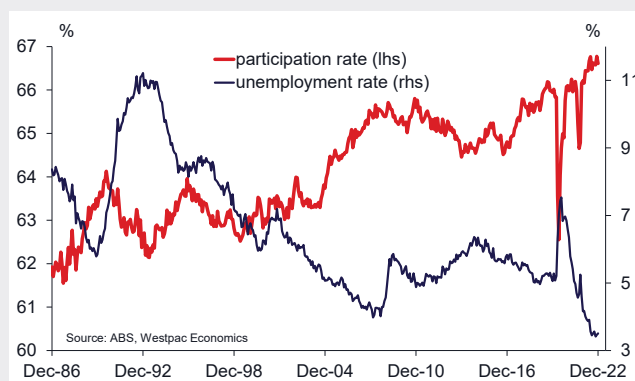
Feb 16, Last: 3.5%, WBC f/c: 3.5%
Mkt f/c: 3.5%, Range: 3.4% to 3.6%

The unemployment rate is just 0.1ppt off the 50-year low print of 3.4% in October, signalling a still historically tight labour market.

The working age population continues to grow at a very strong pace, up from 0.6%/yr in December 2021 to 2.1%/yr in December 2022. The recovery in overseas travel and migration flows is positively contributing to the growth of the working age population, to an extent that exceeds the prior peak of 1.7%/yr in 2018/19 which was also associated with robust immigration.

Holding participation at 66.6% and the rate of growth in the working age population steady, this should see a 20k increase in the labour force in December. Our forecast 15k gain in employment is enough to hold the unemployment rate at 3.5%.

Aus unemployment



Aus Jan overseas arrivals and departures, preliminary

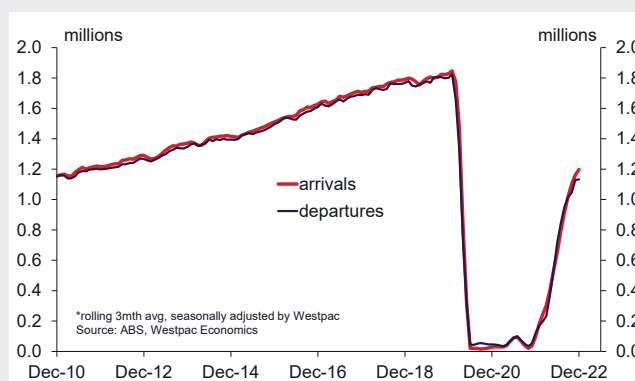
Feb 16, Arrivals, Last: 1,269.2k
Feb 16, Departures, Last 1,523.1k

Over the course of last year, the recovery in overseas travel has forged ahead at an unexpectedly strong pace. As of December, both arrival and departure flows are sitting above 60% of their respective pre-pandemic levels.

Net arrivals of temporary workers and students have also been highlights. Rising at an average of +12.4k/mth and +17.1k/mth respectively, the recovery within these key visa categories is gradually alleviating labour supply constraints. This, coupled with the recovery in short-term visitor flows, is pointing to clear upside risk in the Government's net overseas migration forecast of 235k.

The January provisional estimate will also provide a timely look into the momentum in overseas travel during the summer break and its broader impact on migration flows.

Aus arrivals and departures



The week ahead

US Jan CPI

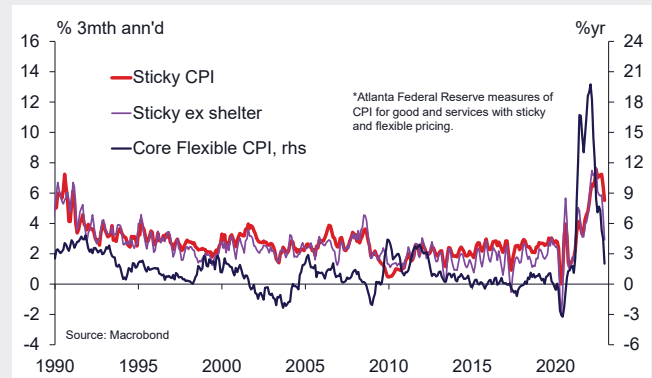
Feb 14: Last: -0.1%, Mkt f/c: 0.5%, WBC: 0.5%

The peak in US inflation is most certainly behind us, bar another large global supply shock. However, for the FOMC to have confidence it can end the tightening cycle soon, as we and the market expect, disinflation needs to broaden to services.

While headline inflation will be pushed higher in January by higher energy prices, the set up for core inflation is constructive. Wages growth has throttled back with inflation, keeping consumer discretionary spending power contained, and market measures point to a material slowing in the sticky shelter component in coming months.

The composition of price changes remains in line with our forecast for inflation to be back near target by year end. But a long road lies ahead.

US inflation

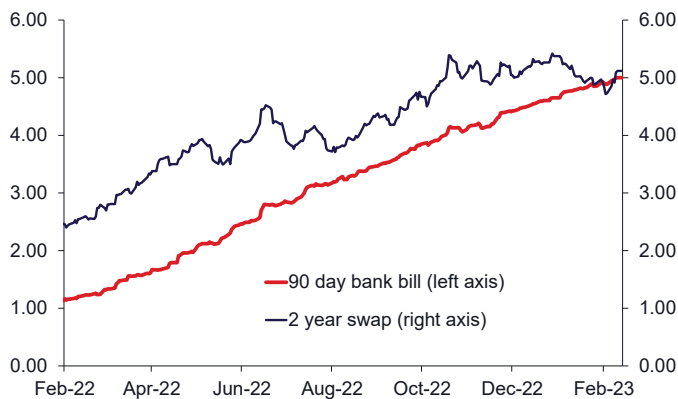


New Zealand forecasts

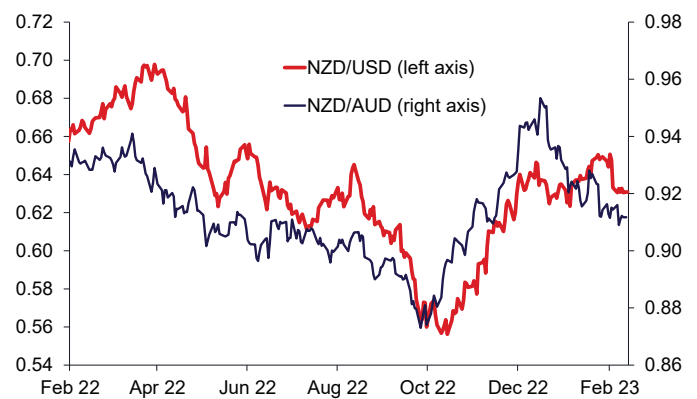
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	2.0	0.5	0.4	0.0	6.1	2.9	2.2	0.0
Employment	1.3	0.1	0.0	0.0	3.3	1.3	0.1	-0.1
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	3.9	4.8
CPI	2.2	1.4	1.4	1.0	5.9	7.2	4.7	2.4
Current Account Balance % of GDP	-7.9	-7.3	-5.9	-5.2	-6.0	-7.3	-4.4	-3.4

Financial forecasts	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Cash	4.75	5.25	5.25	5.25	5.00	4.50	4.00
90 Day bill	5.25	5.35	5.35	5.25	4.80	4.30	3.80
2 Year Swap	4.80	4.60	4.30	4.00	3.80	3.60	3.45
5 Year Swap	4.20	4.10	4.00	3.90	3.80	3.70	3.65
10 Year Bond	4.00	3.90	3.85	3.80	3.70	3.60	3.55
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	72.9	73.1	73.0	73.1	72.9	72.4	71.9

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 13 February 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	4.25%	4.25%
30 Days	4.69%	4.51%	4.34%
60 Days	4.88%	4.75%	4.61%
90 Days	5.00%	4.91%	4.82%
2 Year Swap	5.12%	4.97%	5.03%
5 Year Swap	4.44%	4.32%	4.35%

NZ foreign currency mid-rates as at 13 February 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6308	0.6469	0.6381
NZD/EUR	0.5907	0.5961	0.5896
NZD/GBP	0.5229	0.5237	0.5233
NZD/JPY	82.88	84.36	82.02
NZD/AUD	0.9117	0.9163	0.9175
TWI	71.17	72.32	71.45

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 13					
NZ	Jan BusinessNZ PSI	52.1	-	-	Conditions have been cooling in recent months.
US	Fedspeak	-	-	-	Bowman.
Tue 14					
NZ	Jan REINZ house sales %yr	-39.0%	-	-	Expected date. Continued rises in mortgage rates...
	Jan REINZ house prices %yr	-13.7%	-	-	... will likely keep buyers away and prices down.
	Jan food price index	1.1%	-	1.4%	Seasonal lift in produce prices, shortages of many products.
	Q1 RBNZ inflation expectations	3.6%	-	-	Expected to ease, still uncomfortably high for the RBNZ.
Aus	Feb WBC-MI Consumer Sentiment	84.3	-	-	Crushed by price surge and rate rises. No let-up in sight.
	Jan NAB business survey	12	-	-	Conditions are easing but remain above average.
Eur	Q4 GDP	0.1%	0.1%	-	Narrowly avoided decline; more colour with second estimate.
UK	Dec ILO unemployment rate	3.7%	3.7%	-	Slack will begin to emerge more clearly this year.
US	Jan NFIB small business optimism	89.8	91.0	-	Inflation remains the key concern of small businesses.
	Jan CPI	-0.1%	0.5%	0.5%	Energy supportive in Jan; core held back by turn in services.
	Fedspeak	-	-	-	Logan, Harker, Williams.
Wed 15					
Aus	RBA Governor Lowe speaking	-	-	-	To Senate Committee on Economics.
Eur	Dec industrial production	1.0%	-1.2%	-	Supported by easing supply issues, but outlook is gloomy.
	Dec trade balance €bn	-15.2	-	-	Pressure on deficit to ease as energy price gains unwind.
UK	Jan CPI %yr	10.5%	10.1%	-	Stickiness of core inflation is the key risk.
US	Feb Fed Empire state index	-32.9	-20.0	-	Manufacturing conditions are weak across the nation.
	Jan retail sales	-1.1%	1.7%	-	New year bounce anticipated.
	Jan industrial production	-0.7%	0.5%	-	Performance in line with evidence from regional surveys.
	Dec business inventories	0.4%	0.3%	-	Inventory growth gradually easing; unwanted accrual a risk.
	Feb NAHB housing market index	35	37	-	Housing market is under significant and lasting pressure.
Thu 16					
NZ	Dec net migration	6110	-	-	Net inflows back at strong levels following border reopening.
Aus	Feb MI inflation expectations	5.6%	-	-	Expectations becoming increasingly important for the RBA.
	Jan employment, '000 chg	-14.6k	20k	15k	Illness remains a drag but employment growth set to return...
	Jan unemployment rate	3.5%	3.5%	3.5%	... flat participation should see unemployment rate hold firm.
	Jan overseas arrivals, prelim '000s	1269.2	-	-	Momentum has been building over the summer break.
US	Jan housing starts	-1.4%	-2.0%	-	Demand is being hit hard by interest rates...
	Jan building permits	-1.0%	1.0%	-	... with monthly approvals back at pre-pandemic levels.
	Feb Philly Fed index	-8.9	-7.4	-	Manufacturing conditions are weak across the nation.
	Jan PPI	-0.5%	0.4%	-	Decelerating quickly from historic peak.
	Initial jobless claims	196k	-	-	To remain at a relatively low level for now.
	Fedspeak	-	-	-	Mester, Bullard, Cook.
Fri 17					
Aus	RBA Governor Lowe speaking	-	-	-	Testimony to House of Reps Committee.
UK	Jan retail sales	-1.0%	-	-	Sales volumes under pressure, reflecting household's woes.
US	Jan import price index	0.4%	-0.1%	-	Decelerating quickly from historic peak.
	Jan leading index	-0.8%	-0.3%	-	Pointing to materially weak conditions over the period ahead.

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	7.5	3.9	3.0
Unemployment rate %	5.2	6.8	4.7	3.3	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	2.0	0.5	1.3
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	3.2	0.4	1.5
United Kingdom						
Real GDP %yr	1.7	-9.3	7.4	4.0	-0.7	1.5
China						
Real GDP %yr	6.0	2.2	8.1	3.5	6.0	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.2	4.5	4.3	4.4
World						
Real GDP %yr	2.8	-3.0	6.0	3.3	2.9	3.2

Forecasts finalised 12 December 2022

Interest rate forecasts	Latest	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia									
Cash	3.35	3.60	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.47	3.97	4.05	4.05	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.73	3.45	3.30	3.10	2.90	2.70	2.55	2.50	2.50
International									
Fed Funds	4.625	4.875	4.875	4.875	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.67	3.40	3.30	3.20	3.10	2.90	2.70	2.60	2.50

Exchange rate forecasts	Latest	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6934	0.70	0.71	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	131.77	132	131	130	129	128	127	126	125
EUR/USD	1.0731	1.08	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2105	1.21	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.7906	6.75	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0979	1.09	1.09	1.09	1.10	1.11	1.13	1.13	1.13

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