

WESTPAC WEEKLY ECONOMIC COMMENTARY

The bare essentials.

15 May 2023



Southern rātā

Westpac Economics Team

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The Government has stated clearly not to expect too much from Budget 2023 this week. The economy is close to stall speed, and inflation is running red hot. With a cyclone recovery in the mix, the Government has signalled that it will do what is necessary to alleviate cost-of-living pressures, fast-track recovery from Cyclone Gabrielle, and maintain key public services, but not a lot more.

We have taken this sentiment largely at face value. Our economic forecasts relative to the Half-Year Update are more pessimistic. We have then flowed this through to a lower tax revenue outlook. Indeed, the accounts are already behind what was forecast at the Half-Year Update – total Government revenue is \$2.9bn behind forecast for the nine months to March 2023.

Notably, the squeeze is on corporate and other individuals' tax, with the two tax types collectively running \$1.5bn behind Treasury's Half-Year Update forecasts. That is consistent with businesses feeling the pressure on their margins from inflation and/or from a slowing in demand.

All up, we expect the operating balance (OBEGAL) to tick over into surplus in 2025/26, one year later than previously signalled. Notably, though, the Government would still meet its fiscal rule of running small surpluses allowing for economic conditions.

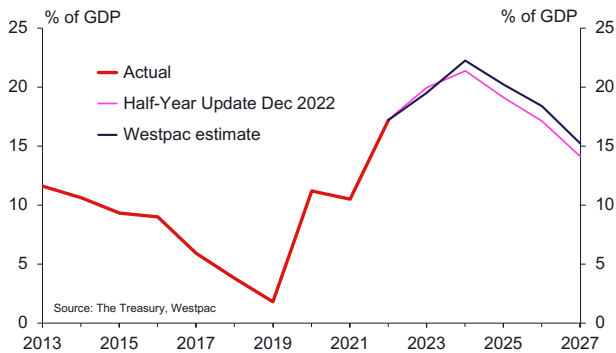
To get there, we expect the Government will run a tight ship. That means no changes (increases) to the Budget allowances as they were signalled back in December (election sweeteners will

have to wait, if they come at all). Although, we do note that the Government has found around \$4bn of savings to spend on its priorities at this Budget.

We also expect the larger deficits to translate to a modest increase in the net debt forecasts. That said, it will be more modest than the increase in deficits alone. Net debt will start the forecast period lower than forecast, as the New Zealand Superannuation Fund has made some large investment gains since the Half-Year Update.

Market interest will be on the size of the bond programme. Overall, we expect an increase of \$12bn over the five-year forecast period relative to Budget 2022. This increase mainly (circa \$10bn) reflects the increase in the forecast deficits resulting from reduced growth assumptions. We have also allowed for a small increase in borrowing (\$2bn) to fund infrastructure costs relating to the cyclone recovery. We have spread the increase evenly across the forecast period, although arguments could be made for this to be front-loaded to a degree.

Net core Crown debt as a % of GDP



Turning to this week's data releases, the stabilisation in the housing market continued in April. House sales were up by another 5% after adjusting for seasonal factors. While the number of sales remains relatively low, they're up by more than 20% from the cycle low that was reached in December last year.

The REINZ house price index rose by 0.3%, the first monthly increase in a year and a half. The rise was fairly widely shared across the country, though with a particularly strong lift in the Otago region. Nationwide prices are still down about 16% from their peaks, with Wellington and Auckland having seen the biggest downward adjustment.

The forces that have been weighing against the housing market over the last couple of years are now starting to turn. There's a growing belief that mortgage rates are at or near their peaks, and there have even been some cuts at the longer fixed terms.

On top of this, the flow of migrants has turned from a modest net outflow to a strong net inflow since we reopened the border. The annual net inflow has surged to 65,000, with the annual pace of recent months around the 100,000 mark. That will put renewed pressure on the housing stock, since the rate of homebuilding is no longer keeping pace with population growth (this is a factor for house prices regardless of whether new arrivals buy or rent, since someone has to own the houses that they will rent).

The latest figures suggest that the housing market may have reached its bottom earlier than we expected (it's also worth noting that house prices are picking up again in Australia, under similar economic conditions). To put this in context though, we've been correctly forecasting a double-digit fall in house prices for the last two years; the last few percentage points are not critical to our view.

We'll be providing updated house and migration forecasts in our quarterly Economic Overview, released tomorrow (16 May).

Nathan Penny, Senior Agri Economist

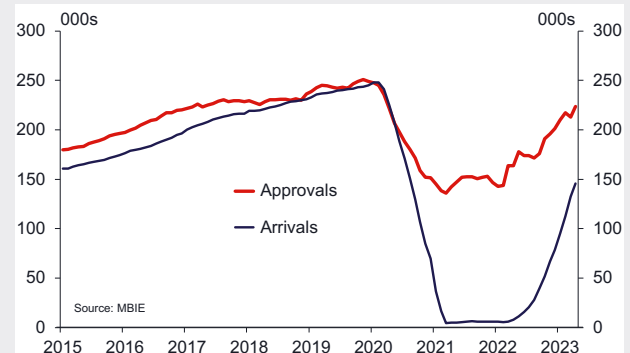
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Chart of the week

Net migration inflows have surged since New Zealand reopened its border, reaching more than 65,000 people in the year to March. Overseas arrivals have been by far the biggest driver, and the pool of potential arrivals is very large. Since the border was closed in March 2020, approvals of work visas have exceeded arrivals by around 370,000. Not all of these will result in a new arrival, but this suggests an upper bound on what's possible over the next couple of years.

Working visas, annual sum

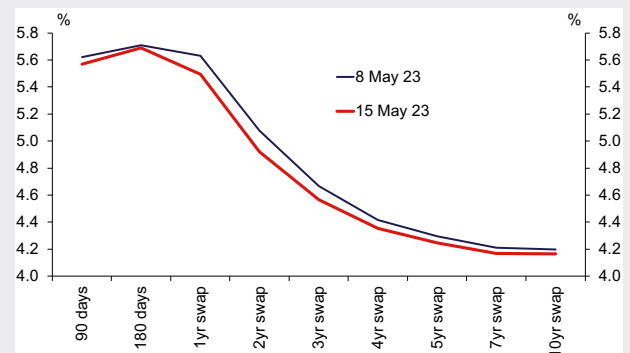


Fixed vs floating for mortgages

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 GlobalDairyTrade auction, whole milk powder prices

May 17, Last: +5.0%, Westpac: Flat

We expect whole milk powder prices (WMP) to be unchanged at the upcoming auction. Flat prices would cement the 6% price gains over the previous two auctions.

Our pick is between the modest fall at last week's mini (GDT pulse) auction and the circa 1% lift that the futures market is pointing to. Over the year, we expect that rebounding Chinese dairy demand and very subdued global supply will lead global dairy prices higher.

Whole milk powder prices



NZ Government Budget 2023

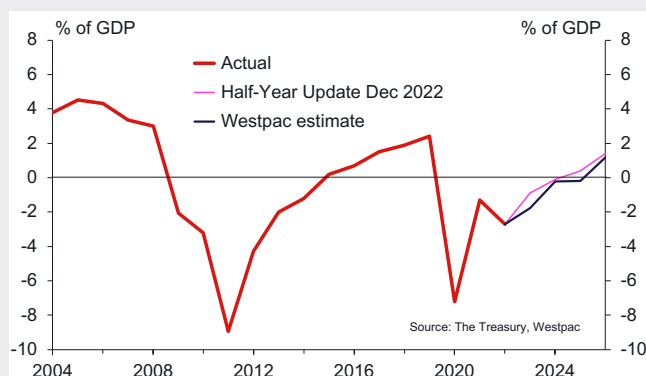
May 18

We expect Budget 2023 will show a moderate deterioration in New Zealand's fiscal position compared to the Half-Year Update in December.

We have taken the recent Government announcements of a "no-frills" Budget at face value, and have factored only limited additional spending focused on cost-of-living pressures and cyclone recovery.

Crucially, we expect the Treasury to factor in a weaker economic outlook, translating into lower tax revenues in future years. With that in mind, we expect the operating balance will return to surplus in 2025/26, a year later than previously forecast. We expect the net debt profile to shift modestly higher, and a moderate lift in the debt programme.

NZ Govt operating balance as a % of GDP



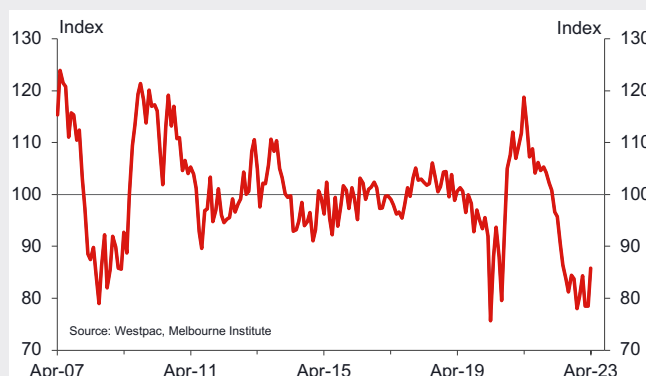
Aus May Westpac-MI Consumer Sentiment

May 16, Last: 85.8

Consumer sentiment surged 9.4% in April, buoyed by the RBA decision to pause the sequence of interest rate hikes that began in May last year. Despite the bounce, the index remained in deeply pessimistic territory at 85.8.

The April story does not augur well for May given the RBA resumed hikes with a surprise 25bp increase. The latest survey will also capture reactions to the Federal Budget, although even a positive reception here may not be enough to counter a rate rise shock.

Aus Consumer Sentiment Index



The week ahead

Aus Q1 Wage Price Index

May 17 Last: 0.8%, Westpac f/c: 0.8%, Mkt f/c: 0.9%

The Wage Price Index was surprisingly soft in the December quarter, the 0.8% gain less than market expectations of 1.0% and Westpac's 1.1% forecast. While a clear step down in pace, the ABS noted that the 0.8% increase was largest result out of all the December quarters in the past decade, following on from September and June quarter increases which were also higher than their comparable quarters back to 2012.

The share of wages negotiated via individual bargaining arrangements continued to grow, lifting from 36% in 2017 to 43% in 2022, which has made wages more responsive to changes in economic conditions.

Our forecast 0.8% increase in the March quarter would lift the annual rate from 3.3%yr to 3.5%yr.

Aus Apr labour force

May 18, Employment Last: +53k, Westpac f/c: +40k, Mkt f/c: +25k

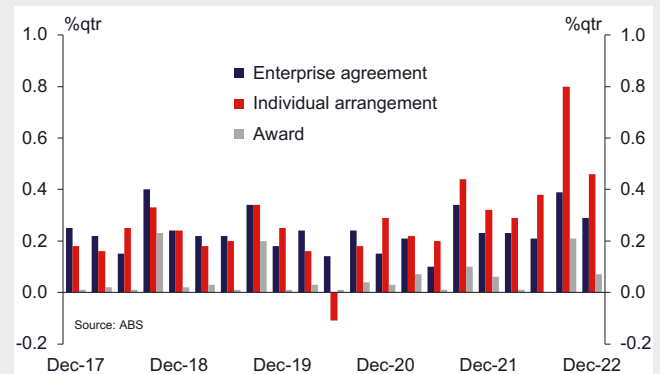
Unemployment rate Last: 3.5%, Westpac f/c: 3.5%, Mkt f/c: 3.5%

Employment posted another strong gain in March, up 53.0k. Underlying this strength is two critical factors: (1) job vacancies are at an elevated level, representing a robust appetite for new workers despite broadening headwinds; and (2) the recovery in immigration, resulting in a large and sustained expansion in the size of the Australian labour force.

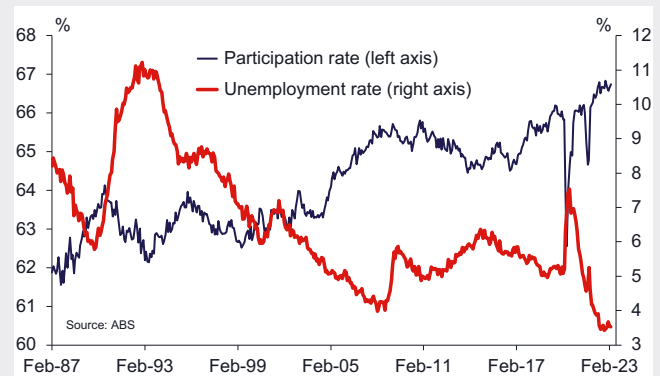
These underlying dynamics present clear upside risk to employment outcomes, at least over the near term. Hence, for April, we have pencilled in an above-trend increase in jobs growth, at +40k.

The strength in labour force growth due to the recovery in immigration is being met with robust labour demand resulting in an unemployment rate holding lower for longer. We see the participation rate rounding up to 66.8%, for a flat unemployment rate of 3.5% in April.

Aus wage increases by bargaining arrangement



Aus unemployment and participation rates

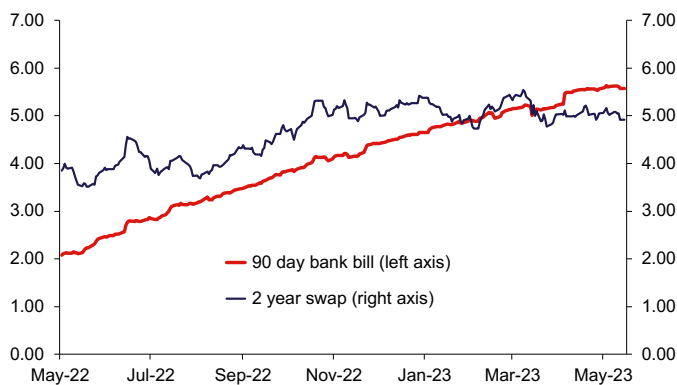


New Zealand forecasts

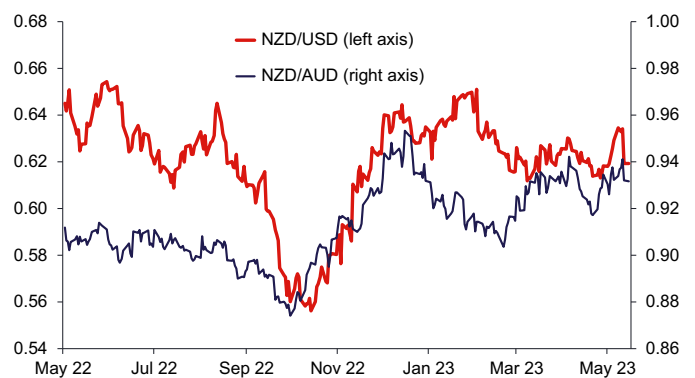
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.6	0.2	0.2	0.2	6.0	2.4	1.1	-0.5
Employment	0.5	0.8	0.3	0.0	3.3	1.3	1.0	-0.3
Unemployment Rate % s.a.	3.4	3.4	3.5	3.7	3.2	3.4	4.0	5.1
CPI	1.4	1.2	1.0	1.7	5.9	7.2	4.5	2.7
Current 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 15 May 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.25%	5.25%	5.25%
30 Days	5.49%	5.42%	5.33%
60 Days	5.53%	5.50%	5.44%
90 Days	5.57%	5.58%	5.55%
2 Year Swap	4.92%	5.06%	5.09%
5 Year Swap	4.25%	4.29%	4.36%

NZ foreign currency mid-rates as at 15 May 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6194	0.6181	0.6197
NZD/EUR	0.5701	0.5614	0.5643
NZD/GBP	0.4970	0.4932	0.4995
NZD/JPY	84.04	84.47	83.03
NZD/AUD	0.9317	0.9305	0.9238
TWI	70.97	70.59	70.45

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 15					
Aus	Apr BusinessNZ PSI	54.4	-	-	Remains resilient, but headwinds mounting.
US	May Fed Empire state index	10.8	-4.0	-	Conditions to remain subdued for now.
	Fedspeak	-	-	-	Bostic, Kashkari, Cook.
Tue 16					
Aus	RBA minutes	-	-	-	More colour on May's surprise move.
	May Westpac-MI Consumer Sentiment	85.8	-	-	RBA's surprise rate hike and Budget reaction to impact.
	Apr overseas arrivals, prelim	1347.3k	-	-	Permanent/long-term arrivals well above pre-Covid levels.
Chn	Chn Apr retail sales ytd %yr	5.8%	8.2%	-	The rebound in consumer spending is well underway...
	Apr industrial production ytd %yr	3.0%	4.9%	-	... and industry is set to benefit from expansion into...
	Apr fixed asset investment ytd %yr	5.1%	5.8%	-	... Asian markets, offsetting softer demand from US/Europe.
Eur	Eur Q1 GDP	0.1%	0.1%	-	Second estimate.
	Mar trade balance €bn	-0.1	-	-	Return to surplus likely on falling energy prices.
	May ZEW survey of expectations	6.4	-	-	Consolidating amid persistent cost-of-living pressures.
UK	UK Mar ILO unemployment rate	3.8%	3.8%	-	Off cycle-low but still indicating a tight labour market.
US	US Apr retail sales	-0.6%	0.7%	-	Rebound from March likely, but underlying weakness clear.
	Apr industrial production	0.4%	0.0%	-	Manufacturing to drag in coming months.
	Mar business inventories	0.2%	0.0%	-	Accrual stalling as economy slows.
	May NAHB housing market index	45	45	-	Long road ahead for home builder confidence recovery.
	Fedspeak	-	-	-	Mester, Barr, Williams, Logan.
Wed 17					
NZ	NZ GlobalDairyTrade auction (WMP)	5.0%	-	0.0%	Dairy prices consolidating after recent rises.
Aus	Aus Q1 Wage Price Index	0.8%	0.9%	0.8%	Wages surprisingly soft in Q4 despite minimum wage lift.
Jpn	Jpn Q1 GDP	0.0%	0.2%	-	Domestically sound on investment, policy; consumption a risk.
Eur	Eur Apr CPI %yr	7.0%	7.0%	-	Final estimate.
US	US Apr housing starts	-0.8%	-1.7%	-	Headwinds around affordability and uncertainty impacting...
	Apr building permits	-7.7%	-0.2%	-	... but multi-family consent issuance presents an opportunity.
	Fedspeak	-	-	-	Bostic & Goolsbee.
Thu 18					
NZ	NZ Budget 2023	-	-	-	Budget to show a moderate deterioration in fiscal position.
Aus	Aus Apr employment	+53k	+25k	+40k	Elevated job vacancies and immigration's recovery is seeing...
	Apr unemployment rate	3.5%	3.5%	3.5%	... robust employment outcomes and low U/E for longer.
US	US Initial jobless claims	264k	-	-	Off recent lows, but still relatively weak versus history.
	May Philly Fed index	-31.3	-21.1	-	Downtrend in business conditions well entrenched.
	Apr existing home sales	-2.4%	-3.6%	-	Supply remains the chief concern.
	Apr leading index	-1.2%	-0.5%	-	Growth to remain well below trend.
	Fedspeak	-	-	-	Jefferson, Barr, Logan.
Fri 19					
NZ	NZ Apr trade balance \$mn	-1273	-	100	Balance to ticking into surplus; underlying weakness remains.
Jpn	Jpn Apr CPI %yr	3.2%	3.5%	-	Should return smoothly back to target in time.
Chn	UK May GfK consumer sentiment	-30	-	-	Pessimism easing, but still by no means optimistic.
US	Fedspeak	-	-	-	Chair Powell & Fmr. Chair Bernanke. Williams, Bowman.

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	3.89	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.33	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	3.46	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	0.6648	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	135.68	132	130	128	127	126	125	124
EUR/USD	1.0865	1.11	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2463	1.25	1.25	1.26	1.26	1.27	1.28	1.29
USD/CNY	6.9591	6.75	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0733	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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