WESTPAC WEEKLY ECONOMIC COMMENTARY

Aftermath.

20 February 2023

Southern rātā

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As the country emerges from under the shadow of Cyclone Gabrielle, it's clear that many parts of the North Island are facing a long and costly recovery. The breadth and the nature of the damage makes it difficult to put a dollar value on it, though it will clearly be measured in the billions.

The cyclone came on top of the severe rains that hit in late January. Together, these events have resulted in extensive damage through large swathes of the upper North Island. They have had a particularly severe impact on Gisborne, the Bay of Plenty, and the Hawke's Bay, as well as Northland, Auckland, and the Waikato. Combined, these regions are home to around 60% of the population.

It's still early days, and until we have more information we can only speak very generally about the cost of these events. The Minister of Finance has indicated that the total cost could be in the vicinity of $13bn. That would make it New Zealand's second-costliest natural disaster, following the Canterbury earthquakes in 2010 and 2011.

The immediate impact on the economy will come in the form of significant disruptions to people's everyday lives, and the loss of business activity. Given that Hawke's Bay and Gisborne were among the worst-affected regions, there has been an especially large impact on our horticulture sector. In particular, some fruit crops like apples are likely to see significant losses given that Gabrielle hit during the picking season. Vegetable growers, including those in the Auckland region, have also been severely impacted, though they may be able to recover sooner given the shorter rotations of crops.

The livestock sector is relatively less affected overall. Certainly there will be some stock losses, but by and large the overall numbers are likely to be moderate. The bigger issue for the sheep and dairy sector, as well as forestry (in Hawke's Bay, Gisborne and Northland) will be the time necessary to restore roading and other infrastructure.

The reconstruction in the wake of these disasters is likely to be spread over several years. In addition to a large number of damaged homes, there has been extensive damage to roading and other infrastructure, as well as damage to business assets. The need for this work comes at a time when the building sector is already stretched, with a large amount of work already planned, widespread shortages of staff, and some continuing shortages of materials. As a result, the recovery may prove to be more 'instead of' rather than 'in addition to' for the construction sector, with some existing work being displaced to make way for essential repairs.

Natural disasters are typically regarded as inflationary on balance. This comes firstly through the direct impacts on prices, whether that be the additional pressure on building costs, disruptions to supply chains, higher food prices due to crop damage, or higher insurance premiums. Some of these price rises may prove to be temporary, while some will be more lasting.

Then there's the impact of the rebuild, which boosts economic activity and draws on the nation's resources of labour and capital. And to the extent that this is funded through insurance payouts and additional government borrowing, this amounts to a net stimulus. (To be clear on what the claim is here: natural disasters are unambiguously bad for the economy. But when they do happen, rebuilding is better for the economy than not rebuilding.)

For the Reserve Bank, this leaves it with a delicate balancing act as it prepares this week's Monetary Policy Statement. To what extent should it respond to these additional inflation pressures, on top of what was already occurring in the economy?

For now, the simple answer is to not respond one way or the other. Monetary policy is a tool for managing the level of demand in the economy; the effects of the cyclone are more in the nature of a supply-side shock. While the disruptions will boost inflation in the near term, they are not a source of sustained price rises over the medium term, which is the relevant horizon for monetary policy.

The answer is a little more complicated when it comes to the impact of the rebuild. If the boost to activity an inflation is spread over several years, there's a greater risk that it could become baked into people's inflation expectations. In this case, the RBNZ would need to run monetary policy tighter than otherwise.

Even then, we'd be careful of overstating this risk. In an economy that produces around $380bn per year, there is scope to absorb a rebuild job of this size. Even the 2011 Christchurch earthquake rebuild, a roughly $40bn rebuild that was spread over many years, did not prove to be the inflationary force that was initially feared. Indeed, inflation was persistently on the lower side of the RBNZ's target over the following decade – monetary policy was kept tighter than it needed to be, given the prevailing conditions across the wider economy.

Of course, the prevailing conditions today are very different from what they were in 2011 – Covid disruptions and an overheated economy have already pushed inflation to a multi-decade high. A period of tight monetary policy is required, at least until it's clear that inflation is on its way back towards the target range.

With that in mind, the RBNZ will be wary of relenting too soon. That means it will need to carry through with the path of tightening that the market has already priced in – another 100 basis points or so over the next few months.

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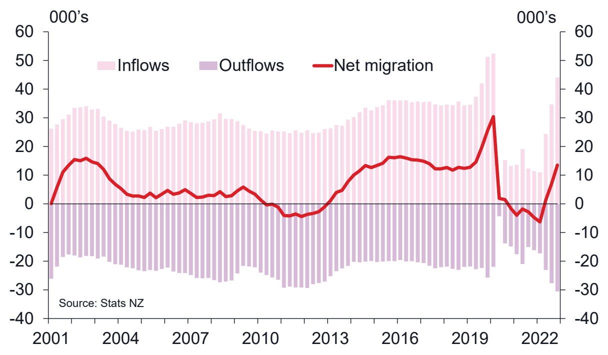
Chart of the week

As New Zealand reopened its border over 2022, the balance of migrant flows turned from slightly negative to strongly positive again. The revival has been in both directions, with both inflows and outflows of migrants now exceeding their pre-Covid levels. This suggests that some pent-up demand to travel during the Covid restrictions is being unleashed – indeed, the apparent spike in arrivals in 2019 likely reflects shorter-term travellers who were inadvertently stuck in the country in 2020 and were reclassified as longer-term migrants. We expect that migration flows will settle down in the year ahead, though with the balance remaining positive.

Migration flows, quarterly

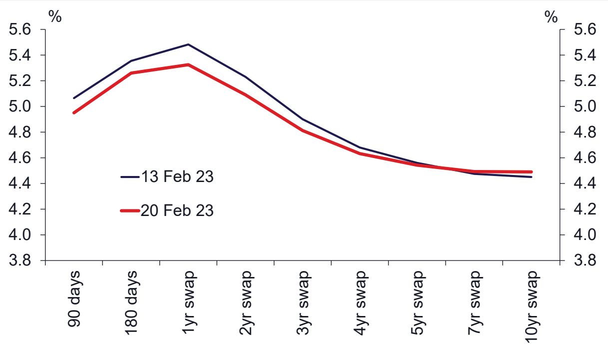


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.25% 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 GlobalDairyTrade auction, whole milk powder prices

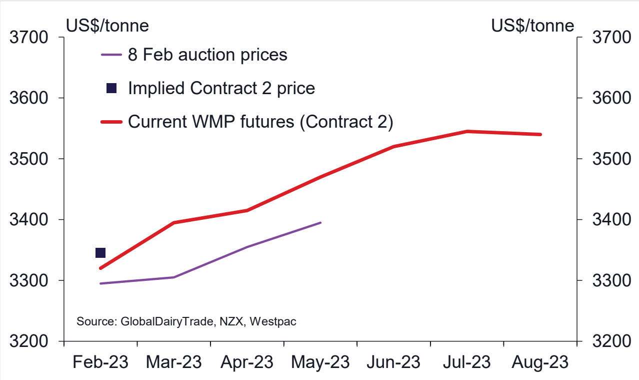
Feb 22, Last: +3.8%, Westpac: +1.0%

We expect whole milk powder prices (WMP) to post a small 1% rise at the upcoming auction. If correct, this rise will build on the 3.8% lift at the previous auction.

Our pick is marginally lower than the circa 2% rise that the futures market is pointing to (as at 12pm Friday 17 February).

Over the first half of this year, we expect that rebounding Chinese dairy demand will lead global dairy prices higher.

Whole milk powder prices



RBNZ Feb Monetary Policy Statement

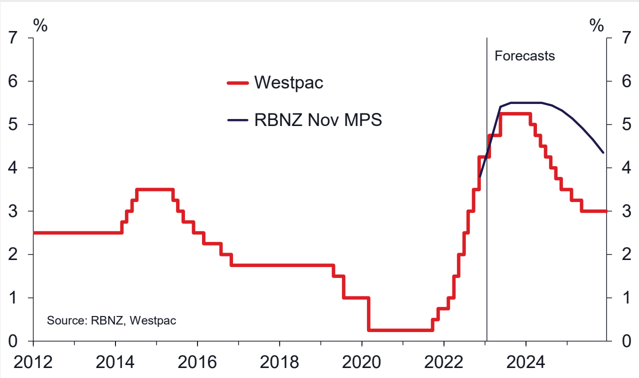
Feb 22, Last: 4.25%, Westpac f/c: 4.75%, Market f/c: 4.75%

We expect the Reserve Bank to lift the Official Cash Rate by 50 basis points to 4.75% this week.

That's down from the 75 basis point rise that the market was widely expecting, and which the RBNZ seemed set on delivering, in the wake of the November Monetary Policy Statement. But the inflation data since then, while strong, hasn't accelerated in the way that the RBNZ was bracing for.

We still expect the RBNZ to retain a hawkish stance, with further hikes projected in the coming months. The RBNZ will want to dissuade the market from factoring in rate cuts too soon, which would risk restimulating the economy before the inflation battle has clearly been.

RBNZ Official Cash Rate



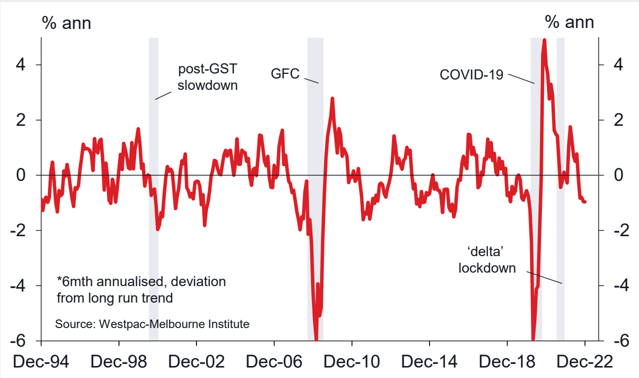
Aus Feb Westpac–MI Leading Index

Feb 22, Last: –0.97%

The six-month annualised growth rate in the Leading Index was –0.97% in December, marking the fifth consecutive negative read, a consistent signal of below-trend growth heading into the first half of 2023.

The February release will include a couple of notable positive component updates, the ASX200 up 6.2% in the month; dwelling approvals posting a strong 18.5% bounce (albeit one that is not expected to sustain). However, this is likely to be swamped by other negatives, including a sharp deterioration in consumer sentiment measures, another steep fall in commodity prices in AUD terms (-9.4%) and a decline aggregate hours worked (-2.1%).

Aus Westpac-MI Leading Index



The week ahead

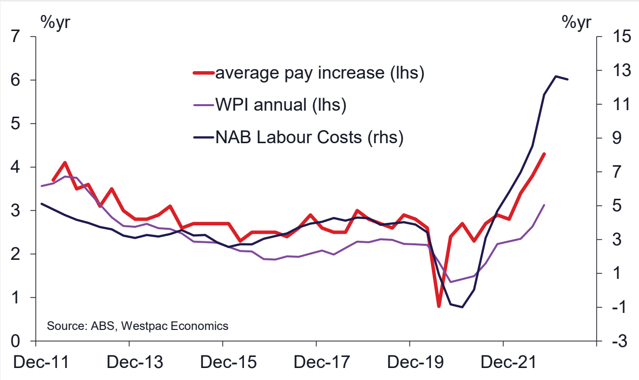
Aus Q4 Wage Price Index %qtr

Feb 22, Last: 1.0%, WBC f/c: 1.1%
Mkt f/c: 1.0%, Range: 0.9% to 1.3%

The Wage Price Index lifted 1.0% in the September quarter, splitting the difference between Westpac's 1.1% forecast the market's 0.9%. The increase boosted the annual pace to 3.1%yr from 2.6%yr, the fastest pace since March 2013 (3.1%yr). Private sector wages lifted 1.2% in the quarter, the strongest increase since September 2010.

Boosting the private sector wages was the largest Fair Work Commission (FWC) minimum wage/award increase in more than a decade. That saw a rise in both the size of the average wage increase and the proportion of private sector jobs recording a wage increase. While most of the increase in the minimum wage was paid in September, the FWC continues to stagger some industries wage increase which will boost the September result.

Aus average pay increase in quarter vs annual WPI



Aus Q4 construction work

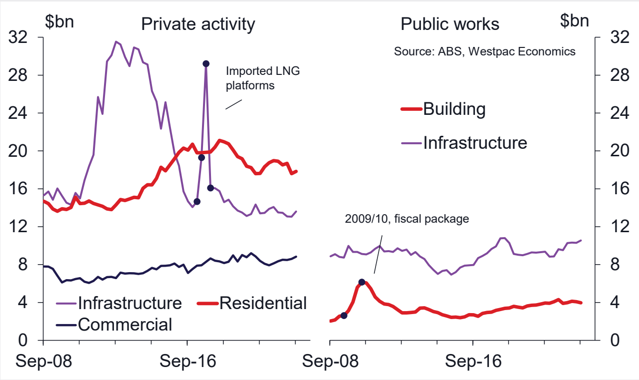
Feb 22, Last: 2.2%, WBC f/c: 1.6%
Mkt f/c: 1.5%, Range: −1.0% to 2.0%

Construction sector activity rebounded by 2.2% in the September quarter, reversing a 2.0% decline the quarter prior.

Some lessening of disruptions in the period facilitated a lift in work - the sector had been hard hit by wet weather and flooding over the first half of the year. That still left a sizeable pipeline of work outstanding (particularly for stand alone homes). The size of the Q3 rebound was constrained by ongoing headwinds (labour and material shortages, as well as rising insolvencies).

These themes likely extended into the December quarter. Accordingly, we anticipate a further but modest rise in overall construction work - up by a forecast 1.6%.

Aus construction work by segment



Aus Q3 private business capex

Feb 23, Last: -0.6%, WBC f/c: 2.0%
Mkt f/c: 1.3%, Range: −3.0% to 4.0%

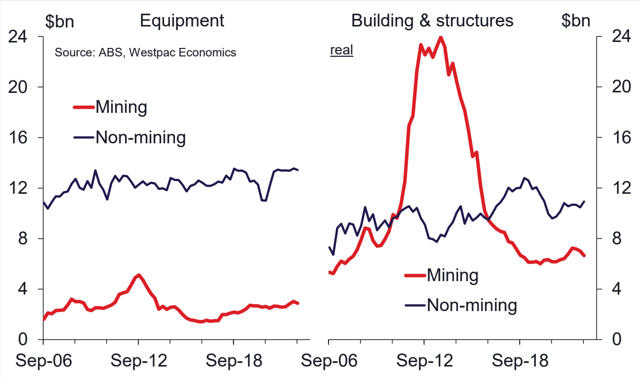
Total business capex spending consolidated over the opening three quarters of 2022. That followed an 11% bounce in 2021, which reversed weakness over the previous two years (-6% and -6.6%).

For the December quarter 2022, we anticipate a rise in the order of 2%, with broadly similar gains across Building & Structures (B&S) and equipment.

Businesses lifted equipment spending in Q1 and Q2 of 2022 (1.4% and 2.2%) associated with the economic reopening. While this was followed by a -1.6% fall in Q3, that was likely a temporary dip.

B&S expenditure moved lower in Q1 and Q2 (-0.5% and -2.0%) hit by disruptions. With those disruptions lessening, the second half of 2022 is more promising, kicking-off with a gain of 0.5% in Q3.

Aus CAPEX

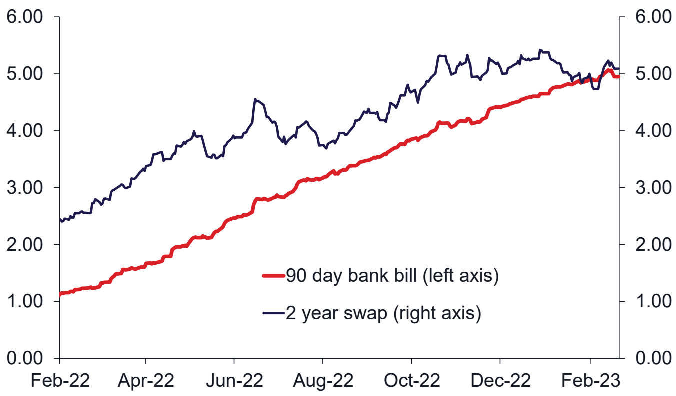


New Zealand forecasts

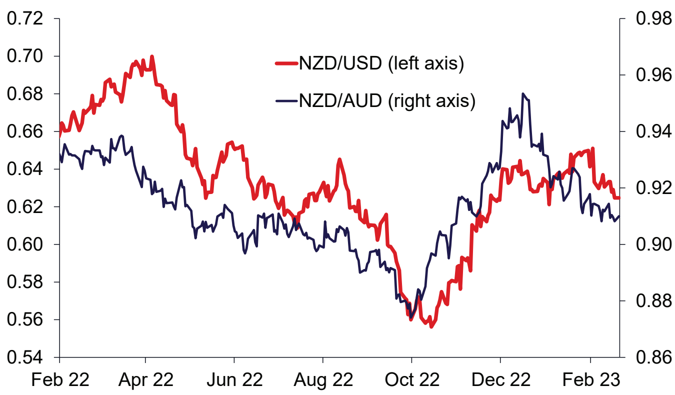
Economic forecasts	Quarterly				Annual			
	2022		2023					
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	2.0	0.5	0.4	0.0	6.1	2.9	2.2	0.0
Employment	1.3	0.1	0.0	0.0	3.3	1.3	0.1	-0.1
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	3.9	4.8
CPI	2.2	1.4	1.4	1.0	5.9	7.2	4.7	2.4
Current 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	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 20 February 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	4.25%	4.25%
30 Days	4.70%	4.54%	4.44%
60 Days	4.85%	4.73%	4.66%
90 Days	4.95%	4.89%	4.87%
2 Year Swap	5.09%	4.73%	4.98%
5 Year Swap	4.54%	4.11%	4.31%

NZ foreign currency mid-rates as at 20 February 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6247	0.6297	0.6485
NZD/EUR	0.5839	0.5849	0.5950
NZD/GBP	0.5181	0.5235	0.5242
NZD/JPY	83.84	83.26	84.33
NZD/AUD	0.9100	0.9136	0.9249
TWI	70.97	70.97	72.47

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
Eur	Feb consumer confidence	–20.9	–	–	Consolidating after a better-than-expected winter.
UK	Feb Rightmove house prices	0.9%	–	–	Price correction to remain entrenched over 2023.
US	President's Day	–	–	–	Public holiday; markets closed.
Tue 21					
NZ	Q4 PPI	1.6%	–	–	Operating costs are rising at a rapid pace.
Aus	RBA minutes	–	–	–	More colour around the hawkish shift in guidance.
Eur	Feb S&P Global manufacturing PMI	48.8	49.3	–	Burgeoning support from better conditions over winter...
	Feb S&P Global services PMI	50.8	50.7	–	... is facilitating growth in services and recovery in mfg...
	Feb ZEW survey of expectations	16.7	–	–	... as confidence rebounds strongly.
UK	Feb S&P Global manufacturing PMI	47.0	47.5	–	Comparatively the UK faces a tough near-term outlook...
	Feb S&P Global services PMI	48.7	49.3	–	... but the expected scale of recession now smaller.
US	Feb S&P Global manufacturing PMI	46.9	47.0	–	S&P in contrast with ISM services, pointing to major slowing...
	Feb S&P Global services PMI	46.8	46.9	–	... in the sector, likely concentrated in small/mid-sized firms.
	Jan existing home sales	–1.5%	2.1%	–	Sales volumes have sunk to near historic lows.
Wed 22					
NZ	GlobalDairyTrade auction (WMP)	3.8%	–	1.0%	Dairy prices rising on rebounding Chinese demand.
	Jan trade balance $mn	–475	–	–1250	Export prices have eased; import demand still firm.
	RBNZ Monetary Policy Statement	4.25%	4.75%	4.75%	Inflation has peaked but remains intense.
Aus	Jan Westpac-MI Leading Index	–0.97%	–	–	Clear signal of slowing to below trend pace.
	Q4 Wage Price Index	1.0%	1.0%	1.1%	Residual min wage increase will further boost Q4 print.
	Q4 construction work done	2.2%	1.5%	1.6%	Up on fewer disruptions and still sizeable work pipeline.
US	FOMC February meeting minutes	–	–	–	Focus is on discussion of path for policy over 2023.
Thu 23					
Aus	Q4 private new capital expenditure	–0.6%	1.3%	2.0%	Equipment upward trend to resume, after Q3 dip.
	2022/23 capex plans Est 5, $bn	155.7	–	–	Est 5 likely to confirm double digit growth implied by Est 4.
	2023/24 capex plans Est 1, $bn	–	–	–	Outlook to sour on slowing economy, but survey slow to adjust.
Eur	Jan CPI %yr	8.5%	8.5%	–	Final estimate to give crucial detail on services inflation.
US	Jan Chicago Fed activity index	–0.49	–	–	Pointing to a material loss of economic momentum.
	Q4 GDP, annualised	2.9%	2.9%	–	Second estimate.
	Initial jobless claims	194k	–	–	To remain at a relatively low level.
	Feb Kansas City Fed index	–1	–	–	Conditions remain highly volatile, but trend weak.
	Fedspeak	–	–	–	Bostic and Daly.
Fri 24					
UK	Feb GfK consumer sentiment	–45	–	–	Inflation and rates have left consumers deeply pessimistic.
US	Jan personal income	0.2%	1.0%	–	New year bounce to offset weakness at end-2022...
	Jan personal spending	–0.2%	1.0%	–	... flattening trend indicates a loss of momentum.
	Jan PCE deflator	0.1%	0.4%	–	FOMC will be closely monitoring...
	Jan core PCE deflator	0.3%	0.4%	–	... services inflation components.
	Jan new home sales	2.3%	0.7%	–	Weakness in sales volumes set to persist.
	Feb Uni. of Michigan sentiment	66.4	66.4	–	Final estimate.
	Fedspeak	–	–	–	Jefferson, Collins and Waller.

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	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	3.83	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	3.89	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	0.6836	0.70	0.71	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	134.74	132	131	130	129	128	127	126	125
EUR/USD	1.0638	1.08	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.1945	1.21	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.8781	6.75	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0995	1.09	1.09	1.09	1.10	1.11	1.13	1.13	1.13

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