

WESTPAC WEEKLY ECONOMIC COMMENTARY

High-five.

20 March 2023



Southern rata

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With signs that the economy isn't running as hot as we or the RBNZ thought, we have revised down our forecast for the Official Cash Rate. We now expect that the OCR will reach a peak of 5.00% (down from our previous forecast of 5.50%). That implies just one more 25bp rise in the current cycle, which we expect will occur at the RBNZ's next policy meeting in April.

For the past 18 months, the Reserve Bank of New Zealand has been hiking the Official Cash Rate at a rapid pace against a backdrop of an overheating economy and a related surge in inflation. And at the time of its last policy decision in February, the RBNZ remained resolute that further rate increases would be needed to get inflation back inside the target band. The forecasts that accompanied their February policy statement showed the cash rate rising from 4.75% to a peak of 5.50%. At that time, we broadly agreed with that assessment.

However, recent updates have cast fresh light on the strength of economic conditions. Although activity remains elevated, GDP figures for the year to December 2022 have shown that the economy is not running as hot as we or the RBNZ had thought. Economic output fell by 0.6% in the December quarter. That was a sharper decline than we and other analysts expected. The result was also well below the Reserve Bank of New Zealand's forecast for a 0.7% rise in activity over the quarter.

Looking under the surface, there was widespread weakness in activity, with declines in both the goods and services

sectors. Notably, there were falls in retail and accommodation spending, transport, and personal services. Those are all sectors that are benefitting from the rebound in tourism currently in train, and their recent declines highlights the softening in domestic demand.

Importantly, it wasn't just the December quarter that has turned out softer than expected – estimates of activity through the middle part of 2022 have also been revised down. Putting that altogether, it's turned out that GDP is running almost two percent below what the RBNZ was expecting in its February Monetary Policy Statement.

Even with the softer-than-expected end to 2022, we're still left with a picture of an economy that is highly stretched, with elevated levels of demand, high levels of employment, and rapidly rising prices. And that means some further rise in the OCR is still needed. However, the economy is not nearly as stretched as the RBNZ thought. That matters for how much of a slowdown – and exactly how much further interest rates need to rise – to bring inflation back under control.

We've revised our forecast for the peak in the OCR to 5.00% (down from 5.50% previously). That implies only one more 25 basis point increase in this cycle, which we still think will be delivered at the April OCR review.

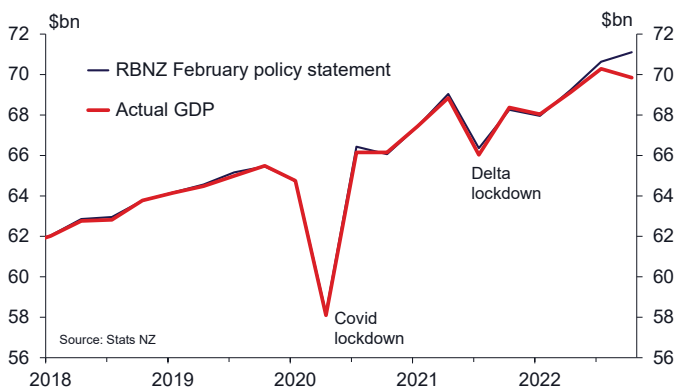
The RBNZ won't necessarily call time on the tightening cycle at that point – and since it won't be publishing new forecasts at the April review, it doesn't have to be explicit about the path forward. Rather, it could shift its language towards noting that a substantial amount of tightening has been put in place over the last 18 months, and that any further moves will be data-dependent.

In terms of what economic data is likely to show over the coming months, New Zealand is widely expected to slip into recession this year. However, the weak economic activity in the December quarter was not necessarily the start of that. In fact, some key gauges of economic activity that had softened through the latter part of 2022 – such as card spending and the PMI manufacturing survey – have actually picked up again in the first two months of this year. On top of that, the clean-up from Cyclone Gabrielle will generate extra activity that will add to GDP over the coming months. More generally, most businesses we've spoken to in recent weeks have continued to report firm levels of demand in recent months. Consistent with that, we expect to see continued, albeit modest, rates of economic growth through the first half of this year.

Looking further ahead, we expect economic activity to cool off through the back half of this year. Over the coming months, large numbers of borrowers will face refixing their mortgages at substantially higher rates. The resulting increases in debt servicing costs will be a substantial drag on households' spending power and domestic demand more generally.

That downturn in domestic demand will help to dampen inflation over time. Even so we're still looking at a strong inflation outlook over the coming year, and that's been exacerbated by the recent storms which have seen sharp rises in the prices of items like fresh produce. Given that strength in inflation pressures (which is already feeding into higher wage claims), we don't think the RBNZ will look at taking their foot off the brake until mid-2024 – slightly later than we previously forecast.

Level of quarterly GDP



Satish Ranchhod, Senior Economist

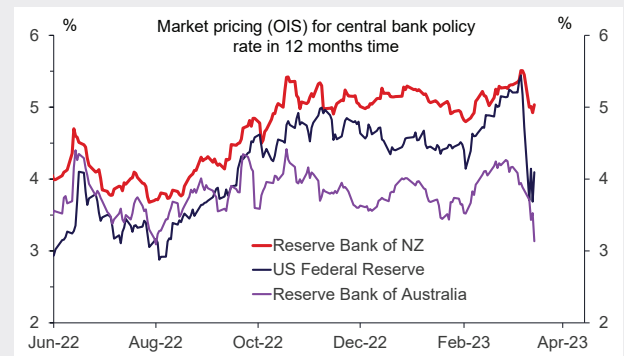
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Chart of the week

Concerns about the health of the global financial system spiked over the past week. Attention was initially focused on a number of regional US banks. However, those concerns have now broadened, with much attention now focused on Europe. Regulators have acted swiftly to ensure the stability of the financial system and restore confidence. Even so, market sentiment remains skittish, and expectations for policy tightening from major central banks have been pared back. While New Zealand's financial system looks to be better positioned, expectations for rate hikes here have also been wound back.

Market pricing for central bank policy rates

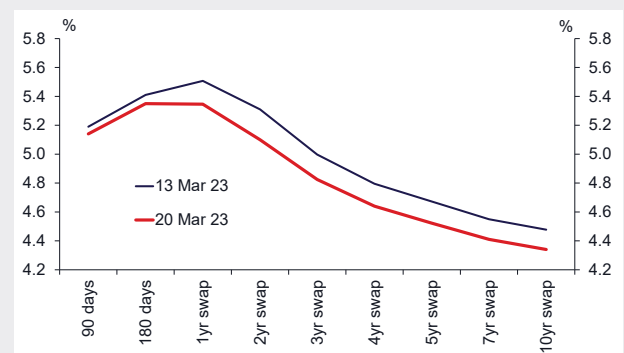


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.00% in the first half of this year. In contrast, interest rate markets are pricing a higher peak of 5.25%. We also see more scope for earlier OCR reductions as inflation pressures recede.

As a result, we believe that there is value in fixing for terms of up to one year. We would 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

Mar 22, Last: 0.2%, Westpac: flat

We expect whole milk powder prices (WMP) to be flat at the upcoming auction. Our pick is marginally higher than the circa 1% fall that the futures market is pointing to.

Over the 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 Q1 Westpac McDermott Miller Consumer Confidence

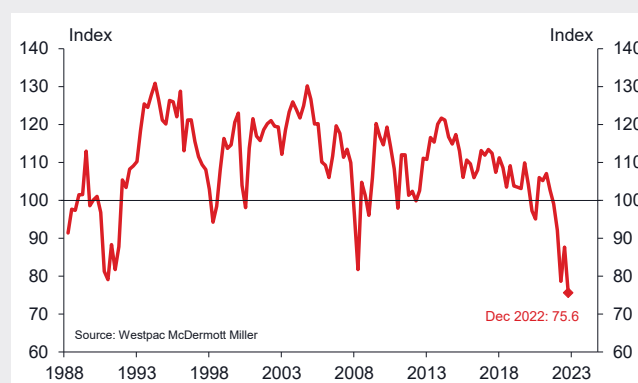
Mar 22, Last: 75.6

Consumer confidence fell sharply at the end of 2022, dropping to its lowest level on record. Underlying that weakness in sentiment have been mounting financial pressures, with sharp rises in living costs and interest rates. Those conditions have been weighing on households' spending appetites.

Since our previous survey, the headwinds buffeting households have remained intense. Mortgage rates have taken another step higher. There's been continued large increases in living costs. And the housing market has continued to weaken. The combination of those factors points to further pressure on households' balance sheets.

In addition to financial pressures, our latest survey occurred in the wake of the recent severe storms. Those events will have added to the challenges for many families.

Consumer Confidence



Aus Q1 ACCI-Westpac business survey

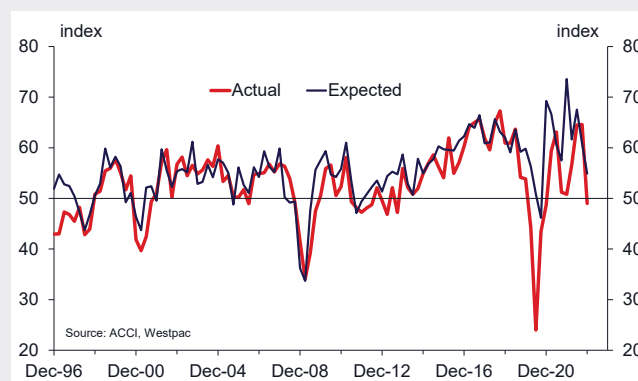
Mar 21, Last: 49.0

The ACCI-Westpac business survey for the March quarter, conducted through February into March, will provide a timely update on manufacturing and insights into economy wide trends.

After a burst in demand through mid-year 2022, momentum in the manufacturing sector abruptly stalled in Q4. There was little change in new orders, a decline in employment and a sharp deceleration in output expansion – together, marking a sober finish to an otherwise robust year of recovery and growth.

The survey also highlights that the manufacturing sector is facing a broad set of challenges. Labour and material shortages, in particular, are acting as a major drag on business activity. Additionally soaring input costs – exacerbated by a surge in energy costs – are flowing through (in part) to higher prices and squeezing margins.

Aus Westpac-ACCI Composite indexes (actual & expected, sa)



The week ahead

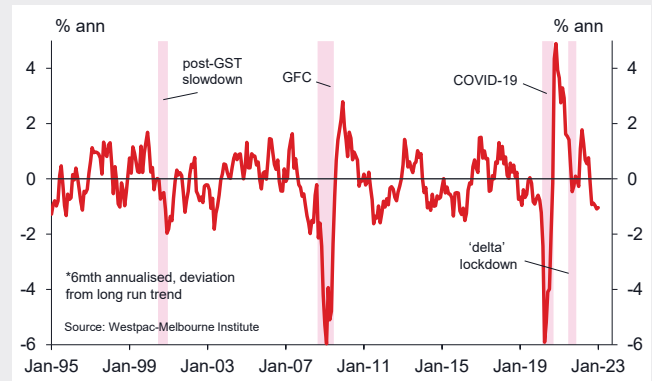
Aus Mar Westpac-MI Leading Index

Mar 22, Last: -1.04%

The Leading Index continued to send a weak signal in Feb, the six-month annualised growth rate coming in at -1.04%, indicating momentum is running well below trend heading in the first half of 2023.

The March report will include a mixed bag of component updates. On the weak side, the ASX200 declined -2.9%; commodity prices fell -4.6% in AUD terms and dwelling approvals dropped -28%, more than unwinding a 15% jump in the previous month. The main positive component update will be on hours worked which surged 3.9% in Feb following a 2.1% drop in Jan – abnormal seasonal shifts around leave contributing to big swings.

Aus Westpac-MI Leading Index



US Mar FOMC meeting

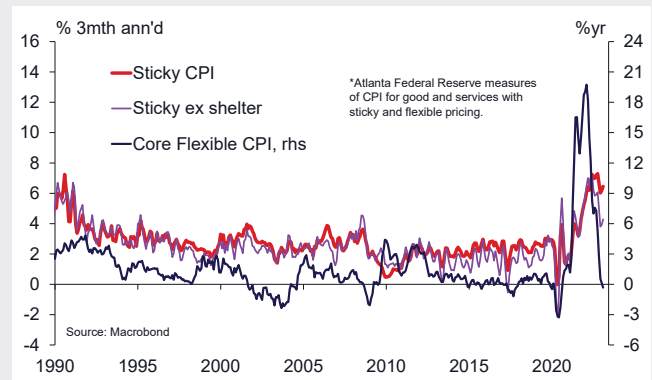
Mar 21-22: fed funds, Last: 4.625%, Mkt f/c: 4.875%, WBC: 4.875%

Versus their January/February meeting, the FOMC have a lot of new information and risks to consider before coming to a decision on the stance of policy.

The data certainly remains supportive of further hikes, with job creation continuing at a pace well in excess of that the FOMC feel is consistent with inflation at target. The February CPI report was constructive for a return to at-target inflation in the second half of 2023, but currently remains elevated.

Then there are the uncertainties around the banking sector. To our mind, recent developments will have a lasting contractionary impact on the economy, but is not a reason to panic. Hence we look for another 25bp hike at the March meeting, but for this to be the last of the cycle, followed by a pause to 2024.

US inflation

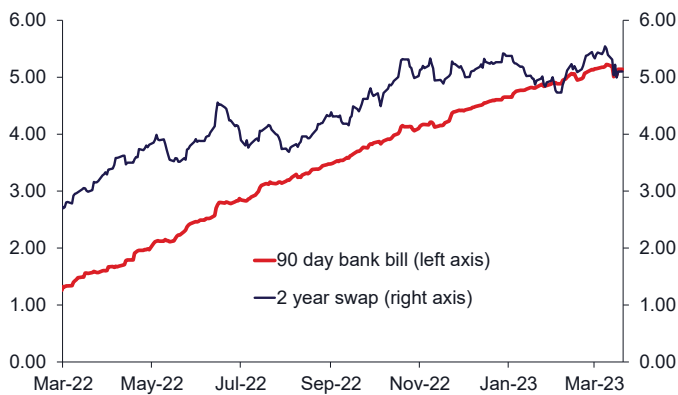


New Zealand forecasts

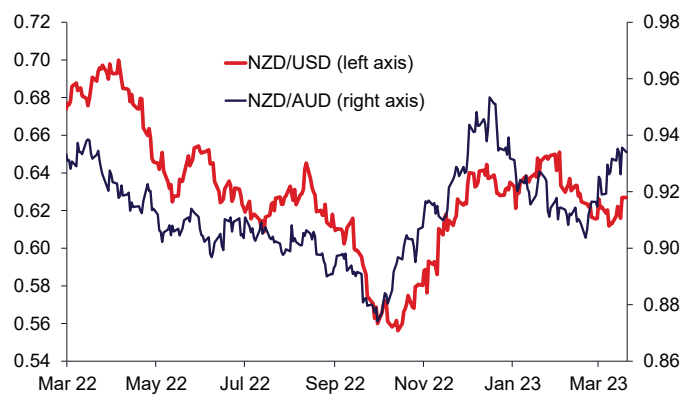
Economic forecasts	Quarterly				Annual			
	2022		2023		2021	2022f	2023f	2024f
% change	Sep	Dec	Mar	Jun				
GDP (Production)	1.7	-0.6	0.2	0.2	6.0	2.4	1.1	-0.5
Employment	1.3	0.1	0.3	0.2	3.3	1.3	0.5	-0.3
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	4.0	5.1
CPI	2.2	1.4	1.3	1.3	5.9	7.2	5.1	2.9
Current Account Balance % of GDP	-8.5	-8.9	-8.5	-8.3	-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	5.00	5.00	5.00	5.00	4.75	4.25	3.75
90 Day bill	5.10	5.10	5.10	5.00	4.55	4.05	3.75
2 Year Swap	4.90	4.60	4.30	4.00	3.70	3.55	3.40
5 Year Swap	4.50	4.30	4.10	3.90	3.80	3.70	3.65
10 Year Bond	4.40	4.20	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	83.8	85.8	86.4	86.4	85.7	85.1	84.3
NZD/EUR	0.59	0.60	0.60	0.60	0.60	0.59	0.59
NZD/GBP	0.52	0.54	0.54	0.54	0.54	0.53	0.53
TWI	71.5	72.6	72.8	72.6	71.8	71.3	71.1

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 20 March 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.75%	4.75%	4.25%
30 Days	4.94%	4.93%	4.71%
60 Days	5.01%	5.05%	4.86%
90 Days	5.14%	5.18%	4.98%
2 Year Swap	5.10%	5.41%	5.14%
5 Year Swap	4.52%	4.84%	4.56%

NZ foreign currency mid-rates as at 20 March 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6269	0.6186	0.6237
NZD/EUR	0.5862	0.5820	0.5836
NZD/GBP	0.5139	0.5150	0.5185
NZD/JPY	83.05	84.14	83.64
NZD/AUD	0.9340	0.9193	0.9037
TWI	71.57	70.92	70.83

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
Aus	RBA Assist' Governor, Financial Mkts	-	-	-	Kent speaking at KangaNews Summit.
Eur	Jan trade balance €bn	-18.1	-	-	Lower energy costs to narrow deficit over time.
UK	Mar Rightmove house prices	0.0%	-	-	Prices decelerating sharply on an annual basis.
Tue 21					
NZ	Feb trade balance \$mn	-1954	-	-800	Export prices have eased; import demand still firm.
Aus	Q1 ACCI-Westpac business survey	49.0	-	-	Manufacturers are under intense pressure from rising costs.
	RBA minutes	-	-	-	Crucial detail around recent 'dovish' shift.
Eur	Mar ZEW survey of expectations	29.7	-	-	Economic sentiment bounce reflecting improved outlook.
US	Feb existing home sales	-0.7%	3.8%	-	Established market near/at nadir; outlook still challenging.
Wed 22					
NZ	GlobalDairyTrade auction (WMP)	0.2%	-	Flat	Awaiting signs of lifting Chinese demand and dairy prices.
	Q1 Westpac-MM consumer confidence	75.6	-	-	Households continuing to grapple with high living costs.
Aus	Feb Westpac-MI Leading Index	-1.04%	-	-	Momentum running well below trend.
UK	Feb CPI %yr	10.1%	9.9%	-	Headline and core off-peak; stickiness of latter main concern.
US	FOMC policy decision, midpoint	4.625%	4.875%	4.875%	Best to focus on inflation and highlight trust in banks.
Thu 23					
NZ	RBNZ Chief Economist Conway	-	-	-	Speech on inflation outlook at KangaNews conference.
Eur	Mar consumer confidence	-19.0	-18.9	-	Inflation and interest rates limiting the up-turn in confidence.
UK	BoE policy decision	4.00%	4.25%	4.25%	Set for last 25bp rate hike with risks to the downside.
US	Feb Chicago Fed activity index	0.23	-	-	Temporary lift but largely below-trend, signalling slowdown.
	Initial jobless claims	192k	-	-	To remain at relatively low levels for now.
	Feb new home sales	7.2%	-3.0%	-	New home market more encouraging; outlook challenging.
	Mar Kansas City Fed index	0	-	-	Regional surveys highlighting headwinds for mfg sector.
Fri 24					
Eur	Mar S&P Global manufacturing PMI	48.5	48.8	-	Manufacturing activity is consolidating as supply issues fade...
	Mar S&P Global services PMI	52.7	52.5	-	... services buoyant for now; inflation and rates still a concern.
UK	Mar S&P Global manufacturing PMI	49.3	-	-	Risks facing the UK are similar to that of Europe...
	Mar S&P Global services PMI	53.5	-	-	... as expected scale of recession continues to shrink.
	Feb retail sales	0.5%	-	-	Real spending capacity under pressure from prices and rates...
	Mar GfK consumer sentiment	-38	-	-	... leaving households deeply pessimistic on the outlook.
US	Feb durable goods orders	-4.5%	1.7%	-	Core orders pointing to subdued demand.
	Mar S&P Global manufacturing PMI	47.3	47.3	-	Manufacturing remains in a fragile state as headwinds build...
	Mar S&P Global services PMI	50.6	50.3	-	... smaller/mid-sized service providers feeling pressure too.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022f	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	3.0
Unemployment rate %	5.2	6.8	4.7	3.5	4.6	5.1
Current account % of GDP	0.7	2.4	3.1	1.2	0.8	-0.1
United States						
Real GDP %yr	2.3	-3.4	5.7	2.1	0.9	1.0
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	-4.6	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 10 March 2023

Interest rate forecasts	Latest	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia								
Cash	3.60	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.66	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.44	3.60	3.40	3.20	3.00	2.80	2.70	2.50
International								
Fed Funds	4.625	4.875	4.875	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.58	3.70	3.50	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	0.6698	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	133.20	131	130	129	128	127	126	124
EUR/USD	1.0636	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2139	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.8916	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0748	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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