WESTPAC WEEKLY ECONOMIC COMMENTARY

It's gonna be a bumpy ride.

23 January 2023

Southern rātā

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The new year has gotten off to a rocky start for the New Zealand economy. Signs of a downturn in both the household and business sectors are mounting. And with a significant tightening in financial conditions over the past year, we expect that economic activity will continue to weaken over 2023. Despite that, we're yet to see signs that inflation pressures are easing.

Looking first at the household sector, nominal spending levels slumped in December, dropping 2.5%. Spending was down in nearly all categories, with sizeable declines in discretionary areas, like durables and apparel. That's particularly notable as for most of the past year, households were continuing to dial up their discretionary spending levels despite some large price increases.

As we've been highlighting for some time, households' finances are coming under increasing pressure on several big fronts. First is the sharp rise in consumer prices that has been eating away at households' spending power. The past year has seen particularly large increases in the prices of necessities. Notably, housing and accommodation costs were up 9% in the year to September, and food price inflation hit a 32 year high of 11% in the year to December. Those increases are being felt by every family across the country. They've been particularly tough on those families on lower incomes, who tend to spend a larger share of their earnings on necessities.

Compounding the pressure on households' finances has been the sharp rise in mortgage interest rates over the past year. Thus far, many households have been insulated from the march higher in mortgage rates. That's because around 90% of New Zealand mortgages are on fixed rates, and many borrowers are still on the very low rates that were on offer in the early stages of the pandemic.

However, as discussed in our recent report "From squeeze to crush"[1] a dramatic increase in borrowing costs is set to hit many New Zealand households through 2023. Around half of all loans will come up for refixing over 2023. Many borrowers will be faced with significant increases in debt servicing costs. In some cases, borrowers could see their mortgage rates rising by more than 3 percentage points. That will offset much of the boost from the strong labour market and accrued savings.

As the full brunt of interest rate increases ripples through the economy, household spending is set to slow sharply and we expect that the economy will slip into a shallow recession

1 https://www.westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2023/Bulletins/Economic-Data_Housing-update_bulletin_18Jan23.pdf

in late 2023/early 2024. And as activity weakens, we're also likely to see unemployment trending higher, rising from 3.3% currently up to 4.8% over the next few years. For the affected households, that will further compound the pressure on their finances.

Adding to the downwards pressure on household demand, the housing market has continued to slow. Prices fell by another 1.3% in December and are now down 15% since their peak in 2021. We've also seen sales dropping to lows that we last saw during the global financial crisis. New Zealanders hold a large amount of their wealth in owner occupied or investor housing. Consequently, the fall in prices now in train represents a sizeable knock to many households' net worth.

The downturn in demand is already being felt in the business sector. The past three months saw a sharp fall in trading activity, with a net 13% of businesses in the latest Survey of Business Opinion reporting weaker trading activity in the December quarter. The majority of businesses expect activity will continue to weaken over the early part of 2023, with businesses scaling back their plans for hiring and capital expenditure.

But while the economy may be turning down, that's after an extended period where it's been running hot. For now, the economy remains stretched. Crucially, we're not seeing any signs that inflation pressures are easing. In fact, recent months have seen increasing numbers of businesses reporting that operating costs have increased. At the same time, there has also been a lift in the number of businesses who have been raising their output prices.

We expect that those ongoing pressures will be reflected in this week's inflation report. We estimate that consumer prices rose by 1.1% in the three months to December. That would see the annual inflation rate slipping to 6.9%, down from 7.2% in the year to September. But even with the annual inflation rate starting to soften, prices are still rising at an alarming pace, with annual inflation remaining close to multi-decade highs.

As always, the devil will be in the detail. The December quarter saw big swings in some specific prices. That includes large supply driven increases in food prices and a continued post-pandemic rise in air fares, as well as a sharp 8% drop in fuel prices. But looking at the underlying trend in prices, most measures of core inflation have been tracking above 6%, and we expect that they will have remained around those levels in the December quarter. Looking ahead, we don't expect that inflation will be back within the RBNZ's target band until mid-2024. That will keep the pressure on the RBNZ to continue hiking the cash rate for some time yet.

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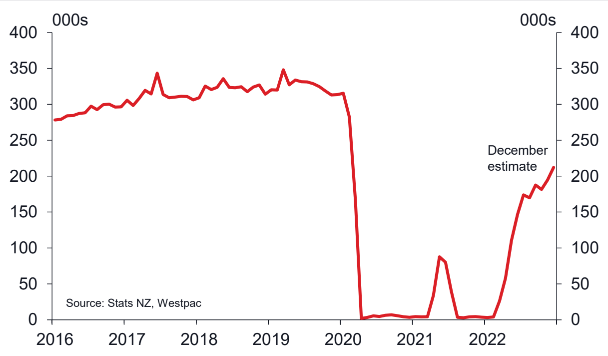
Chart of the week

As New Zealand reopened its border over 2022 we saw a strong pickup in visitor arrivals, which have now reached around two-thirds of their pre-Covid levels. The strongest recovery has been in visitors from Australia (many of whom in turn will be expat Kiwis coming back to see family and friends), while numbers from the US and Europe are about 60% recovered. Chinese visitor numbers have been the laggard to date, but with the Chinese government's surprisingly rapid easing of Covid restrictions, we should see a solid rebound over the course of this year.

Visitor arrivals, seasonally adjusted

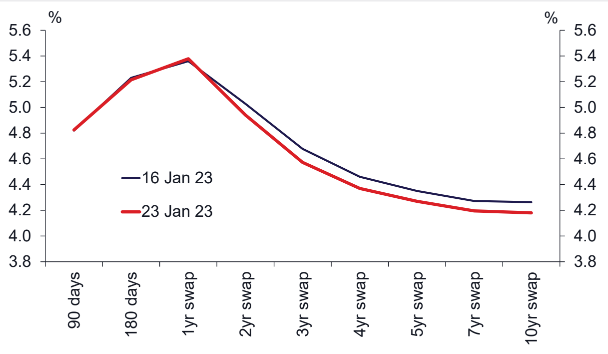


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.5% 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 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 Q4 Consumer price inflation

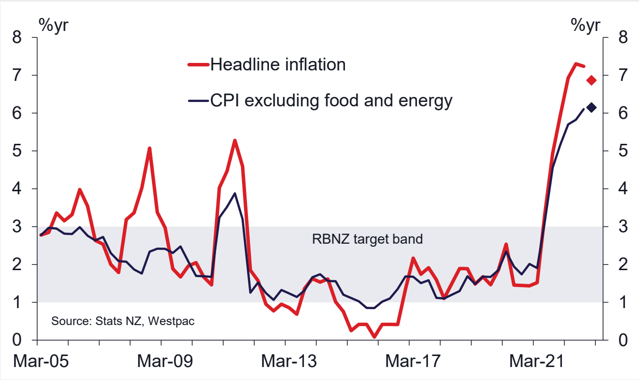
Jan 25, Qty. – Last: +2.2%, Westpac: +1.1%, Market f/c: +1.3%
Jan 25, Annual – Last: +7.2%, Westpac: +6.9%, Market f/c: +7.1%

We estimate that consumer prices rose by 1.1% in the December quarter. While that would see the annual inflation rate slipping from 7.2% last quarter to 6.9%, we're still left with a picture of rapid increases in consumer prices.

The December quarter saw large increases in food prices and housing related costs. December quarter inflation is also likely to be boosted by the post-Covid recovery in domestic and international tourism, and the related price rises for services like airfares. Those increases have been partially offset by the easing in fuel prices.

Measures of core inflation are expected to remain elevated reflecting the strong and widespread price pressures rippling through the economy.

Consumer price inflation



NZ Jan ANZBO business confidence

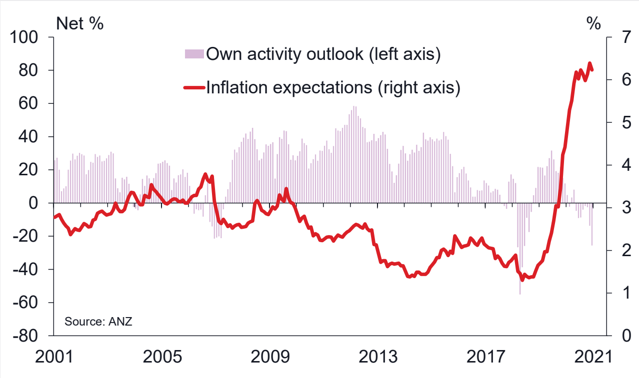
Jan 27, Last: -70.2

Business confidence plummeted to a record low at the end of 2022, with the majority of businesses expecting trading conditions on their own shop floors to deteriorate over the coming months.

With interest costs on the rise and signs that demand is faltering, confidence is set to remain low in the January survey.

The survey's cost and pricing gauges will be a key focus. Large numbers of businesses are reporting pressure on their operating costs, and we expect continued strong pricing pressures over the months ahead.

Business confidence



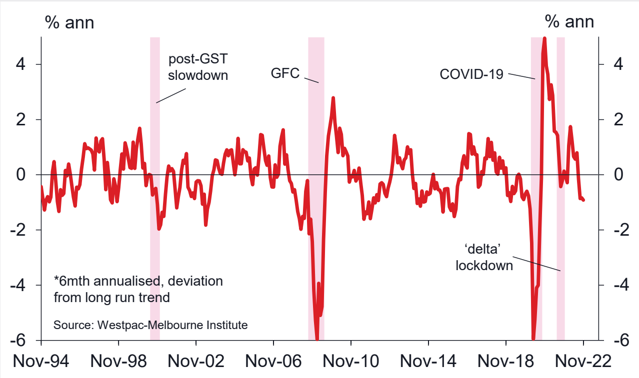
Aus Dec Westpac–MI Leading Index

Jan 25, Last: -0.92%

The six-month annualised growth rate in the Leading Index fell from -0.84% in October to -0.92% in November, the sub-zero read indicating below trend growth momentum heading into late 2022 that will carry well into 2023.

The December update is likely to show another weak read with monthly updates including a large fall in commodity prices (down 10% in AUD terms), a further decline in dwelling approvals (-9%), a sell-off in equities (ASX200 down -3.4%) and more soft reads on US industrial production and aggregate hours worked.

Westpac-MI Leading Index



The week ahead

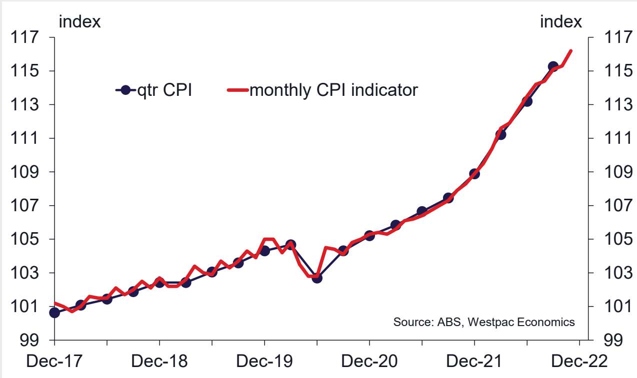
Aus Q4 Consumer Price Index %qtr

Jan 25, Last: 1.8%, WBC f/c: 1.5%
Mkt f/c: 1.6%, Range: 1.5% to 2.2%r

The CPI lifted 1.8% in Q3, greater than the market's 1.6% forecast. The main surprise was the +3.2% jump in electricity prices; Westpac had forecast a -17% fall due to the state government rebates. The ABS estimates that excluding the rebates electricity prices would have risen 15.6% in the quarter. The annual pace lifted from 6.1% to 7.3%, the fastest pace since June 1990 (7.7%yr) and significantly faster than the 5.0%yr pace at the peak of the mining boom.

Westpac is forecasting 1.5% rise in Q4 boosting the annual pace 0.1ppt to 7.4% which is our forecast peak for the current cycle. The reasons behind the step down from 1.8%qtr print in Q3 are the ongoing moderation in pace of price increases for food, clothing & footwear, new dwellings and household contents & services. The Trimmed Mean is forecast to lift 1.6%, a moderation from the 1.8% gain in Q3. The annual pace for the Trimmed Mean is set to lift to 6.6%yr, from 6.1%yr.

CPI Monthly Indicator vs. qtr CPI

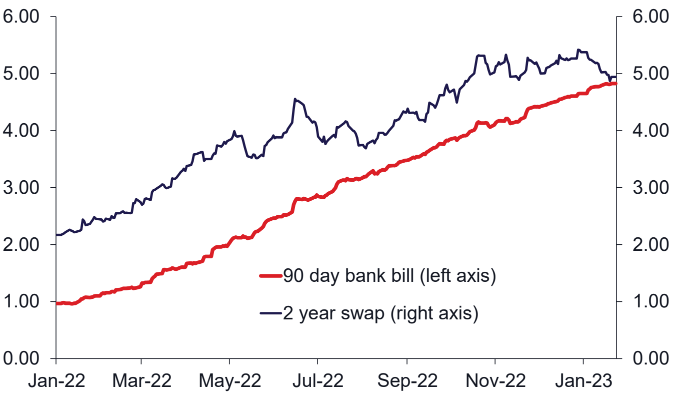


New Zealand forecasts

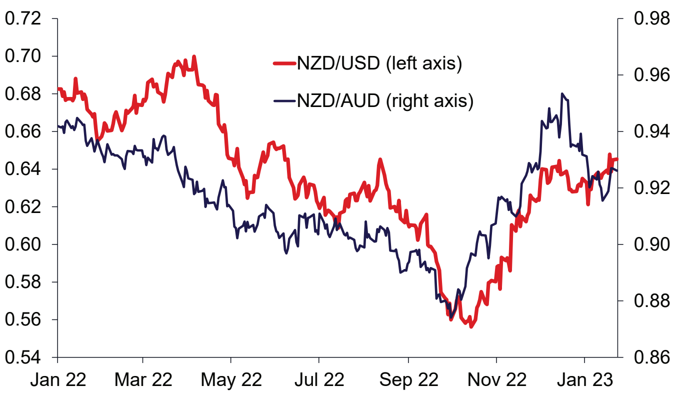
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	2.0	0.5	0.4	0.0	6.1	2.9	2.2	0.0
Employment	1.3	0.1	0.1	0.1	3.3	1.3	0.1	0.0
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	3.2	3.3	3.9	4.8
CPI	2.2	1.1	1.6	1.0	5.9	6.9	4.4	2.4
Current Account Balance % of GDP	-7.9	-7.3	-5.9	-5.2	-6.0	-7.3	-4.5	-3.5

Financial forecasts	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Cash	5.00	5.50	5.50	5.50	5.25	4.75	4.25
90 Day bill	5.50	5.60	5.60	5.50	5.05	4.55	4.05
2 Year Swap	5.00	4.90	4.70	4.50	4.20	3.90	3.70
5 Year Swap	4.40	4.35	4.25	4.15	4.05	3.90	3.80
10 Year Bond	4.00	3.95	3.90	3.80	3.70	3.60	3.50
NZD/USD	0.64	0.65	0.66	0.67	0.68	0.68	0.68
NZD/AUD	0.93	0.93	0.92	0.91	0.90	0.89	0.89
NZD/JPY	87.0	87.8	88.4	88.4	87.8	86.4	85.1
NZD/EUR	0.60	0.61	0.61	0.60	0.60	0.60	0.59
NZD/GBP	0.52	0.53	0.54	0.54	0.54	0.54	0.53
TWI	73.3	73.5	73.2	73.1	73.0	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 23 January 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	4.25%	4.25%
30 Days	4.39%	4.32%	4.32%
60 Days	4.63%	4.55%	4.41%
90 Days	4.83%	4.77%	4.61%
2 Year Swap	4.94%	5.18%	5.27%
5 Year Swap	4.27%	4.61%	4.73%

NZ foreign currency mid-rates as at 23 January 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6453	0.6376	0.6282
NZD/EUR	0.5945	0.5976	0.5912
NZD/GBP	0.5212	0.5263	0.5202
NZD/JPY	83.68	84.56	83.49
NZD/AUD	0.9261	0.9230	0.9347
TWI	72.23	71.95	72.00

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 23					
Asia	Lunar New Year celebrations	–	–	–	New Year on 22nd. Ongoing celebrations/holidays.
Eur	Jan consumer confidence	–22.2	–	–	Falling gas prices to support up-trend in confidence.
US	Dec leading index	–1.0%	–0.7%	–	Signalling a significant softening in economic conditions.
Tue 24					
NZ	Dec BusinessNZ PSI	53.7	–	–	Trended higher last year, but signs demand is cooling.
Aus	Dec NAB business survey	20	–	–	Nov, conditions still elevated, at +20. Pessimistic mood, at -4.
Eur	Jan S&P Global manufacturing PMI	47.8	48.5	–	Lower gas prices providing support to mfg...
	Jan S&P Global services PMI	49.8	50.0	–	... and services, but the outlook remains uncertain.
UK	Jan S&P Global manufacturing PMI	45.3	–	–	Conditions for UK manufacturing are weakening materially...
	Jan S&P Global services PMI	49.9	–	–	... services is more optimistic, but headwinds remain.
US	Jan S&P Global manufacturing PMI	46.2	46.5	–	S&P Global paints a bleak picture for mfg and services...
	Jan S&P Global services PMI	44.7	46.0	–	... in stark contrast to ISMs which just tipped into contraction.
	Jan Richmond Fed index	1	–	–	In subdued territory, like other regional surveys.
Wed 25					
NZ	Q4 CPI	2.2%	1.3%	1.1%	Sharp falls in fuel prices limiting the rise in inflation...
	Q4 CPI %yr	7.2%	7.1%	6.9%	... but prices rises remain widespread and rapid.
Aus	Dec Westpac-MI Leading Index	–0.92%	–	–	Clear signal of slowing to below trend pace.
	Q4 CPI	1.8%	1.6%	1.5%	Electricity pushing on inflation despite rebates but dwelling...
	Q4 CPI %yr	7.3%	7.5%	7.4%	... price inflation is moderating much faster than anticipated.
	Q4 CPI trimmed mean	1.8%	1.5%	1.6%	There are very few negatives to trim from the data which...
	Q4 CPI trimmed mean %yr	6.1%	6.5%	6.6%	... helps to boost core inflation above that for the headline.
Thu 26					
Aus	Australia Day	–	–	–	Public holiday, markets closed.
US	Q4 GDP, annualised	3.2%	2.6%	3.0%	Robust H2 offset H1 declines; stagnation to end-24 f'cast.
	Dec wholesale inventories	1.0%	–	–	Unwanted inventory accrual remains a risk.
	Dec Chicago Fed activity index	–0.05	–	–	Reflecting a subdued growth outlook.
	Initial jobless claims	190k	–	–	Should remain at relatively low levels for time being.
	Dec durable goods orders	–2.1%	2.8%	–	Core orders pointing to subdued investment spending.
	Dec new home sales	5.8%	–4.1%	–	Housing market to remain under significant pressure.
Fri 27					
NZ	Jan ANZBO business confidence	-70.2	–	–	Softening activity, but persistent inflation pressures.
Aus	Q4 PPI	1.9%	–	–	Falling energy prices should see an easing in PPI inflation.
US	Dec personal income	0.4%	0.2%	–	Officials still concerned over robust nominal income growth...
	Dec personal spending	0.1%	–0.1%	–	... which risks a more 'sticky' retreat in inflation pressures.
	Dec PCE deflator	0.1%	0.0%	–	Easing PCE inflation is a key dynamic...
	Dec core PCE deflator	0.2%	0.3%	–	... that must be sustained through early 2023.
	Dec pending home sales	–4.0%	–1.0%	–	Declines in sales volumes are well entrenched.
	Jan Uni. of Michigan sentiment	64.6	64.6	–	Final estimate.

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	3.10	3.60	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	3.27	3.97	4.05	4.05	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.39	3.20	3.10	3.00	2.90	2.80	2.70	2.60	2.50
International									
Fed Funds	4.375	4.875	4.875	4.875	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.40	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	0.6928	0.69	0.70	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	128.87	136	135	134	132	130	128	126	124
EUR/USD	1.0840	1.06	1.07	1.09	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2390	1.22	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.7815	6.90	6.80	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0793	1.08	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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