WESTPAC WEEKLY ECONOMIC COMMENTARY

There's more where that came from.

27 February 2023

Southern rātā

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The Reserve Bank of New Zealand hiked the Official Cash Rate by 50 basis points last week and continued to talk tough on inflation. As a result, we've revised up our forecast for the peak in the cash rate to 5.50%.

As expected, the RBNZ delivered another large 50bp hike at its February policy meeting. That was the latest in a string of large interest rate increases, and it took the cash rate to its highest level since 2008.

Underlying the rapid rise in the cash rate over the past 18 months has been a very familiar story: the economy has been running hot, productive capacity and the jobs market are stretched thin, and inflation pressures are boiling over.

Against that backdrop, tighter policy is needed to get inflation back inside the RBNZ's target band. However, there is more uncertainty around exactly how much more tightening will be needed. Back in November, the RBNZ's forecast signalled a 5.50% peak in the cash rate. But since that time, although inflation has remained strong at 7.2%, it has fallen short of the RBNZ's earlier forecast for a rise to 7.5%. As a result, we had expected that the RBNZ's updated policy projections would indicate that the cash rate could rise by slightly less than they had previously signalled.

However, the central bank has remained resolute: Inflation is much too high, and higher interest rates are still needed to bring it down to more sustainable levels.

Given the RBNZ's clearly stated intentions, we've reversed the change we made to our forecasts in the wake of the December quarter inflation report. We now expect the OCR will rise to a peak of 5.50% in mid-2023 (previously, we were forecasting a peak of 5.25%).

That sort of change in the OCR doesn't indicate a big change in economic conditions more broadly – the RBNZ has already delivered a large amount of tightening, and that will be a significant drag on demand over the coming year. An additional 25 points doesn't change that. However, this does help to clearly signal the RBNZ's intentions. And when the central bank says what it's going to do, it's very likely to follow through (at least in the near term).

There is, however, greater uncertainty around just how quickly the OCR will rise. The RBNZ's forecasts were intentionally ambiguous about the precise pace of tightening from here, including whether the April policy meeting will see a 25bp or 50bp rise in the cash rate. Interest rates have already risen by a large amount and the peak in the policy cycle is approaching. Consequently, the RBNZ is now moving into a 'fine tuning' phase of its tightening cycle, as it considers exactly how much further interest rates need to increase.

With ongoing uncertainties about the economic landscape, the central bank could reasonably shift to 25bp moves from here. However, the RBNZ's preference through the current cycle has been to adjust policy quickly to get interest rates where they think they need to be, rather than spreading them out. As a result, we expect that they will deliver another 50bp hike in April, followed by a 25bp rise in May.

An additional consideration for the RBNZ is the impact of the recent storms and flooding through large swathes of the North Island. Those events will boost inflation in the near term, with much of that due to increases in food prices following the damage to crops in the affected regions. However, the RBNZ recognises that these are temporary supply-side disruptions, which don't warrant a monetary policy response.

Of more concern for the RBNZ is the longer-term boost to demand from reconstruction, and the related impact on inflation. The construction sector is already stretched, and the required repair work will boost demand over the medium-term horizons that are a key focus for monetary policy.

But even then, it's not certain that this will require additional interest rate increases. Borrowing costs have already risen to their highest level in more than a decade, which over the coming year will dampen both demand and inflation. Notably, tighter financial conditions are already weighing on demand in the building sector, with builders reporting a drop-off in new demand and fewer new projects set to come to market over the year ahead. That slowdown in construction activity (and demand more generally) will free up capacity for the rebuild and limit the related rise in inflation pressures. Consistent with that, the RBNZ indicated that the recent floods haven't materially affected the outlook for monetary policy.

It will take some time for the full extent of damage stemming from the floods to be assessed, and the RBNZ's approach could change over time. But for now, it's taken an appropriately measured approach to these events.

Where we continue to differ from the RBNZ is on the timing of OCR cuts. As we've been highlighting, monetary policy acts with a lag. During the tightening cycle, mortgage rate fixing has delayed the impact of rate hikes and households have yet to feel the full brunt of interest rate increases to date (that's likely to be seen through the back part of this year). However, this works in both directions – it will take some time just to stabilise the average interest rate that homeowners are paying, let alone provide some relief as the economy cools off.

The RBNZ's proactive approach should extend to thinking about the appropriate time to start taking its foot off the brake. We expect rate cuts will be appropriate from early-2024 as the downturns in demand and inflation deepen. In contrast, the RBNZ's forecast don't show a material easing in policy until the end of 2024.

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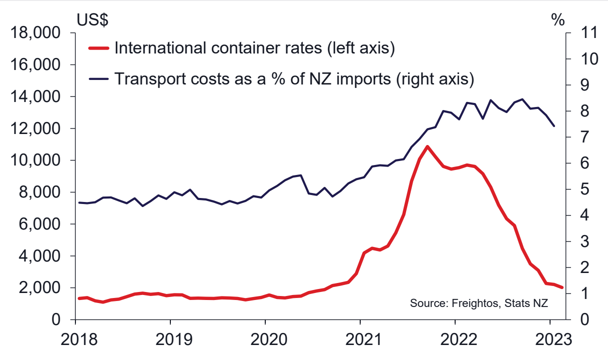
Chart of the week

Global shipping costs spiked over 2020 and 2021, as reduced capacity in the shipping industry met with a resurgence in global demand when pandemic-related restrictions were eased. While that rise in shipping costs largely unwound on the major global routes over 2022, shipping cost to New Zealand routes have remained high. In fact, it's only in the last few months that we've seen costs on New Zealand routes easing. If this continues, it will help to moderate imported inflation in the year ahead.

International transport costs

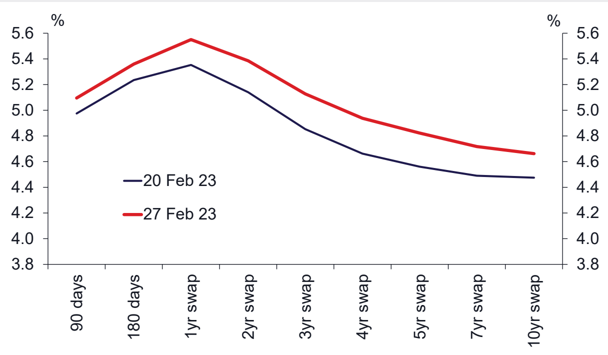


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.50% 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

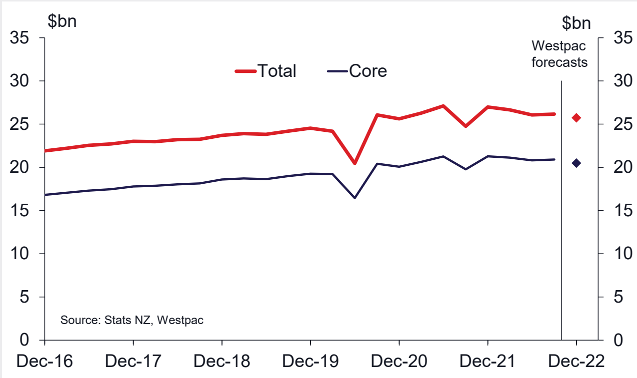
NZ Q4 retail spending volumes

Feb 27, Last: +0.4%, Westpac f/c: -1.7%

Over the past year, nominal spending has continued to rise at a brisk pace. However, while households are splashing out more cash, the actual amount of goods we've been purchasing hasn't really been rising, with large price rises eroding households' spending power. Nevertheless, the resilience in nominal spending, including purchases of discretionary items, points to firmness in spending appetites in the face of the large increases in interest rates.

We expect that the December quarter retail report will highlight that financial pressures, including high inflation and rising interest rates, are now squeezing households' budgets. We're forecasting a 1.7% drop in volumes, with a more modest 0.6% fall in nominal spending. That includes a pullback in spending on discretionary items like household goods.

NZ retail spending volumes



NZ Jan monthly employment indicator

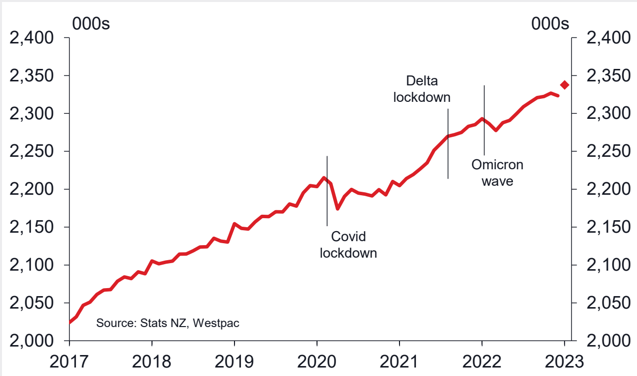
Feb 28, Last: -0.1%, Westpac f/c: 0.5%

The monthly employment indicator is drawn from income tax data, making it a fairly comprehensive record of the number of people in work.

This measure has seen subdued growth in recent months, with a slight decline in December. However, weekly snapshots suggest that this was temporary, due to a larger than normal dip over the Christmas period. We estimate there was a 0.5% pickup in January.

There are some signs that the heat is starting to come out of the labour market. Job advertisements have fallen substantially in the last few months, though that's only taken them from extremely elevated to around pre-Covid levels.

NZ monthly filled jobs



NZ Feb ANZBO business confidence

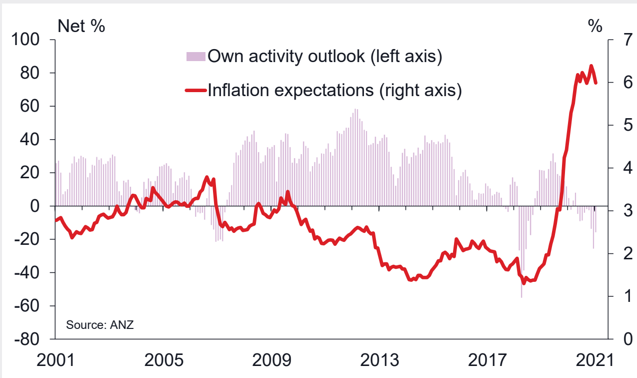
Feb 28, Last: -52.0

While business confidence lifted in the early part of the year, the January confidence survey still pointed to week conditions across New Zealand's business sectors.

The latest survey comes in the wake of the recent severe storms that have caused widespread damage through the upper and central North Island. It is not clear how large of an impact those events will have had on the survey. Some businesses in the affected regions will not have been operating for several days and may not have been contactable.

Given the significant disruptions from the recent storms, as well as the other significant headwinds businesses were already facing, we expect that the February survey will again point to low levels of business confidence. We also expect weakness in trading activity and ongoing pressure on operating costs.

NZ business confidence



The week ahead

NZ Jan building consents

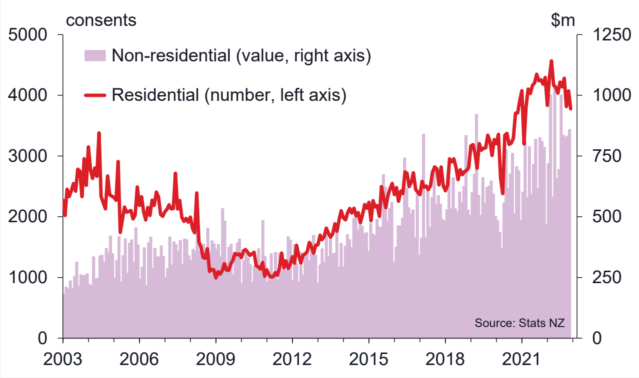
Mar 1, Last: -7.2%, Westpac f/c: +5.0%

Dwelling consent issuance fell by 7% in December. Much of that was due to a fall in the lumpy multi-unit consents category, which relates to dwellings such as townhouses and apartments, and which are often issued in lots. We're forecasting a bounce in January as December's drop reverses.

However, smoothing through the normal month-to-month volatility, monthly consent issuance has started to ease back in many regions, as tighter financial conditions have seen increasing hesitancy among both developers and purchasers. We expect that trend will continue over the next few years.

The January update on consent issuance pre-dates most of the severe weather that struck the North Island. Those events will have a larger impact on consent issuance in the coming months.

NZ building consents



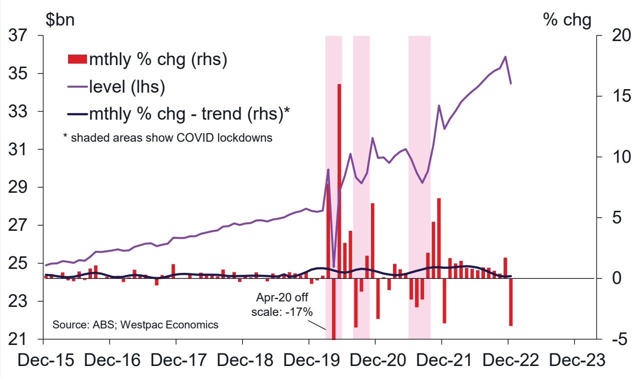
Aus Jan retail trade

Feb 28, Last: –3.9%, WBC f/c: 1%
Mkt f/c: 1.5%, Range: –1% to 5%r

Retail sales posted a very large 3.9% drop in Dec. Some of this looks to be volatility around the Black Friday/Cyber week sales complicated by seasonal adjustment difficulties – Nov's 1.4% gain was marked up to 1.7% and there was a similar choppy profile around Nov–Dec in 2021. However, the Dec fall more than reverses the Nov gain and, taking the two months together, suggests there has been a slowing underlying trend in response to rising interest rates that may have bitten harder late in the year.

Our Westpac Card Tracker and other measures also suggest retail was slowing into year-end with wider spending showing a big pivot towards non-retail segments (travel and hospitality in particular) over and above normal seasonal shifts. Volatility is clearly an issue and we may well see revisions to soften some of the choppy monthly profile. On balance we expect nominal sales to post a 1% gain in Jan, which would still be broadly consistent with stalling underlying growth.

Aus monthly retail sales



Aus Q4 current account balance, $bn

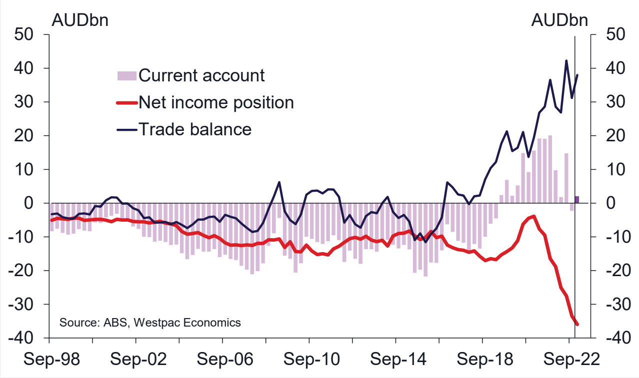
Feb 28, Last: –2.3, WBC f/c: +2.0
Mkt f/c: +5.0, Range: –3.2 to +10.0

Australia's current account position slipped into deficit in the September quarter, to the tune of $2.3bn – ending a record run of 13 consecutive quarters of surplus.

A deterioration of $17bn in the quarter (from +$14.7bn) included an $11bn narrowing of the trade surplus (to $31.2bn, since revised to $29.3bn). It also included a $6bn widening of the net income deficit (NID) on higher returns to international investors in the resource sector (to -$33.2bn, the largest deficit on record at -5.4% of GDP).

In the December quarter, the current account potentially edged back into surplus, to a forecast $2.0bn, on a rebound in the trade position. The trade surplus swelled to around $38bn, on a lift in export volumes and a dip in import volumes. We've factored in a further increase in the NID, to $36bn.

Aus current account



The week ahead

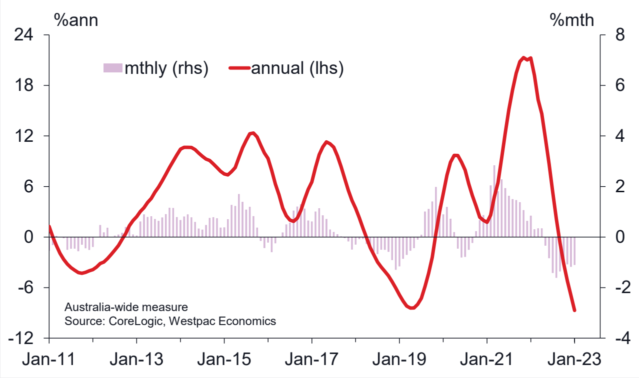
Aus Feb CoreLogic home value index

Mar 1, Last: –1.1%, WBC f/c: –0.1%

The CoreLogic home value index fell 1.1% in January to be down 8.7%yr, the annual pace of falls eclipsing the 2018-19 correction for the first time to be the weakest on records back to 1981. All capital cities and major regional areas recorded price declines in the month.

While the correction looks to have continued into February, the daily index is pointing to a much milder monthly decline. We expect the final wash-up to show a 0.2% dip in prices nationally. That said, some of this looks to be due to temporary factors – in particular, changes in NSW allowing eligible buyers to opt for an annual land tax payment instead of an up-front stamp duty charge which look to have provided a significant boost to demand. Seasonality can also flatter prices a little in February (worth about +0.3ppts on the Jan-Feb price move). More generally, the RBA's interest rate tightening cycle clearly has further to run and will remain a dampener throughout 2023.

Aus dwelling prices



Aus Q4 GDP

Mar 1, Last: 0.6%, WBC f/c: 0.7%
Mkt f/c: 0.7%, Range: 0.4% to 1.9%

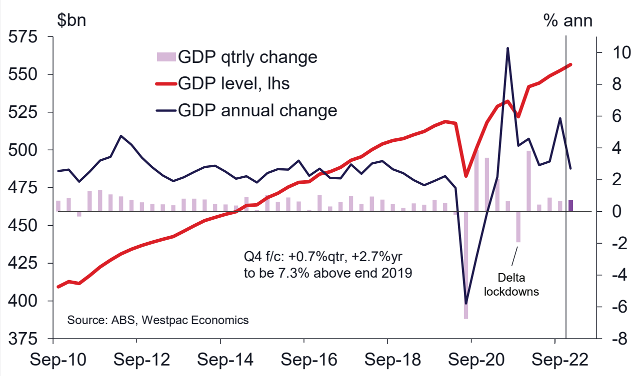
We assess that the Australia's economy grew by a moderate 0.7% in the December quarter, following a 0.6% gain, to be 2.7% higher over the year.

The arithmetic is: domestic demand +0.3% and +0.4ppts on balance from net exports (+1.4ppts) and inventories (-1.0ppt).

Conditions appear to be mixed – with service sectors benefiting from fewer covid disruptions but with the adverse impacts from high inflation and rising interest rates becoming apparent (falling retail sales, declining home renovations and lower housing turnover).

Consumer spending grew by a forecast 0.8%qtr, 5.9%yr; home building was flat; public demand is consolidating (a forecast +0.3%) as the spike in covid related spending unwinds; while business investment appears to have edged lower. The recent export recovery continued, after the weakness from end 2019 to Q1 2022.

Aus GDP



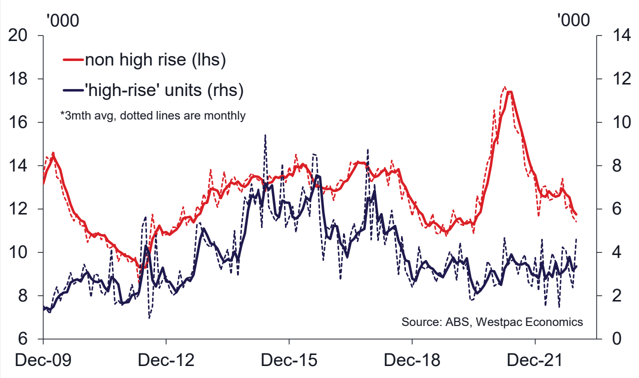
Aus Jan dwelling approvals

Mar 2, Last: 18.5%, WBC f/c: –10%
Mkt f/c: –7.5%, Range: –5% to –12%

Dwelling approvals produced a large upside surprise for December with an 18.5% jump in total approvals for the month. This was very much against the run of play with significant declines in Oct-Nov that suggested rate rises and other pressures were starting to bite. The detail suggests this underlying weakness was still present in December with the headline gain driven by a spike in high rise approvals and 'core' non high rise approvals still tracking lower.

The January update is expected to see a sharp reversal with significant downside risks. Underlying trend weakness looks to have accelerated through year-end, HIA figures on new home sales showing another steep fall in Jan. With high-rise approvals coming off what is very likely a temporary spike, total approvals are primed for a big fall. Overall, we expect approvals to be down 10%mth. Note that the summer low period can also see seasonal adjustment amplify monthly moves in Jan, meaning a much bigger fall is possible.

Aus dwelling approvals

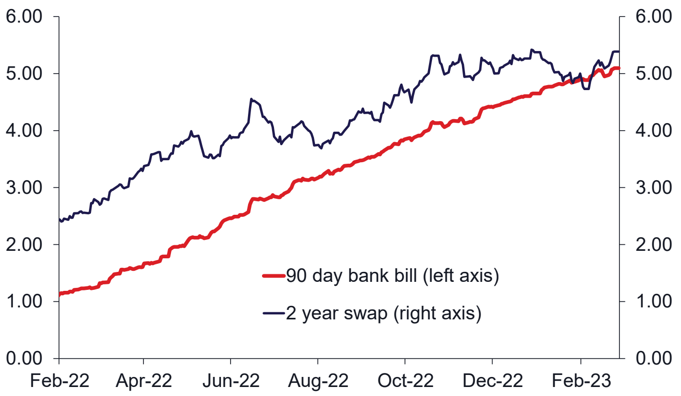


New Zealand forecasts

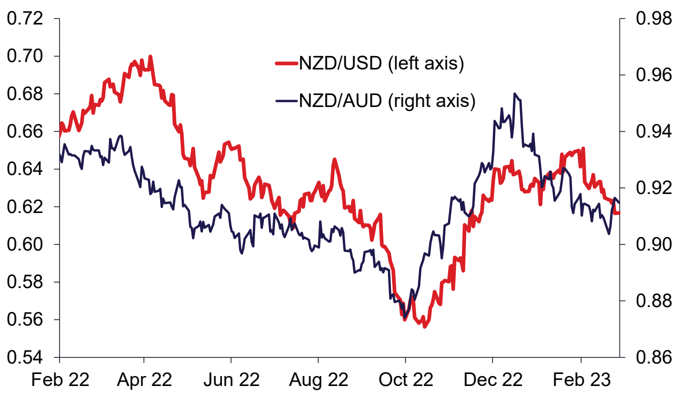
Economic forecasts	Quarterly				Annual			
	2022		2023					
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	2.0	0.5	0.4	0.0	6.1	2.9	2.2	0.0
Employment	1.3	0.1	0.0	0.0	3.3	1.3	0.1	-0.1
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	3.9	4.8
CPI	2.2	1.4	1.4	1.0	5.9	7.2	4.7	2.4
Current 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	5.50	5.50	5.50	5.25	4.75	4.25
90 Day bill	5.40	5.60	5.60	5.50	5.05	4.55	4.05
2 Year Swap	5.30	5.10	4.80	4.40	4.10	3.80	3.60
5 Year Swap	4.80	4.60	4.40	4.20	4.00	3.80	3.70
10 Year Bond	4.60	4.50	4.20	4.00	3.85	3.70	3.60
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 27 February 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.75%	4.25%	4.25%
30 Days	4.82%	4.75%	4.49%
60 Days	4.99%	4.93%	4.71%
90 Days	5.10%	5.07%	4.88%
2 Year Swap	5.39%	5.23%	4.94%
5 Year Swap	4.82%	4.56%	4.29%

NZ foreign currency mid-rates as at 27 February 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6167	0.6333	0.6499
NZD/EUR	0.5849	0.5930	0.5956
NZD/GBP	0.5157	0.5260	0.5237
NZD/JPY	84.17	83.96	84.40
NZD/AUD	0.9148	0.9144	0.9166
TWI	70.88	71.62	72.32

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
NZ	Q4 real retail sales	0.4%	–	–1.7%	Higher interest rates and prices weighing on spending.
	RBNZ Chief Economist Conway speaking	–	–	–	Post-MPS engagement.
Aus	Q4 company profits	–12.4%	1.5%	1.0%	Headline likely to overstate underlying profits.
	Q4 inventories	1.7%	0.0%	–1.0%	Sharp Q3 mining & retail inventory run–up to reverse.
Eur	Feb consumer confidence	–19.0	–	–	Consumer and business sentiment improving...
US	Jan durable goods orders	5.6%	–3.9%	–	Core orders pointing to subdued demand.
	Jan pending home sales	2.5%	0.9%	–	Sales to remain weak for now, but low point likely passed.
	Feb Dallas Fed index	–8.4	–9.5	–	Regional surveys are consolidating in broadly weak territory.
	Fedspeak	–	–	–	Jefferson.
Tue 28					
NZ	Jan employment indicator	–0.1%	–	0.5%	Dec softness looks to have been temporary.
	Feb ANZ business confidence	–52.0	–	–	Activity indicators to remain low, price pressures strong.
Aus	Jan retail sales	–3.9%	1.5%	1.0%	Choppy Nov-Dec-Jan but with an underlying slowdown.
	Q4 current account balance, $bn	–2.3	5.0	2.0	A potential return to surplus on improved trade performance.
	Q4 real net exports, ppts cont'n	–0.2	1.3	1.4	Exports robust rise, imports dip but still at a high level.
	Q4 public demand	0.2%	–	0.2%	Consolidation phase, as covid spending spike unwinds.
	Jan private sector credit	0.3%	0.3%	0.4%	Higher rates biting – but softness in December overstated?
US	Jan wholesale inventories	0.1%	0.1%	–	Pace of inventory accrual has fallen to near–stall speed.
	Dec FHFA house prices	–0.1%	–0.2%	–	House price declines set to continue...
	Dec S&P/CS home price index	–0.54%	–0.35%	–	... as interest rates suppress demand and affordability.
	Feb Chicago PMI	44.3	45.0	–	Reflecting a material loss of economic momentum.
	Feb Richmond Fed index	–11	–	–	Regional surveys are consolidating at weak level.
	Feb consumer confidence index	107.1	108.4	–	Up–trend in confidence limited by rates and real income.
Wed 01					
NZ	Jan building permits	–7.2%	–	5.0%	Bounce in multi-unit consents, longer term trend down.
Aus	Feb CoreLogic home value index	–1.1%	–	–0.1%	Daily measures surprisingly steady in Feb but one–offs at play.
	RBA Assist' Governor (Financial Syst)	–	–	–	Jones, IIF Australia Forum in Sydney.
	Q4 GDP	0.6%	0.7%	0.7%	A mixed end to the year ahead of a sharp slowdown in 2023.
	Jan CPI Monthly Indicator %yr	8.4%	8.0%	7.9%	Falling domestic holidays & survey timing mutes Jan print.
Chn	Feb manufacturing PMI	50.1	–	–	Conditions have drastically improved since the removal of...
	Feb non–manufacturing PMI	54.4	–	–	... COVID–zero; risks around global demand remain, but...
	Feb Caixin manufacturing PMI	49.2	–	–	... burgeoning support from Asia will provide some offset.
Eur	Feb S&P Global manufacturing PMI	48.5	–	–	Final estimate.
UK	Feb S&P Global manufacturing PMI	49.2	–	–	Final estimate.
US	Jan construction spending	–0.4%	0.3%	–	Softening demand weighing on construction.
	Feb S&P Global manufacturing PMI	47.8	47.8	–	Manufacturing activity remains in a fragile state...
	Feb ISM manufacturing	47.4	47.8	–	... with S&P and ISM mirroring each other.
Thu 02					
NZ	Q4 terms of trade	–3.4%	–	–1.0%	Meat prices led overall export prices down over the quarter.
Aus	Jan dwelling approvals	18.5%	–7.5%	–10%	Big pull-back on unwinding high-rise spike & wider weakness.
Eur	Jan unemployment rate	6.6%	–	–	Slack to emerge slowly over 2023.
	Feb CPI %yr	8.6%	–	–	Stickiness of core inflation remains the key concern.
US	Q4 productivity	3.0%	2.5%	–	Final estimate.
	Initial jobless claims	192k	–	–	Holding at a relatively low level.
	Fedspeak	–	–	–	Jefferson.
Fri 03					
NZ	RBNZ speech	–	–	–	Governor Orr speaking.
	Feb ANZ consumer confidence	83.4	–	–	Set to remain weak as financial pressures mount.
Aus	Jan housing finance	–4.3%	–3.0%	–4.0%	No let-up in the broad-based correction, turnover down in...
	Jan investor finance	–4.4%	–	–4.2%	... established market and new construction weakening...
	Jan owner occupier finance	–4.2%	–	–4.0%	... investor loan pull–back a touch faster.
Chn	Feb Caixin services PMI	52.9	–	–	Services sector embracing the easing of restrictions.
Eur	Feb S&P Global services PMI	53.0	–	–	Final estimate.
UK	Feb S&P Global services PMI	53.3	–	–	Final estimate.
US	Feb S&P Global services PMI	50.5	–	–	S&P staged a surprise rebound in February, but larger...
	Feb ISM non–manufacturing	55.2	54.5	–	... service providers in ISM survey still much more buoyant.
	Fedspeak	–	–	–	Logan, Bostic, Bowman.

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	4.10	4.10	4.10	3.85	3.60	3.35	3.10
90 Day BBSW	3.51	4.22	4.30	4.30	4.22	3.97	3.72	3.47	3.22
10 Year Bond	3.88	3.85	3.75	3.45	3.25	3.00	2.80	2.70	2.50
International									
Fed Funds	4.625	4.875	5.375	5.375	5.375	4.875	4.375	3.875	3.375
US 10 Year Bond	3.90	3.90	3.80	3.50	3.30	3.10	2.90	2.80	2.60

Exchange rate forecasts	Latest	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6820	0.70	0.71	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	134.65	132	131	130	129	128	127	126	125
EUR/USD	1.0605	1.08	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2024	1.21	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.9167	6.75	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0934	1.09	1.09	1.09	1.10	1.11	1.13	1.13	1.13

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