WESTPAC WEEKLY ECONOMIC COMMENTARY

When the tide goes out.

27 March 2023

Southern rātā

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A clutch of bank failures has put global markets on edge in recent weeks. If this were to blow up into a wider issue, past experience shows that New Zealand could find it harder and costlier to fund itself from overseas, and global growth would be undermined. But as long as the pressures remain contained, the Reserve Bank's focus can remain on the battle against inflation.

The closure of Silicon Valley Bank, along with two other regional US banks, earlier this month sparked a crisis of confidence in the banking sector. Concerns about contagion – the risk that investors and depositors start to withdraw indiscriminately, potentially putting otherwise healthy banks in distress – led authorities to provide a range of assurances and support measures. Those interventions have been effective so far, and global markets have been calmer in recent days.

Time will tell whether this proves to be the last of the banking sector concerns. Global interest rates have risen substantially in the last year or so. This will inevitably shake out bad investments and bad practices that flourished during the period of extraordinary low interest rates following the Covid shock. For instance, Silicon Valley Bank was among the first banks to fail because, as it turned out, it had done an exceptionally poor job of managing its interest rate risk.

Where this could become a more serious issue for New Zealand is if investors' appetite for risk dries up, and they instead focus on shoring up their own positions. When this occurs, capital tends to flow back to its home markets. And for the most part, 'home' is not New Zealand – we have long been a net borrower on the world stage.

Indeed, just as we were before the 2008 Global Financial Crisis, we are very reliant on international markets to fund our spending behaviour at the moment. Figures released earlier this month showed that our current account deficit has widened to 8.9% of GDP, from as little as 1% two years ago.

The blowout in the deficit has been due to multiple factors: the loss of overseas tourist earnings during the border closure, rising world prices for our imports, and a sharp rise in shipping costs. But the overriding factor is that we have not adjusted our spending to account for these shocks. In fact just the opposite – demand in the domestic economy, including demand for imported goods, has been running hot in the last couple of years.

A loss of risk appetite among global investors would force a narrowing of this deficit, through two potential channels. The first would be a sharp drop in the New Zealand dollar, until it reached a level that made it attractive to investors again. This would actually worsen the deficit initially, as the dollar value of exports, imports, and the (negative) balance would all increase. But over time, this would help to boost export volumes and reduce demand for imports.

The other potential channel is that New Zealand banks and business would find that overseas funding becomes more expensive and harder to come by. That means higher interest rates, independent of what the Official Cash Rate is doing. This would slow the economy and reduce the demand for imports. Indeed, it's possible that market interest rates could rise by more than what the Reserve Bank intended, in which case it may have to adjust its path for the OCR accordingly.

At this stage, though, there's no sign of these sorts of pressures emerging. So the Reserve Bank's interest rate decisions can stay focused on the fight against inflation.

As the RBNZ's chief economist noted in a speech last week, that fight remains incredibly challenging. The inflation rate remains close to a three-decade high, and more worryingly, the drivers of inflation have evolved. The initial spike was mainly due to large price rises in a relatively small number of largely imported items. However, we are now seeing price rises across a wide range of goods and services, and increasingly driven by local rather than global forces.

Against this, the RBNZ's response to inflation is now well advanced. The OCR has been rising since October 2021, and has finally reached a level that the RBNZ considers to be contractionary. There are some early signs that this is having the desired effect, and that demand in the economy is starting to cool off.

Even so, there is a lot of water to go under the bridge before we can be confident that inflation is coming back under control. Firms are still facing a range of cost increases, workers are still in short supply and the upward pressure on wages remains strong. We recently revised our OCR forecast to a peak of 5% this year, with one further 25 basis point increase at the next review in April. However, with the RBNZ continuing to talk tough on inflation, the risks lean towards further cash rate increases beyond that date.

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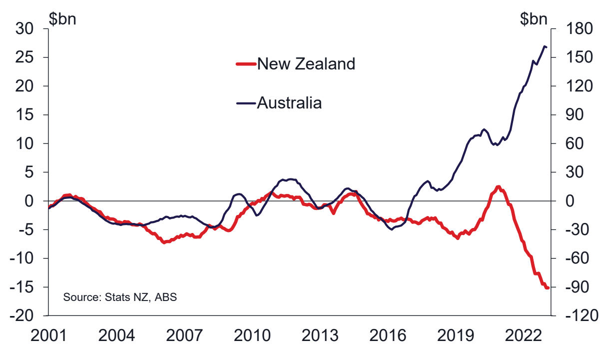
On another note, we welcome Kelly Eckhold, our new Chief Economist for New Zealand. Kelly says:
Hello everyone! I've been working in the US for the last decade for the International Monetary Fund, working on global macroeconomic, monetary policy and financial stability issues. I am really looking forward to re-engaging with New Zealand economic issues. There's a lot going on out there that matters to you our customers, and my goal is to try to bring you a steady supply of relevant, accessible insights that help you as you navigate the times ahead.

Chart of the week

Trade figures last week showed that New Zealand's goods trade balance remained at a record deficit of around $15bn over the last year. That's in stark contrast to the record surpluses that Australia has been recording at the same time. Imports account for only a small share of the difference – since the initial shock of the Covid lockdown, New Zealand's import bill has risen by 54%, compared to 45% in Australia. The bigger difference has been due to exports. Australia was already running ahead before Covid, as years of investment in its mining sector came to fruition. But in the last two years Australia's exports have grown by 63%, compared to just 24% for New Zealand.

Goods trade annual balance, NZ vs Australia

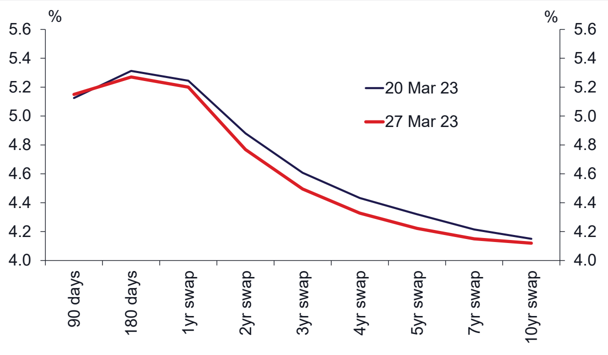


Fixed vs floating for mortgages

We expect the Official Cash Rate to rise to 5.00% at the next review in April, and remain there for the following year. As inflation pressures recede, we see scope for an extended series of rate cuts in 2024 and 2025, by more than that market is currently factoring in.

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 Feb monthly employment indicator

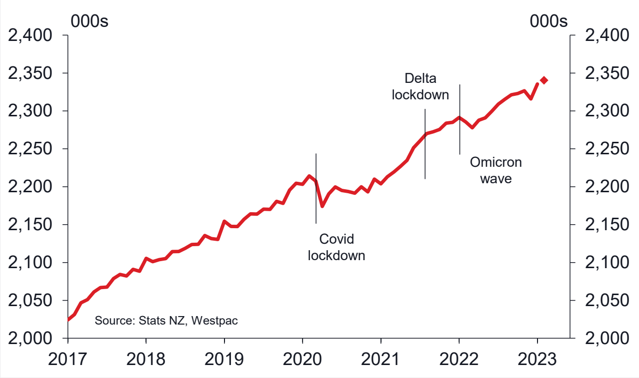
Mar 28, Last: 0.8%, Westpac f/c: 0.2%

The monthly employment indicator is drawn from income tax data. This makes it a fairly comprehensive record of the number of people in work, and helps to fill a gap in what is otherwise largely quarterly data on the labour market.

There was a surprisingly large 0.5% fall in employment in December, although the weekly snapshots indicated that this was limited to a larger than usual dip over the Christmas period. Accordingly, we saw a strong 0.8% rebound in January.

The February figures point to a return to the modest growth pace of the last year. That is in the context of a labour force that is growing again as net migration has turned strongly positive. Even so, there is little in the way of recessionary signals coming from the labour market just yet.

NZ monthly filled jobs



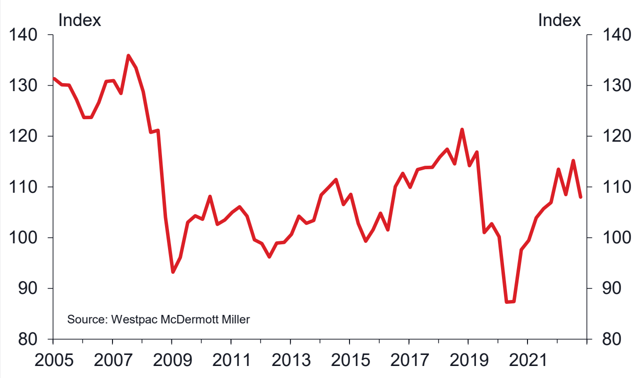
NZ Q1 Westpac McDermott Miller Employment Confidence

Mar 29, Last: 108.0

The Westpac McDermott Miller Employment Confidence Index fell to 108 in December, after having reached a post-pandemic high in September. Perceptions about future job opportunities were notably softer at the end of last year, with households taking heed of the growing warnings of a downturn in economic conditions. Earnings growth was still seen as subdued, perhaps reflecting a sense among many households that they aren't getting ahead of the rising cost of living.

Our latest survey was conducted in the first half of March. The early part of this year has seen some signs that activity has firmed. However, the mounting pressure on living costs remains front of brain for many households, as highlighted in our recent consumer confidence survey.

Employment Confidence Index



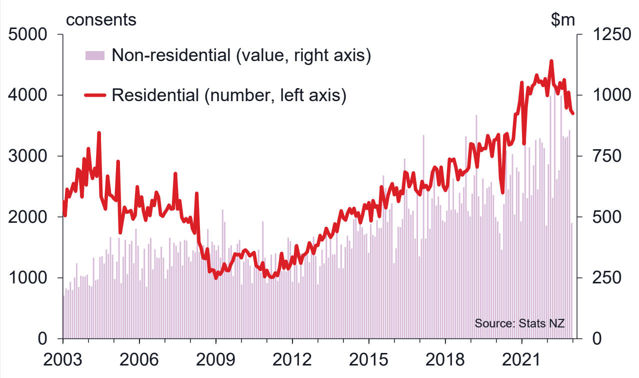
NZ Feb building consents

Mar 30, Last: –1.5%, Westpac f/c: +3.0%

We're forecasting a modest 3% bounce in consents in February following the sharp decline in multi-unit consents in recent months. However, that would only reverse some of the recent weakness. Under the surface, tighter financial conditions mean that fewer new projects are now coming to market. While consent issuance is still elevated, issuance peaked last year and we expect the downturn will become increasingly pronounced over the months ahead.

In late January and early February New Zealand was struck by severe storms. Those events cause significant damage to homes in the upper and central North Island, and the resulting repair work will boost construction over time. However, in February it is more likely that storm related disruptions will have been a drag on consent processing.

NZ building consents



The week ahead

NZ Mar ANZBO business confidence

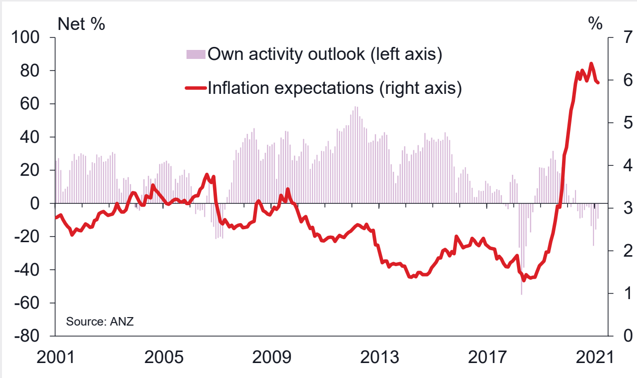
Mar 30, Last: –43.3

While sentiment lifted in February, business confidence remained subdued with the majority of firms still expecting that trading conditions will weaken over the months ahead.

We expect that the March confidence survey will continue to highlight weakness in business sentiment. Although most businesses are continuing to report firm sales, cost pressures remain intense and margins are being squeezed. However, it is a mixed picture across the economy – while retailers and those in the construction sector are reporting softer conditions, businesses in sectors like hospitality are benefiting from the recovery in international tourism.

The survey's cost and pricing gauges will be closely watched. While those gauges have softened in recent months, they continue to point to strong inflation pressures.

NZ business confidence



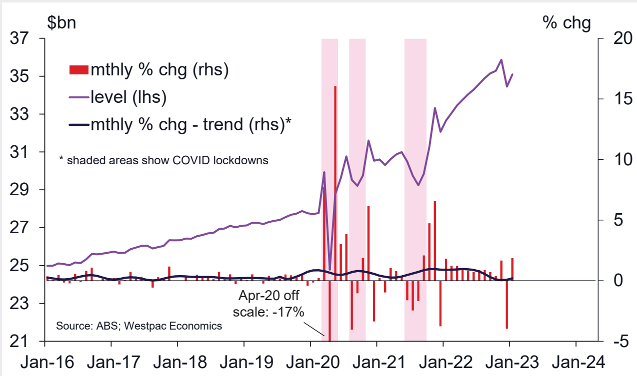
Aus Feb retail trade

Mar 28, Last: 1.9%, WBC f/c: 0.5%
Mkt f/c: 0.1%, Range: –1.2% to 0.8%

Retail sales rose 1.9% in Jan, a partial rebound from the very large 4% drop in Dec, all industries posting gains in the month. Despite the monthly rise, the underlying trend still shows a material slowdown, sales up just 0.1% over the 3mths to Jan compared to the 3mths to Oct. Looking through the volatility, the rising cost of living and RBA tightening cycle both appear to be dampening demand.

Our Westpac Card Tracker suggests the underlying trend in retail slowed further in Feb, dipping into negative on a rolling 3mth basis. That said, the volatile monthly profile since Nov, and the big decline in Dec in particular, mean the Feb month is still likely to see a gain vs Jan. A 0.5% rise will still leave retail sales down 1.4% on a 3mth basis (i.e. Dec-Jan-Feb vs Sep-Oct-Nov). With retail prices still rising, this suggests there has been a more pronounced weakening in sales volumes.

Monthly retail sales



Aus Feb Monthly CPI Indicator %yr

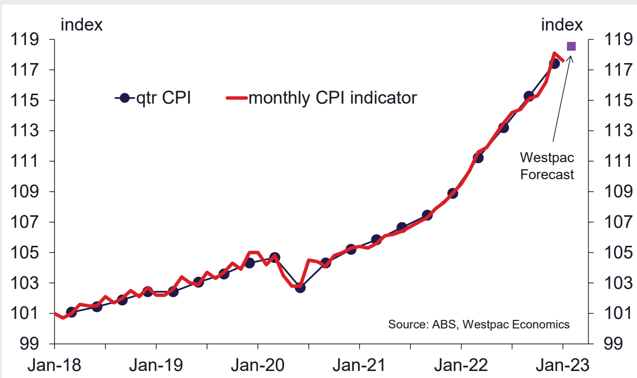
Mar 29, Last: 7.4%, WBC f/c: 7.4%
Mkt f/c: 7.2%, Range: 6.7% to 7.7%t

The Monthly Indicator releases the Quarterly CPI data collected the month in question and with many series are surveyed quarterly, some annually, the Indicator is quite volatile month to month.

The CPI Indicator rose 7.4% in the year to January compared to Westpac's 7.9%yr forecast and the market's 8.0%yr. On a monthly basis the was a 0.4% fall in the index, a moderation from the 1.6% rise in Dec, 0.8% increase in Nov and a 0.2% increase in October. Contributions worth noting was the 3.6% fall in clothing & footwear; a 1.1% rise in auto fuel prices and a very modest 0.2% rise in tobacco.

The February survey will include the quarterly data for restaurants & take away, hairdressing, other household services, spare parts & accessories/maintenance/other services for motor vehicles, urban transport fares, communication, audio visual & computing services, equipment for sport, games/hobbies, sports participation/ other recreation, education, and insurance. Our 7.4%yr forecast is represents a 0.8% increase in the month.

Aus CPI Monthly Indicator vs. qtr CPI

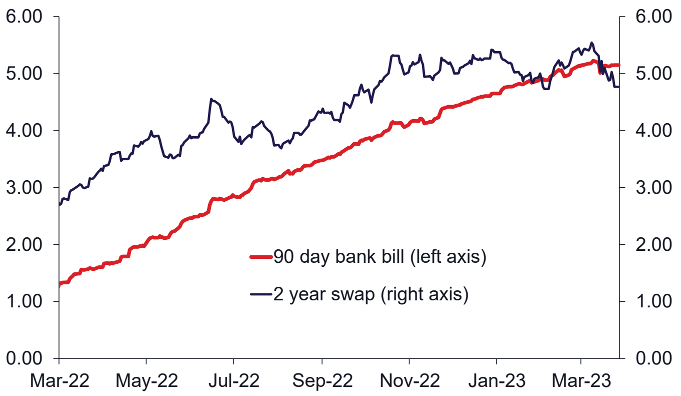


New Zealand forecasts

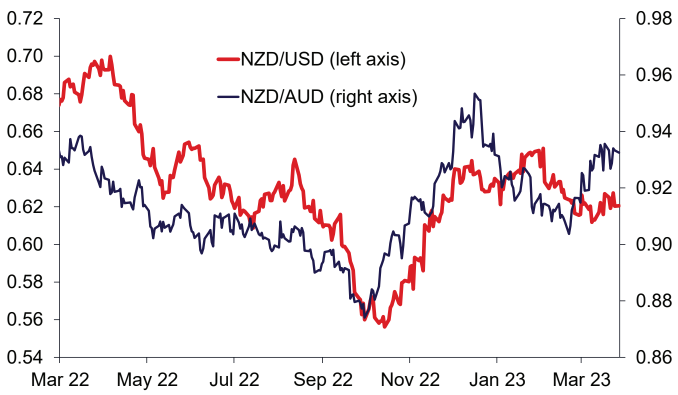
Economic forecasts	Quarterly				Annual			
	2022		2023					
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	1.7	-0.6	0.2	0.2	6.0	2.4	1.1	-0.5
Employment	1.3	0.1	0.3	0.2	3.3	1.3	0.5	-0.3
Unemployment Rate % s.a.	3.3	3.4	3.5	3.6	3.2	3.4	4.0	5.1
CPI	2.2	1.4	1.3	1.3	5.9	7.2	5.1	2.9
Current 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 27 March 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.75%	4.75%	4.75%
30 Days	4.98%	4.96%	4.82%
60 Days	5.07%	5.06%	5.01%
90 Days	5.15%	5.19%	5.14%
2 Year Swap	4.77%	5.31%	5.44%
5 Year Swap	4.22%	4.67%	4.89%

NZ foreign currency mid-rates as at 27 March 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6205	0.6171	0.6155
NZD/EUR	0.5759	0.5782	0.5825
NZD/GBP	0.5072	0.5114	0.5139
NZD/JPY	81.01	82.44	83.89
NZD/AUD	0.9325	0.9310	0.9164
TWI	70.67	70.74	70.82

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
Chn	Feb industrial profits ytd %yr	–4.0%	–	–	Should build as domestic momentum gathers.
US	Mar Dallas Fed index	–13.5	–	–	Regional surveys highlighting manufacturers' challenges.
Tue 28					
NZ	Feb employment indicators	0.8%	–	0.2%	Back to modest growth after a catch–up rise in Jan.
Aus	Feb retail sales	1.9%	0.1%	0.5%	Monthly gains, but in the context of a material slowdown.
	RBA Head of Payments Policy	–	–	–	Connolly speaking at AFR Banking Summit.
UK	Mar Nationwide house prices	–0.5%	–	–	Price correction remains well entrenched.
US	Feb wholesale inventories	–0.4%	–	–	Sustained inventory decline may weigh on growth in 2023.
	Jan FHFA house prices	–0.1%	–	–	Pace of price declines have clearly slowed...
	Jan S&P/CS home price index	–0.51%	–	–	... but a recovery is not yet in sight.
	Mar Richmond Fed index	–16.0	–	–	Regional surveys highlighting manufacturers' challenges.
	Mar consumer confidence index	102.9	101.5	–	Up-trend in confidence limited by rates and real income.
	Fedspeak	–	–	–	Jefferson.
Wed 29					
NZ	Q1 Westpac–MM employment conf.	108.0	–	–	Fell in late 2022 with concerns about job openings.
Aus	Feb CPI Monthly Indicator %yr	7.4%	7.2%	7.4%	Feb will survey a larger number of services prices.
UK	Feb net mortgage lending £bn	2.5	–	–	Downtrend firming amid broad-spread correction.
US	Feb pending home sales	8.1%	–2.3%	–	Likely past low–point after January bounce.
Thu 30					
NZ	Feb building permits	–1.5%	–	3.0%	Bounce in multi–unit consents, but longer term trend down.
	Mar ANZ business confidence	–43.3	–	–	Sentiment to remain subdued as cost pressures bite.
Eur	Mar consumer confidence	–19.2	–	–	Inflation and interest rates weighing on confidence recovery...
	Mar economic confidence	99.7	–	–	... across both consumers and businesses.
US	Q4 GDP, annualised	2.7%	2.7%	–	Final estimate.
	Initial jobless claims	191k	–	–	To remain at a relatively low level for now.
	Fedspeak	–	–	–	Barkin, Collins.
Fri 31					
NZ	Mar ANZ consumer confidence	79.8	–	–	Set to remain low in the face of rising living costs.
Aus	Feb private sector credit	0.4%	0.4%	0.4%	Further confirmation of significant slowdown – rate rises bite.
Chn	Mar manufacturing PMI	52.6	52.0	–	Benefitting greatly from the removal of COVID-zero...
	Mar non–manufacturing PMI	56.3	54.2	–	... momentum should hold firm for the time being.
	Q4 current account balance US$bn	106.8	–	–	Final estimate.
Eur	Feb unemployment rate	6.6%	–	–	Labour market tight for now but slack will emerge gradually.
	Mar CPI %yr	8.5%	–	–	Attention is firmly centred on momentum in services.
UK	Q4 GDP	0.0%	0.0%	–	Final estimate.
US	Feb personal income	0.6%	0.3%	–	Flattening trend set to crystalise...
	Feb personal spending	1.8%	0.3%	–	... indicating a loss of momentum.
	Feb PCE deflator	0.6%	0.4%	–	FOMC will be closely monitoring...
	Feb core PCE deflator	0.6%	0.4%	–	... services inflation components.
	Mar Chicago PMI	43.6	43.8	–	Economic conditions clearly subdued.
	Mar Uni. of Michigan sentiment	63.4	63.4	–	Final estimate.
	Fedspeak	–	–	–	Barr, Williams, Waller, Cook.

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	3.70	3.95	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.23	3.60	3.40	3.20	3.00	2.80	2.70	2.50
International								
Fed Funds	4.875	4.875	4.875	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.40	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	0.6679	0.69	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	130.41	131	130	129	128	127	126	124
EUR/USD	1.0825	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2276	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.8456	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0712	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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