WESTPAC WEEKLY ECONOMIC COMMENTARY

Kia kaha Auckland.

31 January 2023


Southern rātā

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The Westpac Team would like to extend our deepest sympathies to all of those who have been affected by the severe rain in Auckland and other parts of the North Island in recent days. In addition to the impact on the lives of many families, there will also be economic consequences. Those costs are secondary to the human toll of the event, but we will briefly try to summarise some of those impacts here.

The immediate damage

Estimates of the damage are still being developed, and further heavy rains are expected over the coming days. At this stage, the cost of the rains is expected to be New Zealand's largest climate related insurance event. More than 6,000 claims had already been lodged with insurers by Sunday morning.

We estimate that the cost of damage that has been reported thus far will be around $100m, with housing repairs accounting for the bulk of the cost. However, the damage assessment process still has a long way to go. We estimate that the final cost could be in the $200m to $300m range, especially once we allow for costs related to business assets and infrastructure. We'd stress that this is still an early estimate, and we'll refine it as more information comes to hand.

To put the cost in context, New Zealand's annual nominal GDP is around $370bn. The insured cost of the Canterbury earthquakes was around $40bn and the cost of the Kaikōura earthquakes was around $2bn. The previous largest weather-related insurance event was the Timaru hailstorm in 2019, with insured costs of around $170m.

Much of the damage resulting from the floods will be related to housing. At the time of writing around 5,000 homes were being assessed for damage, with at least 40 already red stickered meaning they are unsafe to enter) and around 151 had been yellow stickered (only temporary and restricted access possible). Those estimates are expected to rise as further assessments are carried out. There are reports of particularly severe damage in areas such as Milford, Sunnynook and Titirangi. There will also be expenses related to replacing damaged items, including household contents and vehicles.

Although a large share of those costs will be borne by insurers, many households will be left with large bills. There will also be a large amount of damage that is uninsured.

Businesses in many parts of the city will face disruptions associated with damaged stock and premises. In some cases, there will also be lost trading days as repairs are carried out. A range of businesses have been affected including supermarkets and the regions' airports. The hospitality sector is likely to see significant disruptions. There are also likely to be related disruptions to supply chains.

The challenges for households and businesses are likely to be compounded by disruptions to the regions' transport network, including public transport like buses and rail services.

The recovery

Auckland accounts for around one-third of the nation's economic output. But while the bulk of the damage from the storms has been centred on Auckland, other regions have also been affected, including Northland, the Waikato and Bay of Plenty. Combined, those regions account for another 17% of GDP.

Disruptions to households' everyday activities, business activity and transport networks will be a drag on economic activity over the coming weeks. However, the overall impact on GDP growth through the March quarter as a whole is likely to be modest. That's because there will be a lift in activity following the recent disruptions related to spending to replace damaged household items, as well as some of the initial repair work.

Looking further ahead, the coming quarters will see a large amount of repair work to housing and business assets, as well as work on roading and other infrastructure. However, that 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, repair work related to the recent rains may take some time to complete, while other planned work could be delayed as staff and resources are diverted to essential repairs. The experience with other natural disasters, like the Canterbury earthquakes, highlights that completing this work could take a protracted period of time.

The flooding could have an upward impact on inflation in the short term, albeit a temporary one that will require some patience to look through. Damage to crops could see food price inflation hold up for longer, and repair work will put more pressure on the still-stretched building industry. Over the past year, the cost of building a new home rose by 14%, with costs in Auckland up 17%. We also saw large increases in the cost of services and materials used in property maintenance. Those cost pressures looked like they were starting to soften at the end of last year, but the recent events present an upside risk.

Inflation is currently running close to a multi-decade high, unemployment is close to a record low, and the RBNZ has been hiking the Official Cash Rate at a rapid pace. Given the strength and prevalence of inflation pressures, further large increases in the OCR are expected over the coming months. However, the recent flooding may have some impact on the pace of those hikes – although repair work in the upper North Island will add to inflation pressures, that will need to be balanced against the related disruptions to economic activity.

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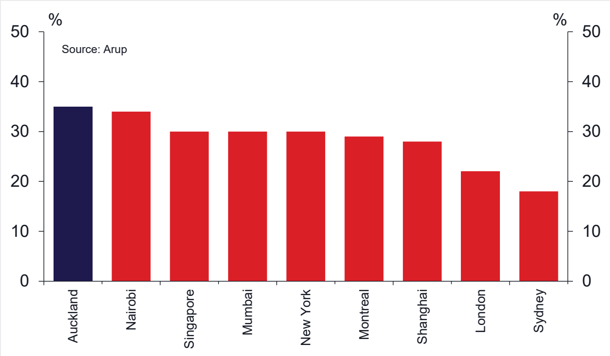
Chart of the week

A study last year found that Auckland was ranked the highest of nine major cities in terms of its 'sponginess', or its ability to absorb heavy rainfall. The scoring was based on the proportion of 'green' and 'blue' areas, soil and vegetation types, and the water runoff potential. Obviously there are shortfalls to this approach – a city-wide average score can hide a lot (and the study didn't cover the suburbs that were hit hardest this week). But it helps to highlight that stormwater management is complex, and involves a lot more than 'grey' infrastructure.

'Sponginess' of major cities

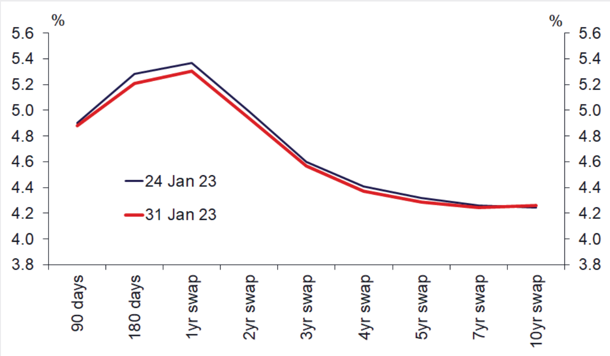


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 5.25% 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 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 Household Labour Force Survey

Feb 1, Employment last: 1.3%, Westpac f/c: 0.3%, Mkt: 0.3%
Unemployment last: 3.3%, Westpac f/c: 3.3%, Mkt: 3.3%

We estimate that the unemployment rate remained at 3.3% in the December quarter. If so, this would mean that unemployment has held at more or less the same low level for a year and a half straight – as good an indication as any that the economy has hit the wall in terms of spare capacity.

While surveys suggest that hiring intentions are starting to ease off from their highs, the shortage of workers remains a major headache for businesses. We expect a 0.3% rise in employment for the quarter, partly helped by the return of migrant workers.

We expect that unemployment will rise in the coming years as the economy cools off. But with the labour typically being a laggard in the economic cycle, we're not likely to see signs of that just yet.

NZ Household Labour Force Survey

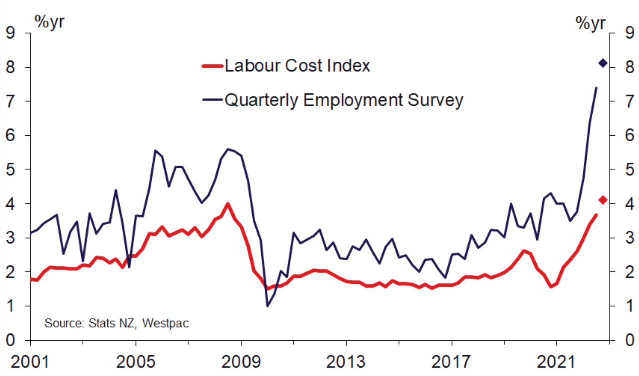
NZ Q4 Labour Cost Index

Feb 1, Last: 1.1%, Westpac f/c: 1.1%

Despite a tight labour market and a surge in the cost of living, wage growth remained fairly modest in 2021. But it picked up the pace significantly in 2022, and we suspect that it has further to go. We expect another 1.1% rise in the Labour Cost Index for the December quarter, which would lift the annual growth rate to 4.1%, topping the previous high of 4% that it reached before the Global Financial Crisis in 2008.

The Quarterly Employment Survey (QES) measure of average hourly earnings has taken off even faster than that, rising by 7.4% in the year to September. The large and growing gap between these two wage growth measures is something of a puzzle, but both are historically high and rising, and nowhere near consistent with 1-3% inflation in the foreseeable future.

NZ salary and wage growth, all sectors



NZ Dec residential building consents

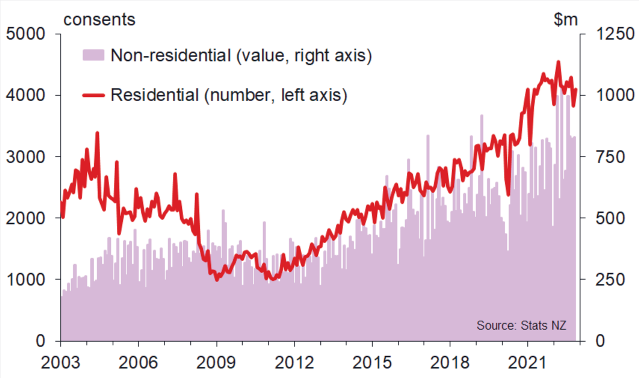
Feb 2, Last: +7.0%, Westpac f/c: -2.0%

Dwelling consent issuance rose by 7% In November. That was close to our forecast and was mainly related to a recovery in multi-unit consents following a fall in October.

We are forecasting a modest 2% decline in consent numbers in December. Financial conditions in the building sector have deteriorated over the past year. House prices and sales have fallen sharply, while building costs and interest rates have risen rapidly. Those conditions mean that prospective purchasers are increasingly hesitant, while developers are cautious about bringing new projects to market.

Consent issuance remains elevated for now. But we expect it will trend down over the year ahead.

NZ building consents



The week ahead

Aus Dec private sector credit

Jan 31, Last: 0.5%, WBC f/c: 0.5%
Mkt f/c: 0.5%, Range: 0.3% to 0.7%tr

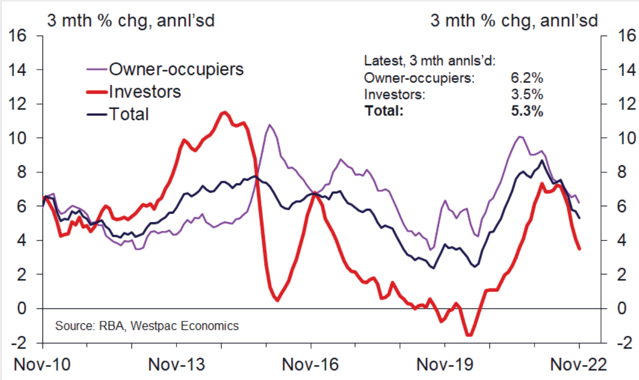
The credit slowdown in the face of sharply higher interest rates is well underway and has further to run.

The pace of monthly total credit growth has slowed progressively and appreciably, from 0.9% for April and May to 0.5% for October and November. We anticipate another 0.5% reading for December, ahead of softer results over the first half of 2023.

The housing sector is cooling as higher interest rates reduce borrowing capacity. New lending in November was 26% below that 10 months earlier. Associated with that, the 3 month annualised pace of housing credit growth has slowed to 5.3% currently, down from a high of 8.7% at the start of 2022.

Business credit growth is also moderating, following a rapid burst in the June quarter, associated with the reopening effect. November posted a 0.7% increase, down from a high of 1.5% in June.

Aus housing credit



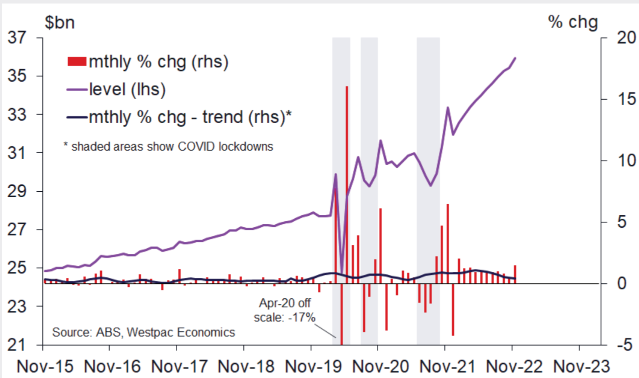
Aus Dec retail trade

Nov 31, Last: 1.4%, WBC f/c: –0.3%
Mkt f/c: –0.2%, Range: –2.5% to 0.8%re

Retailers are coming off a very strong Nov, sales surging 1.4% in the month and previous estimates revised materially higher. Annual growth lifted to 7.7%yr vs what had been shaping as a 5-5.5%yr gain heading into the release. Clearly last year's 'Black Friday' and 'Cyber week' sales were a roaring success. However, the upward revisions also point to a firmer underlying trend which now shows only a very mild slowing in response to higher interest rates.

Our Westpac Card Tracker and other measures point to conditions remaining buoyant through Dec. That said, retail components were softer with gains in card activity centring non-retail segments like travel and recreational services. The high weighting of food (accounting for just over half of retail) also looks to have been a drag, some of which may be price-related. On balance we expect nominal sales to decline 0.3% in Dec. Note that the final Dec release, including Q4 real retail sales estimates, will be published on Feb 6.

Aus monthly retail sales



Aus Jan CoreLogic home value index

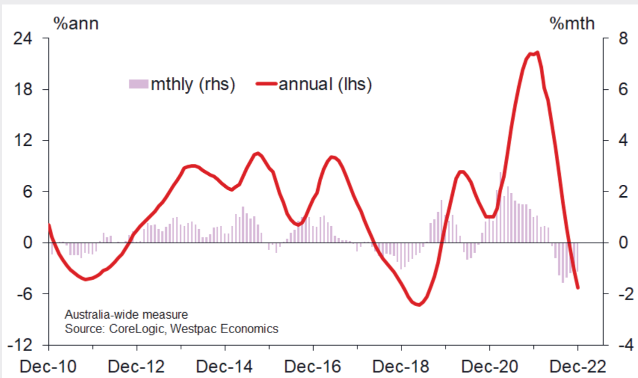
Feb 1, Last: –1.2%, WBC f/c: –1.1%

There looks to have been no holiday repreive for Australia's housing markets with the correction that began around mid-2022 carrying into the first month of the new year. Daily measures show price declines continued to run at a 1.1% monthly pace through Jan.

That said, the Dec-Jan 'low season' means data tends to be less meaningful with the reopening of auction markets in mid-Feb usually providing a better litmus test for conditions in the new year.

Interestingly, there has also been some dissent amongs the various dwelling price measures in recent months with Proptrack and Domain showing a more pronounced moderation in price declines in the December quarter. The exact reason behind the differences is unclear but sustained divergences are fairly rare.

Aus dwelling prices



The week ahead

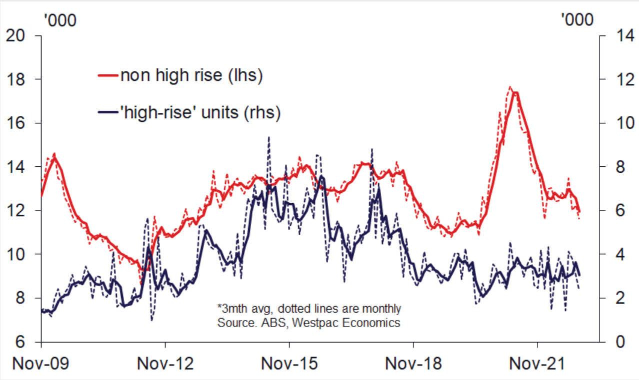
Aus Dec dwelling approvals

Feb 2, Last: –9%, WBC f/c: –4%
Mkt f/c: 1%, Range: –5% to 8%

Dwelling approvals fell 9% in Nov after a 5.6% decline in Oct, the headline and detail pointing to the beginning of a trend weakening, approvals having chopped around a flat trend in Q3. Notably, non high rise approvals are now showing a clear move lower in response to multiple headwinds including: surging costs, supply chain and labour force disruptions, a large backlog of unprofitable jobs, and a sharp downturn in the wider housing market in the wake of rapid interest rate rises.

We expect the Dec update to underscore the shift. HIA figures show new home sales fell steeply in late 2022, dropping 26% in the final quarter of the year. While approvals tend to be more stable, that points to clear downside risks. We expect approvals to fall 4% in the Dec month.

Aus dwelling approvals



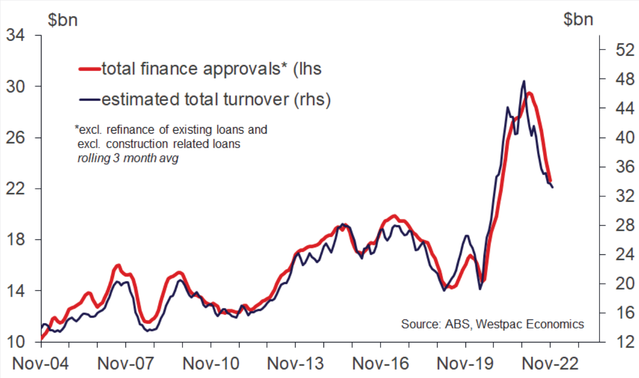
Aus Dec housing finance approvals

Feb 3, Last: –3.7%, WBC f/c: –3%
Mkt f/c: –3%, Range: –4.0% to flat

Housing finance continued to move lower in Nov, the total value of new loans (ex re-finance) down a further 4.1% in the month to be 24% below the peak at the start of the year. Despite the falls, approvals remain well above their pre-COVID levels and previous peaks in 2017.

Dec is expected to show more weakness albeit with a the pace of declines in the established market easing a touch in line with a slight moderation in falls in the total value of property sales. The total value of new finance approvals is expected to show a 3% fall for the Dec month with similar falls across owner occupier and investor segments. Looking ahead, first home buyer activity may get a filip in Jan from changes in NSW that allow eligible buyers to opt for an annual land tax payment instead of an up-front stamp duty charge.

Aus new housing finance approvals



US Feb FOMC policy meeting

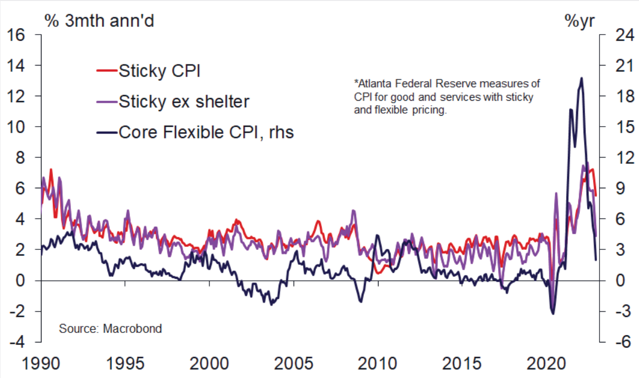
Jan 31/Feb 1: Last: 4.375%, Mkt f/c: 4.625%, WBC: 4.625%

Since the Dec meeting, there has been a significant change in expectations regarding US inflation risks and the policy outlook.

Coming in to the Jan/Feb meeting, the market believes US inflation is well on its way back to the FOMC's target, leaving the Committee with little more to do. indeed, it could be argued that, were the FOMC not as resolute in their determination to remove all inflation risks, the market could have seen this meeting as the last move – so confident participants have become in the US inflation outlook.

Since the CPI peaked in June 2022, we have anticipated a rapid easing in pressures and risks. But, we also recognise it will likely take until March for the FOMC to feel confident to stop. Hence we expect this cycle to end with 25bp hikes in Feb and Mar.

US inflation

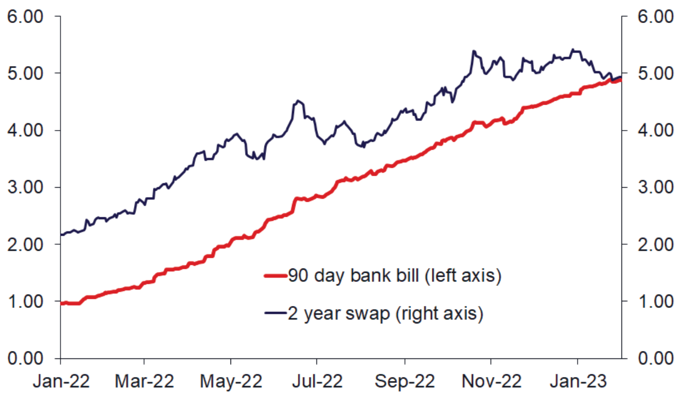


New Zealand forecasts

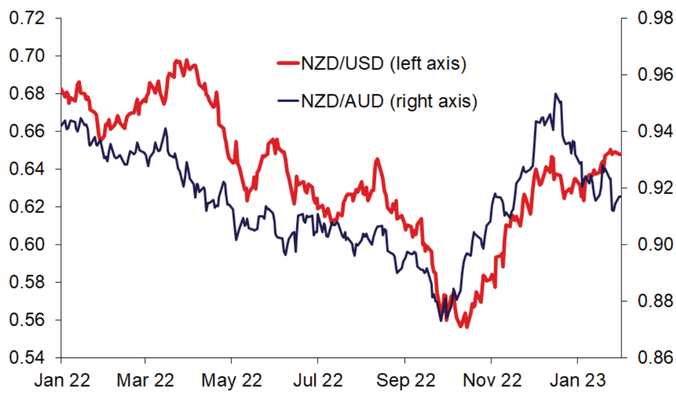
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Sep	Dec	Mar	Jun	2021	2022f	2023f	2024f
GDP (Production)	2.0	0.5	0.4	0.0	6.1	2.9	2.2	0.0
Employment	1.3	0.3	0.1	0.0	3.3	1.5	-0.1	-0.1
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	3.2	3.3	3.9	4.8
CPI	2.2	1.4	1.6	1.0	5.9	7.2	4.4	2.4
Current 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	0.93	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	73.6	73.2	73.2	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 31 January 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	4.25%	4.25%	4.25%
30 Days	4.49%	4.38%	4.32%
60 Days	4.71%	4.62%	4.52%
90 Days	4.88%	4.81%	4.71%
2 Year Swap	4.94%	4.98%	5.34%
5 Year Swap	4.29%	4.36%	4.80%

NZ foreign currency mid-rates as at 31 January 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6479	0.6425	0.6252
NZD/EUR	0.5969	0.5956	0.5926
NZD/GBP	0.5243	0.5229	0.5226
NZD/JPY	84.49	82.34	81.89
NZD/AUD	0.9169	0.9202	0.9292
TWI	72.23	71.53	71.06

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 30					
NZ	Auckland Anniversary	–	–	–	Markets open.
	Dec trade balance $m	–1863	–	–750	Export prices have eased; import demand still strong.
	Dec employment indicators	0.2%	–	0.3%	Availability of workers improving as migration picks up.
Eur	Jan consumer confidence	–20.9	–	–	Falling gas prices should provide some support...
	Jan economic confidence	95.8	–	–	... to overall economic sentiment.
US	Jan Dallas Fed index	–18.8	–	–	Conditions are soft across the regions.
Tue 31					
Aus	Dec retail sales	1.4%	–0.2%	–0.3%	Coming off a very strong Nov. Still a solid finish to 2022.
	Dec private sector credit	0.5%	0.5%	0.5%	Credit slowdown well underway, sharply higher rates biting.
Chn	Jan manufacturing PMI	47.0	–	–	Easing of COVID-zero restrictions to provide some relief...
	Jan non-manufacturing PMI	41.6	–	–	... but virus and global demand remain as risks.
	Dec industrial profits %yr	0.8%	–	–	Profit growth set to rebuild over 2023.
Eur	Q4 GDP	0.3%	–	–	Economic resilience to be tested.
UK	Dec net mortgage lending £bn	4.4	–	–	To gradually ease as housing correction ensues.
US	Q4 employment cost index	1.2%	–	–	A critical update on wage pressures; g'th should moderate.
	Nov FHFA house prices	0.0%	–	–	House price declines to continue...
	Nov S&P/CS home price index	–0.52%	–	–	... as interest rates suppress demand and affordability.
	Jan Chicago PMI	45.1	–	–	Reflecting a material loss of economic momentum.
	Jan consumer confidence	108.3	–	–	Up-trend in confidence limited by rates and real income.
Wed 01					
NZ	Q4 unemployment rate	3.3%	3.3%	3.3%	Expected to hold near record lows...
	Q4 employment change	1.3%	0.3%	0.3%	...as new workers remain in short supply.
	Q4 LCI wage inflation (pvt, ord. time)	1.1%	–	1.1%	Wage growth has picked up rapidly in the last year.
Aus	Jan CoreLogic home value index	–1.2%	–	–1.2%	Broad-based correction still firmly entrenched.
Chn	Jan Caixin manufacturing PMI	49.0	–	–	Tension between fewer restrictions and increased virus risks.
Eur	Jan CPI %yr	9.2%	–	–	Falling energy prices leading the decline in headline inflation.
	Dec unemployment rate	6.5%	–	–	Slack to emerge slowly over 2023.
US	Jan S&P Global manufacturing PMI	46.8	–	–	Manufacturing activity remains in a fragile state...
	Jan ISM manufacturing	48.4	–	–	... with S&P and ISM broadly mirroring each other.
	Dec construction spending	0.2%	–	–	Softening demand weighing on construction.
	Dec JOLTS job openings	10458k	–	–	Gradually falling from historic peak.
	FOMC policy decision, midpoint	4.375%	4.625%	4.625%	Hawkish resolve likely to remain in place till Mar pause.
Thu 02					
NZ	Dec building permits	7.0%	–	–2.0%	Still elevated, financial conditions an increasing drag.
Aus	Dec dwelling approvals	–9.0%	1.0%	–4.0%	Showing a clearer down-trend in response to rate rises.
Eur	ECB policy decision, refi rate	2.50%	–	3.00%	50bp hike most likely, but 25bps a risk.
UK	BoE policy decision	3.50%	–	4.00%	BoE very near the end of this cycle.
US	Initial jobless claims	186k	–	–	To remain at a relatively low level, at least for time being.
Fri 03					
NZ	Jan ANZ consumer confidence	73.8	–	–	Down sharply in recent months as cost of living rises.
Aus	Dec housing finance	–3.7%	–3.0%	–3.0%	Down 24% from Jan peak but still above pre-COVID levels ...
	Dec investor finance	–3.6%	–	–2.5%	... both turnover and average prices still moving lower ...
	Dec owner occupier finance	–3.8%	–	–3.0%	... own-occ a touch weaker on falling building-related loans.
Chn	Jan Caixin services PMI	48.0	–	–	Tension between fewer restrictions and increased virus risks.
US	Jan non-farm payrolls	223k	175k	185k	Payrolls growth gradually slowing but still elevated...
	Jan unemployment rate	3.5%	3.6%	3.5%	... 100k/mth pace in payrolls and softer wages growth...
	Jan average hourly earnings %mth	0.3%	0.3%	0.2%	... is critical to timing fed funds peak and subsequent cuts.

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	3.38	3.97	4.05	4.05	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.57	3.45	3.30	3.10	2.90	2.70	2.55	2.50	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	3.51	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	0.7122	0.69	0.70	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	129.74	136	135	134	132	130	128	126	124
EUR/USD	1.0881	1.06	1.07	1.09	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2400	1.22	1.22	1.23	1.24	1.25	1.26	1.27	1.28
USD/CNY	6.7845	6.90	6.80	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0949	1.08	1.08	1.09	1.10	1.11	1.13	1.13	1.13

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