AUSTRALIA & NEW ZEALAND WEEKLY.

Week beginning 30 May 2022

Editorial: Australia, Q1 GDP preview: a rocky start to the year, activity hit by further disruptions.

Australia: Q1 partials, Q1 GDP, housing updates (dwelling approvals, prices, housing finance), trade, credit.

NZ: building consents, business confidence, Q1 terms of trade, Q1 building work.

China: various PMIs.

Europe: CPI, unemployment, retail sales.

US: Memorial Day holiday, non-farm payrolls, unemployment, house prices, ISMs, factory and durable goods.

Key economic & financial forecasts.

INFORMATION CONTAINED IN THIS REPORT
CURRENT AS AT 27 MAY 2022.

WESTPAC INSTITUTIONAL BANK

Australia, Q1 GDP preview: a rocky start to the year, activity hit by further disruptions

The Australian National Accounts, to be released on Wednesday June 1, will provide an estimate of economic activity for the March quarter.

We assess that output growth was an anaemic 0.2% in the quarter, with annual growth slowing to 2.5% from 4.2%. Activity was hit by further disruptions, notably the omicron wave and wet weather that included severe flooding in NSW and Qld.

The March quarter experience needs to be viewed in the context of how the economy is likely to perform for the year as a whole.

We anticipate that the Australian economy will experience a robust expansion in 2022 as it reopens from the delta lockdowns of 2021. Output growth for the year is a forecast 4.5%. Growth will be centred on, but not confined to, the consumer, with consumption increasing in the order of 6% over the year – which directly adds 3.3ppts to activity.

Pent-up consumer demand, an elevated household saving ratio and a strengthened household balance sheet, as well as the boost from earlier stimulus which has the unemployment rate down at the lowest level since 1974, are all supportive of increased spending this year.

The quarterly profile of activity in 2022 is likely to be uneven, as was the experience during 2020 and 2021.

Activity contracted in three of the past eight quarters, reflecting the impacts of the initial covid outbreak (Q1 and Q2 2020) and then the delta outbreak (Q3 2021). Equally, growth has exceeded 3% in three of the past eight quarters – including a 3.4% outcome in the December quarter 2021, which had the level of activity 3.4% above that at the end of 2019, prior to the pandemic.

Growth in 2022 is likely to be concentrated in Q2 and Q3. It was a rocky start to this year as further disruptions hit activity. The final quarter of the year is likely to see an emerging loss of momentum as rising interest rates from the RBA, in response to a significant inflation challenge, begin to impact. That will set the scene for materially slower growth in 2023, currently forecast at 2.5%

As to the March quarter 2021, the arithmetic of our GDP forecast of 0.2% is: domestic demand +1.5%; net exports -1.4ppts; total inventories flat; and the statistical discrepancy, +0.1ppt.

Consumer spending, +2%, and public demand, +1.2%, add to growth, while housing is flat and business investment is subdued, +0.4%.

The Labour Force survey (LFS) points to downside risks to our forecast, with hours worked reportedly contracting by 1.2% in the March quarter.

We anticipate that this 1.4ppts wedge between our +0.2% on output and the -1.2% on hours worked in the LFS will be accounted for by a rise in productivity and the National Accounts reporting a smaller decline in hours worked. In short, the LFS estimate of hours worked does not feed directly into the National Accounts. See below for a more detailed discussion.

Information and colour around the household sector will be of interest, particularly an update on the household saving ratio, which jumped from 11.8% to 19.8% in the September quarter 2021. The saving ratio then moderated to 13.6% in the December quarter, helping to fund a 6.3% burst in consumer spending. The saving ratio is still elevated and well above an 'equilibrium' rate, which we assess to be around 6%.

Households amassed about $250bn in 'excess' savings over the past two years, since the onset of the pandemic, including a further $46bn in the September quarter 2021 and then an additional $25bn in the December quarter. The savings buffer, strengthening household balance sheets, is supportive of spending going forward and will help to cushion the impact of rising interest rates.

National income expanded at a brisk pace over the past year, boosted by higher export commodity prices – annual nominal GDP growth was a stellar 10.2% in 2021.

For the March quarter, the nominal GDP picture is very different from that for output. Growth is a forecast 2.5% for the quarter, with annual growth easing back to a still brisk 8.8%. The terms of trade jumped in the order of 5½% in the quarter we estimate. Mining profits will be up sharply on a near 14% increase in commodity prices.

Q1 expenditure detail

Household consumption (+2%qtr): Despite the disruptions during Q1, the picture appears to be one of robust consumer spending, up a forecast 2% – which would have the level of consumer spending up by only a modest 2.8% since the end of 2019.

Retail turnover increased by 2.9% in the March quarter. However, sharply higher prices, up 1.7%, eroded consumers spending power - such that real retail sales rose by a more modest 1.2%. That builds upon the Q4 reopening burst, of +7.9%.

Car sales spiked in the quarter, up in the order of 12%, as a flood of imports provided much needed additional supply. This, together with additional expenditure on the operation of vehicles, adds in the order of 0.4% to consumer spending.

Holiday travel, with the Qld state border opening just ahead of Christmas and after the prolonged delta lockdowns, enjoyed a boom over the January summer holiday.

Dwelling investment (-0.1%qtr): Wet weather in NSW and Qld, as well as labour and material shortages, led to a 1.6% decline in new home building – despite a sizeable work pipeline. This was offset by an increase in renovation activity, up by 2.1%.

New business investment (0.4%qtr): A subdued result, with disruptions and supply headwinds a factor. Equipment spending rose modestly, +1.2%, so too infrastructure work, +0.4%. Building work, hit by wet weather, was down, -2.4% – also despite a sizeable work pipeline.

Public spending (+1.2%qtr): Government spending in the form of public demand (27% of the economy) expanded at a brisk pace over the past two years to be at elevated levels, centred on the health response to covid, as well as rising investment.

There was a rare dip in public demand in the December quarter, -0.4%, after a particularly strong +3.5% lift in September associated with delta and volatility in defence spending. We anticipate a solid 1.2% rise for the March quarter.

Net exports (-1.4ppt qtr): Net exports, mirroring domestic spending, have moved through large quarterly swings of late.

The March quarter will likely see a large net export subtraction, a forecast -1.4ppts.

Imports surged, up in the order of 7%, led by consumer goods – representing a catch-up from the delta disruptions over the second half of 2021. Exports disappointed again, slipping 0.5%, led lower by resources on supply disruptions.

Private non-farm inventories (+0.5% qtr, –0.2ppts contribution): Sales and production, as well as inventories, have all moved through large movements quarter to quarter at times during the pandemic. In the December quarter, sales and production both expanded strongly. Associated with this, inventory levels increased solidly, up by 1.1%, +$1.9bn.

In the March quarter, conditions were mixed. That points to a more subdued rise in sales and a patchy production performance. In this environment, any further increase in inventory levels is likely to be more modest.

We have factored in a rise of 0.5% (in part achieved by a flood of imports), but note the large degree of uncertainty around inventories (which are often subject to revision). On our figure, private non-farm business inventories subtract –0.2ppts from activity in the quarter.

Other inventories: We expect 'other' inventories to add 0.2ppts to activity in the period – such that total inventories are neutral. Farm inventories add an expected 0.1ppt, a correction to the sharp run-down evident in Q4. Public authorities inventories may also add 0.1ppts to activity, led by gold on softer demand from China associated with the nation's zero covid policy.

Hours worked and productivity

As noted above, there are downside risks to our Q1 GDP forecast of 0.2%. These relate to hours worked and a view on productivity.

The Labour Force Survey reported that hours worked declined in Q1, down by a sizeable -1.2%.

We are making a couple of key judgements.

We anticipate that the National Accounts estimate of hours worked will not be as weak as the LFS (a rerun of the Q1 2021 experience, when the figures were a +0.2% LFS and a +0.9% National Accounts).

The issue is that the LFS can be an inaccurate guide if the choice of reference period is unrepresentative of conditions for the full month – a particular problem with the holiday January survey.

We also anticipate that output will outperform hours worked, a rise in productivity – as often occurs when there are temporary disruptions leading to softness in hours worked (which was the case in Q1, the omicron wave and wet weather).

Of course estimated productivity swings from quarter to quarter.

For instance, productivity was squeezed when the economy reopened strongly in Q4 2021 and the labour intense hospitality sector strengthened. Total hours worked across the economy rose sharply in Q4 2021, up by 4.3% in the National Accounts, while output underperformed, expanding by 3.4%.

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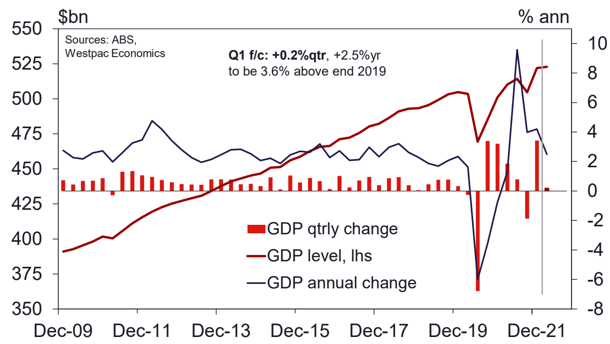
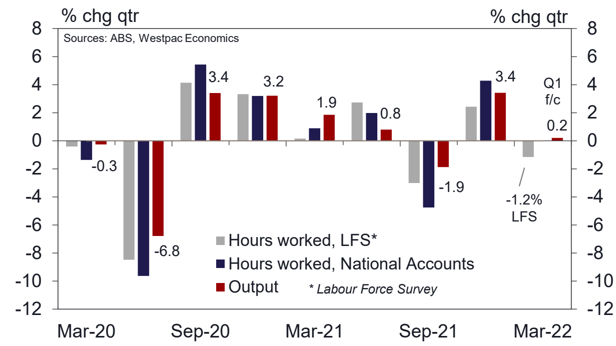
Australian economy: Q1 hit by disruptions



Output and hours worked



THE WEEK THAT WAS

The first of the two key releases received this week for Australia was the Q1 construction work done survey. Activity in the sector disappointed expectations in Q1, with a fall of 0.9% reported against expectations of a modest gain circa 0.5-1.0%. Disruptions related to the omicron wave of COVID-19 and poor weather, particularly in Queensland and New South Wales, are believed to be behind the miss. Note however that the Q4 2021 outcome was revised up as part of the Q1 release, from -0.4% to +0.6%; also, Victorian construction showed strength in Q1, +2.6%, the state economy rebounding strongly following last year's delta wave.

Looking ahead, there is a sizeable pipeline of work to be completed across the economy. However, additional disruptions may delay progress. The most notable risks are the difficulties associated with sourcing necessary construction inputs and Australia's very tight labour market. Highlighting the effect of both, construction costs rose by 2.4% in Q1 and 7.6% over the 12 months to March, the strongest gains since 2008.

Equipment investment, as estimated by the CAPEX survey, also disappointed in Q1, albeit less so than construction, with a 1.2% gain recorded (WBC forecast +2.0%). Total CAPEX (includes buildings and structures as well) fell 0.3% in Q1 across both mining and non-mining. For non-mining, the equipment spend was essentially unchanged in the three months to March, while buildings and structures construction was down 0.6%. Mining meanwhile saw a strong 7.7% gain for equipment, offset by a 3.3% fall in buildings and structures work.

Despite intense uncertainty over the global economic outlook, CAPEX plans for FY2021/22 were broadly unchanged in Estimate 6, implying a 14% lift in investment from FY2020/21. Pleasingly, FY2022/23 plans were revised up in Estimate 2 to now suggest investment will lift 10% in that year. However, note that these are nominal figures and so include cost increases. Over the year to March 2022, CAPEX investment costs were reported to have risen 6.6%.

Having assessed these two surveys, we have confirmed our forecast for Q1 GDP of 0.2%/2.5%yr for next Wednesday's release. The editorial above gives more detail, but in short, strong support from household spending is expected to be largely offset by a sizeable subtraction from net exports. We perceive there to be downside risks to this view given the weakness seen in hours worked in the quarter.

Turning to New Zealand, the RBNZ delivered to Westpac's and the market's expectations at their May meeting, voting in favour of a 50bp hike in the cash rate to 2.00%. Our New Zealand economics team continue to expect another two 50bp increases in July and August, then two 25bp increases in October and November to a peak cash rate of 3.50%. The RBNZ meanwhile project a higher top of 4.00% in 2023. In short, as per the Westpac MPS Review, the RBNZ are worried high inflation will become embedded in expectations and actions, and so are looking to take on a contractionary policy stance until demand is more in line with available supply/capacity. For full detail on the expectations of Westpac NZ economics and the RBNZ, see Westpac's Bulletin.

Data for the US this week has been limited and secondary in significance. However, the May FOMC meeting minutes are worthy of note. On display in the discussions of FOMC members was clear belief in the strength of the US, the economy seen as "very strong" and the labour market "extremely tight". Unsurprisingly, inflation was characterised as "very high" and the primary source of risk for the outlook.

Still, in their discussions regarding policy, the Committee referred to the importance of an expeditious move to 'only' a "more neutral monetary policy stance", with an outright restrictive stance requiring an unfavourable evolution of the outlook/risks. These comments speak to a belief that supply-driven inflation will pass if given time and assuming demand and expectations are well managed. Indeed, "many participants" subsequently noted that the current "removal of policy accommodation would leave the Committee well positioned later this year to assess the effects of policy firming and the extent to which economic developments warranted policy adjustments" – i.e. by the end of the year, the FOMC may have scope to, at least, pause rate hikes.

Westpac remains of the view that the peak fed funds rate will be seen at year end at 2.625%, below the market's 2023 peak expectation. The above views fit with this expectation and highlight clearly that gauging policy tightening in the US is not so much about the timing of each fed funds rate hike, but rather the cumulative impact on term interest rates. Notably, the 2, 5 and 10 year Treasury yields, which act as base rates for private borrowing rates across the economy, are all currently in the top half of the FOMC's neutral range of 2.0-3.0% flagged after the May meeting. This highlights the extent to which policy has already tightened, well ahead of peak fed funds.

Finally on China, Premier Li Keqiang made clear this week both the need to and intent to stimulate the economy with no delay. This week 33 new easing measures were announced across the economy to aid households, reduce business costs and encourage hiring. This follows last week's decision to cut the 5-year loan prime rate, a benchmark for mortgage rates. Clearly, with the COVID-19 situation in Shanghai improving and steady in Beijing, there is a need to accelerate growth and make up for lost time. Such concerted action can still see authorities achieve their 5.5% annual growth target, assuming further lockdowns are not seen and global developments also do not reduce support for China's economy. Sentiment amongst households will take considerable time to repair and rebound and so, for the time being, momentum will continue to be driven by the public sector and, to a lesser extent, private business investment.

Week ahead & data wrap

As expected, the Reserve Bank of New Zealand followed April's 50bp increase in the cash rate with another big 50 point rise at its May policy meeting. Further rapid increases are on the cards over the coming months, and we're forecasting the OCR to reach a peak of 3.50% by the end of this year.

Looking back over the past decade, the chances that the RBNZ would be raising the Official Cash Rate in 50bp bounds seemed like a very distant possibility. However, inflation pressures and the policy landscape in New Zealand have undergone a rapid transformation over the past year.

After struggling to reach even the 2% target midpoint for most of the past decade, inflation is now running at a 30-year high of 6.9%, and it's set to remain well above the RBNZ's target for some time. It's true that much of that is due to offshore disruptions to global supply chains and soaring prices for commodities like oil. However, domestic factors are also playing a big role in boosting inflation, including the drum-tight labour market and the strength of domestic demand. Crucially, that strength in domestic inflation pressures has been underpinned by the very accommodative monetary policy settings that were put in place in recent years.

A further worrying development for the RBNZ has been the rise in inflation expectations. If those spill over into how households and businesses adjust wages and prices, the strength in inflation could persist even after the current supply disruptions ease. That could require even tighter policy to stabilise inflation. On this front, we are already seeing mounting claims for higher wage settlements across the economy.

Against this backdrop, the RBNZ began lifting the cash rate last year. Even so, the Official Cash Rate is still a long way from where it needs to be given the red-hot inflation pressures that are now rippling through the nation.

To limit the longer-term risks for the economy, the RBNZ opened the door to larger increases in the cash rate at its April meeting with a 50bp rise. And as was widely expected, they followed that up with another 50bp move at their May meeting.

Importantly, RBNZ signalled that further rapid rate increases are on the cards over the coming months. The RBNZ's updated projections show the cash rate reaching a peak of close to 4% by the second half of next year, with most of the increase being front-loaded. Their forecasts implies that the OCR will reach 3.5% by the end of this year – and with just four more review dates this year, some of the upcoming moves will have to be 50-pointers as well.

The RBNZ's updated projection fully endorses the forecast track that we published in our recent *Economic Overview*.[1] We're forecasting 50bp hikes in July and August, with 25bp moves in October and November. That would take the cash rate to 3.50% in November. We have no reason to change that view after the RBNZ's May policy statement.

The RBNZ did emphasise that their projections are for a temporary peak in the OCR, rather than a permanently higher level. The intention is to keep monetary policy 'tight' for long enough to bring demand and supply in the economy into better alignment, before returning interest rates to more sustainable long-term levels. That's been a feature of our own forecasts for some time too. We expect the RBNZ to begin lowering the OCR by the second half of 2024, towards a more neutral long-run level of 2%. For any forecast that far ahead, neither the timing nor the level should be taken as gospel. But it's important to emphasise the idea that, even though the RBNZ may be moving in larger steps than we're used to, this is an old-fashioned economic cycle, not a new normal.

The rise in the cash rate, and the related rise in mortgage rates that we have already seen, will ripple through the economy. Around 60% of mortgages are on floating rates or will come up for repricing within one year, and another 20% will come up for repricing within two years. In some cases, borrowers will be looking at mortgage rates that are 2 to 3 percentage points higher than when they last fixed. Combined with the increases in food, fuel and other living costs, that signals a sizeable squeeze on many households' discretionary spending.

That squeeze on household spending will be a drag on overall economic activity, with a period of slower economic growth on the cards over the coming years. In fact, that's what the RBNZ needs to see in order to dampen domestic inflation pressures. But this does leave them treading a very fine line. While the RBNZ wants to slow the economy to ensure inflation pressures remain manageable in the long run, it still wants to avoid a recession.

At this stage, we still think we are most likely to see a slowdown, rather than a recession. A key reason for that is because of the strength of household balance sheets. For most of the past decade, income growth has far outpaced the growth in inflation, and saving levels have been rising. That's providing households with a buffer from the other factors that are crimping their discretionary spending. Similarly, debt servicing costs are expected to account for a low to average share of most households' disposable incomes compared to history, even allowing for a rise in interest costs (though there will be large differences across households).

Satish Ranchhod, Senior Economist

1 https://www.westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2022/Other/Economic-Overview-May-2022-Westpac-NZ.pdf

Round-up of local data released over the last week

Date	Release	Previous	Actual	Westpac f/c
Tue 24	Q1 real retail sales	8.3%	–0.5%	2.2%
Wed 25	RBNZ policy decision	1.50%	2.00%	2.00%
Fri 27	May ANZ consumer confidence	84.4	82.3	–

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

DATA PREVIEWS

Aus Apr dwelling approvals

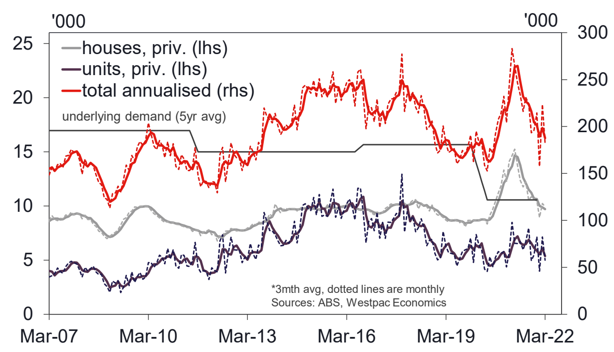
May 31, Last: –18.5%, WBC f/c: 2.0%
Mkt f/c: 2.0%, Range: –6.0% to 9.0%

Virus and weather disruptions have generated enormous volatility in dwelling approvals in early 2022, a –27% plunge in Jan followed by a spectacular +42% rebound in Feb and another steep 18.5% drop in March.

The latest decline centred on a big fall in units, 'high rise' approvals down 70% in to multi-year lows. The segment is coming under pressure on multiple fronts – buyers favouring detached houses; low rental demand in segments catering to foreign students; and the added risk to project viability coming from supply chain and labour force disruptions, which have seen build times and costs blow out.

Approvals are expected to post only a muted 2% rebound in April. High rise approvals should bounce off March's decade low but will remain under intense pressure. Non-high rise approvals are also expected to remain soft. The RBA's interest rate tightening will weigh on both but will take a few months to show through.

Dwelling approvals



Aus Q1 company profits

May 31, Last: 2.0%, WBC f/c: 6.0%
Mkt f/c: 5.0%, Range: 0.8% to 10.0%

Company profits rose by 2% in the December quarter, a result held back by a decline in mining profits, down by a reported 5.7%.

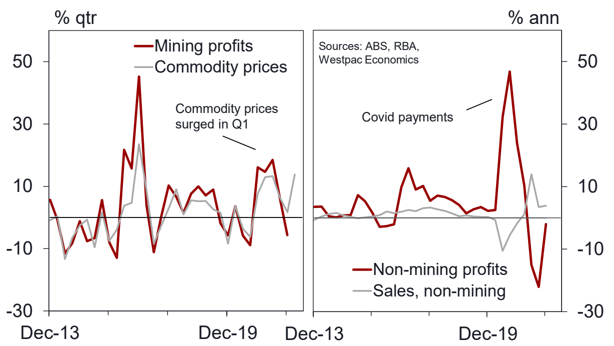
Profits ex mining and ex finance jumped by 8% in Q4 (to be 21.5% above the level at the end of 2019 - prior to the pandemic). The economy roared back on the delta reopening, with output up by 3.4% in the December quarter.

Roll forward to the March quarter, profits are forecast to be up by 6.0%, but the mix will be very different from that last period.

It is the mining sector (representing around 40% of total profits, on this estimate) that will drive a strong Q1 result, boosted by a 14% surge in commodity prices in the period.

Across the non-mining economy, conditions and profits were likely mixed, constrained by disruptions – the omicron wave in January and flooding / wet weather in NSW and Qld.

Company profits: led higher by mining in Q1



Aus Q1 inventories

May 31, Last: 1.1%, WBC f/c: 0.5%
Mkt f/c: 0.7%, Range: 0.0% to 2.3%

Sales and production, as well as inventories have all moved through large movements quarter to quarter at times during the pandemic.

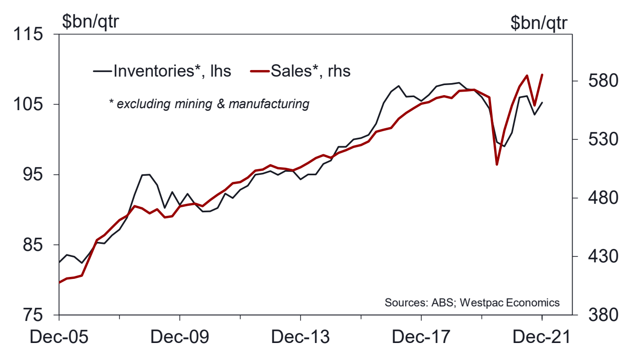
In the December quarter, the Australian economy reopened from the delta lockdown (albeit less so in Victoria). Sales and production both expanded strongly. Associated with this, inventory levels increased, up 1.1%, +$1.9bn, the Business Indicators survey reported.

In the March quarter, conditions were mixed, with disruptions from the omicron wave and wet weather in NSW and Qld. That points to a more subdued rise in sales and a patchy production performance.

In this environment, any further increase in inventory levels is likely to be more modest. We have factored in a rise of 0.5% (in part achieved by a flood of imports), but note the large degree of uncertainty around inventories (which are often subject to revision).

On our figure, private non-farm business inventories subtract -0.2ppts from activity in the quarter.

Inventories and sales: impacted by lockdowns



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Aus Q1 current account, $bn

May 31, Last: 12.7, WBC f/c: 10.5
Mkt f/c: 13.3, Range: 9.0 to 18.0

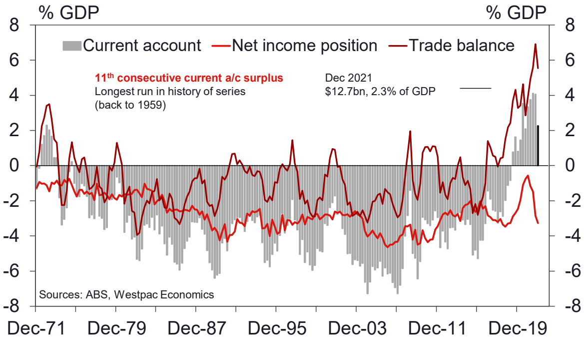
Australia will notch up a 12th consecutive quarterly current account surplus in March. Recall that the surplus narrowed to $12.7bn in December after hitting a record high of $22bn in June and September 2021.

For the March quarter, the current account surplus is expected to print around $10.5bn, 1.8% of GDP.

The trade surplus was $29.2bn for Q1 (on the monthly numbers), down a little from the Q4 outcome of $31bn.

The net income deficit "normalised" over the second half of 2021 after falling to extraordinary low levels during the pandemic. We anticipate a consolidation in Q1, at -$18.7bn, following a -$18.3bn outcome for Q4.

Current a/c: surplus eased back to $12.7bn in Q4



Aus Q1 net exports, ppts cont'n

May 31, Last: -0.2, WBC f/c: –1.4
Mkt f/c: –1.4, Range: –1.8 to –0.2

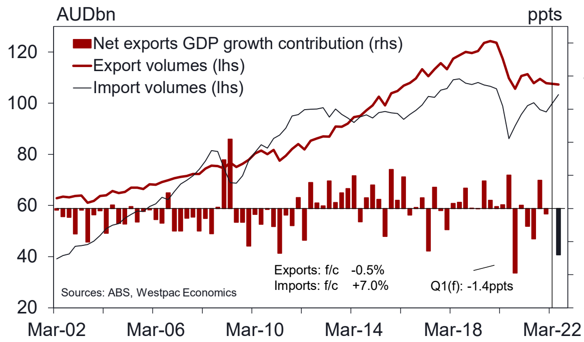
Net exports have swung back and forth during the pandemic. Generally, lockdowns are associated with positive net exports, while the reopening results in a net export drag on growth. Imports are a key swing variable – falling as demand weakens during lockdowns, rebounding as demand recovers on reopening.

For Q1, with the reopening from delta, imports surged and net exports will be a sizeable subtraction, a forecast -1.4ppts.

The import bill jumped by 11.7% in Q1 and, on our figuring, this includes a 7% increase in volumes (led by consumer goods) – which has volumes up by only a modest 3% since mid-2021.

Export volumes remain a source of disappointment. While export earnings rose by around 10% in Q1, on our figuring volumes slipped, down 0.5%, led lower by resources impacted by supply disruptions.

Net exports: Q1 f/c -1.4ppt



Aus Apr private sector credit

May 31, Last: 0.4%, WBC f/c: 0.4%
Mkt f/c: 0.5%, Range: 0.3% to 0.6%

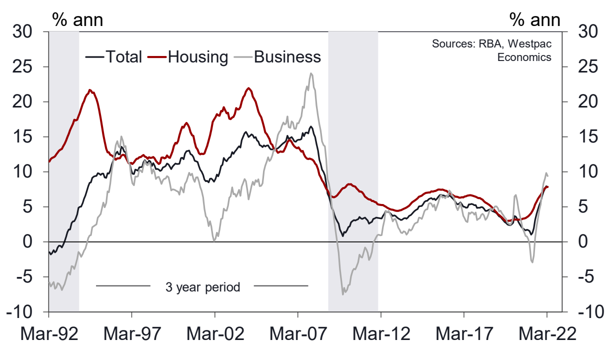
Credit to the private sector expanded by 7.9% over the past year, to February, rounding down to 7.8% in March. The February result was the fastest annual pace since November 2008, but still well below the December 2007 peak of 16.5%, pre–GFC.

Households and businesses alike have borrowed more, responding to considerable policy stimulus. Record low interest rates fired up the housing market, firms accessed lines of credit to improve cash flows to navigate lockdowns and firms also borrowed to invest.

Currently, credit momentum may be cooling as interest rates begin to rise and with the Federal election a source of near-term uncertainty potentially temporarily impacting business lending.

Credit grew by 0.4% in March, including 0.6% for residential, 0.3% for business and -0.2% for personal. We anticipate a 0.4% gain in April. This represents a step down from the 0.7% monthly average from June 2021 to February (a result boosted by delta lockdown impacts on business).

Credit: annual growth holds near 8%, a 13 yr high



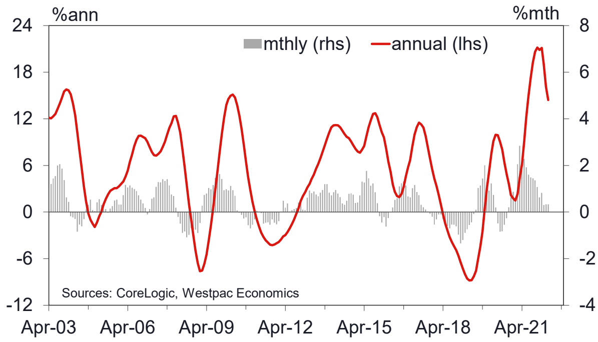
Aus May CoreLogic home value index

Jun 1, Last: 0.3%, WBC f/c: –0.3%

The CoreLogic home value index, covering the eight major capital cities, has seen much slower gains in 2022, averaging about 0.3%mth through Feb-Apr, a sub-5% pace in annualised terms. Turnover has also fallen back steeply, down over 20% from the historic highs seen during the post-delta 'catch-up' late last year.

The market looks to have tipped over into correction in May, daily measures pointing to a 0.3% decline across the major capital cities, Sydney and Melbourne prices down about 0.5%mth. With affordability pressures already acute, the RBA's interest rate rise in May and the prospect of more to come has been the clear catalyst for a correction that we expect to continue through the remainder of 2022 and all of 2023.

Australian dwelling prices



Aus Q1 GDP

Jun 1, Last: 3.4%, WBC f/c: 0.2%
Mkt f/c: 0.6%, Range: 0.0% to 2.0%

The reopening bounce from the delta lockdowns in mid-2021 faltered in Q1 2022 on further disruptions – the omicron wave, as well as wet weather in NSW and Qld, including severe flooding.

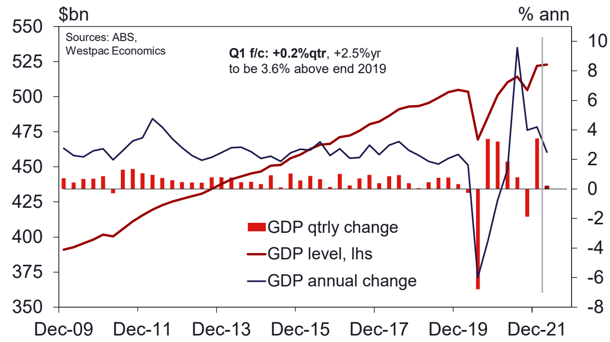
Output surged 3.4% in Q4 2021, to be 3.4% above the level at the end of 2019 (prior to the pandemic). The key driver, a 6.3% jump in consumer spending in Q4, reversing a 4.8% delta driven slump in Q3.

For Q1, we anticipate anaemic growth of 0.2%. The Labour Force survey printed hours worked down 1.2%, pointing to downside risks.

Our Q1 arithmetic is: domestic demand +1.5%; net exports -1.4ppts; total inventories flat; and the statistical discrepancy, +0.1ppt. Consumer spending, +2%, and public demand, +1.2%, add to growth, while housing is flat and business investment is subdued, +0.4%.

For additional detail, see page 2 above.

Australian economy: Q1 hit by disruptions



Aus Apr trade balance, $bn

Jun 2, Last: 9.3, WBC f/c: 9.5
Mkt f/c: 9.0, Range: 7.1 to 10.7

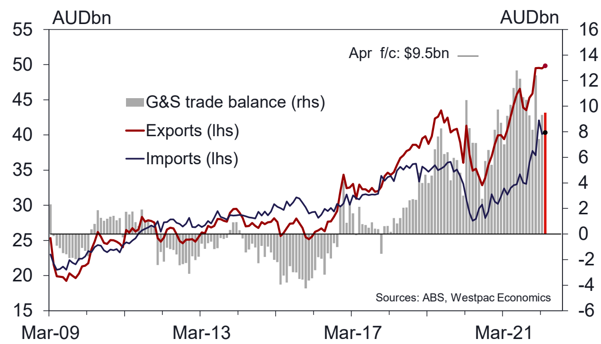
Australia's monthly trade surplus has averaged $9.9bn since the start of 2021, including a $9.3bn outcome for March 2022.

With exports and imports both anticipated to make modest gains in April, the trade surplus is expected to hold around current levels, at a forecast $9.5bn.

Export earnings potentially rose by $0.4bn in April, +0.8%. Coal likely led the way, up $0.8bn on higher prices and volumes. Iron ore volumes were softer in the month and gold demand from China may be down impacted by the country's covid zero policy.

Imports may be up by around $0.2bn, 0.5%. Volumes, having rebounded sharply in Q1 on the post delta reopening, will continue to trend higher to meet rising domestic demand. Prices are likely to be mixed - the AUD was higher in the month, which dampens prices for imports, as well as exports.

Australia's trade balance



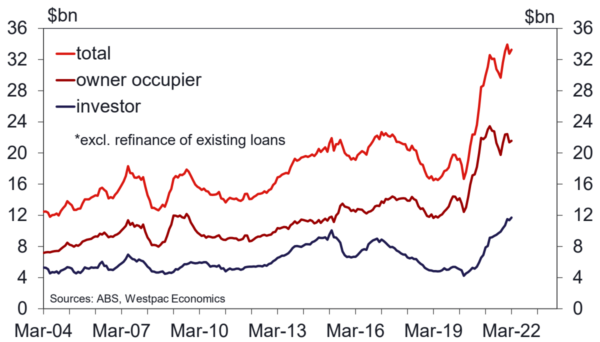
Aus Apr housing finance approvals

Jun 3, Last: 1.6%, WBC f/c: –3.0%
Mkt f/c: –0.3%, Range: –6.0% to 1.8%

Housing finance approvals posted a surprise 1.6% gain in March. That said, this will almost certainly prove to have been the peak in the cycle. Approvals are at a lofty levels with a sharp decline in market turnover (–15% since the start of the year in value terms) pointing to an imminent pull back.

We expect this to show through clearly in April with a 3% decline in the total value of approvals followed by similar-sized declines in following months. Owner occupier loans are likely to see a more pronounced decline (–3.5%) compared to investors (–2.5%).

New finance approvals*



NZ Apr residential building consents

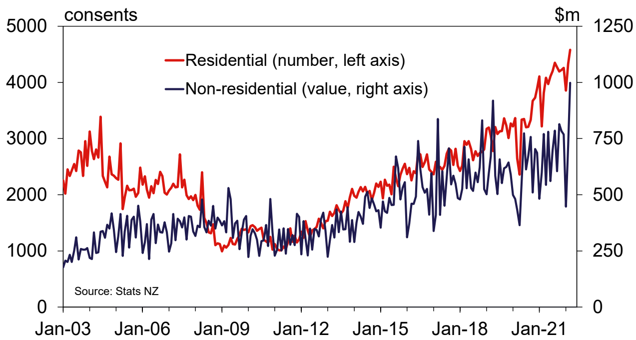
May 31, Last: +5.8%, Westpac f/c: -5.0%

Consent issuance rose by nearly 6% in March. That took annual issuance to just under 50,900 – the highest level on record. Much of the strength has related to a large increase in the number of medium-density developments, such as townhouses and apartments.

We are forecasting a 5% fall in consent issuance in April, as some of last month's sharp rise in multi-unit consents reverses. Stand-alone unit consents are expected to remain steady around firm levels. Looking through the month-to-month volatility, those developments would see annual consent issuance remaining close to their recent record highs.

In the non-residential space, consents for industrial and storage buildings are expected to remain firm, while other categories are likely to be softer.

NZ building consents



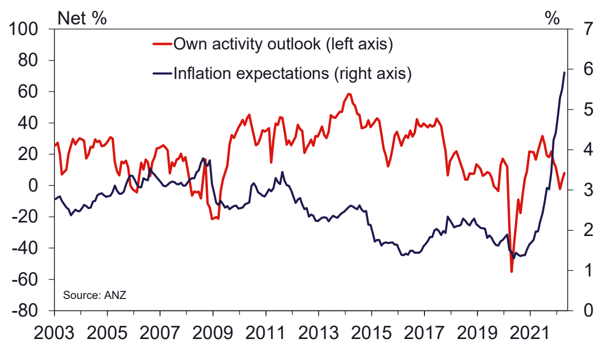
NZ May ANZBO business confidence

May 31, Last: -42.0

With the drag on activity from omicron continuing to fade, confidence is likely to rise slightly in the May business survey. However, that would still leave confidence at low levels. Businesses are continuing to grapple with a range of challenges including ongoing supply disruptions and difficulties sourcing staff. There is also growing nervousness about how the rise in borrowing costs could affect demand.

The survey's cost and inflation gauges are likely to remain at elevated levels. Businesses have been highlighting significant pressure on operating costs and most expect that will continue over the coming months.

NZ business confidence



DATA PREVIEWS

NZ Q1 Terms of Trade

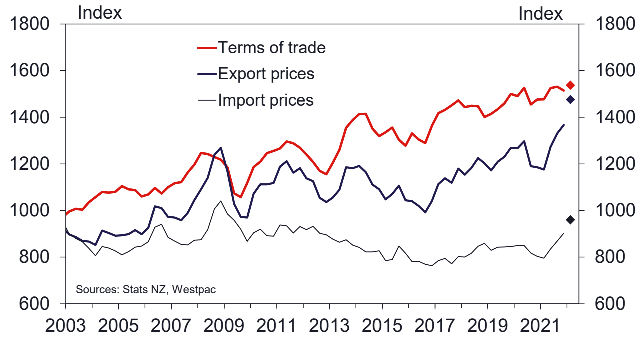
Jun 2, Last: -1.0%, Westpac: 1.5%

We expect the Terms of Trade to rise by around 1.5% over the March 2022 quarter and in the process set a fresh record high.

The catalyst for the rise is a broad lift in export prices, with dairy prices jumping 10% over the quarter. Meanwhile, import prices have also jumped, but not by enough to offset the rise in export prices.

Looking over the remainder of 2022, and with global food shortages expected to remain acute, we expect our food export prices and the Terms of Trade to remain at or near record highs.

NZ terms of trade



NZ Q1 building work put in place

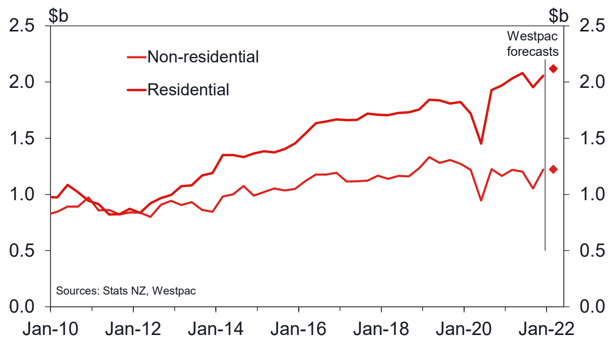
3 Jun, Last: +8.9%, Westpac: +2.0%

Total construction activity rose by 8.9% in the December quarter as earlier delta-related disruptions eased. Underlying December's rise was a 5% lift in residential work and a 16% lift in non-residential construction.

We are forecasting a further 2% rise in construction activity in the March quarter. That's underpinned by a 3% rise in residential construction activity. In contrast, non-residential construction activity is expected to remain steady at around the levels seen over the past year.

We expect that construction activity will remain strong over the year ahead, with a large pipeline of planned work. However, shortages of materials and labour are acting as a handbrake. That's resulting in widespread delays, with completion times stretching out.

NZ real building work put in place



US May employment report

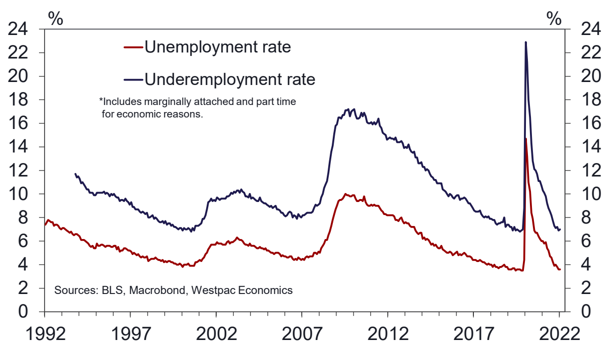
Jun 3, non-farm payrolls, Last: 428k, WBC f/c: 370k, Mkt f/c: 329k
Jun 3, unemployment rate, Last: 3.6%, WBC f/c: 3.5%, Mkt f/c: 3.5%

US employment growth looks to be losing momentum, but is currently still robust, consistent with a further decline in the unemployment rate.

Ahead, we believe employment growth will slow further, as tightening takes effect, and that participation will strengthen, making the unemployment rate of 3.5% expected from this month a likely low for the cycle.

Given the tight state of the labour market, hourly earnings will continue to be bid higher, though not as aggressively as in 2021 and at less than the rate of inflation. As a result, real incomes are set to continue falling through 2022.

US 'maximum employment' achieved



For the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 30					
Eur	May economic confidence	105.0	–	–	Russia-Ukraine conflict is clouding the outlook…
	May consumer confidence	–21.1	–	–	… elevated prices are the chief concern of households.
US	Memorial Day	–	–	–	Public holiday. Markets closed.
	Fedspeak	–	–	–	Waller.
Tue 31					
Aus	Apr dwelling approvals	–18.5%	2.0%	2.0%	Muted bounce from steep high-rise led drop in March.
	Q1 company profits	2.0%	5.0%	6.0%	Profits led higher by mining on 14% jump in commodity prices.
	Q1 business inventories	1.1%	0.7%	0.5%	Rising at a slower rate with mixed conditions due to disruptions.
	Q1 current account, $bn	12.7	13.3	10.5	Still comfortably in surplus, but likely a little lower in Q1.
	Q1 net exports, ppts cont'n	–0.2	–1.4	–1.4	Imports surge on delta reopening, exports slip.
	Q1 public demand	–0.4	–	1.2%	Government sector remains growth driver, after rare dip.
	Apr private sector credit	0.4%	0.5%	0.4%	Emerging loss of momentum, as rates begin to rise.
NZ	Apr building permits	5.8%	–	–5.0%	Pull-back in multi-unit numbers after last month's surge.
	May ANZ business confidence	–42	–	–	Confidence still low but climbing. Price pressures still intense.
Jpn	Apr industrial production	0.3%	–0.2%	–	Supply issues are an ongoing struggle.
Chn	May manufacturing PMI	47.4	49.0	–	To reflect some progress being made but manufacturing…
	May non-manufacturing PMI	41.9	46.0	–	… and services to shrink further under lockdowns.
Eur	May CPI %yr	7.5%	–	–	Price pressures look to be broadening.
UK	Apr net mortgage lending £bn	7.0	–	–	Softer lending to be seen as rates rise and economy slows.
US	Mar FHFA house prices	2.1%	2.0%	–	Strong demand and limited supply are supportive but…
	Mar S&P/CS home price index	2.4%	1.9%	–	… March kick-off for rates to slow price growth over '22.
	May Chicago PMI	56.4	54.5	–	Concerns around supply issues remain.
	May consumer confidence index	107.3	103.9	–	Inflation worries offsetting strength of labour market.
	May Dallas Fed index	1.1	1.5	–	Manufacturers concerned with elevated cost pressures.
Wed 01					
Aus	May CoreLogic home value index	0.3%	–	–0.3%	Price correction looks to have begun in May.
	Q1 GDP	3.4%	0.6%	0.2%	Soft conditions due to disruptions, with downside risks.
Jpn	May Nikkei manufacturing PMI	53.2	–	–	Final estimate for the month.
Chn	May Caixin China PMI	46.0	49.5	–	Manufacturing to recover as COVID-19 disruptions fade.
Eur	May S&P Global manufacturing PMI	54.4	–	–	Final estimate for the month.
	Apr unemployment rate	6.8%	–	–	Tight labour market laying foundation for wages growth.
UK	May S&P Global manufacturing PMI	54.6	–	–	Final estimate for the month.
US	May S&P Global manufacturing PMI	57.5	57.5	–	Final estimate for the month.
	Apr construction spending	0.1%	0.7%	–	Activity supported by home building strength.
	May ISM manufacturing	55.4	55.0	–	Robust momentum still evident in manufacturing.
	Apr JOLTS job openings	11549k	–	–	Pointing to extraordinary demand for workers.
	Federal Reserve's Beige book	–	–	–	Qualitative assessment of conditions across the 12 districts.
	Fedspeak	–	–	–	Williams and Bullard.
Can	Bank of Canada policy decision	1.00%	1.50%	–	Market expects 50bp rate hike in order to tame inflation.
Thu 02					
Aus	Apr trade balance $bn	9.3	9.0	9.5	Exports and imports both expected to make modest gains.
NZ	Q1 terms of trade	–1.0%	–	1.5%	New record high on the back of earlier dairy price surge.
US	May ADP employment change	247k	295k	–	Jobs growth holding at robust levels.
	Q1 productivity	–7.5%	–7.5%	–	Final estimate; will remain volatile through 2022.
	Initial jobless claims	210k	–	–	Set to remain at a low level.
	Apr factory orders	1.8%%	0.7%	–	Capital investment to lift over this year…
	Apr durable goods orders	0.4%	0.4%	–	… as inventories return to pre-pandemic levels.
	Fedspeak	–	–	–	Logan and Mester.
Fri 03					
Aus	Apr housing finance	1.6%	–0.3%	–3.0%	Drop in turnover – already down 15% in value terms – to …
	Apr investor finance	2.9%	–	–2.5%	… show through in finance approvals in coming months…
	Apr owner occupier finance	0.9%	–	–3.5%	… falls likely to be more pronounced for owner occupiers.
NZ	Q1 building work put in place	8.9%	–	2.0%	Capacity constraints limiting the rise in activity.
Jpn	May Nikkei services PMI	51.7	–	–	Final estimate for the month.
Eur	May S&P Global services PMI	56.3	–	–	Final estimate for the month.
	Apr retail sales	–0.4%	–	–	Consumer rebound limited by inflation and conflict.
US	May non-farm payrolls	428k	329k	370k	Employment gains sustaining a healthy pace…
	May unemployment rate	3.6%	3.5%	3.5%	… pushing the unemployment rate lower…
	May average hourly earnings %mth	0.3%	0.4%	0.3%	… and supporting robust wages growth.
	May S&P Global services PMI	53.5	–	–	Final estimate for the month.
	May ISM non-manufacturing	57.1	56.9	–	Services sector remains in robust health.
	Fedspeak	–	–	–	Brainard.

Forecasts

Interest rate forecasts

Australia	Latest (27 May)	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	0.35	0.75	1.25	1.75	2.00	2.25	2.25	2.25
90 Day BBSW	1.13	1.20	1.70	2.05	2.30	2.45	2.45	2.45
3 Year Swap	3.07	3.15	3.15	3.10	3.00	2.90	2.80	2.75
3 Year Bond	2.78	2.95	2.95	2.90	2.80	2.70	2.60	2.55
10 Year Bond	3.28	3.30	3.15	2.90	2.65	2.50	2.40	2.30
10 Year Spread to US (bps)	52	40	35	30	25	20	20	20
US								
Fed Funds	0.875	1.375	2.125	2.625	2.625	2.625	2.625	2.625
US 10 Year Bond	2.75	2.90	2.80	2.60	2.40	2.30	2.20	2.10
New Zealand								
Cash	2.00	2.00	3.00	3.50	3.50	3.50	3.50	3.50
90 day bill	2.43	2.70	3.40	3.60	3.60	3.60	3.60	3.60
2 year swap	3.78	4.00	4.00	3.90	3.70	3.50	3.30	3.10
10 Year Bond	3.48	3.80	3.70	3.50	3.30	3.20	3.10	3.00
10 Year spread to US	72	90	90	90	90	90	90	90

Exchange rate forecasts

Australia	Latest (27 May)	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7097	0.72	0.74	0.76	0.77	0.78	0.79	0.80
NZD/USD	0.6479	0.65	0.67	0.69	0.70	0.71	0.72	0.72
USD/JPY	127.08	128	127	126	125	124	122	121
EUR/USD	1.0729	1.07	1.08	1.09	1.11	1.13	1.14	1.15
GBP/USD	1.2605	1.25	1.25	1.26	1.28	1.30	1.32	1.34
USD/CNY	6.7390	6.65	6.50	6.35	6.25	6.20	6.15	6.15
AUD/NZD	1.0954	1.11	1.10	1.10	1.10	1.10	1.10	1.11

Australian economic growth forecasts

	2021		2022					Calendar years			
% change	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2020	2021	2022f	2023f
GDP % qtr	0.8	–1.9	3.4	0.2	1.9	1.4	0.9	–	–	–	–
%yr end	9.6	4.0	4.2	2.5	3.7	7.1	4.5	–0.8	4.2	4.5	2.5
Unemployment rate %	5.2	4.6	4.7	4.0	3.7	3.4	3.2	6.8	4.7	3.2	3.5
CPI % qtr	0.8	0.8	1.3	2.1	0.9	1.0	1.5	–	–	–	–
Annual change	3.8	3.0	3.5	5.1	5.2	5.4	5.6	0.9	3.5	5.6	2.6
CPI trimmed mean %qtr	0.5	0.7	1.0	1.4	1.0	1.0	1.0	–	–	–	–
%yr end	1.6	2.1	2.6	3.7	4.2	4.5	4.4	1.2	2.6	4.4	3.0

New Zealand economic growth forecasts

	2021		2022					Calendar years			
% change	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2020	2021	2022f	2023f
GDP % qtr	2.5	–3.6	3.0	0.6	0.3	1.0	1.1	–	–	–	–
Annual avg change	5.2	4.8	5.6	5.3	1.4	2.7	2.7	–2.1	5.6	2.7	3.3
Unemployment rate %	4.0	3.3	3.2	3.2	3.1	3.0	3.0	4.9	3.2	3.0	3.3
CPI % qtr	1.3	2.2	1.4	1.8	1.1	1.2	0.4	–	–	–	–
Annual change	3.3	4.9	5.9	6.9	6.7	5.6	4.5	1.4	5.9	4.5	2.7

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