AUSTRALIA & NEW ZEALAND WEEKLY.

Week beginning 25 July 2022

Editorial: RBA to lift the cash rate to 3.35% by February 2023.

Australia: Q2 CPI, retail sales, private credit. Federal Treasurer Ministerial Economic Statement to Parliament.

NZ: business and consumer confidence.

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Key economic & financial forecasts.

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 22 JULY 2022.

WESTPAC INSTITUTIONAL BANK

EDITORIAL

RBA to lift the cash rate to 3.35% by February 2023

We have revised our profile for the RBA cash rate cycle to include 50bp moves in both August and September; followed by a step down in the pace to 25bp increases at every meeting from October to February 2023. The terminal cash rate forecast has been revised up from 2.6% to 3.35%. Under this policy stance economic growth is expected to slow to 1% in 2023 and the unemployment rate to lift from 3% to 4.4% in 2023. We expect the Bank to cut the cash rate by 100bps in 2024.

This week we have received three very important communications from the Reserve Bank. These were: the Minutes of the July Board meeting; and the speeches by both Governor Lowe and Deputy Governor Bullock.

Three consistent themes run through these pieces:

1. The Bank is committed to the concept of assessing the stance of monetary policy through the lens of the neutral rate. The Bank's estimate of neutral is higher than our own.
2. The most significant challenge to returning inflation to the target range is containing inflation expectations and inflation psychology. Such is the emphasis on this issue that it is likely the Bank will err on the side of containing these expectations, even at the risk of weighing more heavily on economic activity than might have been their preference under other circumstances.
3. A key area of interest will be how households respond to higher interest rates. There are reasons to expect a degree of resilience given a tight labour market supporting strong nominal income growth; a high savings rate; and large financial buffers in household balance sheets.

Westpac's forecast for the peak in the terminal cash rate in this cycle has been 2.6%.

That was partly based on our assessment that the neutral cash rate is in the 1.5–2.0% range.

The Minutes, the Governor's speech, and the Deputy Governor's responses in the Q&A session all point to the RBA assessing the neutral rate as being at least 2.5%.

The Governor and the Minutes both note that there are a number of different approaches to the measurement of neutral, but the Governor concludes that "most approaches suggest that the neutral real rate for Australia is at least positive."

Converting this neutral real rate into a nominal rate is trickier when inflation is volatile. Rather than current inflation, the adjustment should use medium to longer term inflation expectations. He currently assesses these as being at the target rate of 2.5% but points out that if inflation expectations were to lift then the neutral rate estimate would also increase.

The cash rate is currently 1.35% and we have been expecting the Board to lift the rate to 1.85% at its August meeting.

That will still be 65bp below the Bank's assessed neutral rate.

We had assumed that having reached 1.85% – within our estimated 'neutral zone' – the Board could step back to smaller increments at a slower pace. Our profile was for: a 25bp lift in September; followed by a pause in October; a 25bp move in November, in response to another sharp lift in annual underlying inflation in the September Quarter inflation report; a pause in December and a final lift of 25bp at the February Board meeting in response to the peak in annual inflation in the December Quarter inflation report. That would see a terminal cash rate of 2.6%.

Given the guidance from the Bank this week, that neutral is 2.5%, it seems unlikely that the Board would take until next February to reach its assessment of neutral.

Such an approach seems particularly unlikely given the nervousness around inflation expectations and the current accurate assessment of a very tight labour market and a resilient household sector. On the latter we also note that momentum in spending is likely to be remain solid through the June and September quarters despite the recent collapse in Consumer Sentiment.

Accordingly, we have revised our profile for the RBA's tightening cycle to reflect these factors.

Firstly, there will need to be a further 50bp increase in the cash rate in September, to 2.35%, moving it more decisively into the RBA's 'neutral zone'.

With the cash rate around neutral and following a cumulative increase of 225bps in only five meetings, it would then be appropriate for the RBA to step the increases down to a 25bp pace in October, taking the cash rate slightly above neutral to 2.6%.

With the policy position now perceived as contractionary the Board would remain on the slower 25bp path, guided by developments around inflation; inflation expectations; the labour market and the economy, while continuing to send the signal that it remains committed to containing inflation by moving policy further into the contractionary zone.

Inflation outcomes and inflation expectation concerns will be the dominant motivating forces for policy.

The September quarter inflation report will signal further increases in underlying inflation to 5% annual growth, prompting a further 25bp move at the November meeting.

The cash rate will be 2.85% before the December meeting. Household spending will be losing momentum and the housing market will have been slowing for nearly six months.

But inflation; inflation expectations and the labour market will still be running too hot and with the cash rate only 35bp above the minimum assessed neutral another 25bp adjustment will come in December.

As in our previous profile we expect that the final increase will be in February following the peak print in both headline and underlying inflation.

As we have assessed previously, we expect the March quarter inflation report, which will inform the May Board meeting, to show a clear fall in both annual and quarterly inflation – a turning point that will allow the Bank to remain on hold.

The difference between this revised profile and our previous profile is that the peak terminal rate will be 3.35% rather than 2.60%. That will be 85bp above the Board's assessed neutral rate and 135bp above our estimate of neutral.

We think this higher terminal rate will reflect the Board's risk averse approach which will lead it to err on the side of ensuring

inflationary expectations are contained so that inflation can return to the target range over the course of 2023.

Just as the Board over-stimulated the economy in the face of the COVID threat, so it will be prepared to tighten to address what it perceives as the greater risk – **losing control of inflation expectations at this time of rising inflation and very tight labour markets rather than fine tuning the economic downturn.**

Central banks refer to this approach as taking the course of least regret.

Forecast changes

This higher terminal rate does mean significant changes to our key forecasts.

GDP growth is revised down from 2% to 1% in 2023; and from 2.5% to 2% in 2024.

Consumer spending growth is downgraded from 2.5% to 1.5% in 2023 and from 2.8% to 2.0% in 2024.

The unemployment rate lifts from 3% by end 2022 to 4.2% in 2023 and 5% in 2024 (compared to 3.2% ,3.5% and 3.9% respectively).

Higher interest rates will also add pressure to the housing market where a price correction is already underway. Prices are now expected to decline 4% over calendar 2022 and 10% in calendar 2023, with a 'peak to trough' fall of over 15%. Rate cuts, which did not figure in our previous profile, will provide some recovery in prices in 2024.

Underlying inflation slows to 3.0% in 2023 and 2.7% in 2024 (compared to 3.2% and 3.0% respectively).

Containing inflation would, justifiably, be seen by the authorities to be a successful outcome, although our previous forecasts also anticipated a sharp slowing in inflation in 2023 mainly in response to supply side adjustments in fuel, food, building materials and energy.

A 1% growth rate and zero per capita growth in consumer spending in 2023 would be seen, in hindsight, as an acceptable cost to not losing control of inflation and inflationary expectations.

A 2ppt increase in the unemployment rate over two years will be painful (in contrast with 1% in our earlier scenario) but certainly enhances the prospects of containing wages growth to around 4% – meaning positive real wages growth through 2023 and 2024 but not a more problematic rise that would add to inflation pressures.

Despite the insipid growth rate of 1% in 2023 the Board will maintain the contractionary policy stance throughout 2023. Underlying inflation is forecast to hold above the top of the target band through most of the year. That will keep the Board cautious about easing back on policy too early and risking a resurgence in inflationary expectations.

Wages growth will also provide some degree of caution in 2023 as annual growth lifts to 4.5% from the June quarter. Without the higher terminal rate that peak would have been 5%.

By early 2024 with inflation slowing back into the band; the economy operating below capacity; wages growth slowing and the unemployment rate rising it will be time to move the policy setting back to neutral.

Over the course of 2024 we expect the cash rate to be reduced by 100bps from 3.35% to 2.35%.

Bill Evans, Chief Economist

Forecasts

Australia	Latest (22 Jul)	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Jun-24	Dec-24
Cash	1.35	2.35	3.10	3.35	3.35	3.35	3.35	2.85	2.35
90 Day BBSW	2.22	3.05	3.55	3.55	3.55	3.55	3.38	2.88	2.38
3 Year Swap	3.52	3.55	3.50	3.30	3.10	2.90	2.80	2.75	2.75
3 Year Bond	3.07	3.20	3.25	3.10	2.90	2.70	2.60	2.55	2.55
10 Year Bond	3.43	3.60	3.50	3.35	3.15	2.90	2.65	2.35	2.15
10 Year Spread to US (bps)	56	50	50	45	45	40	35	25	15
US									
Fed Funds	1.625	2.875	3.375	3.375	3.375	3.375	3.125	2.625	2.125
US 10 Year Bond	2.87	3.10	3.00	2.90	2.70	2.50	2.30	2.10	2.00

In Australia and abroad, it was a quiet week for data, keeping the focus on monetary policy.

At home, the July RBA minutes and speeches by RBA Governor Lowe and Deputy Governor Bullock made clear there is more work to do to contain inflation and related risks. The minutes of the July meeting showed little debate over the choice between a 25bp or 50bp hike, with the latter seen as appropriate given "the level of interest rates was still very low for an economy with a tight labour market and facing a period of higher inflation". "Members [also] agreed that the outlook for domestic economic activity had [only] eased a little." Consumption is to be carefully monitored given the sharp drop in consumer confidence in recent months, but the strength of the labour market; accumulated savings; and the still-elevated level of the savings rate give cause for a sanguine baseline view for near-term spending. The strong financial position of Australian households was further elaborated on by Deputy Governor Bullock in her speech.

The July minutes also noted that "the current level of the cash rate is well below the lower range of estimates for the nominal neutral rate" albeit without giving clarity on what level was seen as neutral. Governor Lowe subsequently provided further detail, outlining in his speech that "most approaches [to modelling neutral] suggest that the neutral real rate for Australia is at least positive" and so, assuming inflation averages 2.5%yr over time, "the neutral nominal rate is at least 2½ per cent".

Following the above RBA comments and last week's labour force survey, Chief Economist Bill Evans today unveiled revisions to our forecasts for 2022–2024. With the RBA perceiving neutral as "at least" 2.5%, the labour market historically tight and inflation risks material, we now forecast 50bp increases in August and September to be followed by 25bp increases each month until February 2023 to a peak cash rate of 3.35%. While this course will, in time, bring inflation back to target, there will also be a significant cost for growth and the labour market. In 2023 and 2024, GDP growth is now forecast to be 1.0% and 2.0% (previously 2.0% and 2.5%) while the unemployment rate is projected to rise by 2ppts to around 5.0% end-2024. Rate cuts in 2024 should subsequently stabilise the economy and also the housing market, the latter after a circa 16% peak-to-trough decline through 2022 and 2023.

Further emphasising a need for careful monitoring of inflation pressures in the antipodes, New Zealand's Q2 CPI came in ahead of expectations at 1.7%/7.3%yr as a result of supply-side factors and tight domestic capacity. While our New Zealand team expect Q2 to prove the peak period for CPI inflation, they do not expect to see annual inflation back within the RBNZ's target range until the middle of 2023 – at the earliest. However, with the RBNZ's tightening cycle already well advanced, much of the inflation seen to date coming from offshore, and early signs that the domestic economy is cooling, our New Zealand team continue to believe a 50bp hike in August followed by two additional 25bp increases will close out this tightening cycle at 3.50% in November. That said, ahead of the August meeting, it will be important to monitor the next round of labour market outcomes to assess upside risks emanating from domestic factors.

Australia's Q2 CPI report is due next week; a headline outcome similar to that seen in New Zealand is anticipated.

The long-awaited July ECB meeting also delivered a hawkish surprise this week, with the Governing Council deciding to lift all of their key rates by 50bps after previously telegraphing a 25bp first move. Underlying this decision were concerns around the inflation outlook (headline 8.6%yr; core 3.7%yr) and inflation expectations despite the latter presently being well anchored. As with many central banks across the developed world, the ECB's front-loaded start to this tightening cycle is a clear indication of their commitment to return inflation back to their medium-term target of 2%.

The economic impact of the ECB's rate hike is expected to be cushioned by the introduction of a new tool to manage fragmentation risks. The Transmission Protection Instrument (TPI) will provide unrestricted support through purchasing government debt securities in markets where uneven monetary policy transmission is present, with some room to consider corporate debt if need be. Until its activation, the ECB will continue to employ ongoing reinvestments of proceeds from maturing securities in a flexible manner across Euro Area rate markets.

On the broader outlook, the ECB seemed quite sanguine given the strength of the labour market and the reopening; however, they acknowledged considerable uncertainty clouds the outlook. Russia's invasion of Ukraine hit confidence hard and materially weakened growth prospects, while tighter lending standards already look to be impacting households and businesses. Still, the inflation challenge remains the clear focus; hence we still expect the ECB to raise the main refinancing rate by 50bp in September and to a year-end peak of 1.50%.

Turning then to the US. While profit reporting season provided many positive surprises for the market this week, economic updates disappointed yet again. Existing home sales fell over 5% in June as affordability and market supply continued to restrict activity; and housing starts fell another 3% after a near 12% fall in May. Received last Friday, though retail sales marginally beat expectations in June, adjusted for inflation, activity in the sector fell again, increasing the odds of a second consecutive quarter of negative GDP growth in Q2. As we continue to emphasise, the key risk for the US is not a technical recession but rather a prolonged period of stagnation, impacting activity and employment outcomes into the medium-term. Increasingly this risk is set to weigh on US term interest rates and the dollar; if a further deterioration in conditions is seen in coming months, either or both of the last two hikes we forecast for the FOMC this cycle could also come up for renewed debate.

Finally to China. Late last week we received Q2 GDP and the final partial data for June. While the market received the large negative outcome for Q2 GDP it was anticipating, the key partial data was constructive on growth prospects into year end and for 2023. Notably, despite the heavy burden of COVID-zero restrictions through Q2, nominal fixed asset investment growth sustained above 6% year-to-date throughout Q2. The trade surplus also continued to print successive highs during the quarter as exports grew strongly and imports growth slipped. Heading into Q3, retail also looks to have momentum, annual growth having recovered from -11% in April, when COVID-zero policies were in full effect, to +3% by June. The Q2 GDP outcome likely rules out authorities' 5.5% growth ambition being achieved on a year-average basis in 2022, but it can still be seen through the year to December as long as the economy is able to rebound without restriction during the second half. A similar annual gain through 2023 would see year-average growth for 2023 at 7.0% after a 3.5% gain in 2022.

Week ahead & data wrap

How fast? How furious?

There's been no let-up in the intense price pressures that have been buffeting New Zealand households. Consumer prices rose by 7.3% in the year to June. That's the highest annual rate of inflation in 32 years.

Much of the strength in consumer prices has been due to large increases in the price of food, petrol and housing costs. However, the high level of inflation isn't just due to a few specific items. Price pressures have been boiling over in every corner of the economy.

Underlying that broad-based strength in inflation has been a cocktail of supply-side cost pressures and firm consumer demand. On the cost side of the ledger, continued disruptions to global and local supply chains have resulted in shortages of both raw materials and consumer goods. There has also been increasing upwards pressure on local wages.

But what's really lit a fire under consumer prices has been the strength of domestic demand. Indeed, if we look at the areas where businesses are reporting significant shortages of supplies, they're predominantly in areas like the construction sector where demand has been strong. That is a big concern for the RBNZ, because if demand continues to run hot, inflation is likely to remain elevated even when the current pressure on operating costs (eventually) eases off. And a key factor underpinning the strength of household demand has been stimulus from low interest rates.

Looking across the broad product groups, imported prices (sometimes referred to as tradables) rose by 1.9% over the past three months, and are up 8.7% over the past year. While much of that was due to fuel costs, other tradable prices are up 5.4% over the past 12 months.

Non-tradable (domestic) prices were up 1.4% in the June quarter and have risen by 6.3% over the past year. The RBNZ pays particular attention to non-tradables inflation, and it is currently running at around twice the pace we've seen over the past two decades.

We think that the June quarter will mark the high point in the current inflation cycle (though given the extent of upside surprises over the past year, we're aware that is a bold call). Much of the rise in prices that we saw over the past year was due to the sharp rise in import prices as the global economy moved out of lockdown. That includes the doubling in international oil prices. Now, while prices remain high, they're not increasing at the same pace that we saw last year. In fact, in the case of petrol prices, they've actually fallen in recent weeks.

But while inflation may have peaked, underlying inflation pressures remain strong. In fact, we aren't forecasting it to return back within the RBNZ's target band until the middle of next year at the earliest.

At its recent policy review, the RBNZ reaffirmed that they are planning to continue raising the cash rate to a level where they are confident that inflation will settle within the 1% to 3% target range. And with price pressures continuing to sizzle, there was nothing in the latest inflation report to dissuade them from that course.

The big question is how far (or furious if you like) and how fast will the RBNZ need to raise the cash rate?

We're expecting the RBNZ will deliver a fourth consecutive 50bp hike at the time of its August policy review. We expect that to be followed by 25bp hikes in both October and November, taking the OCR to a level of 3.50% by year's end.

However, given the continuing and widespread strength in inflation pressures, markets have moved to price in the chance that the cash rate could rise above 4% and that we could see a 75bp move in August.

While we won't completely rule out the chance of a super-sized 75bp move from the RBNZ (as we've seen recently from the US Federal Reserve) we still think that a 50bp increase is most likely. Compared to other economies, New Zealand's tightening cycle started earlier and is now more advanced. As a result, even though rates still need to move higher from here, there's less urgency to do so than in markets that started raising their policy rates later in the cycle.

The sources of inflation also matter. While the RBNZ is trying to lean against domestic inflation pressures, much of the increase in consumer prices has been related to fuel prices and offshore supply disruptions – neither of which the RBNZ can offset with higher interest rates.

In terms of the likely peak in the cash rate, the key concern for the RBNZ is whether there are signs that OCR hikes to date are gaining traction. The strong June CPI result certainly would have got alarm bells ringing at the central bank that more action might be needed to dampen inflation pressures.

From here, the next big markers for the cash rate ahead of the August policy statement will be the labour market and wage figures (due 3 August) and the next survey of inflation expectations (8 August). We're already factoring in strong reads on those fronts. But if they turn out even hotter than expected, we could see the RBNZ revising up the expected peak in the cash rate from the level of 3.9% that was assumed in their last published projections (released in May).

Nonetheless, those data points will also need to be weighed against signs that the economy is already cooling. Confidence has fallen sharply in both the household and business sectors. In addition, both the housing market and retail spending have slowed. We expect a further cooling in demand over the coming months as higher borrowing costs continue to squeeze household budgets. And as evidence that economic activity is cooling becomes clearer, we expect that the pace of rate hikes is likely to become more measured in the latter part of the year.

Satish Ranchhod, Senior Economist

Round-up of local data released over the last week

Date	Release	Previous	Actual	Westpac f/c
Mon 18	Jun BusinessNZ PSI	55.3	55.4	–
	Q2 CPI	1.8%	1.7%	1.4%
Wed 20	GlobalDairyTrade auction prices (WMP)	-3.3%	-5.1%	-4.0%
Thu 21	Jun trade balance $mn	263	-701	-100

Aus Q2 Consumer Price Index

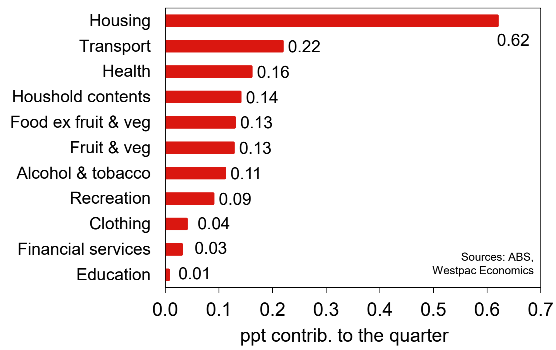
Jul 27, Last: 2.1%, WBC f/c: 1.7%
Mkt f/c: 1.9%, Range: 1.6% to 2.8%

Westpac is forecasting a solid 1.7% rise in the June quarter CPI. Following on from the 2.1% print in the March quarter this will lift the annual pace from 5.1% to 6.1%. We have also raised the peak in annual inflation to 7.2%yr from 6.6%yr in the December quarter 2022.

Core inflation is forecast to lift 1.4% in June, matching the lift in March, taking the annual pace to 4.6%yr from 3.7%yr. We have also revised up the peak in trimmed mean annual inflation from 4.8%yr to 5.0%yr in both the September and December.

This 0.2ppt revision to our preliminary forecast is mostly due to the dwelling prices forecast lifting 0.9ppt to 5.5% due to ongoing construction input cost inflation. Most of the remaining revision was due to a 2.8ppt increase in our food price forecast to 5.4% reflecting ongoing supply disruptions. For more details please refer to the [June Quarter CPI Preview](#)

Contributions 2022Q2 CPI 1.7%qtr forecast



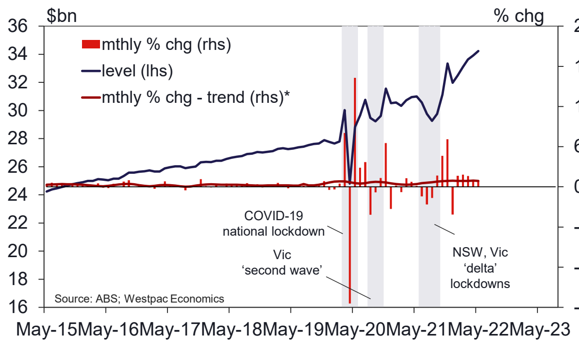
Aus Jun retail sales

Jul 28, Last: 0.9%, WBC f/c: 0.6%
Mkt f/c: 0.5%, Range: -0.2% to 0.7%

Retail sales posted another robust 0.9% gain in May, after a similar sized gain in April and strong gains average 1.7% over the previous three months. Annual growth lifted to a very strong 10.4%yr. Post-COVID reopening and normalising spending and saving patterns still look to be a major positive dynamic, countering any drags from cost of living and interest rate increases - although this may be being partially concealed by a lift in price inflation which supports nominal sales. **Volume estimates for Q2 retail sales, released with the final June report on Aug 3**, will resolve this particular issue, with the CPI update on July 27 providing some clues before that.

The June month should see some moderation in momentum, given rate hikes, slumping consumer confidence and a rotation in spending away from retail to non-retail segments (such as travel and tourism). However, our card data suggests retail activity still held up reasonably well in June, price effects possibly again concealing weakness. Overall we expect nominal sales to show a 0.6% gain.

Monthly retail sales



Aus Federal Treasurer, Ministerial Economic Statement

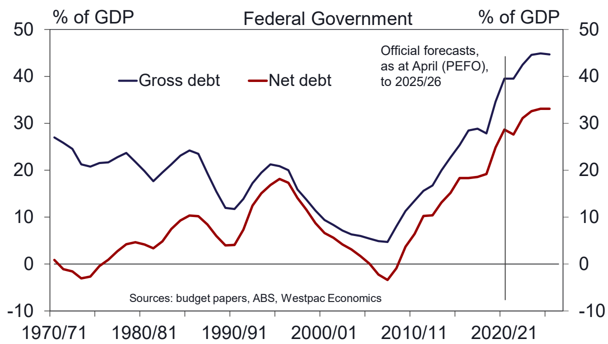
Jul 28

Treasurer Chalmers will deliver a Ministerial Economic Statement to Parliament - in the first week that Parliaments sits after the election. This is ahead of the September Jobs Summit and the October Federal Budget - in which the incoming government will deliver on election promises and reprioritise spending to reflect their policies.

The Treasurer has indicated that news in the Economic Statement "in many ways, will be confronting" and that "My job is to paint the true picture of the economy and our economic challenges". Notable are high inflation, declining real wages and rising interest rates.

The Treasurer has highlighted medium-term fiscal challenges. As at April, the budget estimated that by June 2026, net debt would rise to $865bn (33% of GDP) and gross debt to $1,169bn (44.7% of GDP) - recent sharply higher interest rates will add to debt servicing costs. The looming economic slowdown, recognition of weaker productivity growth and higher program costs (e.g. the NDIS) could all add to the budget deficit profile. Recent comments indicate that the government now plans to make savings in the October Budget.

Australian public debt – servicing costs to rise



DATA PREVIEWS

Aus Jun private credit

Jul 29, Last: 0.8%, WBC f/c: 0.6%
Mkt f/c: 0.7%, Range: 0.5% to 0.8%

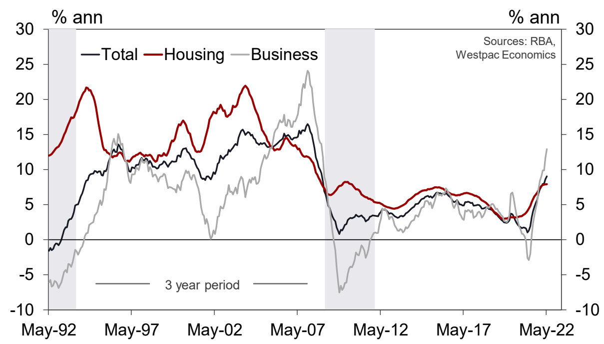
Credit to the private sector grew by 9.0% over the past year to May, the fastest annual pace since October 2008, but still well below the December 2007 peak of 16.5%, pre–GFC.

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.

Credit growth, which averaged 0.6% over Q1, surprised to the high side in April and May, printing +0.9% and +0.8% - centred on a burst of business lending, 1.5% and 1.3%. That's against the backdrop of a strong reopening recovery, after the delta lockdowns in mid-2021.

With the reversal of monetary stimulus, a housing downturn is emerging, which will have flow-on effects to business. For June, we expect credit growth to return to the 0.6% pace evident in Q1 - ahead of a further slowdown over the second half of 2022.

Credit: annual growth hits 9%, a 13½ year high



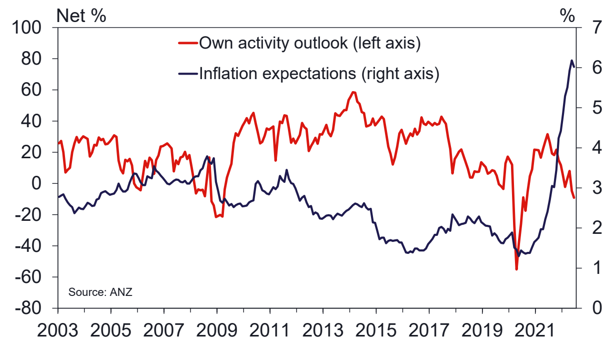
NZ Jul ANZBO business confidence

Jul 28, Last: -62.6

Business confidence continued to sink in June and a growing number of businesses expect that trading conditions on their own shop floors will weaken over the next few months. Businesses have continued to struggle with shortages of staff and materials, strong cost pressures, and the rapid rise in interest rates. With no relief on any of those fronts, we expect that confidence will remain subdued in the July survey.

The survey's cost and inflation gauges will again be closely watched. The RBNZ has been trying to dampen inflation pressures. But while activity has cooled, to date we have yet to see any material easing in the pressure on prices. Businesses have been highlighting significant pressure on operating costs and most expect inflation will remain elevated over the coming year.

NZ business confidence



US Jul FOMC meeting

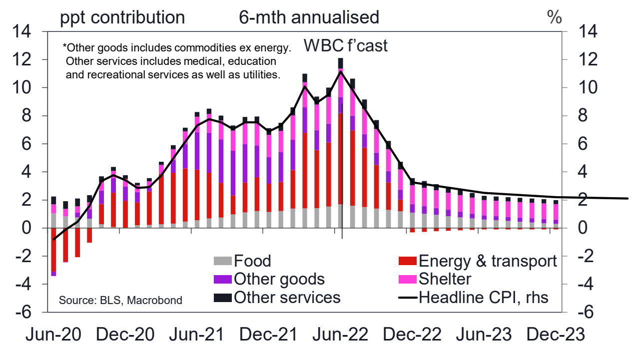
Jul 26–27, fed funds rate, Last: 1.625%, Mkt f/c: 2.375%, WBC 2.375%

There is little-to-no doubt that the FOMC will deliver another 75bp hike at their July meeting, taking the fed funds rate to 2.375%. Given the current pace of inflation and the focus on related risks, another 50bp hike is then expected in September.

Important for the rate outlook thereafter is the evolution of risks around inflation and activity which we hope to see discussed in the communications from this meeting.

Progressively over the remainder of this year, the FOMC will have to focus more on the risks to growth than inflation, recognising that a widening output gap and weaker labour market will bring about a further deceleration in time. We see this trend putting a halt to rate increases after December's 25bp hike to 3.375%.

US inflation to abate, slowly



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.

US Q2 GDP

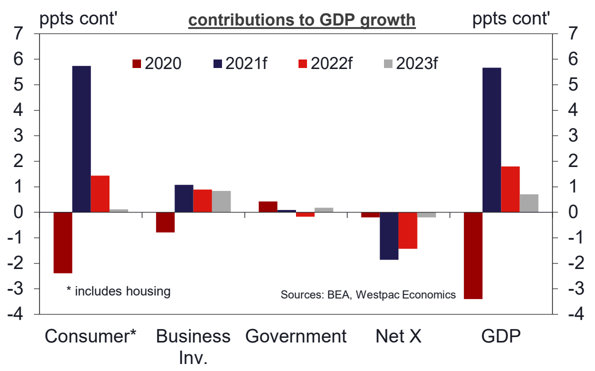
Jul 28, GDP qtr annls'd, Last: -1.6%, Mkt f/c: 0.5%, WBC -0.5%

As the partial data has continued to roll in, it has become increasingly clear that the US economy is stagnating. Following Q1's 1.6% annualised contraction, we expect a 0.5% annualised decline in Q2.

The primary driver of this weakness is consumption, although it is clear that the rest of the economy is also wilting under the weight of declining real incomes, rapidly tightening financial conditions and uncertainty over the outlook.

Come the second half of this year, growth is expected to remain weak, but hopefully positive. And in the first half of 2023, as the full effect of policy is felt via financial conditions and the labour market, this weakness is set to persist. Over 2022 and 2023, year-end growth to December is seen at just 0.2%yr and 0.9%yr.

US entering economic stagnation



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For the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 25					
Ger	Jul IFO business climate survey	92.3	90.5	–	Energy security and recession are prime concerns.
US	Jun Chicago Fed activity index	0.01	–	–	Conditions have weakened materially across the US….
	Jul Dallas Fed index	–17.7	–22.0	–	… as evinced by deteriorating regional surveys.
Tue 26					
US	May FHFA house prices	1.6%	1.6%	–	Price momentum set to slow…
	May S&P/CS home price index	1.77%	1.60%	–	… as rate hikes take effect.
	Jul consumer confidence index	98.7	96.4	–	Inflation concerns weighing heavily on confidence.
	Jul Richmond Fed index	–11	–14	–	Mfg outlook clouded by labour and material shortages.
	Jun new home sales	10.7%	–3.4%	–	Sales weakening on construction headwinds and affordability.
Wed 27					
Aus	Q2 CPI	2.1%	1.9%	1.7%	Housing, food & auto fuel are driving the Q2 spike but…
	Q2 CPI %yr	5.1%	6.2%	6.1%	… widespread price pressures from both domestic…
	Q2 CPI, trimmed mean	1.4%	1.5%	1.4%	… and international sources continue to push core inflation.
	Q2 CPI, trimmed mean, %yr	3.7%	4.7%	4.6%	The 22¢ drop in the fuel excise does proved some offset.
Chn	Jun industrial profits %yr	–6.5%	–	–	Profits to rebound as COVID–19 recovery ensues.
US	Jun wholesale inventories	1.8%	–	–	Inventory levels vary considerably across the economy.
	Jun durable goods orders	0.8%	–0.5%	–	Businesses are still battling supply issues.
	Jun pending home sales	0.7%	–	–	Demand cooling amid higher rates.
	FOMC policy decision, midpoint	1.625%	2.375%	2.375%	75bp hike well telegraphed. View on risks the focus.
Thu 28					
Aus	Jun retail sales	0.9%	0.5%	0.6%	Look to have held up well despite falling consumer sentiment.
	Q2 export price index	18.0%	–	8.0%	Commodity prices moved higher still on supply shocks.
	Q2 import price index	5.1%	–	2.0%	Higher global prices (notably energy), tempered by higher AUD.
	Federal Treasurer	–	–	–	To deliver a Ministerial Economic Statement to Parliament.
NZ	Jul ANZ business confidence	–55.6	–	–	Confidence to remain low, price pressures still elevated.
Eur	Jul economic confidence	104	101	–	Inflation and energy security concerns…
	Jul consumer confidence	–27	–	–	… are weighing heavily on European confidence.
UK	Jul Nationwide house prices	0.3%	–	–	Demand to soften as rate hikes take effect.
US	Q2 GDP, annualised	–1.6%	0.5%	–0.5%	A second consecutive negative quarter looks likely.
	Initial jobless claims	251k	–	–	Slowly starting to lift from historic lows.
	Jul Kansas City Fed index	12	–	–	Mfg outlook becoming increasingly fragile.
Fri 29					
Aus	Jun private sector credit	0.8%	0.7%	0.6%	Growth to ease back after oversized prints for business.
	Q2 PPI	1.6%	–	–	Significant upward pressure on input prices.
NZ	Jul ANZ consumer confidence	80.5	–	–	Continued pessimism about living costs and weaker activity.
Jpn	Jun industrial production	–7.5%	4.0%	–	Expected to bounce upon reopening; supply issues remain.
Eur	Jul CPI %yr	8.6%	8.8%	–	Inflation pressures are broadening notably.
	Q2 GDP	0.6%	0.2%	0.1%	Growth to stall over the remainder of 2022.
UK	Jun net mortgage lending £bn	7.4	–	–	Rising rates and slowing economy to weigh on lending.
US	Q2 employment cost index	1.4%	1.1%	1.0%	Tight labour market supporting robust wages growth.
	Jun personal income	0.5%	0.5%	–	Purchasing power is an ongoing concern…
	Jun personal spending	0.2%	0.8%	–	… as households run down savings.
	Jun PCE deflator	0.6%	0.9%	–	PCE inflation consolidating at high levels…
	Jun core PCE deflator	0.3%	0.5%	–	… but should gradually fall as price pressures abate in H2.
	Jul Chicago PMI	56.0	56.2	–	Supply issues are an ongoing concern.
	Jul Uni. of Michigan sentiment	51.1	51.1	–	Final; inflation concerns weighing heavily on sentiment.

Forecasts

Interest rate forecasts

Australia	Latest (22 Jul)	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Cash	1.35	2.35	3.10	3.35	3.35	3.35	3.35	3.10
90 Day BBSW	2.22	3.05	3.55	3.55	3.55	3.55	3.38	3.13
3 Year Swap	3.52	3.55	3.50	3.30	3.10	2.90	2.80	2.75
3 Year Bond	3.07	3.20	3.25	3.10	2.90	2.70	2.60	2.55
10 Year Bond	3.43	3.60	3.50	3.35	3.15	2.90	2.65	2.50
10 Year Spread to US (bps)	56	50	50	45	45	40	35	30
US								
Fed Funds	1.625	2.875	3.375	3.375	3.375	3.375	3.125	2.875
US 10 Year Bond	2.87	3.10	3.00	2.90	2.70	2.50	2.30	2.20
New Zealand								
Cash	2.50	3.00	3.50	3.50	3.50	3.50	3.50	3.50
90 day bill	3.15	3.40	3.60	3.60	3.60	3.60	3.60	3.60
2 year swap	4.08	4.00	3.90	3.80	3.60	3.40	3.20	3.00
10 Year Bond	3.70	3.80	3.60	3.40	3.20	3.10	3.00	2.95
10 Year spread to US	80	50	50	50	50	60	70	75

Exchange rate forecasts

Australia	Latest (22 Jul)	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
AUD/USD	0.6910	0.72	0.75	0.77	0.78	0.79	0.80	0.80
NZD/USD	0.6237	0.65	0.68	0.70	0.71	0.72	0.72	0.72
USD/JPY	137.70	134	132	130	127	125	123	121
EUR/USD	1.0185	1.05	1.09	1.11	1.13	1.14	1.15	1.16
GBP/USD	1.1965	1.23	1.26	1.28	1.30	1.32	1.34	1.35
USD/CNY	6.7675	6.55	6.35	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.1107	1.11	1.10	1.10	1.10	1.10	1.11	1.11

Australian economic growth forecasts

	2021	2022			2023		Calendar years			
% change	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	2020	2021	2022f	2023f
GDP % qtr	3.6	0.8	2.0	1.0	0.6	0.4	0.2	–	–	–	–
%yr end	4.4	3.3	4.5	7.5	4.4	4.0	2.2	-0.7	4.4	4.4	1.0
Unemployment rate %	4.7	4.1	3.8	3.3	3.0	3.1	3.4	6.8	4.7	3.0	4.2
CPI % qtr	1.3	2.1	1.7	0.8	2.4	1.0	0.6	–	–	–	–
Annual change	3.5	5.1	6.1	6.1	7.2	6.0	4.8	0.9	3.5	7.2	3.0
CPI trimmed mean %qtr	1.0	1.4	1.4	1.2	1.0	0.7	0.7	–	–	–	–
%yr end	2.6	3.7	4.6	5.0	5.0	4.4	3.7	1.2	2.6	5.0	3.0

New Zealand economic growth forecasts

	2021	2022				2023		Calendar years			
% change	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	2020	2021	2022f	2023f
GDP % qtr	3.0	-0.2	1.0	0.7	1.2	0.8	0.6	–	–	–	–
Annual avg change	5.6	5.1	1.0	2.2	2.1	2.7	3.6	-2.1	5.6	2.1	3.3
Unemployment rate %	3.2	3.2	3.1	3.0	3.0	3.0	3.1	4.9	3.2	3.0	3.3
CPI % qtr	1.4	1.8	1.7	1.6	0.1	1.0	0.8	–	–	–	–
Annual change	5.9	6.9	7.3	6.6	5.2	4.4	3.4	1.4	5.9	5.2	3.3

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