AUSTRALIA & NEW ZEALAND WEEKLY.

Week beginning 1 May 2023

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INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 28 APRIL 2023.

WESTPAC INSTITUTIONAL BANK

RBA Board to pause again at its May meeting: 3.6% now the likely cash rate peak

The Reserve Bank Board meets next week on May 2.

Following the release of the March quarter inflation report, Westpac now expects the Board to extend the pause it instigated at its April meeting to the May meeting.

This decision will be despite the likelihood that the FOMC will announce the decision to lift the federal funds rate by 25bps to 5.125% two days after the RBA meeting (see below). However, as with the RBA, we do believe that this decision will mark the peak of the cycle.

We have always argued that May would likely be the peak of the tightening cycle so we are now lowering our forecast cash rate peak from 3.85% to 3.6%.

Given the uncertainty around the current outlook and a need to contain inflation expectations, the Board is almost certain to maintain its clear tightening bias. However, as we move through the remainder of 2023 the credibility of that bias is likely to fade.

In his recent speech on April 4 the Governor justified the pause in April by saying that it would: "give the Board more time to assess the economic outlook and the impact of the increases in interest rates so far." He expanded that: "This approach is consistent with our practice in earlier interest rate cycles … to move interest rates multiple times then wait for a while to assess the pulse of the economy and move again if the situation warranted doing so … it is a return to that world."

The key information available between the two meetings has been around the labour market and inflation.

The March employment report was relatively strong, indicating that, for now, the unemployment remained near 50-year lows. Given that the Board is aiming to return inflation to its target while retaining, as far as possible, the employment gains in recent years, this would not necessarily be viewed as 'bad news' if there was satisfactory progress on achieving the inflation objective.

The Governor describes the inflation objective in terms of reaching the top of the of the 2–3% target range by mid-2025.

That path has been laid out in the Bank's forecasts in the February Statement on Monetary Policy (SOMP). These have trimmed mean inflation slowing from 6.9%yr in December 2022 to 6.2%yr by June 2023, while headline inflation slows from 7.8%yr in December 2022 to 6.7%yr in June 2023.

These forecasts imply an expectation that the March inflation report would print at around 6.5–6.6%yr for trimmed mean and 7.2–7.3%yr for headline inflation.

It seems very unlikely that the staff's refreshed forecasts, which will be supplied to the Board at the May meeting, will indicate that the timing of the achievement of the inflation target needs to be pushed out further – a change that would require an immediate policy response from the Board.

Instead, it seems likely that the staff's forecasts for household spending and GDP growth in 2023 will be lowered somewhat, supporting the view that there is scope to pause (see below).

The March quarter inflation report printed 6.6%yr for the trimmed mean and 7.0%yr for headline inflation. The trimmed mean path is in line with expectations while the headline print looks to be slightly lower than expectations.

That result for the trimmed mean contrasts with the December quarter which printed 6.9%yr compared to the Bank's expectations of 6.5%yr – an upside surprise that prompted the hawkish shift in rhetoric following the February Board meeting.

With the inflation result in line with the Bank's forecast path for eventually achieving its inflation target, the Board can take time to allow a further assessment of the cumulative impact of 350bps of tightening. That includes assessing the lagged impact on the roughly 35% of mortgages that are progressing from fixed rate to much higher floating rate terms over the course of the next year or so. In this unusual cycle, rate increases do not end just because the RBA goes on hold.

The RBA Governor's comment in the speech about "a return to that world" points to linking further decisions to quarterly inflation reports. While useful, the monthly inflation indicators do not provide measures of underlying inflation, and a reliable link between the monthly headline measures and the quarterly headline measures has not yet been established.

If we look forward to the Bank's June quarter forecasts of 6.2%yr trimmed mean and 6.7%yr headline inflation, we expect these 'milestones' to be easily achieved. Our forecasts have headline Inflation back to 4% by December 2023, compared to the Bank's current path which sees it back at 4.8%yr.

Indeed, our weaker growth and inflation path means that the need for further tightening will fade decisively in the second half of 2023.

We have argued for the last six months that the peak in the current cycle will be the May Board meeting. Our preference was for that peak to be 3.85%, with a final 25bp hike in May based on the 'here and now' – record low unemployment and still very high inflation – rather than relying on forecasts. We still believe this would be the better policy approach given the risks, but it appears to be out of line with the Board's intentions.

If, as we now expect, the peak will be 3.6% there are now some upside risks to our growth and inflation profiles through the second half of 2023, although there also look to be downside risks to the first half forecasts.

These upside risks are also associated with our recently revised view that the housing market has stabilised and that immigration has lifted markedly.

On the downside, our already very weak profile for household spending may see a further downgrade given the prospect of a contraction in real retail sales in the March quarter. We are currently forecasting annual household spending growth to slow to 1.8% in the year to the June quarter and 0.7% in calendar 2023.

We currently forecast growth at 1% for 2023 with headline inflation at 4%.

These dynamics – materially below-trend growth and inflation closing in on the top of the inflation target – would be consistent with a rate cut cycle beginning in the March quarter.

The upside risks to the growth and inflation outlook in the second half of 2023 raise the possibility that the rate cut cycle may begin somewhat later, although this is balanced somewhat by downside risks to our near-term profile.

With the uncertainty around next week's meeting, we will review these issues in light of the Board's decision next week.

Revised forecasts in the Statement on Monetary Policy

In his April 4 speech the Governor gave considerable attention to household spending. He revealed the Bank's forecast for spending growth in the March quarter of 0.2%qtr. That implies a likely downward revision to the February SOMP forecast for household consumption over the year to June 2023, from 2.5% to 2% or less. Household consumption growth for calendar 2023 could be lowered from 1.7% to 1% or less, in turn implying a possible downward revision to GDP growth in 2023 from 1.6% to 1.3-1.4%. At the margin these numbers will also have to incorporate a higher profile for population growth.

Conclusion

The inflation report is in line with the Board's path to achieving its stated objective of having inflation back at the top of the 2–3% target by mid-2025. This provides the Board with further scope to extend the pause we saw in April.

The Board will still retain its tightening bias but given that the next 'live' meeting is likely to be in August (following the release of the June quarter inflation report) and that the need for further tightening will have eased further by then, the cash rate appears to have peaked at 3.6%.

Change to FOMC Forecast for 2023

The FOMC also meet for their May meeting next week. Recent data has continued to point to the US economy losing momentum and growing downside risks related to activity and the labour market. Concerns around credit availability following the disruptions to regional banks are also prevalent.

Regardless, comments made by FOMC members ahead of the pre-meeting blackout point to a desire to take out a little more insurance against inflation risks. Recognising this, we now forecast one final 25bp hike by the FOMC in May to 5.125%.

A lengthy pause thereafter is still expected, but the deterioration evident in consumer and business investment partials, the ongoing softening in the labour market and risks surrounding the banking system most likely mean that the first cut will now be seen in December, leaving the federal funds rate at 4.875% at end-2023, unchanged from our prior forecast.

By December 2023, we expect inflation to be back near the 2.0% target on an annualised basis, making way for an additional 200bps of cuts during 2024, leaving the fed funds rate at 2.875% end-2024.

The easing cycle we envisage for the FOMC will begin earlier and be more rapid than the RBA in recognition of the highly contractionary starting point and the likely more severe downturn than we are forecasting for Australia.

Bill Evans, Chief Economist, Westpac Group

Proposed structure of RBA Board poses risks to policy

The Reserve Bank may have paid an unfair price for its recent perceived policy mistakes during COVID, with a lack of recognition of the important role that aggressive easing of fiscal policy played during this period.

The far reaching recommendations of the Review into the Bank – particularly around the composition and operation of the Board – create new challenges and risks for monetary policy, with potential unintended consequences.

The Review has recommended that the separate Monetary Policy Board be made up of seven external directors and two directors from the Bank – the Governor and the Deputy Governor.

These external directors (including the Secretary of the Treasury) will be appointed on the basis of their expertise in areas that are directly relevant to monetary policy with the objective of challenging and potentially out voting the Bank representatives on policy decisions.

In contrast with the current arrangement there is to be a formal vote on the interest rate decision with the result of the vote being disclosed on a non attributed basis.

The Review points out that the practice in the past has been for the Bank representatives to hold sway over the decision with every decision in line with the Bank's recommendation (at least in the last ten years).

The advantage of that system has been that the Bank, and through its representatives, with its impressive research resources, has always been better equipped to formulate the appropriate policy position. Before the hugely disruptive Covid period the Bank was generally considered to have had industry best practice results. Even during Covid it distinguished itself by taking a firm position against the policy of negative interest rates – a policy that had been adopted (including Switzerland, Sweden, Denmark and Japan) or considered (New Zealand) in a number of countries.

A recent modelling study by well respected ANU economist Chris Murphy assessed that 3ppts of the 7.8%yr inflation in 2022 were due to excessive policy stimulus (most of the remainder was due to supply side disruptions). But 2.4ppts were attributed to fiscal policy and 0.6ppts to monetary policy, including such policies as the bank's term funding facilities; yield curve control; and quantitative easing.

This relative responsibility is certainly not reflected in public opinion.

While the Reserve Bank has been required to shoulder the full burden of returning inflation to the 2–3% target zone that study suggests that most of this burden stems from excessive fiscal rather than monetary stimulus.

The recommended structure of the Monetary Policy Board contrasts with the Boards of other central banks where the Bank representatives have the majority of votes.

The Federal Open Market Committee has twelve voting members of whom seven are from the Board of Governors and five from the various districts.

The European Central Bank has twenty five members in the Governing Council including five from the Executive Committee and twenty representing each of the twenty countries which use the Euro.

The Monetary Policy Committee of the Bank of England has nine members, including five from the Bank and four externals.

The Governing Council of the Bank of Canada has six members of whom five are from the Bank and one external.

The Monetary Policy Committee for the Reserve Bank of New Zealand has seven members of whom four are from the Bank and three are external.

The only exception is the European Central Bank. The European Central Bank has twenty five members in the Governing Council including five from the Executive Committee and twenty representing each of the twenty countries which use the Euro. For this reason, the ECB is not really comparable with the other major central banks.

Recently, I wrote about the difficulty of appointing a range of appropriate experts for the external positions on the Reserve Bank's Monetary Policy Board. I noted that the best qualified people, with expertise in monetary policy and monetary theory, who do not have a conflict with their existing roles, are likely to be people who are not practising in the financial system due to these conflicts.

The other central banks that have appointed externals have generally chosen academics to fill those rolls.

The four externals for the BOE are all academics; the external for the BOC is an academic; and two of the three externals for the RBNZ are academics.

Given the preponderance of academics filling the external positions in other Banks there is a significant likelihood that academics will fill a number of positions on the RBA Board.

The risk of an academic/theoretical bias on the Board of the other central Banks is eliminated by the fact that in each case (with the exception of the special case of the ECB) the Bank's own executives carry the majority of votes. That has not meant that all executives vote in a bloc, but it does mean that each internal executive has the advantage of full time access to the Bank's extensive research facilities minimising the risk of an ill informed majority decision.

The review recommends that each Board member spend the equivalent of one day per week at the Bank and receives direct input from staff. That is a positive approach but does not substitute for being fully involved in the Bank on a full time basis.

Conclusion

In proposing to appoint a majority of external monetary policy experts to the Monetary Policy Board the authors of the Review have opted for a much more radical model than we see in other major central banks. In those other banks academic experts are appointed to the Boards but the Bank internal management retains the majority of votes.

It is true that the Reserve Bank Board has always had a majority of outsiders but, as noted by the Review team, these external directors were not appointed as policy experts and the views of the Bank representatives generally prevailed.

Under the revised model it will be the obligation of the externals to challenge the views of the Bank's representatives. The risk is that less informed majority decisions may result.

Certainly, it appears that the authorities in other jurisdictions are not prepared to take that risk.

The revised framework creates a tension between roles and responsibilities. The RBA Governor is to be held accountable for achieving the policy target but the Bank's representatives have only a minority vote on the RBA Board which is making the policy decisions.

Bill Evans, Chief Economist (WestpacGroup)

As noted, recent developments have led us to change our view on the RBA and FOMC ahead of their respectively policy meetings next week.

The Australian Q1 CPI report delivered a downside surprise on underlying inflation, the trimmed mean measure print of 1.2% (6.6%yr) well below the market's expectation and our own. This was largely associated with a broad-based step-down in the pace of goods inflation, from 9.5%yr to 7.6%yr, with softness emerging more clearly, particularly across food, recreation, clothing & footwear and household contents. While annual services inflation recorded a large increase (6.1%yr from 5.5%yr) due to a surge in healthcare costs and housing utilities – components which were likely 'trimmed' out of the underlying measure – the easing in annual headline inflation, according to the RBA's February forecasts, is running ahead of expectations.

Given these developments, as discussed by Chief Economist Bill Evans, we now expect the RBA to extend its policy pause in May, keeping the cash rate at 3.60%, a level which we now believe will prove to be the peak for this tightening cycle. With inflation set to remain in a clear down-trend and slack to emerge in the labour market over coming months, we anticipate that the scope for further interest rate increases will fade in time. Nevertheless, a tightening bias from the Board is to be expected near-term given inflation is still elevated and the labour market historically tight.

Offshore, the week also began quietly, with the US regional Fed surveys and housing partials the only data of note. All but one of the regional surveys showed a marked deterioration in activity and sentiment for US business in April. These outcomes were corroborated by a downside surprise for core durable orders and shipments which declined for a second consecutive month in March. Taken together, these outcomes point to businesses rapidly shifting to a defensive posture. We expect this trend to persist and result in a further marked deceleration in job creation and wage growth through 2023 as well as continued weakness in business investment.

While consumption showed strength in Q1, rising 3.7% annualised versus GDP's 1.1% overall gain, the detail of the GDP report and monthly PCE data makes clear that this momentum was highly concentrated in durables spending and was front-loaded in January. February subsequently saw a marginal decline and, assuming an unrevised February outcome, the Q1 outcome points to another small decline in the month of March. More broadly, the deceleration evident for employment and wage growth, sub-par consumer confidence and challenging housing affordability all speak to a lengthy period of weakness in consumption. It is unsurprising then that businesses stopped accruing inventory in Q1. The potential for inventory stocks to be sold down will linger as a downside risk to growth through the remainder of 2023.

Increasingly then it seems likely that the contraction in GDP we have been forecasting for the second half of 2023 will meet the broader NBER definition of recession. Moreover, risks to the recovery are skewing sharply to the downside given the weakened state of the US banking sector and the clear need for regulatory reform to increase oversight of smaller banks. While FOMC member communication ahead of the pre-meeting blackout suggests members see a need to take out a little more insurance against inflation risks in the near term, one more 25bp hike is now expected at their May meeting, the remainder of the year is expected to show a US economy under significant stress, with growing downside risks. As a result, we expect this last hike to be taken back in December and, with inflation around target on an annualised based by December, a further 200bps of cuts through 2024. Our end-2024 forecast for the fed funds rate is consequently unchanged at 2.875%.

Week ahead & data wrap

Waiting for the turn

With inflation now clearly past its highs, it looks likely that the May policy decision will mark the peak in the Reserve Bank's tightening cycle. But there are still a few things coming up in the weeks ahead that could keep the RBNZ on guard.

First up are the labour market surveys for the March quarter, which will be released next Wednesday. We expect the unemployment rate to hold steady at 3.4%, not quite at the record lows seen last year, but close to it. The labour market remains tight, with labour shortages still one of businesses' top concerns.

The monthly indicator of filled jobs shows that employment has been growing at a fairly steady pace over the last year, and if anything has picked up momentum in the last few months. That will be, at least in part, because there are more people around to hire. Since New Zealand reopened its border last year, net migration has rapidly switched from a modest net outflow to a strong net inflow. The bottom line, though, is that businesses are still firmly in hiring mode.

The RBNZ has emphasised that bringing inflation under control will most likely require engineering a recession, with a corresponding rise in unemployment. However, in its February *Monetary Policy Statement* forecasts, that did not really come into play until the June quarter and beyond. For the March quarter, the RBNZ was expecting just a slight up-tick in unemployment to 3.5%.

Hence, a flat out-turn in line with our forecast probably would not move the dial in terms of the May policy decision. We expect a further 25bp hike to 5.50%. But for the RBNZ to be satisfied that this is enough, its going to need to see some evidence pretty soon that the labour market is losing steam.

What's more, the resurgence of workers from overseas will itself be on the RBNZ's radar. The RBNZ has typically regarded migration as a source of net demand, adding to inflation pressures. And migration has bounced back a lot faster and stronger than the RBNZ expected, enough to warrant a mention in the April OCR review. While we do not share that view – migrants add to both demand and supply, with the net impact on inflation unclear – it is nevertheless the RBNZ's interpretation that this will play a role in upcoming policy reviews.

Wage growth is likely to have remained strong in the March quarter. That's largely because it tends to be the most lagging element of the economic cycle – we did not really see it start to take off until early 2022, long after inflation had surged and the RBNZ had started raising interest rates. In a similar vein, we expect the Labour Cost Index (LCI) to accelerate to an annual pace of 4.4% this quarter, even with consumer price inflation now clearly past its peak.

The LCI is based on pay rates by role, rather than by worker. To get a better sense of what workers are actually getting in hand, we can look at the Quarterly Employment Survey (QES) measure of average hourly earnings, which captures the effects of people changing jobs or even industries in order to get a pay rise. While this measure is much choppier than the LCI from quarter to quarter, it shows that pay growth rose above 7% last year, broadly matching the rate of inflation. That demonstrates the challenge the RBNZ faces: inflation has now got into wages. Once that happens, it can be a long and painful process to remove it again.

The other key event ahead of the May *Monetary Policy Statement* is the Government's Budget on 18 May. One of the big items in the Budget will be the cost of rebuilding after the flooding in late January and Cyclone Gabrielle in early February. This week the Treasury estimated that the total cost of rebuilding could be between $9bn and $14.5bn, easily making it the second most expensive natural disaster in New Zealand's history (after the Christchurch earthquake).

A large share of that cost will be borne by the Government, reflecting the nature of much of the damage, which heavily impacted roads, bridges and water infrastructure. In a speech this week, Prime Minister Hipkins indicated that this will not be funded through new sources of revenue, but from a mix of additional borrowing and reprioritisation of existing spending plans.

The RBNZ has raised the cyclone recovery as an upside risk for inflation, as it will create an additional draw on the nation's resources over several years. Whether it does prove to be a significant inflationary force is up for debate, however. Infrastructure tends to be one of the less inflationary forms of government spending, and the fact that it will be partly funded from within the existing budget will reduce the net impact. Moreover, the experience of the Christchurch earthquake was that although construction costs did pick up substantially when the rebuild began, this did not translate into a lift in inflation more generally.

Nevertheless, these upside risks to inflation will keep the RBNZ on high alert, until it sees convincing evidence that the economy is cooling down.

Michael Gordon, Senior Economist

Round-up of local data released over the last week

Date	Release	Previous	Actual	Westpac f/c
Wed 27	Mar trade balance $mn	–796	–1273	–850
Thu 28	Apr ANZ business confidence	–43.4	–43.8	–
Fri 29	Apr ANZ consumer confidence	77.7	79.3	–
	Mar employment indicator	0.5%	0.4%	0.6%

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.

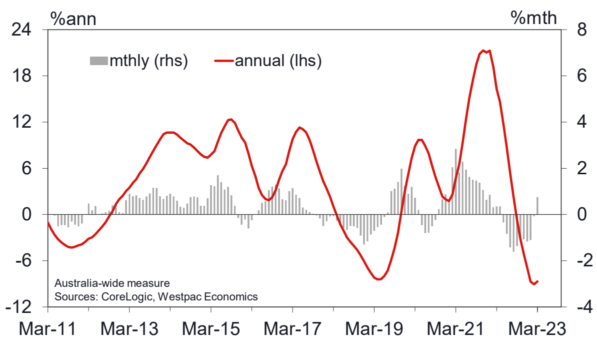
Aus Apr CoreLogic home value index

May 1, Last: 0.8%, WBC f/c: 0.8%

The CoreLogic home value index, covering the eight major capital cities, rose 0.8% in March, following a 0.1% dip in Feb and seven straight months of falls in the 1-1.6% range between May and Dec. While seasonality looks to have flattered the monthly result, and gains appear narrowly-based, prices in all major capital city markets are showing convincing signs of stabilisation.

The CoreLogic daily index shows a very similar story for April, with prices across the major capital cities tracking another solid 0.8% rise for the month, again led by a strong 1.4% gain in Sydney. As noted in our revised house price view, support looks to be coming from a resurgence in immigration, the rising cost of newly built dwellings and low on-market supply. A lift in consumer price expectations also looks to be anchoring gains.

Australian dwelling prices



Aus RBA policy decision

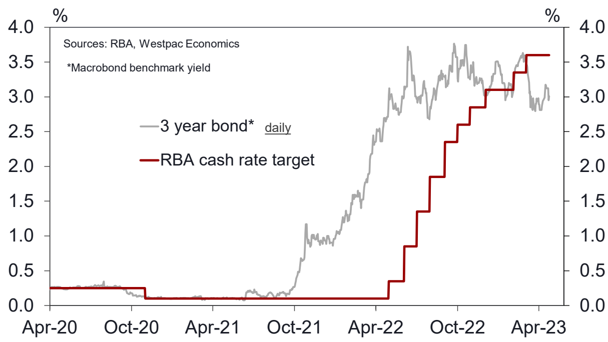
May 2, Last: 3.60%, WBC f/c: 3.60%
Mkt f/c: 3.60%, Range: 3.60% to 3.85%

At the May Board meeting, Westpac anticipates that the RBA will keep the cash rate on hold at 3.60%. The Q1 CPI report delivered a downside surprise on underlying inflation, with the trimmed mean measure printing 1.2% (6.6%yr), well below the market's expectation and our own. This was largely associated with a broad-based step-down in the pace of goods inflation (9.5%yr to 7.6%yr).

While annual services inflation experienced another large rise, it was not enough to offset the disinflation amongst goods components, resulting in a further moderation in headline inflation from 7.8%yr to 7.0%yr. Relative to the RBA's February forecasts, the easing in annual headline inflation is running ahead of expectations. Hence, we believe the cash rate is currently at a level that will prove to be the peak for this tightening cycle. For more detail, see page 2.

Note that the RBA Governor will also be speaking in the evening on May 2, with the RBA's Statement on Monetary Policy out on May 5.

RBA cash rate and 3 year bonds



Aus Mar retail trade

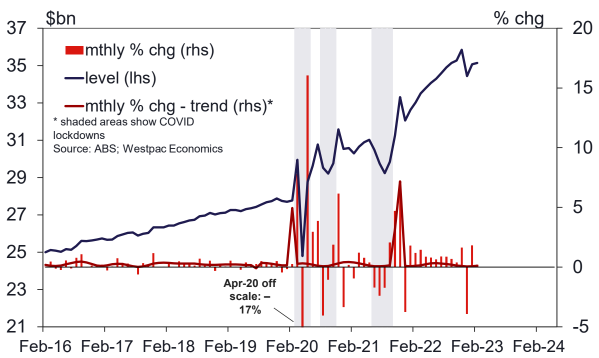
May 3, Last: 0.2%, WBC f/c: 0.2%
Mkt f/c: 0.3%, Range: –0.7% to 0.6%

Retail sales rose 0.2% in Feb but remain soft having only partially recovered from a steep 3.9% drop in Dec. The weakness shows through on a rolling 3mth basis with sales down 1.5% over Dec-Jan-Feb compared to Sep-Oct-Nov.

Our **Westpac Card Tracker** suggests the underlying trend in retail has stalled flat over Q1 as a whole. Another 0.2% gain in March would have nominal sales about flat for Q1 as a whole.

Note that the final March retail report, with full details including estimates of Q1 real retail sales, will be released on May 9. At this stage, a flat nominal result for the quarter and another solid rise in retail price is pointing to a sizeable contraction in sales volumes for the quarter, in the range of –1%qtr.

Monthly retail sales



DATA PREVIEWS

Aus Mar trade balance $bn

May 4, Last: 13.9, WBC f/c: 13.6
Mkt f/c: 13.0, Range: 12.0 to 14.9

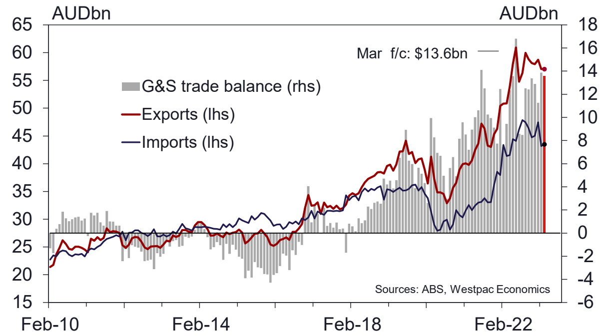
Australia continues to record a sizeable trade surplus each month – averaging $11.7bn during 2022.

The 2023 year is off to a positive start, with outcomes of $11.3bn and $13.9bn for the opening two months. We anticipate the surplus will narrow a little in March, to a forecast $13.6bn.

For the import bill, we have factored in a rise of 0.7%, +$0.3bn. The rise is led by goods on higher prices associated with the weaker currency in the month (-3.3% vs USD, -2.6% TWI).

Export earnings are expected to be broadly flat, constrained by softer global commodity prices in the month (-1.3% in AUD terms). A small fall in goods exports is expected to be offset by a further lift in services, extending the upward trend as student and holiday visitor numbers continue to recover.

Australia's trade balance



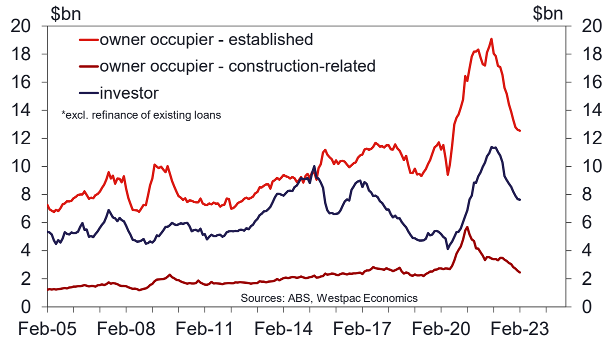
Aus Mar housing finance approvals

May 5, Last: –0.9%, WBC f/c: –0.3%
Mkt f/c: –0.3%, Range: –2.5% to +3.0%

The value of housing finance approvals declined 0.9% in Feb, broadly in line with the stabilisation starting to show through in prices and sales volumes.

March is expected to show a further stabilisation, albeit with some residual weakness still coming through construction-related activity. This will centre on owner occupier loans, which are expected to be down 0.5%mth with new investor lending about flat. Total new loans are expected to be down 0.3%mth (all figures exclude refinance).

New finance approvals by detailed segment



NZ GlobalDairyTrade auction, whole milk powder prices

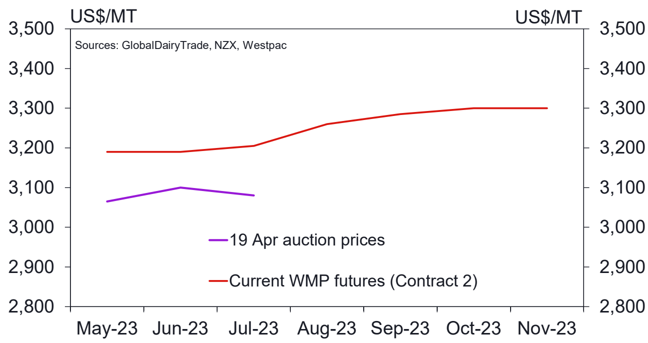
May 3, Last: +1.0%, Westpac: +2.0%

We expect whole milk powder prices (WMP) to lift by around 2% at the upcoming auction.

Our pick is halfway between the very modest lift at last week's mini (GDT pulse) auction and the strong 4% lift that the futures market is pointing to.

Over the year, we expect that rebounding Chinese dairy demand and very subdued global supply will lead global dairy prices higher.

Whole milk powder prices



NZ Q1 labour market surveys

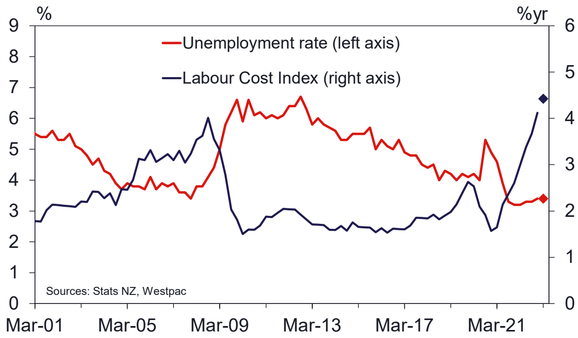
May 3, Unemployment rate last: 3.4%, Westpac f/c: 3.4%
May 3, Labour Cost Index last: 1.1%, Westpac f/c: 1.1%

We expect the unemployment rate to hold steady at 3.4% for the March quarter. Jobs growth has picked up momentum in recent months, in part because the return of migrant inflows means there are more people around to hire. The overriding factor, though, is that businesses are still in hiring mode.

Wage growth typically lags the broader economic cycle. We expect a further acceleration in annual wage growth, even with consumer price inflation now clearly past its peak.

Our forecasts are similar to the RBNZ's for the March quarter, so on their own are unlikely to have a major impact on the May monetary policy decision. However, the RBNZ will need to see some evidence within the next few months that the labour market is losing steam, for it to be satisfied that interest rates have gone high enough.

NZ labour market indicators



NZ Mar building consents

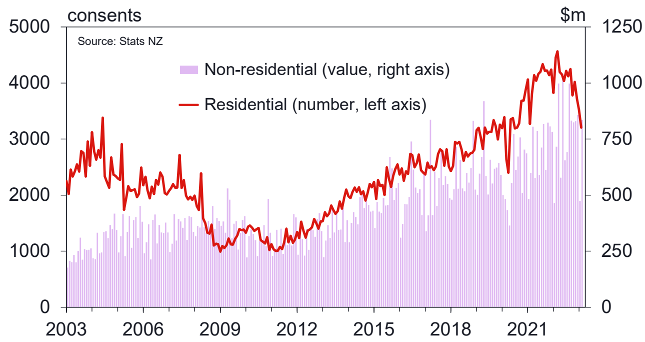
May 4, Last: –9.0%, Westpac f/c: +5.0%

We are forecasting a modest 5% bounce in consents in March. That follows the sharp decline in the choppy multi-unit consents category in recent months. However, the expected bounce would only reverse some of the recent drop in consent issuance.

Under the surface, tighter financial conditions mean that fewer new projects are coming to market. We expect the downturn will become increasingly pronounced over the months ahead.

In late January and early February New Zealand was struck by severe storms. Those events caused significant damage to homes in the upper and central North Island. The resulting repair work will moderate, but not completely offset, the broader slowing in homebuilding. We do not expect that repair work to have a large impact on consent numbers at this stage.

NZ building consents



US May FOMC meeting

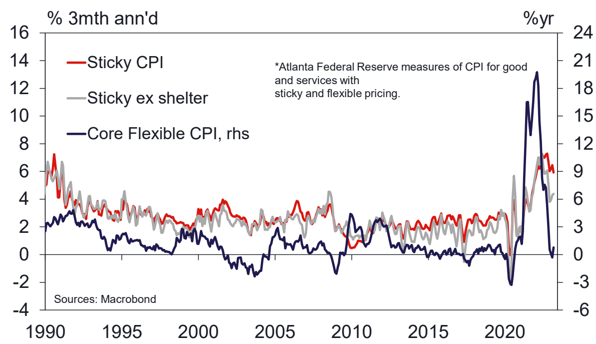
May 2-3: Last: 4.875%, Mkt f/c: 5.125%, WBC: 5.125%

Data received since the March meeting has consistently characterised the US economy as losing momentum but yet to stall. As a result, inflation risks have continued to recede only slowly.

Commentary from FOMC members ahead of the pre-meeting blackout consequently indicated a desire to take out a little more insurance before pausing. To us and the market, this points to one further hike in this cycle to a peak of 5.125%.

This last hike is unlikely to tighten financial conditions. Indeed, with risks around growth and the labour market growing, term interest rates and the US dollar are expected to weaken over coming months. By year-end, it is our expectation that the US will be in recession and inflation will no longer be the pre-eminent concern. Therefore, the first cut is now expected in December, with a further 200bps of easing to follow in 2024.

US disinflation trend to broaden



US Apr employment report

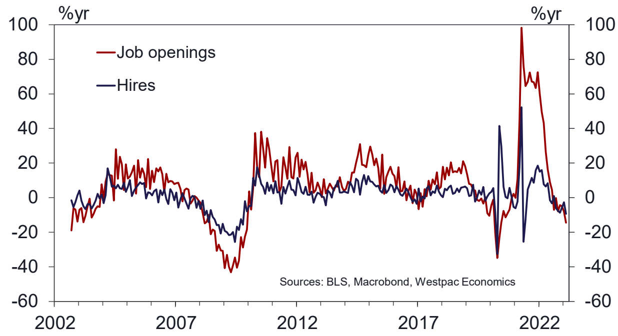
May 5: nonfarm payrolls, Last: 236k, Mkt f/c: 175k, WBC: 150k
May 5: unemployment rate, Last: 3.5%, Mkt f/c: 3.6%, WBC: 3.6%

Over the past year, nonfarm payrolls and household employment have diverged, with payroll job creation averaging 345k but only 214k people entering employment every month according to the household survey. All the while, hours worked have edged down and hourly earnings lost momentum.

To be clear, the outcomes reported over the past year are certainly not weak. But they do point to a material reduction in growth in labour demand and a much reduced willingness to pay up for labour. Many of the business surveys are also now beginning to point to job creation stalling.

The need for a growing share of the population to hold multiple jobs also speaks to binding budget constraints amongst households, which also points to a challenging outlook for demand.

Job openings have lost momentum



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For the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 01					
Aus	Apr CoreLogic home value index	0.8%	–	0.8%	Stabilisation now looking convincing.
	Apr MI inflation gauge %yr	5.7%	–	–	Provides a general view of inflation risks.
	Apr ANZ job ads	-2.4%	–	–	Still elevated but gradually moving off peak.
Jpn	Apr Nikkei manufacturing PMI	49.5	–	–	Final estimate.
US	Apr S&P Global manufacturing PMI	50.4	50.4	–	Some support from easing supply pressures …
	Apr ISM manufacturing	46.3	46.8	–	… but the outlook remains very challenging.
	Mar construction spending	-0.1%	0.2%	–	Softening demand weighing on construction.
Tue 02					
Aus	RBA policy decision	3.60%	3.60%	3.60%	Policy to remain on hold as inflation risks recede.
	RBA Governor Lowe	–	–	–	Speaking at the RBA Board Dinner in Perth, 9:20pm AEST.
Eur	Apr CPI %yr	6.9%	–	–	Services inflation the focus.
	Apr HCOB manufacturing PMI	45.5	45.5	–	Final estimate.
UK	Apr S&P Global manufacturing PMI	46.6	–	–	Final estimate.
	Apr Nationwide house prices	-0.8%	-0.6%	–	Price correction is firmly entrenched.
US	Mar JOLTS job openings	9931k	–	–	Starting to move lower after flattening for many months.
	Mar factory orders	-0.7%	0.8%	–	Weak new orders pointing to subdued capex outlook.
Wed 03					
Aus	Mar retail sales	0.2%	0.3%	0.2%	Nominal sales look to have stalled flat in Q1.
	RBA Assistant Governor (Economic)	–	–	–	Ellis speaking at CEDA Conference in Perth, 2:55pm AEST.
NZ	GlobalDairyTrade auction (WMP)	1.0%	–	2.0%	Dairy prices lifting on better demand and subdued supply.
	RBNZ Financial Stability Report	–	–	–	Six-monthly review of the financial system's health.
	Q1 employment	0.1%	–	0.8%	Hiring has picked up the pace as migrant workers return …
	Q1 unemployment rate	3.4%	–	3.4%	… keeping the unemployment rate steady on balance.
	Q1 LCI wage inflation (pvte, ord. time)	1.1%	–	1.1%	Wage growth still accelerating as it lags behind inflation.
Eur	Mar unemployment rate	6.6%	–	–	Labour market remains in robust health.
US	Apr S&P Global services PMI	53.7	–	–	Further weakness likely in coming months …
	Apr ISM non-manufacturing	51.2	52.0	–	… as growth slowdown materialises.
	FOMC policy decision, midpoint	4.875%	5.125%	5.125%	FOMC desires a little more insurance; first cut seen in Dec.
Thu 04					
Aus	Mar trade balance $bn	13.9	13.0	13.6	Goods X down, lower commodity prices. M up on lower AUD.
NZ	Mar building consents	-9.0%	–	5.0%	Bounce in multi-unit consents, but longer term trend down.
	Apr ANZ commodity prices	1.3%	–	–	Dairy and meat prices lifted over the month.
Chn	Apr Caixin manufacturing PMI	50.0	50.4	–	Manufacturing is in robust health.
Eur	ECB policy decision, refi rate	3.50%	–	3.75%	Downshift to 25bp hike likely; risk centred on April CPI.
	Apr HCOB services PMI	56.6	56.6	–	Final estimate.
UK	Apr S&P Global services PMI	54.9	–	–	Final estimate.
	Mar net mortgage lending £bn	0.7	–	–	Clear down-trend in place given housing correction.
US	Mar trade balance US$bn	-70.5	-68.9	–	Deficit to gradually narrow as consumer demand softens.
	Initial jobless claims	230k	–	–	Likely to remain at a low level versus history.
Fri 05					
Aus	RBA Statement on Monetary Policy	–	–	–	Forecast update.
	Mar housing finance	-0.9%	-0.2%	-0.3%	To corroborate the stabilisation being seen in other indicators.
	Mar owner occupier finance	-1.2%	–	-0.5%	Weakness in construction-related to weigh a bit on own-occ…
	Mar investor finance	-0.5%	–	flat	… but investor lending likely to have flattened out.
Chn	Apr Caixin services PMI	57.8	57.3	–	Services exhibiting great strength post COVID-zero.
Eur	Mar retail sales	-0.8%	–	–	Inflation and rates clearly weighing on discretionary spending.
US	Apr non-farm payrolls	236k	175k	150k	Surveys pointing to continued downtrend in job creation…
	Apr unemployment rate	3.5%	3.6%	3.6%	… which will create uptrend in U/E rate in coming months.
	Apr average hourly earnings %mth	0.3%	0.3%	0.2%	Earnings growth to slowly recede back to average.
	Mar consumer credit $bn	15.3	17.3	–	Demand for credit has been more subdued year-to-date.
	Fedspeak	–	–	–	Bullard, Cook.

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Forecasts

Interest rate forecasts

Australia	Latest (28 Apr)	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Cash	3.60	3.60	3.60	3.60	3.35	3.10	2.85	2.60
90 Day BBSW	3.68	3.70	3.70	3.72	3.47	3.22	2.97	2.72
3 Year Swap	3.45	3.50	3.50	3.40	3.30	3.10	2.90	2.80
3 Year Bond	3.04	3.15	3.15	3.05	3.00	2.85	2.70	2.60
10 Year Bond	3.39	3.40	3.30	3.20	3.00	2.80	2.70	2.50
10 Year Spread to US (bps)	-12	-10	-10	-10	-10	-10	-10	-10
US								
Fed Funds	4.875	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.51	3.50	3.40	3.30	3.10	2.90	2.80	2.60
New Zealand								
Cash	5.25	5.50	5.50	5.50	5.50	5.25	4.75	4.25
90 day bill	5.56	5.60	5.60	5.60	5.50	5.05	4.55	4.25
2 year swap	5.05	5.10	4.80	4.50	4.20	3.90	3.70	3.50
10 year bond	4.09	4.20	4.10	4.00	3.85	3.70	3.60	3.50
10 year spread to US	58	70	70	70	75	80	80	90

Exchange rate forecasts

Australia	Latest (28 Apr)	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6617	0.69	0.72	0.74	0.75	0.76	0.76	0.77
NZD/USD	0.6144	0.64	0.66	0.67	0.68	0.68	0.68	0.68
USD/JPY	134.72	130	129	128	127	126	125	124
EUR/USD	1.1011	1.10	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2482	1.23	1.24	1.25	1.26	1.27	1.28	1.29
USD/CNY	6.9174	6.70	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0768	1.08	1.09	1.10	1.11	1.13	1.13	1.13

Australian economic growth forecasts

	2022			2023				Calendar years			
% change	**Q2**	**Q3**	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2021**	**2022**	**2023f**	**2024f**
GDP % qtr	0.9	0.7	0.5	0.4	0.2	0.1	0.2	–	–	–	–
%yr end	3.1	5.9	2.7	2.5	1.8	1.2	1.0	4.6	2.7	1.0	1.5
Unemployment rate %	3.8	3.5	3.5	3.6	3.5	3.9	4.5	4.7	3.5	4.5	5.0
Wages (WPI)	0.8	1.1	0.8	0.8	1.0	1.0	1.0	–	–	–	–
annual chg	2.6	3.2	3.3	3.5	3.8	3.7	4.0	2.4	3.3	4.0	3.2
CPI Headline	1.8	1.8	1.9	1.4	1.1	0.7	0.7	–	–	–	–
annual chg	6.1	7.3	7.8	7.0	6.3	5.2	4.0	3.5	7.8	4.0	3.1
Trimmed mean	1.6	1.9	1.7	1.4	1.0	0.6	0.7	–	–	–	–
annual chg	5.0	6.1	6.9	6.7	6.1	4.7	3.7	2.6	6.9	3.7	3.1

New Zealand economic growth forecasts

	2022			2023				Calendar years			
% change	**Q2**	**Q3**	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2021**	**2022**	**2023f**	**2024f**
GDP % qtr	1.6	1.7	-0.6	0.2	0.2	0.2	-0.2	–	–	–	–
Annual avg change	1.1	2.7	2.4	2.9	3.2	1.6	1.1	6.0	2.4	1.1	-0.5
Unemployment rate %	3.3	3.3	3.4	3.4	3.6	3.8	4.0	3.2	3.4	4.0	5.1
CPI % qtr	1.7	2.2	1.4	1.2	1.0	1.7	0.5	–	–	–	–
Annual change	7.3	7.2	7.2	6.7	5.9	5.5	4.5	5.9	7.2	4.5	2.7

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