WESTPAC WEEKLY ECONOMIC COMMENTARY

Go large.

30 May 2022

Mount Cook buttercup

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As expected, the Reserve Bank of New Zealand followed April's 50 basis point 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're 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've already seen, will ripple through the economy. 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're 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).

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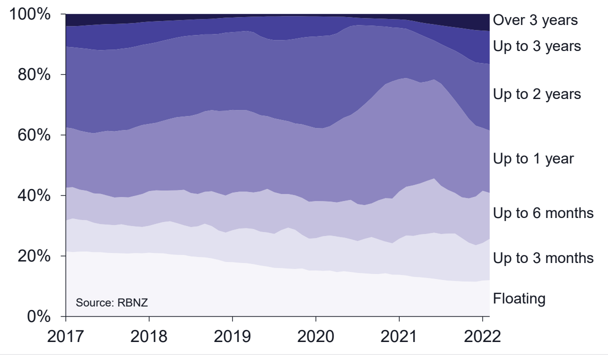
Chart of the week

The rise in interest rates already in train will dampen household spending directly through higher debt servicing costs. In addition to those on floating rates, around half of mortgages will come up for repricing over the coming year, and another 20% will come due within two years. Many of those borrowers will face refixing at substantially higher rates.

Share of mortgages by time to refixing

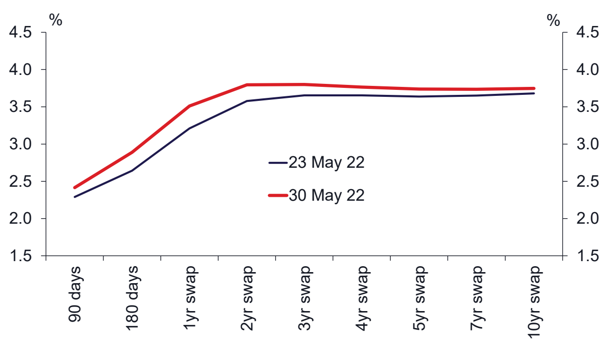


Fixed vs floating for mortgages

Wholesale interest rates remain above our forecast of a 3.5% peak in the Official Cash Rate this year. That suggests to us that there is no cost advantage to fixing for longer terms.

While a one-year mortgage rate is likely to rise further in the year ahead, fixing and rolling for this term is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms would be more suited to those who want certainty in their repayments.

NZ interest rates



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

The week ahead

NZ Apr residential building consents

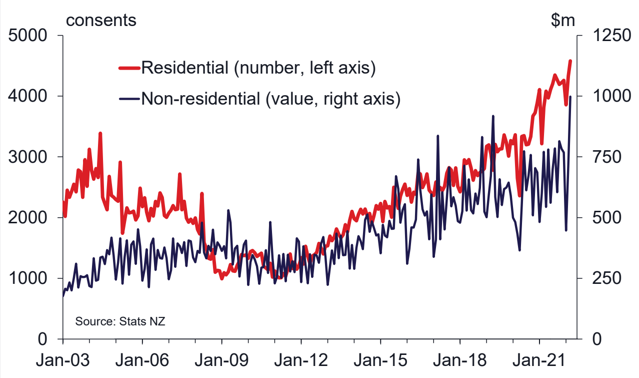
May 31, Last: +5.8%, Westpac f/c: -5.0%

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

We're 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



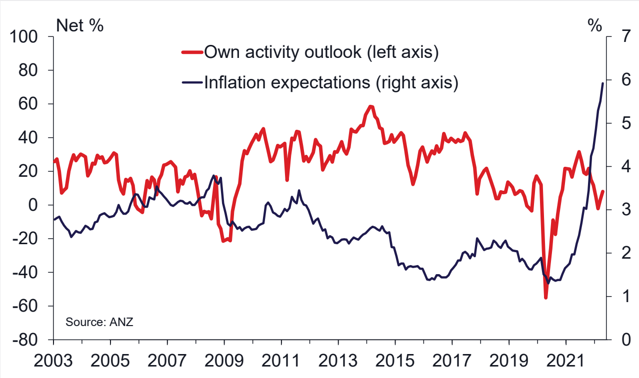
NZ May ANZBO business confidence

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



NZ Q1 Terms of Trade

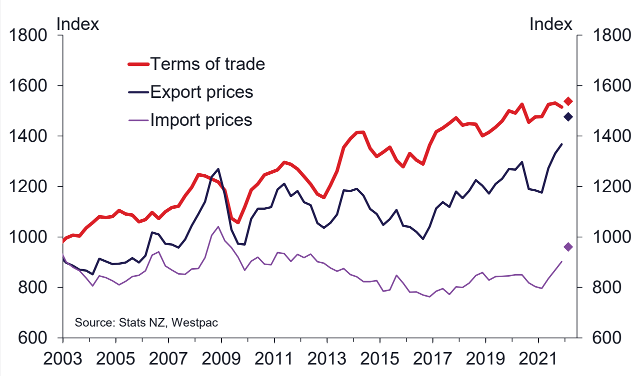
Jun 2, Last: -1.0%, Westpac: 1.5%

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



The week ahead

NZ Q1 building work put in place

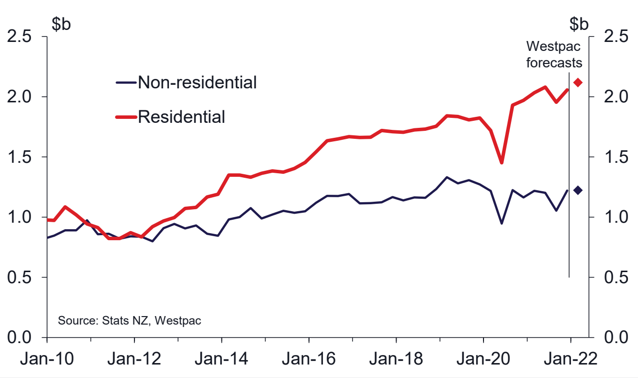
3 Jun, Last: +8.9%, Westpac: +2.0%

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're 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



Aus Apr dwelling approvals

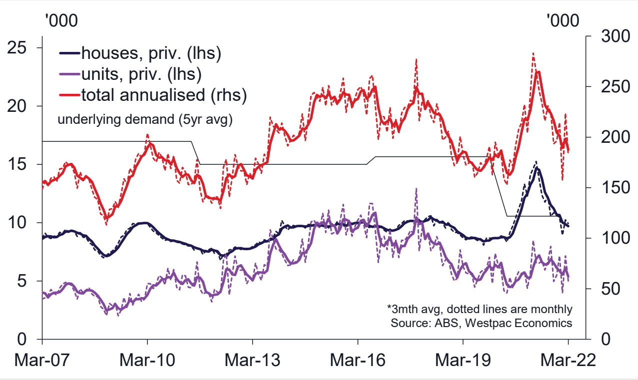
May 31, Last: –18.5%, WBC f/c: 2.0%
Mkt f/c: 2.0%, Range: –6.0% to 9.0%

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.

Aus dwelling approvals



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.ore

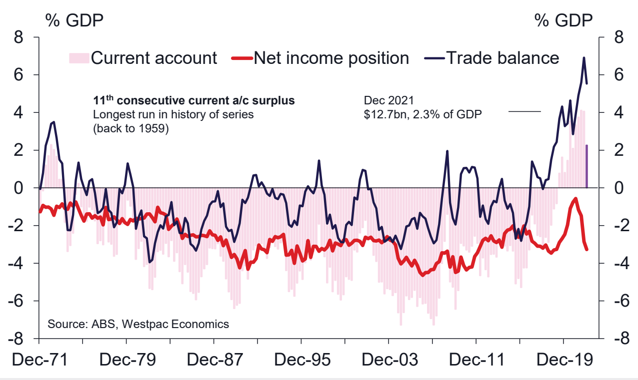
Australia will notch up a 12th consecutive quarterly current account surplus in March. Recall that the surplus narrowed to $12.7bn in December after hitting a record high of $22bn in June and September 2021.

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.

Aus current account



The week ahead

Aus Q1 GDP

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

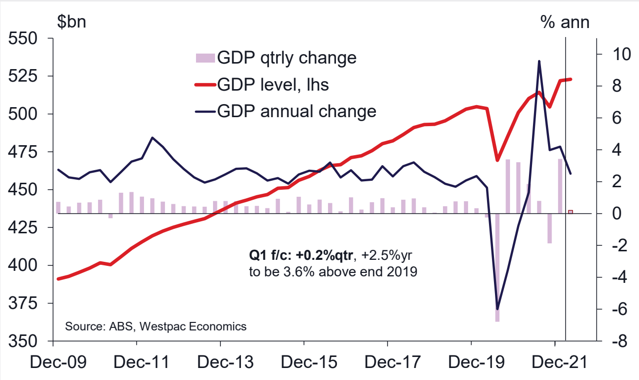
The reopening bounce from the Delta lockdowns in mid-2021 faltered in Q1 2022 on further disruptions – the omicron wave, as well as wet weather in NSW and Qld, including severe flooding.

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%.

Aus GDP



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

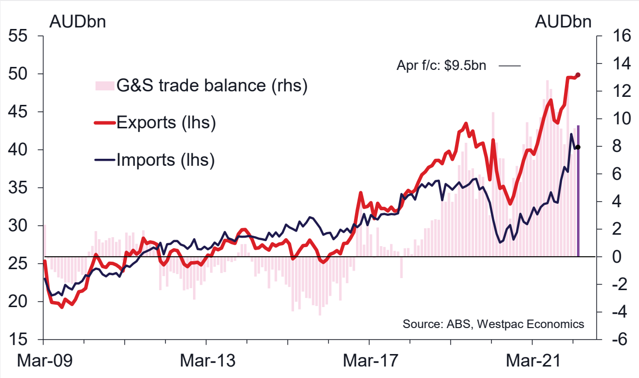
Australia's monthly trade surplus has averaged $9.9bn since the start of 2021, including a $9.3bn outcome for March 2022.

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.

Aus trade balance



US May employment report

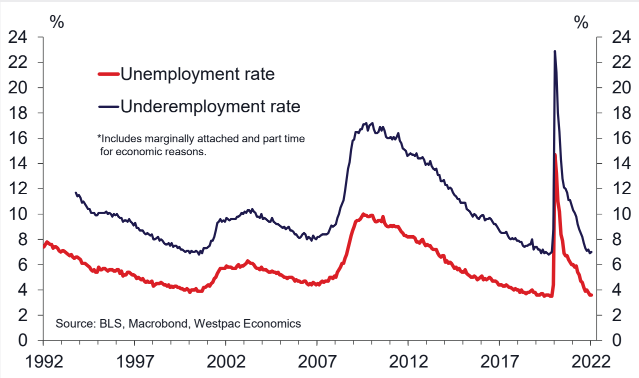
Jun 3, non-farm payrolls, Last: 428k,
WBC f/c: 370k, Mkt f/c: 329k
Jun 3, unemployment rate, Last: 3.6%,
WBC f/c: 3.5%, Mkt f/c: 3.5%

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 unemployment and underemployment

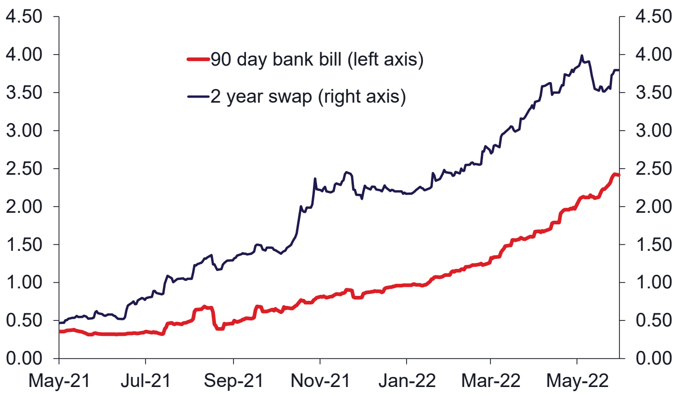


New Zealand forecasts

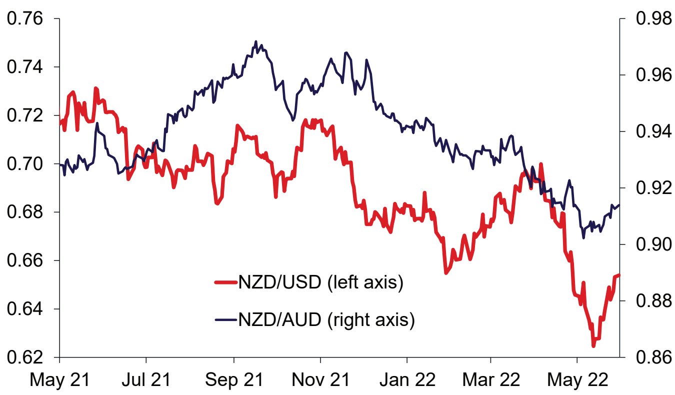
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Dec (a)	Mar	Jun	Sep	2020	2021	2022f	2023f
GDP (Production)	3.0	0.6	0.3	1.0	-2.1	5.6	2.7	3.3
Employment	0.0	0.1	0.3	0.2	0.6	3.5	0.8	0.9
Unemployment Rate % s.a.	3.2	3.2	3.1	3.0	4.9	3.2	3.0	3.3
CPI	1.4	1.8	1.1	1.2	1.4	5.9	4.5	2.7
Current Account Balance % of GDP	-5.8	-5.9	-6.8	-6.9	-0.8	-5.8	-6.6	-5.6

Financial forecasts	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	2.00	3.00	3.50	3.50	3.50	3.50	3.50
90 Day bill	2.70	3.40	3.60	3.60	3.60	3.60	3.60
2 Year Swap	4.00	4.00	3.90	3.70	3.50	3.30	3.10
5 Year Swap	4.10	4.00	3.90	3.70	3.50	3.35	3.20
10 Year Bond	3.80	3.70	3.50	3.30	3.20	3.10	3.00
NZD/USD	0.65	0.67	0.69	0.70	0.71	0.72	0.72
NZD/AUD	0.90	0.91	0.91	0.91	0.91	0.91	0.90
NZD/JPY	83.9	85.8	86.9	87.5	88.0	87.2	87.1
NZD/EUR	0.61	0.62	0.63	0.63	0.63	0.63	0.63
NZD/GBP	0.52	0.53	0.54	0.55	0.55	0.54	0.54
TWI	71.3	72.6	73.8	74.0	74.4	74.4	74.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 30 May 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	2.00%	1.50%	1.50%
30 Days	2.03%	1.87%	1.75%
60 Days	2.22%	2.00%	1.92%
90 Days	2.42%	2.13%	2.08%
2 Year Swap	3.80%	3.53%	3.85%
5 Year Swap	3.74%	3.70%	3.98%

NZ foreign currency mid-rates as at 30 May 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6539	0.6278	0.6452
NZD/EUR	0.6088	0.6017	0.6129
NZD/GBP	0.5182	0.5119	0.5133
NZD/JPY	83.10	81.19	83.79
NZD/AUD	0.9139	0.9069	0.9119
TWI	72.61	70.94	71.78

Data calendar

		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					
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.
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.
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.
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.
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.
Thu 02					
NZ	Q1 terms of trade	–1.0%	–	1.5%	New record high on the back of earlier dairy price surge.
Aus	Apr trade balance $bn	9.3	9.0	9.5	Exports and imports both expected to make modest gains.
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					
NZ	Q1 building work put in place	8.9%	–	2.0%	Capacity constraints limiting the rise in activity.
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.
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.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.2	4.7	4.5	3.5
CPI inflation %yr	1.8	1.8	0.9	3.5	5.6	2.6
Unemployment rate %	5.0	5.2	6.8	4.7	3.2	3.4
Current account % of GDP	-2.1	0.7	2.6	3.5	1.9	-1.8
United States						
Real GDP %yr	3.0	2.2	-3.5	5.7	2.6	1.8
CPI inflation %yr	2.4	1.9	1.3	7.1	3.7	2.3
Unemployment rate %	3.9	3.7	8.1	5.4	3.7	4.1
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	0.3	-4.8	1.8	2.2	1.4
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	2.2	1.5
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	7.2	3.7	0.0
China						
Real GDP %yr	6.7	5.8	2.3	8.1	5.3	5.5
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	4.2	4.5	4.7
World						
Real GDP %yr	3.6	2.8	-3.3	5.5	3.4	3.3

Forecasts finalised 6 May 2022

Interest rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Australia								
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
10 Year Bond	3.28	3.30	3.15	2.90	2.65	2.50	2.40	2.30
International								
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

Exchange rate forecasts	Latest	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
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

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