

# WESTPAC WEEKLY ECONOMIC COMMENTARY

## How fast? How furious?

25 July 2022



Mānuka

### Westpac Economics Team

✉ [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

🌐 [westpac.co.nz/economics](https://westpac.co.nz/economics)



**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 inflation 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. And 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 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.

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

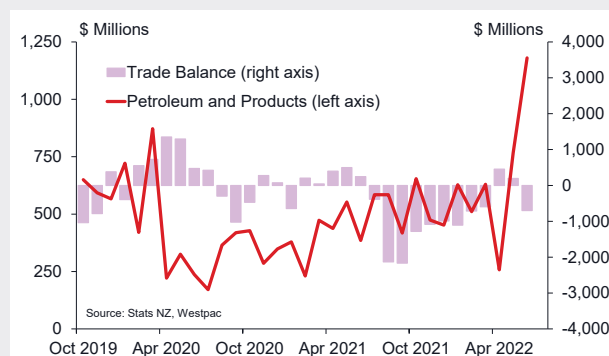
+64 9 336 5668

satish.ranchhod@westpac.co.nz

## Chart of the week

As motorists will be well aware, June coincided with the peak in petrol prices. Indeed, prices shot above \$3 per litre around the country. This spike has now been reflected in our trade data, with June showing a massive spike in petroleum product imports to \$1.2bn. In turn, our trade deficit blew out to a record for a June month of \$701m. Thankfully, petrol prices have since cooled to below \$3 per litre as both oil prices and refining margins have fallen. That also means that the trade balance is likely to show an improvement over the coming months.

Petroleum import values and the trade balance

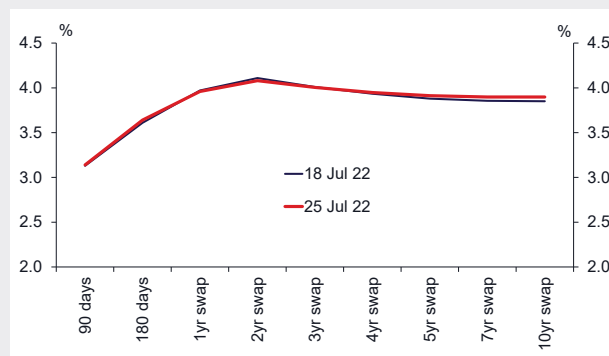


## Fixed vs floating for mortgages

Wholesale interest rates have fallen from their highs in the last few weeks, as markets have reassessed the prospects for the global economy. That in turn has seen cuts to some fixed-term mortgage rates.

Even so, market pricing remains above what would be consistent with our forecast of a 3.5% peak in the Official Cash Rate this year. This suggests to us that fixing for a short period and rolling is still likely to produce a lower borrowing cost on average over the next few years. Fixing for a longer term could prove more expensive, but may suit those who want more certainty in their repayments.

NZ interest rates



# The week ahead

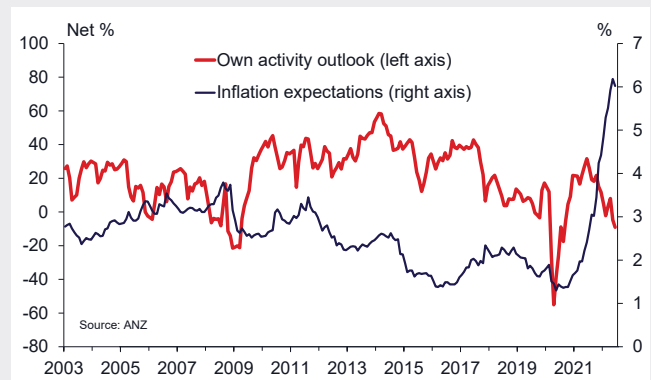
## NZ Jul ANZBO business confidence

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



## Aus Q2 Consumer Price Index

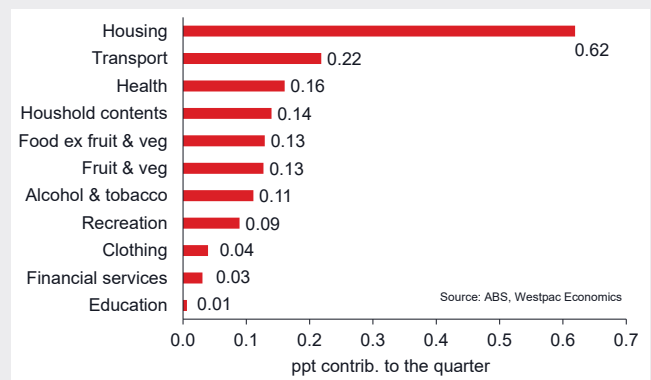
Jul 27, Last: 2.1%, WBC f/c: 1.7%  
Mkt f/c: 1.9%, Range: 1.6% to 2.8%

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.

## Contributions to Australia CPI



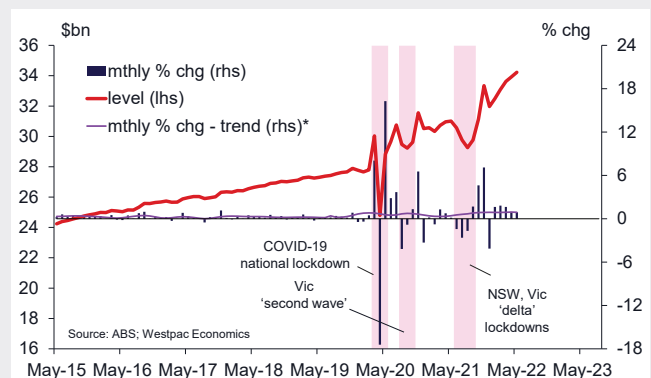
## Aus Jun retail sales

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.

## Aus retail sales



# The week ahead

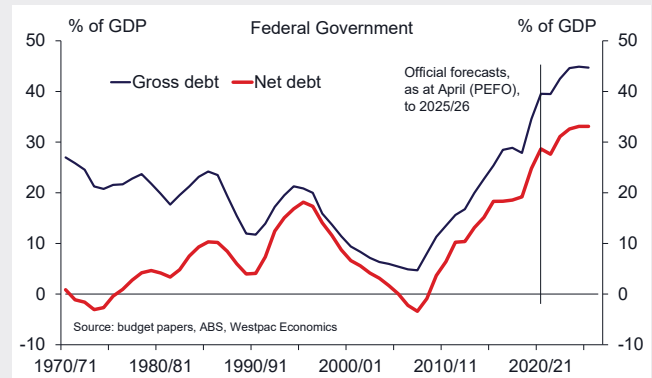
## Aus Federal Treasurer, Ministerial Economic Statement

Jul 28

Treasurer Chalmers will deliver a Ministerial Economic Statement to Parliament - in the first week that Parliaments sits after the election. 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.

## Aus public debt



## 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%

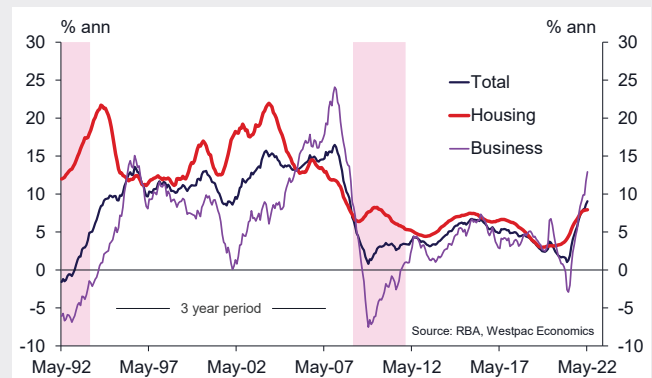
Credit to the private sector grew by 9.0% over the past year to May, the fastest annual pace since October 2008, but still well below the December 2007 peak of 16.5%, pre-GFC.

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.

## Aus credit growth



## US Jul FOMC meeting

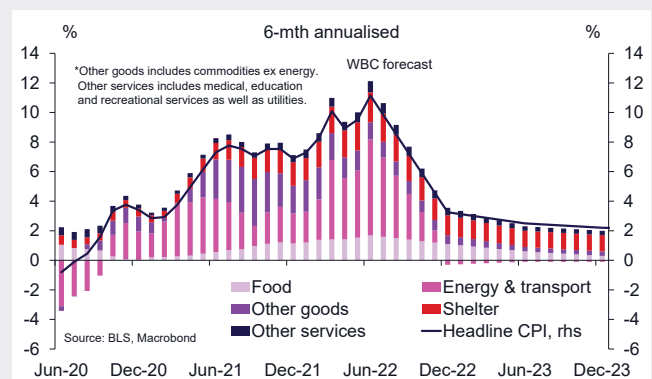
Jul 26-27, fed funds rate, Last: 1.625%, Mkt f/c: 2.375%,  
WBC 2.375%

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%.

## Contributions to US inflation



# The week ahead

## US Q2 GDP

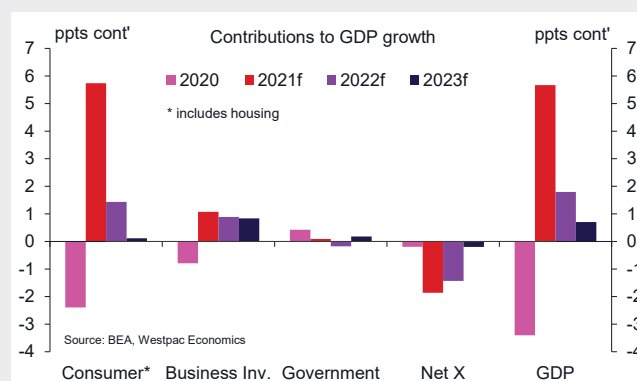
**Jul 28, GDP qtr annls'd, Last: -1.6%, Mkt f/c: 0.5%, WBC -0.5%**

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 GDP



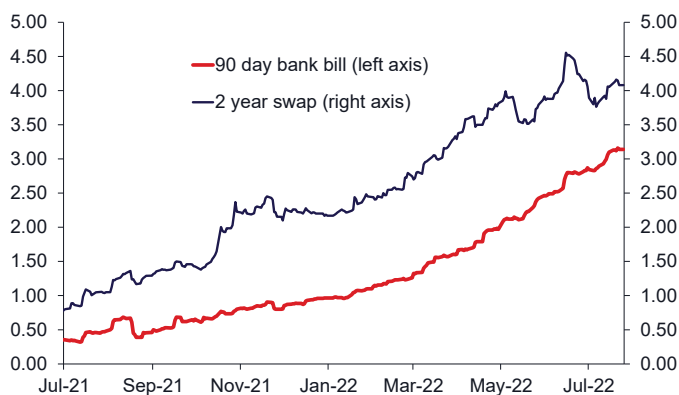


# New Zealand forecasts

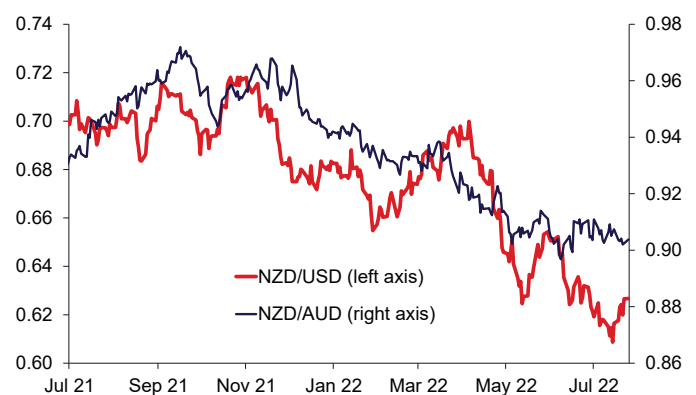
Economic forecasts		Quarterly				Annual			
		2022							
% change		Mar (a)	Jun	Sep	Dec	2020	2021	2022f	2023f
GDP (Production)		-0.2	1.0	0.7	1.2	-2.1	5.6	2.1	3.3
Employment		0.1	0.2	0.2	0.2	0.6	3.5	0.8	0.9
Unemployment Rate % s.a.		3.2	3.1	3.0	3.0	4.9	3.2	3.0	3.3
CPI		1.8	1.7	1.6	0.1	1.4	5.9	5.2	3.3
Current Account Balance % of GDP		-6.5	-7.5	-7.8	-7.5	-0.8	-5.8	-7.5	-6.1

Financial forecasts	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Cash	3.00	3.50	3.50	3.50	3.50	3.50	3.50
90 Day bill	3.40	3.60	3.60	3.60	3.60	3.60	3.60
2 Year Swap	4.00	3.90	3.80	3.60	3.40	3.20	3.00
5 Year Swap	3.90	3.70	3.50	3.30	3.10	3.00	2.90
10 Year Bond	3.80	3.60	3.40	3.20	3.10	3.00	2.95
NZD/USD	0.65	0.68	0.70	0.71	0.72	0.72	0.72
NZD/AUD	0.90	0.91	0.91	0.91	0.91	0.90	0.90
NZD/JPY	85.8	87.7	88.9	88.0	87.2	87.1	86.4
NZD/EUR	0.61	0.62	0.63	0.63	0.63	0.63	0.62
NZD/GBP	0.52	0.54	0.55	0.55	0.54	0.54	0.53
TWI	71.6	73.3	74.4	74.7	74.5	74.7	74.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 25 July 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.00%	2.00%
30 Days	2.70%	2.50%	2.33%
60 Days	2.92%	2.72%	2.57%
90 Days	3.14%	2.93%	2.81%
2 Year Swap	4.08%	3.91%	4.14%
5 Year Swap	3.91%	3.82%	4.13%

NZ foreign currency mid-rates as at 25 July 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6267	0.6150	0.6314
NZD/EUR	0.6139	0.6081	0.5965
NZD/GBP	0.5212	0.5143	0.5143
NZD/JPY	85.34	84.30	85.39
NZD/AUD	0.9038	0.9064	0.9106
TWI	71.37	70.11	71.01

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 25</b>					
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.
<b>Tue 26</b>					
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.
<b>Wed 27</b>					
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.
<b>Thu 28</b>					
NZ	Jul ANZ business confidence	–55.6	–	–	Confidence to remain low, price pressures still elevated.
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.
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.
<b>Fri 29</b>					
NZ	Jul ANZ consumer confidence	80.5	–	–	Continued pessimism about living costs and weaker activity.
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.
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.

# International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021	2022f	2023f
<b>Australia</b>						
Real GDP %yr	2.8	2.0	-2.1	4.8	4.5	2.7
CPI inflation %yr	1.8	1.8	0.9	3.5	6.6	3.0
Unemployment rate %	5.0	5.2	6.8	4.7	3.3	3.5
Current account % of GDP	-2.1	0.7	2.6	3.5	1.7	-1.2
<b>United States</b>						
Real GDP %yr	2.9	2.3	-3.4	5.7	2.0	0.8
CPI inflation %yr	2.4	1.9	1.2	5.1	7.1	2.5
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
<b>Japan</b>						
Real GDP %yr	0.6	-0.2	-4.5	1.6	1.7	1.8
<b>Euro zone</b>						
Real GDP %yr	1.8	1.6	-6.4	5.3	2.2	1.5
<b>United Kingdom</b>						
Real GDP %yr	1.7	1.7	-9.3	7.4	3.3	0.0
<b>China</b>						
Real GDP %yr	6.8	6.0	2.2	8.1	5.3	5.5
<b>East Asia ex China</b>						
Real GDP %yr	4.5	3.8	-2.3	4.1	4.5	4.6
<b>World</b>						
Real GDP %yr	3.6	2.9	-3.1	6.1	3.4	3.2

Forecasts finalised 8 July 2022

Interest rate forecasts	Latest	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
<b>Australia</b>								
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
10 Year Bond	3.43	3.60	3.50	3.35	3.15	2.90	2.65	2.50
<b>International</b>								
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

Exchange rate forecasts	Latest	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
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



# Contact the Westpac economics team

**Michael Gordon, Acting Chief Economist**

+64 9 336 5670

**Satish Ranchhod, Senior Economist**

+64 9 336 5668

**Nathan Penny, Senior Agri Economist**

+64 9 348 9114

**Paul Clark, Industry Economist**

+64 9 336 5656

**Any questions email:**

economics@westpac.co.nz

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