

WESTPAC WEEKLY ECONOMIC COMMENTARY

A long time between drinks.

19 September 2022



Harakeke/flax

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The New Zealand economy grew strongly over the June quarter, comfortably avoiding recession. For us, though, avoiding recession was very much a secondary story. The big news is that the pandemic's economic impact is fading and, as it does, spending patterns are normalising. Indeed, after very long time between drinks, so to speak, it's time for service industries like hospitality, entertainment, and accommodation to return to economic prominence.

The New Zealand economy bounced 1.7% higher over the June quarter. That was very close to our forecast of 1.6% and was substantially ahead of the median market forecast of a 1% rise.

This result means that the economy has well and truly made up for the 0.2% drop in the previous quarter. Indeed, looking through the quarterly ups and downs over the first half of this year, the economy has grown at a respectable annualised pace of 2.9%.

With that in mind, there wasn't much danger of the economy dipping into recession this year. Our assessment at the time was that the March quarter drop was due to two temporary factors: disruptions to activity during the peak of the Omicron wave, and the absence of the uplift in tourist spending that we'd normally see at that time of year.

As we expected, both of those effects were reversed out in the June quarter. Covid cases eased off after peaking in March, with the country moving from the 'red' to the 'orange' traffic light setting, and worker absences becoming less of a constraint on production.

More importantly, the phased reopening of the border since the end of February meant a strong lift in visitor numbers during what normally would have been the seasonal lull. The numbers themselves were still subdued – visitor numbers over the June quarter were around 20% of pre-Covid levels. But going from nothing to something can have a big impact on rates of growth.

That was evident in the spectacular quarterly gains recorded in some sectors. Accommodation and dining out was up by 30%, transport up 20%, and arts and recreational services up 20%. Administrative services, a group that includes travel agencies and tour operators, saw a 4.7% rise.

Even with the strong overall result, it's important to note that there are parts of the economy that are in decline. Retail sales were down 3.7%, mining shrank by another 8%, construction saw a surprising 2.4% fall, and non-food manufacturing (excluding petroleum) fell by 1.3%.

The net effect is that the economy is undergoing 'the big switch'. This switch is occurring as both New Zealand and the

world move beyond the pandemic and the associated Covid restrictions. We note that technically it's 'the 'big switch back', as households unwind the surge in goods spending over the pandemic and redirect spending back to services. That said, pent-up demand may mean that spending on services like travel continues to surge over the next couple of years before the normal spending patterns resume.

As a result, we expect the spending switch to play out at speed. For example, Australians and offshore New Zealanders were the first to arrive on our shores and thus dominated tourist arrivals over the June quarter. Over the remainder of the year and particularly heading into summer, we expect arrivals from further afield to join the party. For example, Air New Zealand recently announced its new flagship route of Auckland to New York, with the route opening over the weekend.

On the local front, the abolishment of the 'traffic light' system of Covid restrictions last week will give the service industry a further boost. Accordingly, the hospitality and entertainment industries are likely to see an ongoing surge in growth, after what has been a very long time between drinks so to speak.

However, over coming years, there may still be a spanner in the works. Given the industry is generally more labour intensive, labour shortages are likely to temper growth in some areas and/or lead to a surge in wages over and above the lift being seen in the rest of the economy. The sector will be competing with other sectors that are also short-handed, in order to secure the necessary staff to support the industry's recovery to pre-Covid levels.

On the flipside, we expect domestic demand and in turn household spending and residential investment to continue to cool over the remainder of 2022 and beyond. On this front, the latest housing data reaffirmed that the housing market continues to cool, with prices falling a further 1.4% over August. Nationwide prices have now fallen 9% from the peak back in November. Auckland (down 14%) and Wellington (down 17%) continue to lead the market lower.

With last week's GDP result very much in line with the RBNZ's forecast of a 1.8% rise, there are no obvious implications for the interest rate outlook. The heart of the issue is that the RBNZ is aware the economy is running above its non-inflationary potential. Higher interest rates will work to close that gap over time, but the challenge is in managing that process. Doing too little means that inflation could become stubbornly persistent; too much could mean an unnecessary period of weak activity and high unemployment. We agree with the RBNZ that lifting the Official Cash Rate to 4% and holding it there would give the best chance of striking that balance.

Nathan Penny, Senior Agri Economist

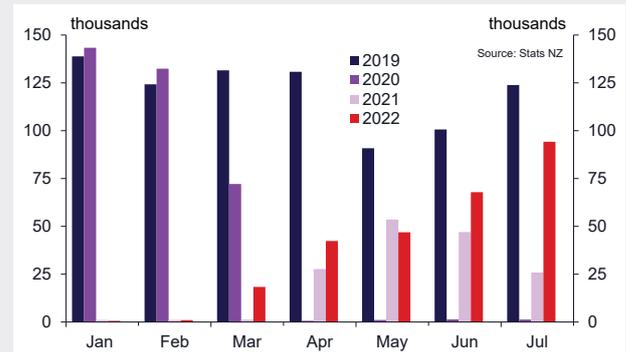
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Chart of the week

With the border open, tourist arrivals are surging. From virtually nothing (5,000) in February, seasonally-adjusted arrivals have grown to 134,000 in July. The number of arrivals has risen from 2% of pre-Covid levels in February to over 40% in July. Australians have been leading the charge. In July, 94,000 Australians crossed the Tasman. That was around 75% of the July 2019 number. From here and heading into the summer peak, we expect tourist arrivals to surge further. And while we expect more Australians to arrive, we expect a second wave to also arrive from long-haul destinations such as the US and Europe.

Monthly tourist arrivals, Australian residents

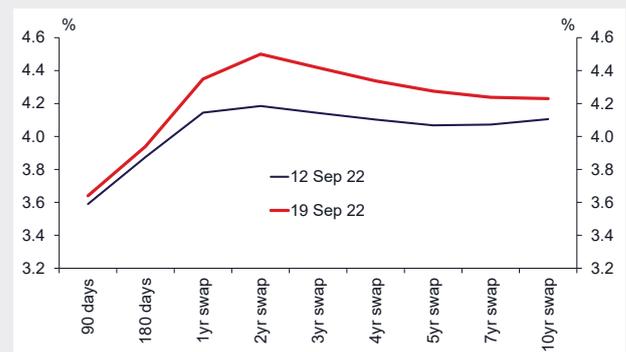


Fixed vs floating for mortgages

We expect the Reserve Bank to lift the Official Cash Rate to 4% and to hold it there for the next couple of years, before reducing it to a more sustainable level in the following years. In contrast, wholesale interest rate markets are priced for a sustained higher level of the OCR for many years to come.

As a result, we believe that there is value in fixing for terms of up to two years. We would regard fixing for terms longer than this as expensive, but this option may suit those who want more certainty in their repayments.

NZ interest rates



The week ahead

NZ GlobalDairyTrade auction, whole milk powder prices

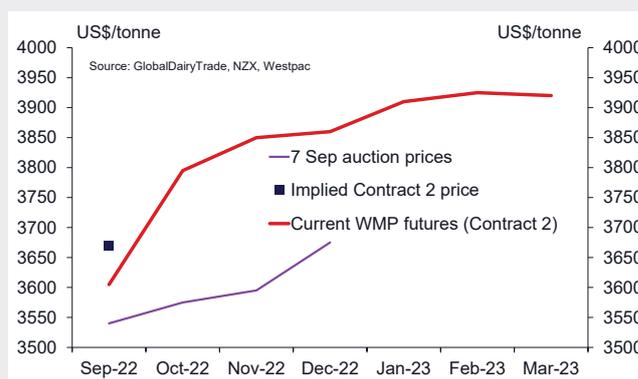
Sep 21, Last: +5.1%, WBC: +4%

We expect whole milk powder prices (WMP) to lift by around 4% at the upcoming auction. This follows a 5.1% price jump at the previous auction.

Our pick is slightly lower than the circa 5% lift that the futures market is pointing to.

We expect global dairy prices to firm over this and coming auctions on the back of very weak global dairy supply and recovering Chinese demand.

Whole milk powder prices



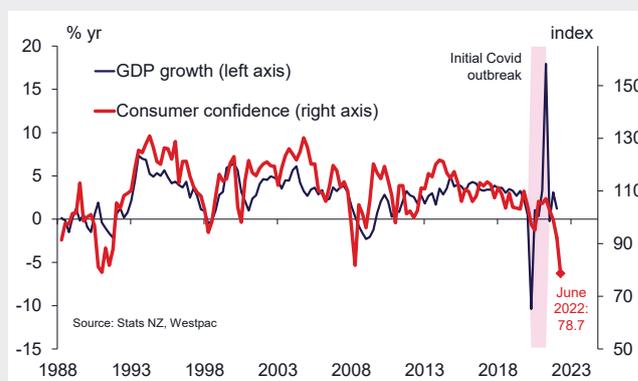
NZ Q3 Westpac McDermott Miller Consumer Confidence

Sep 22, Last: 78.7

Consumer confidence plummeted in the June quarter, falling to its lowest levels since we began surveying consumers back in 1988. Confidence has only come close to these sorts of lows twice before - first during the recession in the early-1990s, and then again during the Global Financial Crisis in 2008/09. Households reported increasing concerns about their financial position as consumer prices and mortgage interest costs pushed higher. There was also growing pessimism around the outlook for economic conditions more broadly.

Our latest survey was conducted in the first half of September. Recent months have seen households continuing to grapple with increases in the cost of living and higher interest rates. However, we have also seen the labour market remaining firm, sharp falls in petrol prices, and an easing in Covid restrictions.

Consumer confidence and economic growth



Aus Aug Westpac-MI Leading Index

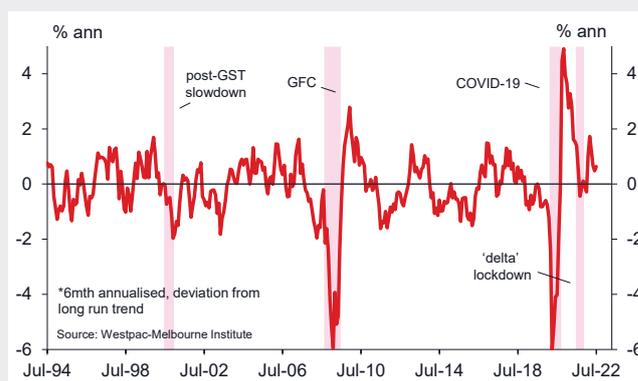
Sep 21, Last: 0.63%

The six-month annualised growth rate lifted slightly to 0.63% in July, remaining at an above trend pace heading into the second half of 2022.

The August read will include some notable negatives in the monthly updates, dwelling approvals plunging 17% and the yield gap closing sharply as the RBA's rapid rate rises lift the short end. Most other components recorded slight positives.

Timing is also of note, the headline measure is based on a six month annualised growth rate that is now cycling out of the strong post-delta (and post-omicron) rebounds that were still giving strong boosts in the first few months of the year (hours worked for example soared 9% in Feb). Some big commodity price gains at the start of the year are also dropping out. As such, a dip to a negative, below trend reading is possible.

Aus Westpac-MI Leading Index



The week ahead

US Sep FOMC meeting

Sep 20-21, fed funds rate,

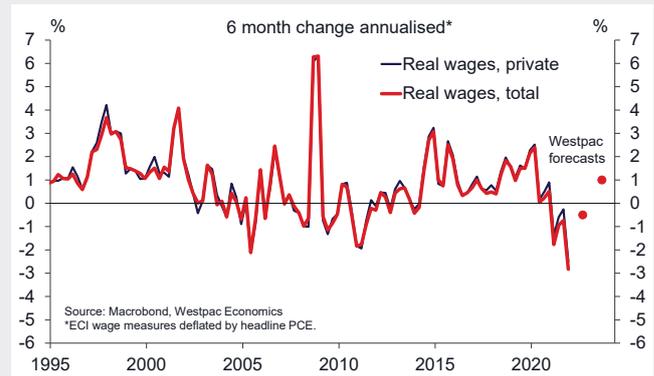
Last: 2.375%, Mkt f/c: 3.125%, WBC 3.125%

Following last week's strong August core CPI and given recent hawkish rhetoric from FOMC members, a 75bp hike at the September meeting seems a done deal. Indeed, the market is pricing some chance of a 100bp increase.

To us, at this point in the cycle and with real term interest rates around +1.0%, a 100bp increase is unnecessary and potentially risky. Also note that an additional 100bps of hikes is forecast for the remainder of the year; and the market sees the risk of more.

Critical to assessing the outlook for policy beyond September will be the FOMC's updated forecasts for inflation, growth and the fed funds rate in 2023 and 2024. We see big risks for growth into the medium-term; but if the FOMC are more sanguine, market pricing could turn more hawkish.

US real wage growth

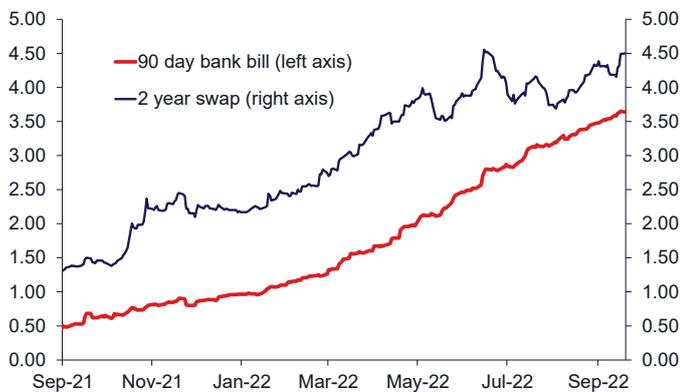


New Zealand forecasts

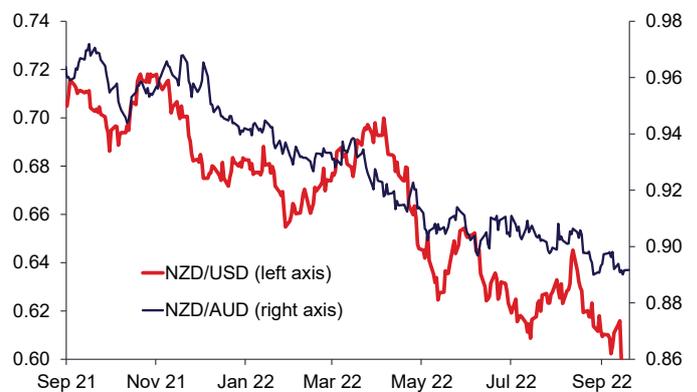
Economic forecasts	Quarterly				Annual			
	2022		2023		2020	2021	2022f	2023f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	1.7	0.4	0.6	0.6	-2.1	5.5	2.2	2.2
Employment	0.0	0.1	0.1	0.1	0.6	3.4	0.2	0.8
Unemployment Rate % s.a.	3.3	3.3	3.4	3.5	4.9	3.2	3.4	3.8
CPI	1.7	1.6	0.3	1.0	1.4	5.9	5.3	3.6
Current Account Balance % of GDP	-7.7	-7.7	-7.1	-6.0	-0.8	-6.0	-7.1	-4.4

Financial forecasts	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Cash	4.00	4.00	4.00	4.00	4.00	4.00	4.00
90 Day bill	4.10	4.10	4.10	4.10	4.10	4.10	3.80
2 Year Swap	4.10	4.00	3.80	3.60	3.40	3.20	2.95
5 Year Swap	4.10	4.00	3.90	3.70	3.50	3.30	3.15
10 Year Bond	4.00	3.80	3.70	3.60	3.45	3.30	3.20
NZD/USD	0.62	0.63	0.64	0.66	0.68	0.70	0.70
NZD/AUD	0.90	0.90	0.90	0.90	0.90	0.90	0.90
NZD/JPY	86.8	86.9	87.0	88.4	89.5	90.4	89.6
NZD/EUR	0.61	0.60	0.59	0.59	0.60	0.60	0.60
NZD/GBP	0.53	0.52	0.51	0.52	0.52	0.53	0.52
TWI	70.9	71.0	71.1	71.8	72.6	73.5	73.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 19 September 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	3.00%	3.00%	3.00%
30 Days	3.29%	3.11%	3.04%
60 Days	3.46%	3.32%	3.21%
90 Days	3.64%	3.53%	3.39%
2 Year Swap	4.50%	4.32%	4.09%
5 Year Swap	4.28%	4.17%	3.94%

NZ foreign currency mid-rates as at 19 September 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5991	0.6101	0.6201
NZD/EUR	0.5983	0.6142	0.6195
NZD/GBP	0.5247	0.5301	0.5253
NZD/JPY	85.63	85.72	84.97
NZD/AUD	0.8917	0.8976	0.8976
TWI	69.91	70.81	71.21

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 19					
NZ	Aug BusinessNZ PSI	51.2	-	-	Interest rate hikes have been weighing on demand.
	RBNZ speech	-	-	-	Governor Orr at Climate Change conference.
Aus	RBA Head of Domestic Markets	-	-	-	Kearns, speaking at AFR Property Summit.
UK	Sep Rightmove house prices	-1.3%	-	-	More declines to come as policy tightening continues.
US	Sep NAHB housing market index	49	48	-	Elevated costs, lack of labour and affordability all biting.
Tue 20					
Aus	RBA minutes	-	-	-	Is it time for the pace of rate hikes to moderate from here?
US	Aug housing starts	-9.6%	1.0%	-	Demand being hit hard by financial conditions...
	Aug building permits	-0.6%	-3.8%	-	... while input constraints continue to limit supply.
Wed 21					
NZ	GlobalDairyTrade auction (WMP)	5.1%	-	4.0%	Dairy prices to continue rebound on very tight global supply.
Aus	Aug Westpac-MI Leading Index	0.63%	-	-	Six-month growth rate looks set to weaken.
	RBA Deputy Governor	-	-	-	Bullock, speaking to Bloomberg.
US	Aug existing home sales	-5.9%	-2.3%	-	Persistent weakness likely as tightening continues.
	FOMC policy decision, midpoint	2.375%	3.125%	3.125%	75bp hike locked in after core inflation upside surprise.
Thu 22					
NZ	Q3 Westpac-MM Consumer Confidence	78.7	-	-	The squeeze on household finances is continuing.
	Aug trade balance \$mn	-1092	-	-2400	Trade deficit widening as agri exports decline seasonally.
	RBNZ speech	-	-	-	Deputy Governor Hawkesby on prudential regulation.
Aus	Public holiday	-	-	-	National Day of Mourning for Her Majesty The Queen.
Eur	Sep consumer confidence	-24.9	-24.6	-	Confidence has collapsed to a historical low.
UK	BoE policy decision	1.75%	2.25%	2.50%	We lean towards a 75bps move, but a close call 75-vs-50bps.
US	Initial jobless claims	213k	-	-	Likely to remain at low levels for time being.
	Aug leading index	-0.4%	0.0%	-	Growth outlook clearly deteriorating.
	Sep Kansas City Fed index	3	-	-	Regional surveys mixed; outlook fragile.
Fri 23					
Eur	Sep S&P Global manufacturing PMI	49.6	49.1	-	A broad-based weakening in demand is becoming...
	Sep S&P Global services PMI	49.8	49.2	-	... an increasingly prominent risk for Europe.
UK	Sep S&P Global manufacturing PMI	47.3	-	-	The UK is in a similar position as both mfg...
	Sep S&P Global services PMI	50.9	-	-	... and services have been hit hard by inflation...
	Sep GfK consumer sentiment	-44	-	-	... and growing pessimism among consumers.
US	Sep S&P Global manufacturing PMI	51.5	51.3	-	S&P PMIs point to much weaker conditions than ISMs...
	Sep S&P Global services PMI	44.6	45.0	-	... potentially implying larger effect on small/mid sized firms.
	Fed Chair Powell	-	-	-	To give opening remarks at Fed Listens event.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.1	4.9	4.2	1.9
CPI inflation %yr	1.8	1.8	0.9	3.5	7.6	3.1
Unemployment rate %	5.0	5.2	6.8	4.7	3.1	4.2
Current account % of GDP	-2.1	0.7	2.4	3.2	1.1	-1.0
United States						
Real GDP %yr	2.9	2.3	-3.4	5.7	1.7	0.5
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	4.4
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	-0.2	-4.5	1.6	1.7	1.7
Euro zone						
Real GDP %yr	1.8	1.6	-6.4	5.3	2.9	0.5
United Kingdom						
Real GDP %yr	1.7	1.7	-9.3	7.4	3.4	-0.5
China						
Real GDP %yr	6.8	6.0	2.2	8.1	3.0	7.0
East Asia ex China						
Real GDP %yr	4.5	3.8	-2.3	4.1	4.5	4.5
World						
Real GDP %yr	3.6	2.9	-3.1	6.1	3.0	3.3

Forecasts finalised 14 September 2022

Interest rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Australia								
Cash	2.35	3.10	3.35	3.35	3.35	3.35	3.10	2.85
90 Day BBSW	2.80	3.55	3.55	3.55	3.55	3.38	3.13	2.88
10 Year Bond	3.73	3.70	3.50	3.40	3.20	3.00	2.80	2.65
International								
Fed Funds	2.375	4.125	4.125	4.125	4.125	4.125	3.875	3.375
US 10 Year Bond	3.45	3.40	3.20	3.10	2.90	2.70	2.50	2.40

Exchange rate forecasts	Latest	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
AUD/USD	0.6708	0.69	0.70	0.71	0.73	0.75	0.77	0.78
USD/JPY	143.37	140	138	136	134	132	130	128
EUR/USD	0.9997	1.02	1.04	1.07	1.10	1.12	1.14	1.15
GBP/USD	1.1462	1.17	1.19	1.21	1.23	1.25	1.26	1.27
USD/CNY	7.0128	6.80	6.70	6.50	6.40	6.30	6.20	6.15
AUD/NZD	1.1239	1.11	1.11	1.11	1.11	1.11	1.11	1.11

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