

WESTPAC WEEKLY ECONOMIC COMMENTARY

Checking the housing pulse.

6 June 2023



Southern rātā

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In our recent *Economic Overview* we revised up our assessment of the New Zealand housing market. We now think that house prices have bottomed out, as interest rates near their peaks and the resurgence in migration provides a fresh source of demand. We're forecasting only a modest lift in prices from here on, but we'll watch the data carefully – history shows that it's difficult to predict how far the housing market will go once it starts to gain some momentum.

The last few years have seen perhaps the most dramatic rise and fall in house prices in New Zealand's history. The sharp drop in interest rates in response to the Covid-19 pandemic, on top of the significant rate reductions in 2019, added new fuel to the fire. House prices fell slightly during the lockdown period, but then shot up by 43% over the following year and a half. Rising mortgage rates put paid to this rally by late 2021, and since then prices have fallen by almost 17% from their peaks. That's still only taken them back to where they were at the start of 2021.

There are now some signs of life returning to the market. House sales appear to have bottomed out in December last year, and have since risen by about 20% – though that still puts them at very low levels compared to history. The number of listed properties also appears to have peaked and turned lower in that same time.

The REINZ House Price Index, released a few weeks ago, showed a 0.2% rise in prices in seasonally adjusted terms in April. That was the first monthly rise that we've seen since

November 2021. We wouldn't read too much into that number on its own – it's a tiny increase, and seasonal adjustment is not an exact science. But it's in keeping with the trend of smaller price declines in previous months.

The REINZ index is our preferred measure of house prices, as we think it provides the best trade-off between quality and timeliness. The other major measure is from CoreLogic, whose figures released last week pointed to a 0.7% drop in prices in May. However, the CoreLogic measure tends to lag REINZ for two reasons: it's a rolling three-month average, and sales are recorded at the date of settlement, which puts them about a month behind the REINZ figures (which are recorded on the date that a sale goes unconditional). On a like-for-like basis, the CoreLogic figures were much in line with the REINZ series.

The forces that have been weighing against the housing market over the last couple of years are now starting to turn. Firstly, the end of the Reserve Bank's monetary policy tightening cycle is in sight. Indeed, the RBNZ has signalled that it now expects to keep the cash rate on hold for an extended period, although

we see the risks tilted to at least one more hike this year, and financial markets are pricing in some chance of a further hike. In any case, the fixed-term interest rates that New Zealand borrowers tend to favour are now being priced for the prospect of OCR cuts in 2024 and beyond.

On top of this, the balance of migration has turned from a modest net outflow to a strong net inflow over the last year, as New Zealand has reopened its international border. This reflects a pent-up demand to live and work in New Zealand, and it will eventually run its course. But it's hugely uncertain how strong this flow could become in the meantime. We're forecasting a net inflow of 100,000 people for this year, but it could be substantially either side of that.

Migrant arrivals provide a fresh source of demand on the housing stock. While many of them won't be positioned to buy a house when they arrive, they will still need a roof over their heads. In that case, the pressure is likely to manifest through upward pressure on rents, which in turn will increase what buyers are willing to pay for a house as a rental property.

Our previous forecast was for a further 7% fall in house prices over 2024. In inflation-adjusted terms, this would have meant a complete reversal of the surge in prices that we saw over 2020-21. However, the recent data suggests that the housing market is stabilising earlier than we expected. And with the developing trends in interest rates and migration, we now think it's likely that prices have reached their bottom.

We're only forecasting a modest lift in prices from here – just 0.5% over the second half of this year, and another 2.5% over next year. But we acknowledge that there are substantial upside risks to this view.

Previous upswings in net migration in New Zealand have been associated with a strong rise in house prices. However, the driver of the migration upturn is different this time. People tend to move to opportunity, and New Zealand has typically seen net inflows when our economy is performing relatively well – and often that's been because it was being fuelled by cyclically low interest rates. This time, however, the migration boom reflects a period of catch-up, and interest rates are already at or near their peak for the cycle.

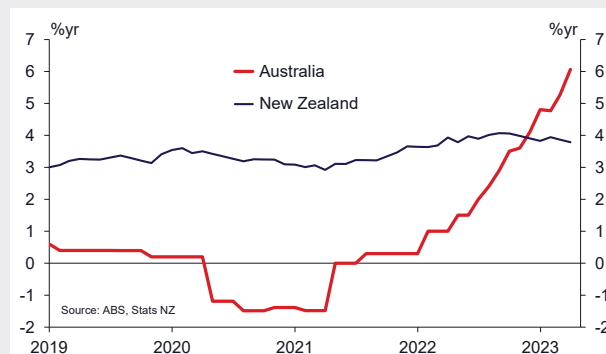
But that doesn't rule out the possibility of a stronger upturn in house prices. We only need to look to Australia for a warning of what may be coming here. Australia is also seeing a sharp surge in net migration (they reopened their border earlier than we did). Rents are now rising sharply, especially in Sydney, and house prices have risen by 3% in the last few months – unwinding about a third of the decline that they saw in 2022.

A resurgent housing market would be a risk to the Reserve Bank's economic forecasts, which assumed a further 3.5% fall in house prices over the next year. Rising house prices are not a direct concern for monetary policy, but they can add to inflation pressures via households' willingness to spend.

Chart of the week

Rental inflation has risen sharply in Australia in recent months, as a resurgence in migration has collided with limited supply. We can't directly compare this with the New Zealand figures, as there are differences in the way that the two countries measure rents for the purposes of the Consumer Price Index (the Australian measure is much more variable over time). However, the Australian performance does highlight one of the risks of what could eventuate here under similar conditions.

CPI rents, annual change

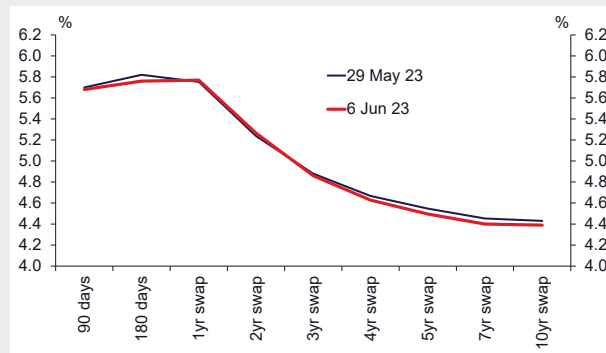


Fixed vs floating for mortgages

The RBNZ has signalled that it expects to hold the cash rate at its current level of 5.50% for an extended period. In contrast, financial markets are pricing in a much earlier start to interest rate cuts, from early next year. We see a risk that the OCR could go higher in the coming months, and that interest rate cuts could be some time away.

As a result, we see value in fixing for terms as long as three years. Rates for terms beyond three years are still relatively expensive, but would provide more certainty around the size of repayments.

NZ interest rates



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The week ahead

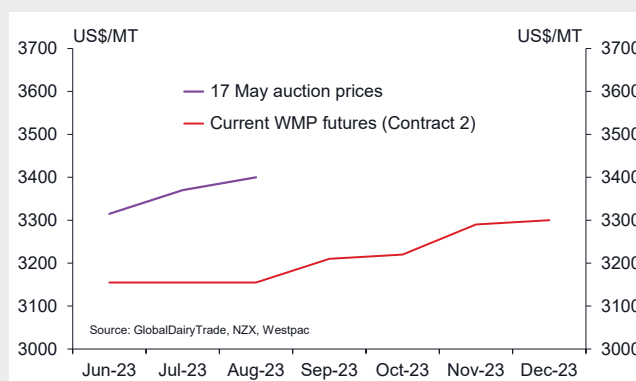
NZ GlobalDairyTrade auction, whole milk powder prices

Jun 7, Last: 0.3%, Westpac f/c: -4.0%

We expect whole milk powder prices (WMP) to fall 4% at the upcoming auction. A fall of this at around this magnitude would reverse much of the recent auction price gains. Our pick is between the 3% fall at last week's mini (GDT pulse) auction and the circa 5% fall that the futures market is pointing to.

In the short term, we expect that very strong New Zealand dairy production over autumn and underwhelming Chinese dairy demand will continue to put downward pressure on prices. In the medium term, we expect that soft underlying global dairy production, and improving Chinese dairy demand will lift dairy prices.

Whole milk powder prices



Aus Q1 current account, \$bn

Jun 6, Last: 14.1, WBC f/c: 7.0
Mkt f/c: 15.0, Range: 7.0 to 15.0

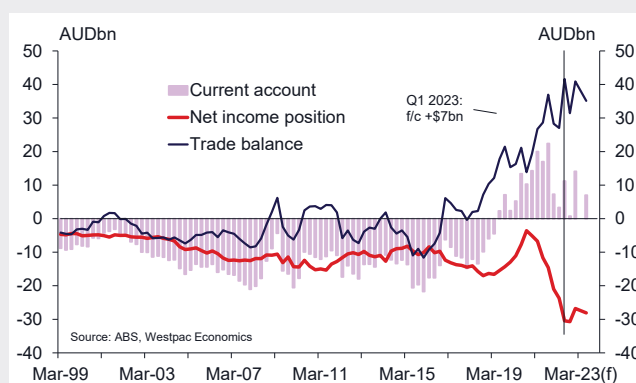
The current account surplus jumped from \$0.75bn to \$14.1bn in the December quarter. That was on a combination of a larger trade surplus and a dip in the net income deficit (NID).

We anticipate a reversal of those dynamics in the March quarter, resulting in a partial unwind of the current account surplus, to a forecast \$7bn.

The trade surplus, on a balance of payments basis, having risen from \$31.5bn for Q3 to \$40.9bn for Q4, is estimated to narrow to around \$35.1bn for Q1. The import bill was broadly flat in the quarter, while export earnings declined on lower prices. Note that these estimates differ from the monthly trade numbers due to seasonal differences and is subject to revisions.

The NID has climbed to be at elevated levels, exceeding \$30bn in Q2 and Q3 in 2022. A dip to \$26.8bn in Q4 was likely temporary, with an expected partial reversal to around \$28.1bn for Q1.

Aus current account



Aus RBA policy decision

Jun 6, Last: 3.85%, WBC f/c: 3.85%
Mkt f/c: 3.85%, Range: 3.85% to 4.10%

At the June Board meeting, Westpac anticipates that the RBA will keep the cash rate on hold at 3.85%.

The Board raised rates 25bps in May after a brief pause in April, citing concerns that more persistent services inflation may delay the already slow return of inflation to the top of the RBA's 2-3% target range.

While the Board may still be uneasy, and will likely consider a further move at the June meeting, we expect it to pause given the uncertain picture from recent inflation and labour force updates and the more general update on the wider economy due with the Q1 National Accounts release on June 7 – the day after the meeting.

That said, the Governor's statement will continue to exhibit a clear tightening bias as risks to inflation dominate.

RBA cash rate and 3 year bonds



The week ahead

Aus Q1 GDP

Jun 7, Last: 0.5%, WBC f/c: 0.2%

Mkt f/c: 0.3%, Range: -0.2% to 0.5%

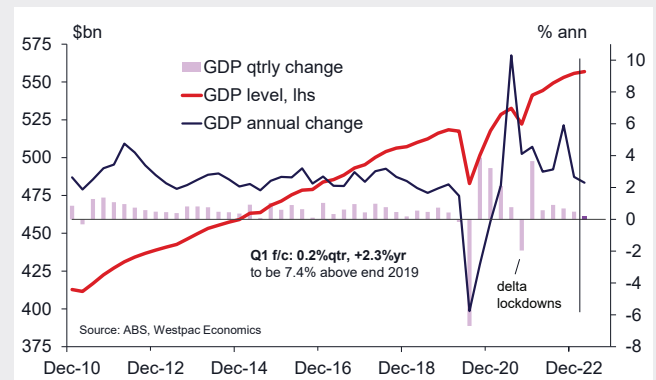
We assess that the Australia's economy slowed appreciably in early 2023, with GDP barely rising 0.2% in Q1 following a weak 0.5% gain in Q4.

The top-line arithmetic is: domestic demand +0.5%, a flat contribution from inventories and -0.3ppts drag from net exports.

Domestically, the detail is expected to show consumer spending stalled flat with the only growth coming from a lift in new business investment and public demand.

The accounts will also provide important updates on household incomes and savings; productivity; labour costs and inflation.

Aus GDP



Aus Apr trade balance, \$bn

Jun 8, Last: 15.3, WBC f/c: 11.8

Mkt f/c: 14.0, Range: 11.8 to 15.5

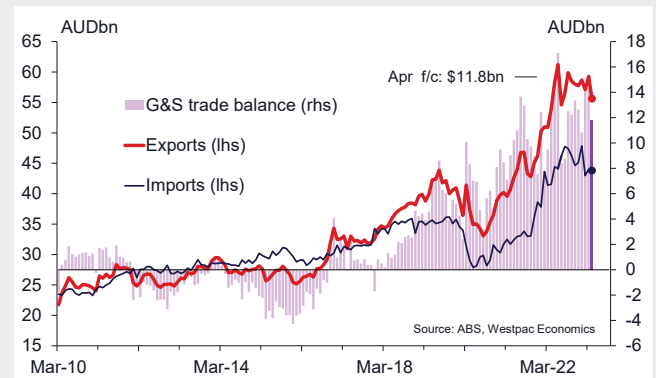
Australia continues to achieve a sizeable trade surplus each month – averaging \$11.7bn during 2022. The 2023 year began on a positive one, with the surplus climbing to be approaching a record high, at \$14.2bn and \$15.3bn for February and March.

For April, a correction from those extreme highs is in prospect, with the surplus forecast to print at \$11.8bn, down by \$3.5bn.

Export earnings are expected to pull-back sharply, declining by 6.2%, -\$3.7bn, on a combination of lower commodity prices (RBA index -4.3% to lowest level since February 2022) and lower volumes (iron ore, cyclone impacts, and coal, maintenance).

On the import bill, we've allowed for a small decline of -0.5%, -\$0.2bn. April was a "holiday month" – more so than usual this year, given the way Easter and school holidays fell. That, and subdued underlying demand, point to the risk of lower volumes in the month.

Aus trade balance

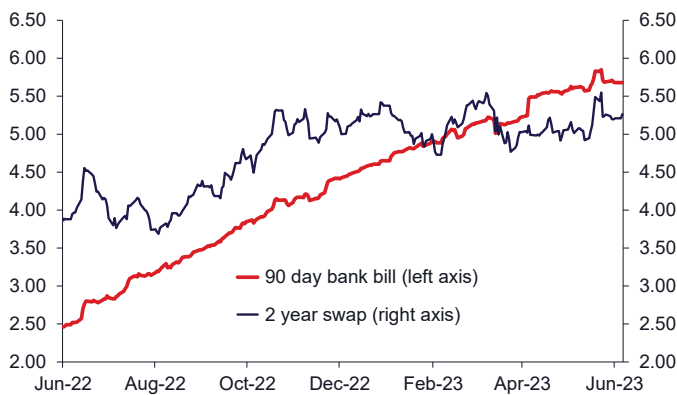


New Zealand forecasts

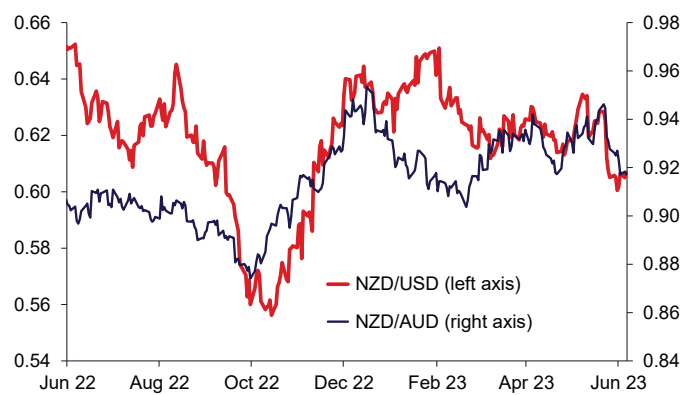
Economic forecasts	Quarterly				Annual			
	2022		2023		2021	2022	2023f	2024f
% change	Sep	Dec	Mar	Jun				
GDP (Production)	1.7	-0.6	-0.2	1.0	6.0	2.4	1.6	0.9
Employment	1.2	0.5	0.8	0.4	3.3	1.6	1.2	-0.4
Unemployment Rate % s.a.	3.3	3.4	3.4	3.5	3.2	3.4	3.9	4.9
CPI	2.2	1.4	1.2	1.0	5.9	7.2	4.6	2.9
Current Account Balance % of GDP	-8.5	-8.9	-8.5	-8.4	-6.0	-8.9	-7.8	-4.8

Financial forecasts	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Cash	5.50	5.75	5.75	5.75	5.75	5.25	4.75
90 Day bill	5.70	5.85	5.85	5.85	5.55	5.05	4.75
2 Year Swap	5.20	5.00	4.80	4.50	4.30	4.10	4.00
5 Year Swap	4.50	4.40	4.30	4.20	4.10	4.00	3.95
10 Year Bond	4.20	4.15	4.10	3.95	3.80	3.75	3.70
NZD/USD	0.64	0.66	0.67	0.68	0.68	0.68	0.68
NZD/AUD	0.93	0.92	0.91	0.90	0.89	0.89	0.88
NZD/JPY	84.5	85.8	85.8	85.7	85.1	84.4	84.3
NZD/EUR	0.58	0.59	0.60	0.60	0.59	0.59	0.59
NZD/GBP	0.51	0.53	0.53	0.54	0.53	0.53	0.53
TWI	71.5	72.5	72.7	72.5	71.7	71.2	71.0

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 6 June 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.25%	5.25%
30 Days	5.60%	5.68%	5.50%
60 Days	5.65%	5.75%	5.56%
90 Days	5.68%	5.83%	5.62%
2 Year Swap	5.27%	5.44%	5.08%
5 Year Swap	4.50%	4.58%	4.30%

NZ foreign currency mid-rates as at 6 June 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6069	0.6285	0.6346
NZD/EUR	0.5666	0.5807	0.5744
NZD/GBP	0.4882	0.5048	0.5011
NZD/JPY	84.72	86.71	85.69
NZD/AUD	0.9172	0.9462	0.9340
TWI	70.26	72.33	72.03

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 05					
NZ	King's Birthday	-	-	-	Markets closed.
Aus	Q1 company profits	10.6%	2.0%	-3.0%	Lower on mining profits. Domestic conditions subdued.
	Q1 inventories	-0.2%	0.3%	0.3%	Q3 +2.1%, Q4, -0.2%. Q1 f/c a tepid 0.3% rise, adds 0.2ppts.
	May MI inflation gauge %yr	6.1%	-	-	Provides a general view of risks.
	May ANZ job ads	-0.3%	-	-	Easing from a very high level; labour demand still robust.
Chn	May Caixin services PMI	56.4	55.2	-	Smooth-sailing post reopening a hard ask.
Eur	Jun Sentix investor confidence	-13.1	-	-	Flattening at weak level given uncertainty over outlook.
US	May ISM non-manufacturing	51.9	52.5	-	Services not yet contracting but under growing pressure.
	Apr factory orders	0.4%	0.8%	-	Underlying weakening, as evinced by core orders...
	Apr durable goods orders	1.1%	-0.2%	-	... highlighting downside to near-term capex outlook.
Global	May S&P Global services PMI	-	-	-	Final estimate due for Japan, Eurozone, UK and US.
Tue 06					
NZ	May ANZ commodity prices	-1.7%	-	-	Dairy and meat prices rose over the month.
Aus	Q1 current account balance, \$bn	14.1	15.0	7.0	Partial reversal of Q4 jump (both trade & NID).
	Q1 net exports, ppts cont'n	+1.1	-0.5	-0.3	M's solid rebound, X's modest gain. Considerable uncertainty.
	Q1 public demand	0.2%	-	0.8%	Up on investment (public construction works rose 4.9%).
	RBA policy decision	3.85%	3.85%	3.85%	Expected to pause but case for hike likely to be discussed.
Eur	Apr retail sales	-1.2%	-	-	Discretionary spending capacity under lasting stress.
Wed 07					
NZ	GlobalDairyTrade auction (WMP)	0.3%	-	-4.0%	Down on strong NZ autumn supply and soft Chinese demand.
Aus	RBA Governor Lowe	-	-	-	Speaking.
	RBA Deputy Governor Bullock	-	-	-	Panel discussion.
	Q1 GDP	0.5%	0.3%	0.2%	Growth slowed to a crawl in early 2023.
Chn	May foreign reserves US\$bn	3204.8	-	-	Little pressure on reserves.
	May trade balance US\$bn	90.2	94.2	-	Intra-regional trade supportive to longer-term outlook.
US	Apr trade balance \$bn	-64.2	-75.4	-	Deficit to gradually narrow as consumer demand softens
	Apr consumer credit \$bn	26.5	21.2	-	Consumer demand to remain under pressure.
Thu 08					
Aus	Apr trade balance \$bn	15.3	14.0	11.8	Exports sharply lower, on both prices & volumes.
Eur	Q1 GDP, final	0.1%	-	-	To provide detailed cross-country comparison.
US	Initial jobless claims	232k	-	-	Job shedding negligible as firms hold onto staff.
	Apr wholesale inventories	-0.2%	-0.2%	-	Final estimate.
Fri 09					
Chn	May CPI %yr	0.1%	0.2%	-	Inflation to remain a benign force...
	May PPI %yr	-3.6%	-4.3%	-	... for both consumers and producers.
	May M2 money supply %yr	12.4%	12.0%	-	Credit is freely available...
	May new loans, CNYbn	718.8	1664.0	-	... as authorities support growth - tentative date.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022f	2023f	2024f
Australia						
Real GDP %yr	1.9	-1.8	5.2	3.7	1.6	1.0
CPI inflation %yr	1.8	0.9	3.5	7.8	4.0	3.1
Unemployment rate %	5.2	6.8	4.7	3.5	4.5	5.0
Current account % of GDP	0.7	2.4	3.1	1.2	1.2	0.3
United States						
Real GDP %yr	2.3	-2.8	5.9	2.1	1.1	0.6
CPI inflation %yr	1.9	1.2	7.2	6.4	2.5	2.0
Unemployment rate %	3.7	8.1	5.4	3.7	4.8	5.5
Current account % of GDP	-2.6	-2.5	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	-0.4	-4.3	2.1	1.0	1.2	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.4
United Kingdom						
Real GDP %yr	1.6	-11.0	7.6	4.3	-0.2	1.2
China						
Real GDP %yr	6.0	2.2	8.4	3.0	6.2	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.3	4.5	4.1	4.4
World						
Real GDP %yr	2.8	-2.8	6.3	3.3	3.0	3.1

Forecasts finalised 5 May 2023

Interest rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia							
Cash	3.85	3.85	3.85	3.60	3.35	3.10	2.85
90 Day BBSW	4.02	3.95	3.97	3.72	3.47	3.22	2.97
10 Year Bond	3.64	3.30	3.20	3.00	2.80	2.70	2.50
International							
Fed Funds	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.61	3.40	3.30	3.10	2.90	2.80	2.60

Exchange rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6607	0.72	0.74	0.75	0.76	0.76	0.77
USD/JPY	138.91	130	128	127	126	125	124
EUR/USD	1.0765	1.11	1.12	1.13	1.14	1.15	1.16
GBP/USD	1.2529	1.25	1.26	1.26	1.27	1.28	1.29
USD/CNY	7.0786	6.60	6.50	6.40	6.30	6.20	6.10
AUD/NZD	1.0850	1.09	1.10	1.11	1.13	1.13	1.13

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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