

WESTPAC WEEKLY ECONOMIC COMMENTARY

Rate hike delayed not cancelled.

7 August 2023



Southern rātā

Westpac Economics Team

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We continue to see the RBNZ raising the cash rate to 5.75%, but now expect that to occur in November instead of August. While recent data have highlighted the lingering strength in domestic inflation pressures, at this stage we doubt this will be enough to overcome the RBNZ's strong bias to keep the OCR at 5.50%. Nevertheless, we think resilience in economic conditions and sticky inflation will eventually force the RBNZ to act.

Since May 2023, we have had the view that the RBNZ would need to tighten policy further to ensure a timely fall of inflation to within the 1-3% target range. This view was predicated on a sense that current very high rates of inflation would be slow to recede and that risks to the longer-term outlook were tilted towards a very protracted easing in inflation pressures. Strong net migration was seen as supporting both the housing market and the economy right at the time the RBNZ would have hoped that growth would be quickly slowing and providing much needed disinflationary impetus.

In large part, the accumulated evidence has supported our view. While GDP in the March quarter was somewhat weaker than expected, we can see tangible signs that strong migration is supporting the economy. The housing market has exhibited strength compared to the relatively dire predictions of commentators earlier this year. Business and consumer confidence have bottomed out and are staging a tentative recovery, which is unusual if the end of the tightening cycle has been reached. The labour market has been a particular area of strength. Employment growth has remained strong in defiance of concerns of a recessionary economy. Large numbers of

migrants have found jobs in a labour market that, while better balanced than a year ago, remains tight. The strong labour market has meant that household incomes have continue to grow strongly, leaning against the considerable disinflationary impact of the RBNZ's 525 bps of interest rate increases delivered in recent years.

The June quarter CPI also provided a timely reminder of the upside risks to the inflation outlook. While annual headline inflation fell to 6% in line with projections, inflation remains far north of the 1-3% target range. And digging under the surface, the details of the latest inflation report raised a number of red flags for the central bank. The most important of those was the continued strength in domestic inflation (aka non-tradable prices). The RBNZ pays particular attention to non-tradables inflation given its close connection to the strength of domestic economic conditions, and they had expected it to fall from 6.8% in the year to March to 6.3% now. But instead, non-tradables inflation has actually held at higher levels than the RBNZ expected, nudging down only slightly to a still strong level of 6.6% in the year to June. That's despite the sharp rise in interest rates.

Looking more closely at those domestic inflation pressures, there has been particular strength in the prices of services, which are up an average of 6.1% over the past year. That's consistent with the ongoing tightness in the labour market and related strength in wage growth (private sector wages were up 4.3% in the year to June). We expect those conditions will see domestic inflation remaining elevated well into the new year.

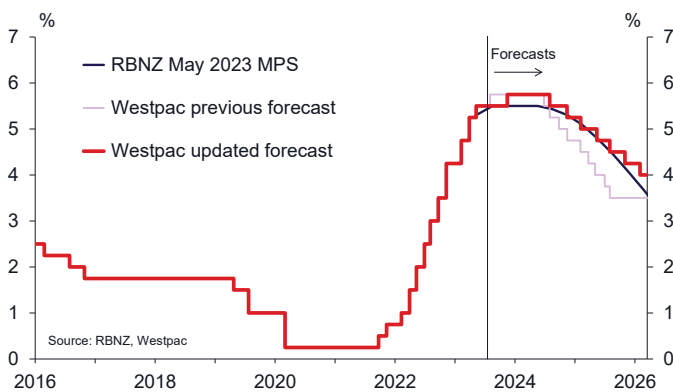
However, while we are seeing strong and potentially concerning data, that probably won't be sufficient to budge the RBNZ's Monetary Policy Committee in August. The RBNZ has previously signalled its very strong bias to keep the OCR steady at 5.5% until the second half of next year, and that's a high hurdle to clear. So on this one we must play the man (the MPC) as opposed to the ball.

We retain confidence that recent trends will continue: the economy will likely continue to be supported by ongoing strong migration, the housing market will continue to strengthen, and inflation will only ease gradually at current interest rates. In addition, we continue to doubt the economy will experience an outright recession in the second half of 2023 as forecast by the RBNZ (although risks from the concerning situation in China and weaker agricultural commodity prices warrant keeping a close eye on that element of the forecast).

Against this backdrop, underlying inflation pressures will likely prove stickier than the RBNZ is expecting. While headline inflation is set to continue easing as earlier supply disruptions drop out of the annual calculations, we don't expect a return within the target band until late next year. And a return to the 2% target mid-point will likely take significantly longer.

Given those conditions, the interest rate reductions we had previously expected to occur in the second half of 2024 will likely now occur more slowly, consistent with the RBNZ only easing cautiously as inflation gradually eases. We suspect many other central banks will be taking a similarly cautious approach.

Official Cash Rate forecasts



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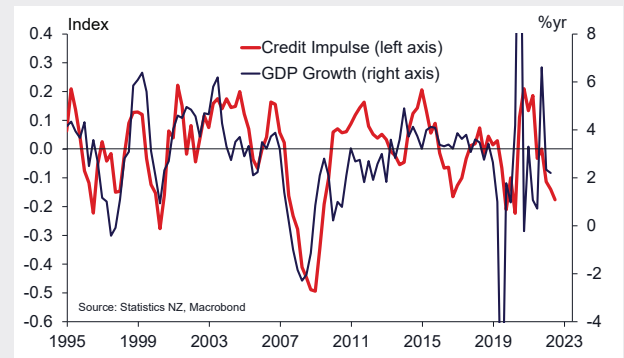
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Chart of the week

Credit plays a key role in greasing the wheels of commerce. Therefore, unsurprisingly, developments in credit growth can be a useful indicator of economic activity. In particular, the change in the rate of credit growth – measured relative to nominal GDP – provides a reasonable indicator of both the economic cycle and where real GDP growth is tracking relative to its underlying trend.

With recent data indicating a slowdown in credit growth, this indicator – often referred to as the 'credit impulse' – is pointing to a slowing economy, but one that is not in recession. This fits well with other economic indicators that we monitor and with our assessment of the outlook for the economy over the next year.

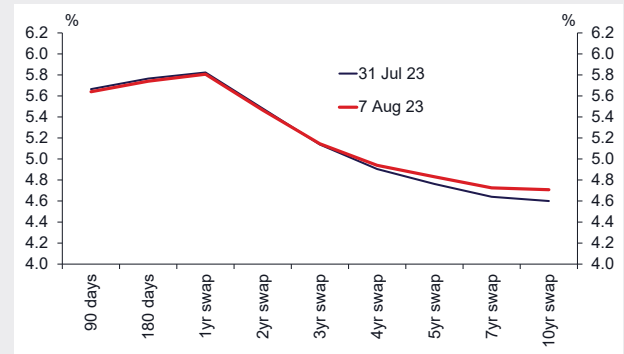
Credit Impulse and GDP



Fixed vs floating for mortgages

We think the current best value for borrowers is fixing for one year and rolling for this term. That 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



The week ahead

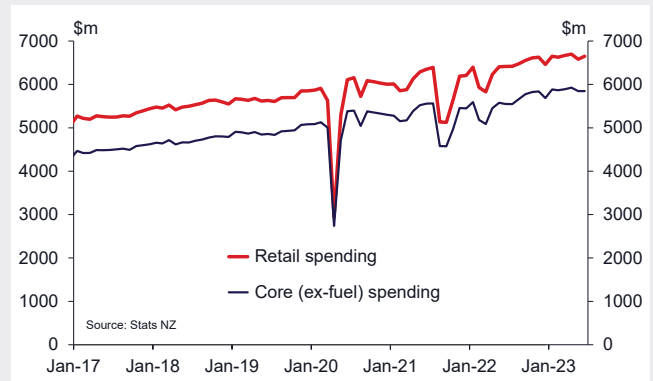
NZ Jul retail card spending

Aug 9, Last: +1.0%, Westpac f/c: +0.7%

Retail sales rose by 1% in June, underpinned by a 2.4% rise in fuel spending as households rushed to fill their tanks ahead of July's lift in fuel taxes. In contrast, spending in core (ex-fuel) categories was subdued. While that may just be a timing effect, with increased spending on fuel diverting spending away from other areas, households' budgets are also being squeezed by increases in both prices and interest rates.

We're forecasting a 0.7% rise in retail spending in July. We expect that to be underpinned by a lift in hospitality spending, including a boost related to the FIFA Women's World Cup matches. However, spending in other areas is expected to be more subdued as a result of the continuing pressures on households' finances.

NZ monthly retail card spending



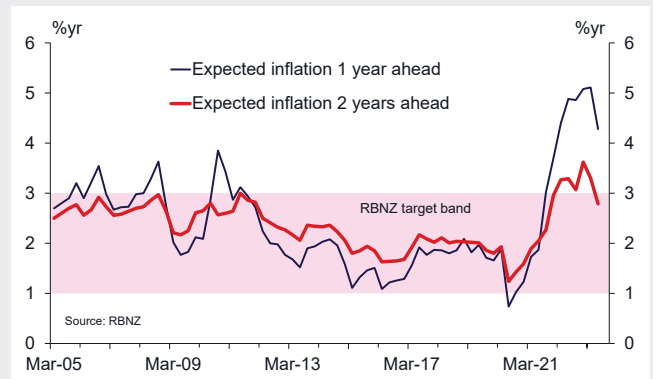
NZ Q3 RBNZ survey of expectations

Aug 9, Expected inflation 2 years ahead, last: +2.79%

The RBNZ's June survey showed that expectations for inflation over the next few years have been dropping back as actual inflation has continued to ease. Notably, expectations for inflation at the closely watched two-year ahead horizon have fallen below 3% for the first time since 2021.

Inflation has continued to ease since the time of the RBNZ's June survey, with headline inflation dropping from 6.7% at the start of the year to 6.0% now. Against this backdrop, expectations are set to fall again in the September quarter survey. However, with 'stickiness' in domestic inflation, any easing in expectations is likely to be gradual.

RBNZ survey of expectations



NZ Jul REINZ house sales and prices

Aug 11 (TBC), Sales, Last: +2.2% m/m, 14.6% y/y

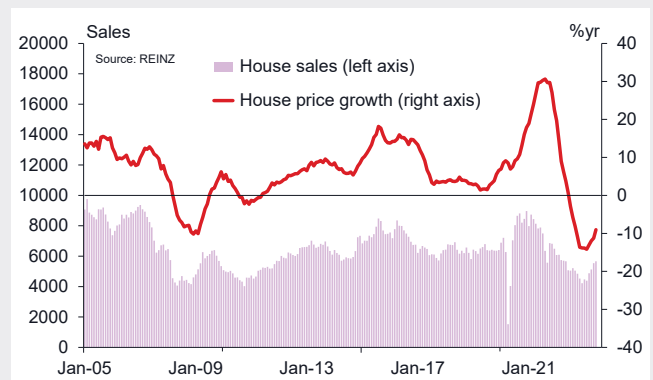
Aug 11 (TBC), Prices, Last: +1.2% m/m, -9.0% y/y

This year, the New Zealand housing market has shown signs of recovery, likely supported by rapid migrant-driven population growth and a growing sense amongst buyers that interest rates are close to or at their peak.

House sales, while still well below average, are up about a third from last year's low-point. Prices have also moved higher in recent months, though they are still 15% below the peak.

Migrant inflows have slowed a little in recent months and mortgage rates have edged higher as funding costs have risen. Should the housing recovery gather pace regardless, this will doubtless raise eyebrows at the RBNZ.

REINZ house prices and sales



The week ahead

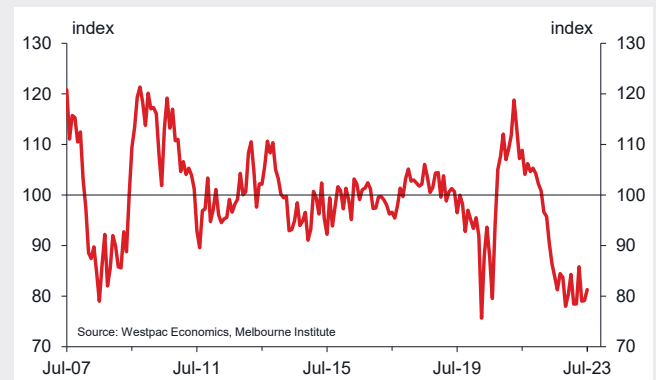
Aus Aug Westpac-MI Consumer Sentiment

Aug 8, Last: 81.3

Consumer sentiment rose 2.7% in July but remained at deeply pessimistic levels overall at 81.3, in the weak range that has prevailed for just over a year now. That modest lift reflected the RBA's decision to hold rates steady at its July meeting, but the improvement in sentiment was limited by widespread expectations of further hikes to come, ongoing cost of living pressures on family finances, and concerns about the economic outlook.

The 'relief rally' in sentiment is likely to get a little more traction in August, following the RBA's decision to leave rates on hold for a second consecutive month, retaining a clear tightening bias but with indications that the 'hurdle' for further rate rises is now higher. That partly reflects a slightly faster improvement in headline inflation which may also allay concerns about sharp rises in the cost of living.

Aus Consumer Sentiment Index



US Jul CPI

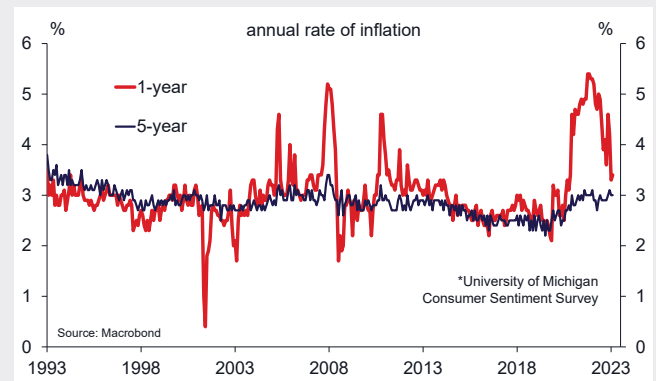
Aug 10, Headline %/mth, Last: 0.2%, Mkt f/c: 0.2%, WBC f/c: 0.2%

The June CPI report was pivotal for the current cycle as a modest 0.2% monthly print brought annual headline inflation down to 3.0%/yr, a third of its peak level. A similar outcome is expected by Westpac and the market in July, though the annual rate will lift slightly owing to an adverse base effect.

The composition of US inflation remains problematic, however. Goods inflation is benign and services ex. shelter increasingly constructive for a return to target well before the medium term. But, because of its weight and scale, by itself shelter inflation has the capacity to hold inflation above the 2.0%/yr target for the foreseeable future.

It is also worth recognising that, while shelter inflation should abate to year end and through early-2024, capacity in the sector will remain a concern for years, and with it shelter inflation.

US CPI

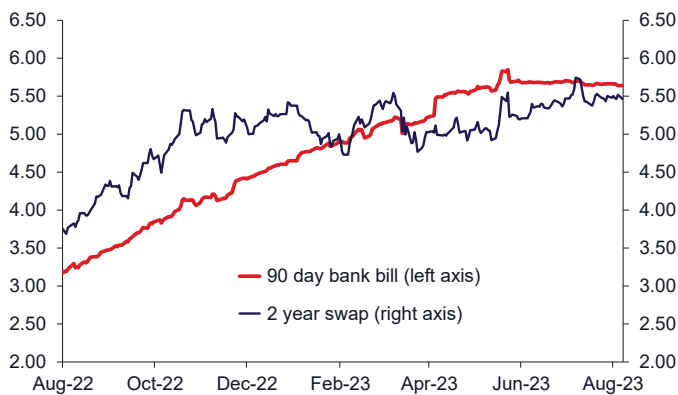


New Zealand forecasts

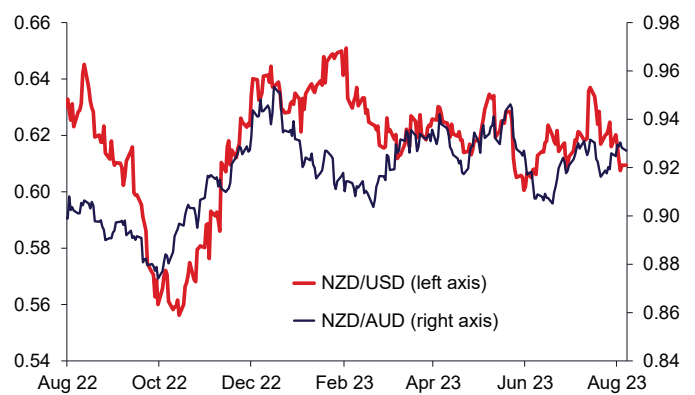
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.8	0.1	6.0	2.7	1.1	0.4
Employment	0.7	1.1	1.0	0.3	3.3	1.7	2.4	0.1
Unemployment Rate % s.a.	3.4	3.4	3.6	3.8	3.2	3.4	4.3	5.2
CPI	1.4	1.2	1.1	2.0	5.9	7.2	4.9	2.9
Current Account Balance % of GDP	-8.7	-8.2	-8.0	-8.2	-5.7	-8.7	-7.7	-5.9

Financial forecasts	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Cash	5.50	5.75	5.75	5.75	5.50	5.25	5.00
90 Day bill	5.70	5.85	5.85	5.85	5.60	5.35	5.10
2 Year Swap	5.64	5.49	5.29	5.06	4.81	4.58	4.37
5 Year Swap	4.84	4.74	4.62	4.51	4.41	4.31	4.23
10 Year Bond	4.50	4.45	4.30	4.15	4.05	3.95	3.85
NZD/USD	0.62	0.63	0.63	0.64	0.65	0.66	0.66
NZD/AUD	0.93	0.93	0.92	0.91	0.90	0.89	0.88
NZD/JPY	87.4	86.9	85.6	85.0	85.0	84.5	83.3
NZD/EUR	0.56	0.56	0.57	0.57	0.57	0.57	0.57
NZD/GBP	0.49	0.49	0.49	0.50	0.50	0.51	0.51
TWI	71.5	71.5	70.9	71.0	71.1	71.0	70.4

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 7 August 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.61%	5.61%	5.62%
60 Days	5.63%	5.63%	5.66%
90 Days	5.64%	5.66%	5.70%
2 Year Swap	5.47%	5.48%	5.72%
5 Year Swap	4.83%	4.73%	5.06%

NZ foreign currency mid-rates as at 7 August 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6094	0.6200	0.6183
NZD/EUR	0.5528	0.5589	0.5642
NZD/GBP	0.4775	0.4831	0.4835
NZD/JPY	86.33	87.50	88.08
NZD/AUD	0.9270	0.9188	0.9310
TWI	70.64	71.37	71.85

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 07					
Aus	Bank holiday, NSW	-	-	-	Financial markets open.
	Jul ANZ job ads	-2.5%	-	-	Declining from an elevated level.
Chn	Jul foreign reserves US\$bn	3193.0	3201.5	-	Little pressure on reserves.
Eur	Aug Sentix investor confidence	-22.5	-25.0	-	Cloudy economic outlook weighing on confidence.
US	Jun consumer credit \$bn	7.2	13.5	-	Consumer credit remains strong despite rate hikes.
	Fedspeak	-	-	-	Bostic and Bowman.
Tue 08					
Aus	Aug WBC-MI Consumer Sentiment	81.3	-	-	A more convincing 'relief rally' after RBA's latest pause?
	Jul NAB business survey	9	-	-	Conditions well down from highs. Confidence soft, fragile.
	RBA Acting Head of Domestic Mkts	-	-	-	Schwartz, speaking at Risk Australia Conference.
Jpn	Jun household spending %yr	-4.0%	-3.8%	-	High inflation weighing on discretionary spending.
	Jun current account balance ¥bn	1862.4	-1414.5	-	Strong investment earnings maintaining the surplus.
Chn	Jul trade balance US\$bn	70.6	67.8	-	Demand from Asia supporting trade surplus.
US	Jul NFIB small business optimism	91.0	90.5	-	Small businesses continue to be upbeat given circumstances.
	Jun trade balance \$bn	-69.0	-65.0	-	Deficit to narrow as US growth slows.
	Jun wholesale inventories	-0.3%	-0.3%	-	Final estimate.
	Fedspeak	-	-	-	Harker.
Wed 09					
NZ	Jul retail card spending	1.0%	-	0.7%	Lift in hospitality spending offsetting softness elsewhere.
	Q3 RBNZ infl. expectations, 2yrs ahead	2.79%	-	-	Set to ease now that headline inflation is well past its peak.
Chn	Jul CPI %yr	0.0%	-0.5%	-	Fixed prices and excess capacity to keep inflation low.
	Jul PPI %yr	-5.4%	-4.0%	-	Softening commodity prices drive declines.
	Jul new loans, CNYbn	3050	760	-	Impact of stimulus measures to materialise in time...
	Jul M2 money supply %yr	11.3%	11.1%	-	... providing support to domestic demand.
Thu 10					
NZ	Jul REINZ house sales %yr	14.6%	-	-	The stabilisation of the housing market is set to continue...
	Jul REINZ house prices %yr	-9.0%	-	-	... with sales turning higher and prices flattening out.
Aus	Aug MI inflation expectations	5.2%	-	-	Provides a general view of risks.
US	Jul CPI	0.2%	0.2%	0.2%	Shelter the focus with goods inflation benign.
	Initial jobless claims	227k	-	-	Likely to remain at historic lows.
	Jul monthly budget statement	-227.8	-	-	Stronger revenues to reduce budget deficit, slightly.
	Fedspeak	-	-	-	Bostic.
Fri 11					
NZ	Jul manufacturing PMI	47.5	-	-	Conditions continue to soften, production and orders weak.
	Jul food price index	1.6%	-	1.6%	Seasonal rise in the price of fresh vegetables.
UK	Q2 GDP	0.1%	0.0%	-	To show resilience in the economy, all things considered.
	Jun trade balance £bn	-6.6	-	-	Weak export demand set to sustain the deficit.
US	Jul PPI	0.1%	0.2%	-	High base from 2022 to keep producer prices weak.
	Aug Uni. of Michigan sentiment	71.6	71.0	-	FOMC's pause to aid in sentiment's recovery.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	2023f	2024f
Australia						
Real GDP %oyr	1.9	-1.8	5.2	3.7	1.6	1.0
CPI inflation %oyr	1.8	0.9	3.5	7.8	3.9	3.2
Unemployment rate %	5.2	6.8	4.7	3.5	3.8	4.7
Current account % of GDP	0.7	2.4	3.1	1.2	1.0	0.3
United States						
Real GDP %oyr	2.3	-2.8	5.9	2.1	1.8	0.4
CPI inflation %oyr	1.9	1.2	7.2	6.4	2.5	2.0
Unemployment rate %	3.7	8.1	5.4	3.6	3.6	4.5
Current account % of GDP	-2.6	-2.5	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %oyr	-0.4	-4.3	2.1	1.1	1.4	1.0
Euro zone						
Real GDP %oyr	1.6	-6.1	5.4	3.5	0.6	1.2
United Kingdom						
Real GDP %oyr	1.6	-11.0	7.6	4.0	0.3	0.5
China						
Real GDP %oyr	6.0	2.2	8.4	3.0	5.2	5.5
East Asia ex China						
Real GDP %oyr	3.8	-2.3	4.3	4.5	3.7	4.3
World						
Real GDP %oyr	2.8	-2.8	6.3	3.4	3.0	3.0

Forecasts finalised 7 August 2023

Interest rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Australia							
Cash	4.10	4.10	4.10	4.10	4.10	3.85	3.60
90 Day BBSW	4.18	4.30	4.30	4.30	4.22	3.97	3.72
10 Year Bond	4.17	3.75	3.55	3.45	3.30	3.25	3.20
International							
Fed Funds	5.375	5.375	5.375	5.125	4.625	4.125	3.625
US 10 Year Bond	4.18	3.80	3.60	3.40	3.20	3.10	3.00

Exchange rate forecasts	Latest	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
AUD/USD	0.6558	0.67	0.68	0.69	0.71	0.73	0.74
USD/JPY	142.63	140	138	135	132	130	128
EUR/USD	1.0952	1.11	1.12	1.12	1.13	1.14	1.15
GBP/USD	1.2715	1.28	1.28	1.29	1.29	1.30	1.30
USD/CNY	7.1695	7.10	7.00	6.80	6.70	6.60	6.50
AUD/NZD	1.0787	1.07	1.08	1.09	1.10	1.12	1.12

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