WESTPAC WEEKLY ECONOMIC COMMENTARY

Can Goldilocks hold the bears at bay?

4 September 2023

Southern rātā

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The New Zealand economy is flirting with recession. Notably, in its most recent policy update, the RBNZ signaled that a recession is necessary to bring inflation to heel. However, there are questions about whether the economy could both avoid recession and tame inflation. So, is that Goldilocks scenario possible?

Last week's key data certainly raised the possibility of a soft landing for the economy. Business sentiment as measured by the ANZ Business Outlook improved over August. Importantly, an increasing number of businesses now expect that their own trading activity will improve over the coming months. While still low, the +11.2 reading for this measure implies annual GDP growth of circa 1.0% - comfortably above recessionary levels.

Notably, while expectations for activity have firmed, the other key takeout from the survey was the ongoing fall in inflation pressures. Businesses slightly reduced their expectations for annual inflation to 5.06% over the coming year – late last year businesses were expecting inflation to hit as high as 6.4%. Similarly, the net percentage of businesses planning to increase their prices fell over 4 points to 44% in August – down from a peak of over 80% in March last year.

A Goldilocks scenario could play out if inward migration continues to add to the supply of labour and help moderate wage pressures – as long as aggregate demand is not excessively supported.

We continue to see ongoing strength in hiring. The monthly employment indicator – a tax-based measure of filled jobs – increased 0.3% in July. However, the unemployment rate is still likely to rise as the number of people in work is rising more slowly than growth in the labour force. A rising unemployment rate should be consistent with less pressure on wages and inflation. Optimists conclude that the current combination of labour market conditions could make the Goldilocks scenario possible.

While the pace of growth has moderated from that seen during the first half of the year, employment is still growing, suggesting ongoing economic growth. The issue will be whether this is sufficient to achieve the required fall in inflation at a fast enough pace. Most pricing indicators remain far north of levels consistent with the inflation target.

That said, the bears also argue that a recession might be on the way. Looking at business sentiment, the agriculture sector clearly bucked the overall positive trend. Indeed, agriculture sector confidence in the August survey plummeted to -62.1% compared to the improved overall reading of -4%.

The fall in agriculture sector confidence is no surprise. The outlook for most of the sector has deteriorated significantly over past months as the Chinese economy and, importantly for New Zealand, the Chinese household sector remains weak. The dairy sector has been particularly hard hit. Whole milk powder prices plunged by over 18% over August alone, adding to the already weak trend in prices. These falls have culminated in cuts to 2023/24 milk price forecasts, with both our forecast and the midpoint of Fonterra's range lowered to $6.75/kg. The pressures on farm businesses are not confined to the dairy sector. Sheep and beef farms are also facing low farmgate prices, particularly for sheep meat. For the horticulture sector, the dynamic is slightly different in that weather, including Cyclone Gabriel, have hit yields hard. But the impact on profits is ultimately the same as other sectors. Lastly, the forestry sector is also battling low prices on the back of very weak demand from the Chinese construction sector.

Significantly, this milk price is likely to translate to most dairy farmers making a loss this season. Indeed, DairyNZ puts the breakeven milk price at $7.50/kg, even allowing for some cost-cutting by farmers. The flow on from these cuts – and farmers' lower incomes' – will be keenly felt in agricultural supply businesses as well as retail businesses in the regions. Indeed, we anticipate many of these regional economies are likely to dip into recession over coming quarters.

The other sector clearly losing steam is construction, although this has been largely anticipated. Building consents fell by 5% in July, and consents are now down by 15% from the peak last year. All up, we expect that residential building activity will fall by around 10% over the coming year.

Finally, it's likely that some of the impact of interest rate hikes still lies ahead of us. Around 50% of fixed-rate mortgages will come up for repricing over the coming year and could add to the slowdown in household spending that we've been seeing in recent months.

All up, the Goldilocks scenario is possible. However, conditions are set to be very mixed across the economy, and there remains risks of a recession over the coming year alongside ongoing resilience in the labour market, demand, and persistent inflation pressure. But if the impact of the agricultural downturn is yet to come, then that may be what tips things the bears' way. We noted in our Economic Overview that the range of future outcomes for the economy was broadening – last week's data only confirms that view.

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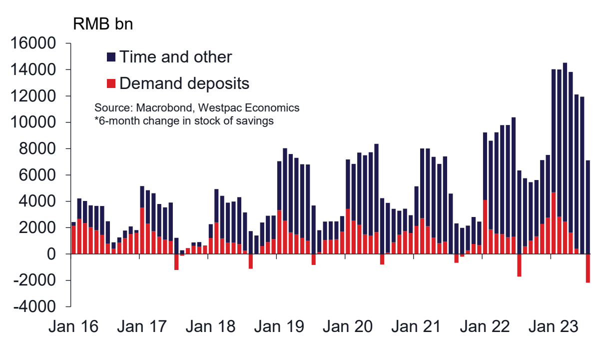
Chart of the week

Chinese households are suffering a crisis of confidence. Concerns about the labour market and property sector are weighing on spending levels and, as shown in the chart below, there's been a related rise in precautionary savings.

Here in New Zealand, that weakness in Chinese demand has been weighing on the prices of some of our key exports. Most notably, recent months have seen prices for dairy products falling sharply, prompting us to revise down our forecast milk price payout for the 2023/24 season. We expect to see further softness in dairy prices in this week's GlobalDairyTrade auction.

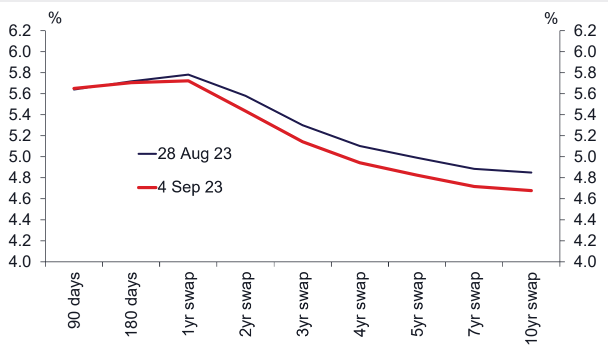
Chinese households increasing precautionary saving



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

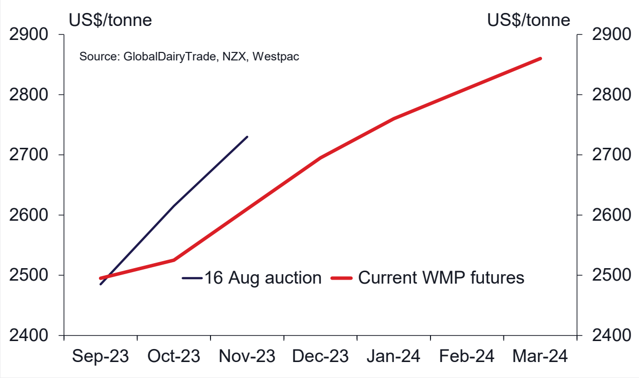
NZ GlobalDairyTrade auction, whole milk powder prices

Sep 6, Last: -10.9%, Westpac f/c: -1.0%

We expect whole milk powder prices (WMP) to fall 1% at the upcoming auction. Note WMP prices slumped by 18% over August and are down by a quarter over the past year. Our pick is roughly in line with the circa 1% fall at last week's mini (GDT pulse) auction and a similar fall that the futures market is pointing to.

In the short term, we expect that underwhelming Chinese dairy demand and recent production strength in New Zealand and China will continue to put downward pressure on prices. At this juncture, we expect that improving Chinese dairy demand will lift dairy prices in late 2023 or early 2024. However, the current risks are that any price recovery comes later rather than sooner.

Whole milk powder prices



NZ Q2 building work put in place

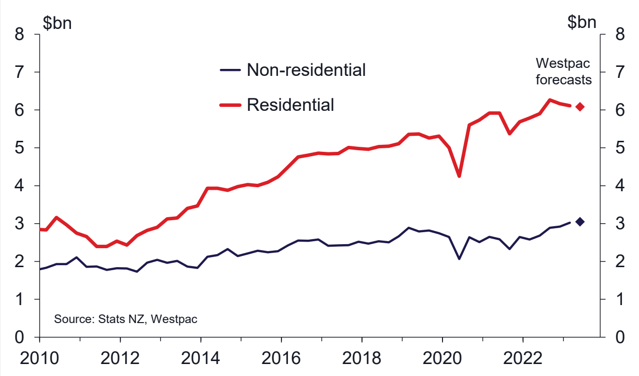
Sep 6, Last: +0.6%, Westpac f/c: -0.1%

The March quarter saw a modest gain in building activity as a rise in non-residential construction offset a drop in residential work.

We're forecasting a small 0.1% fall in construction activity in the June quarter as residential building activity continues to ease. We expect non-residential activity will rise, but only modestly.

While still elevated, we are now past the peak in the construction cycle. Tougher financial conditions are weighing on residential activity, and we expect a gradual easing from the current elevated levels as the existing backlog of projects is completed. Commercial construction is firmer but will be challenged by the broader downturn in economic conditions.

NZ real building work put in place



Aus Q2 company profits

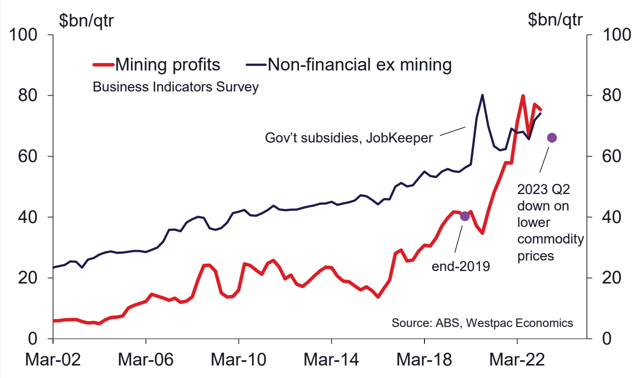
Sep 4, Last: 0.5%, WBC f/c: -5.4%
Mkt f/c: flat, Range: -5.4% to 3.0%tr

The Business Indicators (BI) accounting measure of company profits printed 0.5%qtr, 7.1%yr for the March quarter, while the National Accounts reported a rise of 4.0%qtr.

The BI March quarter detail included mining profits -2.2% (associated with lower commodity prices) and non-financial profits ex mining +3.1%, while the Inventory Valuation Adjustment was a negative. Profits across the broader economy are mixed, squeezed in areas like construction, manufacturing and retail, but recovering in hospitality and professional services, while up in transport, postal & warehousing and in wholesale.

For the June quarter, company profits likely declined, down a forecast -5.4%. Mining profits are dented by a sharp pull-back in commodity prices, -11.4%, and a likely fall in the value of inventories. Non-mining profits are expected to post a rise, but with a very mixed industry picture.

Aus company profits



The week ahead

Aus Q2 non-farm inventories

Sep 4, Last: 1.2%, WBC f/c: 0.3%, (-0.3ppts cont'n)
Mkt f/c: 0.4%, Range: -1.0% to 1.3%

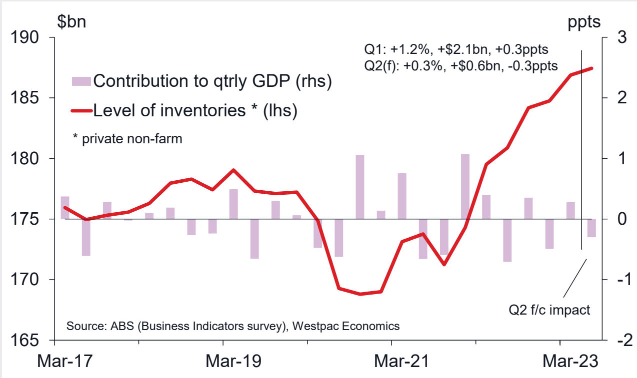
Non-farm business inventories posted a sizeable 1.2% increase for the March quarter, adding 0.3ppts to growth.

The March outcome represented surprising (and likely temporary) strength. Inventories rose by $2.1bn, entirely due to a build-up at the wholesale level, +$2.0bn. The ABS noted that this was around cars (a spike in auto imports, on an easing of supply chain delays, but domestic sales failed to fully respond in the period).

For the June quarter, we anticipate inventories will post only a tepid rise, of 0.3%, thereby subtracting 0.3ppts from activity.

That March quarter spike in wholesale inventories will likely deflate. Across the broader economy while domestic demand is expanding, the pace is modest and uneven.

Aus inventories



Aus Q2 current account, $bn

Sep 5, Last: 12.3, WBC f/c: 4.0
Mkt f/c: 8.0, Range: -3.3 to 12.5

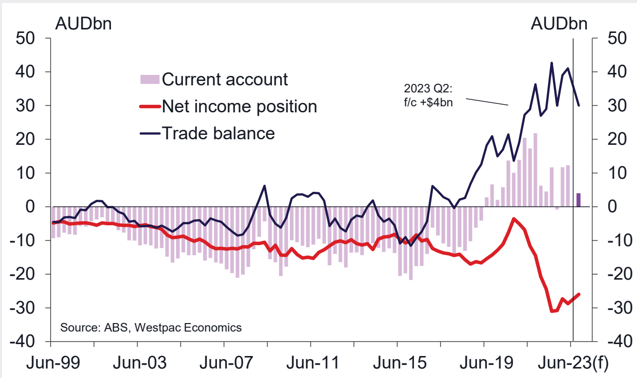
The current account surplus was broadly unchanged in the March quarter, printing $12.3bn after an outcome of $11.7bn.

For the June quarter, we anticipate a narrowing of the current account surplus to a forecast $4bn. This will be the 16th surplus in the past 17 quarters – over which time the current account balance has averaged +$9.7bn per quarter.

We estimate the trade surplus moderated to $30bn – an $11bn deterioration. This is entirely due to a sharp pullback in the terms of trade (estimated to be down 7.3%) as global commodity prices have eased from earlier elevated levels.

For the NID, we've factored in a $2.8bn improvement to $26bn, assisted by a lift in earnings on Australia's overseas investments.

Aus current account



Aus Q2 net exports, ppts cont'n

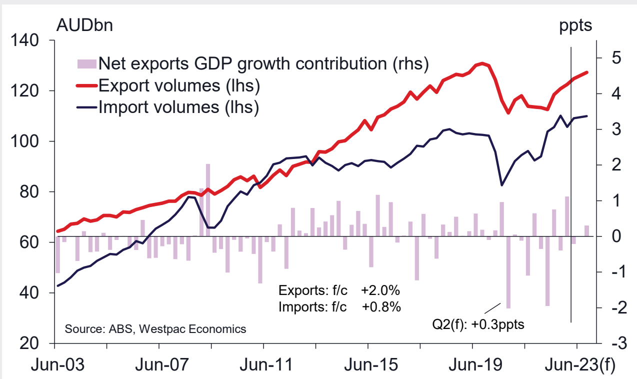
Sep 5, Last: -0.2, WBC f/c: +0.3
Mkt f/c: +0.3, Range: -0.7 to +0.8

For the June quarter, we estimate that net exports added 0.3ppts to growth. Export volumes grew by an estimated 2%, on a jump in services (+8.5%) and goods +0.5%. Import volumes rose 0.8%, we estimate, with a -0.6% dip in goods offset by a sizeable 6.8% lift in services.

Export volumes growth has improved on fewer domestic disruptions, favourable seasonal conditions for agriculture, and a return of international students and holiday makers.

Goods import volume growth has slowed, as domestic demand has cooled, only partially offset by a lift in services as more of us holiday abroad.

Aus net exports



The week ahead

Aus RBA policy announcement

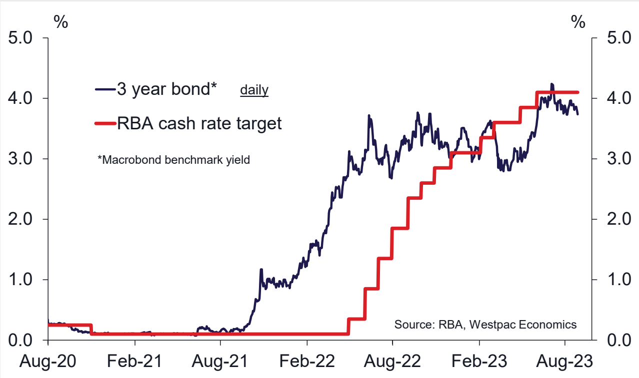
Sep 5, Last: 4.10%, WBC f/c: 4.10%
Mkt f/c: 4.10%, Range: 4.10% to 4.35%

At the September Board meeting, Westpac anticipates that the RBA will leave the cash rate unchanged at 4.10%.

The data flow has been constructive since the August Board meeting, with ongoing signs of moderating inflationary pressures and static wages growth. Some risks still linger, namely around the labour market, but this is not likely to prompt any further action. Rather, the RBA will continue to wait and assess the cumulative impact of the tightening cycle and the evolution of risks hereafter.

Looking ahead, the RBA's next policy move will likely be in the second half of 2024. At that stage, we expect inflation will be approaching the top of the target range and there will be clear evidence of a weakening economy – in our view, warranting a shift towards rate cuts beginning in the September quarter.

RBA cash rate and 3 year bonds



Aus Q2 GDP

Sep 6, Last: 0.2%, WBC f/c: 0.4%
Mkt f/c: 0.4%, Range: 0.0% to 0.8%

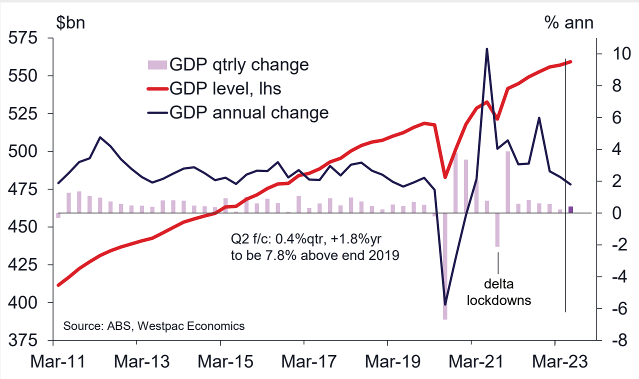
We assess that the Australia's economy grew by 0.4% in the June quarter, an improvement on the 0.2% gain reported for March, but still a subdued result. Annual growth slows to 1.8%.

The arithmetic is: domestic demand +0.3%, net exports +0.3ppts, and inventories -0.3ppts, with the statistical discrepancy +0.1ppt.

Household demand is expected to be flat, constrained by high inflation, rising interest rates and additional tax obligations but supported by labour market strength. Consumer spending is a forecast flat outcome, slowing from +0.2%, with services the key unknown. Home building activity fell, an estimated -0.8%, while turnover in the housing market lifted (OTCs a forecast +3.5%).

Business investment grew a forecast 1.4%, with equipment spending up and construction in an upward trend. Public demand, which is forecast to expand by a modest 0.3%, is cresting as the spike in COVID-related spending unwinds.

Aus GDP



Aus Jul trade balance, $bn

Sep 7, Last: 11.3, WBC f/c: 9.1
Mkt f/c: 10.0, Range: 8.9 to 11.6

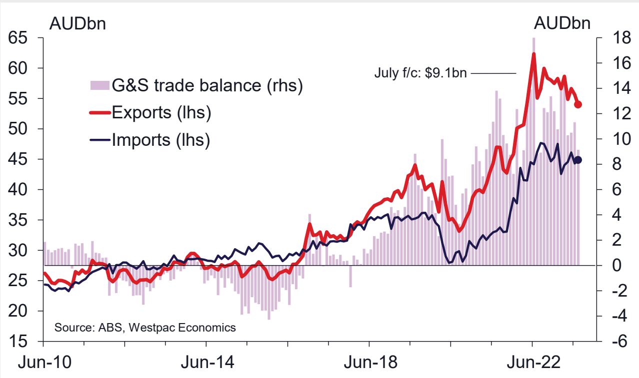
Australia's trade surplus moderated to be at a still elevated $11.3bn in June, as commodity prices pulled-back by a sizeable 16.2% and goods exports contracted by 7.7%.

For July, we're forecasting a trade surplus of $9.1bn – representing a $2.2bn deterioration on June and the smallest result last August.

Export earnings are down by an expected -3% (–$1.6bn), including goods -4% and services +2%. The deflating of commodity prices continued, down -2.9%, to be at the lowest level since end 2021. We've factored in softer resource shipments, around LNG and gold.

On the import side, our guesstimate is that the bill will be up by around 1.3%, +$0.6bn, centred on higher volumes.

Aus trade balance

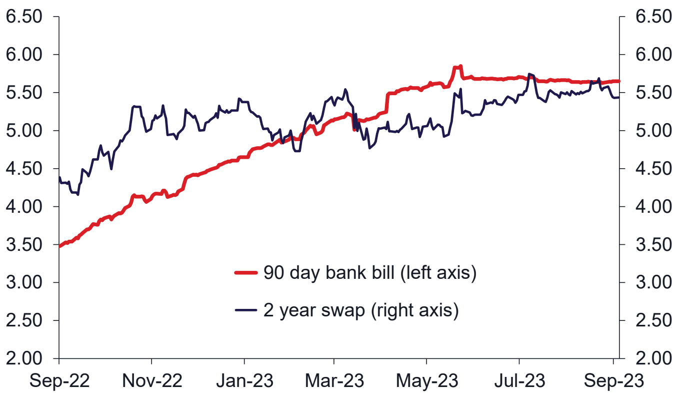


New Zealand forecasts

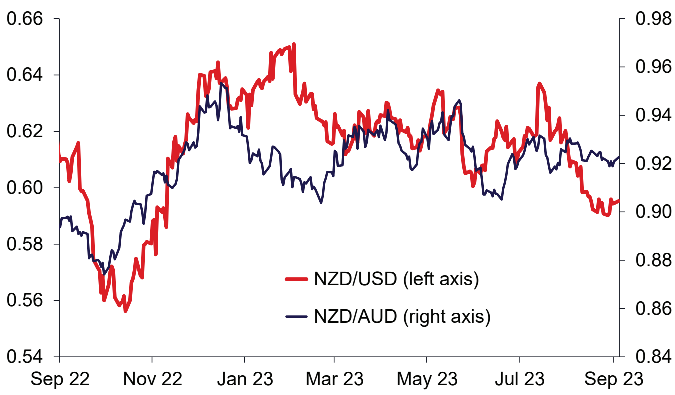
Economic forecasts	Quarterly				Annual			
	2022	2023						
% change	Dec	Mar	Jun	Sep	2021	2022	2023f	2024f
GDP (Production)	-0.7	-0.1	0.8	0.1	6.0	2.7	1.1	0.3
Employment	0.7	1.1	1.0	0.3	3.3	1.7	2.4	0.1
Unemployment Rate % s.a.	3.4	3.4	3.6	3.8	3.2	3.4	4.3	5.2
CPI	1.4	1.2	1.1	2.0	5.9	7.2	4.9	2.9
Current Account Balance % of GDP	-8.7	-8.2	-8.0	-8.2	-5.7	-8.7	-7.8	-6.0

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 4 September 2023

Interest rates	Current	Two weeks ago	One month ago
Cash	5.50%	5.50%	5.50%
30 Days	5.60%	5.61%	5.61%
60 Days	5.63%	5.63%	5.63%
90 Days	5.65%	5.64%	5.64%
2 Year Swap	5.44%	5.64%	5.48%
5 Year Swap	4.83%	5.05%	4.82%

NZ foreign currency mid-rates as at 4 September 2023

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5953	0.5913	0.6088
NZD/EUR	0.5524	0.5425	0.5548
NZD/GBP	0.4729	0.4641	0.4783
NZD/JPY	86.99	86.28	86.66
NZD/AUD	0.9226	0.9231	0.9283
TWI	69.86	69.64	70.84

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
NZ	Q2 terms of trade	-1.5%	–	-2.0%	Import prices down, export prices down by more.
Aus	Q2 company profits	0.5%	0.0%	-5.4%	Mining profits dented by sharp commodity price pull-back.
	Q2 inventories	1.2%	0.4%	0.3%	Modest rise, in wake of one-offs boosting Q1 outcome.
	Aug ANZ job ads	0.4%	–	–	Moderating gradually from an elevated level.
	Aug MI inflation gauge, %yr	5.4%	–	–	Provides a general view of risks.
Eur	Sep Sentix investor confidence	-18.9	–	–	Declining demand is making investors feel pessimistic.
Tue 05					
NZ	Aug ANZ commodity prices	-2.6%	–	–	Dairy prices slumped over August.
Aus	Q2 current account, $bn	12.3	8.0	4.0	Trade surplus narrowed as commodity prices pulled-back.
	Q2 net exports, ppts cont'n	-0.2	+0.3	+0.3	Export vol's f/c +2% (led by services), import vol's f/c +0.8%.
	Q2 public demand	0.8%	–	0.3%	Q1 result boosted by 4% jump in investment.
	RBA policy decision	4.10%	4.10%	4.10%	Data flow remains consistent with on-hold position.
Jpn	Jul household spending %yr	-4.2%	-2.4%	–	Household demand sluggish after post-COVID boom.
Chn	Aug Caixin services PMI	54.1	53.5	–	Outperformance of NBS measure a surprise.
Eur	Jul PPI	-0.4%	–	–	Base effect of high commodity prices still being felt.
US	Jul factory orders	2.3%	-2.5%	–	Slowdown emerging as external demand falters.
Wed 06					
NZ	GlobalDairyTrade auction (WMP)	-10.9%	–	-1.0%	Dairy prices likely to remain at low ebb.
	Q2 building work put in place	0.6%	–	-0.1%	Residential downturn continuing.
Aus	Q2 GDP	0.2%	0.4%	0.4%	Up on business investment & public, while households flat.
Eur	Jul retail sales	-0.3%	-0.3%	–	Consumers are pulling back as cost of living bites.
US	Jul trade balance, $bn	-65.5	-67.5	–	Deficit remains wide; consumer demand supportive.
	Aug ISM non-manufacturing	52.7	52.4	–	Cautious consumers could drive down demand for services.
	Federal Reserve Beige Book	–	–	–	An update on economic conditions across the nation.
	Fedspeak	–	–	–	Collins.
Thu 07					
Aus	Jul trade balance, $bn	11.3	10.0	9.1	Exports f/c -3%, commodity price pull-back continued.
	RBA Governor Lowe	–	–	–	Final speech before term expires.
Chn	Aug foreign reserves, US$bn	3204	–	–	Little change in recent months.
	Aug trade balance, US$bn	80.6	68.5	–	Asian trade partners driving export growth, offsetting US.
Eur	Q2 GDP	0.3%	0.3%	–	Final estimate.
US	Q2 productivity	3.7%	3.7%	–	Final estimate.
	Initial jobless claims	228k	–	–	To remain near lows, for now.
	Fedspeak	–	–	–	Harker Williams, Bostic.
Fri 08					
Jpn	Q2 GDP	1.5%	1.4%	–	Final estimate.
	Jul current account balance ¥bn	1508.8	2261.6	–	Trade balance has improved materially in recent months.
US	Jul wholesale inventories	-0.1%	–	–	Final estimate.
	Fedspeak	–	–	–	Bostic.
Sat 09					
Chn	Aug CPI %yr	-0.3%	–	–	Excess capacity and weak demand to limit price gains.
	Aug PPI %yr	-4.4%	–	–	Capacity also impacting along production chain.
	Aug M2 money supply %yr	10.7%	–	–	Cuts to deposit requirements and interest rates...
	Aug new loans, CNYbn	345.9	–	–	... supportive of credit and money supply into year end.

International forecasts

Economic Forecasts (Calendar Years)	2019	2020	2021	2022	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	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 %yr	2.3	-2.8	5.9	2.1	1.8	0.4
CPI inflation %yr	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 %yr	-0.4	-4.3	2.1	1.1	1.4	1.0
Euro zone						
Real GDP %yr	1.6	-6.1	5.4	3.5	0.6	1.2
United Kingdom						
Real GDP %yr	1.6	-11.0	7.6	4.0	0.3	0.5
China						
Real GDP %yr	6.0	2.2	8.4	3.0	5.2	5.5
East Asia ex China						
Real GDP %yr	3.8	-2.3	4.3	4.5	3.7	4.3
World						
Real GDP %yr	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	4.13	4.30	4.30	4.30	4.22	3.97	3.72
10 Year Bond	4.00	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	4.10	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	0.6473	0.67	0.68	0.69	0.71	0.73	0.74
USD/JPY	145.49	140	138	135	132	130	128
EUR/USD	1.0847	1.11	1.12	1.12	1.13	1.14	1.15
GBP/USD	1.2668	1.28	1.28	1.29	1.29	1.30	1.30
USD/CNY	7.2641	7.10	7.00	6.80	6.70	6.60	6.50
AUD/NZD	1.0852	1.07	1.08	1.09	1.10	1.12	1.12

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