

# WESTPAC WEEKLY ECONOMIC COMMENTARY

## Hot stuff.

8 February 2022



Kākābeak/ngutukākā

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With record high commodity prices, continued strong demand in sectors like construction, as well as a drum tight labour market, we expect firm economic conditions over the coming year despite ongoing Covid headwinds. At the same time, inflation is bubbling over. Given those conditions, financial markets have been flirting with the idea of larger OCR increases from the RBNZ. However, while the OCR is set to push higher over 2022, we expect that this will be in a series of measured 25bp steps.

The past week provided further evidence that the New Zealand economy is running hot. First up was the December quarter labour market report which showed that unemployment has fallen to 3.2%. That's down from a downwardly-revised 3.3% in September and is the lowest level since 1986, when the Household Labour Force Survey began.

The underlying detail of the December quarter update was a little mixed. Employment growth was a touch softer than our forecast at just 0.1%, following a 1.9% jump in the September quarter. Meanwhile, the labour force participation rate edged down from its highs – a slightly unusual combo, as employment and participation tend to move in the same direction. But despite those forecast misses, the overall picture is still one of a very tight labour market. And that tightness has continued into the new year, with job ads running hot and businesses still struggling to find staff.

Adding to this picture of a hot economy, we're also seeing positive indications in some key sectors. On the construction front, the number of dwellings being consented is still

running hot, with just over 4,200 new dwellings consented in December. We expect consent issuance will remain around the current very strong level over the year ahead, signalling a very large pipeline of building work. But while consent issuance is running hot, we expect that actual building activity will rise more gradually. Shortages of labour and materials are providing a brake on the pace of building work. We're also seeing costs rising rapidly. Those factors may mean that completion times are stretching out.

Last week we also upgraded our 2021/22 farmgate milk price forecast by 50 cents to a record high of \$9.50/kg. This revision puts our forecast at the top of Fonterra's recently updated forecast range of \$8.90 to \$9.50/kg. The key catalyst for this revision has been weakness in production, both in New Zealand and in other key export markets like the EU and US. That's in part due to poor weather. At the same time, with sky-high costs (including for feed) farmers don't have the incentive to increase production that one might normally expect given the record-high milk price.

The strength in commodity prices – both in the dairy sector and more generally – is already flowing through the economy. Farm sales are lifting, and spending in rural communities more generally is also on the rise. While increase costs will blunt some of those gains, the outlook for farmgate earnings is looking healthy.

Combined, the strength in the labour market, firm demand in many parts of the economy and strong commodity export earnings all point to firm economic conditions over 2022. Even so, we still expect uneven conditions across the economy. Notably, the outbreak of the omicron variant and dialling up of social distancing requirements will be a sizeable drag on demand in customer facing industries like hospitality. That comes atop of tough trading conditions in those industries over the past few years, and recent weeks have already seen a number of established operators shutting their doors. More generally, we have seen business confidence dropping back, and we expect ongoing hesitancy in relation to investment spending over the coming year.

With a tight labour market and inflation already at a 31 year high, wages have also been pushing higher, with the labour cost index rising 2.6% in the year to December. However, given the clear evidence of skill shortages and strong demand for workers, the lift in wage growth has thus far been more restrained than we had expected. We expect wage growth to pick up over time, as the tight jobs market allows workers to press the case for cost-of-living adjustments (or more). But it will pay to watch the data closely over the coming year, rather than take mounting wage and price pressures as a given.

Importantly for the RBNZ, without widespread pay increases, there's perhaps less risk of a persistent wage-price spiral developing. As we've previously highlighted, the RBNZ will need to continue hiking the OCR over the coming year in response to the build-up of strong cost pressures and firm domestic demand. We're forecasting a 25bp rise at the upcoming February policy decision, and we expect that will be followed by a series of OCR hikes over the coming year.

However, financial markets have been flirting with the idea that the RBNZ could accelerate the pace of monetary tightening with a 50bp hike later this month, rather than 25bp. We already saw that as unlikely given headwinds such as the omicron outbreak, and the restrained pace of wage growth to date adds to the case for more measured OCR changes.

**Satish Ranchhod**, Senior Economist

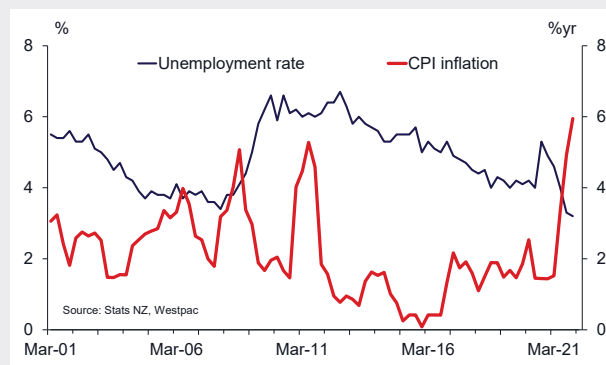
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## Chart of the week

While external supply pressures have pushed inflation higher, firm domestic conditions have also been a big driver of price increases. That strength in domestic demand has been reflected in the record low level of unemployment. Combined, those conditions have seen wage growth starting to lift, and we expect a further rise in wage inflation over the coming year.

NZ inflation and unemployment

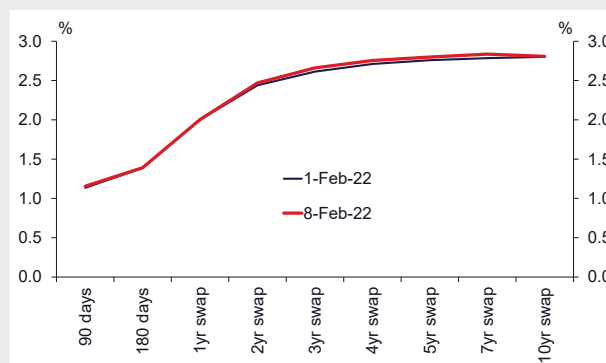


## Fixed vs floating for mortgages

Wholesale interest rates are now largely in line with our forecast of a 3% cash rate by mid-2023. That suggests there is no longer an advantage to fixing for longer terms.

While the one-year mortgage rate is likely to rise further in the next couple of years, fixing and rolling for this term is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms are more suited to those who want certainty in their repayments.

NZ interest rates



# The week ahead

## NZ Jan retail card spending

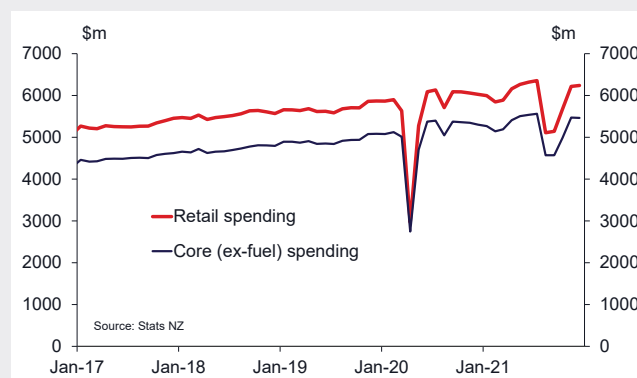
Feb 11, Last: +0.4%, Westpac: +0.4%

We're forecasting only a modest rise in retail spending in January. Spending had been picking up as we moved into the new year. However, the shift to the 'red' Covid traffic light setting in late January is likely to have derailed much of that momentum. The continued rise in petrol prices has also been a drag on households' spending power.

Under the surface, we are seeing differing trends across sectors. Hospitality spending, which had been picking up after last year's lockdown, has been struggling in the face of renewed activity restrictions. At the same time, spending on groceries has surged as households have stocked up in response to omicron worries.

Muddying the picture for spending are supply shortages and rising prices. Those developments may boost nominal spending levels, while limiting the rise in the volume of goods sold.

NZ retail card spending



## NZ Q1 RBNZ survey of expectations

Feb 11, Two-year ahead inflation expectations, Last: 2.96%

We expect the RBNZ's latest survey will show a lift in inflation expectations across all key horizons. The survey comes hot on the heels of the stronger than expected December quarter inflation result. In addition, supply disruptions and pressures on costs have continued into the new year.

The closely watched 2-years ahead measure has already risen to the upper limit of RBNZ's 1%-3% target band, and we expect it will take another step higher and/or breach the band this quarter.

We already expect the RBNZ will increase the cash rate at its upcoming February policy meeting. While a strong rise in inflation expectations would reinforce the case for rate increases, we still expect that the RBNZ will move in measured steps of 25bps. Headwinds, like the omicron outbreak, mean a 50bp move is unlikely.

RBNZ survey of expectations



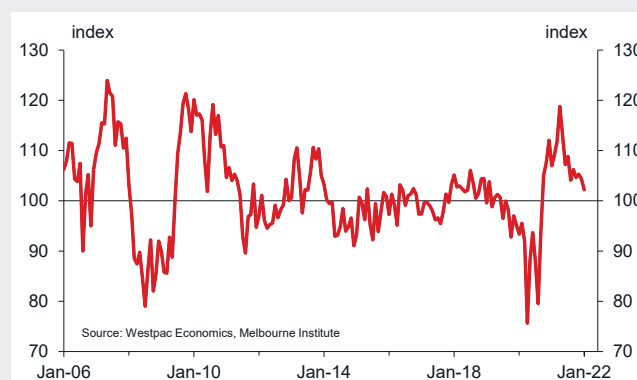
## Aus Feb Westpac-MI Consumer Sentiment

Feb 9, Last: 102.2

Consumer Sentiment fell 2% in January, a surprisingly resilient result given the rapid spread of the omicron variant and associated disruptions around the turn of the year. The fall compares to a 5.2% drop seen in the first month of the delta outbreak in NSW, a 6.1% drop heading into Victoria's 'second wave' outbreak in 2020 and the epic 17.7% collapse when the pandemic first hit in early 2020. At 102.2, sentiment even held in marginally positive territory.

The February survey will see this resilience tested again. Around the virus, cases and hospitalisations are showing tentative signs of easing and associated restrictions remain light compared to the hard lockdowns in 2020 and 2021. However, sentiment will come under more pressure from clear changes in the outlook for interest rates – upside surprises to inflation and a stronger than expected labour market prompting the RBA Governor to 'open the door' to an earlier start to rate rises, now widely expected to begin later this year.

Aus Consumer Sentiment Index

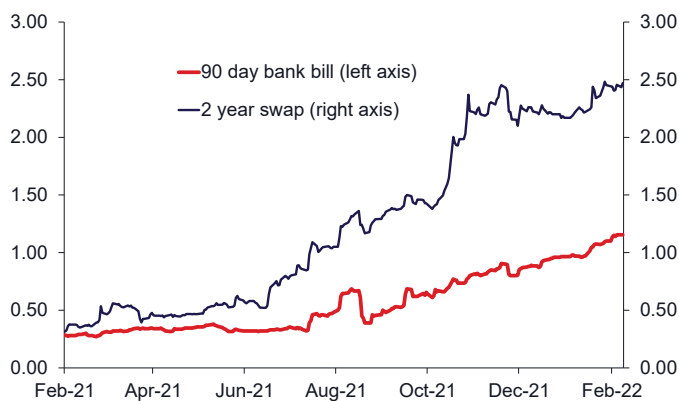


# New Zealand forecasts

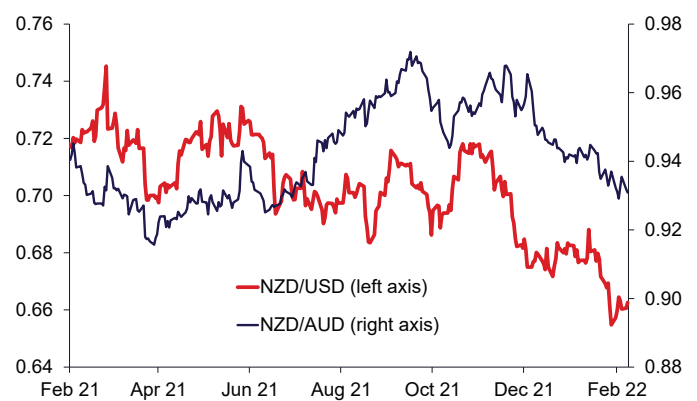
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Sep (a)	Dec	Mar	Jun	2020	2021f	2022f	2023f
GDP (Production)	-3.7	1.1	1.6	2.4	-1.9	5.1	4.4	4.7
Employment	1.9	0.1	0.5	0.1	0.6	3.7	0.9	1.0
Unemployment Rate % s.a.	3.3	3.2	3.1	3.0	4.9	3.2	3.0	3.3
CPI	2.2	1.4	1.1	0.7	1.4	5.9	3.1	2.7
Current Account Balance % of GDP	-4.5	-5.3	-5.4	-6.1	-0.8	-5.3	-5.7	-3.9

Financial forecasts	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	1.00	1.50	2.00	2.25	2.50	2.75	3.00	3.00
90 Day bill	1.40	1.90	2.20	2.45	2.70	2.95	3.10	3.10
2 Year Swap	2.55	2.75	2.90	2.95	3.00	3.00	2.95	2.90
5 Year Swap	2.80	2.95	3.05	3.10	3.15	3.15	3.15	3.10
10 Year Bond	2.80	2.85	2.90	3.00	3.00	3.00	3.00	2.95
NZD/USD	0.65	0.65	0.66	0.68	0.69	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.93	0.93	0.92	0.92	0.92	0.91
NZD/JPY	75.4	75.4	77.2	79.3	81.4	82.6	83.9	84.5
NZD/EUR	0.59	0.60	0.61	0.62	0.62	0.63	0.62	0.62
NZD/GBP	0.48	0.47	0.48	0.49	0.50	0.51	0.52	0.53
TWI	70.1	70.1	70.7	71.9	72.5	73.1	73.4	73.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 8 February 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	0.75%	0.75%	0.75%
30 Days	0.94%	0.83%	0.80%
60 Days	1.05%	0.95%	0.89%
90 Days	1.16%	1.07%	0.97%
2 Year Swap	2.47%	2.36%	2.26%
5 Year Swap	2.80%	2.74%	2.70%

NZ foreign currency mid-rates as at 8 February 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6626	0.6692	0.6774
NZD/EUR	0.5798	0.5912	0.5979
NZD/GBP	0.4898	0.4957	0.4985
NZD/JPY	76.27	76.10	78.29
NZD/AUD	0.9309	0.9376	0.9412
TWI	71.14	71.72	72.74

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Tue 8</b>					
Aus	Jan NAB business survey	8	–	–	Are conditions improving 2nd half of Jan after omicron hit?
US	Dec consumer credit	39.991	25.000	–	Robust demand for credit as pandemic savings worked down.
	Jan NFIB small business optimism	98.9	97.4	–	Confidence hampered by omicron disruptions.
	Dec trade balance US\$bn	–80.2	–83.0	–	Deficit to remain wide on demand & inventory rebuild.
<b>Wed 9</b>					
Aus	Feb Westpac–MI Consumer Sentiment	102.2	–	–	Better virus news but shifting view on interest rates to impact.
Chn	Jan new loans, CNYbn	1130.0	3600.0	–	Authorities are committed to ensure credit...
	Jan M2 money supply %yr	9.0%	9.2%	–	... and liquidity remain ample as demand builds in 2022.
US	Dec wholesale inventories	2.1%	2.0%	–	Final estimate; supply chain issues are being worked through.
<b>Thu 10</b>					
Aus	Feb MI inflation expectations	4.4%	–	–	Peaked at 5.1% in Nov 201, where to in 2022?
	15 Jan Weekly Payrolls - jobs %2wks	–0.5%	–	–	Payrolls tend to fall though the Xmas/New Year period.
US	Jan CPI	0.5%	0.5%	0.5%	Price pressures to hold annual inflation near-40 year highs.
	Initial jobless claims	238k	–	–	To remain at a very low level.
	Fedspeak	–	–	–	Bowman and Mester.
<b>Fri 11</b>					
NZ	Jan manufacturing PMI	53.7	–	–	Expected to continue showing signs of expansion.
	Jan card spending	1.9%	–	0.4%	Fuel prices and the omicron outbreak dampening spending.
	Q1 RBNZ inflation expectations	2.96%	–	–	Set to rise from already elevated levels.
Chn	Q4 current account balance US\$bn	73.6	–	–	Full detail on trade position. X'pts strong; M'pts modest.
UK	Q4 GDP	1.1%	–	–	Growth should remain robust; omicron a downside risk.
	Dec trade balance £bn	626	–	–	COVID-19 and Brexit continue to create trade instability.
US	Feb Uni. of Michigan sentiment	67.2	67.5	–	Inflation and omicron concerns have sunk confidence.

# International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
<b>Australia</b>						
Real GDP %yr	2.8	2.0	-2.2	4.4	4.4	4.0
CPI inflation %yr	1.8	1.8	0.9	3.5	3.3	3.5
Unemployment rate %	5.0	5.2	6.8	4.7	3.8	3.9
Current account % of GDP	-2.1	0.7	2.6	3.7	1.3	-3.1
<b>United States</b>						
Real GDP %yr	3.0	2.2	-3.5	5.7	3.4	2.5
CPI inflation %yr	2.4	1.9	1.2	5.1	5.2	2.5
Unemployment rate %	3.9	3.7	8.1	5.4	3.9	3.6
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
<b>Japan</b>						
Real GDP %yr	0.6	0.3	-4.8	2.3	2.7	1.5
<b>Euro zone</b>						
Real GDP %yr	1.9	1.3	-6.6	4.9	4.1	2.5
<b>United Kingdom</b>						
Real GDP %yr	1.3	1.4	-9.9	7.0	4.5	2.0
<b>China</b>						
Real GDP %yr	6.7	5.8	2.3	8.1	5.7	5.6
<b>East Asia ex China</b>						
Real GDP %yr	4.4	3.7	-2.4	3.9	4.7	4.7
<b>World</b>						
Real GDP %yr	3.6	2.8	-3.3	5.4	4.4	3.6

Forecasts finalised 4 February 2022

Interest rate forecasts	Latest	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
<b>Australia</b>									
Cash	0.10	0.10	0.10	0.25	0.50	0.75	1.00	1.25	1.50
90 Day BBSW	0.07	0.10	0.10	0.35	0.60	0.95	1.20	1.45	1.70
10 Year Bond	1.93	2.15	2.40	2.40	2.50	2.50	2.40	2.30	2.20
<b>International</b>									
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375	1.625	1.875	1.875
US 10 Year Bond	1.83	2.00	2.30	2.40	2.50	2.50	2.40	2.30	2.20

Exchange rate forecasts	Latest	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7137	0.70	0.70	0.71	0.73	0.75	0.76	0.77	0.78
USD/JPY	114.97	116	116	117	117	118	118	119	119
EUR/USD	1.1438	1.10	1.08	1.09	1.10	1.11	1.12	1.13	1.14
GBP/USD	1.3597	1.36	1.37	1.38	1.38	1.37	1.37	1.36	1.35
USD/CNY	6.3613	6.35	6.35	6.30	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.0715	1.08	1.08	1.08	1.08	1.09	1.09	1.09	1.10



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