



Kōkako

# Weekly Economic Commentary.

## Delta force.

The continuing spread of the Delta variant globally and related popping of the travel bubble with Australia has shone a spotlight on the significant risks that the New Zealand economy still faces.

The New Zealand economy has gone from strength to strength in recent months. Retail spending has surged. Construction is booming. And across the business sector we're hearing widespread reports of improved trading activity, with the latest business confidence survey also pointing to firmness in plans for capex and hiring.

Of course, there are still some soft spots, with spending in the travel, accommodation and entertainment sectors still lingering somewhat below pre-Covid levels. At the same time, shortages of supplies and skilled labour are a growing challenge for many businesses.

Nevertheless, the economy as a whole has proven much more resilient than anyone had expected. And compared to most of our peers on the global stage (who in many cases are still wrestling with significant Covid-related health issues), we look like a stand-out performer.

The economy's creditable performance owes much to the fact that we have been able to effectively eliminate Covid on our shores and keep it out. Combined with very stimulatory monetary and fiscal policy, the resulting firmness in domestic demand has helped to offset the drag from the closed border and softness in the global economy.

However, as we have seen in Australia and other regions, the risks associated with Covid have not gone away and are set to be with us for some time to come. For New Zealand, this raises a number of concerns.

First is that border restrictions are now likely to remain in place for longer than previously assumed. The Government has already hit pause on the travel bubble with Australia. And with Delta continuing to spread, as well as the chance of new variants emerging, any easing in travel restrictions with other countries is still a way off. As a result, we're likely to see



continued softness in tourism related sectors, like travel and accommodation. This also means that the recovery is likely to remain very uneven geographically: international tourist hotspots like Queenstown are likely to continue lagging regions which have a larger agricultural backbone and those that focus on providing services for the domestic economy.

But it's not just tourism and travel that will be affected by ongoing health concerns abroad. The flare up in infections is likely to mean that demand offshore will take even longer to recover, adding to the challenges for our exporters of manufactured goods. In addition, there's also the risk that global supply chain disruptions will take even longer to normalise as lockdowns and illness continue to disrupt production and logistics. That signals the potential for ongoing difficulties sourcing materials and finished goods.

The bigger question is what would happen if we had another outbreak onshore. Over the past year, we have had periods where the Alert Level was dialled up in some regions. While that did cause some disruptions, economic activity has proven to be fairly resilient, with increases in the Alert Level often resulting in spending being delayed, rather than cancelled.

However, the Delta variant is proving to be more contagious and harder to contain. Should it arrive on our shores, this raises the risk that health restrictions could be imposed for longer or that they are stricter than during previous incidents (especially given our relatively low levels of vaccinations). That would risk major disruptions to economic conditions and the labour market.

The spread of the Delta variant is also an important consideration for the RBNZ. Ultimately the RBNZ has to set policy for domestic conditions. At the time of their July policy review, the risks around the Delta variant were known and the RBNZ still judged that it was time to tighten monetary settings (consistent with the faster than expected lift in economic activity and inflation pressures in recent months). However, their assessment of conditions could change if Delta risks manifest as a drop in export demand, or if there is a related softening in local confidence and activity.

One of the key considerations for the RBNZ's policy stance will be the strength of the labour market, and we're expecting that Wednesday's labour market reports will add to the case for rate hikes. Coming on the back of strong demand in recent months, we expect to see unemployment dropping to 4.4% (down from 4.7% at the start of the year), along with a sharp rise in wage growth. That would be stronger than the RBNZ assumed in their last set of published forecasts, indicating that economic activity is already back around trend despite the continued closure of the border.

**Satish Ranchhod**, Senior Economist



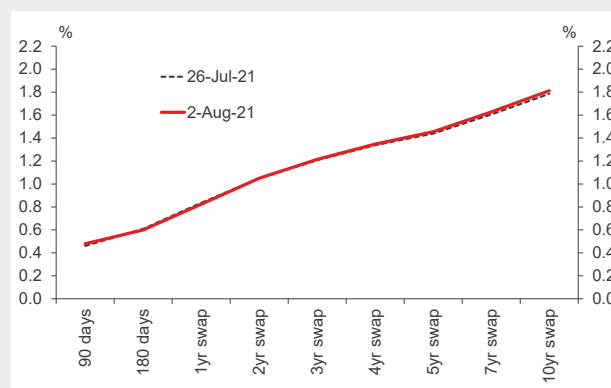
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## Fixed vs floating for mortgages.

We now expect the Reserve Bank to start increasing the OCR over the coming months. Fixed-term mortgage rates have already begun to lift in anticipation; floating rates are likely to rise once the OCR does.

Based on our OCR forecasts over the coming years, we think there is value in moving beyond the currently popular one-year fixed term, towards terms of two to three years. Longer terms (out to five years) don't offer additional value, though they may be suitable for borrowers who value more certainty in their repayments.

### NZ interest rates



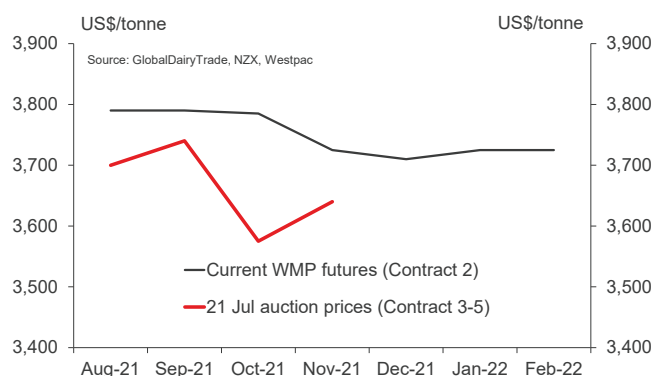
# The week ahead.

## NZ GlobalDairyTrade auction, whole milk powder prices

**Aug 4, Last: -3.8%, Westpac: +2.0%**

- We expect whole milk powder prices to rise at the upcoming dairy auction, regaining some of the lost ground over recent months.
- At the last auction, heightened Delta variant concerns pushed dairy auction prices lower in line with other commodity price declines at the time.
- Stepping back from the auction to auction fluctuations, recent New Zealand production data has been strong. Meanwhile, global demand remains firm and the key test for dairy prices will come in the New Zealand spring.

## Whole milk powder prices

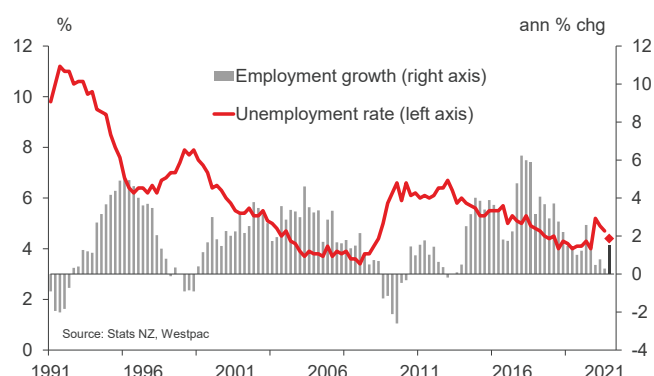


## NZ Q2 Household Labour Force Survey

**Aug 4, Employment last: 0.6%, WBC f/c: 1.0%**  
**Unemployment rate last: 4.7%, WBC f/c: 4.4%**

- We expect the June quarter unemployment rate to fall to 4.4%. That's not quite back to pre-Covid levels, but is getting close to what we would have considered to be 'maximum sustainable employment' even during normal times.
- Demand for labour appears to have strengthened significantly in the last few months, with job advertisements surging well above pre-Covid levels, unemployment benefit numbers falling, and filled jobs accelerating.
- The closure of the international border, and the loss of access to migrant workers, has led to heightened concerns about skill shortages, and a growing number of stories about poaching of workers. Even so, the evidence so far points to a strong net rise in employment.

## NZ Household Labour Force Survey

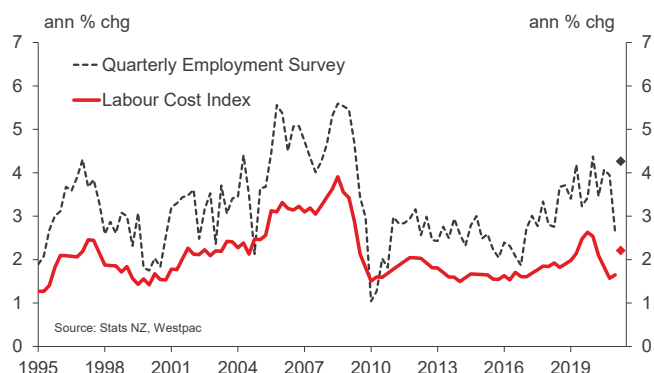


## NZ Q2 Labour Cost Index

**Aug 4, Private sector last: 0.4%, WBC f/c: 0.8%**

- Strong labour demand, combined with a shortage of skilled workers, is putting upward pressure on pay rates. There are anecdotes of very large pay increases in some sectors to attract or retain workers. However, it's unclear how this will translate into aggregate wage growth.
- We've pencilled in a 0.8% increase in the Labour Cost Index for the June quarter, compared to a subdued 0.4% rise last time. That would be a dramatic one-quarter change for what is, by construction, a slowly-moving series. But the risks are probably to the upside of this.
- Monthly tax data suggests a sharp lift in workers' gross earnings over the last few months. However, this could be due to changes in the composition of jobs as well as increases in pay rates. This is more likely to be captured in the Quarterly Employment Survey's measure of average hourly earnings.

## NZ salary and wage growth, all sectors



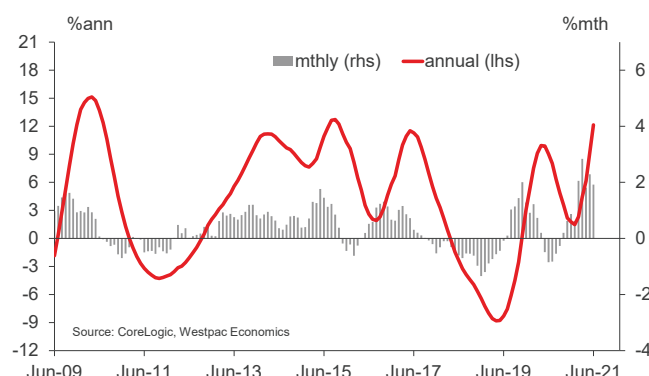
# The week ahead.

## Aus Jul CoreLogic home value index

**Aug 2, Last: 1.9%, WBC f/c: 1.6%**

- Australian dwelling prices continued to surge strongly in June, a 1.9% gain lifting annual growth to 12.4%yr. While the 3mth pace moderated, this was largely due to cycling the big jump in March.
- July is likely to show more convincing signs of moderation, the daily measure pointing to a 1.6% gain. To be sure, that is still a 20%+ annual pace, and the gain in Sydney is set to be stronger still at about 1.9%mt.
- Covid disruptions will take time to impact and are expected to be quite muted for house prices which are carrying strong momentum consistent with other indicators of tight market conditions, and tend to 'look through' near term disruptions, particularly when they are seen as transitory, which they certainly look to have been outside of NSW.

## Aus dwelling prices

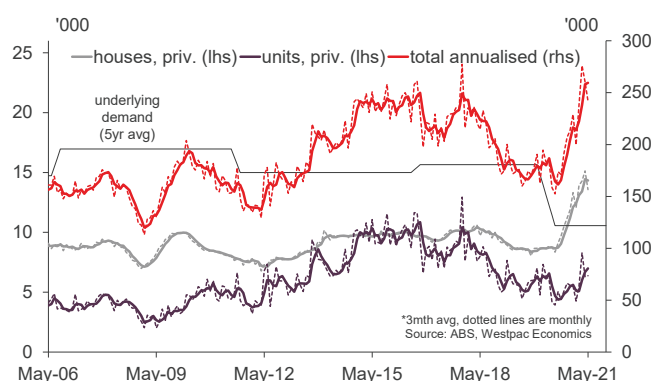


## Aus Jun dwelling approvals

**Aug 3, Last: -7.1%, WBC f/c: -5%  
Mkt f/c: -4.5%, Range: -10.0% to 4.0%**

- Dwelling approvals fell 7.1% in May as an unwinding pull-forward associated with the Federal HomeBuilder scheme continued to come through. Approvals remain at a very high level, up 52.7%yr and 24% above their pre-pandemic peak.
- More steep declines are expected as the unwind continues. With disruptions from recent Covid lockdowns also in the mix, monthly approvals could see some volatile moves, particularly through July-August when NSW and Vic lockdowns were in force. We expect to see a 5% decline for the June month, reinforcing the story around HomeBuilder effects. Note that these effects are most pronounced for sub-markets with median prices below \$750k, and less meaningful for unit markets in major capital cities.

## Aus dwelling approvals

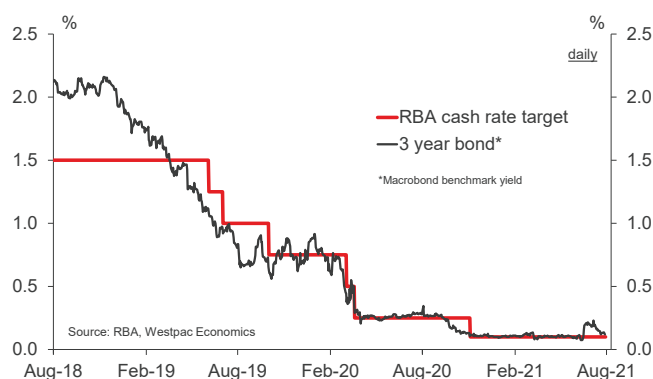


## Aus RBA policy decision

**Aug 3, Last: 0.1%, WBC f/c: 0.1%  
Mkt f/c: 0.1%, Range: 0.1% to 0.1%**

- The Reserve Bank Board next meets on August 3.
- The dominant topic of discussion will be the implication for the Australian economic outlook of the extended lock down in Greater Sydney.
- Given the sharp unexpected deterioration in the economy the Board should send a clear signal that it continues to be committed to supporting the Australian economy with an immediate increase of weekly bond purchases to \$6 billion.
- It should also announce a deferment of the taper from \$5 billion to \$4 billion that was planned for early September.
- It should commit to maintaining the \$6 billion purchase pace through to the November Board meeting in recognition of the economy's sudden deterioration and the uncertainty around the recovery phase.

## RBA cash rate and 3 year bonds



# The week ahead.

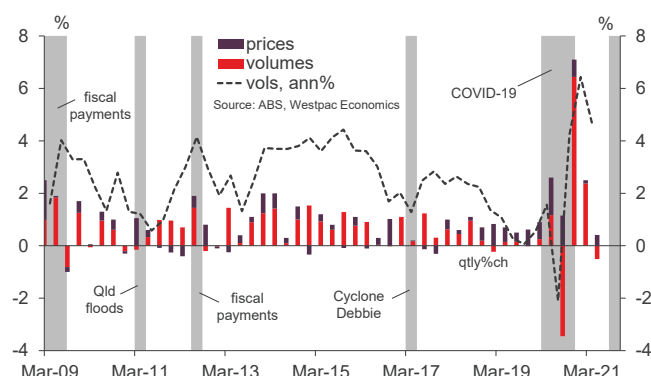
## Aus Q2 real retail sales

**Aug 4, Last: -0.5%, WBC f/c: 0.7%**

**Mkt f/c: 0.9%, Range: 0.7% to 1.2%**

- Real retail sales volumes declined 0.5% in Q1 but remained at a relatively high level, up 4.7%yr and 5.9% above their pre-Covid levels in late 2019. Retailers had a choppy first quarter, with continued 'reopening rebounds' disrupted by a series of mini-lock-downs affecting most states and flooding across parts of in eastern Australia, including Sydney.
- Sales look to have posted a modest gain in Q2. Nominal sales are up about 1.3% compared to a 0.1% dip in Q1. The Q2 CPI detail suggests retail prices were a touch firmer but likely up around 0.6% overall. That gives a volume rise of 0.7%qtr. Annual growth will spike to over 9% due to base effects from last year's Covid lockdown.
- Note that the wider consumption measures reported in the national accounts include many categories not covered by the retail survey that are more heavily affected by Covid restrictions (e.g. travel, fuel, hotels and recreational services).

## Aus quarterly retail volumes and prices



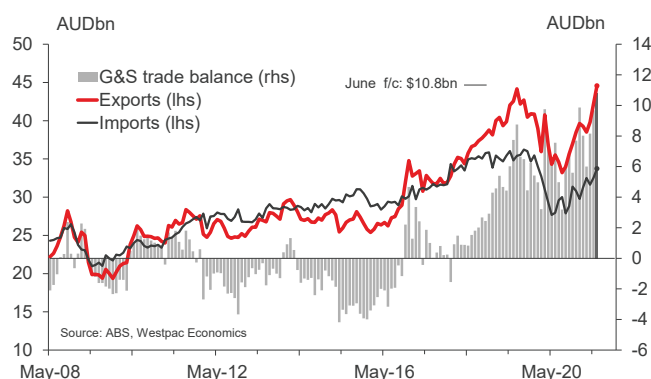
## Aus Jun trade balance, AUDbn

**Aug 5, Last: 9.7, WBC f/c: 10.8**

**Mkt f/c: 10.2, Range: 9.5 to 12.2**

- Australia's trade account has been in surplus for 41 consecutive months, from the start of 2018. The annual surplus swelled from \$23bn for 2018 to \$74bn in 2020 - with rising commodity prices a key driver of the growing surplus.
- For June, the surplus climbs to a forecast record high of \$10.8bn, up \$1.1bn on May, led by export strength. The previous record high was \$9.9bn in January 2021.
- Export earnings increased by a forecast 5.5% in the month, +\$2.3bn. Customs data reports strength in iron ore, coal, gas and gold. Commodity prices jumped 6.8% in the month.
- Imports resumed their upward trend, increasing by a forecast 3.6%, +\$1.2bn, to meet rising domestic demand. Customs data points to strength in fuel (likely in part due to higher prices) and vehicles.

## Aus trade balance



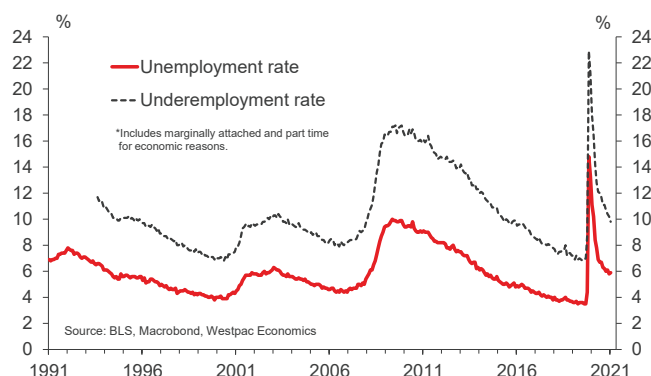
## US July employment report

**Aug 6, nonfarm payrolls, Last: 850k, WBC f/c: 875k**

**Aug 6, unemployment rate, Last: 5.9%, WBC f/c: 5.7%**

- The June nonfarm payrolls report delivered the kind of outcome that the market had been waiting all of 2021 for, 850k new jobs. July is expected to provide a strong follow-up as the economy continues to re-open.
- Covid-19 risks are dissipating with vaccination, and domestic demand has shown great strength in the first half, particularly employment-rich services consumption. Rapid job gains should therefore continue.
- While we expect July's gain to be as outsized as June's (875k versus 850k), the unemployment rate is likely to only edge down in the month. This is because the job creation that is occurring will increasingly attract those who left the labour market over the past year back in. The end of extended unemployment benefits across the nation will further support this trend.

## US labour market continues to heal



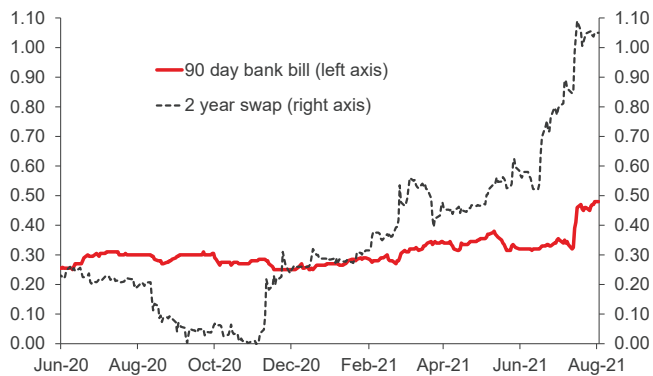


## New Zealand forecasts.

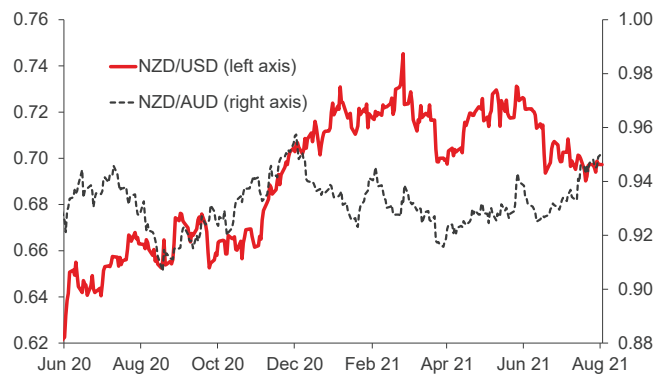
Economic forecasts	Quarterly				Annual			
	2021							
% change	Mar (a)	Jun	Sep	Dec	2019	2020	2021f	2022f
GDP (Production)	1.6	0.6	0.9	1.3	2.4	-2.9	5.8	4.5
Employment	0.5	0.4	0.3	0.4	1.2	0.8	1.7	2.1
Unemployment Rate % s.a.	4.7	4.5	4.4	4.2	4.1	4.9	4.2	3.9
CPI	0.8	1.3	0.9	0.2	1.9	1.4	3.3	2.0
Current Account Balance % of GDP	-2.2	-3.4	-4.4	-4.8	-3.3	-0.8	-4.8	-3.9

Financial forecasts	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Dec-23
Cash	0.50	1.00	1.00	1.00	1.25	1.25	1.50	1.75
90 Day bill	0.90	1.10	1.10	1.20	1.35	1.45	1.70	2.00
2 Year Swap	1.30	1.40	1.50	1.60	1.70	1.80	2.00	2.15
5 Year Swap	1.60	1.75	1.90	2.00	2.10	2.20	2.40	2.55
10 Year Bond	1.80	1.95	2.10	2.15	2.20	2.30	2.45	2.55
NZD/USD	0.71	0.74	0.76	0.77	0.77	0.77	0.75	0.72
NZD/AUD	0.95	0.95	0.95	0.94	0.94	0.94	0.94	0.92
NZD/JPY	78.8	82.1	85.1	86.2	86.2	87.0	85.5	82.8
NZD/EUR	0.59	0.61	0.62	0.63	0.64	0.64	0.63	0.61
NZD/GBP	0.50	0.52	0.53	0.53	0.53	0.53	0.52	0.50
TWI	73.9	76.0	77.1	77.5	77.4	77.3	75.7	73.0

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 2 August 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.33%	0.31%	0.27%
60 Days	0.41%	0.39%	0.31%
90 Days	0.48%	0.46%	0.35%
2 Year Swap	1.05%	1.09%	0.80%
5 Year Swap	1.46%	1.50%	1.37%

NZ foreign currency mid-rates as at 2 August 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6973	0.7003	0.7026
NZD/EUR	0.5874	0.5930	0.5921
NZD/GBP	0.5014	0.5080	0.5081
NZD/JPY	76.45	77.05	77.99
NZD/AUD	0.9505	0.9459	0.9335
TWI	74.03	74.39	74.09

## Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 02</b>					
Aus	Jul CoreLogic home value index	1.9%	–	1.6%	Growth moderating from red hot to hot.
	Jul MI inflation gauge	3.0%	–	–	Follows the 0.8% (3.8%yr) Q2 CPI print.
	Jul ANZ job ads	3.0%	–	–	Vacancies have surged, but should slow during lockdown.
	Bank Holiday	–	–	–	Public holiday in NSW for banking & financial services.
US	Jun construction spending	–0.3%	0.5%	–	Supply-chain disruptions should abate in H2 2021.
	Jul ISM manufacturing	60.6	60.8	–	Further strength expected.
<b>Tue 03</b>					
Aus	Jun housing finance	4.9%	1.5%	2.0%	Strong upturn to start levelling out as slowing FHB demand...
	Jun owner occupier finance	1.9%	0.0%	0.0%	... and unwinding HomeBuilder pull-forward flatten own-occ...
	Jun investor finance	13.3%	8.0%	8.0%	... activity but investor upturn continues.
	Jun dwelling approvals	–7.1%	–4.5%	–5.0%	Coming off highs as HomeBuilder pull forward reverses.
	RBA policy decision	0.10%	0.10%	0.10%	RBA should immediately increase purchases to 6bn/week.
Eur	Jun PPI %yr	9.6%	–	–	Energy input prices forging ahead, biased by base effects.
US	Jun factory orders	1.7%	1.1%	–	Core durable orders point to solid investment gains.
	Fedspeak	–	–	–	FOMC's Bowman to give remarks at Fed conference.
<b>Wed 04</b>					
NZ	GlobalDairyTrade auction (WMP)	–3.8%	–	2.0%	Dairy prices set to regain some recent lost ground.
	Q2 employment change	0.6%	0.8%	1.0%	Demand for workers has surged in recent months...
	Q2 unemployment rate	4.7%	4.4%	4.4%	...suggesting a further drop in unemployment...
	Q2 labour cost index (pvt, ord. time)	0.4%	0.7%	0.8%	...and rising wages as firms compete for workers.
	Jul ANZ commodity prices	0.8%	–	–	Commodity prices coming off the boil as dairy prices cool.
Aus	Jun retail sales	0.4%	–1.8%	–1.8%	Preliminary estimates showed sizeable falls in COVID hit...
	Q2 real retail sales	–0.5%	0.9%	0.7%	... Vic and NSW, but vols should still be up for Q2 overall.
Eur	Jun retail sales	4.6%	1.7%	–	Robust, but focus to shift to leisure and services spending.
US	Jul ADP employment change	692k	675k	–	Remains a poor guide for payrolls.
	Jul ISM non-manufacturing	60.1	60.5	–	Conditions buoyant as consumers switch to services.
	Fed Vice Chair Clarida	–	–	–	To speak at Peterson Institute Event.
<b>Thu 05</b>					
Aus	Jun trade balance \$bn	9.7	10.2	10.8	Higher commodity prices boosting export earnings.
	Jul 17 Weekly Payrolls	–	–	–	Overlaps with reference period of July labour force survey.
UK	BoE policy decision	0.10%	0.10%	–	View on risks for activity and inflation as UK reopens key.
US	Jun trade balance US\$bn	–71.2	–72.4	–	Domestic demand is keeping the deficit wide.
	Initial jobless claims	400k	–	–	Downtrend to accelerate as u/e benefits roll off.
	Fedspeak	–	–	–	FOMC's Waller to discuss central bank digital currency.
<b>Fri 06</b>					
Aus	RBA Governor Lowe	–	–	–	Testimony to Parliament Committee.
	RBA Statement on Monetary Policy	–	–	–	Updated forecasts in focus.
Chn	Q2 current account balance	69.4	–	–	Goods exports the key source of strength.
US	Jul non-farm payrolls	850k	925k	875k	Another strong gain expected by market...
	Jul unemployment rate	5.9%	5.6%	5.7%	... as economy re-opens despite threat from delta.
	Jul average hourly earnings %mth	0.3%	0.3%	0.3%	Low-income professions continue to drive wage growth.
	Jun consumer credit	35.281	20.500	–	Demand for autos remains strong, supporting credit.
<b>Sat 07</b>					
Chn	Jul trade balance USDbn	51.53	–	–	Exports providing robust income gains for China.
	Jul foreign reserves \$bn	3214.01	–	–	FX reserves broadly stable.

## International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
<b>Australia</b>						
Real GDP %/yr	2.4	2.8	1.9	-2.4	4.2	4.4
CPI inflation %/yr	1.9	1.8	1.8	0.9	2.6	2.4
Unemployment rate %	5.5	5.0	5.2	6.8	5.1	4.0
Current account % of GDP	-2.6	-2.1	0.7	2.6	4.2	2.6
<b>United States</b>						
Real GDP %/yr	2.3	3.0	2.2	-3.5	6.5	4.1
CPI inflation %/yr	2.1	2.4	1.9	1.2	2.9	2.1
Unemployment rate %	4.4	3.9	3.7	8.1	5.4	3.8
Current account % of GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
<b>Japan</b>						
Real GDP %/yr	1.7	0.6	0.3	-4.8	2.7	2.3
<b>Euro zone</b>						
Real GDP %/yr	2.6	1.9	1.3	-6.6	4.5	4.4
<b>United Kingdom</b>						
Real GDP %/yr	1.7	1.3	1.4	-9.9	6.2	5.0
<b>China</b>						
Real GDP %/yr	6.9	6.7	5.8	2.3	9.5	5.8
<b>East Asia ex China</b>						
Real GDP %/yr	4.7	4.4	3.7	-2.4	4.9	5.0
<b>World</b>						
Real GDP %/yr	3.8	3.6	2.8	-3.3	5.8	4.6
Forecasts finalised 30 July 2021						


Interest rate forecasts	Latest	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Dec-23
<b>Australia</b>									
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.50	0.75
90 Day BBSW	0.02	0.04	0.07	0.10	0.15	0.20	0.40	0.70	0.95
10 Year Bond	1.19	1.55	1.80	1.95	2.00	2.05	2.10	2.20	2.30
<b>International</b>									
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.375	0.875	0.875
US 10 Year Bond	1.25	1.60	1.80	1.95	2.00	2.05	2.10	2.20	2.30

Exchange rate forecasts	Latest	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Dec-23
AUD/USD	0.7383	0.75	0.78	0.80	0.82	0.82	0.82	0.80	0.78
USD/JPY	109.54	111	111	112	112	112	113	114	115
EUR/USD	1.1877	1.21	1.22	1.23	1.22	1.21	1.21	1.20	1.19
GBP/USD	1.3939	1.41	1.42	1.43	1.44	1.45	1.44	1.44	1.43
USD/CNY	6.4630	6.35	6.25	6.15	6.10	6.05	6.00	6.00	5.95
AUD/NZD	1.0553	1.06	1.05	1.05	1.06	1.06	1.06	1.07	1.08



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