WESTPAC WEEKLY ECONOMIC COMMENTARY

Summer breeze for the housing market?

6 December 2021

Hihi

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Housing-related data this month has hinted at some early signs of a cooling in the wake of higher mortgage rates. We expect a further slowing as the Reserve Bank continues to push ahead with interest rate hikes, although the news of a new Covid variant provides a reminder of the downside risks.

In the last week or so we've had the unwelcome news of a new and potentially more spreadable variant of Covid. Scientists have been racing to understand the nature of the virus itself, but in these early days there's still much to learn about how it will interact with the population – and the implications for the economy.

In the past we've described the Delta variant as a game changer – it was the first time that a variant was infectiousness enough to put 'herd immunity' out of reach. That made it clear that it was no longer feasible to rely on vaccines alone, and that we'd also need other public health measures on an ongoing basis.

An even more infectious variant is unlikely to be a game changer in the same way, to the extent that we've already crossed that threshold of needing ongoing controls. But as the world learns more about Omicron, we'll get a better sense of what will be required of these control measures, such as the traffic light system that began last week.

Last week we had a few data releases relating to the housing market. We've long been saying that higher interest rates will be the trigger for a cooling in house prices. And as markets have moved to pricing in a substantial tightening cycle from the Reserve Bank, fixed-term mortgage rates have risen sharply in a short space of time. So, we'll be watching the impact closely over the next few months.

Some early signs came from the release of property listings from realestate.co.nz which showed both a lift in new listings and the stock of unsold homes for the first time in many months. We're taking a cautious view on this for now because we saw something similar occur when New Zealand came out of lockdown in mid-2020. In that instance, sales took off as well in the following months, and the number of homes on the market was soon in short supply again.

House price data hasn't shown any sign of a meaningful slowing in the market so far. The CoreLogic house price index rose a further 1.8% in November. While the annual growth pace slowed for the first time in over a year, that's really because of a tougher comparison – prices were rising particularly rapidly in late 2020.

In other housing-related data, we saw a modest drop in building consents for the second consecutive month. It's worth keeping in mind that on an annual basis they're still running at a record pace. As we've been noting, this is creating a strong pipeline of work for the construction sector over the next year and will erode much of the housing shortage around the country, especially in Auckland.

However, there are some headwinds for construction in the near term. Costs are rising rapidly, mainly driven by the shortages in building materials and labour. This is due to a combination of supply chain issues globally and the difficulty in accessing skilled labour from overseas because of closed borders. A slowdown in sale prices at the same time would squeeze developers' margins, potentially limiting activity too.

One economic indicator where we have continually seen rising inflationary pressures throughout the year has been the ANZ business confidence survey. The pressures have been apparent across both expectations for the economy in general, and for firms' own costs and prices. In November, inflation expectations for the year ahead were 4.2%, the highest since the early 1990s. Actual inflation has already risen to 4.9%, and we expect it to remain above the RBNZ's target band until the end of next year. Underlying this strength in inflationary pressures has been a cocktail of supply-side cost pressures and strong demand.

On the activity side, expectations for economic conditions have continued to ease but remain at a firm level. That's consistent with our view that we'll see economic conditions continuing to improve in late 2021 and early 2022 after August's Delta disruptions, but that the recovery will be gradual.

Social distancing requirements have continued to limit spending on services, which is likely to have prompted consumers to shift demand towards durable goods like household furnishings. As a result, manufacturing continues to be a bright spot.

The strength of the economy has also continued to be illustrated by monthly filled jobs, which have continued to rise albeit at a slower pace – the recent lockdown that was brought on by the Delta variant has proven to have surprisingly little impact. Similarly, job advertisements remained above their pre-pandemic levels even during the lockdown period. This suggests that most businesses saw the lockdown as a temporary bump in the road, and that labour shortages would remain an issue when restrictions were eased.

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Chart of the week

The number of listed properties jumped in November as Covid restrictions were eased. There was a similar rise after last year's lockdown, with sales soon following them higher. That's less likely to happen this time, in an environment of rising mortgage rates and other dampening measures such as loan-to-value limits.

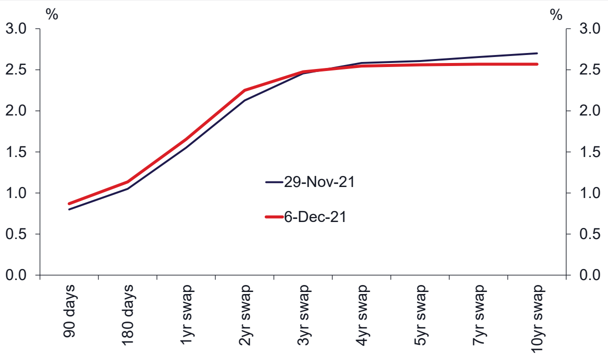
Property listings, seasonally adjusted

Fixed vs floating for mortgages

We expect the Reserve Bank to increase the OCR further at its upcoming reviews, reaching a peak of 3% by mid-2023.

Based on these OCR forecasts, we think there is value in extending fixed-rate terms as far out as 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 Q3 building work put in place

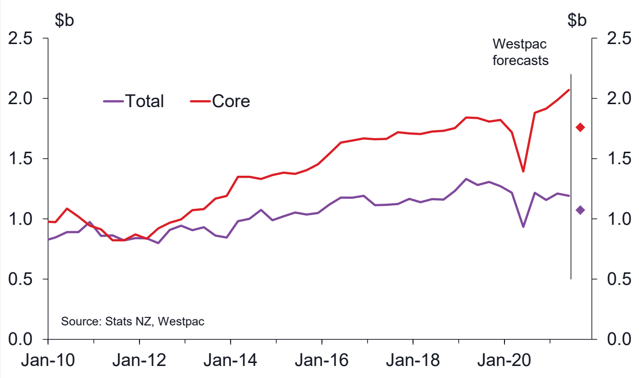
Dec 6, Last: +2.0%, Westpac f/c: -13.0%

Total construction activity lifted by 2.0% in the June quarter. That was underpinned by a 4.2% rise in residential building activity, which offset a 1.5% fall in non-residential work.

We're forecasting a 13% fall in total construction activity in the September quarter, with falls spread across categories. That sharp decline is due to New Zealand's Delta outbreak in mid-August and the related re-imposition of activity restrictions.

Lockdown conditions mean that there is a wide range of uncertainty around our forecasts. But regardless of the extent of the fall in the September quarter, this will just be a temporary slowdown. Activity restrictions are being loosened as we speak and indications for construction have remained strong as we've approached the end of the year.

NZ real building work put in place



NZ GlobalDairyTrade auction, whole milk powder prices

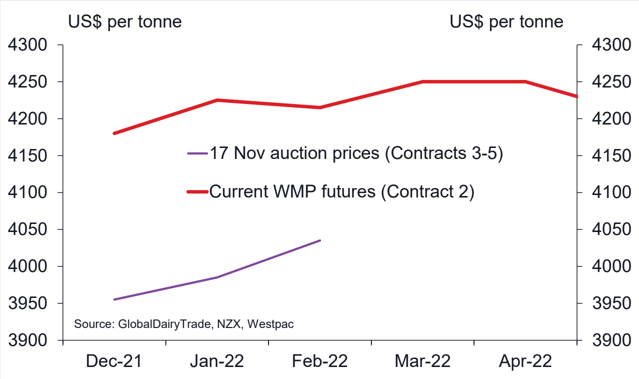
Dec 8, Last: +1.9%, Westpac: +2.0%

We expect whole milk powder prices to lift at the upcoming dairy auction. This lift would build on the circa 12% rise since August.

Our pick is more modest than futures market pricing, where a lift of around 6% is expected.

Recently, soft global supply has been translating into higher global dairy prices. For this auction, weak New Zealand production over October (down 3.1% compared to October 2020) is likely to further boost prices.

Whole milk powder prices



NZ Nov Electronic Card Spending

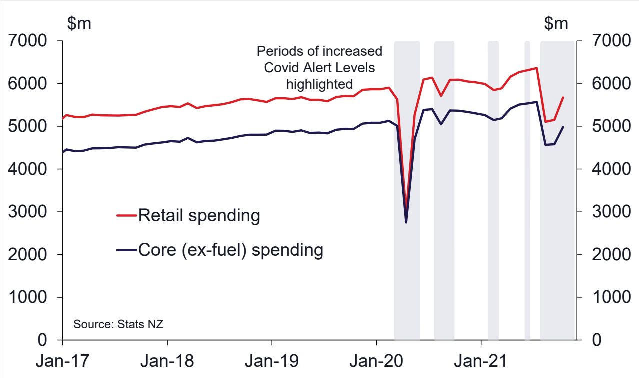
10 Dec, Last +9.5%, Westpac f/c: +5.0%

Retail spending levels rose by 10% in October. That reversed much of the weakness seen in August and September following the dialling up of the Covid Alert Level. Even so, spending levels remained around 10% below those we saw prior to the Delta outbreak.

We are forecasting a 5% rise in spending in November. Spending has been on the rise, in part due to the usual boost from Black Friday sales. However, tighter restrictions in Auckland were still a drag in the early part of the month.

We expect that spending levels will continue to rise as we head into the holiday season and as Covid activity restrictions are loosened further.

NZ retail card spending



The week ahead

Aus Dec RBA policy decision

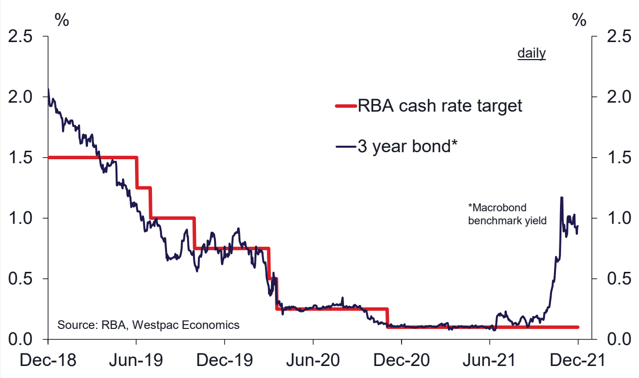
Dec 7, Last: 0.10%, WBC f/c: 0.10%
Mkt f/c: 0.10%, Range: 0.10% to 0.10%

The RBA is expected to keep policy settings unchanged at its last meeting of 2021. As such, the focus will again be on the wording of the Governor's decision statement, particularly any assessments of the latest round of economic data, including the Q3 national accounts, and the shifting external environment, particularly with respect to price inflation in developed economies.

The Bank's following meeting, on February 1 next year, will likely see more meaningful shifts with a scheduled review of the bond buying program expected to see purchases scaled back from $4bn/week to $2bn/week prior to a wind down of the program by mid -May.

The Governor continues to emphasise the Board's patience with respect to the timing of the initial rate increase. Westpac remains comfortable with our view that the bank's first move will come in February 2023 although markets are anxious for a mid-2022 move while the Governor himself is still open to waiting till 2024.

Aus RBA cash rate and 3 year bonds

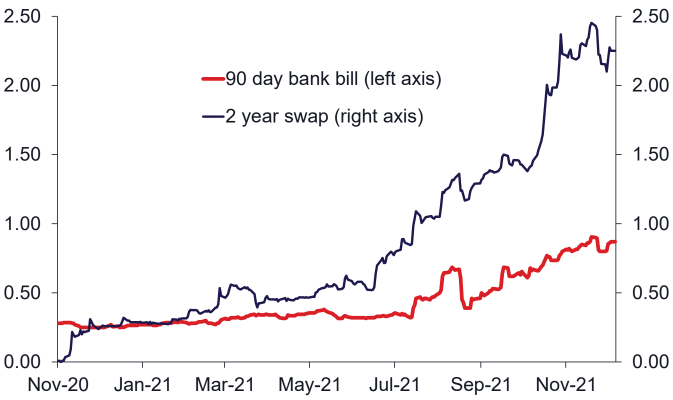


New Zealand forecasts

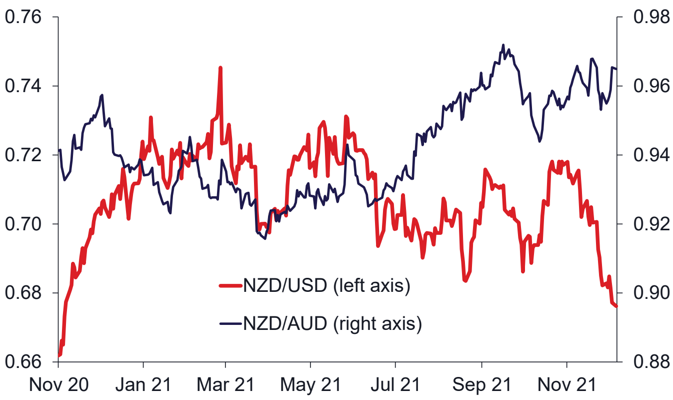
Economic forecasts	Quarterly				Annual			
	2021			2022				
% change	Jun (a)	Sep	Dec	Mar	2019	2020	2021f	2022f
GDP (Production)	2.8	-6.0	2.1	2.9	2.4	-2.1	3.8	4.6
Employment	1.0	2.0	0.0	0.3	1.2	0.6	3.5	0.6
Unemployment Rate % s.a.	4.0	3.4	3.8	3.7	4.0	4.8	3.8	3.5
CPI	1.3	2.2	0.7	0.8	1.9	1.4	5.2	2.8
Current Account Balance % of GDP	-3.3	-4.4	-5.4	-5.6	-2.9	-0.8	-5.4	-6.3

Financial forecasts	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Dec-23
Cash	0.75	1.00	1.50	2.00	2.25	2.50	2.75	3.00
90 Day bill	0.95	1.40	1.90	2.20	2.45	2.70	2.95	3.10
2 Year Swap	2.30	2.55	2.75	2.90	2.95	3.00	3.00	2.90
5 Year Swap	2.60	2.80	2.95	3.05	3.10	3.15	3.15	3.10
10 Year Bond	2.60	2.80	2.85	2.90	3.00	3.00	3.00	2.95
NZD/USD	0.68	0.67	0.66	0.67	0.69	0.70	0.71	0.72
NZD/AUD	0.94	0.94	0.94	0.94	0.95	0.93	0.93	0.92
NZD/JPY	78.2	77.7	76.6	78.4	80.7	82.6	83.8	85.7
NZD/EUR	0.61	0.61	0.61	0.61	0.63	0.63	0.63	0.63
NZD/GBP	0.51	0.49	0.48	0.49	0.50	0.51	0.52	0.53
TWI	72.7	72.1	71.2	71.8	73.1	73.5	74.1	74.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 6 December 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.75%	0.50%	0.50%
30 Days	0.78%	0.83%	0.68%
60 Days	0.83%	0.87%	0.74%
90 Days	0.87%	0.91%	0.80%
2 Year Swap	2.25%	2.44%	2.20%
5 Year Swap	2.56%	2.80%	2.58%

NZ foreign currency mid-rates as at 6 December 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6762	0.7010	0.7109
NZD/EUR	0.5965	0.6211	0.6154
NZD/GBP	0.5105	0.5210	0.5276
NZD/JPY	76.25	79.83	80.67
NZD/AUD	0.9649	0.9676	0.9615
TWI	72.97	75.11	75.71

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 06					
NZ	NZ Q3 building work put in place	2.0%	–10.0%	–13.0%	Drag from lockdown in August.
	Nov ANZ commodity prices	2.1%	–	–	Dairy prices firmed further over November.
Aus	Nov MI inflation gauge	3.1%	–	–	Expectations back at pre-COVID levels.
	Nov ANZ job ads	6.2%	–	–	Back near 13yr highs in Oct.
Eur	Dec Sentix investor confidence	18.3	–	–	Omicron and delta to weigh on confidence.
Tue 07					
Aus	RBA policy decision	0.10%	0.10%	0.10%	On hold but Governor's decision statement of some interest.
Chn	Nov trade balance USDbn	84.54	80.77	–	Demand for Chinese exports strong on growth & restocking.
	Nov foreign reserves $bn	3217.61	3207.60	–	Authorities seem comfortable with current level of CNY.
Eur	Q3 GDP	2.2%	2.2%	–	Third estimate. To confirm component detail from second.
	Dec ZEW survey of expectations	25.9	–	–	Uncertainty continues to cloud outlook.
US	Oct trade balance US$bn	–80.9	–66.8	–	Deficit to remain wide on run to Christmas.
Wed 08					
NZ	GlobalDairyTrade auction (WMP)	1.9%	–	2.0%	Soft global supply is translating into higher global dairy prices.
US	Oct consumer credit US$bn	29.913	25.000	–	Demand for cars continues to buoy credit.
	Oct JOLTS job openings	10438k	–	–	Continues to point to extraordinary demand for workers.
Thu 09					
Aus	RBA Governor Lowe	–	–	–	Payments Summit 2021, 9:00am, online.
Chn	Nov CPI %yr	1.5%	2.5%	–	Consumer price pressures remain sub-par ...
	Nov PPI %yr	13.5%	12.1%	–	... despite intense pressure upstream.
	Nov M2 money supply %yr	8.7%	8.6%	–	Liquidity ample ...
	Nov new loans, CNYbn	826.2	1545.0	–	... and so is credit. Demand to build in early-2022.
US	Initial jobless claims	222k	–	–	To remain historically low for the foreseeable future.
	Oct wholesale inventories	2.2%	–	–	End demand and supply chain restricting stock rebuild.
Fri 10					
NZ	Nov manufacturing PMI	54.3	–	–	Lift supported by easing of restrictions and robust demand.
	Nov card spending	9.5%	–	5.0%	Activity restrictions in Auckland limited this month's rise.
UK	Oct trade balance £bn	–2777	–	–	Brexit and COVID-19 to continue creating trade instability.
US	Nov CPI	0.9%	0.7%	–	Annual inflation to crest in coming months.
	Dec Uni. of Michigan sentiment	67.4	68.0	–	Inflation hit to discretionary incomes a big concern.

International forecasts

Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	3.0	5.0
CPI inflation %yr	1.9	1.8	1.8	0.9	3.0	2.5
Unemployment rate %	5.5	5.0	5.2	6.8	4.9	3.7
Current account % of GDP	-2.6	-2.1	0.7	2.7	4.4	1.8
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	5.6	4.0
CPI inflation %yr	2.1	2.4	1.9	1.2	4.5	3.1
Unemployment rate %	4.4	3.9	3.7	8.1	5.4	4.2
Current account % of GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
Japan						
Real GDP %yr	1.7	0.6	0.3	-4.8	2.3	2.7
Euro zone						
Real GDP %yr	2.6	1.9	1.3	-6.6	4.9	4.4
United Kingdom						
Real GDP %yr	1.7	1.3	1.4	-9.9	6.7	5.5
China						
Real GDP %yr	6.9	6.7	5.8	2.3	8.5	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.4	3.8	4.9
World						
Real GDP %yr	3.8	3.6	2.8	-3.3	5.4	4.6

Forecasts finalised 5 November 2021

Interest rate forecasts	Latest	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Dec-23
Australia									
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.50	0.75
90 Day BBSW	0.05	0.07	0.10	0.15	0.20	0.40	0.65	0.70	0.95
10 Year Bond	1.86	1.90	2.15	2.30	2.30	2.30	2.30	2.25	2.20
International									
Fed Funds	0.125	0.125	0.125	0.375	0.625	0.875	0.875	1.125	1.375
US 10 Year Bond	1.63	1.75	2.00	2.20	2.30	2.30	2.30	2.25	2.20

Exchange rate forecasts	Latest	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Dec-23
AUD/USD	0.7070	0.72	0.71	0.70	0.71	0.73	0.75	0.76	0.78
USD/JPY	113.15	115	116	116	117	117	118	118	119
EUR/USD	1.1294	1.12	1.10	1.08	1.09	1.10	1.11	1.12	1.14
GBP/USD	1.3285	1.34	1.36	1.37	1.38	1.38	1.37	1.37	1.35
USD/CNY	6.3771	6.35	6.35	6.35	6.30	6.25	6.20	6.15	6.10
AUD/NZD	1.0415	1.06	1.06	1.06	1.06	1.06	1.07	1.07	1.08

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