



Weekly Economic Commentary.

Maybe we're just too demanding.

The September quarter labour force surveys marked another stunningly strong data point for the New Zealand economy, and reinforced our view that excess demand, rather than cost shocks, is now the bigger challenge to the inflation outlook. We've revised our interest rate forecasts higher, and we now expect the Reserve Bank will lift the OCR to a peak of 3% over the next two years.

The unemployment rate fell from 4.0% to 3.4% in the September quarter, equalling the record low set in 2007. A drop in unemployment was widely expected, but this was a sharper fall than both we and the Reserve Bank predicted.

The Covid lockdown that began mid-August distorted the result to some degree, although less so than during last year's lockdown. Since some people wouldn't have been able to actively look for work under lockdown conditions, they weren't counted as officially unemployed. Based on more detailed questioning, Stats NZ estimates that this reduced the unemployment rate by 0.2 percentage points. That implies a 'true' measure closer to 3.6% - still much lower than predicted.

The demand for workers has strengthened considerably over the course of this year. Employment surged by 2%

in the quarter, and was up 4.2% on a year ago. That's an extraordinary pace at a time when population growth has been relatively muted, due to the lack of migrant flows. As a result, people who have been out of the workforce for some time are being drawn back in - the drop in unemployment was largely among the longer-term unemployed, and the participation rate jumped back to an equal-record high.

These results demonstrate what we've been saying for months: the defining feature of the labour market right now is not a lack of supply, but strong demand. Individual employers will no doubt perceive this as a labour shortage if they have vacancies that are hard to fill. But at the macro level, that story doesn't stack up: if worker shortages were the main issue, we'd expect to see a stagnation in growth. What we're seeing is just the opposite.



With a labour market this tight, we'd expect to see an acceleration in wage growth. That indeed has been the case in the last two quarters, although it's been far from universal. The average increase has been dragged higher by a growing share of people receiving pay increases of 5% or more, with employers citing the need to match market rates and retain staff. The pressure for cost-of-living increases, with inflation surging higher in the near term, still lies ahead of us.

We've now revised up our forecasts for the OCR over the next few years. Previously, we were forecasting that a gradual glide path up to 2% would be enough to keep inflation on target over the medium term. But that is looking increasingly unlikely. We think that the Reserve Bank will need to go beyond a 'neutral' level of the cash rate and into 'tight' territory, at least for a time, in order to rein in demand.

Higher interest rates will have major implications for the housing market. We have long used a 'user cost' approach (based on a 1984 paper, which we adapted to New Zealand settings) to explain the general trend in house prices. The key insight is that interest rates, rather than supply-side issues, are by far the most important driver of changes in house prices. Notably, in RBNZ Governor Orr's speech on housing last week, the analysis behind it also adopted this user cost approach.

As mortgage rates rise, we expect to see a substantial slowing in house price growth over the coming months, turning to modest price declines by the second half of 2022. Even then, the recent rate of increase has been so dramatic that, on our forecasts, it could take a few years just to get house prices back to where they were at the start of this year.

It's important to note that the upswing in mortgage rates is already well advanced. While most forecasters – and the RBNZ's most recent published projections back in August

– suggest a peak in the cash rate of around 2%, wholesale interest rates are already consistent with a peak closer to our view of 3%. (Whether this reflects a genuinely-held belief by traders, or an overreaction in a volatile market, is irrelevant at this stage.)

Those wholesale interest rates have in turn been reflected in the sharp rise in mortgage rates over recent weeks. The shorter-term fixed mortgage rates, which are generally the most popular, have risen by more than a percentage point from their lows in July. Consequently, even if we're correct that the cash rate will peak at 3%, a two-year fixed mortgage rate is already closer to its peak than its trough for this cycle.

Official Cash Rate



Michael Gordon, Acting Chief Economist

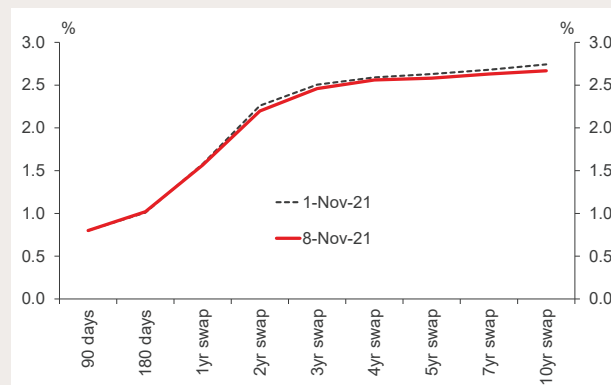
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Fixed vs floating for mortgages.

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



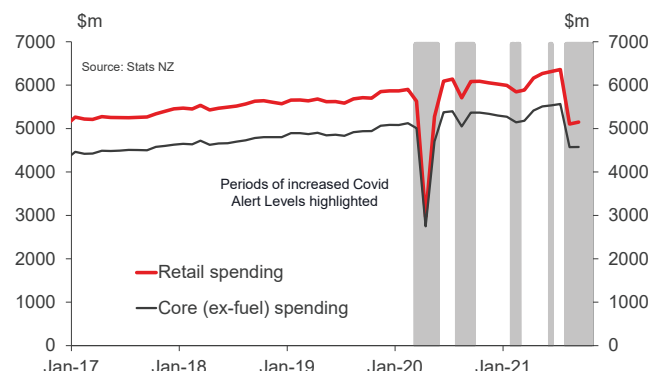
The week ahead.

NZ Oct retail card spending

Nov 9, Last: +0.9%, Westpac f/c: +15.0%

- Following a 20% fall in August, retail spending rose by only 0.9% in September. The Covid Alert Level was dialled back through September. However, tighter restrictions in Auckland earlier in the month and continued social distancing requirements elsewhere meant that spending levels remained subdued.
- We're forecasting a 15% rise in spending in October reflecting the lower Alert Levels compared to September and August. Even so, that would still leave spending below the levels we saw prior to the Delta outbreak.

NZ retail card spending

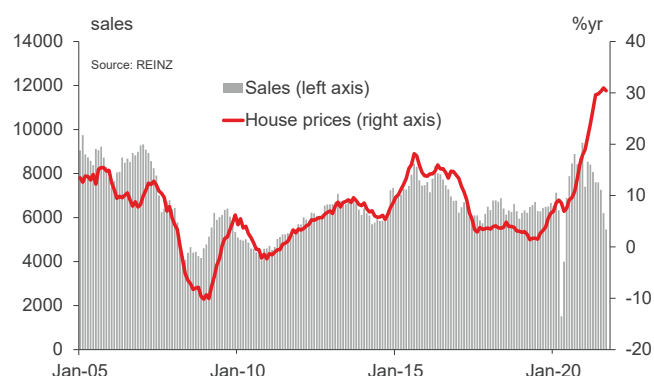


NZ Oct REINZ house sales and prices

Nov 10-12 (TBC), Sales last: -11.9%, Prices last: +30.4%yr

- Housing market turnover has been hit by renewed Covid-19 restrictions since August, although last year's experience left realtors in a better position to provide online services this time. Listings data points to a strong lift in sales in October, if not fully back to pre-lockdown levels, and Auckland remains on the back foot.
- House sale prices have continued their strong momentum through the lockdown, unlike last year when there was at least a short period of falling prices. The flipside is that we don't expect to see a resurgence in prices as the restrictions are lifted this time.
- The bigger looming issue for house prices is that fixed-term mortgage rates are now clearly rising – even the lowest points on the mortgage curve have risen by more than a percentage point since August. We expect this to have a significant impact on the housing market's momentum in the coming months.

REINZ house prices and sales

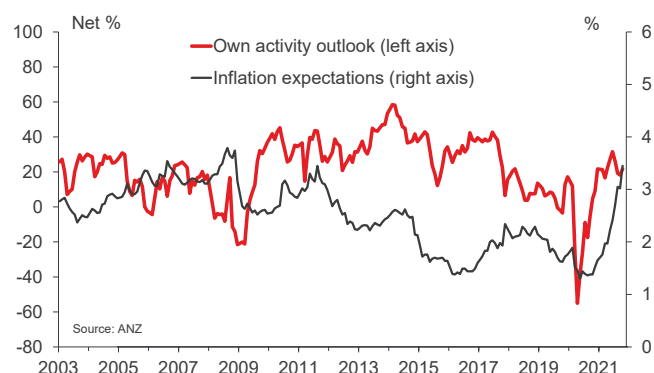


ANZBO business confidence (Preliminary), November 2021

November 11, Expectations for Own Activity: +21.7

- Business confidence held firm in October. In addition, inflation expectations continued to rise; across all industries, inflation expectations are now running above the top of the RBNZ's inflation target band.
- While measures of activity are expected to hold firm in November, there is a risk that expectations for profitability could decrease. This will be the first survey where all responses were taken after the strong CPI release. Anecdotally we're hearing that despite output price increases, many firms are still experiencing margin contraction as costs have risen by a greater amount. With that in mind, it will be worth keeping an eye on the survey's inflation gauges which have continued to escalate in recent months.

NZ business confidence



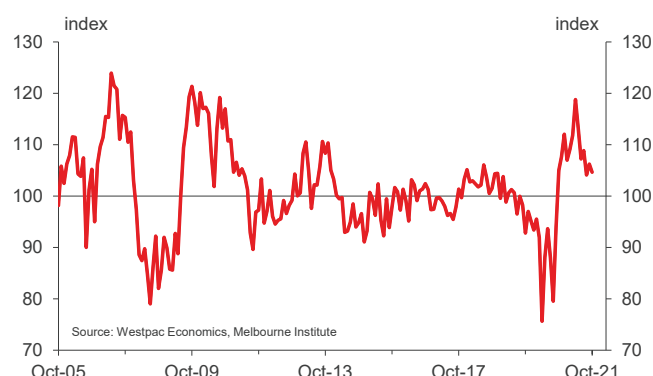
The week ahead.

Aus Nov Westpac-MI Consumer Sentiment

Nov 10, Last: 104.6

- Consumer Sentiment declined 1.5% in October but remained in optimistic territory at 104.6 despite ongoing lockdowns in Sydney and Melbourne. Sentiment has clearly been supported by rising vaccination rates and the promise of an eventual easing of restrictions.
- A month on and that promise is now being realised with life returning to normal for most Sydney-siders, restrictions easing in Melbourne and more to come in coming weeks. COVID cases remain low in NSW and are coming under control in Vic.
- Other developments may be a little unsettling with a lift in inflation both locally and abroad prompting a big shift in market expectations for interest rates and a shift in RBA rhetoric, albeit still with a commitment to leave official rates unchanged for what is likely to be an extended period yet.

Aus Consumer Sentiment Index

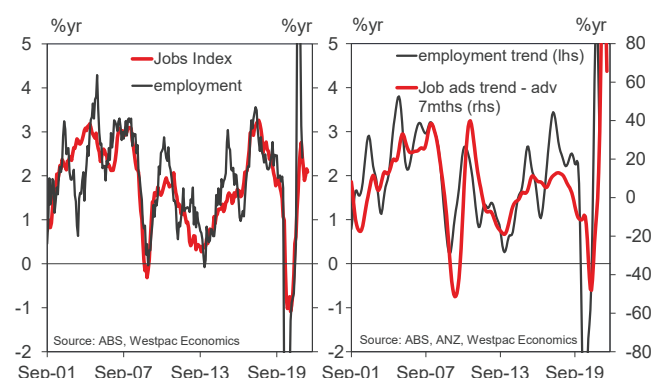


Aus Oct Labour Force employment change

**Nov 11, Last: -138k, WBC f/c: -50k
Mkt f/c: 50k, Range: -50k to 120k**

- The 138k Sep fall in employment was better than our -200k forecast and around market expectations for -150k. Vic was the hardest hit, as expected, but it was not as bad as we feared with the detail also showing signs of a nascent recovery in NSW.
- Surprisingly, hours worked lifted 0.9% in Sep with a 5.4% gain in Qld and a 2.7% gain in NSW partially offset by a 3.6% contraction in Vic. This is a further promising sign the NSW economy is already starting to recover and Qld is building on its solid base.
- The various leading indicators including job ads, unemployment expectations and the business surveys (as summarised in our Jobs Index) remained firmed during the most recent lockdowns, strengthening further as NSW started to reopen in Oct. Our -50k forecast is balancing the start of a recovery in NSW vs ongoing lockdown drags in Vic. Risks are to the upside.

Aus leading indicators of employment

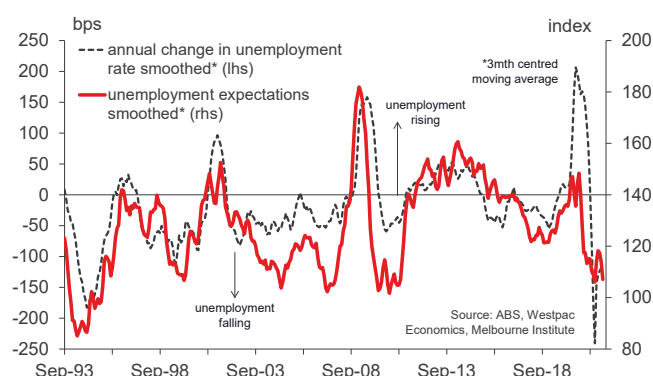


Aus Oct Labour Force unemployment rate

**Nov 11, Last: 4.6%, WBC f/c: 4.7%
Mkt f/c: 4.8%, Range: 4.5% to 4.9%**

- In Sep there was a sizeable 0.7ppt fall in participation to 64.5% driving a 129.1k contraction in the labour force. The labour force has now contracted by 334.4k though the last three months. The Sep fall in participation limited the lift in unemployment to 0.1ppt (4.6%). On current trends it is very possible that unemployment remains below 5% through to the end of the year despite the recent lockdowns in NSW and Vic. A lot will depend on how participation bounces back in the recovery phase.
- We expect to see 0.2ppt drop in participation to 64.3% which will result in a 40k drop in the labour force, enough to limit the rise in unemployment to just 0.1ppt (rounded) to 4.7%.
- Readers may remember that during the recovery through June and July of 2020 a surge in participation lifted the unemployment rate to 7.4% from 7.0%. We expect something similar to happen again in Nov and Dec but it could happen earlier suggesting there is an upside rise to our Oct unemployment forecast.

Aus unemployment rate

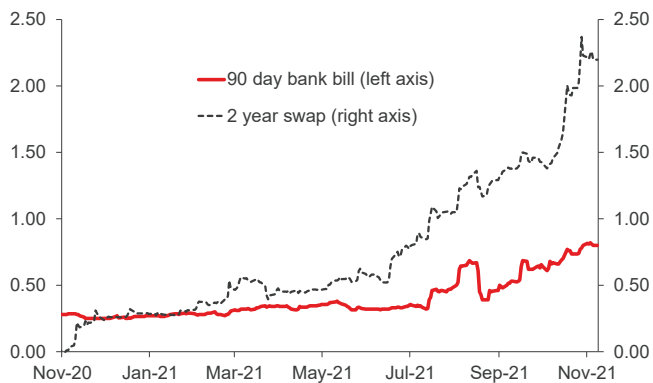


New Zealand forecasts.

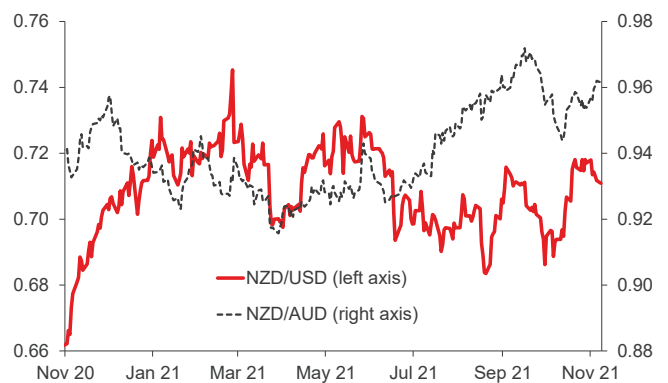
Economic forecasts	Quarterly				Annual			
	2021				2022			
% change	Jun (a)	Sep	Dec	Mar	2019	2020	2021f	2022f
GDP (Production)	2.8	-5.5	4.5	2.2	2.4	-2.1	4.7	4.8
Employment	1.0	2.0	0.2	0.1	1.2	0.6	3.8	0.3
Unemployment Rate % s.a.	4.0	3.4	3.6	3.6	4.0	4.8	3.6	3.5
CPI	1.3	2.2	0.6	0.8	1.9	1.4	5.1	2.7
Current Account Balance % of GDP	-3.3	-3.9	-4.4	-4.2	-2.9	-0.8	-4.4	-5.2

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	2.70	2.80	2.85	2.90	3.00	3.00	3.00	2.95
NZD/USD	0.71	0.72	0.73	0.74	0.74	0.74	0.74	0.73
NZD/AUD	0.95	0.95	0.95	0.95	0.95	0.94	0.93	0.94
NZD/JPY	79.5	80.6	82.5	83.6	84.4	84.4	85.1	84.7
NZD/EUR	0.60	0.60	0.61	0.63	0.63	0.63	0.64	0.63
NZD/GBP	0.51	0.52	0.52	0.52	0.52	0.53	0.53	0.53
TWI	74.6	75.2	75.9	76.6	76.4	76.3	76.0	75.3

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 8 November 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.50%	0.50%	0.50%
30 Days	0.68%	0.56%	0.53%
60 Days	0.74%	0.65%	0.60%
90 Days	0.80%	0.74%	0.67%
2 Year Swap	2.20%	1.99%	1.46%
5 Year Swap	2.58%	2.38%	1.91%

NZ foreign currency mid-rates as at 8 November 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7109	0.7166	0.6930
NZD/EUR	0.6154	0.6172	0.5980
NZD/GBP	0.5276	0.5207	0.5080
NZD/JPY	80.67	81.50	77.72
NZD/AUD	0.9615	0.9565	0.9478
TWI	75.71	75.91	74.05

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 08					
Eur	Nov Sentix investor confidence	16.9	–		Still well above average despite uncertainties.
US	FOMC Chair Powell	–	–	–	To make opening remarks at Fed diversity conference.
	Fedspk	–	–	–	Clarida, Harker, Bowman and Evans.
Tue 09					
NZ	Oct card spending	1.6%	–	15.0%	Covid restrictions still affecting the level of spending.
Aus	Oct NAB business survey	5	–	–	Emerging from lockdowns, a positive for conditions & confidence.
Chn	Oct new loans, CNYbn	1660.0	800.0		Tentative date. Authorities are making sure credit...
	Oct M2 money supply %yr	8.3%	8.3%		... is freely available to the right borrowers.
Eur	Nov ZEW survey of expectations	21	–		Expectations have dropped back to average levels in '21.
US	Oct NFIB small business optimism	99.1	98.5		Tight labour market and delta to weigh on confidence.
	Oct PPI	0.5%	0.6%		Supply issues continue to lift prices.
	FOMC Chair Powell	–	–	–	To speak at joint Fed, ECB and BoC diversity conference.
	Fedspk	–	–	–	ECB's Knot & Fed's Bullard on Panel. Daly & Kashkari too.
Wed 10					
NZ	Oct REINZ house sales (TBC)	–11.9%	–	–	Sales will bounce on easing of Covid restrictions...
	Oct REINZ house prices %yr (TBC)	30.4%	–	–	... while prices never lost their momentum during lockdown.
Aus	Nov WBC-MI Consumer Sentiment	104.6	–	–	End to 'delta' lockdowns to provide a boost?
	Weekly payrolls, week ending Oct 16	–	–	–	The critical 2wks to see how strong the NSW recovery is.
Chn	Oct CPI %yr	0.7%	1.3%		Consumer inflation remains weak...
	Oct PPI %yr	10.7%	12.4%		... despite persistent upstream price pressures.
US	Oct CPI	0.4%	0.6%	0.5%	Step up in core prices to drive lift in Oct.
	Initial jobless claims	269k	–		Gradual downtrend continuing.
	Sep wholesale inventories	1.1%	1.1%		Final release for the month.
Thu 11					
NZ	Oct food price index	0.5%	–	–0.8%	Seasonal drop in vegetable prices.
	Nov ANZ business confidence (prelim)	21.7	–	–	Activity to hold firm, with risk of profitability falling due to costs.
Aus	Nov MI inflation expectations	3.6%	–	–	
	Oct employment	–138.0k	50.0k	–50	Turnaround in NSW & strong lead indicators suggest upside...
	Oct unemployment rate	4.6%	4.8%	4.7%	... risk to job but rebounding part. could still lift unemployment.
UK	Q3 GDP	5.5%	1.5%		Fuel shortages, delta and supply issues to slow growth.
	Sep trade balance £bn	–37.16	–		Trade environment challenging for UK given Brexit.
US	Veterans Day	–	–	–	Federal public holiday (bond markets closed, equities open).
Fri 12					
NZ	Oct manufacturing PMI	51.4	–	–	Continued recovery as Auckland's restrictions were eased.
Eur	Sep industrial production	–1.6%	0.2%		Production to stabilise after Aug drop.
US	Sep JOLTS job openings	10439k	–		Hire & quit rates & openings to give context on job market.
	Nov Uni. of Michigan sentiment	71.7	72.5		Remains weak versus confidence in other similar nations.

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	1.78	1.95	2.05	2.15	2.25	2.30	2.30	2.30	2.30
International									
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.375	0.625	0.875	0.875
US 10 Year Bond	1.53	1.75	1.90	2.00	2.10	2.20	2.25	2.30	2.30

Exchange rate forecasts	Latest	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Dec-23
AUD/USD	0.7399	0.75	0.76	0.77	0.78	0.78	0.79	0.80	0.78
USD/JPY	113.71	114	115	115	115	116	116	117	117
EUR/USD	1.1554	1.18	1.18	1.18	1.17	1.17	1.16	1.16	1.15
GBP/USD	1.3499	1.38	1.39	1.40	1.41	1.41	1.40	1.40	1.39
USD/CNY	6.3971	6.35	6.30	6.25	6.25	6.20	6.20	6.15	6.10
AUD/NZD	1.0413	1.06	1.06	1.05	1.05	1.05	1.07	1.08	1.07

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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