



Kōkako

# Weekly Economic Commentary.

## Too hot to hold.

With unemployment dropping back to its pre-Covid lows and wage growth accelerating, the New Zealand economy is clearly running hot. The Reserve Bank won't be holding interest rates at their current low levels for much longer.

The New Zealand labour market has tightened up even faster than we expected over the last few months. The unemployment rate fell to 4.0% in the June quarter, from a downwardly revised 4.6% in the March quarter. We and the market were forecasting a drop to 4.4%, while the Reserve Bank's May *Monetary Policy Statement* assumed no change. The unemployment rate is now back to the lowest point that it reached in 2018-19 before Covid struck, and is at its lowest since the Global Financial Crisis.

Other measures of labour market capacity tell a similar story. The underutilisation rate had lifted to 12.1% in the March quarter – possibly due to the brief period that Auckland spent at Covid Alert Level 3 – but has now dropped back to 10.5%. This isn't really surprising – as we noted in our preview of the labour data, the underutilisation rate has typically been around 2.5 times the unemployment rate through both booms and busts, and this time is proving to be no different.

Meanwhile, wage growth has started to pick up after some subdued gains in the last year. The Labour Cost Index rose by 0.7% in the June quarter, compared to 0.4% gains in the previous two quarters – a significant turnaround for what is, by design, a slowly-evolving series. The share of workers who received a pay rise was significantly higher – especially for those receiving an increase of 5% or more – and a growing share of employers said that they've had to increase pay rates to attract or retain staff.

It's easy to portray this tightening in the labour market as a product of supply-side constraints. We're hearing more these days about skill shortages across a range of industries, the loss of access to migrant workers due to the border closure, and a rise in poaching of existing workers. But that's only part of the story. If this was solely due to a shortage of workers, some of the things we'd expect to see are:



- A normal number of job vacancies, but with an increasing number of them going unfilled
- A stalling in net employment growth
- Wage pressures emerging while unemployment is still relatively high

That's not what's happening. Job advertisements are about 40% higher than their pre-Covid peak. Employment growth is accelerating. The number of people on the Jobseeker Support benefit is dropping at a record pace, and there's still another 40,000 more than there were before the Covid lockdown. And the pickup in wage growth has been in the context of a 13-year low in the unemployment rate.

The border closure has meant that very few migrants have arrived over the last 18 months. But we've also seen a sharp drop in the number of people leaving the country, and there are many short-term arrivals who have ended up staying here inadvertently.

As a result, we estimate that the working-age population is about 20,000 people (0.5%) smaller than it would have been based on pre-Covid trends. By comparison, the number of people employed has risen by 36,000 since the border closure, and was up by 29,000 in the last quarter alone. (Note that these figures exclude seasonal workers, whose absence has indeed been a severe supply-side constraint for the horticultural sector.)

The facts are more characteristic of strong demand. Recent data has increasingly been pointing to an economy that is rapidly heating up, and the labour market surveys have added to the list.

The labour data cements our view (from 16 July) that the Reserve Bank will start to raise the OCR at this month's *Monetary Policy Statement*, with a total of three 25 basis point

hikes by the end of this year. Financial markets have now firmly moved in favour of an August OCR hike, and are even pricing some chance of a 50 basis point move.

We don't see a 50bp move as the most likely outcome, but we wouldn't rule it out. The RBNZ's Monetary Policy Committee has already shown itself to be an activist one, and if they felt that 50 basis points of tightening was warranted, they wouldn't necessarily space it out for the sake of spacing it out. Ultimately though, the question of 25bp or 50bp is one of tactics rather than economics. If the RBNZ did move by 50bp in one go, we'd still be inclined to forecast a total of 75bps of hikes by the end of the year.

Hiking rates this month would put the RBNZ ahead of its contemporaries by quite some margin. However, that reflects the unique circumstances that the RBNZ faces. Eliminating the spread of Covid has allowed the domestic economy to build up a head of steam over the last year, even as fiscal and monetary policy remain on 'emergency' settings. As Governor Orr reportedly said in a speech last month, this isn't a conversation we'd be able to have in any other country.

Of course, an incursion of the Delta variant onto our shores would mean that all predictions are off the table. Indeed, we were surprised in July that the RBNZ considered an early tightening to be the 'least regrets' approach, especially while our vaccination rate remains so low. But if New Zealand were to be forced into another Covid lockdown, there is nothing that would stop the RBNZ from immediately reversing any rate hikes that it had made; the cost would largely be a reputational rather than an economic one.

**Michael Gordon**, Acting Chief Economist

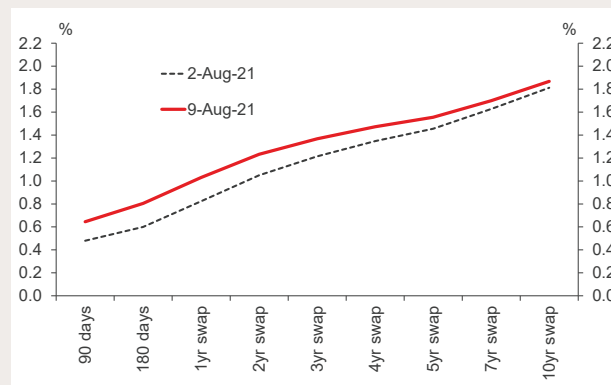
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## Fixed vs floating for mortgages.

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**



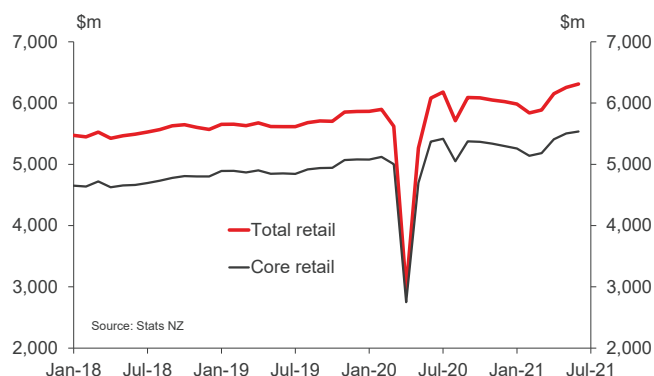
# The week ahead.

## NZ Jul retail card spending

**Aug 10, Last: +0.9%, Westpac f/c: -0.5%**

- Spending in the three months to June was up nearly 6% on the previous three-month period. And while some of that may have been due to price increases, volumes growth also appears to have been robust. Importantly, increases in both retail prices and volumes point to firmness in consumer demand.
- We expect that retail spending levels will edge back by 0.5% in July. That would still leave spending at firm levels. July saw the travel bubble with Australia being put on pause, and that's likely to be a drag on hospitality spending (which had taken a step higher in recent months). Spending on durables, which has driven much of the recent strength in overall spending, is expected to remain robust.

## Retail card spending



## NZ Jul REINZ house sales and prices

**Aug 12 (TBC), Sales last: -1.1%, Prices last: +29.8%yr**

- The housing market has cooled to some degree since loan-to-value restrictions were reimposed in March. However, the pace of sales remains above pre-Covid levels, and prices have continued to rise at an above-average pace.
- Indicators so far suggest that the market remained reasonably active in July. Available listings have fallen to new lows, as homes are being snapped up faster than they are entering the market.
- Short-term mortgage rates began to rise in July, as the Reserve Bank signalled that it is now time to start withdrawing monetary stimulus. While the impact of this may not come through immediately, we expect a more substantial cooling in the housing market over the following months.

## REINZ house prices and sales

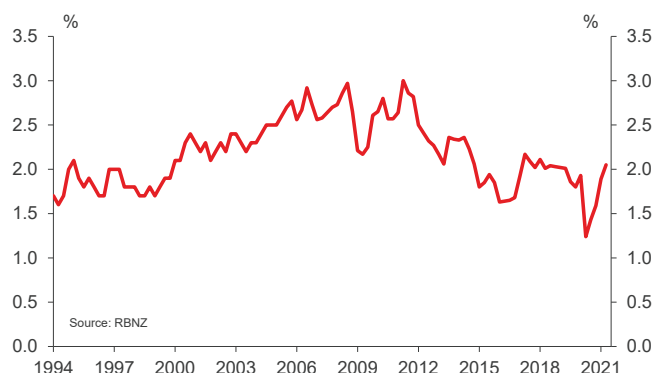


## NZ Q3 Survey of expectations

**Aug 12, Two year ahead inflation expectations, Last: 2.05%**

- Inflation expectations have been pushing higher in recent months and are now running a little above the RBNZ's 2% target mid-point.
- We expect that the closely watched RBNZ measure of two-year ahead inflation expectations will continue to push higher this quarter. The latest survey comes hot on the heels of the much stronger than expected June quarter inflation result. Recent months have also seen firm indications for domestic activity and widespread reports of growing cost pressures.
- We already expect the RBNZ will increase the cash rate at its August meeting. However, a strong rise in inflation expectations could be important for the RBNZ's rhetoric around the outlook.

## RBNZ survey of inflation expectations



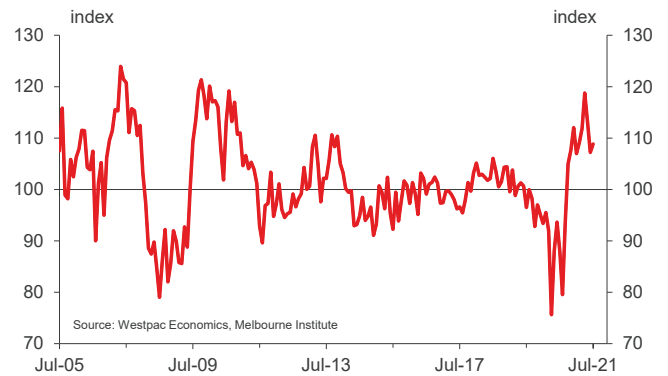
## The week ahead.

### Aus Aug Westpac-MI Consumer Sentiment

**Aug 11, Last: 107.2**

- Sentiment rose 1.5% to 107.2 in July. The survey was conducted in the midst of NSW's 'delta' lockdown but prior to the tightening and extension of restrictions announced on July 9. The month to month rise was due to strong gains in Vic and WA, where Covid restrictions deployed in June had been eased, more than offsetting a sharp fall in NSW.
- The Covid situation will likely weigh more heavily on sentiment in August. In NSW, lockdown measures remain firmly in place and have had a mixed impact on cases – slowing but not stopping the virus spread – with the policy focus now on accelerating vaccinations. Meanwhile, Vic and Qld have both imposed new snap lockdowns during the survey week. For sentiment, the concern is two-fold: 1) that sentiment in NSW is still coming from a relatively firm level and so has scope for more substantive declines; and 2) that spill-overs to other states have been minimal. Both highlight downside risks to the August update.

### Aus Consumer Sentiment Index

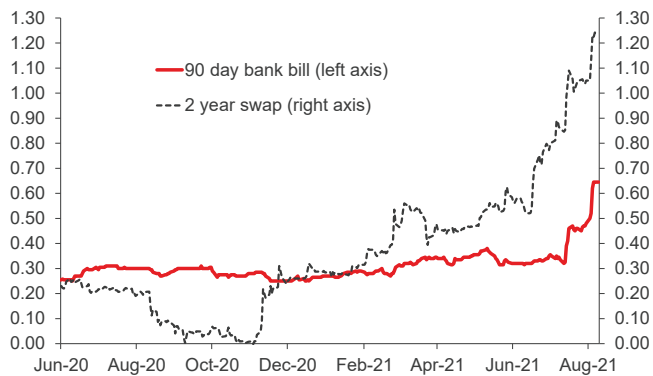


# New Zealand forecasts.

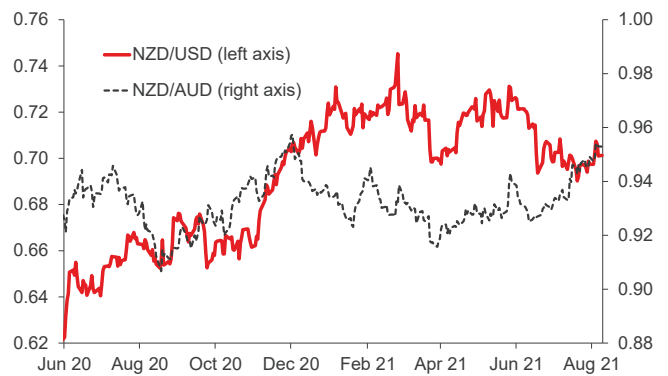
Economic forecasts		Quarterly				Annual		
	2021							
% change	Mar (a)	Jun	Sep	Dec	2019	2020	2021f	2022f
GDP (Production)	1.6	0.6	0.9	1.3	2.4	-2.9	5.8	4.5
Employment	0.6	1.1	0.5	0.4	1.2	0.7	2.6	1.5
Unemployment Rate % s.a.	4.6	4.0	3.8	3.7	4.0	4.8	3.7	3.5
CPI	0.8	1.3	0.9	0.2	1.9	1.4	3.3	2.0
Current Account 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	0.73
NZD/AUD	0.95	0.95	0.95	0.94	0.94	0.94	0.94	0.94
NZD/JPY	78.8	82.1	85.1	86.2	86.2	87.0	85.5	84.0
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	0.51
TWI	74.4	76.4	77.5	77.9	77.7	77.6	76.0	74.3

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 9 August 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.46%	0.32%	0.27%
60 Days	0.55%	0.39%	0.30%
90 Days	0.65%	0.46%	0.34%
2 Year Swap	1.23%	1.05%	0.86%
5 Year Swap	1.56%	1.44%	1.34%

NZ foreign currency mid-rates as at 9 August 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7013	0.6976	0.6996
NZD/EUR	0.5962	0.5924	0.5892
NZD/GBP	0.5051	0.5070	0.5035
NZD/JPY	77.36	77.10	77.07
NZD/AUD	0.9529	0.9474	0.9351
TWI	74.57	74.23	73.97

## Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 09</b>					
Chn	Jul CPI %yr	1.1%	0.8%	-	Softer food/agricultural prices should see CPI growth slow.
	Jul PPI %yr	8.8%	8.6%	-	Coal and steel to be a major driver of upstream prices.
	Jul M2 money supply %yr	8.6%	8.7%	-	Annual growth has accelerated off low of 8.1% in May.
	Jul new loans, CNYbn	2120.0	1200.0	-	Should be aided by required reserve ratio cut in mid-July.
Eur	Aug Sentix investor confidence	29.8	-	-	Reopening optimism may be curtailed by Delta.
US	Jun JOLTS job openings	9209k	9270k	-	Reports of widespread shortages to keep openings elevated.
	Fedspeak	-	-	-	FOMC's Bostic and Barkin to speak.
<b>Tue 10</b>					
NZ	Jul card spending	1.6%	-	-0.5%	Closure of the travel bubble will be a drag.
Aus	Jul NAB business survey	24	-	-	Gauging the impact of recent lockdowns.
Eur	Aug ZEW survey of expectations	61.2	-	-	Accommodative ECB to support expectations.
US	Jul NFIB small business optimism	102.5	102.0	-	Will be looking for detail around employment and prices.
	Q2 productivity	5.4%	3.5%	-	Productivity has been volatile on labour market flux.
	Fedspeak	-	-	-	FOMC's Mester to discuss inflation risks.
<b>Wed 11</b>					
Aus	Aug WBC-MI Consumer Sentiment	108.8	-	-	Delta likely weigh more heavily on sentiment this month.
US	Jul CPI	0.9%	0.5%	-	Inflation transitory; contained by labour market slack.
	Jul monthly budget statement	-174.2	-255.0	-	To remain wide on stimulus outflows.
	Fedspeak	-	-	-	FOMC's Bostic & George, and NY Fed's Logan to speak.
<b>Thu 12</b>					
NZ	Jul REINZ house sales	-1.1%	-	-	Due this week. The housing market remains perky...
	Jul REINZ house price index %yr	29.8%	-	-	...but rising interest rates will be a drag over time.
	Jul food price index	1.40%	-	0.7%	Ongoing firmness in fresh produce prices.
	Q3 RBNZ inflation expectations	2.05%	-	-	Set to push higher consistent with firmness in activity.
Aus	Aug MI inflation expectations	3.7%	-	-	To gauge hhlds' views on food, fuel & dwelling price rises.
Eur	Jun industrial production	-1.0%	0.4%	-	Spending shifting from goods to leisure and services.
UK	Q2 GDP	-1.6%	4.8%	-	Growth has accelerated briskly out of double-dip recession.
	Jun trade balance £bn	884	-	-	Beginning to stabilise after Covid/Brexit volatility.
US	Initial jobless claims	-	-	-	Downtrend to continue, hastened by expiry of u/e benefits.
	Jul PPI	1.0%	0.6%	-	Business surveys indicate upstream pressures are cresting.
<b>Fri 13</b>					
NZ	Jul manufacturing PMI	60.7	-	-	Strong rises in house prices should provide a tailwind
	Jun net migration	1182	-	-	Still low despite increased in arrivals from Australia.
Eur	Jun trade balance €bn	9.4	-	-	Easing off Jan high, in part due to supply shortages.
US	Jul import price index	1.0%	0.6%	-	Energy prices a major driver of recent rise.
	Aug Uni. of Michigan sentiment	81.2	81.2	-	12mth inflation expectations surge, but contained long-term.



## 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	4.5
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	2.4
<b>United States</b>						
Real GDP %/yr	2.3	3.0	2.2	-3.5	6.1	4.3
CPI inflation %/yr	2.1	2.4	1.9	1.2	4.5	2.8
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	2.5	2.7
<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	6.5	5.0
<b>China</b>						
Real GDP %/yr	6.9	6.7	5.8	2.3	9.3	5.8
<b>East Asia ex China</b>						
Real GDP %/yr	4.7	4.4	3.7	-2.4	4.6	5.0
<b>World</b>						
Real GDP %/yr	3.8	3.6	2.8	-3.3	5.7	4.7
Forecasts finalised 6 August 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	0.01	0.04	0.07	0.10	0.15	0.20	0.40	0.70	0.95
10 Year Bond	1.18	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	1.23	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	0.7396	0.75	0.78	0.80	0.82	0.82	0.82	0.80	0.78
USD/JPY	109.87	111	111	112	112	112	113	114	115
EUR/USD	1.1826	1.21	1.22	1.23	1.22	1.21	1.21	1.20	1.19
GBP/USD	1.3923	1.41	1.42	1.43	1.44	1.45	1.44	1.44	1.43
USD/CNY	6.4616	6.35	6.25	6.15	6.10	6.05	6.00	6.00	5.95
AUD/NZD	1.0499	1.06	1.05	1.05	1.06	1.06	1.06	1.07	1.07

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