



Weekly Economic Commentary.

Back to work.

New Zealand economic data continues to beat expectations by a wide margin. First GDP was much stronger than expected, then inflation surprised on the upside, and now unemployment has fallen from 5.3% to 4.9% when we expected an increase. Market thoughts are starting to turn to the timing of RBNZ hikes, but we still think that is years off. Meanwhile, housing construction is now wildly exceeding population growth.

The labour market report featured a solid rise in employment, a shift away from part-time to full-time work, a drop in the number of underemployed people, and a sharp lift in hours worked. The only weak-spot was that wage growth remains slow.

Despite its resilience overall, the labour market is actually very uneven. The closure of the border has seen a substantial drop in employment in areas such as retail and accommodation, transport, media and travel services. But the Government's massive fiscal stimulus measures, combined with the RBNZ's interest rate reductions, have pumped up sectors like construction, housing, healthcare, education, and public services, and that is where the jobs growth was found.

Even before last week's figures, our view was that unemployment was nearing its peak. Indicators based on

tax data suggest that the number of jobs has picked up after last year's lockdown, and job ads show that firms are rapidly returning to hiring. We expect unemployment will fall gradually over most of 2021, from a much lower starting point than previously expected.

The question now is whether the RBNZ and Government start to reduce their stimulus measures. The rebound in the level of GDP, the surging housing market, higher than expected inflation, and now falling unemployment all make it obvious that low interest rates and massive fiscal spending have had a very powerful effect. Whether that proves "too much" or not will depend mainly on inflation.

In the near term, it is obvious that inflation is going to lift sharply in response to higher oil prices and the disruptions



to supply chains. The case was sealed by last week's ANZ Business Outlook survey, which revealed that 47.1% of firms expect to increase their prices over the coming 12 months. That was the highest proportion in the history of the survey, which goes back to 1992. Following that data, we have lifted our forecast of near-term inflation once again, to 2.5% by June.

Assuming inflation does come in that high by June, it will be an alarming number for financial markets, where thoughts are already turning to the timing of interest rate hikes. But we do not think the RBNZ will be too fazed – we are forecasting that the RBNZ will keep the OCR at 0.25% for years, because we expect inflation to fall again. Once the supply disruptions have eased and oil prices have stabilised, annual inflation will drop back below 2%. The exchange rate has risen recently, and we are forecasting a further strong rise over the remainder of this year. In time, that will help suppress inflation, potentially pushing it well below 2%. Finally, there remains a big hole in aggregate demand due to the lack of international tourists, which is suppressing prices in areas like accommodation and could keep inflation suppressed for some time.

The earliest realistic time for the RBNZ to even think about tightening monetary policy is some time after international tourism has resumed. And that is still looking like it will be a way off. Optimism that a travel bubble with Australia could be established by Easter has faded as the new strains of the virus have generated renewed caution. And the border is highly unlikely to reopen to other countries this year. New Zealand's vaccine rollout will begin in earnest only in the second half of 2021, so immunity levels in the population will allow a cautious border opening only during 2022. It remains to be seen just how quickly tourism will recover after that.

Building boom.

The most obvious go-ahead sector in the economy right now is construction. Data last week showed that consent issuance

for residential buildings rose another 4.9% in December, and is now up a massive 16% over the past three months. Over 2020 as a whole, 39,420 new dwellings were consented, the highest number since 1974. 2021 is highly likely to prove even stronger.

Consent issuance numbers like this portend a very big construction boom indeed. Two key drivers are rising house prices and low interest rates, which improve the financial reward from building. We are also seeing households divert expenditure from overseas travel to house building and renovations, adding to demand.

This building boom is coming at a time when population growth has plunged to its lowest level in a decade. Net migration has been close to zero since Covid-19 struck, a far cry from the 70,000 net migrants the country received in 2019. This means that the severe housing shortages that have been dogging New Zealand are now rapidly eroding. By our estimates, housing shortages will continue to shrink even after migration resumes, because today's level of construction activity is so much higher than what is needed to keep pace with population growth even in a normal year.

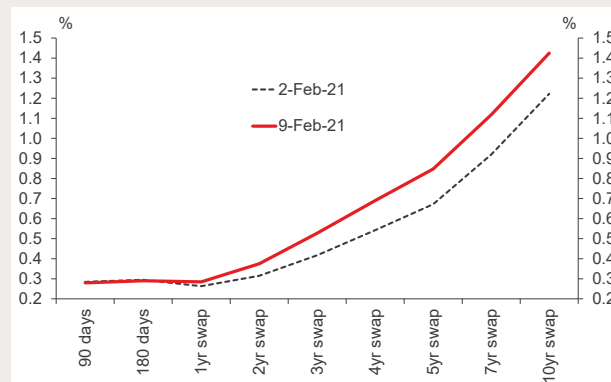
From a social point of view, it will be many years before anybody is saying that New Zealand has "enough houses" on the ground. But the economic effect of building so far in excess of population growth could become apparent sooner. We expect to see rent inflation easing within a year. And this erosion of housing shortages is one reason that we expect house price inflation to start gradually cooling from later in 2021.

However, the more important driver of house prices is interest rates. We expect rates will stay low for much of this year, and therefore we expect 15% house price inflation in 2021.

Fixed vs Floating for mortgages.

We now think that the RBNZ's OCR reduction cycle is over. If that is correct, there will be a period of relative stability in both fixed and floating mortgage rates ahead. Also, if there are no further OCR cuts then locking in a longer term mortgage rate, from three to five years, may prove less expensive for borrowers than taking a short-term rate now and refinancing later.

NZ interest rates



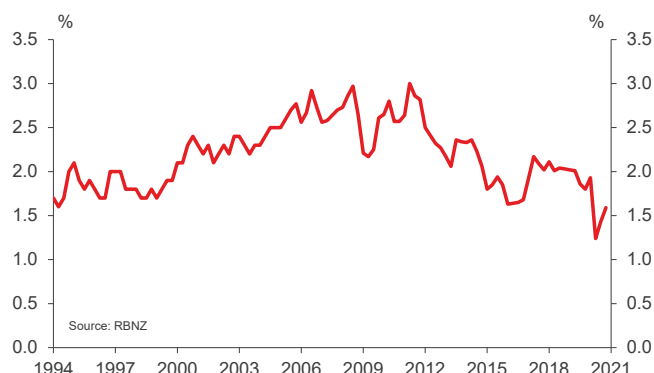
The week ahead.

NZ Q1 RBNZ survey of expectations

Feb 9, Inflation expectations – 2 years ahead, last: 1.59%

- While still low, the RBNZ's closely-watched survey of 2 year ahead inflation expectations pushed higher through the back half of 2020.
- We expect that there will be a further rise in the upcoming March quarter survey. Inflation surprised to the upside in the December quarter and supply disruptions have boosted the prices of some goods. We have also seen a firming in economic conditions.
- While some of the recent lift in inflation is likely temporary, a continued rise in inflation expectations would reinforce the case for the RBNZ keeping policy settings on hold at its upcoming February policy meeting.

RBNZ survey of inflation expectations

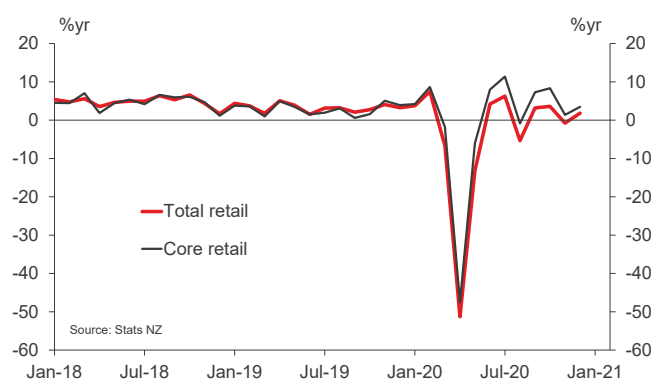


NZ Jan Retail Card Spending

Feb 11, Last: +3.5%/yr

- Retail spending growth lost some steam in late 2020. In part that's due to a lack of international tourists which has been a significant drag on spending in areas like hospitality and accommodation. That's been felt particularly acutely in regions like Queenstown and Auckland.
- Spending by New Zealanders has been firmer. And with overseas holidays off the cards, that's also boosted spending on domestic tourism, particularly in the central North Island.
- The closure of the borders has disrupted the normal seasonal pattern in monthly retail spending. As a result, Stats NZ is now only reporting unadjusted data. We expect that the January report will show that annual spending growth has cooled, mainly due to the loss of high spending international visitors during the peak of the tourist season

Retail spending on electronic cards



Aus Feb Westpac-MI Consumer Sentiment

Feb 10, Last: 107.0

- Consumer sentiment fell 4.5% in Jan, impacted by a partial tightening in COVID restrictions following clusters in parts of Sydney. While a pull-back was to be expected, the decline compares favourably to the 15% drop when clusters emerged in mid-2020, with the index level of 107.0 still firmly in optimistic territory.
- Local virus concerns have mostly eased since the start of the year with measures bringing Sydney's clusters back under control, cases remaining contained elsewhere and most measures relaxed. That said, the situation is still 'on edge' with Perth going into a 5-day lockdown and measures in Melbourne reintroduced after cases of community transmission were discovered. The Feb update will also capture reactions to the RBA's decision to extend extraordinary policy stimulus; more positive signs around the domestic economy, the housing sector in particular; and more positive news on the virus abroad albeit with vaccine rollouts yet to show a decisive impact.

Consumer Sentiment Index

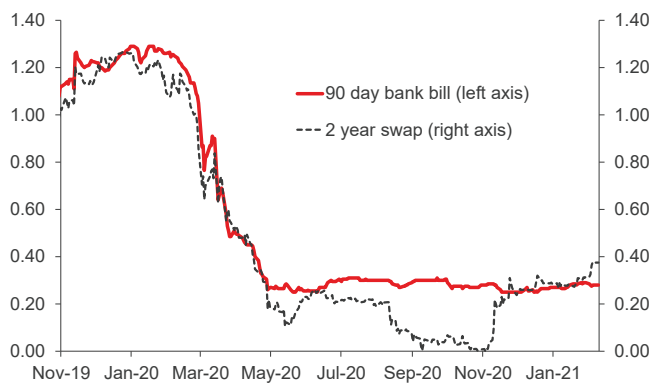


New Zealand forecasts.

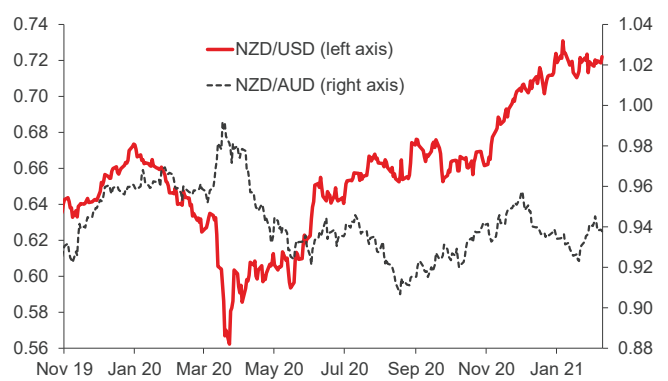
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Sep (a)	Dec	Mar	Jun	2019	2020f	2021f	2022f
GDP (Production)	14.0	0.0	0.6	1.6	2.3	-2.6	5.9	2.5
Employment	-0.8	-0.5	0.3	0.6	1.2	-0.6	2.2	2.9
Unemployment Rate % s.a.	5.3	4.9	5.0	5.1	4.1	4.9	4.9	4.2
CPI	0.7	0.5	0.6	0.4	1.9	1.4	1.6	1.3
Current Account Balance % of GDP	-0.8	-0.9	-1.2	-1.9	-3.3	-0.9	-2.1	-2.0

Financial forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.30	0.30	0.30	0.30	0.30	0.30
2 Year Swap	0.25	0.25	0.25	0.25	0.25	0.25
5 Year Swap	0.60	0.60	0.60	0.60	0.60	0.65
10 Year Bond	1.10	1.20	1.30	1.35	1.40	1.45
NZD/USD	0.73	0.74	0.75	0.76	0.78	0.78
NZD/AUD	0.94	0.94	0.94	0.93	0.92	0.92
NZD/JPY	75.9	77.0	78.0	79.0	81.9	81.9
NZD/EUR	0.60	0.60	0.60	0.61	0.62	0.61
NZD/GBP	0.53	0.54	0.54	0.55	0.55	0.55
TWI	75.8	76.1	76.5	76.7	77.9	77.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 9 February 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.26%	0.26%	0.26%
60 Days	0.27%	0.28%	0.27%
90 Days	0.28%	0.29%	0.27%
2 Year Swap	0.38%	0.31%	0.28%
5 Year Swap	0.85%	0.64%	0.57%

NZ foreign currency mid-rates as at 9 February 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7221	0.7190	0.7193
NZD/EUR	0.5993	0.5914	0.5912
NZD/GBP	0.5255	0.5251	0.5330
NZD/JPY	75.97	74.56	74.89
NZD/AUD	0.9378	0.9305	0.9321
TWI	75.19	74.69	74.86

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 08					
NZ	Waitangi Day observed	–	–	–	Markets closed.
Chn	Jan foreign direct investment %yr	5.5%	–	–	Easing off from growth peak in September
Eur	Feb Sentix investor confidence	1.3	–	–	Weak 'current situation' component offset by expectations.
US	Fedspeak	–	–	–	FOMC's Mester discusses the economy.
Tue 09					
NZ	Q1 RBNZ inflation expectations survey	1.6%	–	–	Likely to push higher, given recent supply disruptions.
Aus	Jan NAB business survey	14	–	–	Conditions up 7pts in Dec to an elevated +14 on reopening.
Chn	Jan new loans, CNYbn	1260.0	3500.0	–	A big month expected ahead of LNY holidays in Feb.
	Jan M2 money supply %yr	10.1%	10.0%	–	Set to maintain momentum.
US	Jan NFIB small business optimism	95.9	96.5	–	Should get a boost from success in controlling infections.
	Dec JOLTS job openings	6527	6450	–	Claims and employment change point to ongoing churn.
Wed 10					
Aus	Feb WBC-MI Consumer Sentiment	107.0	–	–	State border closures and COVID measures remain a focus.
Chn	Jan CPI %yr	0.2%	–0.2%	–	Recent increase driven by food prices; likely to abate.
	Jan PPI %yr	–0.4%	0.3%	–	Commodity prices have supported the recent rise.
UK	Dec trade balance £bn	–4995	–	–	Deficit widening on rising imports.
	Q4 GDP	16.0%	–	–	Monthly GDP points to a turbulent qtr on holiday lockdowns
US	Jan CPI	0.4%	0.4%	–	Price recovery has seen CPI pick up, but still below target.
	Jan monthly budget statement	–143.6	–	–	Deficit widened c. 60% through the year to Q4 2020.
	Fed Chair Powell	–	–	–	Speaks to the Economic Club of New York.
Thu 11					
NZ	Jan retail card spending, %yr	3.5%	–	–	A lack of international visitors is dampening spending.
Aus	Feb MI inflation expectations	3.4%	–	–	Interested to see if Covid is affecting price expectations.
US	Initial jobless claims	779k	–	–	Claims moderating from early January peak.
Fri 12					
NZ	Jan manufacturing PMI	48.7	–	–	Business conditions have been firming.
	Jan food price index	0.1%	–	1.0%	Annual growth easing as Covid disruptions pass.
Eur	Dec industrial production	2.5%	0.0%	–	Output subdued with major producers still under lockdown.
US	Feb Uni. of Michigan sentiment	79.0	80.5	–	Accelerating vaccine rollout should support confidence.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP %/yr	2.4	2.8	1.9	-2.6	4.2	3.3
CPI inflation %/yr	1.9	1.8	1.8	0.9	2.6	2.2
Unemployment rate %	5.5	5.0	5.2	6.8	6.0	5.3
Current account % of GDP	-2.6	-2.1	0.7	2.4	1.9	-0.1
United States						
Real GDP %/yr	2.3	3.0	2.2	-3.5	4.4	4.5
CPI inflation %/yr	2.1	2.4	1.9	1.1	1.8	1.9
Unemployment rate %	4.4	3.9	3.7	8.1	5.7	4.5
Current account % of GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
Japan						
Real GDP %/yr	2.2	0.3	0.7	-5.5	2.5	2.2
Euro zone						
Real GDP %/yr	2.6	1.8	1.3	-6.8	4.0	3.5
United Kingdom						
Real GDP %/yr	1.9	1.3	1.5	-10.5	5.0	5.5
China						
Real GDP %/yr	6.9	6.8	6.1	2.3	10.0	5.7
East Asia ex China						
Real GDP %/yr	4.7	4.4	3.7	-2.6	5.2	5.0
World						
Real GDP %/yr	3.8	3.5	2.8	-3.2	5.8	4.6
Forecasts finalised 5 February 2021						

Interest rate forecasts	Latest	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Dec-22
Australia								
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.01	0.02	0.02	0.02	0.02	0.04	0.06	0.10
10 Year Bond	1.24	1.15	1.30	1.45	1.55	1.70	1.75	1.95
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.14	1.10	1.25	1.40	1.50	1.60	1.65	1.75

Exchange rate forecasts	Latest	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Dec-22
AUD/USD	0.7601	0.78	0.79	0.80	0.82	0.85	0.85	0.82
USD/JPY	105.53	104	104	104	104	105	105	105
EUR/USD	1.1963	1.22	1.23	1.24	1.25	1.26	1.27	1.28
GBP/USD	1.3668	1.37	1.37	1.38	1.39	1.41	1.41	1.41
USD/CNY	6.4717	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0621	1.07	1.07	1.07	1.08	1.09	1.09	1.09

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