WESTPAC WEEKLY ECONOMIC COMMENTARY

Was Covid's bark worse than its bite?

13 December 2021

Hihi

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The festive season is upon us. And as the economy opens up again, households are also opening up their wallets. We expect that the recent Delta-related softness will give way to firmer activity over the coming months with a return to strong levels of economic activity in 2022. But at the same time, interest rates are also on the rise, and they will become an increasing drag on demand over time.

It's been a rocky few months for the New Zealand economy, particularly for those in Auckland and other parts of the upper North Island. We expect that this week's GDP report (due for release on Thursday) will show that economic output fell by 3% in the September quarter, dragged down by the outbreak of the Delta variant and related dialling up of Alert Level restrictions. But while that would be a sizeable fall in economic output, it's actually less of a drop than we had anticipated at the start of this latest outbreak. Indeed, a number of recent economic reports indicate that the increase in the Alert Level has been less of a drag on demand in affected areas than it was during previous lockdowns. Consistent with that, we've seen hiring and job advertisement numbers remaining firm in recent weeks.

Importantly, as we've approached the end of the year and activity restrictions have been rolled back, we're seeing positive indications for demand in several key parts of the economy. Most notably, household spending appetites have remained robust despite the uncertainty around the evolving health situation. Nationwide spending levels rose nearly 10% in November and are now running 2.9% above those we saw this time last year (though retail prices have also risen in that time).

We expect that households will continue to give their credit cards a good workout through the festive season, especially given the pent-up demand that has developed in some regions in recent weeks.

And it's not just the retail sector that's in good cheer. Indicators for construction activity continue to run red-hot, with nearly 48,000 new dwellings consented over the past year. Much of that strength is centred on Auckland. However, there is a large amount of work planned right across the country with low interest rates and strong house price growth encouraging development activity.

On top of that, there's also been continued gains in the prices for our key commodity exports, which are up 26% over the past year. There's been particular firmness in the prices for dairy products and, combined with expectations for a fall in the NZD, that's prompted us to revise up our forecast for the farmgate milk price. We're now expecting a payment of $9.00/kg in 2021/22 (right at the top of Fonterra's forecast range) and $7.50/kg in 2022/23.

There are still some soft spots. Notably, the latest BusinessNZ PMI did point to some lacklustre conditions in the manufacturing sector, with orders and production still lingering below the levels we saw earlier in 2021. Spending in the hospitality sector also remains well down on the levels we saw prior to the Delta outbreak.

But while it is a mixed picture, the overall outlook for the New Zealand economy remains robust, and we expect that the new year will see economic activity rising back to firm levels. In fact, by mid-2022 we're expecting to see GDP running at the sorts of levels that we would have seen if there hadn't been any Covid outbreak. That's despite the loss of international tourist dollars, and reflects the strength of domestic spending appetites.

As we've been highlighting for some time, one of the key factors underpinning New Zealand's strong economic performance over the past few years has been very supportive monetary policy. OCR reductions and the related falls in mortgage interest rates since the start of 2020 have put around $600m back into households' wallets each quarter. At the same time, the rapid rise in house prices has provided a massive boost to many households' balance sheets.

However, with the economy on firmer footing, the labour market in good health and inflation bubbling over, interest rates are now on the rise. We're forecasting a series of rapid OCR increases over the coming years, with the cash rate to peak at 3% in the third quarter of 2023. That would take the cash rate above neutral and into 'tight' territory.

The expected increases in borrowing costs will reverberate through all parts of the economy, with the current strong economic conditions set to give way to a period of modest economic growth through 2023 and 2024.

Mortgage fixing will blunt the impact of rate rises on household balance sheets for a time. Even so, we estimate that spending on debt servicing (excluding principal repayments) is likely to rise from 5.6% of households' disposable incomes currently to around 8.7% in 2023. That would more than offset the increase in households' spending power seen over the past year, and the resulting squeeze on discretionary incomes will dampen both household demand and economic growth more generally over the coming years.

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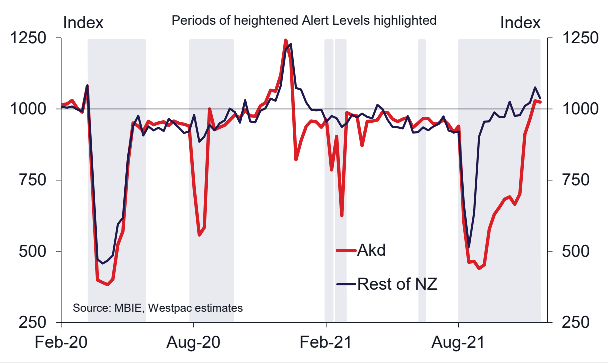
Chart of the week

Household spending has continued to lift as we head into the holiday season. Notably, spending in Auckland has come charging back as activity restrictions have eased, and is now running in line with other parts of the country. We expect spending will remain firm through into the new year.

NZ weekly retail spending

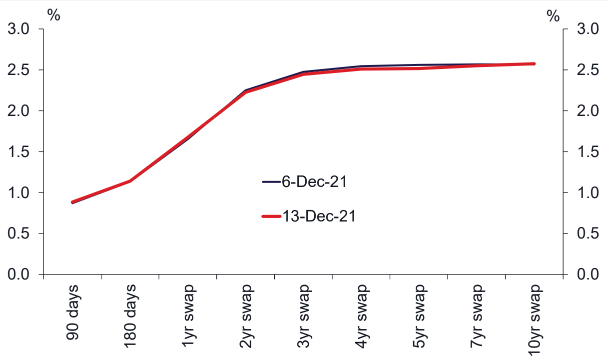


Fixed vs floating for mortgages

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 Nov REINZ house sales and prices

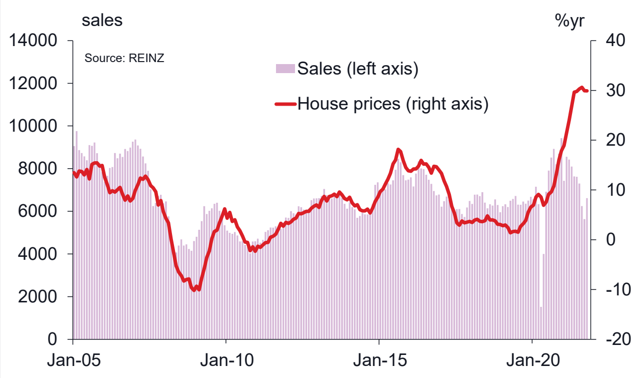
Dec 13 (TBC), Sales last: +17.5%, Prices last: +29.9%yr

House sales picked up in October as Covid restrictions were eased further, though they remained well down from the peak seen late last year. Sales prices continued to rise at a solid pace.

The screws are beginning to tighten on the housing market, including a further tightening of loan-to-value restrictions in November and a sharp rise in mortgage rates since September. Hence, we'll be looking for evidence of a meaningful cooling in the market over the coming months.

Listings data for November showed a substantial rise in the stock of unsold homes. While this may be an early sign of housing market pressures easing, the details suggest it was due to a catch-up surge in new listings, rather than buyers stepping back.

REINZ house prices and sales



NZ Current Account Balance, % of GDP

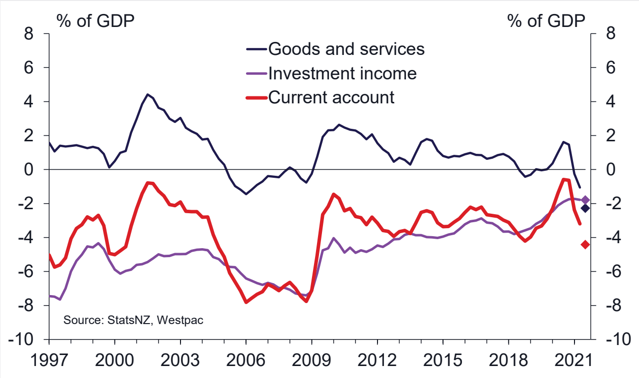
Dec 15, Last: -3.2%, Westpac: -4.4%

We expect the annual current account deficit to widen to 4.4% of GDP in the September quarter, from 3.2% in the June quarter.

The widening of the deficit beyond the average level of recent years essentially reflects the hot New Zealand economy – we are, at least temporarily, living beyond our means.

Looking ahead, we expect the current account to widen further on the strength of the domestic economy and the ongoing absence of tourism exports. We expect the deficit to reach its widest point of around 6% in the second half of 2022, before narrowing.

Annual current account balance



NZ Half-Year Economic and Fiscal Update

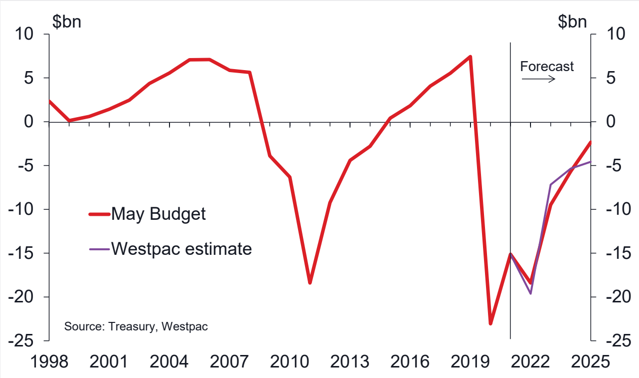
Dec 15

On balance and despite the Delta outbreak, we expect the HYEFU to show little change in the Government's books. The Delta lockdown has led to additional government expenditure, but tax revenue has remained surprisingly resilient, buffering much of this extra expenditure.

Over the remainder of the fiscal year and with the move to the traffic light system, we expect government expenditure to slow, but for tax revenue growth to accelerate. All up, we expect the HYEFU to show an OBEGAL roughly in line with the Budget forecast. In later years, we expect ongoing strength in tax revenue to lead to an upgrade in the OBEGAL relative to the Budget.

With the above in mind, we expect little change in the borrowing programme at the HYEFU. If we are right around the ongoing strength in tax revenues, reductions in the programme may be incorporated into Budget 2022.

Operating balance (excluding gains and losses)



The week ahead

NZ Q3 GDP

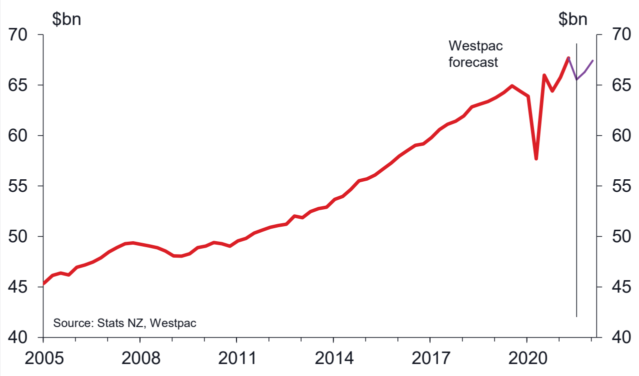
Dec 16, Last: 2.8%, Westpac f/c: -3.0%, Mkt f/c: -4.7%

We expect a 3% fall in GDP for the September quarter, following a 2.8% rise in June. Economic activity was running hot through the middle part of this year, until the discovery of an outbreak of the Delta variant which saw the country go back into a strict lockdown from 18 August.

Sectors that were most heavily impacted by restrictions will unsurprisingly see the largest declines. This would also include sectors where a large share of activity occurs in Auckland which spent more time in Alert Level 4. On the other hand, those that could continue operating under Covid requirements are expected to record gains.

A 3% fall is a sizeable upgrade from our initial forecast of -6%. However, recent data has proven to be more resilient than we expected, which suggests that businesses were much better prepared to operate under Covid restrictions this time around.

Production-based GDP



ANZBO business confidence (Final), Dec 2021

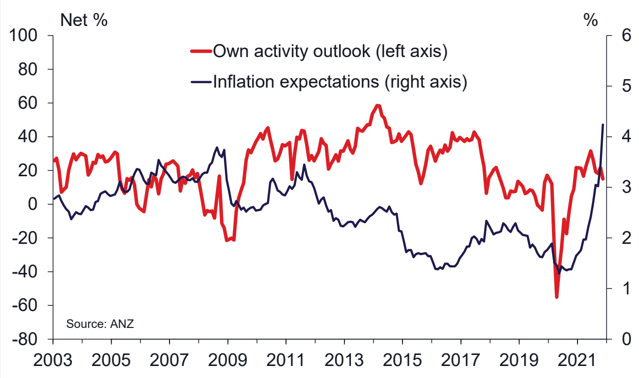
Dec 17, Expectations for Own Activity: +15.0

Businesses' expectations for economic conditions have continued to ease, but remain firm. Inflationary pressures remain elevated with inflation expectations in most sectors printing over 4%.

Gauges of activity should remain steady as restrictions continued to be eased over the past month. The survey will include some responses from early December when the country moved into the new 'traffic light' system for managing Covid.

Inflation gauges will again be worth keeping an eye on as both prices and costs have showed almost no signs of slowing down. Inflation has been increasingly pronounced over the past year and is expected to remain above the RBNZ's target band until the end of next year.

NZ business confidence



Aus Q4 ACCI Westpac business survey

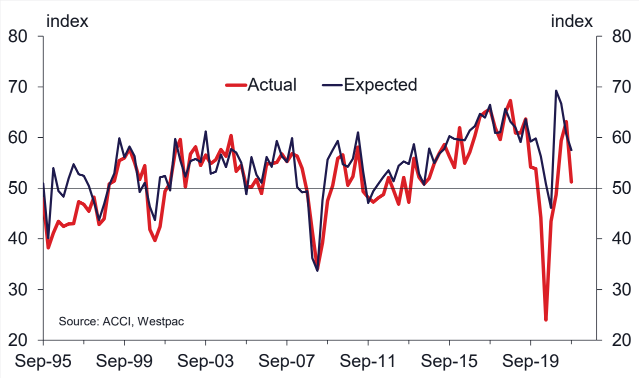
Dec 14, Last: 51.2

The ACCI–Westpac business survey for the December quarter, conducted through November into December, will provide a timely update on manufacturing and insights into economy wide trends.

Recall that in the September quarter, conditions in the manufacturing sector stalled, hit by the lockdowns. The Westpac–ACCI actual composite index moderated from 63.1 in Q2 to 51.2 in Q3. Output in the sector was flat, so too employment levels, while new orders rose modestly. Ahead of the lockdowns, the sector had considerable momentum, benefiting from the strong, broadly based economic recovery.

The December survey will gauge the progress made in navigating the staggered reopening from the delta lockdowns. Of particular interest, an update on the ongoing supply headwinds impacting the sector and the economy – with labour more difficult to find, so too sourcing materials given global bottlenecks.

Aus Westpac-ACCI Composite indexes - actual & expected, sa



The week ahead

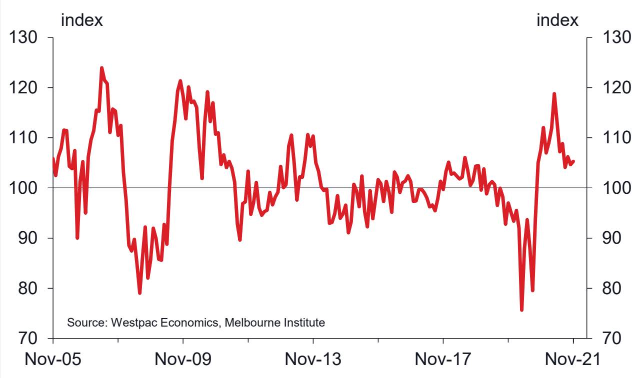
Aus Dec Westpac-MI Consumer Sentiment

Dec 15, Last: 105.3

Consumer Sentiment nudged up 0.6% in November, holding firmly in optimistic territory, buoyed by easing COVID restrictions in NSW, Vic and the ACT.

The December survey is in the field over the week ended Dec 11. It will capture initial reactions to the emergence of the new omicron variant that has seen restrictions on international travel reintroduced, albeit temporarily if risks prove to be low. Rising inflation concerns may also be starting to undermine sentiment although these may be allayed somewhat by the RBA Governor's clear intention to leave official interest rates on hold for a long time yet. Recent declines in fuel prices – down over 12¢ to $1.43/litre from two year highs over $1.55/l last month – may also help.

Aus Consumer Sentiment Index



Aus Nov Labour Force Survey, employment '000

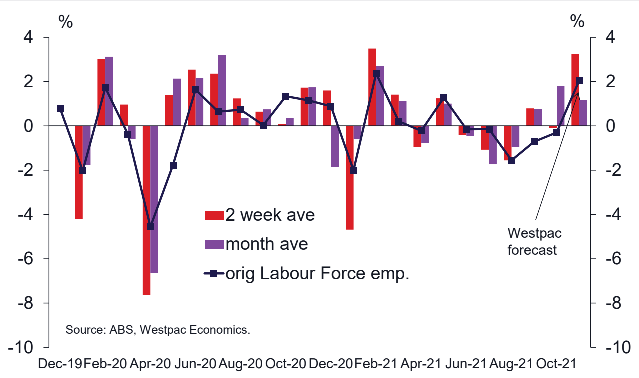
Dec 16 Last: –46.3k, WBC f/c: 220k
Mkt f/c: 200k, Range: 150k to 280k

Overall, the October labour market survey was broadly as expected with the timing of the survey generating a negative print on employment (the two week reference period ended October 9th). Total employment fell 46.3k with weakness in full–time employment.

Weekly payrolls jobs lost some momentum heading into November but gains were made earlier in the month. If we compare the average level of the last two weeks to the two-week reference period for the October Labour Force survey we get a 3.2% increase. Back in February there was a 3.5% rise in payrolls while employment rose 2.4% in original terms.

Our 220k forecast is a 2.2% rise in original terms.

Aus Payrolls vs Labour Force Employment



Aus Nov Labour Force Survey, unemployment %

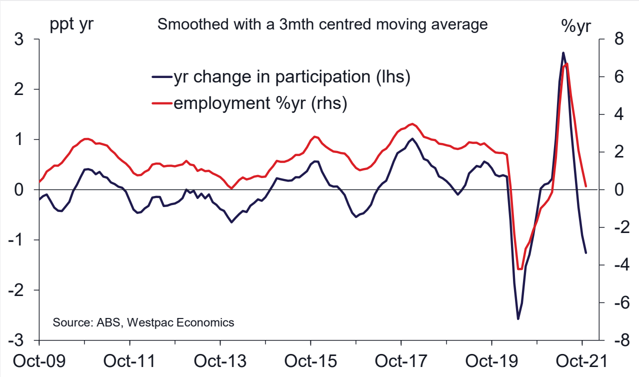
Dec 16, Last: 5.2%, WBC f/c: 5.3%
Mkt f/c: 5.0% Range: 4.7% to 5.5%

Our preview highlighted a risk that the October Labour Force Survey could see a surge of workers returning to the labour market, lifting participation and thus boosting unemployment.

However, we have to admit surprise at the magnitude of the rise in participation the October Labour Force Survey, as well as the loss in hours worked. Participation rose to 64.7% from 64.5% boosting the labour force by 35.5k lifting the unemployment rate to 5.2% from 4.6%. Hours worked fell 0.1% and the underemployment rate lifted to 9.5% from 9.2%.

We expect the pace of workers returning to the labour force to continue to outpace gains in employment in November. Our forecast for a 242k lift in the labour force will see participation rise to 65.8% and unemployment rise to 5.3%. Before the latest lock downs the participation rate peaked at 66.2% in June 2021.

Aus participation & employment



The week ahead

Aus 2021/22 Federal Mid-Year Economic & Fiscal Outlook

Dec 16: 2021/22 budget balance -$106.6bn (prelim')

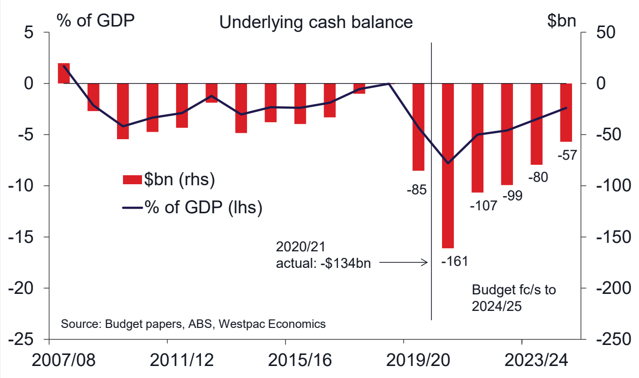
The Federal Treasurer will deliver the budget update, MYEFO.

We expect the government to downgrade their forecast for the 2021/22 budget deficit from –$106.6bn to –$117bn (–5.3% of GDP). Expenses are up, in the order of $32bn, largely on the cost of responding to the delta lockdowns.

Limiting the impact, revenues are also up, potentially by $25bn. This reflects a stronger starting point (a $20bn upside surprise in 2020/21) and a boost from faster national income growth, due to higher commodity prices.

In the following years, the budget profile potentially improves modestly driven by higher revenue. We expect the 2022/23 deficit forecast to be trimmed by $10.3bn to $89bn (–3.9% of GDP).

Aus Federal budget: May 2021 government forecasts



US Dec FOMC meeting

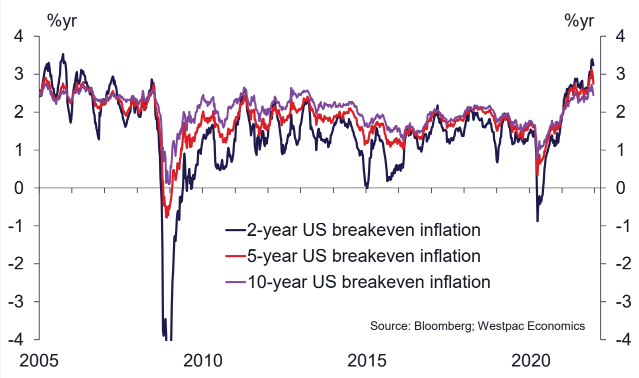
Dec 14-15

Since the November FOMC meeting, there has been a material change in expectations surrounding US monetary policy.

Although it was only initiated a month ago, the pace of the taper is now expected to be doubled at the December meeting such that it will end in March instead of mid-2022. To our mind, and consistent with comments made by numerous FOMC members, this decision is to provide optionality in 2022 to combat inflation risks as and when necessary.

When we changed our call to expect the accelerated taper, we also forecast three rate hikes in 2022, beginning in June. Come 2023 and 2024, three additional hikes six months apart are seen, leaving the federal funds rate at 1.625% by June 2024. It will be interesting to see the degree to which the FOMC's dots are revised in December.

US unrestrained inflation risks real incomes

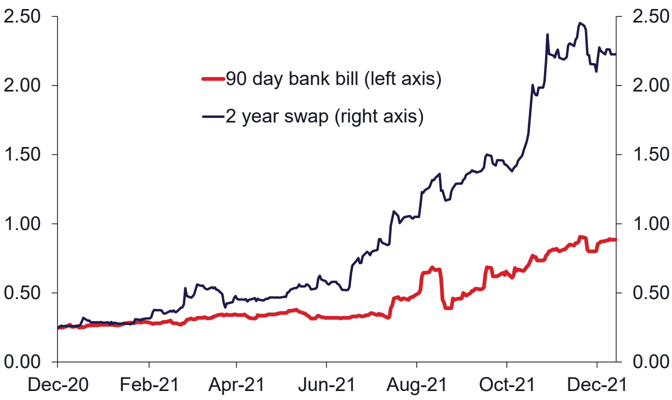


New Zealand forecasts

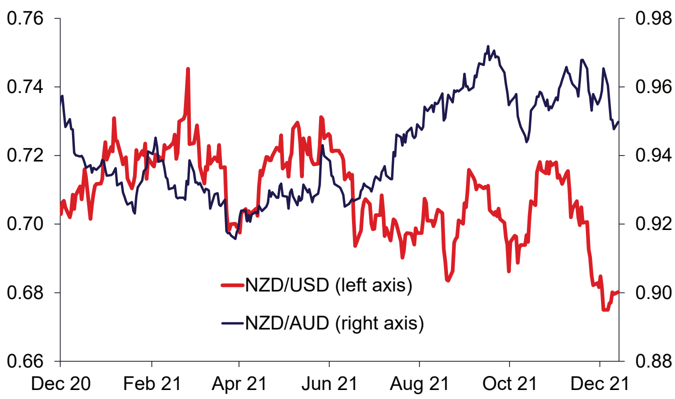
Economic forecasts	Quarterly				Annual			
	2021			2022				
% change	Jun (a)	Sep	Dec	Mar	2020	2021f	2022f	2023f
GDP (Production)	2.8	-3.0	1.1	1.7	-2.1	5.2	4.6	4.5
Employment	1.0	2.0	0.0	0.3	0.6	3.5	0.6	1.2
Unemployment Rate % s.a.	4.0	3.4	3.8	3.7	4.8	3.8	3.5	3.6
CPI	1.3	2.2	0.7	0.8	1.4	5.2	2.8	2.2
Current Account Balance % of GDP	-3.3	-4.5	-5.3	-5.4	-0.8	-5.3	-5.9	-4.1

Financial forecasts	Mar–22	Jun–22	Sep–22	Dec–22	Mar–23	Jun–23	Sep–23	Dec–23
Cash	1.00	1.50	2.00	2.25	2.50	2.75	3.00	3.00
90 Day bill	1.40	1.90	2.20	2.45	2.70	2.95	3.10	3.10
2 Year Swap	2.55	2.75	2.90	2.95	3.00	3.00	2.95	2.90
5 Year Swap	2.80	2.95	3.05	3.10	3.15	3.15	3.15	3.10
10 Year Bond	2.80	2.85	2.90	3.00	3.00	3.00	3.00	2.95
NZD/USD	0.67	0.66	0.67	0.69	0.70	0.71	0.72	0.72
NZD/AUD	0.94	0.94	0.94	0.95	0.93	0.93	0.94	0.92
NZD/JPY	77.7	76.6	78.4	80.7	82.6	83.8	85.7	85.7
NZD/EUR	0.61	0.61	0.61	0.63	0.63	0.63	0.64	0.63
NZD/GBP	0.49	0.48	0.49	0.50	0.51	0.52	0.53	0.53
TWI	72.1	71.2	71.7	73.1	73.5	74.1	75.0	74.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 13 December 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.75%	0.75%	0.50%
30 Days	0.78%	0.78%	0.73%
60 Days	0.84%	0.79%	0.79%
90 Days	0.89%	0.80%	0.85%
2 Year Swap	2.23%	2.13%	2.31%
5 Year Swap	2.52%	2.61%	2.68%

NZ foreign currency mid-rates as at 13 December 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6802	0.6827	0.7047
NZD/EUR	0.6014	0.6027	0.6155
NZD/GBP	0.5133	0.5124	0.5251
NZD/JPY	77.06	77.49	80.26
NZD/AUD	0.9498	0.9563	0.9621
TWI	73.11	73.51	75.13

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 13					
NZ	Nov REINZ house sales	17.5%	–	–	Due this week. Lending restrictions and higher mortgage rates...
	Nov REINZ house prices %yr	29.9%	–	–	...should slow the housing market in the coming months.
	Nov BusinessNZ PSI	44.6	–	–	Expected to remain soft with activity restrictions still in place.
	Oct net migration	653	–	–	Set to remain low while border restrictions remain in place.
Tue 14					
NZ	Nov food price index	–0.9%	–	–0.3%	Seasonal fall in produce prices.
Aus	Q4 ACCI-Westpac business survey	51.2	–	–	Update on reopening progress + supply headwinds.
	Nov NAB business survey	11	–	–	Reopening gathering pace, emerging from delta lockdowns.
Eur	Oct industrial production	–0.2%	1.5%	–	Supply issues remain a material headwind.
UK	Oct ILO unemployment rate	4.3%	4.2%	–	Recovery has supported the fall in unemployment in 2021.
US	Nov NFIB small business optimism	98.2	98.3	–	Confidence hampered by labour market tightness and Covid.
	Nov PPI	0.6%	0.5%	–	Supply issues will likely continue to support producer prices.
Wed 15					
NZ	Q3 current account balance $bn	–1.396	–	–7.825	Deficit set to continue widening through to mid 2022.
	Half-Year Economic and Fiscal Update	–	–	–	Despite Delta, we expect little change in the Govt's books.
Aus	Dec WBC–MI Consumer Sentiment	105.3	–	–	Omicron variant to dampen reopening optimism?
Chn	Nov retail sales %yr	4.9%	4.8%	–	Underlying strength to become apparent in '22.
	Nov industrial production YTD %yr	10.9%	10.4%	–	Power outages and supply remain as headwinds.
	Nov fixed asset investment YTD %yr	6.1%	5.4%	–	Regulatory reform continues to weigh on res. investment.
UK	Nov CPI	1.1%	0.4%	–	Inflation pressures will persist well into 2022.
US	Dec Fed Empire state index	30.9	25.0	–	Will provide view on manufacturing in NY state.
	Nov retail sales	1.7%	0.8%	–	Goods consumption at very high level versus history.
	Oct business inventories	0.7%	1.0%	–	Should continue to build as supply chain allows.
	Dec NAHB housing market index	83	84	–	Stable at high level so far in 2021.
	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	Taper to be done by Mar '22; dot plot to be a focus.
Thu 16					
NZ	Q3 GDP	2.8%	–4.5%	–3.0%	A hit from Delta lockdown, but more resilient than expected.
Aus	Nov employment	–46.3k	200.0k	220k	Solid momentum through Oct lifted payrolls 3.2% suggesting...
	Nov unemployment rate	5.2%	5.0%	5.3%	...a robust gain in emp. but rising participation lifts unemp.
	2021/22 Federal mid-yr budget update	–106.6	–	–117	2021/22 deficit deteriorated on cost of responding to delta.
	RBA Governor Lowe speaking	–	–	–	Address to CPA Australia (no Q&A), Wagga Wagga.
	Dec MI inflation expectations	4.6%	–	–	Fuel prices have eased, have expectations followed?
Eur	Dec Markit manufacturing PMI	58.4	57.7	–	Growth in manufacturing and services...
	Dec Markit services PMI	55.9	54.5	–	... likely to be dampened by inflation and Covid concerns.
	Oct trade balance €bn	6.1	–	–	Surplus likely to narrow through to end of 2021.
	ECB policy decision	0.0%	0.0%	0.0%	Additional APP stimulus needed post Feb PEPP expiration.
UK	Dec Markit manufacturing PMI	58.1	57.6	–	Strength of manufacturing and services impressive...
	Dec Markit services PMI	58.5	57.5	–	... but supply issues and Covid concerns remain.
	BoE policy decision	0.10%	0.10%	0.10%	Omicron argues against hike in Dec; but hikes not far off.
US	Initial jobless claims	184k	–	–	Should remain near historic lows for foreseeable future.
	Nov housing starts	–0.7%	3.3%	–	Expected to lift given robust underlying demand for housing.
	Dec Phily Fed index	39.0	27.0	–	Will offer a gauge of business activity in the region.
	Nov building permits	4.0%	1.0%	–	Strong demand partly offset by high costs & labour shortages.
	Nov industrial production	1.6%	0.7%	–	Conditions remain volatile given supply chain.
	Dec Kansas City Fed index	24	–	–	Manufacturing outlook promising for the region.
Fri 17					
NZ	Dec ANZ consumer confidence	96.6	–	–	Easing in activity restrictions likely to stymie the fall in sentiment.
	Dec ANZ business confidence	15.0	–	–	Holding firm, first look at the effect of the 'traffic light' system.
Eur	Nov CPI %yr	4.9%	4.9%	–	Energy is responsible for around half of annual inflation.
UK	Dec GfK consumer sentiment	–14	–17	–	Inflation concerns and Covid fears to weigh on confidence.
	Nov retail sales	0.8%	–	–	New restrictions to limit re-opening shift to services.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.2	4.3	5.5	3.5
CPI inflation %yr	1.8	1.8	0.9	3.0	2.5	2.6
Unemployment rate %	5.0	5.2	6.8	5.3	3.8	3.8
Current account % of GDP	-2.1	0.7	2.6	3.9	0.9	-2.2
United States						
Real GDP %yr	3.0	2.2	-3.5	5.7	4.3	2.7
CPI inflation %yr	2.4	1.9	1.2	5.0	3.1	2.3
Unemployment rate %	3.9	3.7	8.1	5.4	4.2	3.8
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	0.3	-4.8	2.3	2.7	1.5
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	4.4	2.5
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	6.7	5.2	3.0
China						
Real GDP %yr	6.7	5.8	2.3	8.5	5.7	5.6
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	3.8	4.8	5.0
World						
Real GDP %yr	3.6	2.8	-3.3	5.4	4.6	3.6

Forecasts finalised 8 December 2021

Interest rate forecasts	Latest	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Australia									
Cash	0.10	0.10	0.10	0.10	0.10	0.25	0.50	0.50	0.75
90 Day BBSW	0.06	0.10	0.15	0.20	0.40	0.65	0.70	0.95	0.95
10 Year Bond	1.69	2.15	2.30	2.30	2.30	2.30	2.25	2.25	2.20
International									
Fed Funds	0.125	0.125	0.375	0.625	0.875	0.875	1.125	1.125	1.375
US 10 Year Bond	1.52	2.00	2.20	2.30	2.30	2.30	2.25	2.25	2.20

Exchange rate forecasts	Latest	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7160	0.71	0.70	0.71	0.73	0.75	0.76	0.77	0.78
USD/JPY	113.52	116	116	117	117	118	118	119	119
EUR/USD	1.1299	1.10	1.08	1.09	1.10	1.11	1.12	1.13	1.14
GBP/USD	1.3231	1.36	1.37	1.38	1.38	1.37	1.37	1.36	1.35
USD/CNY	6.3662	6.35	6.35	6.30	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.0521	1.06	1.06	1.06	1.06	1.07	1.07	1.07	1.08

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