
Kakī

Weekly Economic Commentary.

Growing pains.

New Zealand's recovery has been gaining traction with a continued firming in domestic economic conditions and strength in our commodity export prices. Those developments are helping to offset the ongoing drag from the loss of long-haul tourist dollars. However, while the economy is on increasingly firm footing, we are encountering growing pains. That includes difficulties sourcing labour and disruptions to supply chains. Those challenges will be with us for some time yet, and that's raising big questions about the outlook for costs and inflation.

We expect this week's GDP report will show that the economy grew by 0.6% in the March quarter, underpinned by firmness in construction, manufacturing activity and retail spending. That's a much stronger result than the 0.6% contraction the RBNZ factored into their May policy statement and would leave economic activity just fractionally below the levels that we saw prior to the outbreak.

Importantly, the domestic recovery has been picking up a head of steam as we've moved into the middle part of the year. That includes a 6.8% increase in retail spending in the past two months alone, record levels of residential dwelling consent issuance, and strong readings for trading activity in both the manufacturing and services sectors. Reinforcing this positive news on the domestic front, we've also seen record prices for our key commodity exports, including dairy.

Of course, there are still some soft spots in the economy. Most notably, the lack of long-haul tourists remains a drag on sectors like hospitality and accommodation in regions like Queenstown. However, it's clear that the economy as a whole is on increasingly firm footing. Against this backdrop, we've also seen businesses looking to take on additional staff, with job advertisements rising strongly in the past few months.

But as the recovery has been gaining traction, the economy has been experiencing growing pains on several fronts. The challenge that businesses have most frequently highlighted to us is that it has become increasingly difficult to source the labour that they need. This has been a particular issue in relation to specialised labour (a situation that has been exacerbated by the closure of the borders). However, we've recently had a number of businesses telling us that it's become difficult to source less skilled staff as well.

This tightness in the labour market is likely to persist for some time yet and we expect that it will gradually pass through to higher wage inflation. To help address this issue, the Government has made some changes to visa programmes for migrant workers who are already in the country. But we won't realistically see any material easing in labour shortages until the borders are reopened to new skilled migrants.

Even when border restrictions are eventually lifted, New Zealand is likely to face enduring challenges with regards to meeting its skilled labour needs. The Government has announced a review of migration settings with the aim of rebalancing migration flows to support the development of skills onshore and job opportunities for existing New Zealand citizens. We expect that this will result in much lower levels of migration than we saw prior to the Covid outbreak, with flow-on implications for demand and the economy's supply capacity. Creating job opportunities and developing our skills base are laudable aims, but will take time. Furthermore, even if we are able to develop skills locally, retaining them will be challenging as talented young New Zealanders will inevitably look to opportunities abroad. In the meantime, many businesses will find it tough to attract and retain the skilled labour that they need.

One of the other significant challenges that businesses have been wrestling with are difficulties sourcing inputs as a result of ongoing disruptions to global shipping and supply chains. That was reflected in last week's PMI, which showed deliveries of raw materials failing to keep pace with the strong lift in orders in recent months. On top of that, some exporters are also reporting difficulties securing container space on shipping vessels.

Disruptions to supply chains and shortages of labour are adding to cost pressures. That's part of the reason why we expect that CPI inflation will charge higher over the coming months, towards the top of the RBNZ's target band.

However, while businesses across the economy are reporting increases in cost pressures, it's less clear that this will pass into the prices paid by consumers in all cases. One sector where we are likely to see larger increases in output prices is construction, where activity is roaring away. However, in sectors like retail and services, competitive pressures remain strong. As a result, some of the recent increases in costs are likely to manifest as pressure on margins.

The key issue for the RBNZ isn't the impact of near-term supply disruptions on prices. Rather, it's the risk of a persistent and widespread rise in inflation. Some of the lift in inflation currently in train will be temporary (such as post-Covid volatility in airfares and large increases in used car prices). In addition, as production cycles normalise around the globe, we're also likely to see a related easing in cost pressures in the manufacturing sector. Those dynamics will be reinforced by the rollout of vaccines, which will support a reorientation of household spending away from goods and back towards services.

However, the upside risks for inflation have been building. In particular, we have seen business expectations for inflation pushing higher in recent months. In fact, in the latest ANZBO survey, expectations for inflation over the coming 12 months rose to 2.3% – their highest level in nearly four years. That's a particularly notable development for the RBNZ as higher expectations for inflation could become embedded in future decisions about wage and price setting. And that could result in a stronger and more protracted rise in inflation.

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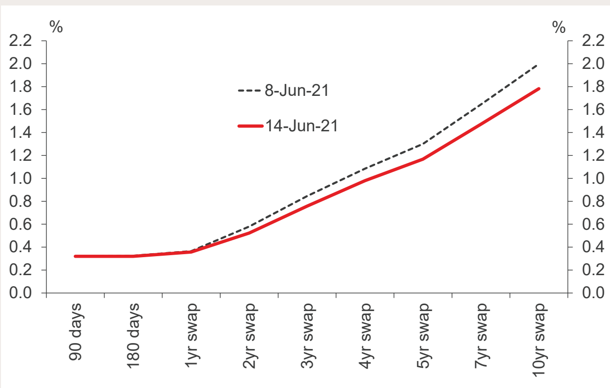
Fixed vs floating for mortgages.

We expect that floating rates, and shorter fixed-term rates, will be stable over the coming months. Inflation is set to spike higher this year, but the Reserve Bank will not need to respond to this.

Longer-term interest rates are now rising in response to the improved economic outlook. Given our forecasts, longer-term fixed rates (three to five years) no longer offer good value, relative to taking a short-term rate now and refixing later (albeit at a higher rate).

NZ interest rates



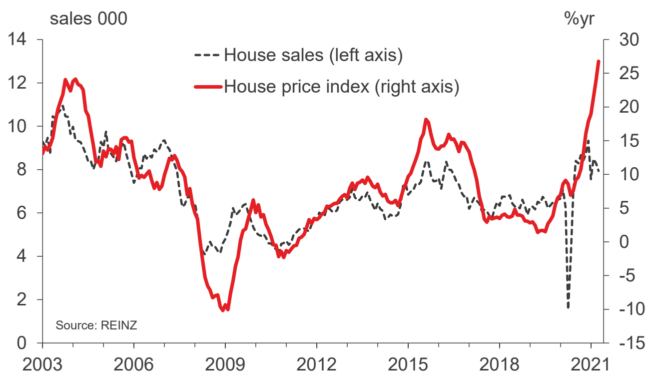
The week ahead.

NZ May REINZ house sales and prices

Jun 15 (TBC), Sales last: -4.3%, Prices last: +26.8%yr

- The April REINZ report suggested only a slight cooling in the hot housing market. That followed the Reserve Bank's reintroduction of loan-to-value restrictions and the Government's announced changes to the tax treatment of investors.
- It's still early days to gauge the impact of the latter policy change. However, lending data suggests that homebuyers have been stepping in to take the place of investors, and have been willing to pay current prices.
- We expect prices to flatten off by the end of this year. The greater test for the housing market will come in the following years, as mortgage rates rise from their record lows.

REINZ house prices and sales

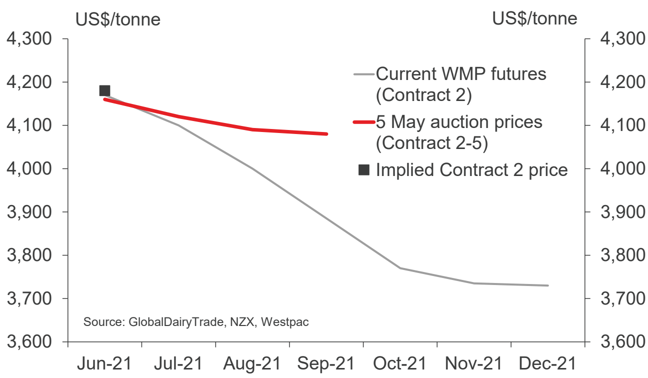


NZ GlobalDairyTrade auction, whole milk powder prices

Jun 16, Last: -0.5%, Westpac: -1.0%

- We expect whole milk powder prices to dip a touch at the upcoming dairy auction.
- We are a little more bearish than current futures market pricing; the futures market is pointing to effectively flat prices.
- Recent New Zealand production data has been strong, so this may lead prices lower in the short-term. However, global demand remains firm and the key test for dairy prices will come in the New Zealand spring.

Whole milk powder prices

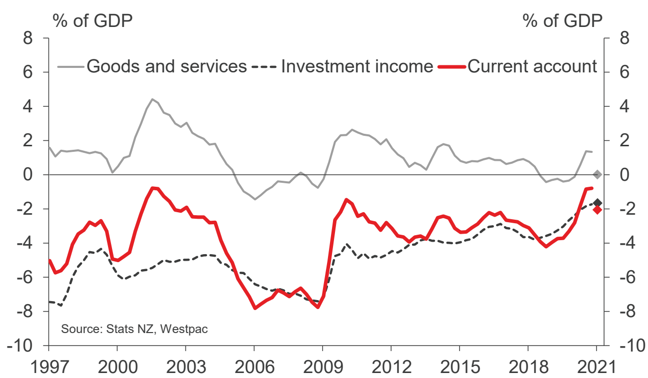


NZ Q1 Current Account Balance, % of GDP

Jun 16, Last: -0.8%, Westpac: -2.1%

- We expect the annual current account deficit to widen to 2.1% of GDP in the March quarter, after having narrowed to a 19-year low of 0.8% late last year.
- The main factor is the lack of the usual lift in overseas visitor spending at this time of year. This will see the deficit widen further over the rest of 2021, with the border not fully opening until next year.
- Meanwhile, the March quarter goods balance (in seasonally adjusted terms) is also likely to tip back into negative territory. Importantly, import volumes continue to rebound after last year's dramatic drop during the Covid lockdown.

Annual current account balance



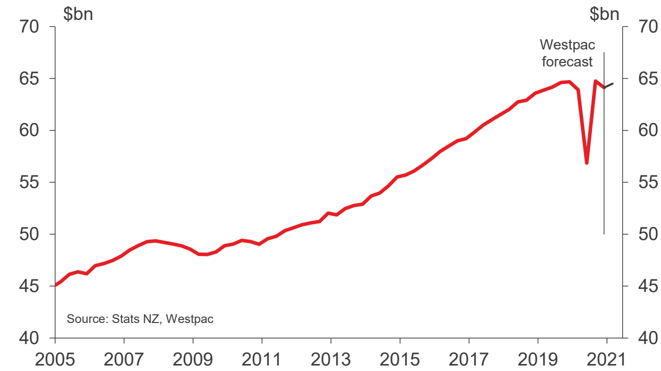
The week ahead.

NZ Q1 GDP

Jun 17, Last: -1.0%, Westpac f/c: +0.6%, Mkt f/c: +0.5%

- We expect a 0.6% rise in GDP for the March quarter following a fall of 1.0% in December. The absence of international tourism is likely to continue disrupting the seasonal patterns in the data.
- The domestic economy continues to be supported by a strong housing market which many sectors have benefitted from. Natural resources saw a bit of a pull back, partially driven by the dry summer.
- Despite the increase of Alert Levels during the quarter this is unlikely to materially impact GDP. As we learnt last time, lockdowns just mean delayed rather than lost spending.

Production-based GDP

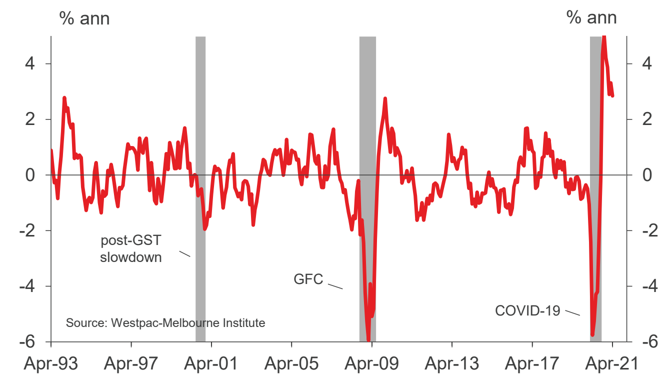


Aus May Westpac–MI Leading Index

Jun 16, Last: 2.85%

- The six-month annualised growth rate in the Leading Index eased from 3.31% in March to 2.85% in April. Momentum has fallen sharply since late last year but was coming from an extremely strong starting point with most of the variation due to six month growth rates cycling the initial rebound from last year's Covid disruptions. The Index growth rate remained relatively strong in April – above all other growth rates recorded since the early 1980s. The signal remains consistent with growth running well above trend in 2021.
- The May read is likely to see a further slowdown with several components recording pull-backs in the month, with the latest Vic lockdown delivering a shock to consumer sentiment and a notable pull back in dwelling approvals (-8.6% vs 18.9% last month). Against this, the Index growth rate will continue to get some offsetting support from a rising sharemarket and buoyant commodity prices (up 5.8% in AUD terms).

Aus Westpac-MI Leading Index

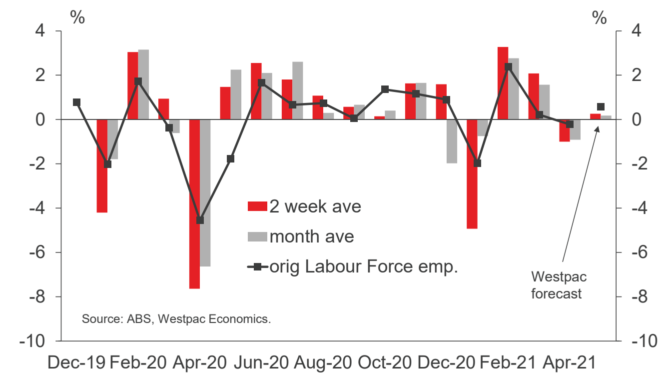


Aus May Labour Force employment '000

Jun 17, Last: -30.6, WBC f/c: 30.0
Mkt f/c: 30.0, Range: -19.0 to 45.0

- April employment came in below expectations with evidence pointing to a stronger-than-usual seasonality around the Easter/school holidays. Declining female and part-time employment are indirect signs, a surge working zero hours due to being on leave is a more direct sign.
- Payrolls data have been a consistent guide to the direction, if not always the magnitude, of changes in Labour Force employment. Payrolls for the first two weeks of May (the reference weeks for the May Labour Force Survey) are now up 0.3% on the first two weeks in April. Our forecast for employment in May is +30k/0.2% which in original terms (Payrolls are not seasonally adjusted) is a +74.0k or 0.6% rise; May has tended to have a seasonal rise of around 0.3%
- Payrolls had a significant fall in SME jobs, plus the greater loss of jobs in the sectors more dependent on JobKeeper, suggesting some firms are facing meaningful headwinds.

Aus payrolls vs labour force employment



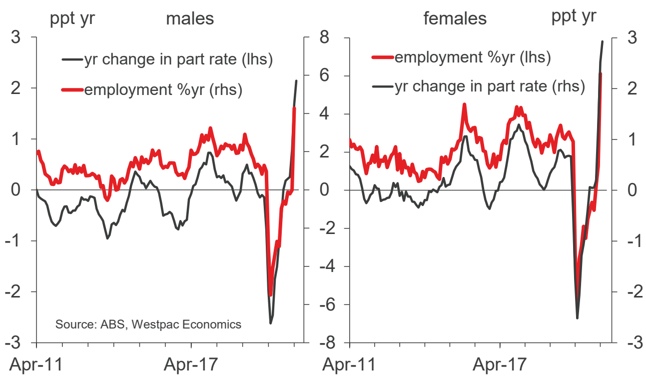
The week ahead.

Aus May Labour Force unemployment %

Jun 17, Last: 5.5%, WBC f/c: 5.7%
Mkt f/c: 5.5%, Range: 5.7% to 5.4%

- Consistent with a strong holiday effect, April participation fell an out sized 0.3ppts from its record high of 66.3% to 66.0%. Females led the fall, down 0.5ppt, compared to males at –0.1ppt. We suspect that as there is a larger share of females who are marginally attached to the labour force, compared to males, the effect of family holidays would have a bigger impact on females. This resulted in a much larger –54.0k/–0.8% fall in the female labour force compared to the –10.3k/–0.1% decline in the male labour force (almost flat in the month).
- Despite the fall in total employment, lower participation saw unemployment edge down 0.2ppt, from a revised 5.7% to 5.5% in April. Given that we think the holidays had a meaningful impact on participation as well as employment we are looking for a post–holiday bounce in May.
- Our forecast for participation to return to 66.3% will lift the unemployment rate back to 5.7%.

Aus employment and labour force participation

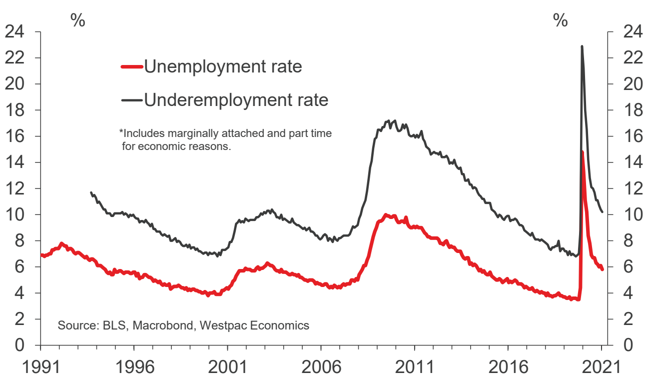


US Jun FOMC meeting

Jun 15-16

- The June FOMC meeting will be interesting for a number of reasons.
- First up, after the meeting, the Committee's revised forecasts will be provided, guiding on their central expectations for the coming three years.
- Second, the press conference will give a good guide on the degree of confidence the Committee has in their central projection for both inflation and the labour market - the FOMC's two core concerns.
- Third, for these two aspects of the economy, an assessment of the risks will be provided. This will help guide on how great an impact key risks are likely to have on the outlook for policy, should they eventuate.

US labour market

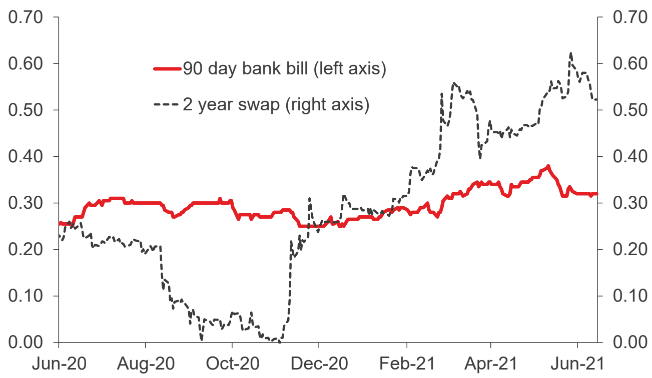


New Zealand forecasts.

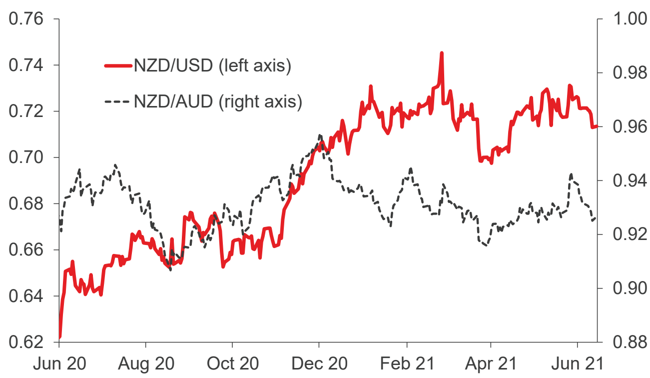
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Dec (a)	Mar	Jun	Sep	2019	2020	2021f	2022f
GDP (Production)	-1.0	0.6	1.2	0.5	2.4	-2.9	4.9	4.4
Employment	0.6	0.5	0.1	0.4	1.2	0.8	1.4	2.1
Unemployment Rate % s.a.	4.9	4.7	4.7	4.6	4.1	4.9	4.5	4.1
CPI	0.5	0.8	0.5	0.8	1.9	1.4	2.4	1.4
Current Account Balance % of GDP	-0.8	-2.1	-3.0	-3.8	-3.3	-0.8	-4.0	-3.0

Financial forecasts	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.35	0.35	0.35	0.35	0.35	0.35
2 Year Swap	0.45	0.45	0.50	0.55	0.60	0.65
5 Year Swap	1.15	1.20	1.25	1.30	1.35	1.40
10 Year Bond	1.80	1.90	2.00	2.10	2.20	2.30
NZD/USD	0.74	0.76	0.78	0.78	0.78	0.78
NZD/AUD	0.93	0.93	0.92	0.92	0.92	0.92
NZD/JPY	80.7	82.8	85.8	85.8	86.6	86.6
NZD/EUR	0.60	0.61	0.62	0.62	0.61	0.61
NZD/GBP	0.52	0.53	0.55	0.54	0.54	0.54
TWI	75.7	76.8	78.0	77.6	77.4	77.2

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 14 June 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.27%
60 Days	0.30%	0.30%	0.32%
90 Days	0.32%	0.33%	0.36%
2 Year Swap	0.52%	0.60%	0.55%
5 Year Swap	1.17%	1.34%	1.24%

NZ foreign currency mid-rates as at 14 June 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7135	0.7252	0.7238
NZD/EUR	0.5893	0.5947	0.5961
NZD/GBP	0.5060	0.5112	0.5136
NZD/JPY	78.24	79.67	79.12
NZD/AUD	0.9266	0.9403	0.9301
TWI	74.23	75.33	75.36

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 14					
NZ	May BusinessNZ PSI	61.2	–	–	Likely to show economic momentum continuing.
	Apr net migration	825	–	–	Remains near zero due to border closures.
Aus	Queen's Birthday	–	–	–	Public holiday – except for the mining states of Qld & WA.
Chn	Dragon Boat Day	–	–	–	Public holiday.
Eur	Apr industrial production	0.1%	0.4%	–	Will continue to advance as the economy reopens.
Tue 15					
NZ	May REINZ house prices %yr	26.8%	–	–	Due this week. Prices have continued to rise...
	May REINZ house sales	–4.3%	–	–	...but lending restrictions have seen sales slow a little..
	May food price index	1.1%	–	0.2%	Moderate gain after last month's min. wage related rise.
Aus	RBA minutes, June meeting	–	–	–	Any colour ahead of July decision on YCC and QE.
Eur	Apr trade balance €bn	13.0	–	–	Mfg recovery and demand from Asia will be supportive.
UK	Apr ILO unemployment rate	4.8%	4.8%	–	Furlough scheme continues to hold down u/e rate.
US	May retail sales	0.0%	–0.4%	0.0%	Consumption buoyant, but should see shift to services.
	May PPI	0.6%	0.4%	–	Will be looking for signs of upstream price pressures...
	Jun Fed Empire state index	24.3	22.0	–	... in both official price measures and mfg surveys.
	May industrial production	0.7%	0.6%	–	Strength on reopening, but may see signs of disruptions.
	Apr business inventories	0.3%	–0.1%	–	Should make a positive contribution to growth over the year.
	Jun NAHB housing market index	83	83	–	Homebuilding sentiment stabilising at very high levels.
	Apr total net TIC flows	146.4	–	–	Saw a pullback in China and Japan holdings in March.
Wed 16					
NZ	GlobalDairyTrade auction (WMP)	–0.5%	–	–1.0%	Dairy prices likely to fall a touch on strong recent production.
	Q1 current acct. balance % of GDP	–0.8%	–	–2.1%	Tourism earnings down, import demand rebounding.
Aus	May Westpac–MI Leading Index	2.85%	–	–	Cycling initial Covid rebound but still well above trend.
Chn	May retail sales ytd %yr	29.6%	26.3%	–	Consumer spending should continue to show strength...
	May industrial production ytd %yr	20.3%	18.0%	–	.. with production and incomes buoyed by...
	May fixed asset investment ytd %yr	19.9%	17.0%	–	... domestic and external demand which should sustain.
UK	May CPI %yr	1.5%	1.8%	–	Through-the-year prices to push forward on base effects.
US	May housing starts	–9.5%	5.2%	–	Input costs, predominantly lumber, may serve as a drag...
	May building permits	0.3%	–0.2%	–	... on both housing starts and permits.
	May import price index	0.7%	0.7%	–	Stronger energy import prices pushing up index.
	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	Assessment of risks and revised forecasts the focus.
	Fed Chair Powell	–	–	–	To hold post-meeting press conference.
Thu 17					
NZ	Q1 GDP	–1.0%	0.5%	0.6%	Strength is driven by construction and manufacturing.
Aus	RBA Governor Lowe speaking	–	–	–	From Recovery to Expansion, Toowoomba, 10am.
	May employment	–30.6k	30.0k	30.0k	Payrolls suggests the ending of JobKeeper hit SME jobs...
	May unemployment rate	5.5%	5.5%	5.7%	...which was mostly offset by gains in larger firms.
	RBA Bulletin	–	–	–	Includes RBA research articles.
Eur	May CPI	0.3%	0.3%	–	Final print, will get more detail on price components.
US	Initial jobless claims	376k	–	–	Downtrend to continue as labour market slack absorbed.
	Jun Phily Fed index	31.5	30.5	–	Input prices pushed up to highest level in 40yrs in May.
	May leading index	1.6%	1.1%	–	Pace of recovery still brisk, but will begin to moderate.
Fri 18					
UK	May retail sales	9.2%	–	–	Pent-up demand will drive sales as the economy reopens.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	5.4	3.8
CPI inflation %yr	1.9	1.8	1.8	0.9	2.6	1.8
Unemployment rate %	5.5	5.0	5.2	6.8	5.0	4.7
Current account % of GDP	-2.6	-2.1	0.7	2.6	4.2	2.6
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	6.5	4.1
CPI inflation %yr	2.1	2.4	1.9	1.2	2.9	2.2
Unemployment rate %	4.4	3.9	3.7	8.1	5.3	4.3
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	2.7	2.1
Euro zone						
Real GDP %yr	2.6	1.9	1.3	-6.6	4.2	4.0
United Kingdom						
Real GDP %yr	1.7	1.3	1.4	-9.9	5.8	5.5
China						
Real GDP %yr	6.9	6.7	5.8	2.3	10.0	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.4	4.9	4.9
World						
Real GDP %yr	3.8	3.6	2.8	-3.3	5.9	4.6
Forecasts finalised 9 June 2021						

Interest rate forecasts	Latest	Sep–21	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22
Australia							
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.03	0.07	0.09	0.10	0.10	0.10	0.10
10 Year Bond	1.48	1.95	2.10	2.20	2.30	2.40	2.50
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.44	1.85	2.00	2.10	2.20	2.30	2.40

Exchange rate forecasts	Latest	Sep–21	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22
AUD/USD	0.7755	0.80	0.82	0.85	0.85	0.85	0.85
USD/JPY	109.39	109	109	110	110	111	111
EUR/USD	1.2189	1.23	1.24	1.25	1.26	1.27	1.27
GBP/USD	1.4184	1.42	1.43	1.43	1.44	1.44	1.44
USD/CNY	6.3865	6.30	6.20	6.15	6.10	6.05	6.00
AUD/NZD	1.0777	1.08	1.08	1.09	1.09	1.09	1.09

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