
Tīeke

Weekly Economic Commentary.

Just when I thought I was out, they pull me back in.

New Zealand has been pushed back into lockdown following the discovery of three cases of the more virulent UK-variant of Covid-19 in the community. From today, the Alert Level in Auckland has been raised to level 3, while the rest of the country is now at Alert Level 2. Those settings are scheduled to remain in place for the next three days as authorities determine what the next steps for the country will be.

If this is just a temporary scare, and the Alert Levels are raised only briefly, then the economic implications are likely to be very limited. We estimate that, for each week that Auckland is at Level 3 and the rest of New Zealand at Level 2, about $300m of economic activity is foregone, or 0.5% of quarterly GDP. However, in the case of a short lockdown, much of the activity would be delayed rather than cancelled, so the final economic cost would be lower. That was certainly the experience from August, when there was also a dialling up of restrictions for several weeks in response to an outbreak in Auckland. And while that did cause some temporary disruptions to economic activity, there turned out to be no discernible impact on GDP over the quarter as a whole.

Additionally, our central forecasts already assumed that temporary periods at a higher alert level would occur. Therefore we see no reason to alter our GDP or unemployment forecasts at this stage. Of course, the longer restrictions remain in place – or if they're dialled up – the greater the economic impact could be. For now, we'll keep our fingers crossed – and keep scanning our Covid tracers – as we wait to see how the situation evolves.

While the overall impact of this latest outbreak will hopefully be limited, it will be particularly worrying news for those in New Zealand's hospitality sector, which is still reeling from the exclusion of international tourists from the country. That loss has been reflected in retail spending levels, which fell by 0.4% in January and have now fallen by 1.7% since September.

Over the Christmas / New Year period, the loss of international tourist dollars was partially offset by New Zealanders taking holidays onshore. But now, with New Zealand families heading back to work and school, we are hearing that the absence of international tourists is being felt much more acutely. And the seasonal nature of tourist flows means that their absence will be much more evident in economic data also, with negative GDP growth expected in the summer months.

The past week also saw the RBNZ's March quarter survey of expectations reveal a sharp rise in expectations for inflation over the coming years. That included a rise of 0.4 ppts in the closely watched two-year ahead gauge to 1.89%. However, expectations of longer-term inflation, which are a key focus for monetary policy, have been more stable and remain close to 2%.

A major part of the reason for the lift in shorter term expectations has been recent disruptions to global shipping and supply lines, leading to price increases. Combined with a firming in domestic demand, we expect those disruptions will take annual inflation from 1.4% at the end of last year to 2.5% in June. But while this will be a dramatic turnaround in inflation, we think that it will be short lived and that inflation will drop back below 1% over 2022 as global supply chains unclog. That decline will be amplified by the sharp rise in the NZD already in train.

With the RBNZ still facing a low inflation outlook, we think that any rise in the OCR is years off. Before contemplating any hikes, the RBNZ will want to see that the economy is back to full health and that inflation is on a sustained path to 2%. That won't happen for some time yet, especially with the borders still closed.

Finally, the RBNZ has confirmed that Loan to Value restrictions on residential mortgages will come back into force in March and that they will be further tightened in May, with a focus on cooling demand from investors. On top of that, the Government has announced that it plans to introduce a range of measures over the coming months to address both demand and supply side pressures in the housing market. However, we don't think that such interventions will prevent a big lift in house prices this year.

The cost of cutting carbon.

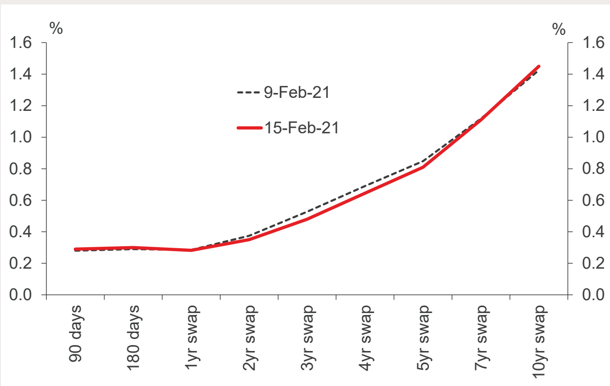
According to a recent report by the Climate Commission more needs to be done if New Zealand is to deliver on its 2050 emission reductions targets. Among the Commission's recommendation are changes to New Zealand's Emissions Trading Scheme (ETS). The Commission estimates that the cost of taking an additional tonne of carbon dioxide equivalent out of the atmosphere will be around $140 by 2030 (in today's prices). We think that implies that the price of carbon in the ETS should be sitting around that level, compared to $39 at present. ETS auction mechanisms currently encourage the price to sit between $20 and $50. The Commission has recommended these mechanisms be altered such that the range is lifted to $30 to $70 immediately, with annual increases pencilled in thereafter. Such a price increase is likely to have a profound impact on emitters and forest owners alike, threatening the viability of some businesses that are unable to reduce their emissions, while bolstering the fortunes of others.

The Commission also suggests a set of command and control policy interventions to help smooth the costs of transitioning to a low carbon future and make it more equitable than if left entirely to the market mechanism. We agree with the intent but think that the balance may have swung too far as some these measures could prove costly. For example, requiring businesses to convert from natural gas to electricity makes sense for most. But some uses of gas, such as cooking in restaurants, are enormously valued by society. Restaurants would rather pay a high price for using carbon than convert. The ETS naturally allows an exemption for such firms, whereas blanket rules do not.

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 refixing later.

NZ interest rates



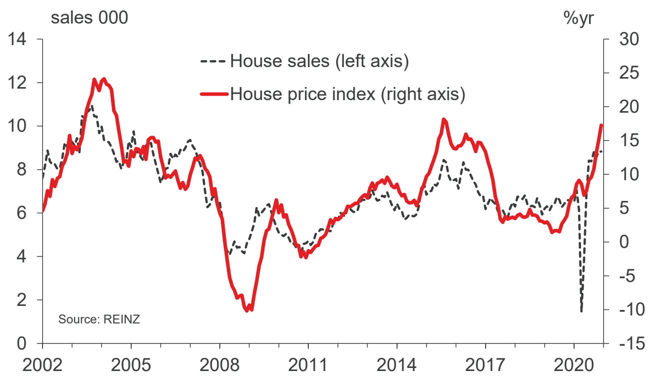
The week ahead.

NZ Jan REINZ house prices and sales

Feb 15 (TBC), Sales last: 0%, Prices last: +17.3%yr

- The New Zealand housing market went from red-hot to white-hot by the end of 2020. Prices have risen 9% over the last three months, the fastest pace on record. Sales are running at their highest levels since 2007, and the stock of unsold homes has fallen sharply.
- We expect the market's strength to continue into the early part of this year, supported by record-low mortgages rates.
- Banks have been tightening their loan-to-value ratio limits in anticipation of the RBNZ's changes. But historically this measure has had only a modest impact on the rate of house price inflation.

REINZ house prices and sales

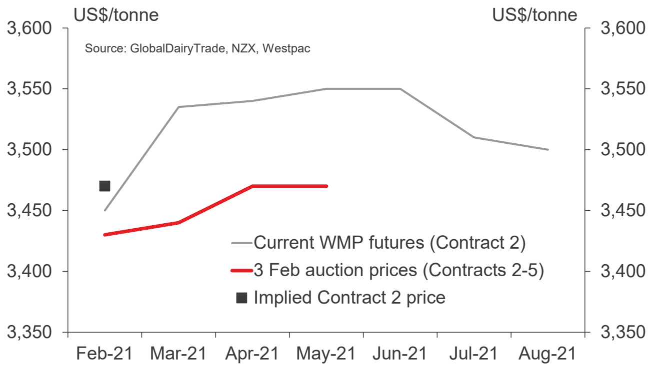


NZ GlobalDairyTrade auction, whole milk powder prices

Feb 17, Last: 2.3% chg, Westpac: No change

- We expect no material whole milk powder price change at the upcoming dairy auction. No change in prices would still represent a firm result as this would cement the strong recent price gains.
- Our pick is slightly below current futures market pricing – futures pricing is pointing to a lift of circa 1%.
- Beyond this auction, we expect dairy prices will strengthen further. This lift is part of a broad global lift in protein and other agricultural commodity prices.

Whole milk powder prices

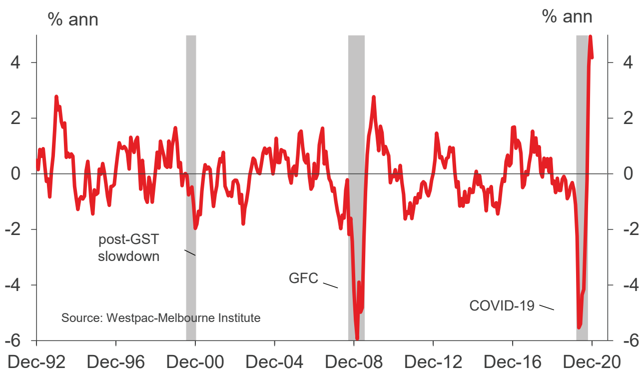


Aus Jan Westpac–MI Leading Index

Feb 17, Last: 4.18%

- The Leading Index growth rate fell from 4.94% in Nov to 4.18% in Dec, still a very strong pace but suggesting the growth rebound is starting to moderate. The picture remains consistent with healthy above trend growth in the first half of 2021.
- The Jan update is likely to be a similar story. It will include positive updates on US industrial production (+2% vs +1.5% last month); commodity prices, up 4.8% (in AUD terms) vs 6% last month; and dwelling approvals, up 10.9% vs 3.4% last month. Most other components posted small gains as well.

Westpac-MI Leading Index



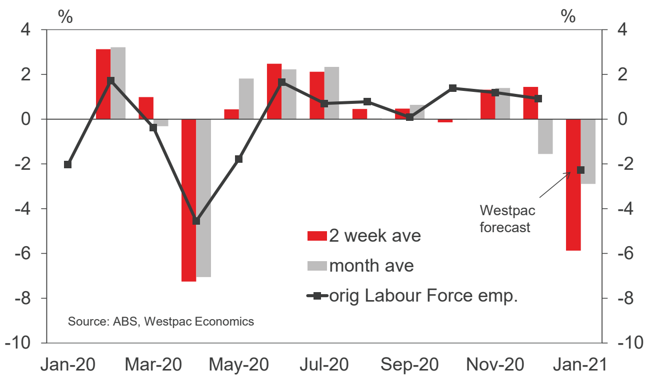
The week ahead.

Aus Jan Labour Force: employment, '000 chg

Feb 18, Last: 50k, WBC f/c: 10.0
Mkt f/c: 30.0, Range: 10.0 to 67.5

- In Dec employment lifted 50k (0.4%) on par with the market median. Employment is now up 518.8k from the April low and is just 87.6k (or 0.7%) shy the level in March, a far more solid recovery than was widely expected.
- The Victorian economy re-opened on November 8th and with the ongoing recovery in NSW we had expected to see a positive employment run into the year end. Also, the Northern Beaches was not declared a hot spot until December 18, too late to have an impact on this survey.
- The business surveys have seen a recent, very solid recovery in their employment indicators, particularly the AiGroup of surveys. However, the Weekly Payrolls are pointing to a sizeable seasonal drop in early January.
- Due to the balance of risks we have held our earlier forecast for a 10k rise in employment.

Aus payrolls and employment

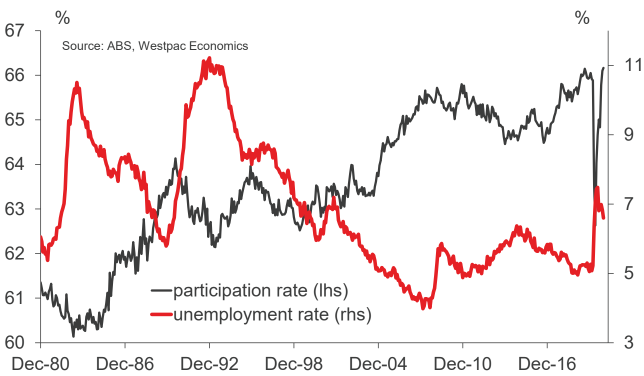


Aus Jan Labour Force: unemployment rate, %

Feb 18, Last: 6.6%, WBC f/c: 6.6%
Mkt f/c: 6.5%, Range: 6.7% to 6.4%

- The Dec survey reported a decline in unemployment even with a solid lift in participation, we had expected that the re-opening of the Victorian economy to would drive participation higher and that this would lift unemployment further. In the end, participation lifted 0.6ppt to 66.16% resulting in a 20.0k lift in the labour force. As this was less than the rise in employment, unemployment fell 0.2ppt to 6.6%.
- Also worth noting is that the fall in underemployment in Dec, from 9.4% to 8.5% which is now lower that it was in March, a very unexpected outcome give the rising share of part-time employment.
- Holding participation flat at 66.2% and continuing the current pace of growth in the working age population means a 10k gain in employment is enough to hold the unemployment rate at 6.6%.

Aus labour force participation and employment

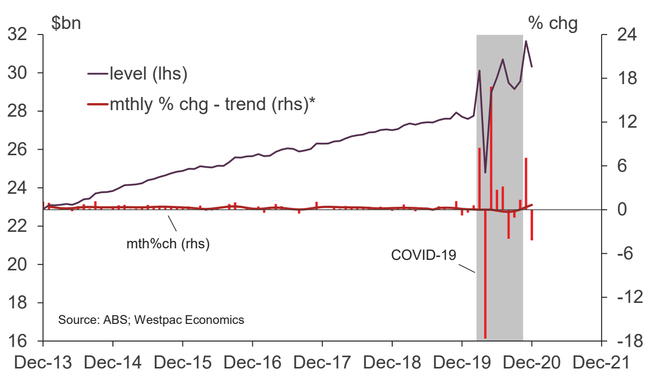


Aus Jan retail trade

Feb 19, Last: –4.1%, WBC f/c: 2.0%
Mkt f/c: 2.0%, Range: -1.5% to 5.0%

- Retail sales contracted 4.1% in Dec but were still up 9.4%yr having come off a big 7.1% gain in Nov. The detail pointed to some impact from virus-related measures late in the month but with weakness also reflecting the cycling of boosts from 'Black Friday' sales and a post-reopening catch-up in Vic.
- The monthly profile of sales remains very choppy with more noise likely near term as further virus-related disruptions impact (a 3-day lockdown in Brisbane in Jan, a 5-day lockdown in Perth and more restrictive measures in Melbourne in Feb). That said, these measures look to be having much smaller disruptions than last year's hard lockdowns and the level and underlying momentum to sales still looks positive. Our Westpac Card Tracker shows this momentum carried into Jan and suggests sales nationally will report a small rise – we expect a 2% gain.

Aus monthly retail sales

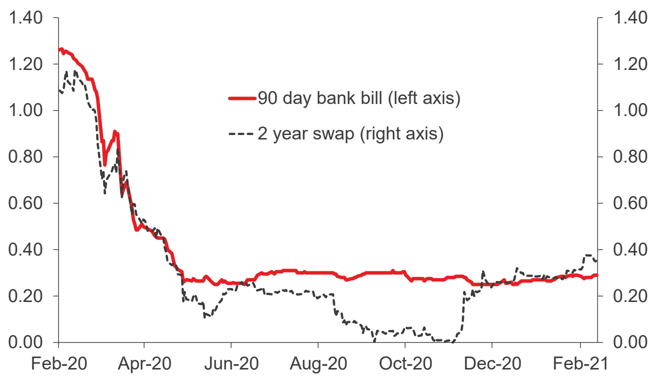


New Zealand forecasts.

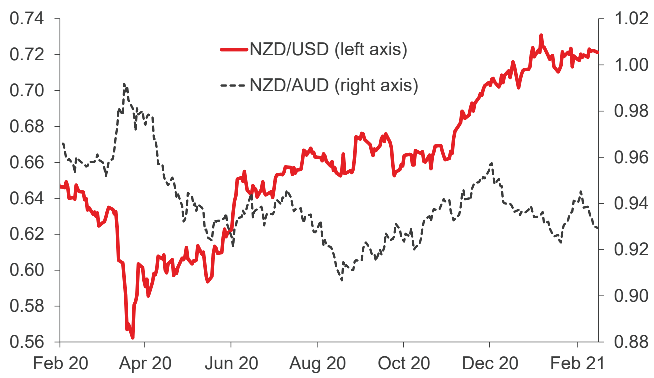
Economic forecasts	Quarterly				Annual			
	2020		2021					
% change	Sep (a)	Dec	Mar	Jun	2019	2020f	2021f	2022f
GDP (Production)	14.0	0.0	0.6	1.6	2.3	-2.6	5.9	2.5
Employment	-0.7	0.6	-0.1	0.2	1.3	0.7	1.0	3.0
Unemployment Rate % s.a.	5.3	4.9	5.0	5.1	4.1	5.6	5.5	5.3
CPI	0.7	0.5	0.8	0.6	1.9	1.4	1.8	0.8
Current 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 15 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	0.28%	0.28%	0.27%
90 Days	0.29%	0.29%	0.28%
2 Year Swap	0.35%	0.31%	0.28%
5 Year Swap	0.81%	0.67%	0.58%

NZ foreign currency mid-rates as at 15 February 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7214	0.7162	0.7147
NZD/EUR	0.5954	0.5935	0.5911
NZD/GBP	0.5209	0.5237	0.5250
NZD/JPY	75.75	75.18	74.11
NZD/AUD	0.9298	0.9385	0.9276
TWI	74.93	74.76	74.41

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 15					
NZ	Jan REINZ house prices %yr (TBC)	17.3%	–	–	TBC. Prices growth to remain strong...
	Jan REINZ house sales (TBC)	0.0%	–	–	...supported by low mortgage rates and a lack of listings.
	Jan BusinessNZ PSI	49.2	–	–	The closure of the border remains a drag on services.
Chn	Golden Week	–	–	–	National holiday, continues through to Wednesday.
Eur	Dec trade balance €bn	25.1	–	–	Approaching pre-pandemic surplus.
UK	Feb Rightmove house prices	–0.9%	–	–	Price growth slowed into year end.
US	President's Day Holiday	–	–	–	Stock and bond markets closed.
Tue 16					
NZ	Dec net migration	672	–	–	Set to remain low due to continued border restrictions.
Aus	RBA Minutes of February meeting	–	–	–	Additional colour around QE program of interest.
	Weekly Payroll Jobs and Wages	–	–	–	For the week ending 30 Jan.
Eur	Q4 GDP	–0.7%	–0.7%	–	Second estimate to confirm 0.7% contraction (–5.1%yr).
	Feb ZEW survey of expectations	58.3	–	–	Expectations remain firm despite immediate headwinds.
US	Feb Fed Empire state index	3.5	6.0	–	Will be supported by falling case count in New York.
Wed 17					
NZ	GlobalDairyTrade auction – WMP	2.3%	–	0.0%	Dairy prices to cement recent strong gains.
Aus	Jan Westpac–MI Leading Index	4.18%	–	–	Growth showing very strong momentum, albeit off its peak.
	RBA Assist Gov Financial Mkts	–	–	–	Chris Kent, panel at FX roundtable webinar, 12pm.
UK	Jan CPI	0.3%	–	–	To gradually pick up as low energy prices/VAT cuts unwind.
US	Dec total net TIC flows	214.1	–	–	Approaching 7 year highs.
	Jan PPI	0.3%	0.4%	–	Upstream price pressures remain muted.
	Jan retail sales	–0.7%	0.8%	–	A soft finish to 2020, but falling cases will support turnover.
	Jan industrial production	1.6%	0.4%	–	In contrast to the consumer, output was robust into year end.
	Dec business inventories	0.5%	0.5%	–	Nov saw 5 consecutive quarters of inventory expansion.
	Feb NAHB housing market index	83	83	–	Homebuilders continue to benefit from limited housing supply
	FOMC Meeting Minutes	–	–	–	For Jan 27 meeting.
	Fedspeak	–	–	–	FOMC's Rosengren Takes Part in Panel.
Thu 18					
Aus	Jan employment, '000	50.0	30.0	10.0	Business surveys have bounce back but Weekly Payrolls...
	Jan unemployment rate	6.6%	6.5%	6.6%	...pointing to greater uncertainty & flat unemployment.
Eur	Feb consumer confidence	–15.5	–14.5	–	Lagging vaccine rollout will hinder confidence recovery.
US	Jan housing starts	5.8%	–1.1%	–	Housing starts and permits expanding at a prolific pace...
	Jan building permits	4.5%	–2.0%	–	... and will continue to remain elevated as families seek space.
	Jan import price index	0.9%	1.0%	–	Industrial supplies and nonagricultural goods prices rising.
	Initial jobless claims	793k	–	–	Choppy profile points to ongoing churn in the labour market.
	Feb Philly Fed index	26.5	19.8	–	To benefit from falling cases and strengthening production.
	Fedspeak	–	–	–	FOMC's Brainard and Bostic.
Fri 19					
Aus	Jan retail sales, prelim.	–4.2%	2.0%	2.0%	Holding up well despite virus disruptions.
Chn	Q4 current account balance	40.1	–	–	Remains near an all-time high.
Eur	Feb Markit PMIs	–	–	–	Mfg and services PMIs for Euro Area, Germany, and the UK.
UK	Feb GfK consumer sentiment	–28	–	–	Prospects for a return to normality will lift sentiment.
	Jan public sector borrowing £bn	33.4	–	–	Stimulus will see the public deficit continue to widen.
US	Feb Markit manufacturing PMI	59.2	58.5	–	Both services and mfg remain firmly in expansion...
	Feb Markit services PMI	58.3	58.0	–	... as cases fall and output continues to recover.
	Jan existing home sales	0.7%	–3.0%	–	Existing home sales at highest level in 15 years.
	Fedspeak	–	–	–	FOMC's Rosengren Speaks at Yale Symposium.

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	1.22	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	1.16	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	0.7750	0.78	0.79	0.80	0.82	0.85	0.85	0.82
USD/JPY	104.79	104	104	104	104	105	105	105
EUR/USD	1.2126	1.22	1.23	1.24	1.25	1.26	1.27	1.28
GBP/USD	1.3799	1.37	1.37	1.38	1.39	1.41	1.41	1.41
USD/CNY	6.4583	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0730	1.07	1.07	1.07	1.08	1.09	1.09	1.09

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