



Kōkako

Weekly Economic Commentary.

Back to “normal”.

It's now very clear that the RBNZ can start to remove last year's emergency stimulus and return monetary policy settings back to more normal ones. We expect that the Reserve Bank will lift the OCR by 25 basis points on Wednesday. That would be the first hike in seven years. In addition, we've now had our first glimpse at how New Zealand will reopen to the world and the Government's plans for a controlled opening of the border.

The expected OCR hike is a dramatic turnaround from just a few months ago, when the RBNZ was still saying that it would take “considerable time and patience” to meet its targets. But since then, we've seen a much stronger than expected lift in inflation, and a sharp drop in unemployment back to its pre-Covid lows.

It's becoming clear that this is not just about cost pressures and labour shortages, though they are a factor too. It's also about strong demand. With New Zealand's Covid elimination strategy proving a resounding success, the New Zealand economy has been able to build up a real head of steam over the last year, more so than we've seen in other countries.

Recent data have reinforced this picture of economic strength. July card spending data showed that the strength in household spending continues to surprise, with spending

up a seasonally-adjusted 0.6% versus our expectation of a small decline. July housing data were similarly strong. If anything, the housing market has strengthened despite the implementation of tighter tax rules for investors and the RBNZ tightening of loan to value restrictions. Meanwhile, inflation expectations for two years ahead lifted to around 2.3%, the highest reading since 2014.

So it's now time to start removing some of the support that was put in place during the depths of the Covid crisis. We expect a 25 basis point increase in the cash rate this week. But there is some speculation, rightly so, about the possibility of a 50 point move. That would be very unusual, but not entirely unprecedented. And it would reflect the fact that the economy is at a vastly different point now to what was expected even three months ago.



But that is really a question of tactics rather than economics. Hiking 50 points in one go, or spreading it out over two meetings, would make very little difference in terms of the impact on the economy.

Regardless of the size of the move next week, our broader view is that we'll see a cash rate of 1% by year-end, rising to 2% over the next couple of years. That has already started to come through in the more popular one- to two- year fixed mortgage rates, and they're likely to rise further.

We're not talking big increases compared to history, but it will be enough to change the arithmetic for the property market. After the 30% rise in house prices in the last year, spurred by record low mortgage rates, we expect price growth to slow significantly by early next year.

Last week we also got our clearest indication to date of New Zealand's path forward as we learn to live in a world with Covid-19. Of course, New Zealand's path forward is not so much a case of regaining freedoms but more of a case of how we reintroduce ourselves to the world via a controlled opening of the border.

On that front, we learned that the Government is planning a phased approach. From the first quarter of 2022, New Zealand will move to new individualised risk-based border settings that will establish low, medium and high risk pathways into the country. The 'low risk' pathway will essentially allow vaccinated travellers from low-risk countries free entry into the country. While at the other extreme, unvaccinated travellers from high-risk countries will still have to quarantine

for two weeks upon arrival. The medium risk pathway will lie somewhere in between, with travellers having to self-isolate upon arrival or stay in quarantine for a shorter period of time.

To help manage the Covid risks from opening the border, the Government is ramping up the vaccine rollout. The strategy is also changing subtly away from targeted vaccinations to more widespread coverage. Now, all eligible ages will be able to book in their vaccine by 1 September. And to help broaden coverage, the time between the first and second dose is being lengthened to 6 weeks so that more people are at least partially vaccinated as soon as possible.

Interestingly, the Government is also piloting self-isolation, while at the same time setting up new testing and vaccine checking systems at the border. Clearly, this means that the Government's approach will evolve as it learns what works best, whilst the virus itself and the associated health risks will also continue to evolve.

In the same way, the RBNZ's policy responses will continue to evolve over coming months. As a result, it will be some time before we know what the "new normal" really looks like.

Nathan Penny, Senior Agri Economist

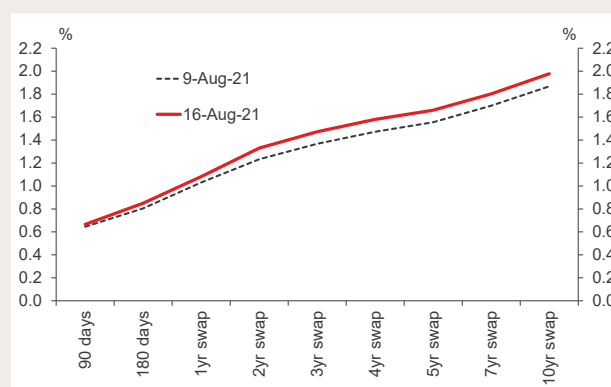
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Fixed vs floating for mortgages.

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



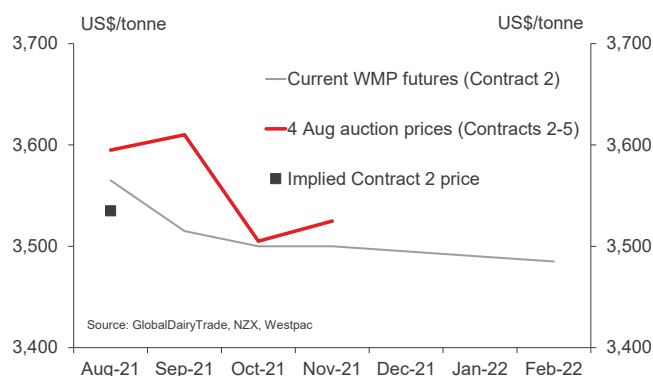
The week ahead.

NZ GlobalDairyTrade auction, whole milk powder prices

Aug 18, Last: -3.8%, Westpac: -1.0%

- We expect whole milk powder prices to fall at the upcoming dairy auction, continuing the run of price declines.
- This pick is in line with dairy futures market pricing as at 13 August (10am).
- Strong recent New Zealand production data has driven prices lower and this remains the key influence on prices for now. However, the strength or otherwise of New Zealand spring production will provide fresh impetus for prices either way.

Whole milk powder prices

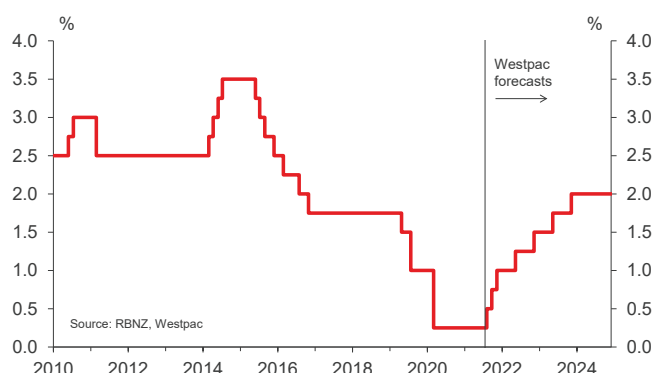


RBNZ Monetary Policy Statement

Aug 18, last: 0.25%, WBC f/c: 0.50%, Market f/c: 0.50%

- We expect the Reserve Bank to lift the Official Cash Rate by 25 basis points to 0.5% next week.
- This would put it well ahead of international peers, but that reflects the local conditions that the RBNZ is facing. The Covid-free New Zealand economy has built up a real head of steam, and emergency monetary policy settings are no longer appropriate.
- Markets are pricing at least a 25bp hike, with some chance of a 50bp move. We agree with that risk assessment – a move of this size would be highly unusual but not unprecedented, and the economy is starting from a markedly different point than what the RBNZ expected in its May forecasts.

RBNZ Official Cash Rate

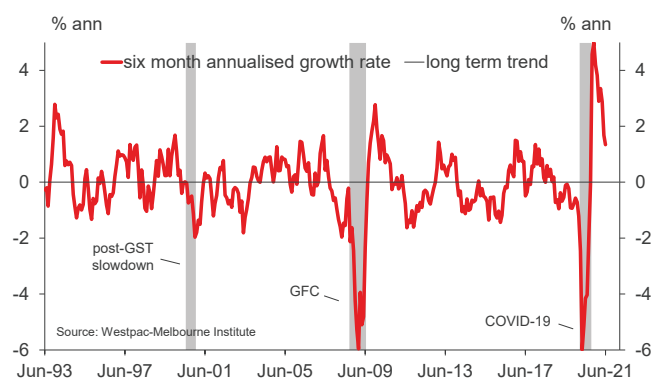


Aus Jul Westpac-MI Leading Index

Aug 18, Last: 1.34%

- The six-month annualised growth rate in the Leading Index slowed from 1.68% in May to 1.34% in June. While down sharply on the 5% peak back in November last year it remains comfortably above zero – signalling above trend growth momentum.
- The July update is likely to show a further slowing although components have been somewhat mixed over the last month. On the plus side, commodity prices continued to surge in July, up 8.5% in AUD terms and equities put on more gains (ASX200 +1.1%). However, virus disruptions are starting to impact locally: the Westpac-MI Consumer Expectations Index down -4% and the Westpac-MI Unemployment Expectations Index posting an even sharper deterioration (13.7%). Dwelling approvals have also continued to unwind a HomeBuilder driven surge, down -6.7% in June.

Aus Westpac-MI Leading Index



The week ahead.

Aus Q2 Wage Price Index %qtr

Aug 18, Last: 0.6%, WBC f/c: 0.7%

Mkt f/c: 0.6%, Range: 0.5% to 0.7%

- The Wage Price Index (WPI) lifted 0.6% in Q1, spot on Westpac's forecast and a touch stronger than the market's 0.5% estimate. The second consecutive 0.6% rise followed two quarters of the softest quarterly increases in the history of the series. The annual pace lifted slightly to 1.5% from the record low of 1.4%yr.
- State wages are converging around 1.5%yr but in Vic the wage correction there in 2020 exceeded what you would expect; the rebound has been just as surprising. Special factors at play included the phased implementation of the Fair Work Commission's minimum wage review and catch-up from early wage freezes and temporary wage cuts.
- For Q1 the contributions to the 0.5% rise in original terms were: awards, 0.07ppt; enterprise agreements, 0.21ppt and individual agreements, 0.22ppt. For Q2 we are looking for a 0.5% rise in original terms: awards, 0.01ppt; enterprise agreements, 0.22ppt; and individual arrangements, 0.22ppt.

Aus method of pay setting



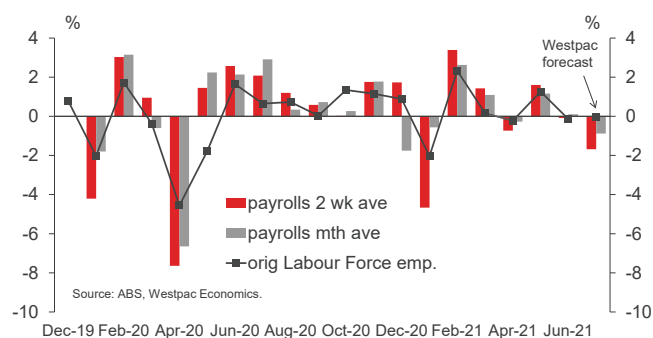
Aus July Labour Force Survey employment '000

Aug 19, Last: 29.1k, WBC f/c: 20k

Mkt f/c: 30k, Range: -90k to +20k

- The 29.1k gain in June would have been stronger were it not for the Victorian lockdown, which fell during the two-week survey reference period. In addition, all of the growth was outside of the SE corner with NSW employment falling 0.2% and Vic employment falling 0.3%.
- Why not forecast a negative for June given that the lockdown was extended and tightened through Greater Sydney. In addition, the ABS Weekly Payrolls fell 2.4% in the two weeks to 17 July, compared to a revised -0.2% for fortnight ending 3 July (originally published as -1.0%).
- Payrolls are not seasonally adjusted; they measure only people paid in the week so those working zero hours but still employed are not counted; and, due to late submissions positive revisions can be significant (note the change of the previous two weeks). Our 20k forecast is a flat print in original terms.

Aus employment



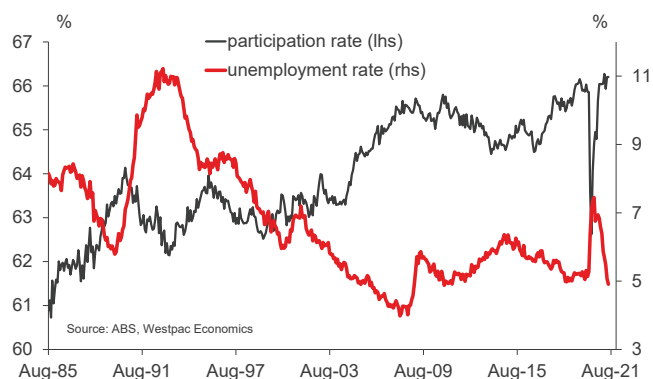
Aus July Labour Force Survey unemployment %

Aug 19, Last: 4.9%, WBC f/c: 4.8%

Mkt f/c: 5.0%, Range: 5.2% to 4.5%

- While the 29.1k rise in June employment was somewhat surprising, that was matched by flat participation, thus a 0.2ppts decline in unemployment to 4.9% was even more so. Unemployment is now 0.4ppts below Mar 2020 (pre-Covid) and is the lowest it's been since December 2010.
- There was a 51% lift the number working less hours due to not enough work or being stood down (economic reasons), 48% higher than pre-Covid levels. It is, however, only 30% of the peak hit in April 2020.
- The ABS reported a 16.1k fall in female employment. The significant fall in female employment was offset by a 0.8ppt fall in the participation rate, resulting in a 0.3ppt fall in female unemployment to 4.9%. Female participation can be very responsive to employment so a rise in participation is a clear risk. However, given all the uncertainty in the month a flat print is more likely.

Aus participation and unemployment

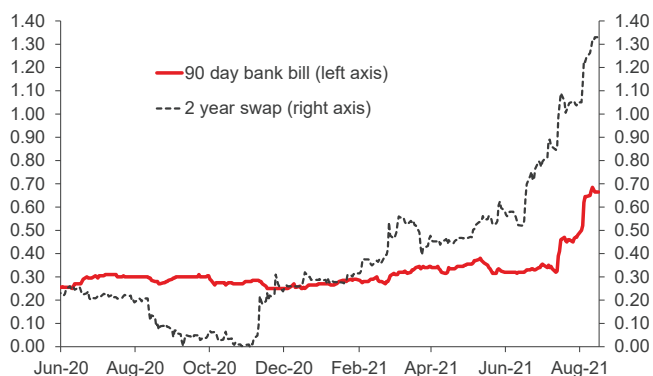


New Zealand forecasts.

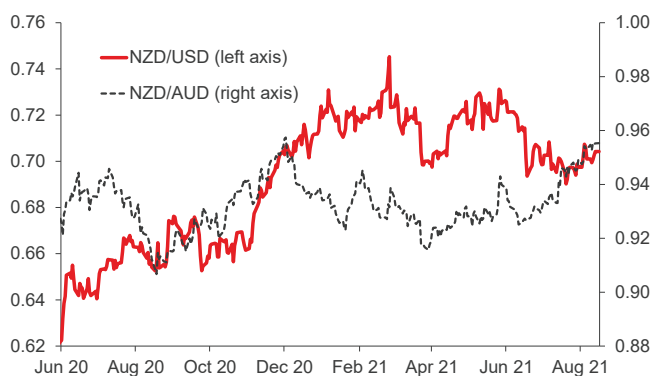
Economic forecasts		Quarterly				Annual		
	2021							
% change	Mar (a)	Jun	Sep	Dec	2019	2020	2021f	2022f
GDP (Production)	1.6	0.6	0.9	1.3	2.4	-2.9	5.8	4.5
Employment	0.6	1.1	0.5	0.4	1.2	0.7	2.6	1.5
Unemployment Rate % s.a.	4.6	4.0	3.8	3.7	4.0	4.8	3.7	3.5
CPI	0.8	1.3	0.9	0.2	1.9	1.4	3.3	2.0
Current Account 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 16 August 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.53%	0.33%	0.31%
60 Days	0.60%	0.41%	0.39%
90 Days	0.67%	0.48%	0.46%
2 Year Swap	1.33%	1.05%	1.09%
5 Year Swap	1.66%	1.46%	1.50%

NZ foreign currency mid-rates as at 16 August 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7042	0.6973	0.7003
NZD/EUR	0.5970	0.5874	0.5930
NZD/GBP	0.5088	0.5014	0.5080
NZD/JPY	77.24	76.45	77.05
NZD/AUD	0.9553	0.9505	0.9459
TWI	74.86	74.03	74.39

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 16					
NZ	Jul BusinessNZ PSI	58.6	–	–	Likely to hold firm as the economy remains strong.
Chn	Jul retail sales ytd %yr	23.0%	21.2%	–	Covid-19 outbreaks still seem to be affecting spending.
	Jul industrial production ytd %yr	15.9%	14.6%	–	Finding a base, having come off recovery peak.
	Jul fixed asset investment ytd %yr	12.6%	11.3%	–	Gains are broad based, private sector leading the way.
US	Aug Fed Empire state index	43	28.5	–	To provide a timely update on business conditions in NY.
	Jun total net TIC flows	105.3	–	–	Recent trend led by selling from China and Japan.
Tue 17					
Aus	RBA minutes	–	–	–	Looking for any colour around bond purchase discussion.
Eur	Q2 GDP	–0.3%	2.0%	–	Second estimate; set to confirm flash read.
UK	Jun ILO unemployment rate	4.8%	–	–	Job losses being held down by extended furlough scheme.
US	Jul retail sales	0.6%	–0.2%	–	Reopening to see consumers shift to leisure spending ...
	Jul industrial production	0.4%	0.5%	–	... which should cool demand for manufactured goods.
	Jun business inventories	0.5%	0.8%	–	Inventories a drag on Q2 GDP; should begin to rebuild.
	Aug NAHB housing market index	80	80	–	Homebuilders upbeat, but rising input costs a headwind.
	Fed Chair Powell	–	–	–	Hosting a town hall with educators.
Wed 18					
NZ	GlobalDairyTrade auction (WMP)	–3.8%	–	–1.0%	The run of price declines is set to continue for a 9th auction.
	RBNZ policy decision	0.25%	0.50%	0.50%	Risk of a 50bp move given the strength of recent data.
Aus	Jul Westpac-MI Leading Index	1.34%	–	–	Set for further slowing in momentum as outbreak impacts.
	Q2 wage cost index	0.6%	0.6%	0.7%	Lifting from Covid wage freezes but remains well contained.
Eur	Jul CPI	0.3%	–0.1%	–	Energy & travel prices underlying much of the price growth.
UK	Jul CPI	0.5%	–	–	BoE sees near-term spike, but at target over medium-term.
US	Jul housing starts	6.3%	–2.2%	–	Elevated input costs and affordability metrics ...
	Jul building permits	–5.1%	1.0%	–	... have served as a drag on building activity.
	FOMC Meeting Minutes	–	–	–	Focus will be on discussion around timing/nature of taper.
Thu 19					
Aus	Jul employment	29.1k	30k	20k	Sydney in lockdown light so pressure more likely to be in hrs ...
	Jul unemployment rate	4.9%	5.0%	4.8%	... worked than employment, but strong participation a risk.
US	Aug Philly Fed index	21.9	24.2	–	Will be looking closely at prices and employment detail.
	Initial jobless claims	375k	–	–	Downtrend entrenched, but delta still poses near-term risk.
	Jul leading index	0.7%	0.7%	–	Jobless claims and ISMs continue to be source of strength.
Fri 20					
Aus	RBA's Kent (Asst. Gov. Fin Mkts)	–	–	–	FX Markets 2021 Conference – Online.
UK	Aug GfK consumer sentiment	–7	–	–	Consumer activity and confidence to reflect relaxation ...
	Jul retail sales	0.5%	–	–	... of legal restrictions on July 17 'Freedom Day'.
	Jul public sector borrowing £bn	22.0	–	–	Deficit to remain wide on record peacetime borrowing.

International forecasts.


Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
Australia						
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
United States						
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
Japan						
Real GDP %/yr	1.7	0.6	0.3	-4.8	2.5	2.7
Euro zone						
Real GDP %/yr	2.6	1.9	1.3	-6.6	4.5	4.4
United Kingdom						
Real GDP %/yr	1.7	1.3	1.4	-9.9	6.5	5.0
China						
Real GDP %/yr	6.9	6.7	5.8	2.3	9.3	5.8
East Asia ex China						
Real GDP %/yr	4.7	4.4	3.7	-2.4	4.6	5.0
World						
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
Australia									
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.50	0.75
90 Day BBSW	0.02	0.04	0.07	0.10	0.15	0.20	0.40	0.70	0.95
10 Year Bond	1.22	1.55	1.80	1.95	2.00	2.05	2.10	2.20	2.30
International									
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.375	0.875	0.875
US 10 Year Bond	1.35	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	0.7336	0.75	0.78	0.80	0.82	0.82	0.82	0.80	0.78
USD/JPY	110.40	111	111	112	112	112	113	114	115
EUR/USD	1.1735	1.21	1.22	1.23	1.22	1.21	1.21	1.20	1.19
GBP/USD	1.3806	1.41	1.42	1.43	1.44	1.45	1.44	1.44	1.43
USD/CNY	6.4779	6.35	6.25	6.15	6.10	6.05	6.00	6.00	5.95
AUD/NZD	1.0478	1.06	1.05	1.05	1.06	1.06	1.06	1.07	1.07

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- (iii) and well defined wall/cell crossing procedures;
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