



Weekly Economic Commentary.

Biding their time.

There were no surprises from the Reserve Bank in last week's Monetary Policy Review. The RBNZ is prepared to wait and see on both inflation pressures and the effects of recent attempts to cool the red-hot housing market.

The RBNZ left all its policy settings unchanged last week, with the Official Cash Rate remaining at 0.25% and no changes in large-scale bond purchases or the Funding for Lending Programme for banks. While this was the first occasion since the RBNZ was freed from its self-imposed commitment to not change the OCR for 12 months, there was little prospect of a move this time. The RBNZ believes that it has already put a substantial amount of monetary stimulus in place, and is now prepared to let it run its course.

The bottom line of the RBNZ's statement was more or less identical to the previous review in February:

"The Committee agreed to maintain its current stimulatory monetary settings until it is confident that consumer price inflation will be sustained at the 2 percent per annum target midpoint, and that employment is at or above its maximum sustainable level. Meeting these requirements will necessitate

considerable time and patience. The Committee agreed that it was prepared to lower the OCR if required."

With regard to inflation, the key word is 'sustained'. It's well recognised that annual inflation is set to jump higher this year – though not so much for the March quarter, which will be published this week. We expect annual inflation to dip slightly to 1.3%, reflecting the end of the big annual increases in tobacco excise and a moderation in food prices from last year's highs.

However, we expect inflation to jump to around 2.5% by the June quarter. Much of that is due to base effects – oil prices are substantially higher than they were in mid-2020, in the depths of the Covid shock. More recently there's been upward pressure on import prices due to global supply chain disruptions and a spike in shipping costs.



But these are likely to be one-off factors, rather than a source of sustained price increases. As the initial effects faded, we'll be left with an economy that's still running short of its full capacity, mostly due to the international border closure. We expect that by next year annual inflation will be back in the lower half of the RBNZ's target range.

That means the conditions for a tightening of monetary policy could be quite some time away. As we noted last week, we expect the OCR to remain unchanged until early 2025. That's in keeping with what we expect from overseas central banks, as they try to navigate through this uncertain environment. But it remains out of step with global financial markets, where a potential rebound in inflation still tends to dominate thinking.

The housing market didn't feature much in the RBNZ's statement, despite the developments on this front since February. First, the Minister of Finance has added housing as a consideration to the RBNZ's remit. On the monetary policy side, it's a fairly soft change – the RBNZ is required to assess how its decisions affect the Government's wider housing affordability goals, but it doesn't have to set interest rates with regard to house prices in any way.

The inclusion of housing into the RBNZ's financial stability remit is potentially more significant. The Minister of Finance has asked the RBNZ for information on the role of high debt-to-income and interest-only mortgages (presumably with an eye towards restrictions on these). The RBNZ noted that it has prepared some preliminary material that will feature in next month's *Financial Stability Report*.

The bigger development was the Government's announcement of changes to the tax treatment of property investors. We think this will be quite effective in dampening


investor demand (and likely making restrictions on high debt-to-income lending redundant). The RBNZ took a cautious approach in this week's review, noting that the impact "will take time to be observed".

The Government's announcement probably came too late to affect the housing figures for March, which were once again extraordinarily strong. Sales remained at some of their highest levels since 2007, and the house price index rose another 3% for the month, to be up 24% on a year ago. There was no noticeable impact from the formal reintroduction of loan-to-value ratio (LVR) restrictions at the start of March, which was not surprising as the major lenders had already adopted the new limits well in advance.

The April figures will be the more significant test. From 27 March, an investor who buys a property won't be able to deduct their mortgage interest costs from their taxable income. (For investment properties bought before that date, the change will be phased in over four years.) As a result, we expect to see highly-leveraged investors stepping back from the market, leaving an opening for homebuyers and cashed-up investors.

While record-low interest rates mean that there will still be willing buyers in the housing market, they'll be under less pressure to chase prices higher. We expect house prices to flatten out over the rest of this year. That's not too far from what the RBNZ was forecasting in its February *Monetary Policy Statement*, albeit for different reasons.

Michael Gordon, Acting Chief Economist

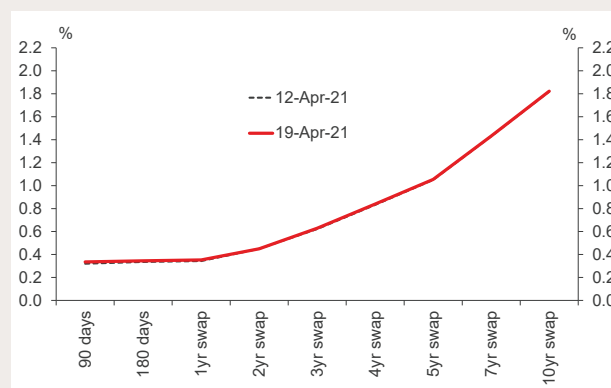
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Fixed vs Floating for mortgages.

We expect that floating rates, and shorter fixed-term rates, will be stable over the coming months. The Reserve Bank will not respond to a temporary spike in inflation. Longer-term fixed rates may rise sooner, in response to a large increase in wholesale fixed rates over the past few months.

We expect mortgage rates to rise over the course of the coming years. Based on our forecasts, taking a longer-term fixed rate (from three years to five years) will prove less expensive for borrowers than taking a short-term rate now and refinancing later.

NZ interest rates



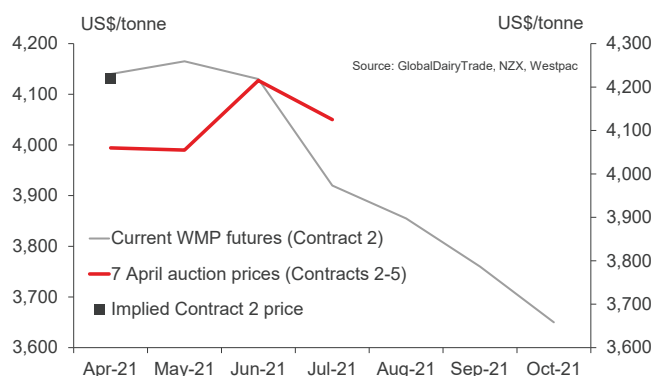
The week ahead.

NZ GlobalDairyTrade auction, whole milk powder prices

Apr 21, Last: no change, Westpac: +2.0%

- We expect whole milk powder prices to lift at the upcoming dairy auction. Prices were unchanged in the first April auction.
- Our pick is in line with current futures market pricing.
- With the New Zealand winter looming, we expect dairy auction prices to remain under upward pressure until the new season kicks off in the spring.

Whole milk powder prices

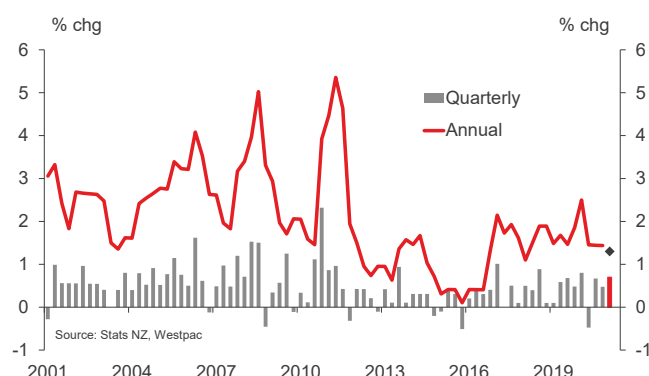


NZ CPI inflation

Apr 21, Last: +0.5%, Westpac: +0.7%, Mkt median f/c: +0.8% Range: +0.6% to +1.1%

- We expect a 0.7% rise in consumer prices in the March quarter. That would see annual inflation slipping back to 1.3%, with the annual rate dampened by changes to tobacco excise taxes.
- Underlying inflation is being boosted by a combination of higher oil prices, supply disruptions and firm conditions in the construction sector.
- Ongoing disruptions to trading activity across sectors in the wake of last year's outbreak continue to cloud the near term outlook for prices.

NZ CPI inflation

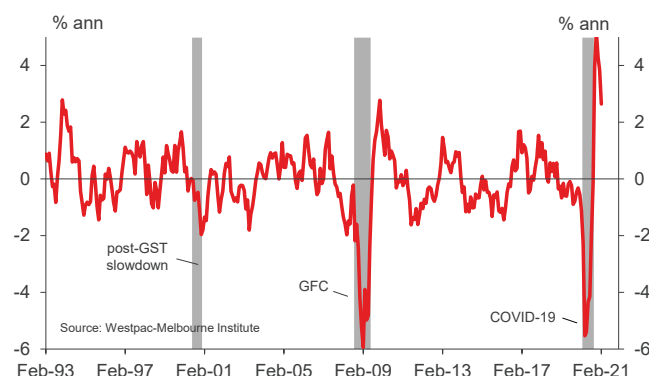


Aus Mar Westpac-MI Leading Index

Apr 21, Last: 2.64%

- The Leading Index continues to cycle last year's COVID disruptions. The headline growth rate, which is a six month annualised measure, fell to 2.64% in Feb, down from a peak of 5.17% in Nov.
- That move mostly reflects initial reopening rebounds dropping out of the picture. The growth rate has retraced from extraordinary highs but remains comfortably in positive territory consistent with above trend growth.
- The March reading will include some very positive component updates: the Westpac-MI Consumer Expectations Index, up 6.6%; dwelling approvals up 21.6%; and total hours worked up 2.2%, with a 5.8% jump last month also being incorporated into this month's update. Other components have also seen positives: the ASX200 up 1.8%; commodity prices up 1.3% and the yield spread widening 35bps. The combined effect is very likely to hold the six month growth rate well above trend.

Aus Westpac-MI Leading Index



The week ahead.

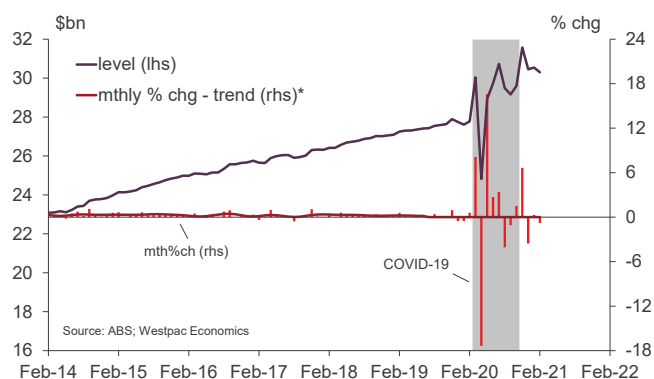
Aus Mar retail trade, prelim.

Apr 21, Last: -0.8%, WBC f/c: -1.5%

Mkt f/c: 1.0%, Range: -1.5% to 3.0%

- It has been a softer start to the year for retail sales, albeit coming off a strong finish to 2020. Sales fell 0.8% in February following a subdued 0.3% gain in January, albeit with sales still well above pre-COVID levels, up an impressive 9.1%/yr. The decline centred on WA (-5.4%) and Victoria (-3%) where 'mini-lockdowns' impacted.
- March will see a rebound in WA and Vic where lockdowns ended. However, total retail sales may still be soft. The month saw more disruptions: another mini-lockdown in Qld that impacted Easter holiday-related activity; and severe floods in parts of NSW (including Sydney) and Qld. There are also signs that retail is easing in areas where COVID reopening is more advanced – reflecting both waning 'catch-up' demand and a shift back towards non retail spending.
- Our Westpac Card Tracker suggests total retail sales fell sharply in March although this doesn't capture 'cash' spending. On balance we expect official sales to show a 1.5% decline.

Aus monthly retail sales

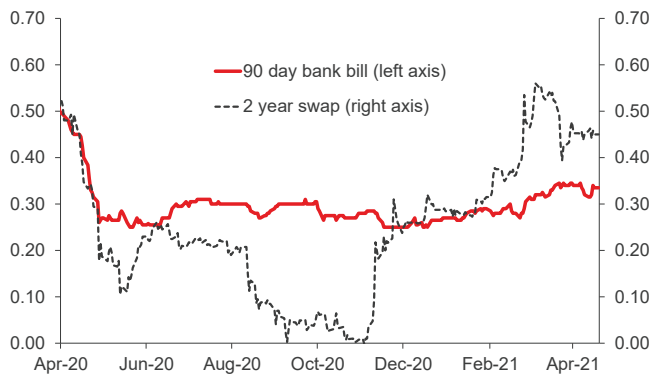


New Zealand forecasts.

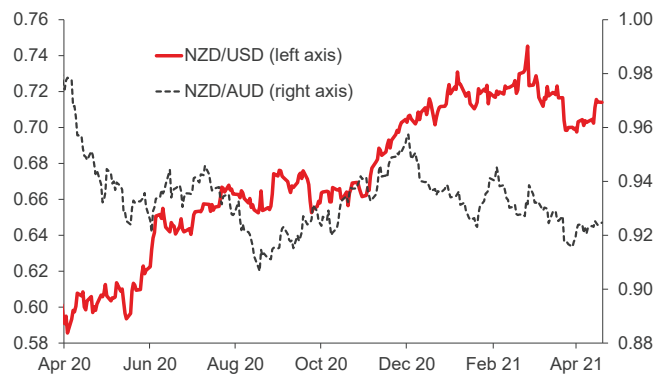
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Dec (a)	Mar	Jun	Sep	2019	2020	2021f	2022f
GDP (Production)	-1.0	-0.4	1.8	0.4	2.4	-2.9	3.9	4.0
Employment	0.6	0.1	0.1	0.4	1.3	0.7	1.0	2.6
Unemployment Rate % s.a.	4.9	5.0	5.1	5.0	4.1	4.9	4.9	4.2
CPI	0.5	0.7	0.6	0.7	1.9	1.4	2.3	1.3
Current Account Balance % of GDP	-1.0	-1.4	-2.1	-2.5	-3.3	-1.0	-2.5	-2.2

Financial forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-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	0.45	0.45	0.45	0.45
5 Year Swap	1.00	1.00	1.00	1.05	1.10	1.15
10 Year Bond	1.80	1.85	1.90	1.95	2.00	2.10
NZD/USD	0.72	0.73	0.74	0.76	0.76	0.75
NZD/AUD	0.91	0.91	0.90	0.89	0.89	0.89
NZD/JPY	78.5	80.3	82.1	85.1	84.4	83.3
NZD/EUR	0.60	0.60	0.60	0.61	0.60	0.59
NZD/GBP	0.51	0.52	0.52	0.54	0.54	0.53
TWI	74.5	74.9	75.0	76.1	75.8	74.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 19 April 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	0.30%	0.30%	0.30%
90 Days	0.34%	0.34%	0.34%
2 Year Swap	0.45%	0.45%	0.52%
5 Year Swap	1.05%	1.11%	1.19%

NZ foreign currency mid-rates as at 19 April 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7140	0.7059	0.7158
NZD/EUR	0.5965	0.5977	0.6018
NZD/GBP	0.5163	0.5076	0.5171
NZD/JPY	77.67	77.80	77.70
NZD/AUD	0.9247	0.9226	0.9298
TWI	74.86	74.46	75.10

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 19					
NZ	Mar BusinessNZ PSI	49.1	–	–	Alert Levels were increased, so expect weakness.
UK	Apr Rightmove house prices	0.8%	–	–	Robust, but a slower pace than other developed economies.
Tue 20					
Aus	RBA minutes	–	–	–	Colour on shifting risks as activity surprises to the upside.
UK	Feb ILO unemployment rate	5.0%	5.1%	–	Furlough scheme will support labour market until Sep.
Wed 21					
NZ	GlobalDairyTrade auction (WMP)	0.0%	–	2.0%	After a pause, we expect upward price trend to resume.
	Q1 CPI	0.5%	0.8%	0.7%	Boosts from oil, supply disruptions and construction.
Aus	Mar Westpac-MI Leading Index	2.64%	–	–	Growth momentum remains well above trend.
	Mar retail sales, prelim	–0.8%	1.0%	–1.5%	Card data suggests soft month, Qld lock-down + severe floods.
UK	Mar CPI	0.1%	–	–	Base effects & fuel prices to lead to rise in coming months.
Thu 22					
Aus	Q1 NAB business survey	14	–	–	March monthly survey reported conditions at record high.
Eur	ECB policy decision	0.0%	0.0%	–	Will talk to the delayed rollout, but some cause for optimism.
	Apr consumer confidence	–10.8	–11.5	–	Near term headwinds will continue to constrain confidence.
US	Mar Chicago Fed activity index	–1.09	–	–	Dipped below 0 in Feb in part due to weather disruptions.
	Initial jobless claims	576k	–	–	Hit a pandemic low last week; broad downtrend to continue.
	Mar leading index	0.2%	0.6%	–	Jobless claims, stock prices, ISM survey will be supportive.
	Mar existing home sales	–6.6%	–0.8%	–	Sales have cooled recently on tight supply & high prices.
	Apr Kansas City Fed index	26	–	–	To keep pace with the strength seen in other mfg surveys.
Fri 23					
Eur	Apr Markit PMI	–	–	–	Mfg and services PMIs for the Euro Area and UK.
UK	Apr GfK consumer sentiment	–16	–	–	Off pandemic lows, will continue to lift on vaccine success.
	Mar retail sales	2.1%	–	–	Pent-up demand will spur retail trade as lockdowns relax.
	Mar public sector borrowing £bn	18.4	–	–	To remain elevated on record peacetime deficit.
US	Apr Markit manufacturing PMI	59.1	60.0	–	Both mfg and services PMIs will continue to...
	Apr Markit service PMI	60.4	61.3	–	... point to the brisk pace of the economic recovery.
	Mar new home sales	–18.2%	12.0%	–	Should see some catch up after weather-disrupted Feb.

International forecasts.


Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP %/yr	2.4	2.8	1.9	-2.4	5.2	3.6
CPI inflation %/yr	1.9	1.8	1.8	0.9	2.6	2.1
Unemployment rate %	5.5	5.0	5.2	6.8	5.7	5.2
Current account % of GDP	-2.6	-2.1	0.7	2.5	3.7	1.8
United States						
Real GDP %/yr	2.3	3.0	2.2	-3.5	6.0	4.1
CPI inflation %/yr	2.1	2.4	1.9	1.2	2.2	2.1
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	2.2
Euro zone						
Real GDP %/yr	2.6	1.9	1.3	-6.6	4.2	3.9
United Kingdom						
Real GDP %/yr	1.7	1.3	1.4	-9.9	5.5	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	5.0	4.9
World						
Real GDP %/yr	3.8	3.6	2.8	-3.3	5.9	4.5
Forecasts finalised 9 April 2021						

Interest rate forecasts	Latest	Jun-21	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	0.10
90 Day BBSW	0.04	0.02	0.02	0.02	0.04	0.06	0.08	0.10
10 Year Bond	1.73	1.85	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	0.125
US 10 Year Bond	1.58	1.75	1.85	2.00	2.10	2.20	2.30	2.40

Exchange rate forecasts	Latest	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
AUD/USD	0.7733	0.79	0.80	0.82	0.85	0.85	0.84	0.82
USD/JPY	108.85	109	110	111	112	111	111	110
EUR/USD	1.1958	1.20	1.21	1.23	1.25	1.26	1.27	1.27
GBP/USD	1.3759	1.40	1.40	1.41	1.41	1.41	1.42	1.42
USD/CNY	6.5309	6.40	6.30	6.20	6.15	6.10	6.05	6.00
AUD/NZD	1.0799	1.10	1.10	1.11	1.12	1.12	1.12	1.11

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