Tīeke

Weekly Economic Commentary.

Two wrongs make a right.

New Zealand has managed to escape with just a brief period of lockdown to deal with the most recent community cases of Covid-19. With that, the economic focus turns back to the broader picture, where domestic activity has had a strong rebound, but the loss of overseas visitors continues to weigh on a substantial portion of the economy.

Last week the Covid Alert Level was raised to level 3 in Auckland and level 2 in the rest of the country, after the discovery of three community cases from an as-yet unknown source. With the evidence suggesting that the spread of this infection was contained, the Alert Level has now been lowered to level 2 in Auckland (which still requires physical distancing) and level 1 elsewhere.

Based on previous experience, we've estimated that at the higher alert levels around 6% of economic activity is prevented from happening. But this greatly overstates the overall cost, as much of the 'missing' spending is either delayed or diverted to other areas.

With this immediate risk to the recovery out of the way, the focus comes back on the broader economic picture. As we note in our latest quarterly *Economic Overview*, activity has bounced back strongly from last year's lockdown, but the shock to the economy is not over yet. We expect growth to be patchy over the coming year while the international border remains closed, and the absence of overseas tourists will be felt particularly keenly over the summer months.

Some of the recent data has highlighted the size of this hole in the economy. Spending on credit and debit cards has dropped over the last four months, though it's still up on year-ago levels. We've also seen the Performance of Services Index drop below 50 (signalling a contraction) for the last three months. This survey includes the tourism and hospitality sectors, but covers a range of other service industries as well.

The loss of international tourism will continue to shine through until around March; we're expecting GDP to shrink by 0.7% over the December and March quarters. This doesn't constitute a second recession – it's still the same downturn that began in March last year, along with a disruption to the usual seasonal patterns in activity. In fact, after the summer dip in GDP we expect to see very strong growth in the June quarter, because the usual outflow of people from the country won't occur this year.

With tourism out of action for now, economic growth over the next year will inevitably be driven by domestic forces, with household spending likely to take the lead. One key source of support for households is the strength in house prices, which typically have a strong link to consumer spending growth in New Zealand.

REINZ figures for January showed that house prices continued to surge higher. The rate of increase has slowed a little, but from a pace that was unsustainable – prices rose 9.5% over the last three months of 2020, the fastest increase on record. We're forecasting a further 17% rise in prices over 2021, on the back of continued low mortgage rates.

Export earnings are another important source of support. This year the agricultural sector looks set to cash in on its previous resilience, with firming demand in our key export markets and rising commodity prices. Dairy prices saw a 3% rise in the latest GlobalDairyTrade auction, making it the seventh consecutive increase. Log export prices have also rebounded to close to pre-Covid levels, supported by strong construction activity in China.

The key event this week is the Reserve Bank's *Monetary Policy Statement*. The economic backdrop has changed substantially since their last review more than three months ago. Relative to the RBNZ's forecasts, GDP has proved stronger, inflation higher, unemployment lower, and export commodity prices better. House prices are shooting through the roof when the RBNZ expected the market to slow. And inflation expectations have risen back to around the 2% mid-point of the target range. That suggests much less need for monetary stimulus than the RBNZ thought back in November.

At the same time, the RBNZ will have to acknowledge that its recent measures have produced less stimulus than hoped. In November it introduced a Funding for Lending Programme (FLP) for banks, aimed at driving bank lending rates lower. However, lending rates have barely budged since then.

Put together, it appears that two wrongs have made a right – the RBNZ hasn't been able to provide the stimulus that it thought was needed, but the stronger economy means that that additional stimulus isn't necessary.

The key for the RBNZ is that while policy settings are about right, they will need to remain in place for some time. Financial markets here and elsewhere are turning towards 'reflation' trades – for instance, long-term government bond yields have risen sharply from their lows over the last few months, driven largely by a rise in inflation expectations. With that has come speculation about when central banks will start to withdraw stimulus. We think this discussion is premature.

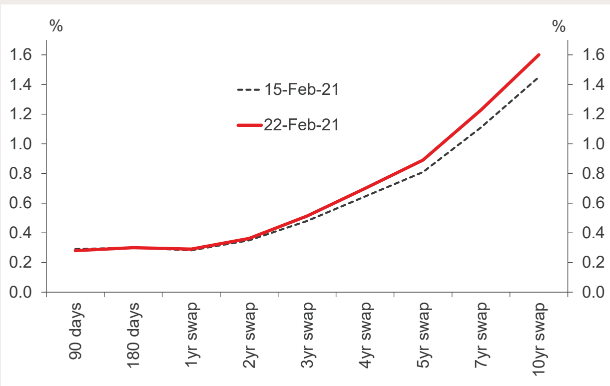
In New Zealand we've recently seen inflation surprise to the upside, and we expect it to reach 2.5% by the June quarter this year. However, we don't think this will last. Covid-related disruptions have led to some price increases for imported goods, but we don't expect this to translate into sustained inflation – indeed, prices are likely to ease again as the disruptions fade. Meanwhile, a stronger New Zealand dollar will weigh on import prices over the coming year. By the middle of next year, we expect annual inflation to have dropped back to 0.8%.

That suggests the RBNZ is under no pressure to start removing stimulus. We expect the OCR to remain at its current level until early 2024.

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



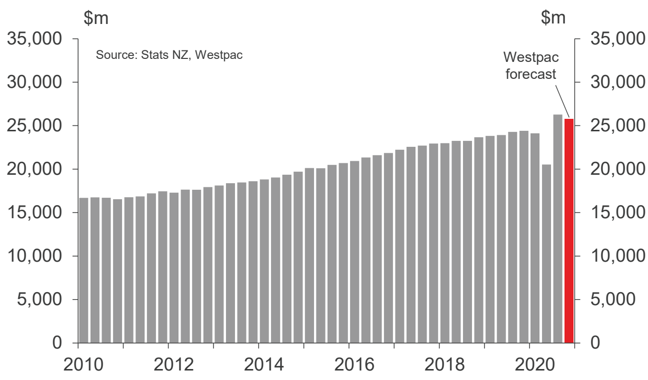
The week ahead.

NZ Q4 retail spending

Feb 23, Last: +28.0%, WBC f/c: -2.0%, Market -0.5%

- Retail sales rebounded in the September quarter, rising by 28% following the winding back of Covid-related restrictions on activity. There were particularly large increases in spending on vehicles, as well as strong spending on household durables. Strength in those areas more than offset the ongoing softness in spending on hospitality.
- We expect a 2% pull back in spending through the December quarter. For the most part, that reflects a normalisation in spending on vehicles. However, monthly spending gauges indicate that New Zealanders have continued to spend up on household durables, in part due to the continued restrictions on international travel.

NZ quarterly real retail sales

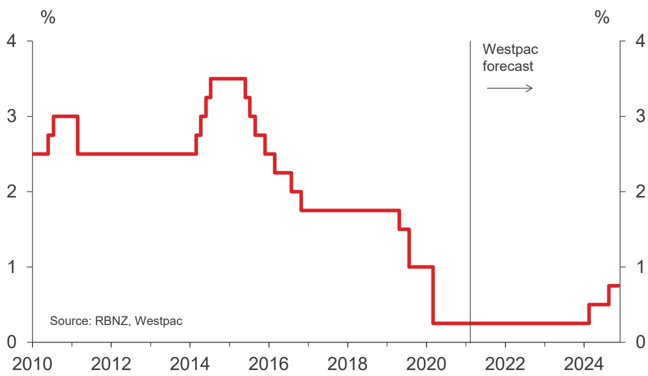


NZ RBNZ monetary policy decision

Feb 24, Official Cash Rate: 0.25%,
Westpac f/c: 0.25%, Market 0.25%

- We expect that the Reserve Bank will strike a more constructive note on the economy, with no further changes to monetary policy settings.
- The RBNZ will acknowledge that there is now much less need for monetary stimulus than it thought back in its November review. GDP, inflation, employment and commodity prices have been stronger than forecast, and house prices are shooting through the roof.
- However, the RBNZ will also note that its recent measures, including the Funding for Lending Programme for banks, have provided less stimulus than hoped. The net result is that current policy settings are appropriate for the economy, but will need to be held in place for some time.

RBNZ Official Cash Rate

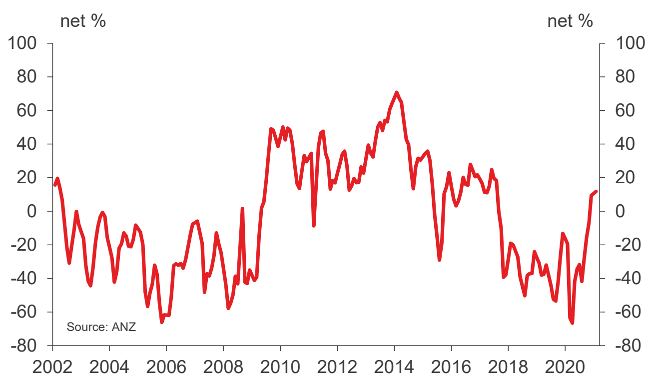


NZ Feb ANZ Business Outlook survey (final)

Feb 25, Own activity Feb prelim: 22.3

- The preliminary results of the February business outlook survey revealed small increases in both business confidence and expectations for activity over the coming months. Gauges of business conditions are now back around average levels.
- We don't expect much change in the headline figures when the final results of the February survey are released. However, the sectoral breakdown of the results will be of interest. While sectors like construction are booming, the services sector is being weighed down by the lack of international tourist dollars.
- It will also be worth watching the gauges of pricing intentions which have spiked higher in early 2021. We'll be looking to see if these pressures are concentrated in the retail sector or if they are becoming more widespread.

NZ business confidence



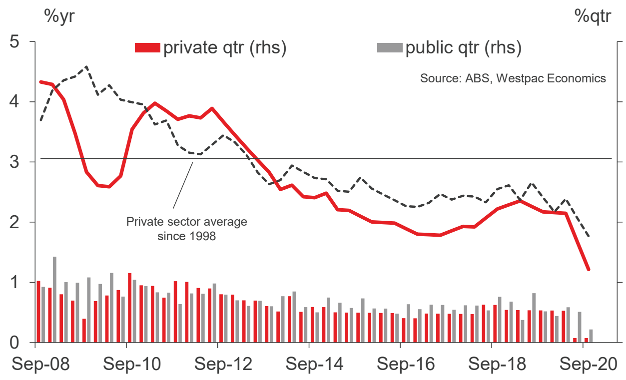
The week ahead.

Aus Q4 wage price index

Feb 24, Last: 0.1%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: 0.1% to 0.4%

- The COVID shock was quite unique in that not only did wage inflation moderate broadly and rapidly across the economy there were also reported falls in hourly wage rates in a number of sectors.
- The Wage Price Index (WPI) lifted 0.1% in September, spot on Westpac's forecast. It was in fact a soft 0.1% at 0.07%.
- Private wages lifted 0.1% following on from a 0.1%qtr rise in the June quarter with the annual pace falling to 1.2%yr from 1.4%yr. The recent peak was 2.4%yr in March 2019. One promising sign, private sector wages in Victoria were flat in September, they fell -0.1% in the June quarter.
- Again in September a number of sectors reported outright declines in hourly wage rates. With the recovery gathering momentum through December we see less scope for further declines in wage rates.

Private sector wages collapse

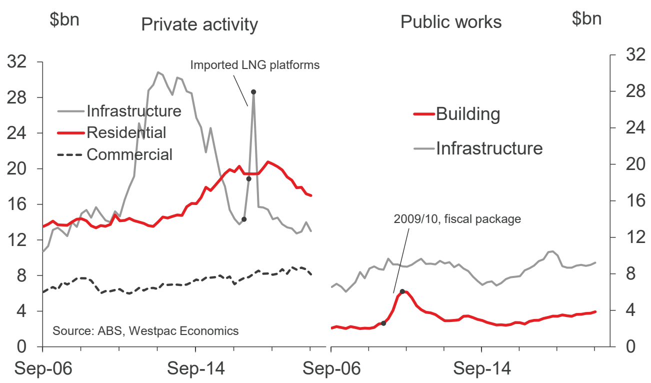


Aus Q4 construction work

Feb 24, Last: -2.6%, WBC f/c: 0.7%
Mkt f/c: 1.0%, Range: –1.1% to 5.0%

- During 2020, the construction sector was relatively resilient despite the disruptions and the turmoil. For Q4, we anticipate a rise of 0.7%, which would see work down by only 0.6% for the year.
- The strength in Q4 will be centred on housing and public works. Private commercial building and infrastructure will likely fall, reflecting sharp drops in approvals.
- Public works, 25% of the total, are forecast to rise by 2% in Q4 and to be 6% higher than a year ago. Governments have, to some degree, accelerated works during this period.
- The housing sector bust pre-Covid has swung to a strong surge, ignited by cheap credit and government incentives - ignoring a stalling of population growth. Home building and renovations are set for strong gains in Q4 and beyond.

Construction work: by segment

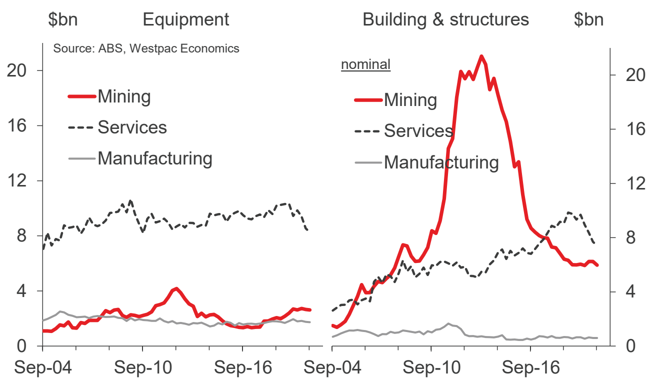


Aus Q4 private business capex

Feb 25, Last: -3.0%, WBC f/c: -1.8%
Mkt f/c: –0.3%, Range: –2.0% to 5.0%

- Private business capex contracted sharply in 2020 as a result of the covid recession - as is typical of recessions. The mix of weaker demand, uncertainty and emerging excess capacity are all significant negatives for business investment.
- Capex slumped in Q3, falling by -3%qtr, -13.8%yr. This included a –3.7%qtr, -15%yr for building & structures (B&S) and a –2.2%qtr, -12.3%yr in equipment
- More of the same is likely in Q4, with capex a forecast –1.8%.
- Our Q4 forecast factors in a -2.2% for B&S, with downside risks given the sharp declines in approvals and commencements.
- We anticipate a -1.5% for equipment - with uncertainty in both directions. Businesses are upbeat, uncertainty has decreased and supply lines have improved - however, for most, excess capacity remains.

CAPEX: by industry by asset



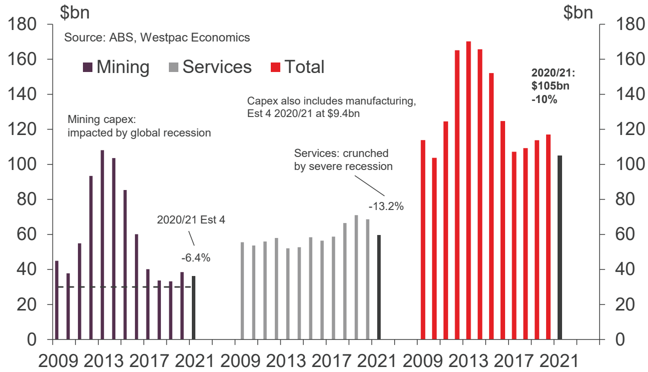
The week ahead.

Aus 2020/21 & 2021/22 capex plans

Feb 25

- Business capex will decline in 2020/21, hit by the recession.
- Est 4 for 2020/21 was $105bn, –12.6% below Est 4 a year ago. That Est 4 figure will be revised to around $115bn, with the ABS expanding the industry coverage of the survey in this update - including education and health.
- The recovery in general activity conditions from mid-2020 and into 2021 will lead to a recovery in business investment as well. The question is timing. An immediate bounce in business investment is unlikely in our view (construction approvals are down sharply and there is excess capacity). We see an upturn more likely in 2021/22.
- This update will include Est 5 for 2020/21, as well as Est 1 for 2021/22 (with the initial estimate often unreliable). An Est 5 of $119bn is arguably plausible - that's a 3% upgrade on Est 4 and some -9% vs Est 5 a year ago.

Capex plans, by industry: Estimate 4

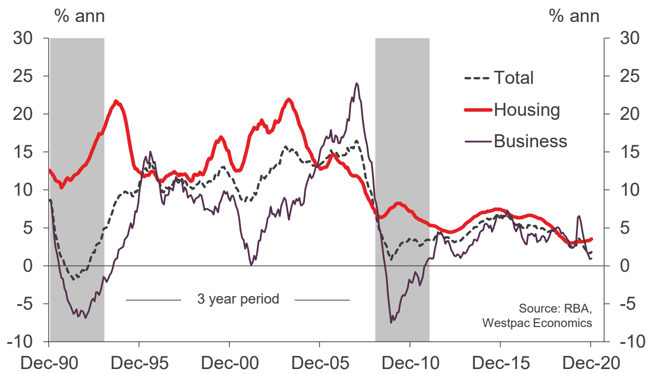


Aus Jan private credit

Feb 26, Last: 0.3%, WBC f/c: 0.2%
Mkt f/c: 0.3%, Range: 0.1% to 0.5%

- Credit expanded by 0.3% in December to be 1.8% higher over the year. That is an improvement on the 7-month period April to October, when credit was either flat or fell - with a cumulative decline of 0.4% over the period.
- Housing credit grew by 4.3% annualised over the past three months, up from a mid-year low of 2.8% annualised. New lending is surging, in response to cheap credit and government incentives to build new homes.
- Business credit is contracting, down for 7 consecutive months to November. Near-term, further modest falls are likely, given an overhang of excess capacity. That said, the December result surprised, printing a small rise, +0.2%.

Credit: annual growth slows to 1.8%

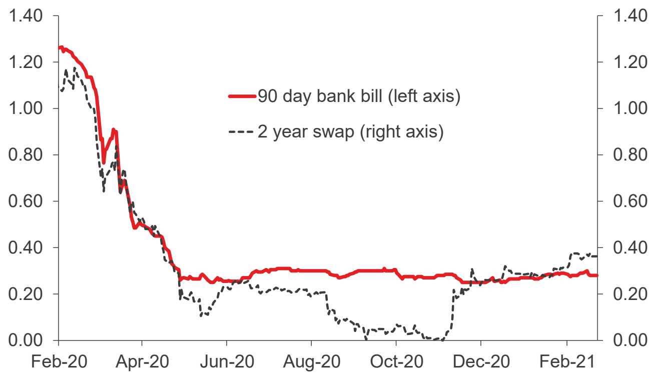


New Zealand forecasts.

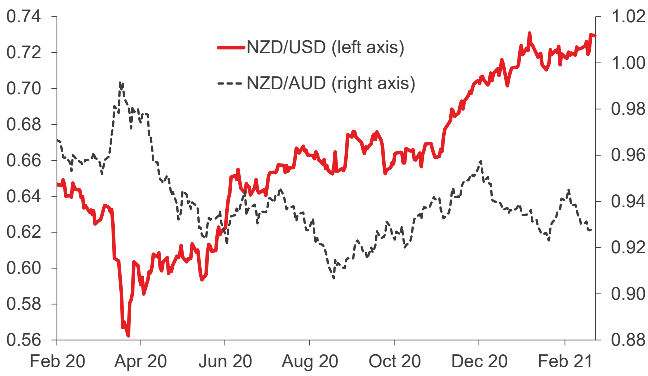
Economic forecasts	Quarterly				Annual			
	2020		2021					
% change	Sep (a)	Dec	Mar	Jun	2019	2020f	2021f	2022f
GDP (Production)	14.0	-0.7	0.0	1.9	2.3	-2.8	4.5	3.8
Employment	-0.7	0.6	-0.1	0.2	1.3	0.7	1.0	3.0
Unemployment Rate % s.a.	5.3	4.9	5.0	5.1	4.1	4.9	4.9	4.2
CPI	0.7	0.5	0.8	0.6	1.9	1.4	1.9	0.9
Current Account Balance % of GDP	-0.8	-0.8	-1.1	-1.8	-3.3	-0.8	-2.7	-2.8

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	0.35	0.35	0.35	0.40	0.45	0.50
5 Year Swap	0.90	0.90	0.95	1.00	1.10	1.20
10 Year Bond	1.60	1.65	1.75	1.85	1.95	2.05
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	75.5	75.9	76.2	76.5	77.6	77.4

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 22 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	0.27%	0.27%	0.28%
90 Days	0.28%	0.28%	0.29%
2 Year Swap	0.36%	0.38%	0.31%
5 Year Swap	0.89%	0.85%	0.64%

NZ foreign currency mid-rates as at 22 February 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7294	0.7221	0.7190
NZD/EUR	0.6022	0.5993	0.5914
NZD/GBP	0.5204	0.5255	0.5251
NZD/JPY	76.87	75.97	74.56
NZD/AUD	0.9279	0.9378	0.9305
TWI	75.55	75.19	74.69

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 22					
US	Jan Chicago Fed activity index	0.52	–	–	Positive read indicates growth above trend.
	Jan leading index	0.3%	0.3%	–	New orders, stock prices & building permits major drivers.
	Feb Dallas Fed index	7	–	–	Recovery cooled in January; update on company outlook.
	Fedspeak	–	–	–	FOMC's Bowman to discuss economic inclusion.
Tue 23					
NZ	Q4 real retail sales	28.0%	–0.5%	–2.0%	Pullback in vehicles, other durables spending still firm.
UK	Dec ILO unemployment rate	5.0%	5.2%	–	The furlough scheme continues to hold back job losses.
US	Dec FHFA house prices	1.0%	–	–	The property market remains on a tear...
	Dec S&P/CS home price index	1.4%	–	–	... as families seek space & supply constraints boost prices.
	Feb consumer confidence index	89.3	90.0	–	Fiscal supportive, but weak income expectations are a drag.
	Feb Richmond Fed index	14	–	–	New orders eased in Jan, but employment is expanding.
	Fed Chair Powell	–	–	–	To deliver semi-annual monetary policy report.
Wed 24					
NZ	RBNZ policy decision	0.25%	0.25%	0.25%	Policy settings on hold as economy outperforms.
Aus	Q4 wage cost index	0.1%	0.3%	0.3%	Lift due to temporary wage cuts being reversed.
	Q4 construction work done	–2.6%	1.2%	0.7%	Public up again. Housing set to rise. Private non-res down.
US	Jan new home sales	1.6%	2.0%	–	New sales near 10yr high; affordability a potential drag.
	Fedspeak	–	–	–	Powell, Brainard and Clarida.
	Fed Vice Chair Clarida				Virtual event hosted by AmCham Australia & ABE.
Thu 25					
NZ	Feb ANZ business confidence	22.3	–	–	Overall activity has firmed, but uneven across sectors.
Aus	Q4 private new capital expenditure	–3.0%	–0.3%	–1.8%	Falls across building & structures and equipment.
	2020/21 capex plans, AUDbn	–	–	–	Est 4 was -10% vs Est 4 yr ago.
Eur	Jan M3 money supply %yr	12.3%	–	–	Accommodative conditions will buoy money supply growth.
	Feb economic confidence	91.5	–	–	Lockdowns and slow vaccine rollout a damper.
US	Jan durable goods orders	0.5%	1.3%	–	Flash GDP pointed to robust business investment.
	Initial jobless claims	861k	–	–	Recent lift in claims shows how much healing is needed.
	Q4 GDP	4.0%	4.1%	4.2%	Second estimate to confirm advance read.
	Jan pending home sales	–0.3%	–	–	Elevated prices beginning to crimp sales.
	Feb Kansas City Fed index	17	–	–	Strong momentum in orders and employment component.
	Fedspeak	–	–	–	Bostic, Bullard, Quarles, Williams.
Fri 26					
NZ	Feb ANZ consumer confidence	113.8	–	–	Consumer confidence has been on the rise.
	Jan trade balance $m	17	–	–630	Pullback in export volumes for the month.
Aus	Jan private sector credit	0.3%	0.3%	0.2%	Housing upswing, off low base, business soft.
US	Jan personal income	0.6%	10.0%	11.0%	Stimulus to drive strong income gain in Jan.
	Jan personal spending	–0.2%	0.7%	1.0%	Retail was very strong; report will guide on services.
	Jan core PCE deflator	0.3%	0.1%	0.1%	Inflation pressures very soft.
	Jan wholesale inventories	0.3%	–	–	Inventories to continue adding to growth.
	Feb Chicago PMI	52.4	–	–	Conditions firming across all components, bar jobs.

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	1.42	1.50	1.60	1.75	1.90	2.05	2.20	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	1.29	1.40	1.50	1.65	1.80	1.95	2.10	2.40

Exchange rate forecasts	Latest	Mar–21	Jun–21	Sep–21	Dec–21	Mar–22	Jun–22	Dec–22
AUD/USD	0.7771	0.78	0.79	0.80	0.82	0.85	0.85	0.82
USD/JPY	105.59	106	106	106	106	107	107	107
EUR/USD	1.2092	1.22	1.23	1.24	1.25	1.26	1.27	1.28
GBP/USD	1.3963	1.39	1.40	1.40	1.41	1.41	1.41	1.42
USD/CNY	6.4704	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0762	1.07	1.07	1.07	1.08	1.09	1.09	1.09

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