



Mōhua

Weekly Economic Commentary.

Reshaping the world.

New Zealand's recovery is gaining traction and we expect economic activity will continue to strengthen over the year ahead. However, conditions are set to remain uneven across sectors for an extended period. At the same time, significant policy changes are being rolled out which will reshape key parts of the economic landscape over the coming years.

It's been roughly a year since New Zealand exited its Covid-19 related lockdown and the economic impacts of the virus are still being felt. Our tourism and hospitality sectors are continuing to struggle with the loss of international tourist dollars. And while the recent establishment of travel bubbles with Australia and the Cook Islands has been welcome news, the sector will face big challenges while long-haul travel remains off the cards.

However, as we discuss in our latest *Economic Overview*,¹ New Zealand's strict lockdown and resulting elimination of the virus has left us with a starkly different picture for domestically focused parts of the economy. The labour market is continuing to firm, with unemployment now down to 4.7%. We're also seeing resilience in household spending, especially on durable items. And on top of that, business

sector indicators are pointing to a firming in trading activity, with an increasing number of businesses looking at taking on new staff or increasing their capex.

Reinforcing those favourable domestic conditions, prices for our key commodity exports (including dairy) have been firming and are expected to remain at healthy levels over the year ahead.

Putting that all together, overall economic activity remains a bit below pre-Covid levels. However, the recovery is gaining traction. And with continued support from monetary and fiscal policy, we expect domestic economic activity will continue to firm through the back half of 2021 and into 2022. Over time, growth will also be boosted by the rollout of vaccines here and abroad, which will allow for restrictions

¹ Available here: <https://www.westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2021/Other/Economic-Overview-May-2021-Westpac-NZ.pdf>



on international travel to be relaxed. However, that's likely to occur only gradually, with GDP set to remain below the path it was on before the pandemic for some time yet.

The benefits of last year's strict lockdown have not only been seen in terms of health outcomes, but also financially. And with the economic recovery well in train, the Government is now in a position to reorient its spending plans, with a renewed focus on its 'Wellbeing' targets. Those developments were reflected in last week's Budget announcements which struck a balance between more spending and more investment, but also a lower borrowing requirement.

The flagship policy initiative announced in the Budget was a substantial increase in the main benefit rates. Additional funding was also allocated to areas like infrastructure, education and health. Overall, the Budget included an extra \$19bn of core Crown spending over the next five years, with the largest increases over the June 2022 and June 2023 years. However, with a stronger than expected tax take and the economy on firmer footing, net debt is now expected to peak at 48% of GDP (compared to a peak of 52.6% assumed in the Government's previous update).

The spending plans in this year's Budget were underpinned by tax revenue forecasts that we think are surprisingly conservative relative to the economic outlook. We expect that tax revenue will continue to exceed the Treasury's forecasts over the next couple of years. That will provide scope for more substantial spending plans and faster debt reduction in future fiscal updates.

The Government is also continuing to roll out reforms in many areas, with the mooted policy changes likely to reshape key parts of the economy over the coming years. Some of the most notable interventions that have been announced include the suite of policies aimed at cooling demand from residential property investors unveiled in March. The Government is also continuing with its programme of labour market reforms.

On top of those changes, the Government has recently announced a review into migration settings, with a focus on how migration has affected parts of the economy, such as the labour market and housing. We expect that this will result in a significant tightening in migration settings in the form of tougher skills requirements for new migrants.

A tightening in migration settings along the lines we expect would mean that, when the borders do eventually reopen, net migration is likely to settle around 30,000 per annum through the middle part of the decade. That would be well down on the levels of around 50,000 to 60,000 per annum that we saw over much of the past decade. This would see annual population growth slow from rates of close to 2% prior to the outbreak to a little over 1% in the coming years. That signals a huge reduction in the economy's underlying growth rate and is a key reason why we expect GDP will linger below its pre-Covid trend for an extended period.

Changes to migration policy will have a myriad of effects on the economy. On the demand side, this will moderate an 'easy' source of growth that businesses in sectors like retail and hospitality have enjoyed in recent years. It will also have an important impact on the housing market, with population inflows adding to the demand for both rental and owner-occupied housing.

In terms of the labour market, lower net migration will reduce the pool of available workers in some industries, which signals a related lift in wage pressures. However, with the Government looking at a targeted tightening of migration settings, impacts will be varied across sectors. In particular, we're likely to see fewer unskilled workers arriving, which will be particularly important in areas like hospitality and retail.

Satish Ranchhod, Senior Economist

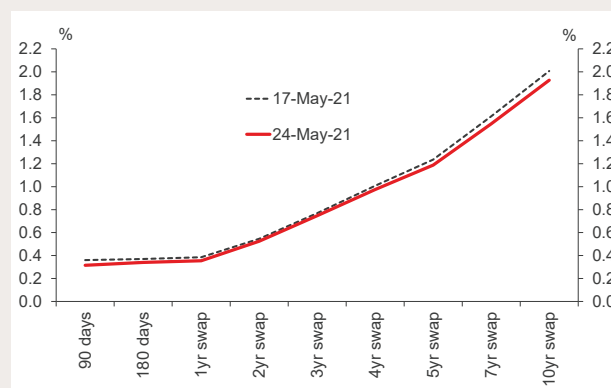
+64 9 336 5668

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. Based on our forecasts, taking a longer-term fixed rate (three to five years) will still be less expensive for borrowers than taking a short-term rate now and refixing later. However, the advantage is narrowing.

NZ interest rates



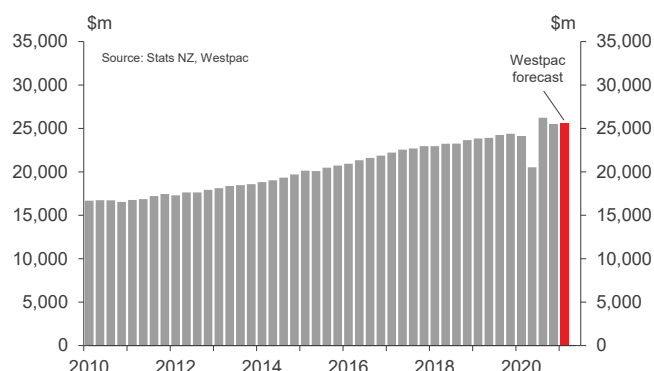
The week ahead.

NZ Q1 retail spending

May 24, Last: -2.7%, Westpac f/c: +0.7%

- Retail spending fell by 2.7% in the December quarter. That followed a massive 28% rise in the September quarter after the economy exited lockdown. Much of that earlier rise was related to spending on durable household items, like vehicles and household furnishings. As spending on such items can be 'lumpy' on a quarter-to-quarter basis, it wasn't surprising to see some easing in December.
- We're forecasting a modest 0.7% rise in spending in the March quarter. New Zealand's recovery is gaining traction and households are continuing to spend up on durable items. However, spending continues to be dampened by the sharp slowdown in population growth and the absence of tourists during the normal summer peak.

NZ quarterly real retail sales

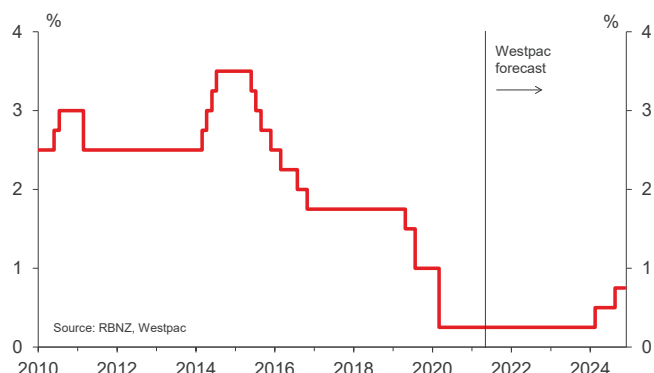


NZ RBNZ Monetary Policy Statement

May 26, last: 0.25%, WBC f/c: 0.25%, Market f/c: 0.25%

- We expect the Reserve Bank will leave its monetary policy settings unchanged at next week's MPS.
- The economic outlook has improved on balance, despite a soft patch in growth over the summer period.
- Inflation is expected to rise well above 2% this year, but the RBNZ has already foreseen this and will regard it as temporary.
- We expect OCR hikes will begin only in early 2024, although unconventional monetary policy measures will unwind before then.

RBNZ Official Cash Rate

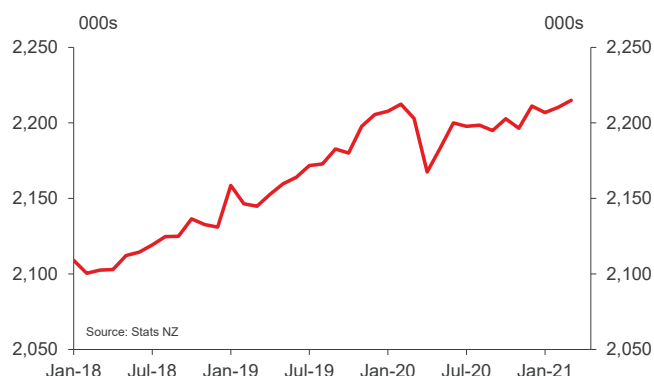


NZ Apr employment indicator

May 28, Last: +0.2%, Westpac f/c: +0.5%

- The monthly employment indicator is a relatively new release, based on data from income tax filings. It provides a less detailed but more timely snapshot of employment trends compared to the quarterly surveys.
- New Zealand's labour market has been resilient to the softening in economic conditions over the past year. In fact, monthly filled jobs are already back at the levels we saw prior to the outbreak.
- We're expecting a 0.5% rise in filled jobs in April. Business surveys have pointed to a firming in hiring in recent months. In addition, the absence of international tourists will be less of a drag on the demand for workers through the middle part of the year, with the winter month's typically the low season for visitor arrivals.

NZ Monthly Employment Indicator filled jobs



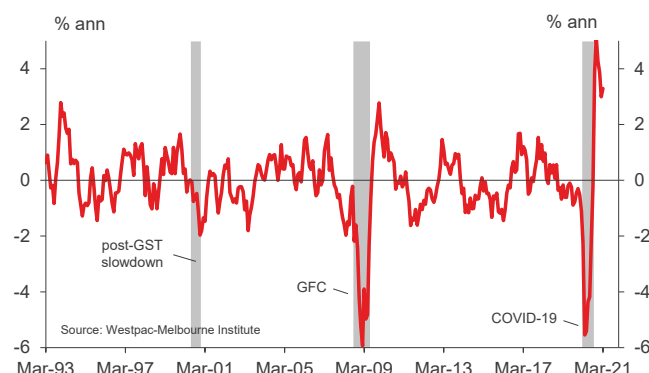
The week ahead.

Aus Apr Westpac-MI Leading Index

May 26, Last: 3.3% annls'd

- The six-month annualised growth rate in the Leading Index lifted from 3.0% in February to 3.3% in March, consistent with comfortably above trend growth continuing through the remainder of 2021.
- The April read is likely to show something similar although there has been a mixed bag of component updates over the last month. On the positive side: equities, commodity prices; dwelling approvals and consumer unemployment expectations have all show substantial improvements. Against this: wider consumer sentiment has retraced from last month's 11 year high, US industrial production and total hours worked have declined and the yield spread has narrowed slightly.

Aus Westpac-MI Leading Index

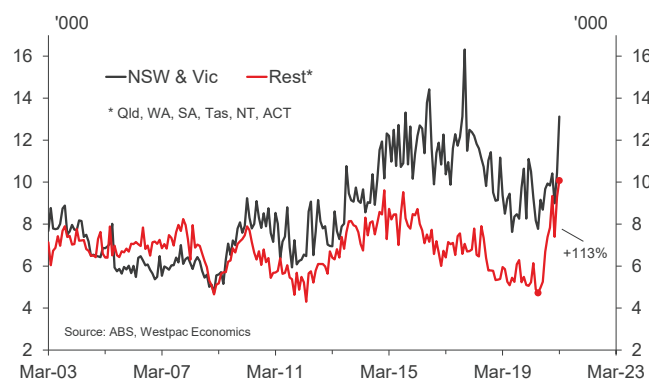


Aus Q1 construction work

May 26, Last: -0.9%, WBC f/c: 0.8%
Mkt f/c: 2.0%, Range: -1.0% to 4.0%

- The avalanche of policy support in response to covid will see a turnaround in construction in 2021, albeit an uneven one, with the upturn led by housing.
- In Q4 2020, work declined by 0.9%, with strength in housing outweighed by further falls in business construction and a dip in public works (continuing a choppy profile for this segment).
- For Q1 2021, we anticipate a rise of 0.8%, with another strong showing for housing but further falls in business construction. The housing market is on fire - dwelling approvals have spiked alongside record low rates and government incentives.
- The swing factor is public works - the Q4 drop of -3.6% looks to be overdone, with the prospect of a modest lift in Q1 as governments commit to new projects.

Aus dwelling approvals

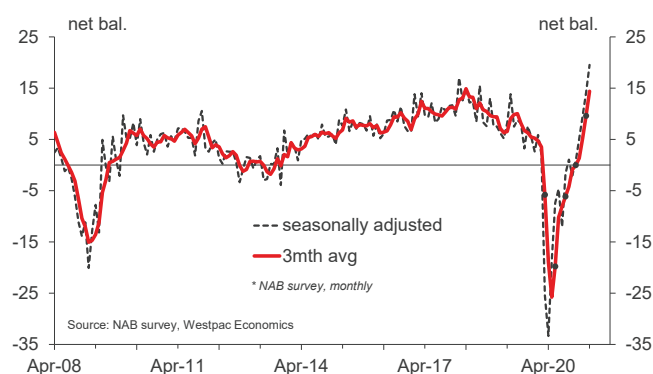


Aus Q1 private business capex

May 27, Last: 3.0%, WBC f/c: 1.6%
Mkt f/c: 2.1%, Range: 1.0% to 5.0%

- Capex spending ended 2020 on a somewhat firmer note, with a 3% bounce in Q4.
- The Q4 result included a 5.7% rebound in equipment spending as the economy reopened and supported by tax incentives, as well as a 0.7% rise in building & structures, an outcome at odds with the underlying downtrend.
- For Q1, we anticipate a further gain of 1.6%. The recovery in equipment spending appears to have extended into 2021, up a forecast 5.2% in Q1. Businesses are optimistic, activity is rebounding briskly and tax incentives are generous.
- On the construction side, the risk is that the downtrend resumes, a forecast -1.6%, tracking softer commencements.

Aus capital expenditure index

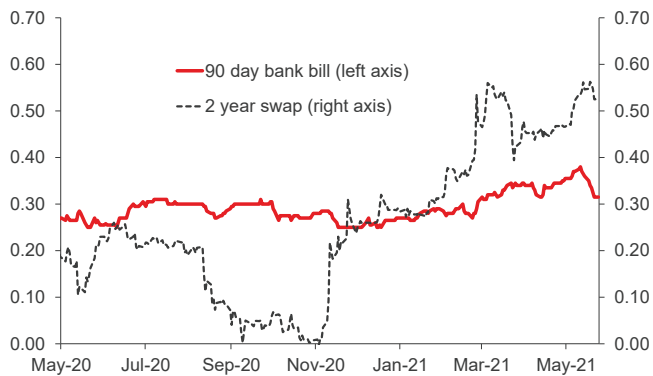


New Zealand forecasts.

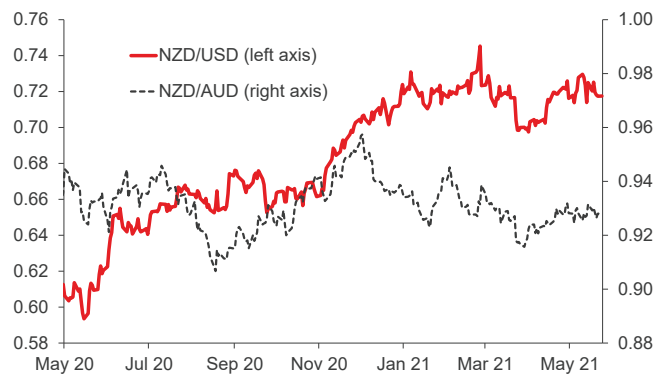
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Dec (a)	Mar	Jun	Sep	2019	2020	2021f	2022f
GDP (Production)	-1.0	0.0	1.2	0.5	2.4	-2.9	4.2	4.4
Employment	0.6	0.5	0.1	0.4	1.2	0.8	1.4	2.1
Unemployment Rate % s.a.	4.9	4.7	4.7	4.6	4.1	4.9	4.5	4.1
CPI	0.5	0.8	0.5	0.8	1.9	1.4	2.4	1.4
Current Account Balance % of GDP	-0.8	-1.9	-2.9	-3.6	-3.3	-0.8	-3.7	-2.7

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	0.50	0.55	0.60
5 Year Swap	1.10	1.15	1.20	1.25	1.30	1.35
10 Year Bond	1.75	1.80	1.90	2.00	2.10	2.20
NZD/USD	0.73	0.73	0.74	0.76	0.76	0.76
NZD/AUD	0.92	0.91	0.90	0.89	0.89	0.89
NZD/JPY	79.6	80.3	82.1	85.1	84.4	84.4
NZD/EUR	0.61	0.60	0.60	0.61	0.60	0.60
NZD/GBP	0.52	0.52	0.52	0.54	0.54	0.54
TWI	75.6	74.9	75.0	76.1	75.7	75.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 24 May 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.28%	0.27%	0.26%
60 Days	0.30%	0.32%	0.31%
90 Days	0.32%	0.37%	0.35%
2 Year Swap	0.53%	0.52%	0.47%
5 Year Swap	1.19%	1.16%	1.04%

NZ foreign currency mid-rates as at 24 May 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7175	0.7283	0.7238
NZD/EUR	0.5892	0.5987	0.5987
NZD/GBP	0.5068	0.5206	0.5207
NZD/JPY	78.16	79.13	78.26
NZD/AUD	0.9282	0.9280	0.9276
TWI	74.67	75.54	75.47

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 24					
NZ	Q1 real retail sales	-2.7%	-	0.7%	Firm spending on durables offsetting softness in hospitality.
US	Apr Chicago Fed activity index	1.71	-	-	Industry surveys positive on current conditions & outlook.
	Fedspeak	-	-	-	FOMC's Brainard, Mester, Bostic & George to speak.
Tue 25					
Aus	May 8 Weekly Payroll Jobs	-	-	-	Further adjustment from the end of JobKeeper?
UK	Apr public sector borrowing £bn	27.3	-	-	To remain elevated on record peacetime deficit.
US	Mar FHFA house prices	0.9%	1.4%	-	Demand for housing is strong...
	Mar S&P/CS home price index	1.17%	1.37%	- driving prices higher at a rapid rate...
	Apr new home sales	1021k	950k	-	... affordability a risk for activity in the second half.
	May consumer confidence index	121.7	120.0	-	Confidence continues to lag activity. Virus & jobs at play.
	May Richmond Fed index	17	19	-	Industry surveys positive on current conditions & outlook.
	Fedspeak	-	-	-	FOMC's Quarles to testify before Senate Banking Committee.
Wed 26					
NZ	Apr trade balance, \$mn	33	-	390	Imports eased after a catch-up in March.
	RBNZ policy decision	0.25%	0.25%	0.25%	Stimulus to remain in place for an extended period.
Aus	Apr Westpac-MI Leading Index	3.3%	-	-	Growth momentum continues to run well above trend.
	Q1 construction work done	-0.9%	2.0%	0.8%	Higher on housing upturn & expected gain in public.
US	Fedspeak	-	-	-	FOMC's Quarles to speak.
Thu 27					
Aus	Q1 private new capital expenditure	3.0%	2.1%	1.6%	Equipment spending rebound as economy reopens.
	2020/21 capex plans, AUDbn	121.4	-	125	Est 5 \$121bn, -7% on Est 5 yr ago. See textbox.
	2021/22 capex plans, AUDbn	105.5	-	116	Est 1 \$105.5bn, -3.4% on Est 1 yr ago. Prospects improving.
	May ABS Business Conditions	-	-	-	May give colour around the impact of the end of JobKeeper.
Chn	Apr industrial profits %yr	92.3%	-	-	China's quality growth agenda is paying dividends.
US	Initial jobless claims	444k	-	-	Tracking lower, signalling reduced churn in the labour market.
	Apr durable goods orders	0.8%	0.8%	-	Equipment investment outlook positive...
	Q1 GDP, second estimate	6.4%	6.4%	-	... but consumer to remain the driver of overall momentum.
	Apr pending home sales	1.9%	1.2%	-	Affordability & supply risks for activity in the second half.
	May Kansas City Fed index	31	-	-	Industry surveys positive on current conditions & outlook.
Fri 28					
NZ	May ANZ consumer confidence	115.0	-	-	Firming economic conditions supporting lift in sentiment.
	Apr employment indicators	0.2%	-	0.5%	Employment trends improving as summer lull passes.
Eur	May economic confidence	110.3	-	-	Will be buoyed by prospects of H2 economic rebound.
UK	May Nationwide house prices	2.1%	-	-	Constrained supply and furlough scheme driving prices.
US	Apr wholesale inventories	1.3%	-	-	Should be supportive of demand into second half.
	Apr personal income	21.1%	-15.0%	-	Income is being supported by job gains, wage growth...
	Apr personal spending	-4.2%	0.4%	-	... and stimulus which has triggered discretionary spending...
	Apr PCE deflator	0.5%	0.6%	-	... with a material consequence for the price of goods in...
	Apr core PCE deflator	0.4%	0.6%	-	... demand, though underlying inflation is benign.
	May Chicago PMI	72.1	69.5	-	Industry surveys positive on current conditions & outlook.

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	2.2	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	2.5	3.5	1.9
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	2.1
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	2.1
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	5.5	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	4.8	4.9
World						
Real GDP %/yr	3.8	3.6	2.8	-3.3	5.9	4.5
Forecasts finalised 7 May 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	0.05	0.07	0.09	0.10	0.10	0.10	0.10
10 Year Bond	1.74	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	1.63	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	0.7760	0.79	0.80	0.82	0.85	0.85	0.85	0.85
USD/JPY	108.86	109	109	110	111	111	111	110
EUR/USD	1.2231	1.21	1.21	1.23	1.25	1.26	1.27	1.27
GBP/USD	1.4181	1.40	1.40	1.41	1.41	1.41	1.42	1.42
USD/CNY	6.4333	6.40	6.30	6.20	6.15	6.10	6.05	6.00
AUD/NZD	1.0797	1.08	1.10	1.11	1.12	1.12	1.12	1.12

Contact the Westpac economics team.

Michael Gordon, Acting Chief Economist

 +64 9 336 5670


Satish Ranchhod, Senior Economist

 +64 9 336 5668

Nathan Penny, Senior Agri Economist

 +64 9 348 9114

Paul Clark, Industry Economist

 +64 9 336 5656

Gregorius Steven, Economist

 +64 9 367 3978

Any questions email:

 economics@westpac.co.nz

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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