



# Weekly Economic Commentary.

## Culling the OCR cuts.

With the economy weathering the Covid storm and the housing market hot, we have changed our OCR call. However, while the border remains closed and the hole in the tourism sector remains stark, stimulatory monetary is still necessary. So, on balance, the OCR needs to stay low, but we no longer expect that it will need to go lower.

We now expect that the OCR will remain on hold at 0.25% for the foreseeable future. Previously, we were forecasting two cuts of 25bps in May and August this year. We still think the RBNZ would not hesitate to take the OCR into negative territory, if required. It is just that the economy no longer seems to need it.

The RBNZ is not yet out of the woods though. There is still a great need to maintain highly stimulatory monetary policy settings. Covid-19 headwinds continue to be a significant drag on parts of the economy, with the hole in the economy from absent international tourists still stark. And against that backdrop, inflation remains relatively low and below the 2% midpoint of the RBNZ's target band.

On that front, December quarter annual CPI inflation, released last Friday, was steady at 1.4%, stronger than our forecast

of 1.0%. This print will be a welcome surprise to the RBNZ as they had factored in annual inflation of 1.1%.

One caveat within the December quarter data, however, is that much of the surprise (at least for us) came on the tradables side, particularly big-ticket imported items like cars. We believe that these price rises owed to Covid-related global supply chain disruptions. So, while the higher than expected print will usefully help anchor inflation expectations at a higher than expected level, there is a risk that this source of inflation proves temporary as global supply chains eventually normalise over the year ahead.

At the same time, up to the minute data like electronic card transactions have been slowing over recent months as the lack of international tourists over the peak summer months weighs on the economy. This weakness will be particularly



noticeable in seasonally-adjusted December and March quarter GDP data – there is the possibility of negative GDP prints over one or both quarters.

The rising exchange rate is also making the RBNZ's job harder – without OCR cuts, we now see scope for the NZD to rise into the mid-70s against the USD over this year, and to rise slightly against the AUD. Finally, the RBNZ's quantitative easing programme is also going to run out of fuel. The Government has scaled back its bond issuance plans, meaning there are fewer bonds available for the RBNZ to buy.

However, developments over the past month or so have called into question the degree of monetary stimulus that will be required. The OCR needs to stay low, but we no longer expect that it will need to go lower.

- (1) The economy has weathered the Covid storm better than anticipated, and GDP has already recovered to its pre-Covid level. The December quarter survey of business opinion, released last week, was another case in point. The survey signalled that the New Zealand economy is back on firm footing. Overall economic output is on the climb, and businesses are increasingly confident about the outlook.
- (2) The housing market has outstripped even our very bullish expectations. We now predict that annual house price inflation will peak at 20% later this year (previously 16%). And looking at calendar 2021, we are now forecasting that house prices will rise 15%, on top of the 12% increase over calendar 2020.

- (3) Global supply and distribution of goods has been disrupted by Covid-19, which as mentioned above has temporarily boosted inflation. Global oil prices have also risen, along with prices for other key global commodities, including global dairy prices. Indeed, last week we lifted our 2020/21 farmgate milk price forecast by 50 cents to \$7.50/kg and our 2021/22 forecast by 25 cents to \$7.25/kg. More generally, these commodity price lifts could provide an additional boost to inflation.

The surge in house prices is particularly important. It is now abundantly clear that the RBNZ's OCR cuts have had a stimulatory effect on house prices. Over time, the buoyant housing market will stimulate consumer spending and inflation. The impact of monetary policy on house prices has proven far more potent than the RBNZ anticipated.

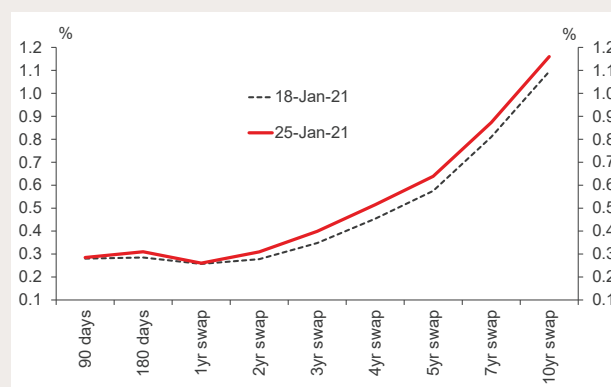
Accordingly, now is a time for the RBNZ to sit back and observe how the stimulus it has provided translates from house prices to the economy and then to inflation, rather than to cut further. It just does not seem likely that the RBNZ would cut the OCR amid 20% house price inflation. The political microscope is already sharply focused on the RBNZ's policy settings (recall the Minister of Finance wrote to the RBNZ Governor on this matter late last year) and the Bank will be keen to avoid further attention where possible.

Meanwhile, we continue to expect that the RBNZ will gradually taper the pace of Government bond purchases over the course of the year. The tapering will see pace drop from the recent average of \$800m per week down to around \$500m by the end of the year.

## 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 refinancing later.

NZ interest rates



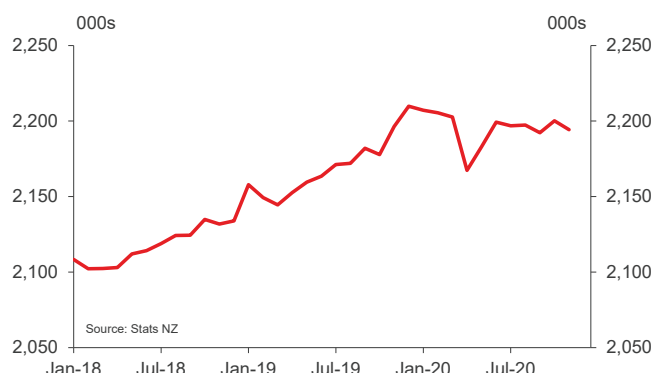
# The week ahead.

## NZ Dec employment indicators

**Jan 29, Last: -0.3%, Westpac f/c: -0.3%**

- 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.
- Filled jobs rebounded strongly in mid-2020 as the Covid-19 lockdown was lifted, but they have tended to drift lower in recent months.
- The weekly raw data published by Stats NZ suggests a further dip in December. It's likely that the lack of overseas tourists will have a more noticeable impact on economic activity over the summer months.

## NZ Monthly Employment Indicator filled jobs

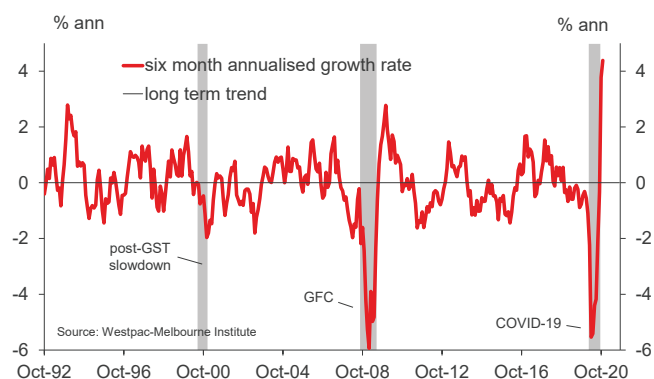


## Aus Dec Westpac-MI Leading Index

**Jan 27, Last: 4.38%**

- The Leading Index growth rate rose from +3.77% in October to +4.38% in November, the strongest pace in the sixty year history of the measure. While that is consistent with a robust recovery from the COVID recession in the first half of 2020, the strength of readings still largely reflects the severity of the preceding contraction which saw the Index growth rate drop to an extreme low of -5.5% in April. In level terms, the Index has now recouped 80% of that fall.
- The December update is likely to again be strong. Component-wise it will include a strong iron ore driven lift in commodity prices (+6.1% in AUD terms vs 0.6% last month); and more solid gains for the ASX200 (+1.1%) and dwelling approvals (+2.6%). The December labour force survey showed total hours worked rose 0.1%mt. However, a weakening in sentiment following more local virus-related disruptions may take some of the gloss off, the Westpac-MI Consumer Expectations Index falling 4.5% to 107 in January.

## Aus Westpac-MI Leading Index



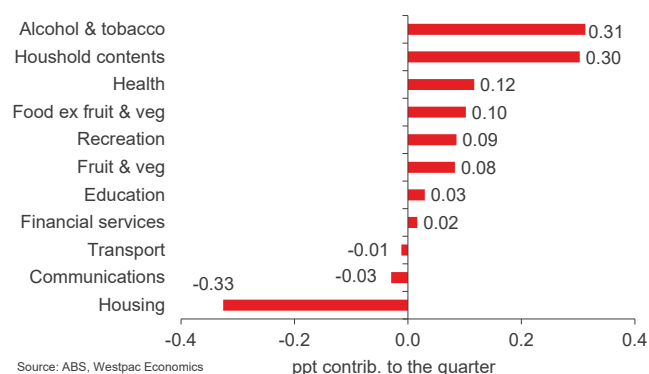
## Aus Dec consumer price index %qtr

**Jan 27, Last: 1.6%, WBC f/c: 0.7%**

**Mkt f/c: 0.7%, Range: 0.4% to 0.9%**

- The September quarter CPI lifted 1.6%, a modest rebound given the policy-induced -1.9% fall in the June quarter. It was on par with the market median 1.6%. At two decimal places, the CPI gained 1.57% lifting the annual pace to 0.7%yr from -0.3%yr. The main surprise was the flat print for housing, WBC forecast -2.0%. The other significant surprise was the 2.5% rise in car prices compared to our 0.4% forecast.
- Westpac is forecasting a 0.7% lift in the Q4 CPI which will hold the annual rate steady at 0.7%yr. The trimmed mean is forecast to rise 0.3%qtr which will see the annual rate ease back from 1.2%yr to 1.1%yr which would be a new record low.
- Holding back the rise in the CPI is the WA Household Electricity Credit and Federal Government Homebuilder Grants supplemented in WA and Tasmania by state grants.

## Contributions to Australia's 2020 Q4 CPI 0.7%qtr forecast



# The week ahead.

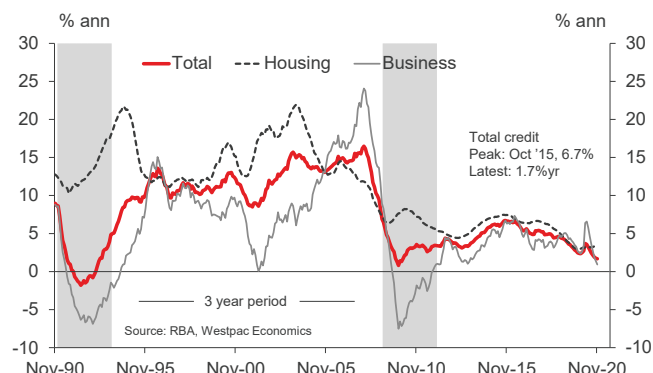
## Aus Dec private credit

**Jan 29, Last: 0.1%, WBC f/c: 0.1%**

**Mkt f/c: 0.2%, Range: 0.1% to 0.3%**

- Credit to the private sector inched higher in November, up 0.1%, following four consecutive monthly declines in the period to August. We expect credit to eke out a further 0.1% increase in December.
- Weakness in credit is to be expected with the economy navigating a recession, leading to a sharp jump in spare capacity and increased uncertainty.
- Business and personal credit are contracting, as is typical during a recession. Further falls are in prospect - although the pace of decline in business credit has moderated with the downturn proving to be not as deep as feared.
- The interest rate sensitive housing sector is responding to cheap credit. That has housing credit lifting from its lows, albeit up a still soft 0.33% in November, an improvement on the 0.22% average over the four months to August.

## Aus credit growth



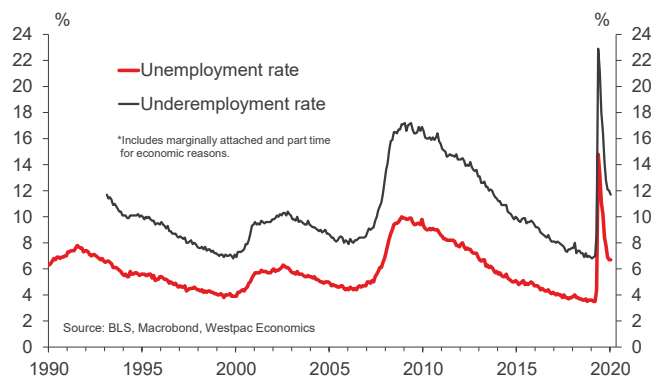
## US January FOMC meeting

**Jan 26-27, fed funds rate, Last: 0.125%, Westpac f/c:**

**0.125%**

- While recent data for the US has been decidedly downbeat and pandemic risks remain elevated, the FOMC is likely to err on the optimistic side when assessing the economic outlook.
- In December they made clear their intent to provide the economy all the monetary support it needs; and, now that the Democrats have control over Congress, prospects for fiscal stimulus are much improved. Moreover, vaccine deployment has begun and is expected to quickly ramp up.
- The above does not mean the FOMC will take a back step with policy in the foreseeable future. Financial conditions must remain highly accommodative so as to make sure the recovery does not mature before full employment is reached and inflation is back at target.
- The risks to inflation and employment will remain to the downside throughout 2021.

## US labour market



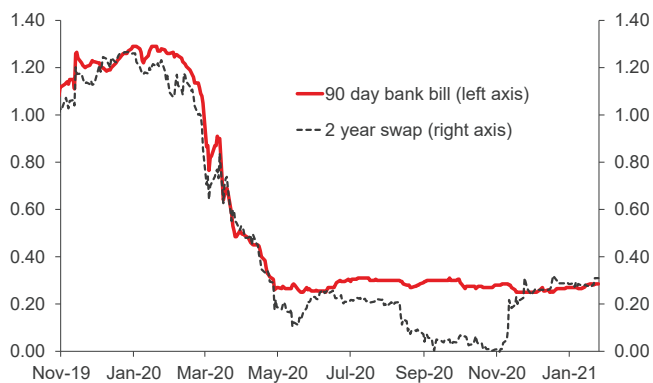


## New Zealand forecasts.

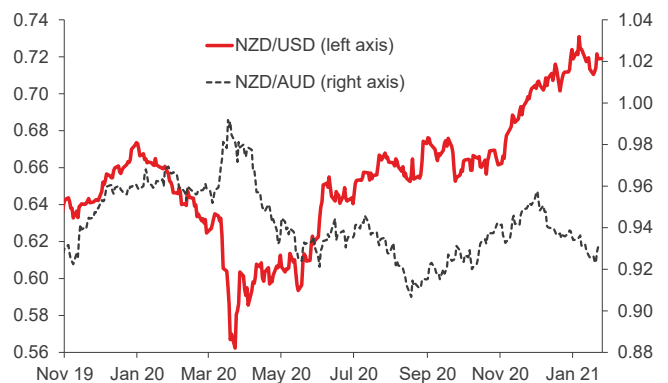
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Sep (a)	Dec	Mar	Jun	2019	2020f	2021f	2022f
GDP (Production)	14.0	0.0	0.6	1.6	2.3	-2.6	5.9	2.5
Employment	-0.8	-0.5	0.3	0.6	1.2	-0.6	2.2	2.9
Unemployment Rate % s.a.	5.3	6.0	5.9	5.7	4.1	6.0	5.4	5.0
CPI	0.7	0.5	0.4	0.1	1.9	1.4	1.0	1.1
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	0.60
10 Year Bond	1.10	1.10	1.20	1.20	1.20	1.25
NZD/USD	0.72	0.73	0.74	0.75	0.76	0.76
NZD/AUD	0.92	0.94	0.94	0.94	0.93	0.93
NZD/JPY	74.9	75.9	77.0	78.0	79.8	79.8
NZD/EUR	0.59	0.59	0.59	0.60	0.60	0.59
NZD/GBP	0.54	0.54	0.54	0.54	0.54	0.54
TWI	74.8	75.2	75.5	76.0	76.3	76.1

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 25 January 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%	0.26%	0.27%
90 Days	0.29%	0.27%	0.27%
2 Year Swap	0.31%	0.28%	0.29%
5 Year Swap	0.64%	0.57%	0.54%

NZ foreign currency mid-rates as at 25 January 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7190	0.7193	0.7118
NZD/EUR	0.5914	0.5912	0.5827
NZD/GBP	0.5251	0.5330	0.5273
NZD/JPY	74.56	74.89	73.64
NZD/AUD	0.9305	0.9321	0.9372
TWI	74.69	74.86	74.43

## Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 25</b>					
US	Dec Chicago Fed activity index	0.27	–	–	Moderating, but still points to growth above trend.
<b>Tue 26</b>					
NZ	Dec BusinessNZ PSI	46.7	–	–	Closure of the borders remains a drag.
Aus	Australia Day	–	–	–	Public holiday.
UK	Nov ILO unemployment rate	4.9%	5.2%	–	Furlough scheme holding down unemployment.
US	Nov FHFA house prices	1.5%	0.6%	–	All regions have shown strong price growth since June...
	Nov S&P/CS home price index	1.61%	0.85%	–	... with S&P/CS measure rising 7.95%yr in October.
	Jan consumer confidence index	88.6	88.8	–	Encouraging fiscal prospects to support sentiment.
<b>Wed 27</b>					
Aus	Q4 CPI	1.6%	0.7%	0.7%	Construction & power grants offset by rising child care...
	Q4 CPI %yr	0.7%	0.7%	0.7%	...while the rise in health insurance delayed to Q4.
	Q4 trimmed mean CPI	0.4%	0.4%	0.4%	Fall in dwelling prices trimmed out of core measure...
	Q4 trimmed mean CPI, %yr	1.2%	1.1%	1.1%	...so a larger fall in dwellings will not impact on core.
	Dec Westpac-MI Leading Index	4.38%	–	–	Likely to be strong on iron ore, ASX, and dwelling approvals.
	Dec NAB business survey	9	–	–	Conditions up 7pts to +9 in Nov, as restrictions eased further.
US	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	View on balance of risks now and in medium-term key.
	Fed Chair Powell	–	–	–	Will hold the post-meeting press conference.
<b>Thu 28</b>					
NZ	Dec trade balance \$m	252	–	1450	Trade balance widens as import disruptions continue.
Aus	Q4 export price index	–5.1%	5.3%	4.0%	Advance on higher commodity prices, notably iron ore.
	Q4 import price index	–3.5%	–1.0%	–1.5%	Imports cheaper as AUD strengthens.
Eur	Jan economic confidence	90.4	90.9	–	Supported by ECB's commitment to monetary stimulus.
UK	Jan Nationwide house prices	0.8%	–	–	Continue to benefit from historically low rates.
US	Initial jobless claims	900k	–	–	Stabilised last week after recent spike.
	Q4 GDP	33.4%	4.1%	3.9%	Recovery slowed abruptly in Q4 as COVID-19 cases surged.
<b>Fri 29</b>					
NZ	Jan ANZ consumer confidence	112.0	–	–	Consumer sentiment has been firming in recent months.
	Dec employment indicator	–0.3%	–	–0.3%	Job numbers softening as lack of summer tourists bites.
Aus	Dec private sector credit	0.1%	0.2%	0.1%	Business & personal contracting, housing up from lows.
	Q4 PPI	0.4%	–	–	The earlier update on the CPI will be the key focus.
Eur	Dec M3 money supply %yr	11.0%	–	–	Easing at ECB Dec meeting will keep money growth elevated.
US	Dec personal income	–1.1%	0.2%	0.3%	Stimulus to provide another boost in new year.
	Dec personal spending	–0.4%	–0.5%	–0.4%	Hit by COVID-19 surge & spending pull forward.
	Dec core PCE deflator	0.0%	0.1%	0.1%	Inflation pressures to remain absent.
	Q4 employment cost index	0.5%	0.5%	0.4%	Wage gains to remain weak for foreseeable future.
	Dec pending home sales	–2.6%	–0.3%	–	High prices and supply limitations have constrained turnover.
	Fedspeak	–	–	–	FOMC's Kaplan to speak at energy forum.
<b>Sun 31</b>					
Chn	Jan manufacturing PMI	51.9	51.5	–	Surging external demand a boon for manufacturers...
	Jan non-manufacturing PMI	55.7	54.7	–	... but services still lag due to slower consumer recovery.

## International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
<b>Australia</b>						
Real GDP %/yr	2.4	2.8	1.9	-2.7	4.2	3.3
CPI inflation %/yr	1.9	1.8	1.8	0.9	2.0	1.8
Unemployment rate %	5.5	5.0	5.2	7.0	6.0	5.2
Current account % of GDP	-2.6	-2.1	0.7	2.2	1.3	-0.5
<b>United States</b>						
Real GDP %/yr	2.3	3.0	2.2	-3.6	4.1	3.3
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	5.5	4.3
Current account % of GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
<b>Japan</b>						
Real GDP %/yr	2.2	0.3	0.7	-5.8	3.0	2.2
<b>Euro zone</b>						
Real GDP %/yr	2.6	1.8	1.3	-7.7	4.0	5.0
<b>United Kingdom</b>						
Real GDP %/yr	1.9	1.3	1.5	-10.8	7.1	5.5
<b>China</b>						
Real GDP %/yr	6.9	6.8	6.1	1.7	10.0	5.6
<b>East Asia ex China</b>						
Real GDP %/yr	4.7	4.4	3.7	-2.8	5.3	5.1
<b>World</b>						
Real GDP %/yr	3.8	3.5	2.8	-3.7	5.8	4.6
Forecasts finalised 11 December 2020						

Interest rate forecasts	Latest	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Dec-22
<b>Australia</b>								
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	1.12	1.05	1.05	1.15	1.25	1.40	1.50	1.70
<b>International</b>								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.11	1.00	1.00	1.10	1.20	1.30	1.40	1.50

Exchange rate forecasts	Latest	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Dec-22
AUD/USD	0.7745	0.78	0.78	0.79	0.80	0.82	0.82	0.80
USD/JPY	103.57	104	104	104	104	105	105	105
EUR/USD	1.2172	1.23	1.24	1.25	1.26	1.27	1.28	1.27
GBP/USD	1.3712	1.36	1.36	1.38	1.39	1.41	1.41	1.41
USD/CNY	6.4705	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0765	1.08	1.07	1.07	1.07	1.08	1.08	1.08

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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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