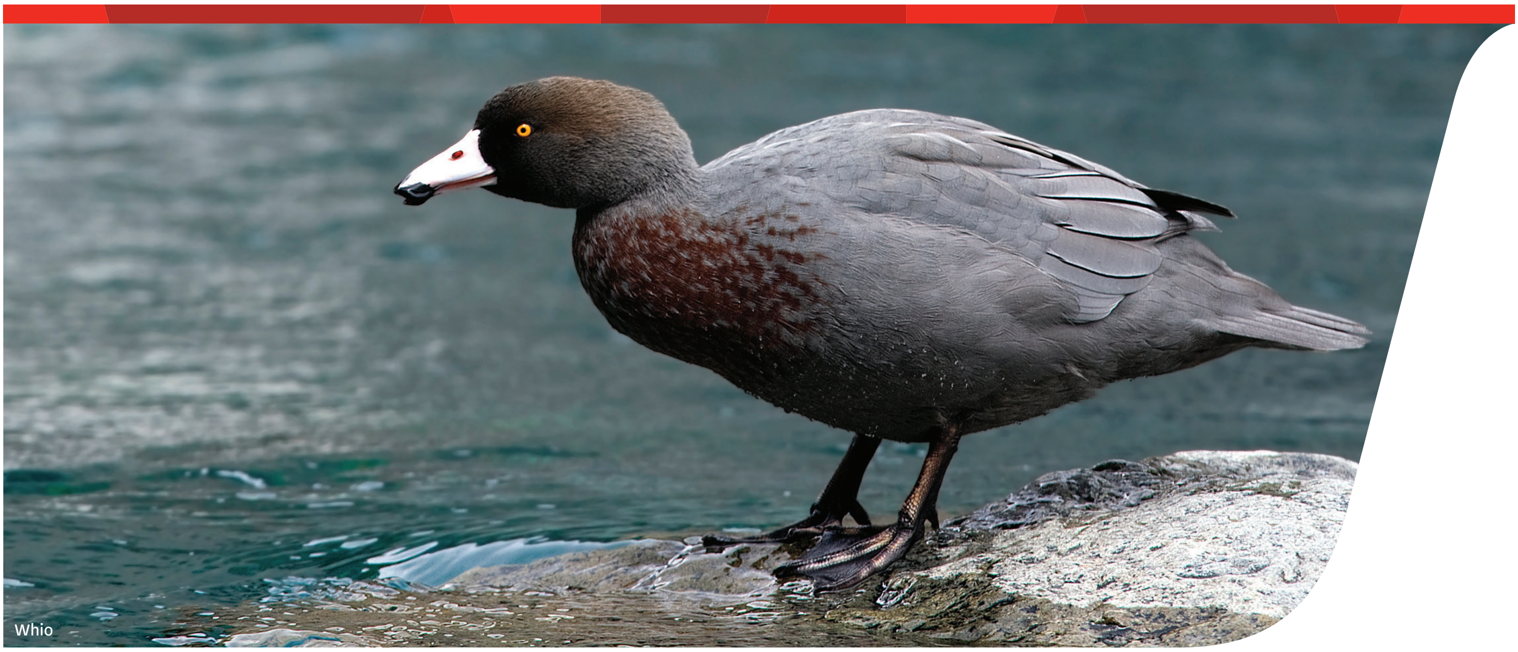


Weekly Economic Commentary.

Inflation asteroid requires higher interest rates.

Last week's policy statement from the Reserve Bank of New Zealand reinforced our expectations for a series of rate hikes over the coming years, with the cash rate set to rise into 'tight' territory in late 2022 and beyond.

The RBNZ increased the Official Cash Rate by 25bps at last week's policy meeting, taking it to a level of 0.75%. That increase came hot on the heels of a rate rise at the October policy meeting, and we expect that it will be followed by a series of rate increases in quick succession over the coming years.

Ahead of the decision, there was no doubt that the cash rate was headed upwards. GDP growth has been much stronger than the RBNZ had expected. Unemployment has fallen to a record-equalling low of 3.4%. And inflation has risen to 4.9%, its highest level in a decade.

With regards to inflation, it's true that much of the rise we've seen has been due to domestic and imported cost pressures. Many of those cost rises will be temporary, or at least non-repeating. Furthermore, there's not much domestic monetary policy can do to offset the impacts of offshore price increases that have already occurred.

But like us, the RBNZ recognises that much of the strength in inflation is also due to strong domestic demand. That's been underpinned by increases in fiscal spending, a strong labour market, rapid house price growth and – most importantly – very low interest rates. The boost from those factors has meant that demand has outstripped supply in some key sectors of the economy, like the construction sector. And combined with rising input costs, that's resulted in some significant increases in output prices.

Recent months have also seen measures of inflation expectations (including the RBNZ's own survey of medium-term expectations) pushing above the 2% inflation target. That's a major concern for the RBNZ as if this passes through into wage and price setting behaviour, even a temporary spike in inflation could result in a period of ongoing price increases. And on this front, we're already seeing growing demands for cost-of-living adjustments to wages.

Combined, the above conditions have left the RBNZ with a worrying cocktail of strong inflation pressures, and there's a very real risk that New Zealand will see a protracted period of elevated domestic inflation over the next few years.

With the labour market in good health and inflation pressures bubbling over, markets had been pricing in a meaningful chance of a 50bp hike in November. However, on the day, ongoing headwinds from the Delta outbreak saw the RBNZ opting for a more measured approach to removing stimulus.

But while the RBNZ went for the more cautious move last week, their policy statement acknowledged that the cash rate will need to go beyond 'neutral' and into 'tight' territory in order to knock the inflation asteroid off its trajectory.

The question is how far and how fast will the RBNZ need to go?

Given the strong inflation outlook, we're forecasting a series of rapid OCR increases from the RBNZ, with the cash rate to peak at 3% in the third quarter of 2023. That sort of profile is broadly in line with the RBNZ's own forecasts, which also signalled a series of frontloaded rate hikes over the coming years. The RBNZ have assumed a lower peak in the cash rate of 2.6%. However, that's not a big difference at this stage of the economic cycle.

With strong inflation pressures and a significant amount of policy tightening required, there is an argument for larger increases in the cash rate, at least in the near term. But while we wouldn't completely rule out the chances of a 50bp increase at some point, two factors are likely to mean that the RBNZ will continue to move in 25bp increments.

First is that there have already been sizeable increases in mortgage rates, and we haven't had a chance to assess how that's affecting spending patterns or the housing market.

Second is uncertainty about how the economy will fare as the country's approach to managing Covid shifts from elimination to living with the virus in the community. Although the New Zealand economy has been fairly resilient to Covid-related disruptions thus far, activity restrictions have still been a drag on demand. In addition, nervousness about the changing health landscape could dampen spending by both households and businesses.

New Zealand is not the only country where inflation pressures have been simmering away. In the US, inflation has risen to multi-decade highs, and momentum in activity has been building.

Against that back drop the December 14–15 FOMC meeting is expected to see a significant change in the Fed's policy stance. At that meeting, we now expect the taper to be accelerated to conclude in March 2022, making room for three 25bp rate hikes at the June, September and December 2022 meetings (that compares with our previous view that the taper would extend to June, prior to an expected first rate hike in December 2022).

With a strengthening in the outlooks for US inflation and monetary policy, and the RBNZ adopting a more measured stance than some in markets had expected, we've revised down our forecast for the NZD/USD. We now expect that the Kiwi will drop to 66 cents by June next year. Further ahead, we expect the Kiwi will take flight again as the OCR pushes higher, with the NZD/USD set to reach 72 cents in late 2023 (previously we had expected the NZD/USD to rise to 74 cents by the end of next year).

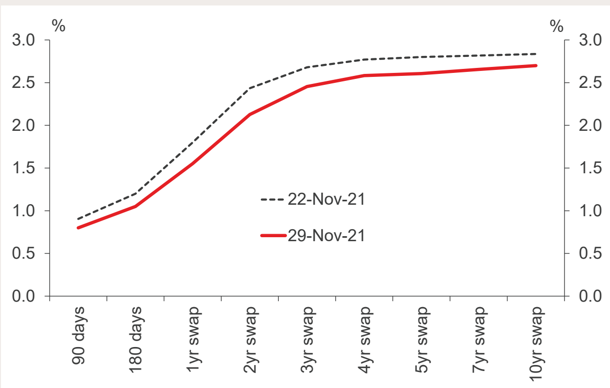
Satish Ranchhod, Senior Economist
+64 9 336 5668

Fixed vs floating for mortgages.

We expect the Reserve Bank to increase the OCR further at its upcoming reviews, reaching a peak of 3% by mid-2023.

Based on these OCR forecasts, we think there is value in extending fixed-rate terms as far out as 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



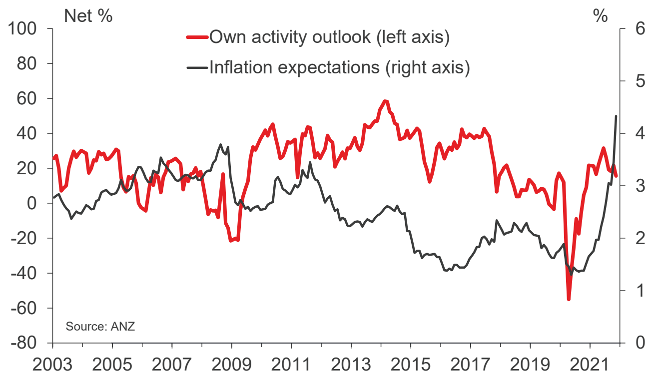
The week ahead.

ANZBO business confidence (Final), November 2021

Nov 30, Expectations for Own Activity: +15.6

- Business confidence held firm in the preliminary read for November. In addition, inflation expectations continued to rise and came in at 4.33%, the highest since the early 1990s.
- Measures of activity are expected to hold firm as restrictions were eased further over the month. The data so far has shown that the economy has been resilient since the Delta outbreak. During the month, it was announced that New Zealand would be shifting to the new 'traffic light' system for managing Covid. However, given the timing of the survey, we won't see the full impact of this announcements on business sentiment until next month.
- Inflation gauges will again be worth keeping an eye on as both prices and costs continue to increase. Inflation pressures have become increasingly pronounced over the past year, with strong increases in operating costs and strong demand in many parts of the economy.

NZ business confidence

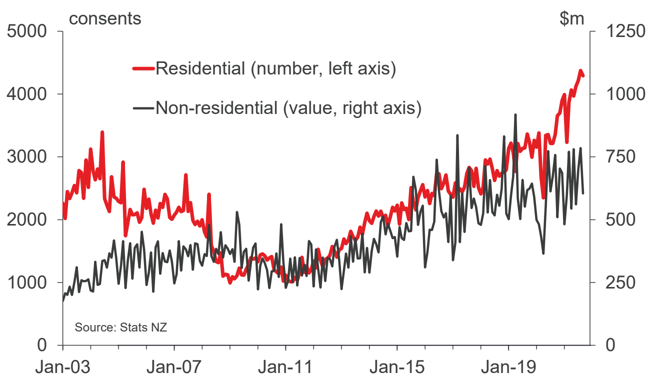


NZ Oct residential building consents

Dec 1, Last: -1.9%, Westpac f/c: Flat

- Residential consent issuance fell 1.9% in September after sizeable increases in recent months. However, annual consent issuance once again reached a fresh all-time high.
- We expect that consent issuance will again hold at firm levels in October, with strong house prices continuing to support elevated levels of issuance across the country.
- Although we expect high levels of home building over the coming year, shortages of staff and materials are providing a brake on the pace of building, with start and completion times stretching out. Those same factors have also contributed to increases in build costs.

NZ building consents

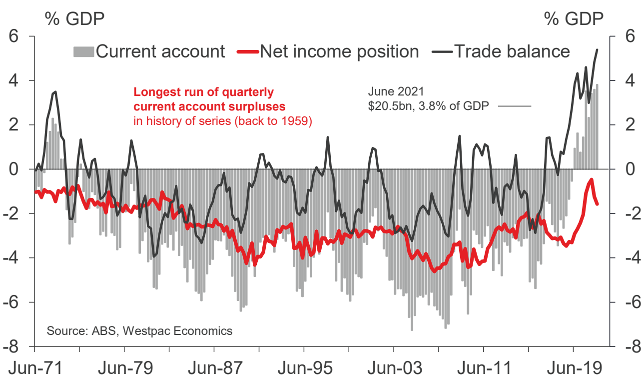


Aus Q3 current account balance, $bn

Nov 30, Last: 20.5, WBC f/c: 31.0
Mkt f/c: 29.3, Range: 17.0 to 33.0

- The September quarter will be the 10th consecutive quarterly current account surplus, a record run in modern times. Moreover, the surplus is getting larger, inflated by higher commodity prices boosting export earnings.
- For the September quarter, we anticipate a current account surplus of $31.0b (representing around 5.8% of GDP, a fresh record high). This includes an estimated trade surplus of $41.7bn and a net income deficit (NID) of -$9.7bn.
- The June quarter current account surplus of $20.5bn included a trade surplus of $28.9bn (revised to $31.3bn) and a -$8.4bn NID.
- The trade surplus jumped in Q3 as export earnings advanced on higher volumes and higher prices.

Aus current a/c: surplus rose to $20.5bn in Q2



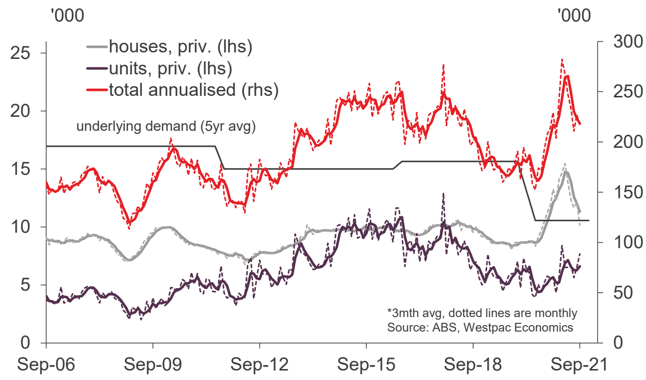
The week ahead.

Aus Oct dwelling approvals

Nov 30, Last: –4.3%, WBC f/c: –4.0%
Mkt f/c: -2.0%, Range: 5.0% to -5.0%

- Dwelling approvals declined 4.3% in September, the detail on the weak side with a spike in Sydney high-rise approvals the only thing preventing what would have otherwise have been a double-digit monthly fall. The wider backdrop is of a continued unwind from a very high peak in March associated with the Federal government's HomeBuilder scheme that expired in June.
- As of September, approvals were down 18.8% below their April peak but still at a relatively high level, up 12.8%yr. New home sales suggest the unwind effect is starting to end although dwelling approvals still look to have a little further to go. On units, the September rise centred on a few large projects in Sydney and will very likely reverse, although the segment may have some underlying recovery traction in place. Overall, we expect approvals to show a further 4% decline, a milder decline in detached houses combining with a partial reversal of the September lift in units.

Aus dwelling approvals

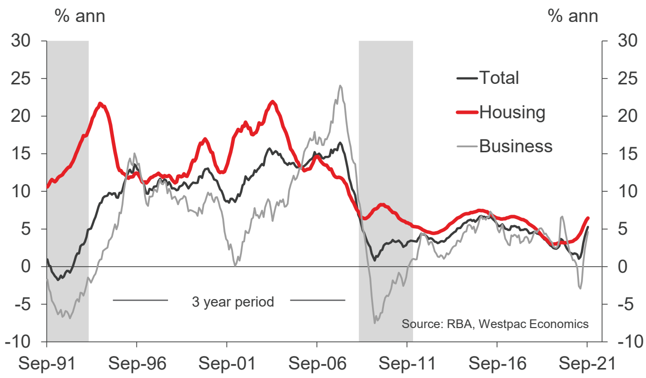


Aus Oct private sector credit

Nov 30, Last: 0.6%, WBC f/c: 0.5%
Mkt f/c: 0.6%, Range: 0.4% to 0.8%

- Private sector credit growth stepped–up during the delta lockdowns. The key driver, firms accessing existing lines of credit to ease cashflow pressures – a rerun of the 2020 experience.
- Credit growth lifted from a 0.4% monthly average pace ahead of the latest lockdowns to gains during the June to September period of: 0.9%; 0.7%; 0.6% and 0.6%. This included a 4.1% spike in business credit, with monthly outcomes of: 1.6%; 1.2%; 0.6% and 0.7%.
- Move forward to October, we anticipate a 0.5% lift in total credit, including a further but more modest rise in business credit as firms navigate the final stages of the delta lockdowns.
- In the housing market, new lending dipped during the lockdown, down by –6.9% in the four months to September. This has trimmed housing credit growth, from 0.69% for June, to 0.63% for September and with the prospect of a softer October read.

Aus credit: annual growth jumps to 5.3%

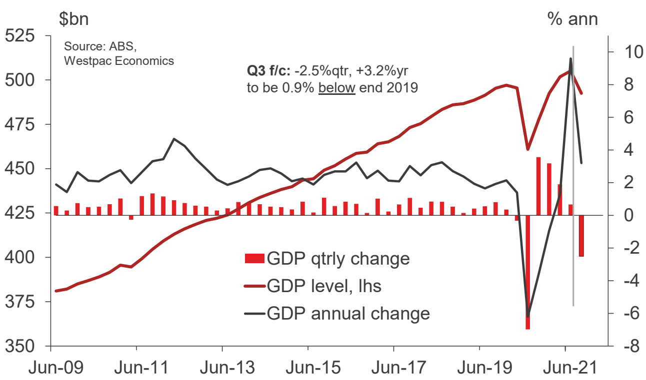


Aus Q3 GDP

Dec 1, Last: 0.7%, WBC f/c: –2.5%
Mkt f/c: –2.5%, Range: –4.2% to 2.8% tail trade

- The delta lockdowns centred in NSW and Victoria impacted activity, but the disruptions appear to have been less damaging than originally anticipated – particularly in Victoria.
- Our forecast is for output to contract by around –2.5% in the September quarter and to be 3.2% higher than a year ago.
- The arithmetic of our Q3 GDP forecast is: domestic demand –3.0%; total inventories –0.7ppts; and net exports +1.2ppts. Consumer spending is a forecast –5.5%; home building +1.6%; business investment –1.6%; and public demand +1.2%.
- The Labour Force survey (LFS) reported hours worked down by –3.1% (including a sharp fall in NSW, of –9.0%, but a surprise rise in Victoria, +0.4%). For context, hours worked slumped by –8.3% in Q2 2020 (on the LFS measure) and activity contracted by –7.0%.

Australian economy: Q3 hit by delta lockdowns



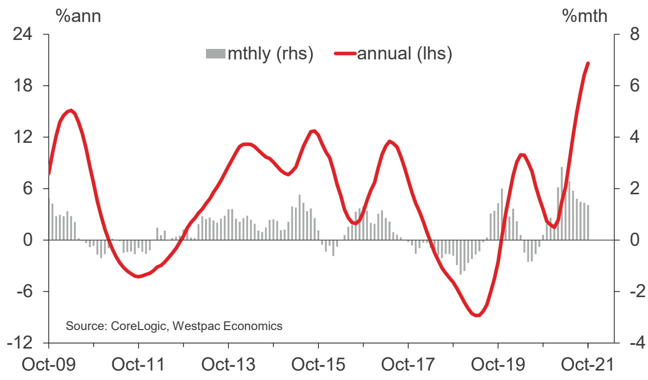
The week ahead.

Aus Nov CoreLogic home value index

Dec 1, Last: 1.4%, WBC f/c: 1.1%

- Australian dwelling prices rose 1.4% in Oct, a touch slower than the 1.5% gains in September and August and the 1.6% rise in July but still a robust double-digit annualised pace. The slowdown looks to have more to do with stretched affordability than disruptions from delta lockdowns. Prices are now up 20.8%yr, the fastest annual growth since June 1989.
- Delta has impacted turnover, markets rebounding strongly in October as restrictions eased in Sydney and Melbourne, the latter spiking over 50% to a record monthly high.
- Daily measures point to another slower month with a gain of 1.1% in November The capital city detail shows a softer performance in Melbourne and a continued stalling in gains in Perth since mid-year but price growth accelerating in Brisbane. Sydney's result is in line with the national move, indicating how little delta disruptions appear to have affected price momentum.

Australian dwelling prices

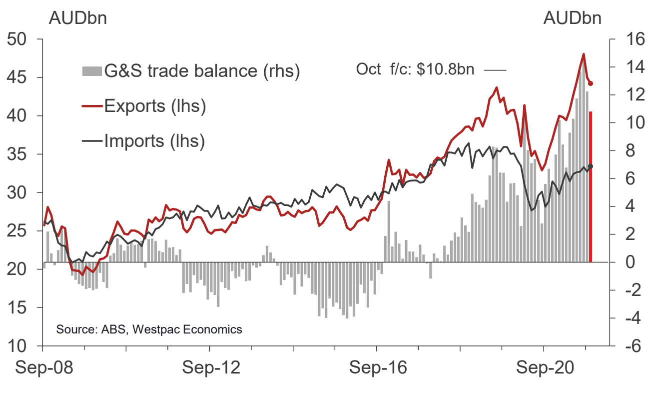


Aus Oct trade balance, $bn

Dec 2, Last: 12.2, WBC f/c: 10.8
Mkt f/c: 10.8, Range: 10 to 14

- The peak in the trade surplus has now passed, with the bursting of the iron ore price bubble. The surplus hit a high of $14.7bn in August, moderating to $12.2bn in September.
- For October, we anticipate a narrowing of the surplus to $10.8bn on higher imports and a further pull-back in export earnings.
- The import bill is expected to rebound, up by 2.1%, $0.7bn, after a 1.8% dip in September. Fuel import costs will rise on sharply higher oil prices and auto imports are expected to bounce off a weak base.
- Export earnings are forecast to declined by 1.7% in the month, –$0.75bn, following a 6.4% drop in September. The iron ore spot price was at US$120/t in October, well down from around US$210/t in June and July. For October, anticipated lower iron ore export earnings more than outweigh a lift in coal, on higher prices, and a bounce in gold, off a weak base.

Australia's trade balance

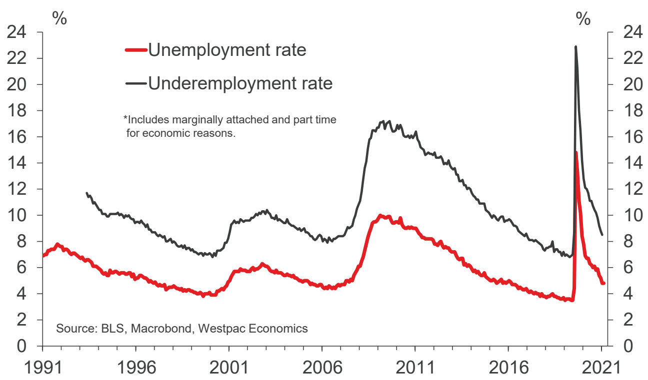


US Nov employment report

Dec 3, nonfarm payrolls, Last: 531k, WBC f/c: 550k, Mkt f/c: 500k
Dec 3, unemployment rate, Last: 4.6%, WBC f/c: 4.5%, Mkt f/c:4.5%

- Through September and October, not only has job creation strengthened, but revisions to prior months have seen the weakness initially reported midyear revised away.
- Come November, a gain of around 550k is expected, and there is again the possibility of further upward revisions. Gains around this level on an ongoing basis are more than enough to see maximum employment attained by end-2022.
- The potential wage and inflation impact of a robust unemployment downtrend and constrained labour supply is, in our view, likely to see the FOMC speed up the taper at their December meeting.

US full employment remains attainable

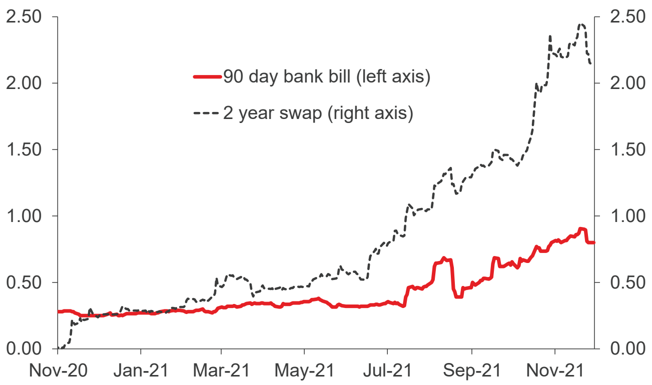


New Zealand forecasts.

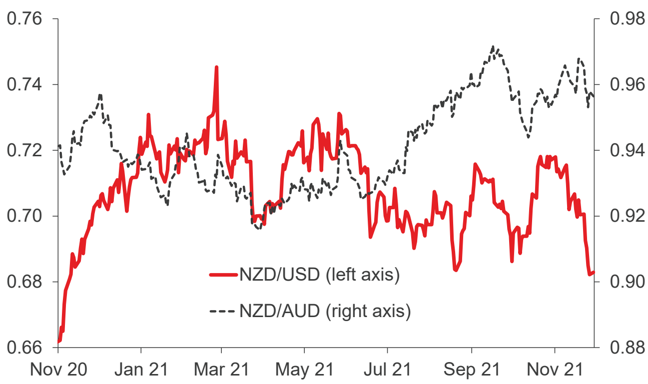
Economic forecasts	Quarterly				Annual			
	2021			2022				
% change	Jun (a)	Sep	Dec	Mar	2019	2020	2021f	2022f
GDP (Production)	2.8	-6.0	2.1	2.9	2.4	-2.1	3.8	4.6
Employment	1.0	2.0	0.0	0.3	1.2	0.6	3.5	0.6
Unemployment Rate % s.a.	4.0	3.4	3.8	3.7	4.0	4.8	3.8	3.5
CPI	1.3	2.2	0.7	0.8	1.9	1.4	5.2	2.8
Current Account Balance % of GDP	-3.3	-4.5	-5.5	-5.7	-2.9	-0.8	-5.5	-6.3

Financial forecasts	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Dec-23
Cash	0.75	1.00	1.50	2.00	2.25	2.50	2.75	3.00
90 Day bill	0.95	1.40	1.90	2.20	2.45	2.70	2.95	3.10
2 Year Swap	2.30	2.55	2.75	2.90	2.95	3.00	3.00	2.90
5 Year Swap	2.60	2.80	2.95	3.05	3.10	3.15	3.15	3.10
10 Year Bond	2.60	2.80	2.85	2.90	3.00	3.00	3.00	2.95
NZD/USD	0.68	0.67	0.66	0.67	0.69	0.70	0.71	0.72
NZD/AUD	0.94	0.94	0.94	0.94	0.95	0.93	0.93	0.92
NZD/JPY	78.2	77.7	76.6	78.4	80.7	82.6	83.8	85.7
NZD/EUR	0.61	0.61	0.61	0.61	0.63	0.63	0.63	0.63
NZD/GBP	0.51	0.49	0.48	0.49	0.50	0.51	0.52	0.53
TWI	72.7	72.1	71.2	71.8	73.1	73.5	74.1	74.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 29 November 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.75%	0.50%	0.50%
30 Days	0.78%	0.73%	0.59%
60 Days	0.79%	0.79%	0.70%
90 Days	0.80%	0.85%	0.80%
2 Year Swap	2.13%	2.31%	2.26%
5 Year Swap	2.61%	2.68%	2.63%

NZ foreign currency mid-rates as at 29 November 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6827	0.7047	0.7159
NZD/EUR	0.6027	0.6155	0.6195
NZD/GBP	0.5124	0.5251	0.5229
NZD/JPY	77.49	80.26	81.70
NZD/AUD	0.9563	0.9621	0.9532
TWI	73.51	75.13	75.94

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
Aus	Q3 company profits	7.1%	3.0%	5.0%	Gov't support payments outweigh delta hit to revenues.
	Q3 business inventories	0.2%	0.0%	–1.1%	Inventory run-down associated with delta lockdowns.
Eur	Nov economic confidence	118.6	117.8	–	Persistent inflationary pressures and delta's resurgence.
UK	Oct net mortgage lending £bn	9.5	–	–	Conclusion of stamp duty break to partially offset Sep gain.
US	Oct pending home sales	–2.3%	0.7%	–	Expected to bounce back after Sep's surprise fall.
	Nov Dallas Fed index	14.6	17.0	–	To provide a timely update on manufacturing in Texas.
	Fedspeak	–	–	–	Chair Powell to speak. Williams, Hassan & Bowman too.
Tue 30					
NZ	Nov ANZ business confidence	15.6	–	–	Activity to hold firm while prices & costs continue to rise
Aus	Q3 current account balance, $bn	20.5	29.3	31.0	Up on larger trade surplus – higher export prices & vols.
	Q3 net exports, ppts	–1.0	1.0	1.2	Export vols rebound off weak base, imports vols dip on delta.
	Q3 public demand	1.9	–	1.2	Strong growth extends into Q3; boosted by health response.
	Oct dwelling approvals	–4.3%	–2.0%	–4.0%	Further unwind of HomeBuilder and lumpy rise in spike.
	Oct private sector credit	0.6%	0.6%	0.5%	Businesses accessing lines of credit to navigate lockdowns.
	RBA Deputy Governor Guy Debelle	–	–	–	Indigenous Economics Symposium and ACI Conference.
Chn	Nov non-manufacturing PMI	52.4	51.3	–	Delta and power outages remain as potential headwinds...
	Nov manufacturing PMI	49.2	49.8	–	... but underlying strength of economy clear.
Eur	Nov CPI %yr	4.1%	4.3%	–	Inflationary pressures expected to persist into 2022.
US	Sep FHFA house prices	1.0%	1.2%	–	Expected to post a modest gain with Sep's existing sales...
	Sep S&P/CS home price index	1.17%	1.30%	–	... highlighting the strength of underlying demand.
	Nov Chicago PMI	68.4	67.0	–	Supply disruptions and delta are ongoing issues.
	Nov consumer confidence index	113.8	110.0	–	Confidence to be held back by delta concerns.
	Fedspeak	–	–	–	Chair Powell & Yellen before Senate Panel. Williams & Clarida.
Wed 01					
NZ	Oct building permits	–1.9%	–	Flat	Issuance to remain elevated across the country.
Aus	Q3 GDP	0.7%	–2.5%	–2.5%	Delta lockdowns impact, but disruptions less than feared.
	Nov CoreLogic home value index	1.3%	–	1.1%	Slowing but more due to affordability than 'delta' impacts.
Chn	Nov Caixin China PMI manufacturing	50.6	50.4	–	Delta and supply issues expected to keep growth stagnant.
Eur	Nov Markit manufacturing PMI	58.6	58.6	–	Final release for the month.
UK	Nov Markit manufacturing PMI	58.2	–	–	Final release for the month.
US	Nov ADP employment change	571k	515k	570k	Another strong result expected.
	Nov Markit manufacturing PMI	59.1	–	–	Final release will continue to signal robust growth.
	Oct construction spending	–0.5%	0.5%	–	Expected to lift given the strength of housing demand.
	Nov ISM manufacturing	60.8	61.0	–	Mfg strong despite supply and delta concerns.
	Federal Reserve's Beige book	–	–	–	Current economic conditions across the Fed districts.
	Fedspeak	–	–	–	Chair Powell & Yellen before House Panel.
Thu 02					
NZ	Q3 terms of trade	3.3%	2.0%	2.0%	Export commodity prices outstripping imported goods prices.
Aus	Oct trade balance $bn	12.2	10.8	10.8	Imports rebound, export earning pull-back continues.
Eur	Oct unemployment rate	7.4%	7.4%	–	Fall in unemployment expected to become more gradual.
US	Initial jobless claims	199k	–	–	Initial claims at multi-decade lows.
	Fedspeak	–	–	–	Bostic, Quarles, Daly and Barkin.
Fri 03					
Chn	Nov Caixin China PMI services	53.8	50.9	–	Delta and power shortages remain as risks.
Eur	Nov Markit services PMI	56.6	56.6	–	Final release for the month.
	Oct retail sales	–0.3%	0.3%	–	Set to lift as demand evens out between goods and services.
UK	Nov Markit services PMI	58.6	–	–	Final release for the month.
US	Nov non-farm payrolls	531k	500k	550k	Momentum in employment growth expected to persist...
	Nov unemployment rate	4.6%	4.5%	4.5%	... edging the unemployment rate lower.
	Nov average hourly earnings %mth	0.4%	0.4%	–	Wage growth to remain steady given the tight labour market.
	Nov Markt service PMI	57.0	–	–	Services continue to see strong growth...
	Nov ISM non-manufacturing	66.7	65.0	–	... but delta remains a headwind.
	Oct factory orders	0.2%	0.5%	–	Expected to advance further, transport a source of volatility.
	Oct durable goods orders	–0.5%	–	–	Final release; ex transport orders point to solid Q4 investment.
	Fedspeak	–	–	–	Bullard to speak at Missouri Bankers Association.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	3.0	5.0
CPI inflation %yr	1.9	1.8	1.8	0.9	3.0	2.5
Unemployment rate %	5.5	5.0	5.2	6.8	4.9	3.7
Current account % of GDP	-2.6	-2.1	0.7	2.7	4.4	1.8
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	5.6	4.0
CPI inflation %yr	2.1	2.4	1.9	1.2	4.5	3.1
Unemployment rate %	4.4	3.9	3.7	8.1	5.4	4.2
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	2.3	2.7
Euro zone						
Real GDP %yr	2.6	1.9	1.3	-6.6	4.9	4.4
United Kingdom						
Real GDP %yr	1.7	1.3	1.4	-9.9	6.7	5.5
China						
Real GDP %yr	6.9	6.7	5.8	2.3	8.5	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.4	3.8	4.9
World						
Real GDP %yr	3.8	3.6	2.8	-3.3	5.4	4.6
Forecasts finalised 5 November 2021						

Interest rate forecasts	Latest	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22	Mar–23	Jun–23	Dec–23
Australia									
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.50	0.75
90 Day BBSW	0.05	0.07	0.10	0.15	0.20	0.40	0.65	0.70	0.95
10 Year Bond	1.79	1.90	2.15	2.30	2.30	2.30	2.30	2.25	2.20
International									
Fed Funds	0.125	0.125	0.125	0.375	0.625	0.875	0.875	1.125	1.375
US 10 Year Bond	1.63	1.75	2.00	2.20	2.30	2.30	2.30	2.25	2.20

Exchange rate forecasts	Latest	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22	Mar–23	Jun–23	Dec–23
AUD/USD	0.7146	0.72	0.71	0.70	0.71	0.73	0.75	0.76	0.78
USD/JPY	114.74	115	116	116	117	117	118	118	119
EUR/USD	1.1221	1.12	1.10	1.08	1.09	1.10	1.11	1.12	1.14
GBP/USD	1.3302	1.34	1.36	1.37	1.38	1.38	1.37	1.37	1.35
USD/CNY	6.3922	6.35	6.35	6.35	6.30	6.25	6.20	6.15	6.10
AUD/NZD	1.0460	1.06	1.06	1.06	1.06	1.06	1.07	1.07	1.08

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

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer.