

Home Truths.

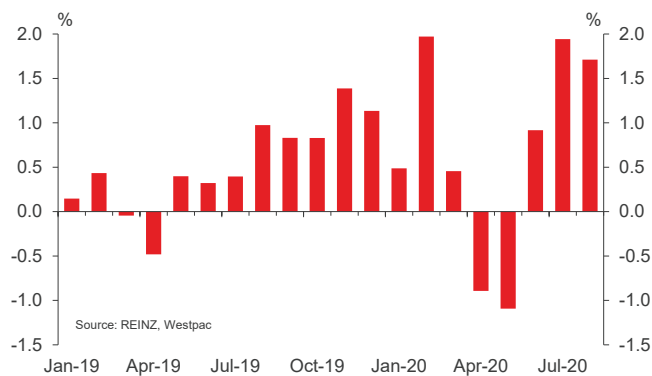
14 September 2020



House price forecasts upgraded... again.

When Covid-19 first broke out in New Zealand, we predicted a 7% decline in house prices between March and December. Other major banks, the Treasury and the Reserve Bank forecast even greater declines. But our collective predictions of house price decline have been proven wrong. Between March and August house prices have actually risen 2.6%, on a like-for-like, seasonally adjusted basis. Data released today showed that August was the third consecutive month of house price increase, so this is no statistical quirk or brief period of catch-up.

Monthly seasonally adjusted change in House Price Index



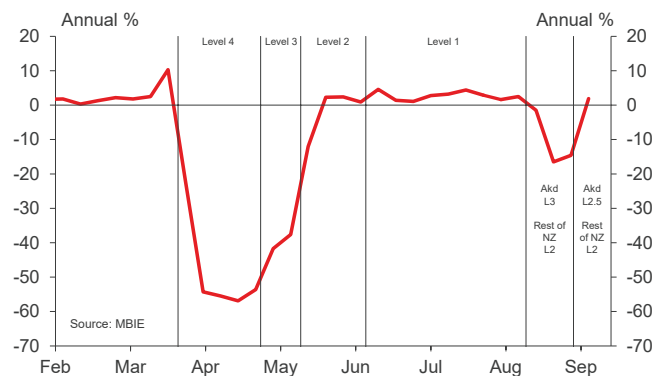
Back in July we upgraded our house price forecasts. We shifted to forecasting a fall of 2.5% over the second half of 2020, and an increase of 8% over 2021. However, even this is looking too pessimistic. Today we are upgrading our house price forecast again. We now expect an *increase* of 3.5% between March and December 2020, and we are sticking with an annual increase of 8% for 2021.

This month *Home Truths* takes a good look at how the housing market has so thoroughly defied a global pandemic.

First and foremost, Covid-19 and the associated lockdowns have proven less economically damaging than originally anticipated. We had expected that economic losses and rising unemployment would dent the housing market. And they did – there was a dip in house prices during Alert Level 4, and prices have probably been weaker than they otherwise would have been. But the surprising resilience of the economy has meant less of an impact on house prices than anticipated.

We were stunned when we saw that, outside of activities related to international travel, the economy quickly rebounded after the first lockdown. For example, employment fell by 34,000 people in April, but had regained the entire loss by June. Early data is showing that the second lockdown is following much the same trajectory as the first – a hit to activity followed by a rapid rebound. For example, weekly electronic card data suggests that consumer spending snapped back to previous levels almost as soon as Auckland dropped from Level 3 to Level 2.5.

Weekly retail spending on electronic cards, New Zealand



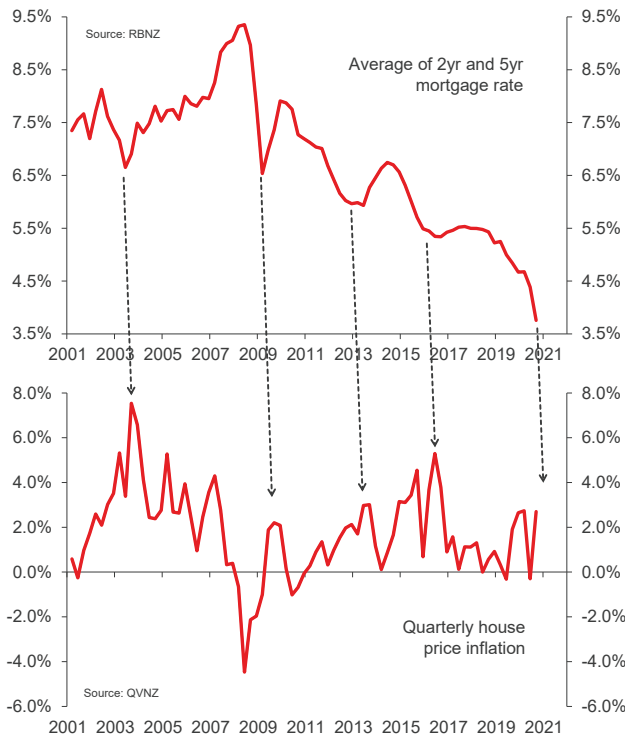
Our original GDP forecast was that the economy would shrink 3.6% between March 2020 and December 2020. As the facts have revealed the surprising resilience of the economy, we have upgraded that to a 0.6% decline in GDP over those nine months. Similarly, our forecast for peak unemployment has dropped from 9.5% to 7%. To be clear, this still amounts to a severe recession, but it is not as bad as we first feared.

This surprising economic resilience is actually a global phenomenon – in recent months we have also revised up our GDP forecasts for China, Australia and the United States.

The second reason for rising house prices is low mortgage rates. Low interest rates push savers out of bank deposits and into more active investment classes, such as investment housing and shares. This tends to push asset prices up in general. Low mortgage rates also make large mortgages more affordable for owner occupiers, allowing them to bid more for houses. And New Zealand's tax system, where income is taxed but capital gains is not, tends to exaggerate the attractiveness of land-based assets even further when interest rates fall.

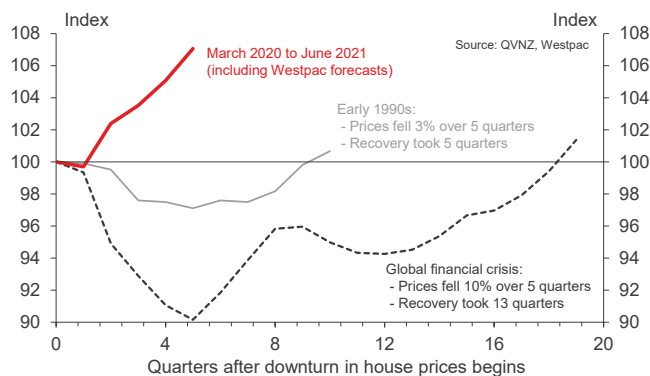


House prices and mortgage rates



Our original expectation for a fall in New Zealand house prices was based on the fact that prices fell during the recessions of the early 1990s, 1998, and 2009. This created an association between rising unemployment and falling house prices in the data, and we expected that association to repeat. But all of those past recessions were preceded by a rapid increase in interest rates, whereas the current recession was not. This unusual feature of the current recession may be teaching us that interest rates play an even more powerful role in determining house prices than previously appreciated.

New Zealand house prices during economic downturns

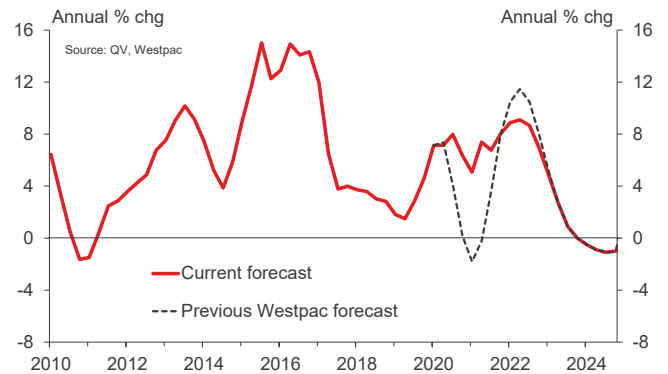


With this lesson in mind, we are upgrading our house price forecasts today. We now expect a small 3.5% rise in house prices from March to December this year. There was a very strong increase in prices in March quarter, so this would put annual house price inflation for 2020 at 6.3%. Our forecast still attempts to balance low interest rates against the weak

economy. We expect unemployment will continue to rise this year, and that will hold the house price horses back to some extent – if interest rates fell this far in a strong economic environment, the house price increase would be much larger.

Next year, we expect the economy to be beginning its post-Covid recovery journey. At the same time, we are actually expecting another decline in mortgage rates, as the RBNZ drops the OCR into negative territory in response to low inflation. Therefore, we are forecasting an 8% increase in house prices for 2021.

Westpac house price forecasts



When will house prices stop rising?

Over the past decade *Home Truths* has repeatedly identified episodes of falling interest rates that beget rising house prices. This cannot continue forever, so the big question is when will it all end?

The answer is when inflation rises enough to concern the Reserve Bank. Only at that point will the Reserve Bank see fit to increase interest rates. When interest rates eventually do rise, the forces that have driven New Zealand house prices ever higher over the past decade will go into reverse. Investors will be attracted back into bank deposits rather than riskier investments. Aspiring owner occupiers will face higher mortgage payments, meaning they can't bid as high. Existing homeowners will find their mortgage payments become less affordable, forcing some to sell. All of this could see house prices decline, as they have after other periods of rising interest rates. We are pencilling in a period of declining house prices from 2024, but such long-range forecasts are subject to extreme uncertainty, so the timing is perhaps less important than the principle – when interest rates rise, house prices will fall.

Dominick Stephens, Chief Economist

+64 9 336 5671

Contact the Westpac economics team.

Dominick Stephens, Chief Economist

+64 9 336 5671

Michael Gordon, Senior 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

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.

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ("Westpac").

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. 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.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QF Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed,

directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts of interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (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.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ("the Exchange Act") and member of the Financial Industry Regulatory Authority ("FINRA"). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.