

Nelson Lakes National Park, New Zealand

Weekly Economic Commentary.

Agri exports doing well, but what are the risks?

The economy's surprising resilience to Covid-19 continues, and has been most evident in agricultural exports. New Zealand's exports are now heavily concentrated on China. The risks involved in being so focussed on one country are more pertinent for some export sectors than others. Meanwhile, New Zealand's election later this week seems unlikely to elicit a large market reaction.

Recent data have continued to bear out the theme of economic resilience in the face of Covid-19. For example, business confidence, as reported in last week's ANZBO survey, has risen back to levels we saw prior to the initial Covid outbreak. This data also aligns with the many anecdotes we are hearing from businesses. Those anecdotes suggest that businesses outside of tourism-related industries have emerged from the lockdowns relatively unscathed and are now acting on previously on-hold investment plans, for example.

Also, last week, dairy auction prices posted a second successive gain. This result points to firm global dairy demand. Notably, the price lift was despite October being the seasonal peak in New Zealand dairy production, with the latest production data showing a solid lift on a year ago.

Looking at the rebound in global demand, we have previously pointed out that growth in the Chinese and many South-East Asian economies has been rebounding on the back of the successful management of Covid. This rebound in growth contrasts to the fragile recoveries in the US and Europe, with those regions still struggling to contain Covid outbreaks.

More broadly, New Zealand's agricultural export prices are proving resilient and are holding up much better than we anticipated. All up, New Zealand's key goods export prices are above their long-run averages, albeit down on the very high levels from a year ago. Our milk price forecast for this season, for example, sits at \$6.50/kg compared to \$7.14/kg for last season. Importantly, most dairy farmers remain profitable at this level.



This resilience in exports owes much to the fact that New Zealand's key agricultural markets lie in China and the rest of Asia. In turn, our exporters are benefitting from the rebound in growth in this region, with roughly 60% of our food exports destined for these markets.

Recent developments in global trade and the relative firmness in export prices have highlighted one of the questions that we most frequently get asked by clients: is New Zealand too reliant on China?

China is, of course, a highly profitable market and in most export sectors it is our largest market. So as our exports have increased rapidly, there is increasingly a trade-off between potential profits and the risk of becoming too highly concentrated in one market. However, as we discuss in a recent report,¹ it is not simply a question of how much New Zealand exports to China, but also how reliant China is on New Zealand for those imports. If China ever chose to put pressure on New Zealand via the trade relationship, some sectors would be more at risk than others.

The export sectors with the highest risk exposure are tourism, export education and seafood. This high exposure risk is because we are a small supplier in these sectors, and because China can easily find other markets to meet its import needs.

In terms of agriculture, we found that gold kiwifruit is highly exposed due to the ability of China to easily switch to other fruits like bananas and pineapples, which actually in terms of the global fruit basket account for a much bigger share than kiwifruit. In addition, Chinese growers have reportedly planted unlicensed Sungold kiwifruit vines.

At the opposite end of the exposure risk spectrum is the dairy sector. China is heavily reliant on New Zealand dairy

imports, with around half of China's imports coming from New Zealand. Dairy is also a very 'strategic' food, with few substitutes. For example, China's dietary guidelines advise for a daily intake of 300g of dairy, well beyond current per capita consumption levels.

Similarly, the viticulture sector has a low exposure to China. If anything, our exporters would like to send more product to China to tap more fully into the growing middle and upper classes in China.

Meanwhile, we judge that wood, meat and our other fruit exports lie towards the middle of this risk spectrum.

Financial market reaction to election result likely to be muted.

The 2020 election is less than a week away. At the current juncture, polls favour a return to power of the Labour party, with the Green party as a likely coalition partner. Other outcomes are possible, but much less likely. The second most likely outcome would be Labour governing alone. This could occur if the Green Party failed to meet the 5% threshold and didn't enter Parliament at all, and if Labour polled close to 50%. The third most likely outcome would be a centre-right coalition of the National and ACT parties.

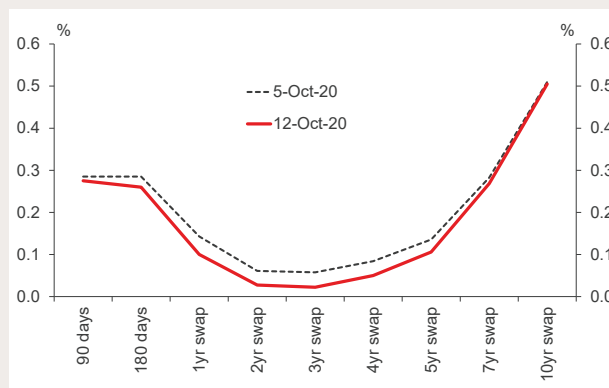
Financial markets tend not to react much on the day of an election result. And with neither of the big parties promising major policy shifts, this time is unlikely to be an exception. Markets tend to react more when the coalition negotiations have been concluded, the new government has been formed, and major policies have been announced. Depending on the election outcome, that could be weeks away.

¹ Available here: <https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Bulletins-2020/China-Exposure-Oct-2020-Westpac-NZ.pdf>

Fixed vs Floating for mortgages.

Fixed mortgage rates fell sharply over May and June, but are stable now and don't look likely to move much in the short run. However, in November we expect the Reserve Bank will introduce a Funding for Lending Programme, the aim of which is to reduce retail interest rates. At that time, we expect that both fixed and floating mortgage rates will fall. How far they fall will depend on the details of the Reserve Bank's programme, which are not known at this stage.

NZ interest rates



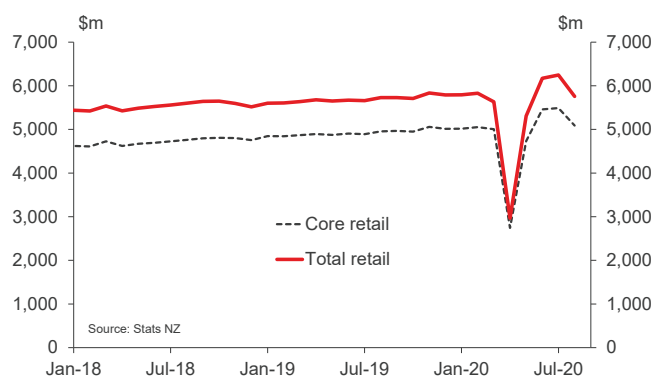
The week ahead.

NZ Sep retail card spending

Oct 13, Last: -7.9%, Westpac f/c: +9%

- Retail spending on electronic cards fell by 7.9% in August. The re-imposition of health-related restrictions on activity, including stricter restrictions in Auckland, pulled spending down sharply in August. The drop in spending was heavily centred on the hospitality sector.
- We estimate spending levels rose by 9% in September. Weekly indicators have shown a pickup in spending on hospitality as health restrictions were gradually rolled back over the past month. There has also been continued firmness in spending on durables.

Card transactions

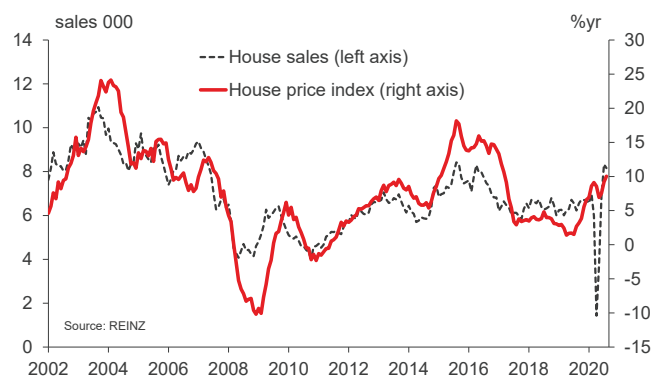


NZ REINZ House Price Index

Oct 14 (TBC), Sales last: -2.1%, Prices last: +10.0%/yr

- The housing market is on a tear. For the past two months REINZ data has shown seasonally adjusted sales above 8,000, making these some of the briskest months since 2007. Prices have been rising by just under 2% per month.
- Reports from the industry and second-tier data sources suggest that this market strength continued into September, so we anticipate another month of high sales and rising prices.
- We are forecasting 6.3% house price inflation for 2020, and 8% for 2021.

REINZ house prices and sales

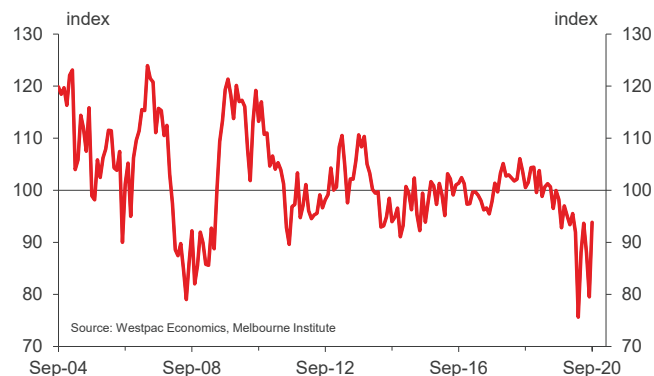


Aus Oct Westpac-MI Consumer Sentiment

Oct 14, Last: 93.8

- Consumer sentiment surged 18% in September, coming off an extremely weak 79.5 read in August when Victoria moved back into lockdown and consumers were clearly fearing similar outbreaks in other states. September's rebound came as case counts showed the virus was not spreading inter state and Victoria's outbreak was quickly coming under control. Remarkably, the rebound took the index 1.6% above the average over the six months prior to virus shocks and came despite official confirmation that Australia had experienced its first recession since 1992 - highlighting just how dominant COVID developments have become.
- Virus developments since September have continued to be mostly positive although there may be some disappointment around the very gradual approach the Vic state government is taking to the roll back of restrictions. The October read will also capture reactions to the Federal Budget unveiled on October 6, which included tax relief and one off payments that will boost incomes for many consumers.

Consumer Sentiment Index



The week ahead.

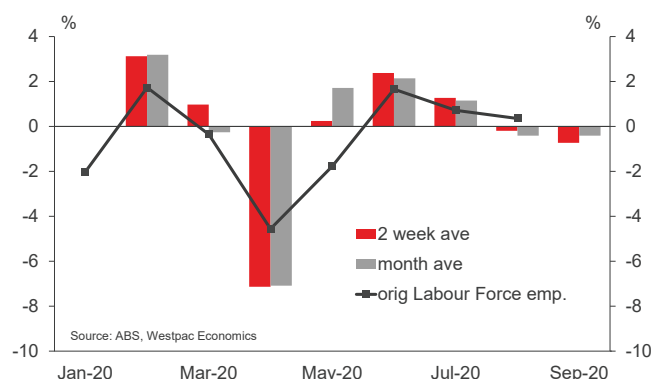
Aus Sep labour force: total employment change

Oct 15, Last: 111.0k, WBC f/c: -50k

Mkt f/c: -35k Range: -90k to 100k

- In August total employment rose +111.0k of which full-time was +36.2k and part-time +74.8k which was much stronger than expected. The ABS noted that the increase in original employment was due to a 50.2k increase in owner managers (self-employed mostly unincorporated sole traders) without employees, that is 'gig workers'.
- On investigation Westpac found different seasonality for employees and self-employed. On average through the last five years employees fell -66.5k in August while the self-employed lifted 24.1k. So it was not the strength of the self-employed that was surprising but rather the lack of weakness in employees (+2.6k in the month compared to an average of -66.5k).
- Our Weekly Payroll measure is pointing to a -0.7% in September in original terms. Our forecast -50k/-0.4% decline, using current seasonal factors, is equivalent to a flat 2.2k/0.0% print in original terms.

Payrolls vs Labour Force Employment



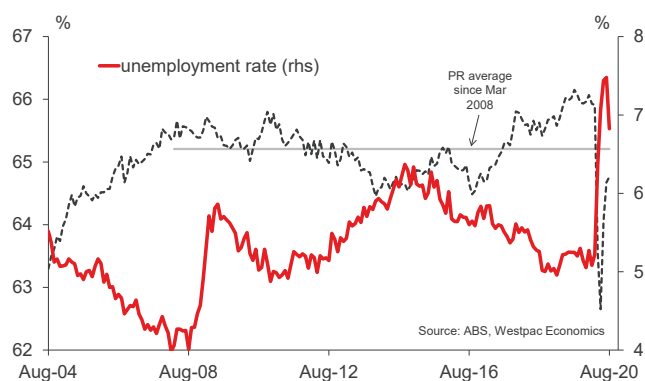
Aus Sep labour force: unemployment rate %

Oct 15, Last: 6.8%, WBC f/c: 7.2%

Mkt f/c: 7.1% Range: 6.5% to 7.5%

- In August, the weakness in Victorian labour market muted the rise in participation that was reported in most other states. Nationally, the participation rate rose just 0.1ppt to 64.8%, despite the 111k bump up in employment, limiting the rise in the labour force to just 24.5k.
- This resulted in the unemployment rate falling back to 6.8% from 7.5%. Back in May the unemployment rate was 7.1%. It was 6.4% in April.
- We have allowed the participation rate to round down to 64.7% from 64.8% which will hold the labour force flat in September. With this, our forecast -50k decline in employment is enough to lift the unemployment rate to 7.2% from 6.8%.

Unemployment and participation rates

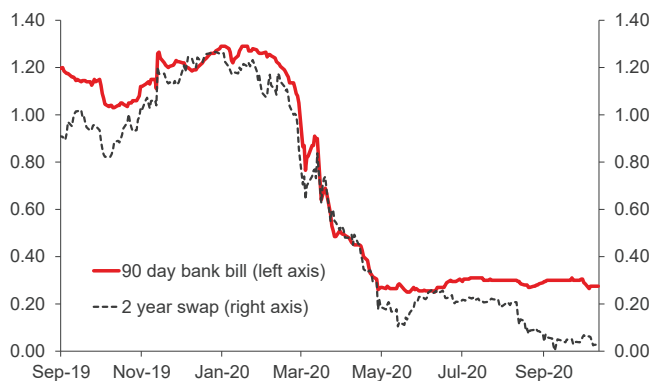


New Zealand forecasts.

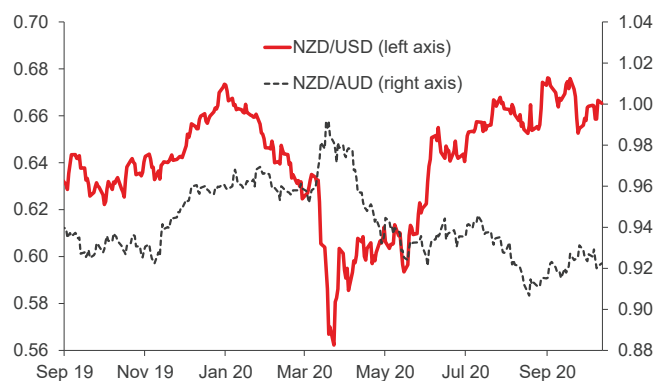
Economic forecasts	Quarterly				Annual			
	2020	2021			Annual			
% change	Jun (a)	Sep	Dec	Mar	2018	2019	2020f	2021f
GDP (Production)	-12.2	8.5	3.7	0.5	3.2	2.3	-5.1	6.0
Employment	-0.4	-2.8	-1.0	0.2	1.9	1.0	-3.2	1.8
Unemployment Rate % s.a.	4.0	5.5	6.2	6.6	4.3	4.1	6.2	6.5
CPI	-0.5	0.6	-0.1	0.1	1.9	1.9	0.8	0.5
Current Account Balance % of GDP	-1.9	-1.2	-1.2	-1.6	-4.3	-3.4	-1.2	-3.6

Financial forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
Cash	0.25	0.25	-0.50	-0.50	-0.50	-0.50
90 Day bill	0.30	-0.10	-0.20	-0.20	-0.20	-0.10
2 Year Swap	0.05	0.00	-0.10	-0.10	-0.10	0.10
5 Year Swap	0.20	0.20	0.20	0.25	0.35	0.55
10 Year Bond	0.60	0.65	0.70	0.75	0.80	1.00
NZD/USD	0.67	0.66	0.66	0.68	0.70	0.70
NZD/AUD	0.89	0.87	0.87	0.87	0.88	0.88
NZD/JPY	70.4	69.3	70.0	72.1	74.2	74.9
NZD/EUR	0.55	0.54	0.54	0.55	0.56	0.56
NZD/GBP	0.50	0.49	0.49	0.50	0.50	0.50
TWI	71.5	69.9	69.5	70.7	72.0	71.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 12 October 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.28%	0.28%	0.27%
60 Days	0.28%	0.29%	0.29%
90 Days	0.28%	0.30%	0.30%
2 Year Swap	0.03%	0.04%	0.05%
5 Year Swap	0.11%	0.11%	0.13%

NZ foreign currency mid-rates as at 12 October 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6653	0.6542	0.6662
NZD/EUR	0.5635	0.5628	0.5629
NZD/GBP	0.5108	0.5119	0.5210
NZD/JPY	70.41	69.05	70.69
NZD/AUD	0.9224	0.9304	0.9152
TWI	71.46	71.28	72.01

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	Aug net migration	-26	-	-	Set to remain low due to border restrictions.
Tue 13					
NZ	REINZ house sales	-2.1%	-	-	Due this week. Recent firmness in sales...
	REINZ house prices %yr	10.0	-	-	... and prices is set to continue.
	Sep food price index	0.7%	-	-1.2%	Falls in fruit and veg prices following earlier large gains.
	Sep card spending	-7.0%	-	9.0%	Spending has lifted as health restrictions have eased.
Chn	Sep trade balance USDbn	58.93	59.20	-	Global rebound to support continued export gains.
Eur	Oct ZEW survey of expectations	73.9	-	-	Reached 16yr high; virus resurgence should weigh.
UK	Aug ILO unemployment rate	4.1%	4.3%	-	Risks to the upside as furlough scheme winds down.
US	Sep NFIB small business optimism	100.2	101.2	-	Signs of recovery; job-creation plans improved in Aug.
	Sep CPI	0.4%	0.2%	-	Used vehicle prices spiked 5.4%, driving 40% of m/m gain.
Wed 14					
Aus	Oct WBC-MI Consumer Sentiment	93.8	-	-	Rebounded strongly in Sep on easing virus fears.
Eur	Aug industrial production	4.1%	0.2%	-	Output rebound from pandemic lows losing momentum.
US	Sep PPI	0.3%	0.1%	-	Upstream price pressures minimal.
	Fedspeak	-	-	-	Clarida, Kaplan and Quarles.
Thu 15					
Aus	RBA Governor Phillip Lowe	-	-	-	Online Speech at Citi Annual Investment Conf. 8:45 AEST.
	Oct MI inflation expectations	3.1%	-	-	At the low end of their historical range.
	Sep employment, '000	111	-40	-50	Payrolls pointing to larger fall but they miss self-employed.
	Sep unemployment rate	6.8%	7.1%	7.2%	Part rate to ease a little, not enough to stop unemp. rising.
Chn	Sep PPI %yr	-2.0%	-1.8%	-	Commodity price weakness to abate.
	Sep CPI %yr	2.4%	2.0%	-	Consumer price pressures to remain modest.
	Sep Money Supply M2 %yr	10.4%	10.4%	-	Missed market expectations as growth slowed.
	Sep New Yuan loans CNYbn	1280	1680	-	Credit freely available. Demand continues to firm.
US	Initial jobless claims	840k	-	-	Initial claims still 4x pre-virus level.
	Oct Fed Empire state index	17	12	-	New orders positive and 6-month outlook improving...
	Oct Philly Fed Index	15	14.5	-	...inventories and employment continue to lag.
	Sep import price index	0.9%	0.3%	-	Down 1.4%yr; industrial supply costs drive return to growth.
	Fedspeak	-	-	-	Kaplan, Quarles and Kashkari.
Fri 16					
NZ	Sep manufacturing PMI	50.7	-	-	Business conditions resilient despite Covid headwinds.
Eur	Aug trade balance €bn	20.3	-	-	Trade surplus widening with imports weaker than exports.
	Sep CPI	0.1%	0.1%	-	Down 0.3%yr; decline primarily driven by services.
US	Sep retail sales	0.6%	0.7%	-	Growth now normalising after strong rebound from lows.
	Sep industrial production	0.4%	0.6%	-	Manufacturers optimistic, but production gains moderate.
	Aug business inventories	0.1%	0.3%	-	Demand for goods since lows justifies restocking.
	Oct Uni. of Michigan sentiment	80.4	80.0	-	6-month high, driven by upper-income household optimism.
Sat 17					
NZ	General Election	-	-	-	Polls close 7pm NZ time.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.4	2.8	1.8	-3.3	2.3
CPI inflation % annual	1.5	1.9	1.8	1.8	0.4	2.2
Unemployment %	5.7	5.5	5.0	5.2	7.7	7.6
Current Account % GDP	-3.1	-2.6	-2.1	0.6	2.6	0.1
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-4.7	3.4
Consumer Prices %yr	1.4	2.1	2.4	1.9	1.1	1.8
Unemployment Rate %	4.9	4.4	3.9	3.7	8.8	7.9
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.5	2.2	0.3	0.7	-5.2	1.5
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	-7.6	5.4
United Kingdom						
Real GDP %yr	1.9	1.9	1.3	1.4	-11.0	7.0
China						
Real GDP %yr	6.8	6.9	6.8	6.1	2.5	10.5
East Asia ex China						
Real GDP %yr	4.1	4.6	4.4	3.7	-2.3	5.2
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.8	5.8

Forecasts finalised 9 September 2020

Interest rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
Australia							
Cash	0.25	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.08	0.04	0.04	0.04	0.04	0.04	0.10
10 Year Bond	0.88	0.80	0.90	1.00	1.05	1.15	1.25
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.79	0.60	0.65	0.75	0.75	0.85	0.95

Exchange rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
AUD/USD	0.7176	0.75	0.76	0.76	0.78	0.80	0.80
USD/JPY	106.02	105	105	106	106	106	107
EUR/USD	1.1765	1.21	1.22	1.23	1.24	1.25	1.25
GBP/USD	1.2939	1.33	1.34	1.35	1.37	1.39	1.40
USD/CNY	6.7908	6.75	6.75	6.70	6.60	6.50	6.40
AUD/NZD	1.0891	1.12	1.15	1.15	1.15	1.14	1.14

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