



Weekly Economic Commentary.

Pre-Christmas cheer.

This week brings several important economic releases ahead of the Christmas break. In particular, the September quarter national accounts (Thursday) and the Government's half-year fiscal update (Wednesday) are expected to highlight the New Zealand economy's rapid bounceback from the Covid-19 lockdown.

We expect a 13% rise in September quarter GDP, following a 12.2% drop in the June quarter. The speed of the rebound from lockdown conditions highlights a point that we've been making lately: elimination of the virus is immensely beneficial to the economy. In that respect, successful lockdowns (the key word being successful) are much less costly than was initially feared. Indeed, the temporary increase in Covid alert levels in August and September in response to a mystery outbreak had a relatively muted impact. The restrictions appear to have mostly delayed spending rather than preventing it.

Our forecast of the September quarter would see GDP about 2% below where it was at the end of last year, before the Covid shock. If we consider trend growth over that time, that puts the economy about 4-5% below where it would have been in the absence of Covid. That's about the size of the hole left by the loss of international travel while the country's

borders remain closed. In other words, the rest of the domestic economy is already operating at something close to full speed.

That said, the experience has differed greatly across industries. Some areas are more or less back at pre-Covid levels, either because of a quick rebound (e.g. construction) or because they were deemed essential and were able to keep operating through the Covid restrictions (e.g. agriculture, food manufacturing). The worst-performing sectors are those most obviously linked to the ongoing closure of the international border, such as transport, travel services and hospitality.

Meanwhile, some parts of the economy are running red-hot – particularly retail, which we estimate is up by about 9% on its pre-Covid level. Some of this will be due to substitution. The border closure has also halted outbound tourism, so Kiwis have been spending up on areas such as homewares and



renovations instead. The data on electronic card spending shows that this has continued beyond September.

In a sense, this suggests that the fiscal and monetary policy response to the Covid crisis has been successful. No amount of stimulus was going to bring back the international tourism industry, so it's necessary to supercharge other parts of the economy in order to avoid unacceptably low inflation and employment outcomes. That stimulus can be wound back as the border is reopened, although that could be some time away yet.

The other notable release is the Government's Half-Year Economic and Fiscal Update (HYEFU). Up to now, the Treasury's economic forecasts have been markedly downbeat, despite the mounting evidence that the economy had rebounded readily from the lockdown. We believe the Treasury is now on board with that view, and is set to revise up its forecasts significantly.

That will mean a stronger expected tax take, and smaller (though still large) operating deficits over the next few years. Previously, the Treasury had forecast a deficit of over \$31bn for the June 2021 fiscal year. But in the four months to October alone the deficit has come in almost \$5bn less than expected. Around two-thirds of that is due to a stronger tax take, relative to the Treasury's downbeat forecasts. The rest is due to lower spending, in particular a much lower than assumed uptake of the extended wage subsidy scheme.

Smaller deficits over the next few years will mean a lower borrowing requirement, compared to what was announced at the pre-election fiscal update in September (which in turn was reduced relative to the May Budget). Applying our own economic forecasts, the Government's borrowing requirement over the next four years could be as much as \$30bn lower. We don't expect that they'll go quite that far this time, but there is a case for reducing the bond programme by at least \$5bn per year.

A reduction in bond issuance will have consequences for the Reserve Bank's Large-Scale Asset Purchase (LSAP) programme. With fewer government bonds in the market, buying up to \$100bn of bonds would leave the RBNZ holding more than 60% of the bonds outstanding. That's not a hard limit, but going above that level raises concerns about a loss of liquidity and the potential for market dysfunction.

To avoid this, the RBNZ could either reduce the total size of the LSAP or spread it out over a longer period than two years. Either way, this would mean slowing the weekly pace of bond purchases – in fact the RBNZ has already done so in recent weeks. But slowing the pace of purchases would also mean reducing the degree of stimulus being applied, at a time when the RBNZ is still at risk of undershooting its inflation target.

The HYEFU doesn't normally include decisions on policy (though admittedly these are not normal times). However, we do think that over the coming year the Government will need to reassess its Covid response and recovery fund. In the May Budget up to \$62bn was approved for this purpose, though not all was allocated at the time. In the pre-election update, the Government indicated that it expected to spend around \$58bn of this amount.

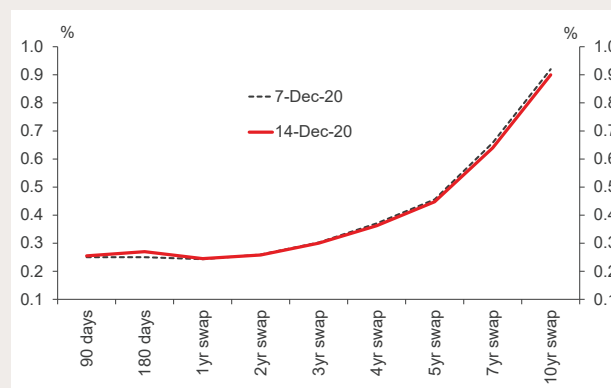
With a stronger economy and less unemployment than expected, we suspect that the Government is increasingly going to struggle to find things to spend this money on that could reasonably be labelled a Covid response. Many of the programmes announced in the Budget had a strong job-creation element, based on forecasts of mass unemployment that haven't eventuated. We expect that some of the fiscal package will eventually be repurposed towards more permanent spending commitments, such as increased funding for health and education.

Fixed vs Floating for mortgages.

There could be a small decline in floating mortgage rates in the near future, depending on the impact of the Reserve Bank's recently introduced Funding for Lending Programme (FLP) for banks. However, the near-term outlook for fixed mortgage rates is uncertain. The FLP argues for lower rates, but a recent sharp lift in wholesale interest rates argues in the other direction.

Next year we do expect a drop in fixed mortgage rates, because we expect wholesale interest rates to drop away again. If our view proves correct, then shorter-term fixed rates, such as six months or one year, will prove to be the best value for borrowers.

NZ interest rates



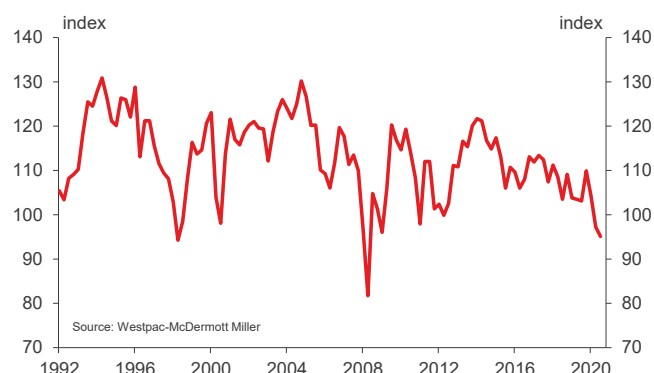
The week ahead.

NZ Q4 Westpac McDermott Miller Consumer Confidence

Dec 15, Last: 95.1

- At the time of our last survey of New Zealand households in September, economic confidence was lingering at low levels. Activity in some parts of the economy was still well below its pre-Covid level and joblessness was rising. There was also a flare up in infections around the time of the September survey which resulted in activity restrictions being reimposed.
- Since the September survey, restrictions on activity have eased and economic activity has strengthened. We've also seen house prices rising rapidly. On top of those developments, we've also seen increasingly positive news about the development of a vaccine.

Westpac-McDermott Miller consumer confidence

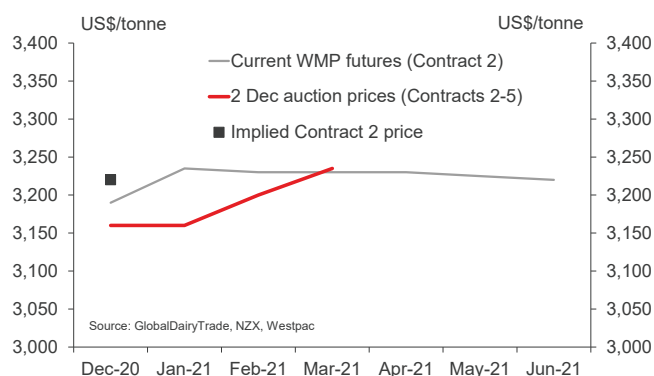


NZ GlobalDairyTrade auction, whole milk powder prices

Dec 16, Last: +5.0% chg, Westpac: +1.0%

- We expect whole milk powder prices will lift a touch at the upcoming dairy auction. Prices jumped 5% at the last auction, as commodity markets were buoyed by Covid vaccine news.
- Our pick is largely consistent with current futures market pricing.
- Dairy markets are starting to anticipate more normal economic activity and dairy demand next year. With little room for supply to respond, the upshot is that prices are likely to move higher in the short term.

Whole milk powder prices

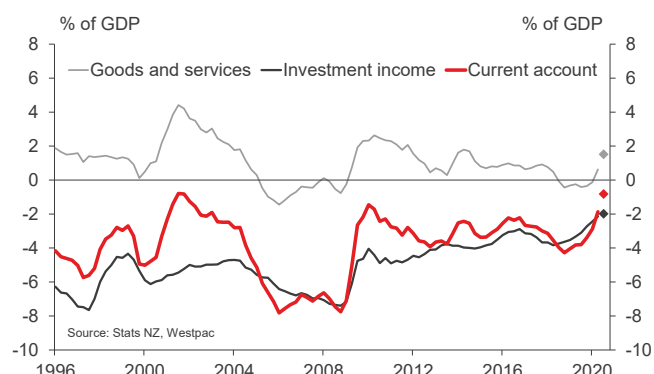


NZ Current Account Balance, % of GDP

Dec 16, Last: -1.9%, Westpac: -0.8%

- We expect the current account deficit to narrow over the September quarter to just 0.8% of GDP. If this proves correct, the deficit would be the smallest since 2001.
- Imports remain well below pre-Covid levels. Meanwhile, goods exports continue to hold up well.
- The balance of services improved slightly in the September quarter, after a sharp deterioration in June. Tourism and education have been hit hard by the border closure, but exports of business services picked up as the country moved out of lockdown.

Annual current account balance



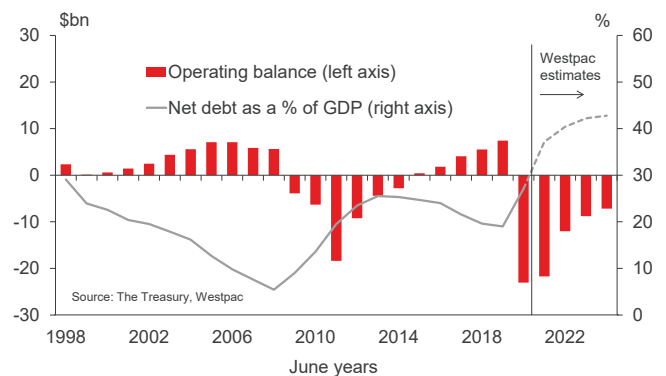
The week ahead.

NZ Half-Year Economic and Fiscal Update

Dec 16

- The Treasury's economic forecasts to date have been notably downbeat. However, we expect that the HYEFU will bow to the mounting evidence that the economy has bounced back readily from the Covid-19 lockdown.
- That will mean a stronger expected tax take, smaller (but still large) operating deficits, and a lower borrowing requirement over the next few years.
- We expect the bond programme to be reduced by at least \$5bn over each of the next two years.

NZ fiscal position



NZ Q3 GDP

**Dec 17, Last -12.2%, Westpac f/c: +13.0%,
Mkt f/c: +13%, Range: +7.3% to +14.0%**

- New Zealand's economy has bounced back in the September quarter following the easing of Covid-related activity restrictions. Our forecasts suggest that GDP is almost back to where it was at the end of last year, before the Covid shock.
- Conditions have varied greatly across sectors. Areas such as retail, primary industries, construction and professional services are now back at pre-Covid levels or even higher. In contrast, sectors linked to international travel remain down significantly on last year.
- The September quarter GDP release will include a range of revisions going back several years. The biggest change will come from incorporating the 2018 Census results, which revealed a larger population (and hence more growth in recent years) than previously assumed.

Production-based GDP

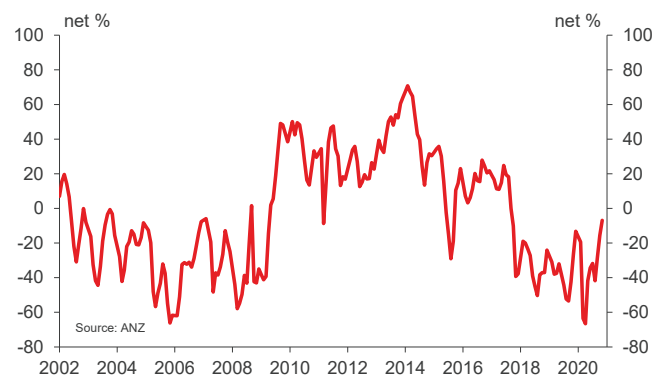


NZ Dec ANZBO business confidence

Dec 18, Last: -6.9

- Business confidence rose through November and is now back above the levels we saw prior to the outbreak of Covid-19. While the strengthening in business conditions has been widespread, it has been stronger among builders and manufacturers. In contrast, some retailers and businesses in services sectors are reporting that activity is recovering more gradually.
- We expect that there will be some further increase in business confidence through December. There has been continued positive news regarding vaccine development in recent weeks. There has also been continued strength in the housing market and household spending.
- We'll also be keeping an eye on the survey's inflation and pricing gauges which have been firming.

NZ business confidence



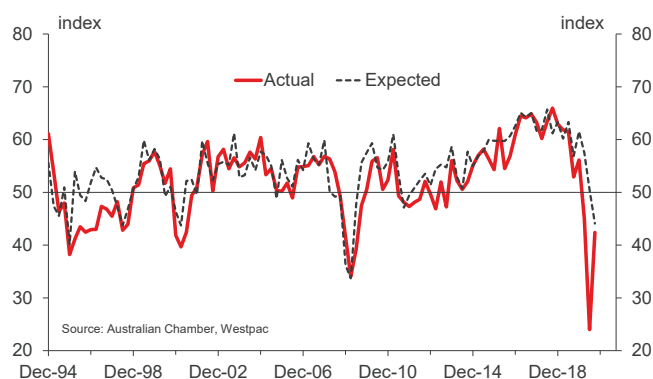
The week ahead.

Aus Q4 AusChamber–Westpac business survey

Dec 15, Last: 42.8

- The Australian Chamber–Westpac Survey of Industrial Trends, Australia's longest running business survey dating from 1966, provides a timely update on manufacturing and insights into economy-wide trends. The Q4 survey was conducted from November 9 to December 1.
- In Q3, the Actual Composite improved to 42.8 after falling dramatically to 24.0 in the June quarter, associated with the initial lock-down in response to covid. The manufacturing sector has been greatly impacted by the disruptions and the downturn.
- Whilst the sub-50 read in September suggested that conditions were contracting, new orders and output were declining at a slower pace.
- The emerging rebound from the initial lock-down experienced set-backs, with Victoria going into a second lock-down. However, by November, the pace of the reopening was beginning to pick up.

Westpac-AusChamber Composite indexes

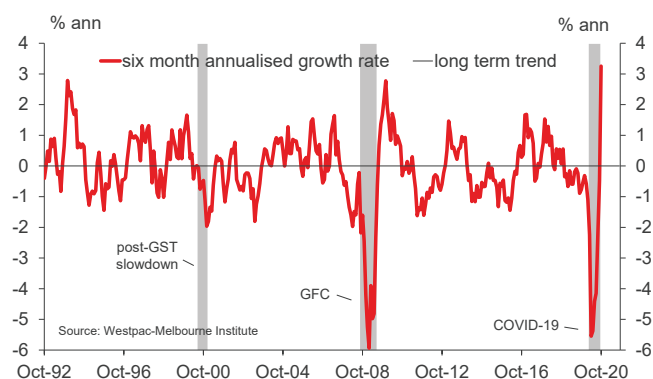


Aus Nov Westpac–MI Leading Index

Dec 16, Last: 3.25%

- The Leading Index growth rate rose from -0.47% in September to +3.25% in October – marking the first positive, above trend, growth rate since 2018 and the strongest gain since the early 1980s. That is consistent with the economy recovering from its COVID recession although the outright strength reflects the severity of the preceding contraction more than the overall condition of the economy.
- The Nov update is likely to show a similar result. It will include particularly positive updates on: the ASX200 (up 10%); dwelling approvals (up a further 3.8% after a 16% spike last month); and around the labour market – the Westpac–MI Unemployment Expectations Index dropping -16.2% (a big improvement) and total hours worked up another 1.2%. Other components have remained supportive as well.

Westpac-MI Leading Index



Aus Nov employment, '000 chg

**Dec 17, Last: 178.8, WBC f/c: 75
Mkt f/c: 40, Range: -10 to +100**

- Total employment surged 178.8k (1.4%) in October, significantly larger than Westpac's and the market's -30k forecast and still much larger than the top of the market forecast of +30k. Employment is now just 1.7% less than what it was in March 2020, a rather surprising recovery in employment.
- Victoria did stand out with a 81.6k gain in employment but NSW added 36.4k, Qld added 25.3k and WA added 15.3k.
- Victoria remains a long way behind in the recovery with the economy only being reopened in November. As such we expect the Victorian recovery to continue to at least December if not into the first quarter of 2021.
- Even allowing for some pull back in the other states, a solid 75k rise is easily achievable. In fact it is possible that the reopening has had a positive flow-on to other states supporting further gains there as well.

Westpac jobs index*



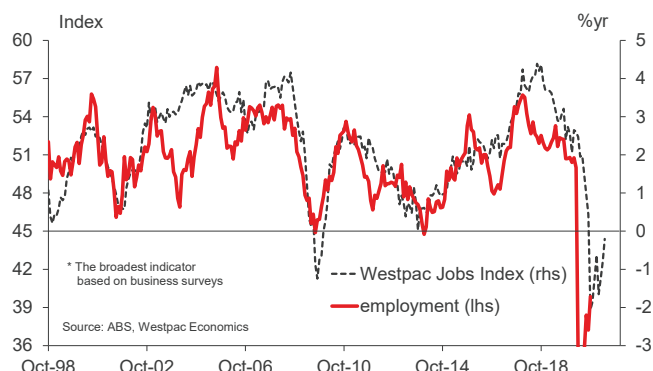
The week ahead.

Aus Nov unemployment rate

Dec 17, Last: 7.0%, WBC f/c: 7.0%
Mkt f/c: 7.0%, Range: 7.3% to 6.5%

- October unemployment lifted 0.1ppt to 7.0% due to a strong rebound in participation from 64.9% to 65.8%. This significant jump in participation drove a 204.3k surge in the labour force and took participation back to within range of the pre-COVID peak of 66.2%. This is not something we expected to see so soon but in all fairness, we have been arguing that participation has been very dynamic so it should not be surprising that a strong rise in employment was associated with a strong gain in participation.
- In October Victoria participation leapt from 63.0% to 65.0% which saw the unemployment rate rise 0.7ppt to 7.4% despite the very robust gain in employment. Yet it is still well below pre-COVID levels so has plenty of room to rise.
- We are looking for Victoria to drive the participation rate higher so our 75k forecast gain in employment will only be enough to hold unemployment flat at 7.0%.

Westpac jobs index*

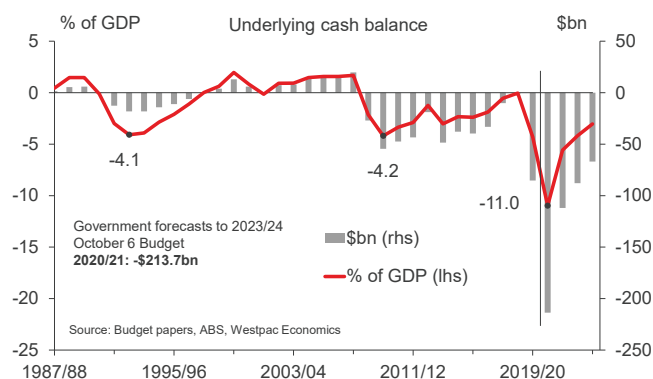


Aus Federal budget, Mid-Year Economic and Fiscal Outlook

Dec tbc, 2020/21: -\$213.7bn, 11% of GDP

- The Federal government's MYEFO may be released sometime this week. The government currently expects the budget deficit to peak at \$213.7bn in 2020/21, up from \$85bn in 2019/20, then moderate in the following years.
- MYEFO will see an upgrade of the economic forecasts. The economy in 2020/21 will potentially be 3% larger than anticipated in the October 6 Budget – boosting revenues and reducing expenses, in the order of \$10 to \$15bn.
- We assess that the government's budget deficit forecast for 2020/21 will be trimmed, lowered from \$213.7bn currently, to be approaching \$200bn (10% of GDP).

Federal budget: hit by covid recession

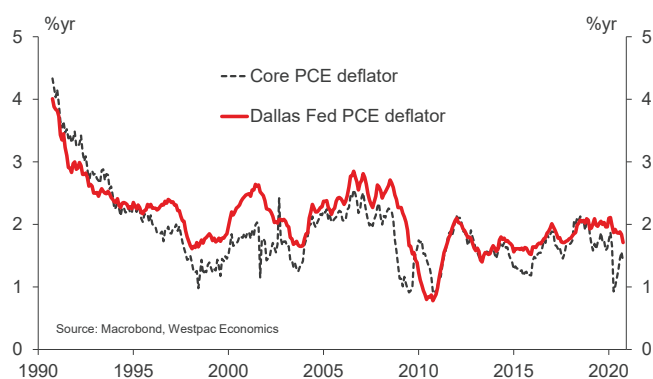


US Dec FOMC meeting

Dec 15-16, federal funds rate, last: 0.125%, WBC: 0.125%

- The December FOMC meeting comes at a time of immense uncertainty for the US. Since the last meeting in November, the daily new case count has continued to make new highs, currently circa 220k; available capacity at hospitals continues to dwindle; and authorities in many states are responding with new restrictions, albeit to varying degrees.
- Against this immediate reality stands the promise of a strong recovery from 2021, made possible by rapid vaccine deployment.
- Even if the economy rebounds strongly in 2021, given the current degree of slack and following many years of inflation disappointment, there is clearly a justification for the FOMC to increase accommodation in December. It is much easier to pull back on stimulus than to make up for lost time.

For the US, 2%/yr inflation a long way off

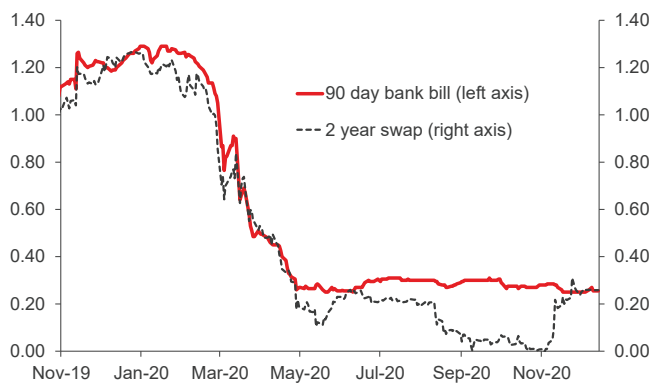


New Zealand forecasts.

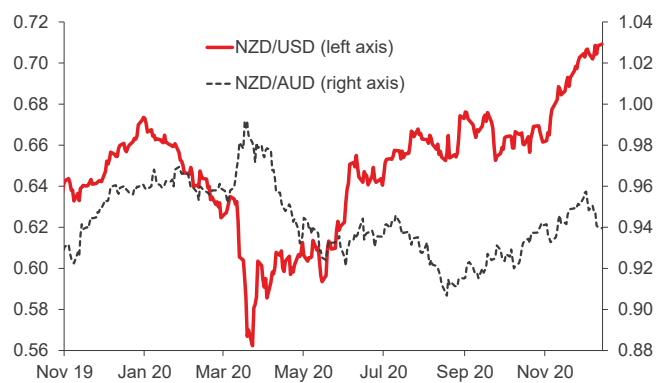
Economic forecasts	Quarterly				Annual			
	2020	2021			2019	2020f	2021f	2022f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	-12.2	13.0	1.5	0.7	2.3	-3.7	5.6	2.9
Employment	-0.3	-0.8	-0.6	0.1	1.2	-0.7	1.7	3.4
Unemployment Rate % s.a.	4.0	5.3	6.0	6.2	4.1	6.0	6.0	5.2
CPI	-0.5	0.7	0.0	0.3	1.9	1.0	0.9	1.2
Current Account Balance % of GDP	-1.9	-0.8	-0.6	-0.7	-3.4	-0.6	-2.5	-2.4

Financial forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
Cash	0.25	0.25	0.00	-0.25	-0.25	-0.25
90 Day bill	0.25	0.20	-0.05	-0.20	-0.20	-0.20
2 Year Swap	0.25	0.20	-0.05	-0.10	-0.10	0.00
5 Year Swap	0.45	0.45	0.25	0.20	0.20	0.30
10 Year Bond	0.90	1.00	0.95	0.90	0.90	1.10
NZD/USD	0.71	0.72	0.73	0.74	0.74	0.74
NZD/AUD	0.95	0.95	0.94	0.94	0.93	0.90
NZD/JPY	73.8	74.9	75.9	77.0	77.0	77.7
NZD/EUR	0.59	0.59	0.59	0.59	0.59	0.58
NZD/GBP	0.53	0.54	0.54	0.54	0.53	0.52
TWI	74.8	75.1	75.2	75.6	75.0	74.1

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 14 December 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.26%	0.27%	0.27%
60 Days	0.26%	0.26%	0.27%
90 Days	0.26%	0.25%	0.27%
2 Year Swap	0.26%	0.26%	0.18%
5 Year Swap	0.45%	0.47%	0.36%

NZ foreign currency mid-rates as at 14 December 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7092	0.7022	0.6841
NZD/EUR	0.5849	0.5871	0.5786
NZD/GBP	0.5311	0.5275	0.5192
NZD/JPY	73.81	72.96	71.64
NZD/AUD	0.9396	0.9505	0.9414
TWI	74.33	74.27	72.86

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 14					
NZ	Nov BusinessNZ PSI	51.4	-	-	Business conditions have been firming.
	Oct net migration	808	-	-	Set to remain low due to continued border restrictions.
Aus	2020/21 Federal budget update, \$bn	-213.7	-	-200	Date tbc. Upside surprises on economy to trim deficit.
Eur	Oct industrial production	-0.4%	1.8%	-	Demand expected to be hit by restrictions at year end.
Tue 15					
NZ	Q4 WBC-MM Consumer Confidence	95.1	-	-	Household conditions have firmed since the Sept survey.
Aus	RBA speak	-	-	-	Kearns, Head of Financial Stability, at 11:40am
	RBA minutes	-	-	-	In "watch-and-wait" mode, after delivering Nov stimulus.
	Q4 AusChamber-Westpac survey	42.4	-	-	Business conditions improving as economy reopens.
	Weekly Payrolls W.E. 25th Nov	0.1%	-	-	Collapse in small business payrolls been key to soft prints.
Chn	Nov industrial production ytd %yr	1.8%	2.2%	-	China will continue to outperform...
	Nov retail sales ytd %yr	4.3%	5.0%	-	... rest of world as broad-based support for activity...
	Nov fixed asset investment ytd %yr	1.8%	2.6%	-	... remains intact.
UK	Oct ILO unemployment rate	4.8%	5.2%	-	The furlough programme will provide support until March.
US	Dec Fed Empire state index	6.3	7.5	-	Restrictions' impact continues to grow...
	Nov industrial production	1.1%	0.3%	-	... vaccine deployment won't help until months into 2021.
Wed 16					
NZ	GlobalDairyTrade - WMP	5.0%	-	1.0%	Dairy prices lifting on vaccine news.
	Q3 current account balance	-1.9%	-0.9%	-0.8%	Current account deficit narrowing as imports remain weak.
	Half Year Economic & Fiscal Update	-	-	-	Stronger economic forecasts and reduced borrowing.
Aus	Nov Westpac-MI Leading Index	3.25%	-	-	Nov update to include positive developments.
Eur	Oct trade balance €bn	24.0	-	-	Global growth a tail wind into 2021.
UK	Nov CPI	0.0%	-	-	Inflation pressures absent.
US	Nov retail sales	0.3%	-0.2%	-	Has slowed dramatically in recent months.
	Dec Markit manufacturing PMI	56.7	55.8	-	Restrictions to weigh on manufacturing...
	Dec Markit service PMI	58.4	55.0	-	... and, to a greater degree, on services.
	Oct business inventories	0.7%	0.6%	-	Restocking to be a positive into 2021.
	Dec NAHB housing market index	90	88	-	Housing outlook very positive.
	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	Further easing warranted on risks and inflation.
	Fed Chair Powell	-	-	-	To hold post-FOMC meeting press conference.
Thu 17					
NZ	Q3 GDP	-12.2%	12.8%	13.0%	Bounce back after activity restrictions were lifted.
Aus	Nov employment, '000	178.8	39k	75k	Victoria will drive a solid bounce in employment but the...
	Nov unemployment rate	7.0%	7.0%	7.0%	... other states had a strong rebound in participation.
Eur	Nov CPI	-0.3%	-0.3%	-	Inflation pressures absent.
UK	BoE policy decision	0.10%	0.10%	-	Easing likely in coming months despite vaccines.
US	Dec Philly Fed index	26.3	20.0	-	Regional conditions mixed; near-term risks growing.
	Initial jobless claims	853k	-	-	Have risen in three of past four weeks.
	Nov housing starts	4.9%	-0.2%	-	Housing outlook very positive...
	Nov building permits	0.0%	1.0%	-	... labour market and rates to drive further gains.
Fri 18					
NZ	Dec ANZ consumer confidence	106.9	-	-	Has been trending higher, still at low levels.
	Nov trade balance \$m	-501	250	250	Stronger exports after an October drop.
	Dec ANZ business confidence	-6.9	-	-	Business conditions have been firming in recent months.
UK	Dec GfK consumer sentiment	-33	-	-	Consumers focused on labour market and COVID's spread.
	Nov retail sales	1.2%	-4.2	-	Restrictions impacting spending into year end.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
Australia						
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
United States						
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
Japan						
Real GDP %/yr	2.2	0.3	0.7	-5.8	3.0	2.2
Euro zone						
Real GDP %/yr	2.6	1.8	1.3	-7.7	4.0	5.0
United Kingdom						
Real GDP %/yr	1.9	1.3	1.5	-10.8	7.1	5.5
China						
Real GDP %/yr	6.9	6.8	6.1	1.7	10.0	5.6
East Asia ex China						
Real GDP %/yr	4.7	4.4	3.7	-2.8	5.3	5.1
World						
Real GDP %/yr	3.8	3.5	2.8	-3.7	5.8	4.6

Forecasts finalised 11 December 2020

Interest rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22	Dec-22
Australia								
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.02	0.02	0.02	0.02	0.02	0.04	0.06	0.10
10 Year Bond	0.98	0.95	1.05	1.15	1.25	1.40	1.50	1.70
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.91	0.90	1.00	1.10	1.20	1.30	1.40	1.50

Exchange rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22	Dec-22
AUD/USD	0.7533	0.76	0.78	0.79	0.80	0.82	0.82	0.80
USD/JPY	103.99	104	104	104	104	105	105	105
EUR/USD	1.2145	1.23	1.24	1.25	1.26	1.27	1.28	1.27
GBP/USD	1.3302	1.34	1.36	1.38	1.39	1.41	1.41	1.41
USD/CNY	6.5441	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0620	1.06	1.07	1.07	1.08	1.11	1.11	1.11

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