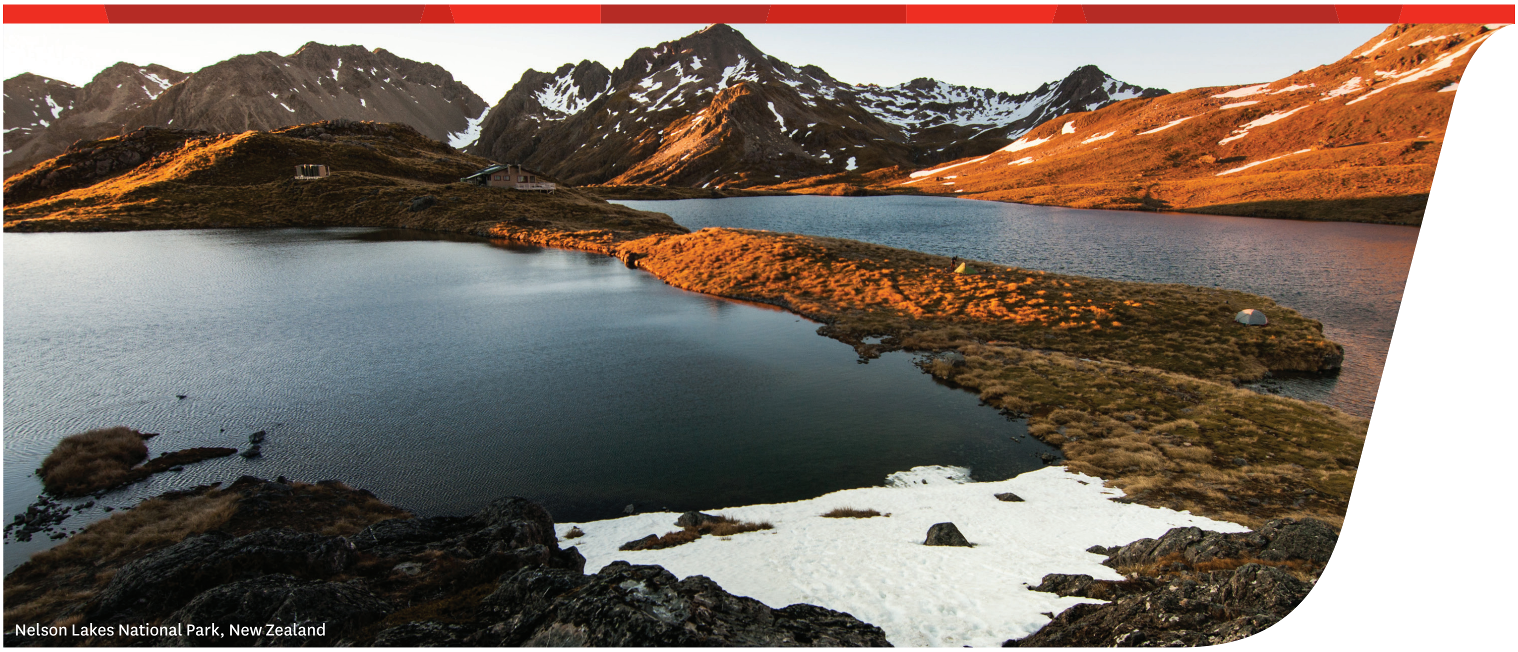


Nelson Lakes National Park, New Zealand

Weekly Economic Commentary.

Up..up..but away.

The New Zealand economy is continuing to grapple with the closure of our borders and downturn in the global economy. But while such headwinds have been a significant drag on GDP, we're actually seeing greater than expected resilience in domestic economic conditions. Since the outbreak of the virus, Westpac's forecasts have consistently been at the less bearish end of the spectrum, and recent developments have been firmer than even we expected. But while this resilience in domestic activity is welcome news, we're still left with an economy that is operating below trend, and that's left inflation lingering at uncomfortably low levels.

Resilience in domestic economic conditions has been seen on several key fronts. It's been particularly evident in the household sector, with retail spending tracking around pre-Covid levels in recent months (save for a modest dip in August when health restrictions were reimposed). But while overall spending is holding up, what we're buying has changed. With overseas holidays off the menu and many families spending more time around the house, New Zealanders have been spending up on appliances, recreational items and household renovations. That's offset reduced spending on entertainment activities and travel.

Reinforcing the resilience in households' spending appetites has been the roaring strength of the housing market. There was a brief drop in prices during the lockdown in March and April, but since then house prices have been rising rapidly and are up by 11% over the past year. Those gains have been widespread and have been underpinned by the dramatic fall in mortgage interest rates in recent months. We're forecasting a further 8% rise in house prices over 2021, with the risks to that forecast skewed firmly to the upside.

Westpac has long highlighted the close link between house prices and interest rates. And while the pickup in the housing market has exceeded even our forecasts, the strength in the housing market has come as a much bigger surprise to other forecasters and the Government. Importantly, as New Zealander's hold a large proportion of their wealth in housing assets, this acceleration in the housing market is likely to underpin continued firmness in spending appetites as we head into the new year.

The labour market has also been resilient. Last week's Employment Indicators report showed that the number of filled jobs rose by 0.7% in September quarter, and has now retraced most of the lockdown-related fall that we saw earlier in the year. As businesses are still reluctant to take on new staff, jobs growth has still lagged increases in the working-age population. As a result, unemployment is likely to have risen – we're expecting that the upcoming HLFS (out this Wednesday) will show that the unemployment rate rose to 5.5% in the September quarter. There's also likely to be some further job losses over the coming months as the Government's job support programmes roll off. Nevertheless, the downturn in the jobs market looks like it will be much less severe than had been feared when Covid first arrived on our shores.

Turning to the business sector, a number of recent surveys point to a post-Covid bounce in domestic economic activity, with businesses reporting a rise in trading activity back to levels that we saw at the start of the year. But as with households spending, conditions across the business sector have been varied. At the head of the pack, those businesses linked to the building industry are reporting strong demand. We've also seen lifts in manufacturing activity and gains in the retail sector. In contrast, there continues to be weakness in parts of the services sector, particularly among those businesses who are reliant on international tourist flows. That's unlikely to change in the near-term, with the opening of our borders still some way off.

Putting this altogether, economic activity still remains below the levels that prevailed prior to the outbreak of Covid-19, mainly due to the loss of international tourist spending. However, the recovery in domestic economic conditions is well on track. Furthermore, it looks like there is a good deal of momentum in domestic demand as we head into the new year.

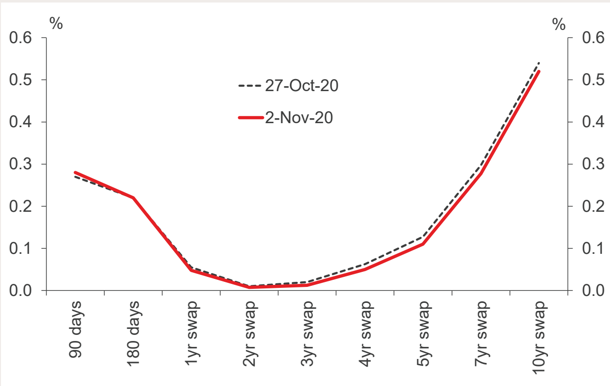
While domestic demand has been picking up, inflation has remained stubbornly low. Annual inflation fell to 1.4% in the September quarter, below our own forecast and the Reserve Bank's estimate. Furthermore, with a full recovery in economic conditions still some way off, we expect that inflation will drop to just 0.2% next year, and there is a real risk of deflation.

The Reserve Bank has pulled out all the stops to boost demand and prevent deflation. However, reducing interest rates in this way tends to increase asset prices, especially in the housing market. We expect that the danger of deflation will remain present for years, so monetary stimulus will be required for some time yet. And that means house prices are also likely to continue charging higher for some time. The circuit breaker will be a lift in inflation. When that happens, the RBNZ will have to lift interest rates, and that is likely to produce a period of declining house prices.

Fixed vs Floating for mortgages.

Fixed mortgage rates in the New Zealand banking system could fall in the near future. Term deposit rates are currently dropping, and that is often a pre-cursor to mortgage rate declines. The Reserve Bank is expected to introduce a Funding for Lending Programme in early November, which could put downward pressure on both fixed and floating mortgage rates. How far interest rates fall will depend on the details of the Reserve Bank's programme, which are not known at this stage.

NZ interest rates



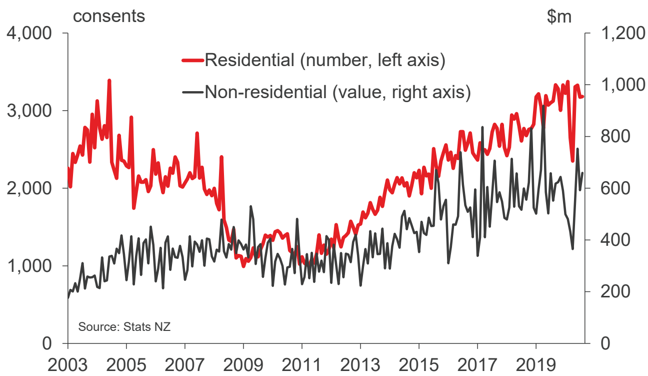
The week ahead.

NZ Sep residential building consents

Nov 2, Last: +0.3%, Westpac f/c: Flat

- The number of residential dwelling consents rose by 0.3% in August. Consent issuance has shown continued resilience in the wake of Covid-19. In fact, except for a brief drop during the Level 4 lockdown, monthly consent issuance has held up at the very strong levels that prevailed prior to the outbreak.
- We expect that the level of consent issuance will remain elevated in September. Strong house price growth and tightness in many regions are supporting demand. Those factors have offset earlier uncertainty around the economic outlook.

NZ building consents

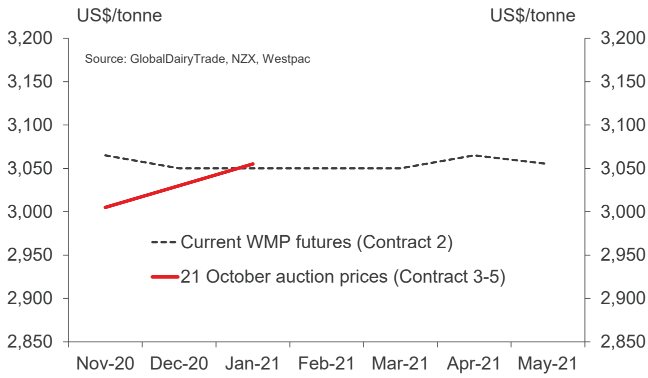


NZ GlobalDairyTrade auction, whole milk powder prices

Nov 4, Last: +0.3% chg, Westpac: Flat

- We expect whole milk powder prices will be largely unchanged at this auction, thus consolidating earlier gains. Prices have risen a cumulative 5% or so over the last two auctions.
- We are marginally more bearish than the dairy futures market. It is pointing to a slightly larger price lift of up to 2% as at the time of writing.
- Global dairy prices continue to prove resilient as evidenced by our 2020/21 milk price forecast upgrade to $7.00/kg following the previous auction. The strength or otherwise of New Zealand production, though, remains a swing factor.

Whole milk powder prices



NZ Q3 Household Labour Force Survey

Nov 4, Employment last: -0.3%, WBC f/c: -0.6%, Mkt f/c: -0.6%
Unemployment rate last: 4.0%, WBC f/c: 5.5%, Mkt f/c: 5.5%

- We expect the unemployment rate to rise to 5.5% for the September quarter, following a surprise drop to 4.0% in the June quarter.
- The previous quarter was understated as the Covid-19 lockdown during April made it impractical for people to actively look for work. More detailed analysis showed that unemployment rose over the course of the quarter.
- Jobseeker benefit numbers continued to rise over the September quarter, albeit more gradually. The rapid elimination of community spread of Covid-19 and extensive government support meant that the impact on the labour market has been much less than initially feared.

Household Labour Force Survey

The week ahead.

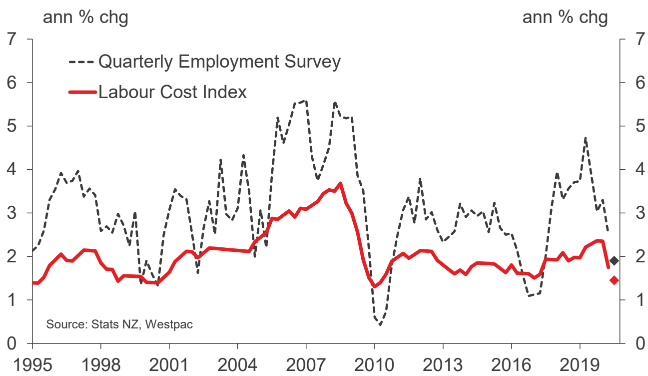
NZ Q3 Labour Cost Index

Nov 4, Private sector last: 0.2%, WBC f/c: 0.3%, Mkt f/c: 0.2%

– We expect the wage measures in both the Labour Cost Index (LCI) and the Quarterly Employment Survey (QES) to be subdued again, with the annual rate of growth slowing sharply.

– Wage increases will have been hard to come by in the post-Covid environment, other than previously agreed increases such as the next stage of the primary school teachers' pay settlement.

LCI and QES salary and wages, all sectors



NZ Nov ANZBO business confidence (flash)

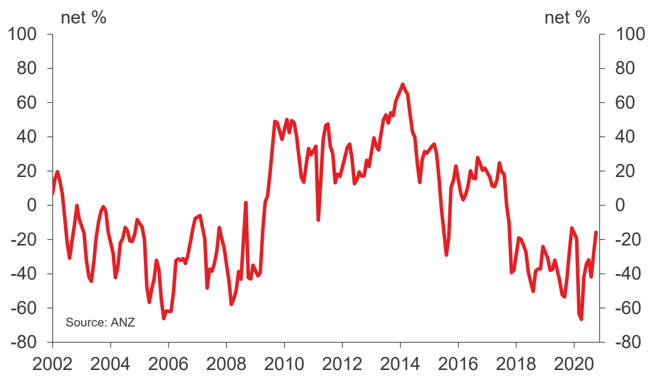
Nov 5, Last: -15.7

– October saw a continued rise in business confidence back to pre-Covid levels. Gauges of business confidence and activity are not at historically strong levels, and businesses are continuing to wrestle with a number of challenges. Nevertheless, a growing number of indicators point to the economy recovering from the outbreak much faster than had been expected.

– Developments over the past few weeks indicate that economic activity is continuing to firm, particularly in sectors that are linked to the housing market. That's likely to be reflected in the November confidence survey.

– While activity is picking up, inflation expectations have remained stubbornly low – a result that will be of particular interest to the RBNZ.

NZ business confidence



NZ Q4 RBNZ survey of expectations

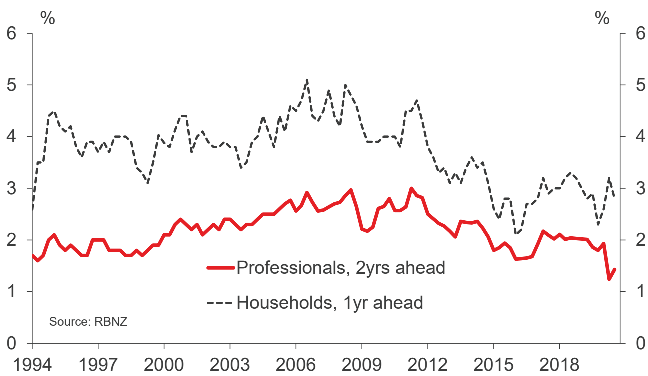
Nov 6, Inflation expectations – 2 years ahead, last: 1.43%

– Inflation expectations fell sharply in the wake of Covid-19. And while there was a modest bounce last quarter, most measures remain at low levels. Notably, the RBNZ's closely watched two years ahead measure has been sitting at 1.4% - well below the mid-point of the RBNZ's target band.

– While activity gauges have been picking up since health restrictions have been eased, pricing gauges have generally remained at low levels. We've also seen CPI inflation surprising to the downside.

– We expect that inflation expectations will remain below 2% in the November survey. Such ongoing softness in inflation expectations will be a key concern for the RBNZ ahead of the November policy meeting.

RBNZ survey of inflation expectations



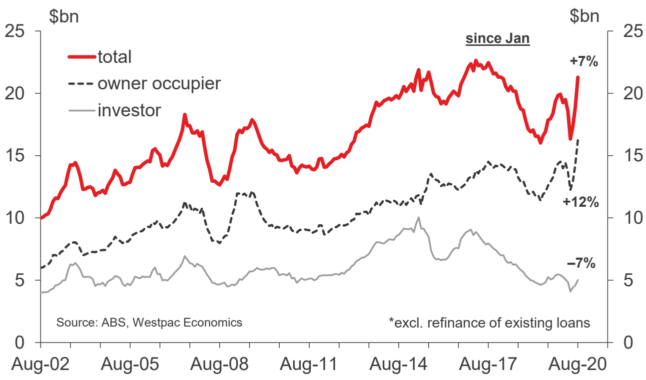
The week ahead.

Aus Sep housing finance approvals

Nov 2, Last: 12.6%, WBC f/c: -2%

- Housing finance approvals surged 12.6% in Aug to be up over 30% in just three months. That followed a 16.3% decline in March-May, quite a mild COVID shock in the scheme of things. Somewhat remarkably, the rebound means the total value of loan approvals is now 9% above its pre-COVID levels.
- Notably, there was not much impact from Vic's 'second wave' lockdown in Aug – Vic approvals instead surging 13.9%. This will undoubtedly show through in Sep although the exact timing and scale of the impact is uncertain and will likely be offset by continued gains elsewhere, the HomeBuilder scheme also providing some support.
- On balance, we expect the total value of approvals to decline 2.0% but clearly there are many moving parts.

New finance approvals*

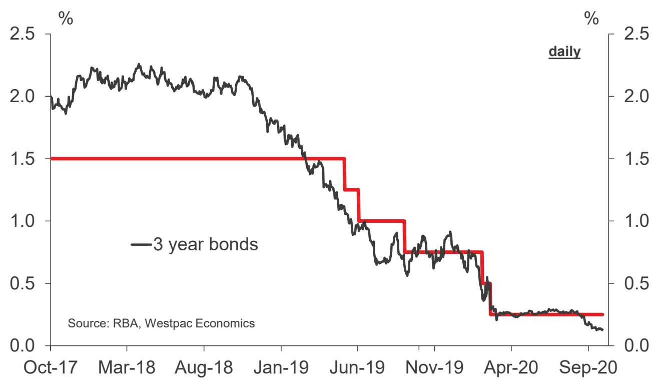


Aus RBA policy decision

Nov 3, Last: 0.25, WBC f/c: 0.10
Mkt f/c: 0.10, Range: 0.10 to 0.25

- The Reserve Bank is set to unveil additional stimulus at the November Board meeting.
- Recall that in March the RBA cut rates and introduced a package of measures as an initial response to the pandemic and the resulting recession. In September, the Bank boosted the Term Funding Facility.
- In November, another package of measures will be unveiled.
- As we indicated in September, we expect the RBA to lower rates, cutting both the cash rate target and the 3 year government bond target from 0.25% to 0.10%. In addition, the Bank will announce an expanded bond buying program, QE, with the aim of lowering rates across the curve, including 5 years to 10 years.

RBA cash rate and 3 year bonds

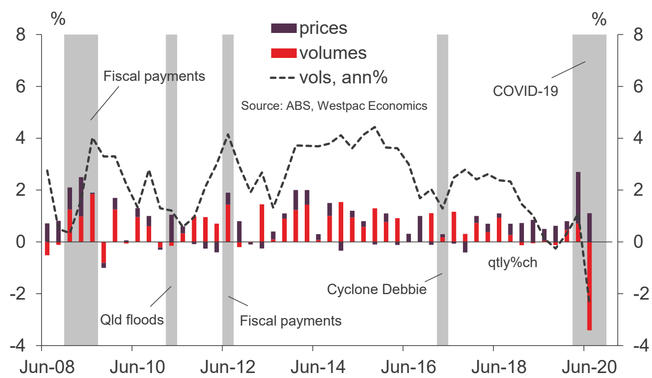


Aus Q3 real retail sales

Nov 4, Last: –3.4%, WBC f/c: 6.0%
Mkt f/c: 6.0%, Range: 2.1% to 6.6%

- The pandemic and lock-downs have generated considerable volatility in the economy - particularly for retail.
- In Q1, the value of retail jumped by 2.7% including a 1.9% surge in prices and a modest 0.7% rise in real sales, with panic buying and hoarding the story of the day.
- In Q2, the value of retail sales fell by 2.3%, including yet another jump in prices, +1.2%, and a 3.4% plunge in turnover with the nation in a partial lock-down.
- For Q3, sales more than recovered - with the value of retailing surging by 6.8%. We anticipate a 0.8% rise in prices and a 6.0% rise in real sales. The end of the lock-down (outside of Victoria) and a redirection of spending away from overseas travel to hardware stores etc is the key theme.

Quarterly retail volumes and prices



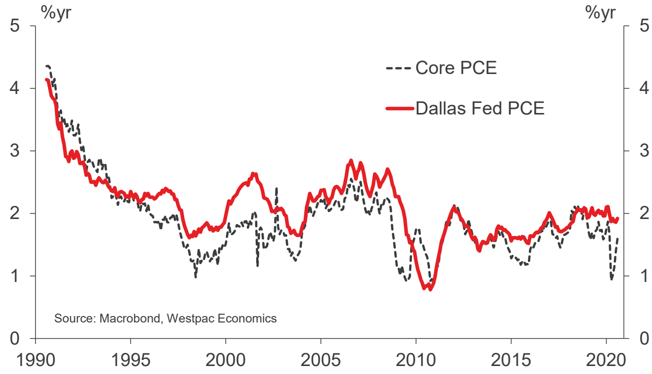
The week ahead.

US Nov FOMC meeting

Nov 4-5

- The November FOMC meeting will occur with the knowledge that GDP rebounded strongly in Q3 following the recession of the first half, but likely before the results of the Presidential and Congressional elections are fully known, and as COVID-19 risks for the US and world continue to mount.
- Our expectation is then that the November meeting communications will focus more on the immense uncertainty before the US and global economy than the gains to date.
- From the inflation and labour market data to hand, there is already a case for additional easing. If the US' own case count countinues to rise further into winter, putting at risk the recovery, and/or Europe's prospects deteriorate further, this will become all the more the case between the November and December meetings.

US inflation

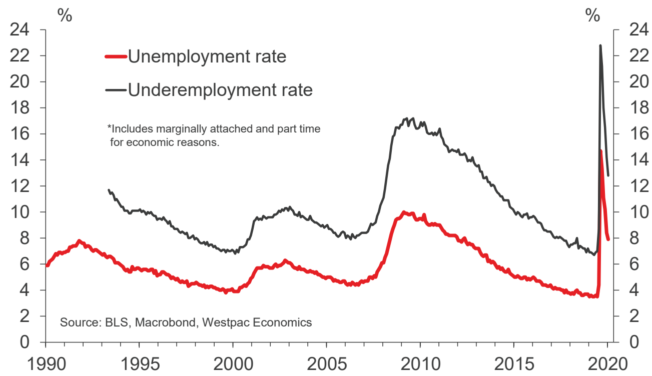


US Oct employment report

Nov 6, nonfarm payrolls, last: 661k, WBC: 570k
Nov 6, unemployment rate, last 7.9%, WBC 7.8%

- Employment growth slowed dramatically in September, while still remaining very strong versus history. An additional step down is anticipated in October, as initial claims continue to point to significant churn in the labour market; support from fiscal policy ebbs; and COVID-19 risks mount yet again.
- Softer momentum in employment, combined with a likely rise in participation, is anticipated to more or less stabilise the unemployment rate at 7.8% in October, though there are clear risks in both directions.
- The historic scale of labour market slack will weigh on hourly earnings in October, and likely for many years to come. A second successive gain of 0.1% is expected in the month.

US unemployment and underemployment

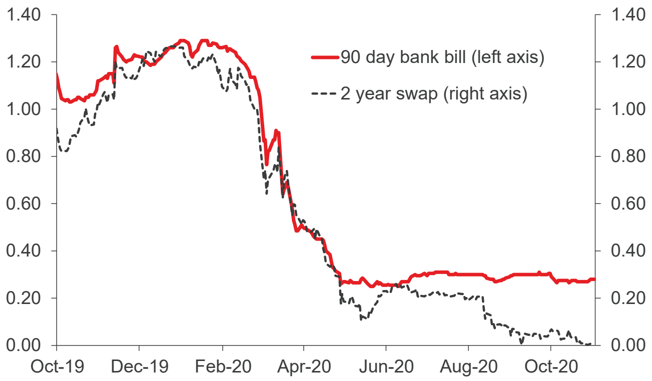


New Zealand forecasts.

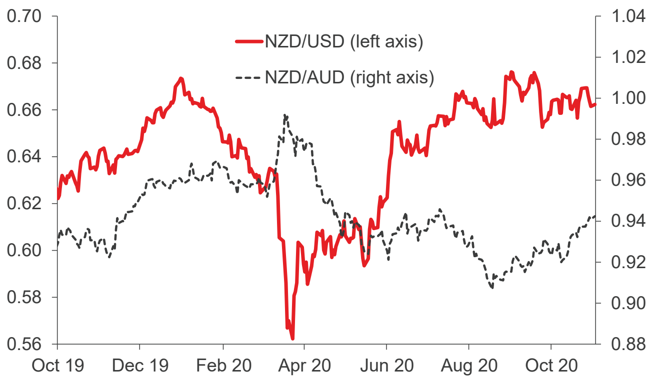
Economic forecasts	Quarterly				Annual			
	2020			2021				
% change	Jun (a)	Sep	Dec	Mar	2019	2020f	2021f	2022f
GDP (Production)	-12.2	8.5	3.7	0.5	2.3	-5.1	6.0	5.1
Employment	-0.3	-0.6	-0.7	-0.3	1.2	-0.5	1.4	3.5
Unemployment Rate % s.a.	4.0	5.5	6.2	6.4	4.1	6.2	6.2	5.4
CPI	-0.5	0.7	0.0	0.1	1.9	1.0	0.5	1.1
Current Account Balance % of GDP	-1.9	-1.2	-1.1	-1.6	-3.4	-1.1	-3.5	-2.9

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	0.25	-0.20	-0.40	-0.40	-0.40	-0.30
2 Year Swap	0.00	-0.10	-0.20	-0.20	-0.20	-0.10
5 Year Swap	0.10	0.10	0.10	0.10	0.15	0.30
10 Year Bond	0.50	0.45	0.45	0.50	0.55	0.80
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	0.51	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 2 November 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.28%
60 Days	0.28%	0.27%	0.26%
90 Days	0.28%	0.28%	0.29%
2 Year Swap	0.01%	0.03%	0.06%
5 Year Swap	0.11%	0.10%	0.14%

NZ foreign currency mid-rates as at 2 November 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6623	0.6610	0.6630
NZD/EUR	0.5683	0.5636	0.5665
NZD/GBP	0.5124	0.5114	0.5131
NZD/JPY	69.23	69.59	69.83
NZD/AUD	0.9424	0.9329	0.9258
TWI	71.49	71.33	71.73

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 02					
NZ	Sep building permits	0.3%	–	0.0%	Consent issuance expected to remain at firm levels.
Aus	Oct CoreLogic home value index	–0.2%	–	0.2%	Melb prices still falling; Sydney flat; others firming.
	Sep dwelling approvals	–1.6%	1.5%	–3.0%	Vic's second lockdown partially offset by gains elsewhere.
	Sep housing finance approvals	12.6%	–	–2.0%	Aug finance approvals well above pre–COVID level...
	Sep owner occ. finance approvals	13.6%	–	–2.0%	... with additional support from HomeBuilder scheme...
	Sep investor finance approvals	9.3%	–	–2.0%	... but Vic's lockdown impact set to hit in Sep.
	Oct AiG PMI (manufacturing)	46.7	–	–	Down 2.6pts in Sep. To rebound as economy reopens.
	Oct MI inflation gauge, %yr	1.3%	–	–	Remains subdued, below the target band.
	Oct ANZ job ads	7.8%	–	–	Employment rebounding from lows supported by reopening.
Chn	Oct Caixin manufacturing PMI	53	52.8	–	Small retreat due to Golden Week.
Eur	Oct Markit manufacturing PMI	54.4	54.4	–	Business activity and confidence to deteriorate.
UK	Oct Markit manufacturing PMI	54.1	53.3	–	Summer's recovery proving fleeting.
US	Oct Markit manufacturing PMI	53.3	53.3	–	Business optimistic despite rising new case count...
	Oct ISM manufacturing	55.4	55.6	–	.... domestic demand the primary support.
	Sep construction spending	1.4%	1.0%	–	Residential construction in strong upturn.
Tue 03					
Aus	RBA policy decision	0.25%	0.10%	0.10%	Rates to be lowered as part of another stimulus package.
US	Sep factory orders	0.7%	0.5%	–	Rebound moderating as transport and electronics ease.
	2020 US Presidential Election	–	–	–	Results expected in AEST afternoon.
Wed 04					
NZ	GlobalDairyTrade auction	0.3%	–	0.0%	Prices consolidating after recent gains.
	Q3 unemployment rate	4.0%	5.5%	5.5%	Understated in Q2 as lockdown hindered job seekers...
	Q3 employment change	–0.3%	–0.6%	–0.6%	...but overall Covid impact has been less than feared.
	Q3 wage inflation (pvt, ord. time)	0.2%	0.2%	0.3%	Wage increases will be hard to come by.
	Oct ANZ commodity prices	–0.2%	–	–	Dairy prices ticked up over October.
Aus	Sep retail sales	–4.0%	–1.5%	–1.5%	Prelim. est's showed soft finish to Q3 but nominal sales still...
	Q3 real retail sales	–3.4%	6.0%	6.0%	... up very strongly, pointing to 6% rebound in vols to >Q1.
	Oct AiG PCI	45.2	–	–	In Sep, up 7.3pts, improved in all states except Victoria.
	Oct 17 Weekly Payrolls, % month	–0.4%	–	–	Victoria was still locked down, other states were stalling.
Chn	Oct Caixin China PMI services	54.8	55	–	Exports and domestic demand remain robust.
Eur	Oct Markit services PMI	46.2	46.2	–	Gov't lockdowns and curfews to hit activity hard.
UK	Oct Markit services PMI	56.1	52.3	–	Customer demand and business expectations to weaken.
US	Oct ADP employment change	749k	738k	–	Service jobs gaining, led by trade and hospitality.
	Sep trade balance US$bn	–67.1	–64.3	–	Largest deficit since '06 seen.
	Oct Markit service PMI	56	–	–	Hope of fiscal stimulus supporting.
	Oct ISM non–manufacturing	57.8	57.5	–	Continues to point to robust growth in services.
Thu 05					
NZ	Nov ANZ business confidence	–15.7	–	–	Domestic activity indicators have been picking up.
Aus	Sep trade balance $bn	2.6	3.8	5.2	To widen, imports pull–back and exports advance.
Eur	Sep retail sales	4.4%	–0.5%	–	Containment measures to halt consumer rebound.
UK	BoE policy decision	0.10%	0.10%	0.10%	Risks continue to mount for UK. BoE to take careful note.
US	Initial jobless claims	751k	–	–	Persistent churn in labour market being seen.
	Q3 productivity	10.1%	3.3%	–	Rose at fastest pace in 11yrs due to strength in output.
	FOMC policy decision, midpoint	0.25%	0.25%	0.25%	Likely to focus on risks instead of rebound to date.
Fri 06					
NZ	Q4 RBNZ inflation expectations	1.4%	–	–	Low actual inflation points to continued softness.
Aus	RBA Statement on Monetary Policy	–	–	–	Growth forecasts to be upgraded.
	Oct AiG PSI	36.2	–		In Sep, –6.3pts crunched by Melbourne lock–down.
US	Oct non–farm payrolls	661k	610k	570k	Hospitality and retail posting gains...
	Oct unemployment rate	7.9%	7.7%	7.8%	... but only half of jobs lost in Mar/Apr have been recovered.
	Sep wholesale inventories	–0.1%	–		Inventories to be rebuilt as demand dictates.

International forecasts.

Economic forecasts (Calendar years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP % yr	2.4	2.8	1.8	-3.3	2.5	3.4
CPI inflation % annual	1.9	1.8	1.8	0.1	1.9	2.1
Unemployment %	5.5	5.0	5.2	7.7	7.5	6.7
Current Account % GDP	-2.6	-2.1	0.6	2.6	0.1	-2.0
United States						
Real GDP %yr	2.4	2.9	2.3	-4.7	3.4	2.7
Consumer Prices %yr	2.1	2.4	1.9	1.1	1.8	1.9
Unemployment Rate %	4.4	3.9	3.7	8.4	6.8	5.8
Current Account %GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
Japan						
Real GDP %yr	2.2	0.3	0.7	-5.3	2.2	1.7
Euro zone						
Real GDP %yr	2.5	1.9	1.2	-7.8	5.4	2.7
United Kingdom						
Real GDP %yr	1.9	1.3	1.4	-11.0	7.0	4.0
China						
Real GDP %yr	6.9	6.8	6.1	2.5	10.5	5.6
East Asia ex China						
Real GDP %yr	4.6	4.4	3.7	-2.6	5.2	4.7
World						
Real GDP %yr	3.9	3.6	2.8	-4.0	6.0	3.8
Forecasts finalised 13 October 2020						

Interest rate forecasts	Latest	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21	Jun–22	Dec–22
Australia								
Cash	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.06	0.04	0.04	0.04	0.04	0.04	0.10	0.15
10 Year Bond	0.84	0.75	0.75	0.75	0.80	0.85	1.00	1.30
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.86	0.70	0.65	0.65	0.70	0.75	0.90	1.10

Exchange rate forecasts	Latest	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21	Jun–22	Dec–22
AUD/USD	0.7035	0.75	0.76	0.76	0.78	0.80	0.80	0.78
USD/JPY	104.53	105	105	106	106	106	107	107
EUR/USD	1.1674	1.21	1.22	1.23	1.24	1.25	1.25	1.24
GBP/USD	1.2927	1.32	1.34	1.35	1.37	1.39	1.40	1.40
USD/CNY	6.7150	6.70	6.65	6.60	6.55	6.50	6.40	6.30
AUD/NZD	1.0616	1.12	1.15	1.15	1.15	1.14	1.14	1.12

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.

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