
Paparoa National Park, New Zealand

Weekly Economic Commentary.

Thanks for the memories.

As 2020 draws to a close, the New Zealand economy has rebounded by more than expected. And heading into the new year, we're seeing signs of solid momentum in domestic activity. That's helping to offset ongoing headwinds in sectors like international tourism. It's also raised questions about how much support the economy will need from monetary and fiscal policy over 2021.

The New Zealand economy is ending 2020 in a stronger position than had been anticipated. The latest GDP figures showed that economic activity rose by 14% in the September quarter as the country moved out of the Covid-19 lockdown. That was stronger than our forecasts for a 13% rise, and higher than either the RBNZ or Treasury were expecting. Plus, with a sizeable upward revision to the previous quarter (a drop of 11% rather than 12.2% as initially estimated), the recovery has been much more comprehensive than expected. In fact, GDP is now slightly above the levels we saw prior to Covid-19.

The faster than expected recovery in activity is more impressive given that we are still wrestling with the closure of the borders, which continues to be felt acutely in sectors like travel services and education. However, balanced against that softness has been firmness in domestically focused parts of the economy like retailing and construction, both of which are up around 9% on pre-Covid levels. That means the domestic economy is more or less running at its full potential.

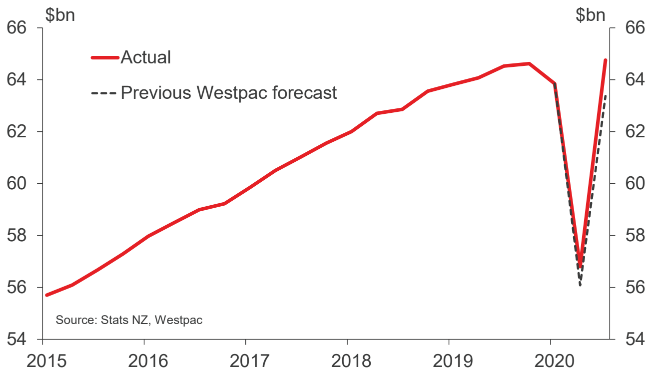
Some of the strength in September quarter GDP was likely due to post-lockdown catch up activity. As a result, it wouldn't be surprising to see a reversal in some areas next quarter. However, we wouldn't expect such quarter-to-quarter swings to derail the broader picture of a strong recovery in New Zealand economic activity. In fact, a range of recent indicators point to ongoing momentum in activity as we head into the new year. That includes firmness in retail spending in the run-up to Christmas and continued strength in housing market. There's also been resilience in the agricultural sector and export prices. And on top of all that, recent weeks have seen encouraging news in terms of vaccine development and potential international travel bubbles. The combination of those factors has given a boost to both consumer and business confidence.

Two big factors have underpinned the New Zealand economy's resilience. First was our success in limiting the spread of Covid-19 on our shores. That put New Zealand in an enviable position compared to many of our peers in the global economy, with domestic activity able to swing back into action rapidly once lockdown restrictions were lifted.

Second has been the boost to demand from both monetary and fiscal stimulus. However, the strength of the economy's rebound does raise questions around how much stimulus is still needed going forward. Indeed, in its recently released Half-Year Economic and Fiscal Update ,the Treasury has scaled back its assumption about the size of the Covid response and recovery programme to around $50bn (down from $58bn in the pre-election update, out of approved funding of $62bn). The programme was a welcome pro-active response at the time it was announced – at around 20% of annual GDP, it was maybe the largest fiscal support package in the world. But with the economy recovering much faster than the Government expected, we think it will be increasingly difficult to find things to spend this money on that could reasonably be labelled a 'Covid response'. Even so, we still expect significant Government spending over the coming years, focused on addressing a range of social issues.

For the Reserve Bank', however, it's not so clear-cut. Its bottom line is whether inflation is on track to meet its mandated target, and stimulating the economy is a means to an end. The stronger performing economy, as well as the recent rise in global oil prices, does point to higher inflation than otherwise. But while the near-term outlook for inflation has firmed, our forecasts still suggest that the RBNZ will still struggle to bring inflation back to 2% over the next couple of years. In addition, the recent good news on the economic front has also led to a sharp rise in the New Zealand dollar, and that will keep a lid on imported inflation.

Level of quarterly GDP



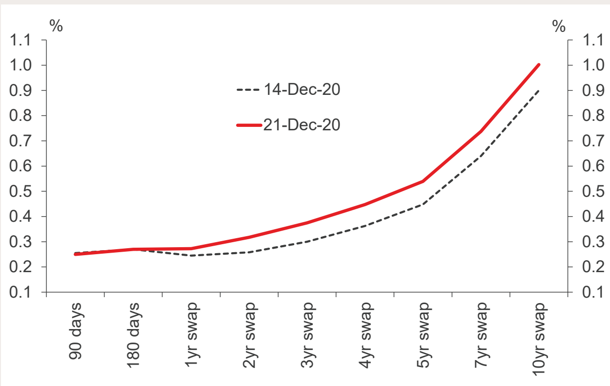
This is our last Weekly Economic Commentary for 2020.
We'd like to wish you all a merry Christmas and a happy New Year!

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



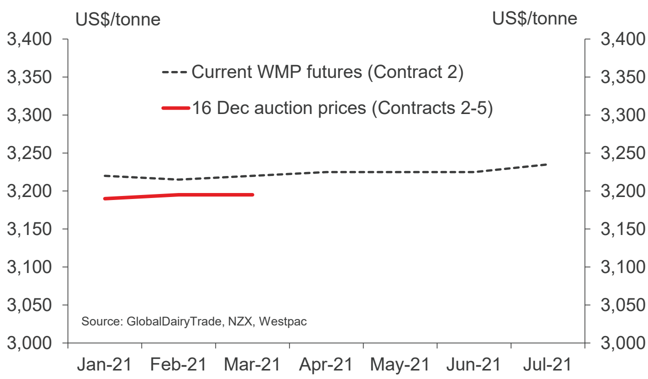
Upcoming data.

NZ GlobalDairyTrade auction, whole milk powder prices

Jan 6, Last: +0.5%, Westpac: Flat

- We expect whole milk powder prices will be unchanged at the upcoming dairy auction. Prices rose 0.5% at the last auction.
- Dairy prices ended 2020 on a high as markets were buoyed on Covid vaccine news.
- Dairy markets are starting to anticipate more normal economic activity and dairy demand over 2020. With little room for supply to respond, the upshot is that prices are likely to move higher over the first half of the year.

Whole milk powder prices

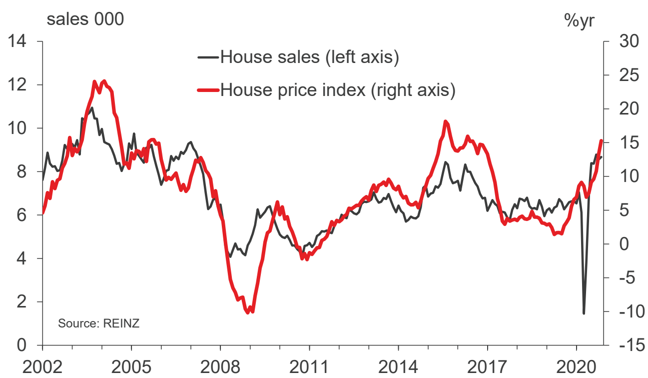


NZ Dec REINZ House Price Index

Jan 15 (TBC), Sales last: +1.3%, Prices last: +15.3%yr

- The housing market has been running red-hot since New Zealand emerged from the Covid-19 lockdown, boosted by record-low mortgage rates. The REINZ house price index rose by 3% in November. That came hot on the heels of a similarly massive increase in October and left prices up 15% over the past year.
- The rapid pace of house price growth has given rise to concerns about affordability and financial stability. The RBNZ has already signalled its intent to reintroduce restrictions on high loan-to-value lending early in the new year. In addition, the Government is looking at other interventions that could cool the housing market. However, with interest rates set to remain low for some time, we expect that the housing market will remain hot over 2021.

REINZ house prices and sales

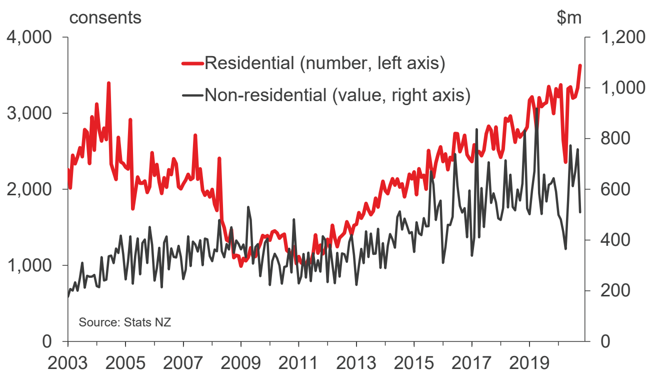


NZ Nov residential building consents

Jan 15, Last: +8.8%, Westpac f/c: -2%

- The number of residential dwelling consents rose by nearly 9% in October. Much of that strength relates to the large number of town houses / medium density consents being issued is Auckland. Medium density consent issuance has been running at very high levels since the economy has exited lockdown.
- While Covid disruptions clouded the outlook for building earlier in the year, strong house price growth and tightness in many regions are supporting continued firmness in home building. Over the past year, 37,981 new dwellings have been consented. That's the highest level in 46 years.
- After strong issuance in recent months, we expect that consent numbers will edge down 2% in November. That would still leave annual issuance at very high levels, signalling a strong construction pipeline as we head into the new year.

NZ building consents

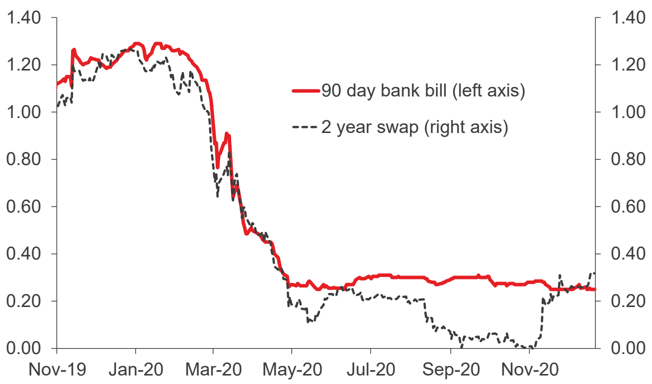


New Zealand forecasts.

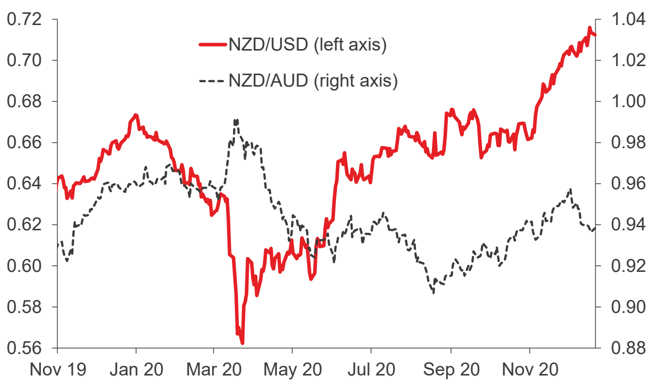
Economic forecasts	Quarterly				Annual			
	2020			2021				
% change	Jun (a)	Sep (a)	Dec	Mar	2019	2020f	2021f	2022f
GDP (Production)	-11.0	14.0	0.0	0.6	2.3	-2.6	5.9	2.5
Employment	-0.3	-0.8	-0.6	0.4	1.2	-0.7	2.3	2.9
Unemployment Rate % s.a.	4.0	5.3	6.0	5.9	4.1	6.0	5.4	5.0
CPI	-0.5	0.7	0.0	0.4	1.9	1.0	1.0	1.3
Current Account Balance % of GDP	-1.8	-0.8	-0.9	-1.2	-3.3	-0.9	-2.1	-2.0

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 21 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%	0.26%
90 Days	0.25%	0.25%	0.25%
2 Year Swap	0.32%	0.26%	0.22%
5 Year Swap	0.54%	0.46%	0.40%

NZ foreign currency mid-rates as at 21 December 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7124	0.7058	0.6927
NZD/EUR	0.5829	0.5813	0.5845
NZD/GBP	0.5303	0.5262	0.5216
NZD/JPY	73.72	73.42	71.93
NZD/AUD	0.9383	0.9506	0.9474
TWI	74.43	74.01	73.57

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 21					
Eur	Dec consumer confidence	–17.6	–	–	Consumer activity hit by lockdowns, but PMIs have held up.
US	Nov Chicago Fed activity index	0.83	–	–	Conditions mixed across nation given restrictions.
Tue 22					
Aus	Nov retail sales (preliminary)	1.4%	2.5%	4.0%	Card activity showed big reopening rebound in Vic.
UK	Nov public sector borrowing £bn	21.6	–	–	Will remain elevated as public sector provides support.
	Q3 GDP	15.5%	–	–	Final estimate to affirm partial rebound from Q2 collapse.
US	Q3 GDP	33.1%	33.1%	–	Final estimate for quarter. Revisions minimal.
	Dec consumer confidence index	96.1	97.5	–	To remain dependent on strength of labour market.
	Nov existing home sales	4.3%	–2.2%	–	Supply remains an issue. Demand well supported.
	Dec Richmond Fed index	15	12	–	Conditions mixed across nation given restrictions.
Wed 23					
US	Nov personal income	–0.7%	–0.3%	–	Personal income growth has weakened sans stimulus.
	Nov personal spending	–0.5%	–0.1%	–	Services spending is being hampered by COVID restrictions.
	Nov PCE deflator	0.0%	0.1%	–	Inflation target of 2% to prove a difficult challenge.
	Oct FHFA house prices	1.7%	0.5%	–	Strong demand and low rates supporting prices.
	Nov new home sales	–0.3%	–0.9%	–	Residential construction beginning long upcycle.
Thu 24					
US	Initial jobless claims	885k	–	–	Highlighting churn and impact of new COVID restrictions.
	Nov durable goods orders	1.3%	0.6%	–	Initial, modest rebound in investment being seen.
Fri 25					
Aus, NZ	Christmas Day	–	–	–	Public holiday
Chn	Q3 current account balance	94.2	–	–	China growth has benefitted from strong external demand.

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	0.99	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	0.93	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	0.7600	0.76	0.78	0.79	0.80	0.82	0.82	0.80
USD/JPY	103.38	104	104	104	104	105	105	105
EUR/USD	1.2247	1.23	1.24	1.25	1.26	1.27	1.28	1.27
GBP/USD	1.3532	1.34	1.36	1.38	1.39	1.41	1.41	1.41
USD/CNY	6.5400	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0660	1.06	1.07	1.07	1.08	1.11	1.11	1.11

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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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