

Weekly Economic Commentary.

On the road to recovery.

Business conditions are picking up. However, inflation remains low and more stimulus will be required from the RBNZ. We expect the RBNZ will announce a Funding for Lending Programme for banks at next month's Monetary Policy Statement. That would reduce mortgage rates and term deposits, and would add even more fuel to the housing market rocket-ship.

After slumping during the lockdown of the economy earlier in the year, New Zealand businesses have reported a strong rebound in trading conditions through the September quarter. The September Quarter Survey of Business Opinion (QSBO) showed that the number of businesses reporting an increase in trading activity rising to its highest level in two years. That is consistent with activity rebounding as Covid activity restrictions gradually rolled back over the quarter.

While economic activity may be picking up, sectors of the economy are moving at different speeds. At the head of the pack, retailers and building firms are reporting a solid increase in demand and forward orders. There has also been a lift in manufacturing activity. In contrast, businesses in the services sector are still reporting that trading conditions remain soft. That's likely to reflect the loss of international

tourist spending, as well as the recent mini (Auckland) lockdown. Those factors have been a particular drag on hospitality sector businesses.

Also, understandably, businesses remain nervous about the economic outlook. Consequently, while plans for capital spending have lifted after last quarter's Covid-induced fall, they generally remain at low levels in most sectors (the notable exception being the building sector, where plans for capital expenditure have been dialled up again). Meanwhile, hiring remained muted through the September quarter, but firms are signalling that they are planning to restart hiring over the months ahead.

All up, these data continue to paint the picture of an economy that has been impacted by Covid, but less severely than first



feared. If anything, the sectors of the economy unaffected by the border closure are effectively back running at or around their pre-Covid levels.

And New Zealand is not alone in this regard. As discussed in our recently released October *Market Outlook*,¹ we have made broad revisions to our global growth forecasts. Our world economy growth forecast for 2021 now stands at 6.0%, compared to 5.8% in September and 5.0% back in August.

This better than expected global growth is being reflected in global food prices. Case in point is the milk price. Last week, we revised our 2020/21 milk price forecast up by 50 cents to \$7.00/kg of milk solids. Notably, Chinese household spending growth, including demand for dairy products, has rebounded stronger and sooner than we expected, prompting the revision.

Turning to broader inflation, the September quarter reading saw annual inflation fall to 1.4% from 1.5% back in June. However, the bigger story in the data was a material undershoot versus expectations. We had pencilled in an annual increase of 1.6%, while the market and the RBNZ had 1.7% and 1.9%, respectively.

Moreover, it appears that the downward pressure on inflation is not going to let up any time soon. The QSBO also showed that most businesses are still signalling downward pressure on output prices. The notable exception is the retail sector, where there has been a sharp rise in the number of businesses who are planning on increasing their prices. That chimes with anecdotes of stock shortages in some sectors (like household appliances) and is also consistent with reports of a solid lift in domestic sales in recent months for durable items. However, competitive pressures are still likely to be a brake on the extent of price rises over the coming months.

With the above in mind, the RBNZ needs to pull out all the stops to stimulate the economy in order to prevent a further fall in inflation to levels below its target range. In short, the loss of the tourism sector means that the RBNZ needs to engineer a massive lift in other sectors, if we are to avoid a serious shortfall of demand that causes deflation. The measures the RBNZ has taken to date – including cutting the OCR to 0.25%, the introduction of the large scale asset purchase program, and removal of loan-to-value-restrictions – have provided the economy with a powerful shot in the arm. We continue to expect the RBNZ to announce a Funding for Lending Programme (FLP) for banks, aimed at driving interest rates even lower, at next month's *Monetary Policy Statement*. And we continue to expect that the OCR will be cut to -0.5% next April.

We have lowered our forecasts of Bank Bill rates and swap rates. We expect that the Reserve Bank will detail the FLP at the November 11 *Monetary Policy Statement*. If the FLP is introduced, one consequence will be that the spread between Bank Bills (the rate at which banks lend to one another) and the OIS curve (expectations of the future OCR) will drop almost to zero (this spread is usually about 20bps). Since swap rates are priced off Bank Bill rates, swap rates would also fall. It is worth noting that markets already anticipate the introduction of an FLP, so much of the decline in Bank Bill rates and swap rates has already happened.

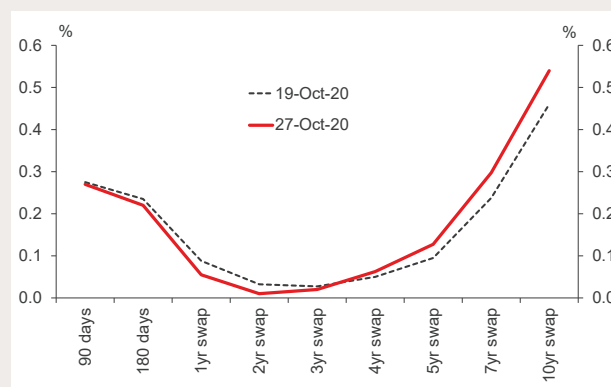
The FLP will reduce mortgage rates and term deposits via this decline in swap rates, and also directly by reducing bank funding costs. Lower mortgage rates would add even more fuel to the housing market rocket-ship, so we may have to upgrade our house price forecast to something higher than the current 6.3% for 2020 and 8% for 2021.

¹ Available here: https://westpaciq.westpac.com.au/wibiqauthoring/_uploads/file/Australia/2020/October/WestpacMarketOutlookOctober2020.pdf

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 employment indicators

Oct 28, Last: +0.3%

- The monthly employment indicator is a relatively new release, based on data from income tax filings. It provides a less detailed but more timely snapshot of employment trends compared to the quarterly surveys.
- Filled jobs fell sharply in April during the Covid-19 lockdown, but quickly bounced back to their previous levels. However, they have fallen short of population growth in that time, which implies rising unemployment.
- The raw data published by Stats NZ on a weekly basis suggests that filled jobs were broadly flat in September. Covid restrictions were temporarily raised in mid-August but the impact on business activity appears to have been limited.

NZ Employment Indicator filled jobs

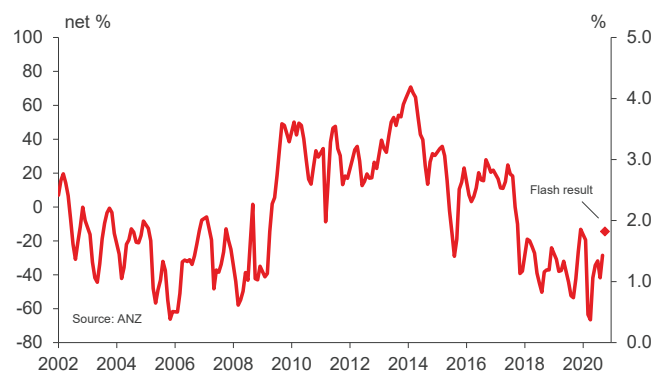


NZ Oct ANZBO business confidence (final)

Oct 29, Last: -28.5, flash October result: -14.5

- The flash business outlook report for October showed 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.
- We are not expecting much change when the final result for October is released. The general election did occur during the survey period, but it is not expected to have had any large impact on the survey.

NZ business confidence



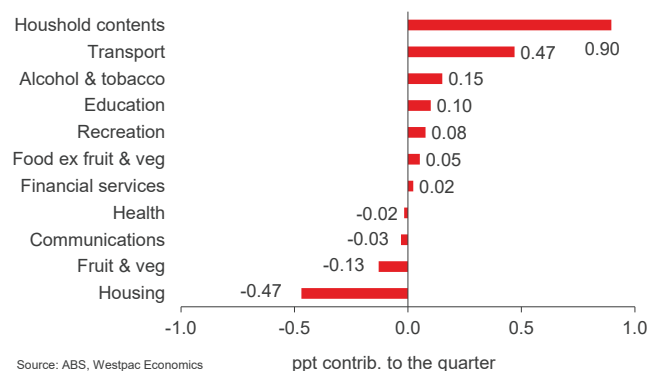
Aus Q3 Consumer Price Index %qtr

Oct 28, Last: -1.9%, WBC f/c: 1.1%

Mkt f/c: 1.6%, Range: 0.5% to 2.1%

- The June quarter CPI fell -1.9%, the largest quarterly fall in the 74-year history of the CPI. As broadly expected the main sources of the collapse was free child care (-95%, -1.13ppt), falling automotive fuel (-19.3%, -0.62ppt) and a fall in pre-school and primary education (-16.2%, -0.16ppt) with free pre-school being provided in NSW, Vic and Qld. Excluding these three components, the CPI would have risen 0.1%.
- Westpac is forecasting a 1.1% jump in the CPI which will lift the annual rate to 0.3% from -0.3%. The trimmed mean is flat in Q3 with base effects taking the annual pace down to 0.8% from 1.2%yr, a new record low for this measure of core inflation.
- Driving the bounce in the CPI is the 1,400% surge in childcare as the subsidy is unwound in all states except Victoria. HomeBuilder grants are providing something of an offset.

Contributions 2020 Q3 CPI 1.1%qtr forecast



The week ahead.

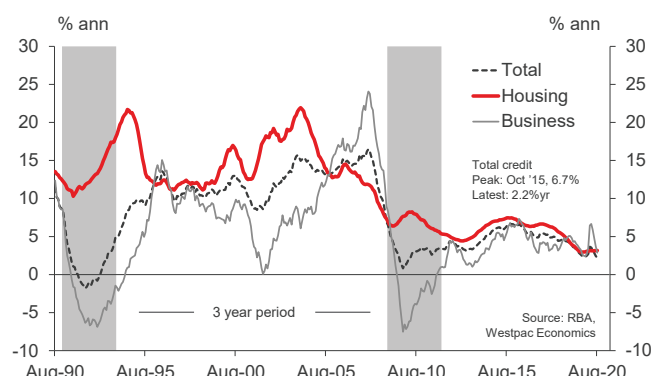
Aus Sep private credit

Oct 30, Last: -0.03%, WBC f/c: -0.1%

Mkt f/c: 0.1%, Range: -0.1% to 0.5%

- Credit to the private sector is contracting with the prospect of further falls as the Covid recession reduces the appetite for debt. We anticipate a -0.1% for September, which would see annual growth slow to 1.8%.
- Businesses are in survival mode and the economy is awash with excess capacity. That has firms looking to cut non-essential spending and reduce borrowings. Credit to the sector fell in each of the past four months, down 2.3% in total.
- Personal credit, 5% of total credit, plunged by a record 12.5% over the past year. Here too, weakness is set to continue.
- Housing credit in the 3 months to August grew by only 2.7% annualised. A turning point has been reached with new lending rebounding sharply from the low of May. That saw credit growth edge higher in August (+0.24% following a +0.21% in July) with further upside in coming months.

Aus credit: annual growth slips below 2¼%

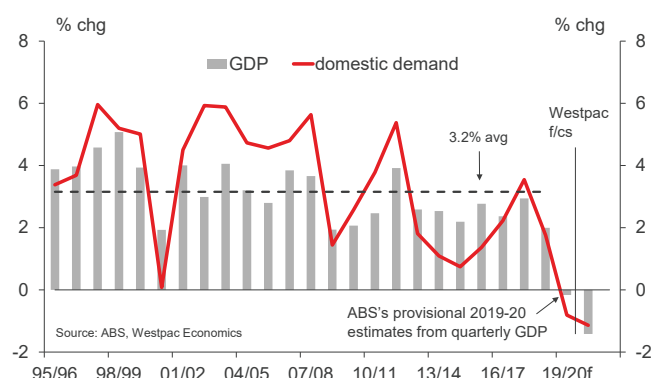


Aus 2019–20 national accounts

Oct 30, Current estimate: -0.2%

- The June quarter national accounts confirmed a deep recession over the first half of 2020. The annual national accounts provide new 'benchmark' estimates of income, expenditure, production and balance sheets with more detail on sectors, industries and aspects such as productivity.
- The annual re-benchmarking can lead to significant revisions to previously published estimates - revisions that only get incorporated into the quarterly GDP data with the Q3 release in early December. These can be most pronounced for areas that rely on annual survey sources where quarterly indicators are unavailable, such as consumer spending on services.
- Note that the quarterly GDP figures currently have growth for the full 2019–20 year at -0.2%/yr - milder than the through the year contraction (i.e. June quarter on June quarter last year) of -6.3%/yr. Revisions will not alter the fact of the recession but may see changes to its estimated depth and complexion.

Australia: annual economic performance

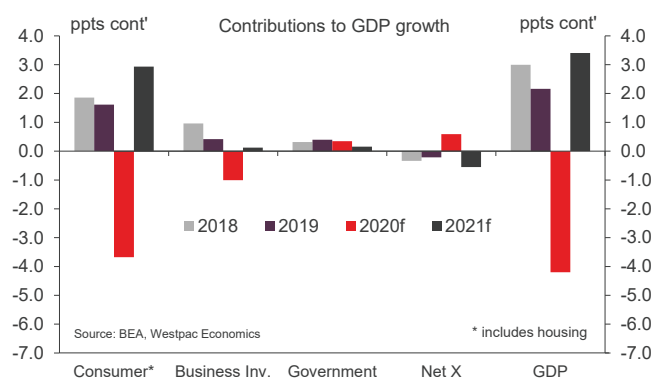


US Q3 GDP

Oct 29, last %ann'd: -31.4%, WBC: 27.9%

- US GDP is expected to bounce back strongly in Q3, rising by 28% on an annualised basis. This will however still leave US GDP 4.5% lower than at the end of 2019.
- Leading the recovery is household demand, particularly consumption. As has been the case worldwide, US households have increased goods purchases, particularly through online channels, while services consumption has been restricted. Residential construction has also bounced back strongly.
- Business investment meanwhile has remained weak, with the outlook still clouded by uncertainty. With many of the goods consumed imported, net exports should be an outright negative in Q3.
- To fully recover the activity lost, additional meaningful fiscal stimulus is a must.

US Q3 GDP rebound will partially retrace H1 loss

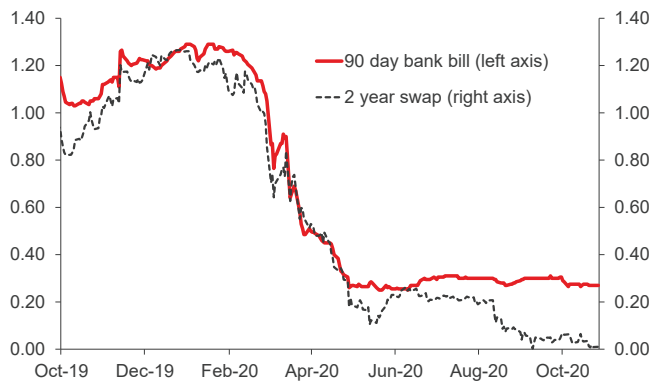


New Zealand forecasts.

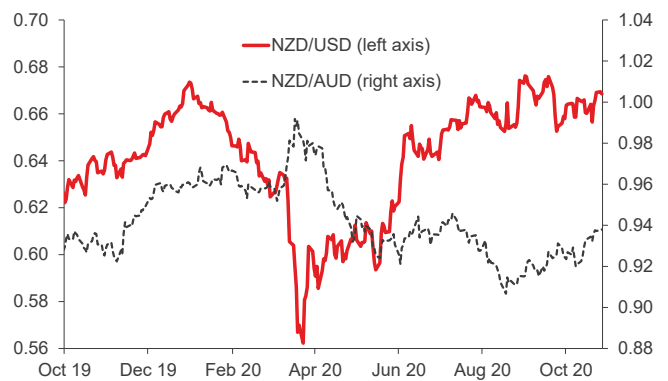
Economic forecasts	Quarterly				Annual			
	2020	2021			2019	2020f	2021f	2022f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	-12.2	8.5	3.7	0.5	2.3	-5.1	6.0	5.1
Employment	-0.3	-2.2	-1.2	-0.2	1.2	-2.6	1.1	3.3
Unemployment Rate % s.a.	4.0	5.5	6.2	6.6	4.1	6.2	6.5	5.6
CPI	-0.5	0.7	0.0	0.1	1.9	1.0	0.5	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 27 October 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.28%	0.28%
60 Days	0.27%	0.28%	0.29%
90 Days	0.27%	0.28%	0.30%
2 Year Swap	0.01%	0.03%	0.04%
5 Year Swap	0.13%	0.11%	0.11%

NZ foreign currency mid-rates as at 27 October 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6685	0.6653	0.6542
NZD/EUR	0.5658	0.5635	0.5628
NZD/GBP	0.5132	0.5108	0.5119
NZD/JPY	70.09	70.41	69.05
NZD/AUD	0.9380	0.9224	0.9304
TWI	71.97	71.46	71.28

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Tue 27					
NZ	Sep trade balance \$m	-353	-	-1017	Export values softer after bumper August.
Chn	Sep industrial profits %yr	19.1%	-	-	Stronger domestic and external demand aiding profits.
Eur	Sep M3 money supply %yr	9.5%	-	-	Prospect of more asset purchases as second wave hits.
US	Sep durable goods orders	0.5%	1.0%	-	Momentum moderating as transport, machinery orders slow.
	Aug FHFA house prices	10%	0.7%	-	Up 6.5%yr, demand supported by low rates.
	Oct consumer confidence index	101.8	101.9	-	15.5pt gain highest in 17yrs; but uncertainty lingers.
	Oct Richmond Fed index	21	18	-	Buoyed by increases in new orders.
Wed 28					
NZ	Sep employment indicators	0.3%	-	-	Weekly data points to broadly flat jobs growth in Sept.
Aus	Q3 CPI %qtr	-1.9%	1.6%	1.1%	A 1,400% rise in childcare, lift in fuel prices & before/after...
	Q3 CPI %yr	-0.3%	1.0%	0.3%	... school care is offset but HomeBuilder grant & falling...
	Q3 CPI trimmed mean %qtr	-0.1%	0.5%	0.0%	... rents. More broadly there is very little inflationary...
	Q3 CPI trimmed mean %yr	1.2%	1.3%	0.8%	... pressure as consumption growth is narrowly focused.
UK	Oct Nationwide house prices	0.9%	-	-	Structural effects of working from home supporting prices.
US	Sep wholesale inventories	0.4%	-	-	Durables and autos leading rise, still down 5.2%/yr.
Thu 29					
NZ	Oct ANZ business confidence	-14.5	-	-	Business conditions have been firming.
Aus	Q3 import price index	-1.9%	-2.0%	-2.0%	Lower as AUD rebounds, offsetting higher fuel prices.
	Q3 export price index	-2.4%	-3.5%	0.6%	Commodity prices up, outweighing impact of higher AUD.
Eur	Oct economic confidence	91.1	89.6	-	Deterioration of growth outlook starting to hit sentiment...
	Oct consumer confidence	-15.5	-	-	... as business and consumer caution weighs on demand.
	ECB policy decision	-	-	-	Expected to highlight risks and capacity to act.
UK	Sep net mortgage lending £bn	3.1	4.0	-	Stamp duty holiday (ends March '21) driving demand.
US	Initial jobless claims	787k	-	-	Still elevated, highlighting persistent churn.
	Q3 GDP	-31.4%	32.0%	27.9%	Strong recovery from largest contraction ever seen.
	Sep pending home sales	8.8%	3.5%	-	Record high as low mortgage rates fuel housing rally.
Fri 30					
NZ	Oct ANZ consumer confidence	100	-	-	Lingering nervousness in the household sector.
Aus	Sep private sector credit	-0.05	0.1%	-0.1%	Led lower by business & personal. Housing lifting from lows.
	Q3 PPI	-1.2%	-	-	Higher fuel costs offset by stronger AUD & soft demand.
	2019-20 annual national accounts	-	-	-	Annual re-benchmarking can see significant revisions.
Eur	Sep unemployment rate	8.1%	8.3%	-	Increase in spite of temporary benefits & less restrictions.
	Q3 GDP	-11.8%	9.4%	9.0%	Largest contraction on record; uplift expected for Q3.
	Oct CPI %yr	0.1%	0.1%	-	Lingering demand shock to persist as cases surge.
US	Sep personal income	-2.7%	0.3%	-	Fell after Federal jobless benefits expired.
	Sep personal spending	1.0%	1.0%	-	Food and healthcare spending up, durables down.
	Sep PCE core deflator	0.3%	0.2%	-	Temporary upward pressure from vehicles moderating.
	Q3 employment cost index	0.5%	0.6%	-	Wage growth expected to remain modest.
	Oct Chicago PMI	62.4	58.5	-	Production and new orders posting monthly gains.
	Oct Uni. of Michigan sentiment	81.2	81.2	-	Rebound facing headwinds in absence of federal stimulus.
Sat 31					
Chn	Oct manufacturing PMI	51.5	-	-	Rise in overseas demand complimenting domestic gains...
	Oct non-manufacturing PMI	55.9	-	-	... recovery now broadening to smaller firms.

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	0.7124	0.75	0.76	0.76	0.78	0.80	0.80	0.78
USD/JPY	104.87	105	105	106	106	106	107	107
EUR/USD	1.1822	1.21	1.22	1.23	1.24	1.25	1.25	1.24
GBP/USD	1.3083	1.32	1.34	1.35	1.37	1.39	1.40	1.40
USD/CNY	6.6851	6.70	6.65	6.60	6.55	6.50	6.40	6.30
AUD/NZD	1.0679	1.12	1.15	1.15	1.15	1.14	1.14	1.12

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