



Weekly Economic Commentary.

Vaccines ready to roll.

With vaccines ready and rolling out soon, financial market sentiment has turned bullish. Equities, commodities and currencies like the New Zealand dollar are all on the up. Financial markets also see less need for the Reserve Bank to cut the OCR. We disagree. We still expect OCR cuts next year, albeit less of them and later than we previously thought.

Covid vaccines are ready and they are rolling out soon. First cab off the rank is the Pfizer BioNTech vaccine, after the announcement that the UK government has given the vaccine its approval and will begin vaccinations as soon as Tuesday. The US and other countries are not far behind.

The vaccine news has buoyed financial markets. They are taking the view that the vaccine approvals and rollout will give the world economy a real shot in the arm (pun intended). Notably, equity and commodity markets have rallied. Oil prices and copper prices, for example, have jumped over recent weeks, while US share indices such as the Dow Jones have cracked record high levels.

This improved financial market sentiment has also started to flow through to New Zealand commodity markets. Last week's dairy auction saw prices lift across the board. Overall prices gained 4.3%, with whole milk powder prices up a solid 5%.

This result has reaffirmed our milk price forecasts of \$7.00/kg for both this season and next. And Fonterra now agrees with our view. On Friday, the Co-operative narrowed its forecast range to \$6.70/kg - \$7.30/kg, meaning that the forecast range midpoint also lifted 20 cents to \$7.00/kg.

However, the improved market sentiment has also lifted the New Zealand dollar. In fact, the New Zealand dollar has a head of steam up and we expect that this momentum will see the NZD/USD hitting 0.74 by the middle of next year. If this view proves correct, gains in New Zealand commodity prices will be tempered, if not offset, by the stronger New Zealand dollar.

In a similar vein, financial markets now think that further Official Cash Rate (OCR) cuts are unnecessary. However, we disagree. We have run an assessment of what would happen if the Reserve Bank kept monetary settings unchanged next



year. Inflation would be significantly lower than otherwise and would remain below 2% for much longer. Inflation expectations would drop even further, raising the risk of deflation. Unemployment would remain higher for longer. And the exchange rate would rise into the mid-to-high-70s against the USD.

We judge that these outcomes would be unacceptable to the Reserve Bank. The only silver lining would be a slower and more drawn-out episode of house price inflation, but that wouldn't be enough to compensate for the extra unemployment and risk of deflation.

We do acknowledge the recent letter from the Minister of Finance to the Reserve Bank Governor asking the Bank to consider excessive house price volatility within its remit. But we think that this development will only manifest in a more cautious Reserve Bank, rather than a change away from the Bank's inflation focus. In other words, we think that the Reserve Bank as it moves to take into account housing as part of its remit will then deliver slower and later cuts in the OCR.

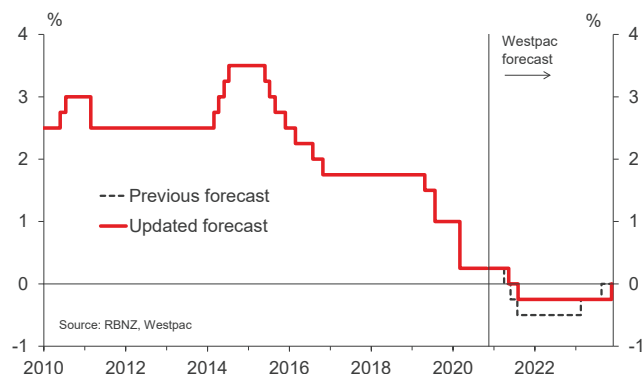
On this basis, we have adjusted our OCR forecast. We now expect just two 25 basis point OCR cuts, with one in each of May and August 2021, taking the OCR down to -0.25. This forecast compares with our previous call for three earlier cuts that would have taken the OCR down to -0.50%.

We have long been of the view that reducing the OCR below zero would be the Reserve Bank's unconventional monetary policy tool of choice, after the expiry of the one-year commitment to keep the OCR at 0.25%. We still think that a negative OCR is more likely than any other tool, but other options now look like more of a possibility.

With the exchange rate set to rise much higher than we previously anticipated, adding foreign bonds to the Large Scale Asset Purchases programme (which would directly reduce the exchange rate) is starting to look more like a sensible alternative option. The other advantage is that foreign bond purchases don't have an obvious "front page" link to the housing market.

Another alternative option would be for the Reserve Bank to expand the Funding for Lending Programme (FLP) further. The advantage would be that the FLP is already an established tool, so there is less risk of unanticipated consequences. But we are not convinced that increasing the size of the FLP would have much effect on interest rates – it is more the presence of any FLP that is going to cause term deposit rates and wholesale funding rates to come down, thereby reducing bank funding costs.

Official Cash Rate

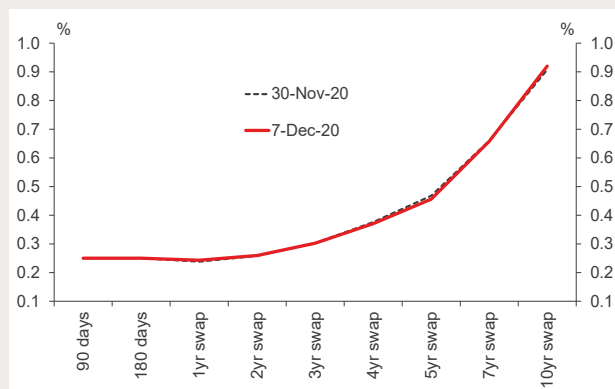


Fixed vs Floating for mortgages.

There could be a small decline in floating mortgage rates in the near future, because the Reserve Bank will soon introduce its 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



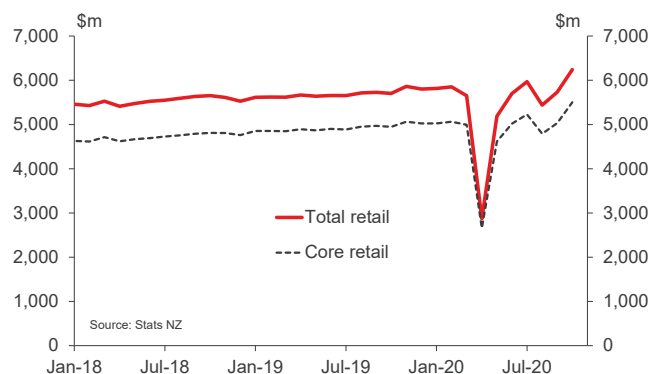
The week ahead.

NZ Nov Retail Card Spending

Dec 10, Last: +8.8%, Westpac f/c: -0.3%

- Retail spending rose by 8.8% in October. That followed a strong 5.4% gain in September and took spending above pre-Covid levels. Spending appetites have been buoyed by the combination of low interest rates, a resurgent housing market and significant fiscal spending. Together, those factors have given household demand a powerful shot in the arm.
- We expect a modest 0.3% pull back in spending in November. That reflects that much of the rise in spending last month was related to durables spending, which can be lumpy on a month to month basis. A result in line with our forecast would still leave spending at firm levels.
- Black Friday / cyber Monday sales signal some upside risk to our forecast.

Card transactions



NZ Nov REINZ House Price Index

Dec 11 (TBC), Sales last: -4.5%, Prices last: +13.5%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 has risen by almost 10% in the last five months; October alone saw a 3% increase.
- Turnover is close to its 2007 highs, although it dipped in October. The number of listed homes dropped to new record lows in November, which highlights the strength of demand but could itself crimp the pace of sales.
- Last month the Reserve Bank announced that it would reimpose its restrictions on high loan-to-value ratio lending from March next year, although banks have already adopted these settings. That could see some cooling in activity from December, but we expect that low interest rates will continue to be the main driver of prices.

REINZ house prices and sales

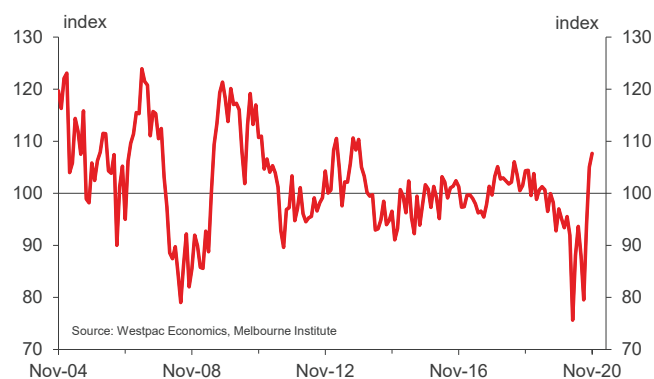


Aus Dec Westpac-MI Consumer Sentiment

Dec 9, Last: 107.7

- Consumer sentiment lifted a further 2.5% to 107.7 in Nov, extending the very strong rebound since August to be up 35% in three months, taking the index to a seven year high. The key development has been the containment of the COVID outbreak in Victoria which culminated in a significant relaxation in restrictions in early Nov.
- Importantly, the Nov survey was completed before other positives emerged, particularly around prospective COVID vaccines. Sentiment in Dec may also be influenced by: a further easing in restrictions domestically, particularly on inter-state travel; confirmation that the economy started to recover in the September quarter after recording a sharp contraction in the first half of the year; more signs of a strengthening and broadening upturn in housing markets; but mixed news from abroad including worsening COVID outbreaks in the US. However, the positive news on vaccines has dominated financial markets, the S&P500 surging 4.5% since the Nov survey.

Consumer Sentiment Index

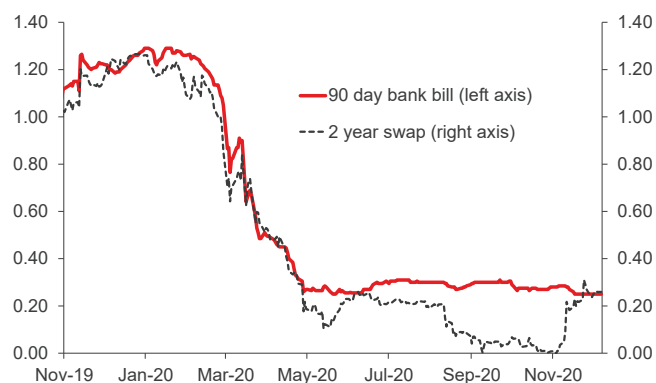


New Zealand forecasts.

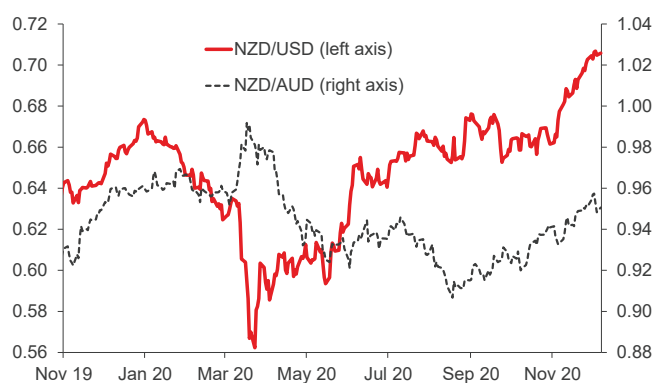
Economic forecasts	Quarterly				Annual			
	2020			2021				
% change	Jun (a)	Sep	Dec	Mar	2019	2020f	2021f	2022f
GDP (Production)	-12.2	12.0	1.0	1.3	2.3	-4.2	6.1	3.0
Employment	-0.3	-0.8	-0.6	0.1	1.2	-0.7	1.7	3.4
Unemployment Rate % s.a.	4.0	5.3	6.0	6.2	4.1	6.0	6.0	5.2
CPI	-0.5	0.7	0.0	0.1	1.9	1.0	0.6	1.6
Current Account Balance % of GDP	-1.9	-1.4	-1.7	-2.4	-3.4	-1.7	-4.1	-4.0

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	0.73
NZD/AUD	0.95	0.95	0.94	0.94	0.93	0.91
NZD/JPY	73.8	75.6	77.4	78.4	78.4	78.1
NZD/EUR	0.60	0.60	0.60	0.61	0.60	0.58
NZD/GBP	0.54	0.55	0.56	0.57	0.58	0.57
TWI	75.1	75.7	76.1	76.6	76.0	74.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 7 December 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.27%
60 Days	0.26%	0.26%	0.28%
90 Days	0.25%	0.25%	0.29%
2 Year Swap	0.26%	0.22%	0.04%
5 Year Swap	0.46%	0.40%	0.14%

NZ foreign currency mid-rates as at 7 December 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7058	0.6927	0.6782
NZD/EUR	0.5813	0.5845	0.5705
NZD/GBP	0.5262	0.5216	0.5154
NZD/JPY	73.42	71.93	70.00
NZD/AUD	0.9506	0.9474	0.9337
TWI	74.01	73.57	72.17

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 07					
Aus	Nov AiG PSI	51.4	-	-	Oct saw 15pt jump and first >50 read since Nov 2019.
	RBA Governor Lowe	-	-	-	Keynote address to Australian Payments Network
	Nov ANZ job ads	8.1%	-	-	Strong reopening rebound underway but still down 16%yr.
Chn	Nov trade balance USDbn	58.44	53.75	-	Exports benefitted materially from US/Euro demand in '20.
	Nov foreign reserves \$bn	3127.98	3150.00	-	Has trended down since the peak in August.
Eur	Dec Sentix investor confidence	-10	-	-	Pressured by concerns of a "double-dip" growth profile.
Tue 08					
Aus	Nov NAB business survey	1	-	-	Vic-drove Oct 'pop' in confidence. Activity back to pre-covid.
Eur	Dec ZEW survey of expectations	32.8	-	-	Vaccine news a positive, but growth headwinds persist.
	Q3 GDP	12.6%	12.6%	-	Q3 final est; Q4 expected to see another contraction.
US	Oct consumer credit	16.214	18.000	-	Auto-loan and credit-card debt leading the recovery.
	Nov NFIB small business optimism	104	102.5	-	In limbo until more clarity on fiscal/outbreaks/vaccine.
Wed 09					
Aus	Dec WBC-MI Consumer Sentiment	107.7	-	-	Sentiment hit a 7yr high in Nov even before vaccine news.
Chn	Nov PPI %yr	-2.1%	-1.8%	-	Persistently low factory-gate price growth...
	Nov CPI %yr	0.5%	0.0%	-	... translating into consumer prices.
US	Oct JOLTS job openings	6436	6300	-	Job openings recovering; considerable churn apparent.
Thu 10					
NZ	Nov card spending	8.8%	-	-0.3%	A modest pullback after last month's surge in durables.
Aus	Dec MI inflation expectations	3.5%	-	-	Has recovered from recent lows.
	RBA Bulletin	-	-	-	Showcasing the RBA's latest research.
Chn	Nov M2 money supply %yr	10.5%	10.5%	-	Accommodative financial conditions...
	Nov new loans, CNYbn	689.8	1450.0	-	... supporting elevated money supply and loan growth.
	Nov foreign direct investment %yr	18.3%	-	-	Running well above pre-COVID levels.
Eur	ECB policy decision	0.0%	0.0%	-	Expect size/duration of PEPP and TLTRO to be extended.
UK	Oct trade balance £bn	613	350	-	Progressively moderated since peak in May.
US	Nov CPI	0.0%	0.1%	-	To remain a concern for the Fed in months/ years ahead.
	Initial jobless claims	712k	-	-	Clear signal to be provided post Thanksgiving.
	Nov monthly budget statement	-284.1	-	-	Monthly deficit has narrowed, but remains historically wide.
Fri 11					
NZ	Nov manufacturing PMI	51.7	-	-	Business conditions have been firming.
	Nov food price index	-0.7%	-	-	Annual inflation running at about 3%.
	Oct REINZ house prices %yr	13.5%	-	-	Due this week. Low mortgage rates are boosting prices.
	Oct REINZ house sales	-4.5%	-	-	Sales have surged and listings are at record lows.
US	Nov PPI	0.3%	0.1%	-	Food/energy components have supported headline PPI.
	Dec Uni. of Michigan sentiment	76.9	76.3	-	Expectations component likely to see a boost from vaccine.
	Fedpeak	-	-	-	Quarles to discuss bank supervision (04:40 AEDT).

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP %/yr	2.4	2.8	1.8	-2.7	4.2	3.2
CPI inflation %/yr	1.9	1.8	1.8	0.9	2.1	1.9
Unemployment rate %	5.5	5.0	5.2	7.0	6.0	5.2
Current account % of GDP	-2.6	-2.1	0.6	2.0	-0.8	-3.0
United States						
Real GDP %/yr	2.3	3.0	2.2	-3.6	3.1	2.2
CPI inflation %/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 % 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	2.2	1.7
Euro zone						
Real GDP %/yr	2.6	1.8	1.3	-8.3	3.1	3.0
United Kingdom						
Real GDP %/yr	1.9	1.3	1.5	-11.3	5.7	5.0
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	-2.9	4.9	4.7
World						
Real GDP %/yr	3.8	3.5	2.8	-3.8	5.3	4.0

Forecasts finalised 4 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	0.02	0.06	0.10
10 Year Bond	1.00	0.85	0.95	1.05	1.15	1.25	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	0.80	0.90	1.00	1.10	1.20	1.40	1.50

Exchange rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22	Dec-22
AUD/USD	0.7430	0.75	0.76	0.78	0.79	0.80	0.80	0.78
USD/JPY	103.90	104	105	106	106	106	107	107
EUR/USD	1.2145	1.20	1.20	1.21	1.22	1.24	1.25	1.25
GBP/USD	1.3450	1.34	1.34	1.36	1.38	1.39	1.40	1.40
USD/CNY	6.5377	6.60	6.55	6.50	6.45	6.40	6.30	6.20
AUD/NZD	1.0520	1.07	1.07	1.10	1.11	1.13	1.13	1.11

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