

Nelson Lakes National Park, New Zealand

Weekly Economic Commentary.

Change in the mix.

We expect that this week's Monetary Policy Statement will reveal a change in tone from the Reserve Bank. That's due to the run of stronger economic data over the past few months than the RBNZ had factored in back in August.

Case in point was last week's labour market update. The September quarter data showed a lift in the unemployment rate to 5.3%, from 4% for the June quarter. While that was a material lift, the 5.3% reading compares to the RBNZ's August forecast of 7%.

Moreover, we anticipate that job losses have since continued to slow significantly, and thus the unemployment rate is starting to top out. In fact, the peak in the unemployment rate in the aftermath of Covid may not be much more than 6%. This likely peak presents a stark comparison to the RBNZ's (August) forecast peak of 8.1% that it had pencilled in for end of the year.

Housing market data have also surprised to the upside. While house prices did fall as expected over April and May, they then stabilised and have risen sharply in recent months. Back in August, the RBNZ forecast that house prices would fall 7% over the year. Now, house prices are on track to lift around 9% for the year!

While activity in the parts of the economy that are still 'open' is running considerably stronger than the RBNZ expected, the border closures continue to drag on. Indeed, with overall economic activity still significantly down, the outlook for inflation remains very weak. On that basis, extraordinary monetary support will still need to remain in place for an extended period.

The RBNZ is also facing two conundrums. The first is that it is running out of bonds to purchase for its Large Scale Asset Purchase programme (LSAP). Specifically there is a risk that the Bank ends up owning too many bonds for the bond market to function properly (or becomes illiquid). And the second conundrum is that a rapid rise in house prices is not a 'good look' during what is still a tough economic time for much of the New Zealand population.

To get around these issues, we expect the RBNZ to announce the introduction of a Funding for Lending Programme



(FLP) this week. Essentially, the FLP is cheap loans for New Zealand's banks, but we expect clear incentives to be included for banks to on-lend these loans to businesses. In that sense, the FLP is likely to be of a similar ilk to the RBA's programme. The programme is likely to have a start date of 1 December or 1 January.

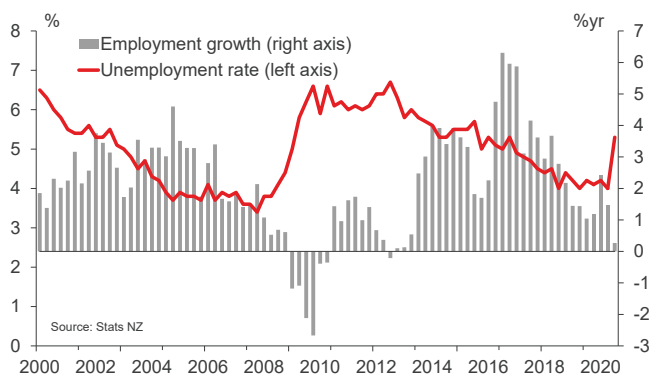
In addition, we still expect the RBNZ to cut the OCR below 0% next year, but at a more gradual pace than the 'big bang' cut we had factored in previously. As such we have pencilled in OCR cuts of 25 basis points for April, May and August, taking the OCR down to -0.50%.

As the FLP and OCR cuts take effect, the RBNZ will be able to slow the pace of bond purchases under its quantitative easing programme or LSAP. Importantly as the Bank makes this transition, it will be aiming to do so without creating a lift in interest rates. With that in mind, next week's announcement and the likely subsequent policy changes next year represent a switch of monetary tools, rather than a change or increase in the pace of monetary stimulus.

It also pays to point out that this switch represents a subtle shift in policy towards a period of prolonged monetary policy support. Previously the RBNZ had indicated a bias towards front-loading stimulus in order to push interest rates even lower in the short term.

The last leg of the trilemma is that we expect the Bank to announce the reintroduction of loan-to-value ratio restrictions (LVRs) next year, very much focused on property investors. While the announcement may come early next year, the restrictions won't come into effect until 1 May as the RBNZ has previously committed to not reintroduce the LVRs until then. In this way, the Bank will be able to demonstrate that while it stimulates the broader economy via monetary policy, it is still keeping one eye on any emerging distortions or overheating of the housing market.

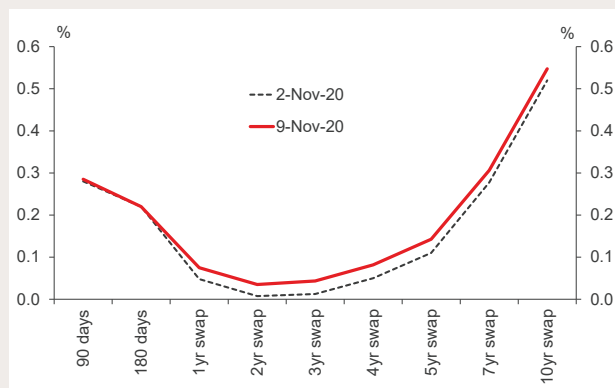
Unemployment rate and employment growth



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 announce a Funding for Lending Programme this week, 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



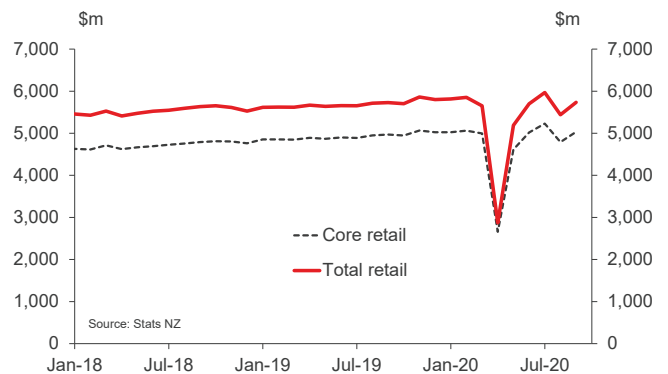
The week ahead.

NZ Oct retail card spending

Nov 10, Last: +5.4%, Westpac f/c: +3%

- Retail spending rose 5.4% in September. That rise followed the easing in lockdown conditions that restrained spending in August. September saw particular strength in spending on durable items like household furnishings, a result that was likely boosted by the strength of the housing market.
- We expect a further 3% rise in spending through October. Weekly spending gauges point to ongoing firmness in durables spending. That's helping to offset the more gradual recovery in hospitality spending and continuing drag from the closure of the borders.

Card transactions

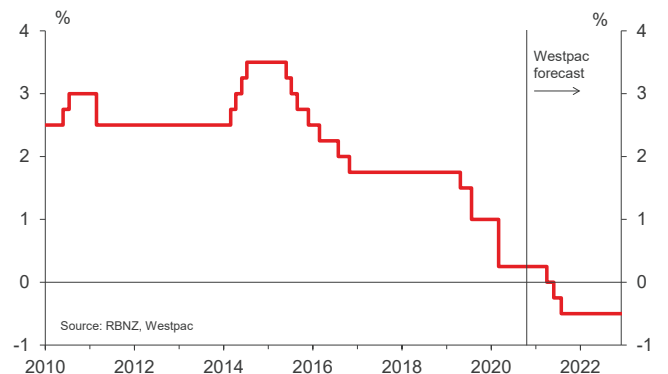


NZ RBNZ monetary policy decision and policy statement

Nov 11, Official Cash Rate: 0.25%, Westpac f/c: 0.25%, Market 0.25%

- We expect the RBNZ's November policy statement will be less dovish than markets expect with the economy proving to be far more resilient to Covid-19 than anticipated. The key message will be that the RBNZ intends to keep interest rates low for a prolonged period, rather than pushing rates lower. However, the mix of tools the RBNZ is using to keep rates low is changing over time.
- We now expect 25bp OCR cuts in April, May and August next year (previously we had expected one 75bp cut in April).
- We expect a Funding for Lending Programme (FLP) will be announced. It will be small and targeted at business lending. We expect no official change to the LSAP to be announced. However, as the FLP and negative OCR take effect, the pace of LSAP bond purchases will be gradually reduced in a switch of monetary tools.

RBNZ Official Cash Rate



NZ REINZ House Price Index

Nov 13 (TBC), Sales last: +4.0%, Prices last: +11.1%yr

- The housing market is on a tear, fuelled by record low mortgage rates. Sales in September reached their highest levels since early 2007, and the REINZ House Price Index has risen by 6.3% in just the last four months.
- Indicators for October point to continued strength in house prices. Meanwhile, the strong pace of sales meant that the stock of unsold homes has fallen to its lowest on record going back to 2007.
- The resurgent housing market will give the RBNZ pause for thought about further measures to drive interest rates lower. Restrictions on high loan-to-value loans are also likely to be reintroduced from May next year.

REINZ house prices and sales



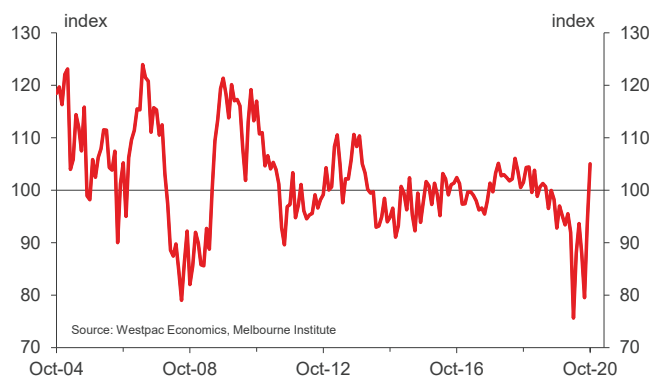
The week ahead.

Aus Nov Westpac-MI Consumer Sentiment

Nov 11, Last: 105.0

- Consumer sentiment surged a further 11.9% in Oct to be up 32% in the space of two months, the Index hitting a 15 month high of 105. Sentiment was boosted by a well-received Federal Budget, ongoing success in containing the COVID outbreak locally, and rising expectations that the RBA would take further measures to lower interest rates. Remarkably, the Oct read is 1.6% above the average over the six months prior to virus shocks and came despite official confirmation that Australia had experienced its first recession since 1992.
- While some of the Budget-related boost to sentiment may have faded a month on, local developments have again been mostly positive. Vic's restrictions have eased further as cases remain contained. The RBA also delivered on promised further easing, cutting target rates to 0.1% and announcing a \$100bn govt bond purchase program. News on the economy has been mostly positive as well. However, offshore, COVID outbreaks have worsened materially in Europe and the US, and the US Presidential election was hanging in the balance at the time of the survey.

Consumer Sentiment Index

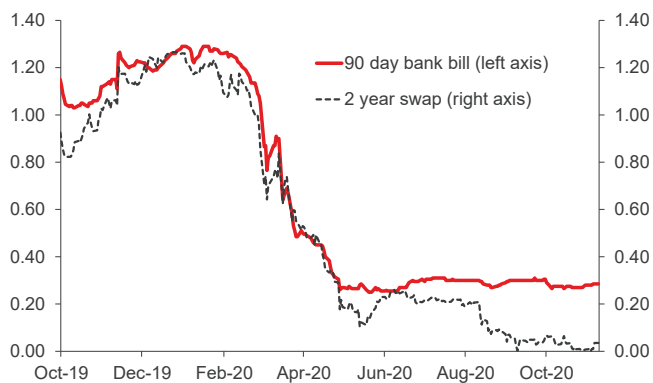


New Zealand forecasts.

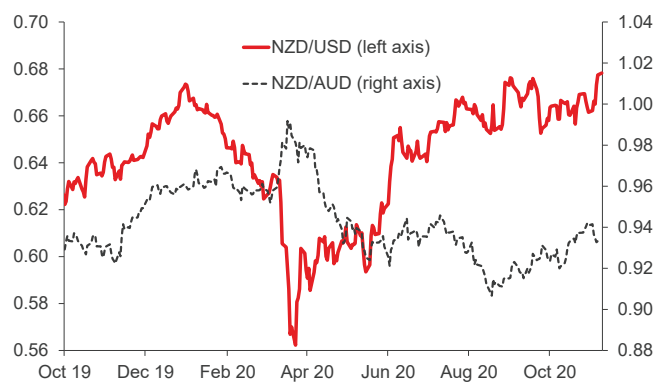
Economic forecasts	Quarterly				Annual			
	2020	2021			2019	2020f	2021f	2022f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	-12.2	8.5	3.7	0.5	2.3	-5.1	6.0	5.1
Employment	-0.3	-0.8	-0.6	0.1	1.2	-0.7	1.6	3.4
Unemployment Rate % s.a.	4.0	5.3	6.0	6.2	4.1	6.0	6.0	5.2
CPI	-0.5	0.7	0.0	0.1	1.9	1.0	0.5	1.1
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	-0.25	-0.50	-0.50	-0.50
90 Day bill	0.25	0.05	-0.30	-0.40	-0.40	-0.40
2 Year Swap	0.00	-0.10	-0.20	-0.20	-0.20	-0.15
5 Year Swap	0.10	0.05	0.00	0.00	0.00	0.15
10 Year Bond	0.50	0.50	0.55	0.65	0.75	0.85
NZD/USD	0.69	0.69	0.69	0.69	0.70	0.70
NZD/AUD	0.92	0.91	0.91	0.88	0.88	0.88
NZD/JPY	72.5	72.5	73.1	73.1	74.2	74.9
NZD/EUR	0.58	0.58	0.57	0.57	0.57	0.56
NZD/GBP	0.53	0.52	0.51	0.51	0.51	0.50
TWI	73.4	72.9	72.5	71.8	72.2	71.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 9 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%	0.28%
90 Days	0.29%	0.27%	0.28%
2 Year Swap	0.04%	0.01%	0.03%
5 Year Swap	0.14%	0.13%	0.11%

NZ foreign currency mid-rates as at 9 November 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6782	0.6685	0.6653
NZD/EUR	0.5705	0.5658	0.5635
NZD/GBP	0.5154	0.5132	0.5108
NZD/JPY	70.00	70.09	70.41
NZD/AUD	0.9337	0.9380	0.9224
TWI	72.17	71.97	71.46

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 09					
Eur	Nov Sentix investor confidence	-8.3	-	-	Virus resurgence to stall recovery in business confidence.
US	Fedspeak	-	-	-	FOMC's Mester to speak at Fintech Conference.
Tue 10					
NZ	Oct card spending	4.8%	-	3.0%	Firm housing market supporting durables demand.
Aus	Oct NAB business conditions	0	-	-	Oct survey to capture Budget reactions & reopening impacts.
Chn	Oct PPI %yr	-2.1%	-1.9%	-	Sustained price decline for means of production.
	Oct CPI %yr	1.7%	0.8%	-	Marked slowdown in food prices; core CPI weak.
Eur	Nov ZEW survey of expectations	52.3	-	-	Morale to slip as lock-downs batter economic activity.
UK	Sep ILO unemployment rate	4.5%	4.7%	-	Extension of wage subsidy a big positive.
US	Oct NFIB small business optimism	104	104.2	-	Diverse conditions across the states.
	Sep JOLTS job openings	6493	6500	-	Hires; fires; quits and job openings.
	Fedspeak	-	-	-	FOMC's Quarles, Rosengren and Kaplan to speak.
Wed 11					
NZ	RBNZ policy decision	0.25%	0.25%	0.25%	Funding for lending programme likely to be announced.
Aus	Nov Westpac Consumer Sentiment	105.0	-	-	Above pre-COVID levels in Oct after big two month surge.
Thu 12					
NZ	Sep net migration	1133	-	-	Border restrictions will keep the balance near zero.
Aus	Nov MI inflation expectations	3.4%	-	-	Dropped -1ppt during COVID but not falling further.
Eur	Sep industrial production	0.7%	0.9%	-	Economic recovery shows signs of slowing.
	ECB Forum	-	-	-	ECB's Lagarde, BoE's Bailey, Fed's Powell speaking.
UK	Sep trade balance €bn	1364	-	-	External demand a headwind.
	Q3 GDP	-19.8%	15.8%	-	A big bounce to be followed by another contraction.
US	Oct CPI	0.2%	0.2%	-	2.0%yr inflation to be a long time in coming.
	Initial jobless claims	751k	-	-	Remain elevated, signalling churn.
	Fedspeak	-	-	-	FOMC's Evans will speak.
Fri 13					
NZ	Oct REINZ house prices %yr	11.1%	-	-	Due this week. Low interest rates have fuelled prices...
	Oct REINZ house sales	4.0%	-	-	... and the stock of unsold homes has hit record lows.
	Oct manufacturing PMI	54.0	-	-	Manufacturing conditions have firmed in recent months.
	Oct food price index	-1.0%	-	-0.4%	Annual food price inflation running at about 3%.
Chn	Oct M2 money supply %yr	10.9%	10.9%	-	Central bank stepping up efforts to support the economy.
	Oct new loans, CNYbn	1900	720	-	Jump in corporate loans points to a recovery in demand...
	Oct foreign direct investment %yr	25.1%	-	-	... and a broader stabilisation in trade.
Eur	Sep trade balance €bn	21.9	-	-	Surplus widened as fall in exports outpaced imports.
	Q3 GDP	12.7%	12.7%	-	2nd estimate to confirm strength in post-first wave rebound.
US	Oct PPI	0.4%	0.2%	-	Upstream price pressures to remain weak.
	Nov Uni. of Michigan sentiment	81.8	82.0	-	Sentiment has lagged activity in bounce.

International forecasts.

Economic forecasts (Calendar years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP % yr	2.4	2.8	1.8	-3.3	2.3	3.4
CPI inflation % annual	1.9	1.8	1.8	0.6	1.6	2.1
Unemployment %	5.5	5.0	5.2	7.5	7.5	6.6
Current Account % 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
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	-5.8	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 6 November 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	0.76	0.70	0.70	0.70	0.75	0.80	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	0.76	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	0.7254	0.75	0.76	0.76	0.78	0.80	0.80	0.78
USD/JPY	103.70	104	105	106	106	106	107	107
EUR/USD	1.1803	1.19	1.20	1.21	1.22	1.24	1.25	1.25
GBP/USD	1.3118	1.31	1.33	1.35	1.37	1.38	1.40	1.40
USD/CNY	6.6065	6.60	6.65	6.50	6.45	6.40	6.30	6.20
AUD/NZD	1.0721	1.09	1.10	1.10	1.13	1.14	1.14	1.11

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