



Paparoa National Park, New Zealand

Weekly Economic Commentary.

Don't call it a comeback.

The New Zealand economy has started 2021 on firm footing. GDP has retraced its earlier declines, and recent indicators point to solid momentum in the early part of 2021. However, while economic activity is on the rise, inflation is still missing in action.

In contrast to most of our peers in the global economy, economic activity in New Zealand has already retraced its pre-Covid level. That's in large part due to our effective control of the virus on our shores, which has meant that most domestic economic activity can continue unencumbered. On top of that, extremely supportive monetary and fiscal stimulus has super-charged demand in some key parts of the economy, helping to offset continued headwinds in sectors like international tourism.

The resulting strength in demand has been seen most clearly in the housing market, with last week's update from REINZ showing that prices rose 17% in the year to December. Prices have risen strongly across all regions in recent months, with the largest increases seen in the lower North Island. The continued strength of the housing market is particularly notable given that banks began to tighten up on investor lending back in November. The Reserve Bank has signalled that it intends to reimpose loan-to-value ratio restrictions

from March this year, but the major banks have already adopted the proposed restrictions for investors. We think the current episode of house price inflation has a way to run yet. House prices are being driven by low interest rates, which are set to stay low or fall further over the coming year. In fact, our models point to a further 12% rise in house prices over 2021.

With the housing market continuing to charge upwards, we're also seeing related strength in other parts of the economy. Most notably, we're seeing a boom in residential construction activity, with last week's update on consent numbers showing that issuance is at its highest level since 1974 (and that's in spite of the slowdown in net migration and population growth). On top of that, we're continuing to hear anecdotes of solid retail spending through the summer months.

Against this backdrop, economic confidence has also been on the rise. Late last year, our own Westpac McDermott Miller consumer confidence index picked up again after falling



through mid-2020. Similarly, the December ANZBO business outlook survey (released just before Christmas) also showed that business sentiment has picked up. Importantly, that lift in business confidence has underpinned a rise in plans for both hiring and investment spending after they fell to very low levels in mid-2020.

The next major read on economic activity and business conditions will be Tuesday's Quarterly Survey of Business Opinion. We expect that the closely watched gauges of domestic trading activity and business confidence will continue to rise, consistent with a further strengthening in activity in the early part of 2021.

But while overall conditions in the New Zealand economy have continued to firm, it is still an uneven recovery. Strength has been heavily centred on the construction sector and those parts of the retail sector catering to local consumers. However, those businesses who are closely linked to international tourism continue to struggle with the closure of our borders. That's been felt particularly acutely in areas like Queenstown and Auckland. And with a resurgence in infection numbers in many countries, the risks are tilted towards the borders remaining shut for even longer even as vaccine roll outs begin.

While activity has picked up rapidly, keeping inflation on target remains the missing piece of the puzzle. For the December quarter CPI (out this Friday) we expect a flat outcome for the quarter, which would see annual inflation slow to 1.0% - right at the bottom of the RBNZ's target band.

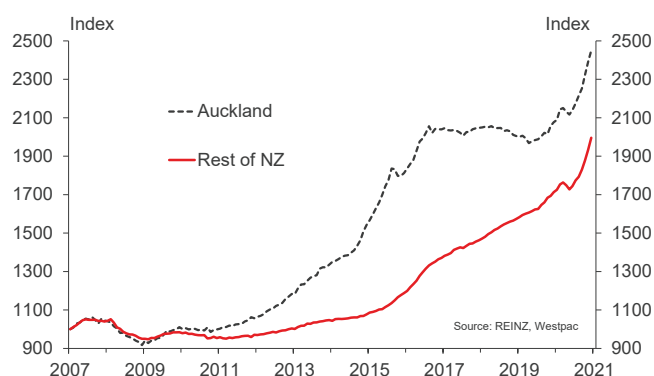
The December quarter is usually a soft one, mainly due to seasonal declines in food prices. Normally that's partly offset by rising travel-related prices during the summer holiday period, but we expect less of that this time. Overseas airfares, which would normally rise sharply at this time of year, have been largely excluded from the CPI, and while we expect some increase in domestic airfares and car rentals, it will be less than usual.

The well-publicised disruptions to imports are the main uncertainty around our forecast. We haven't seen widespread evidence of outright price increases as a result of supply shortages, but this could manifest instead as an absence of discounting. We've already made a small allowance for this in our forecast, but the risks are still to the upside.

Looking to the months ahead, the near-term risks for inflation are to the upside as a result of the disruptions to international supply chains and recent poor weather locally that's likely to push the prices of some fresh produce higher. Consistent with those factors, we've already seen a sharp increase in the number of business who are planning to increase their prices.

But while the above factors might push inflation higher for a period, any impact would be temporary and is likely to be reversed as supply conditions normalise. And as such disruptions pass, we expect that we'll be left with a very benign picture of underlying inflation pressures, especially given the rise in the New Zealand dollar and very low level of inflation expectations.

House prices

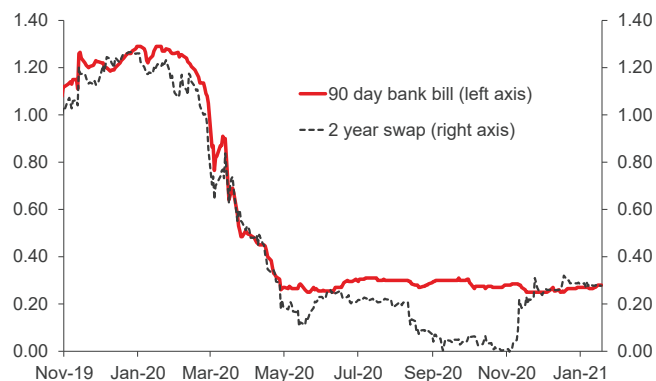


New Zealand forecasts.

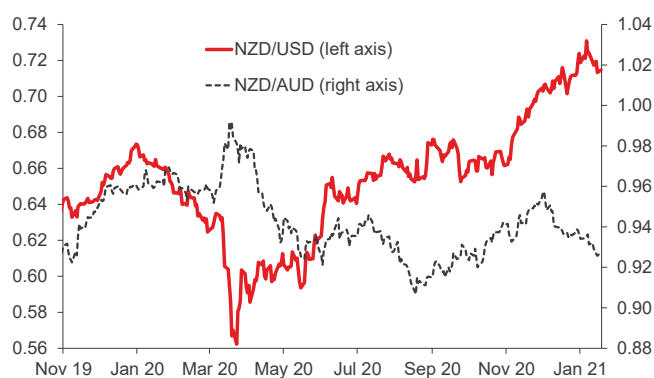
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Sep (a)	Dec	Mar	Jun	2019	2020f	2021f	2022f
GDP (Production)	14.0	0.0	0.6	1.6	2.3	-2.6	5.9	2.5
Employment	-0.8	-0.6	0.4	0.6	1.2	-0.7	2.3	2.9
Unemployment Rate % s.a.	5.3	6.0	5.9	5.7	4.1	6.0	5.4	5.0
CPI	0.7	0.0	0.4	0.1	1.9	1.0	1.0	1.3
Current Account Balance % of GDP	-0.8	-0.9	-1.2	-1.9	-3.3	-0.9	-2.1	-2.0

Financial forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Cash	0.25	0.00	-0.25	-0.25	-0.25	-0.25
90 Day bill	0.20	-0.05	-0.20	-0.20	-0.20	-0.20
2 Year Swap	0.20	-0.05	-0.10	-0.10	-0.05	0.00
5 Year Swap	0.45	0.25	0.20	0.20	0.25	0.30
10 Year Bond	1.00	0.95	0.90	0.90	1.00	1.10
NZD/USD	0.72	0.73	0.74	0.74	0.74	0.74
NZD/AUD	0.95	0.94	0.94	0.93	0.90	0.90
NZD/JPY	74.9	75.9	77.0	77.0	77.7	77.7
NZD/EUR	0.59	0.59	0.59	0.59	0.58	0.58
NZD/GBP	0.54	0.54	0.54	0.53	0.52	0.52
TWI	75.1	75.2	75.6	75.0	74.3	74.1

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 18 January 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.26%	0.26%	0.26%
60 Days	0.27%	0.27%	0.26%
90 Days	0.28%	0.27%	0.25%
2 Year Swap	0.28%	0.29%	0.32%
5 Year Swap	0.58%	0.54%	0.54%

NZ foreign currency mid-rates as at 18 January 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7147	0.7225	0.7124
NZD/EUR	0.5911	0.5878	0.5829
NZD/GBP	0.5250	0.5277	0.5303
NZD/JPY	74.11	74.28	73.72
NZD/AUD	0.9276	0.9343	0.9383
TWI	74.41	74.80	74.43

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
UK	Jan Rightmove house prices	-0.6%	-	-	A robust finish to 2020, but Q1 may start on a slower note.
Chn	Q4 GDP %yr	4.9%	6.2%	-	Growth figures to underscore China's outperformance.
	Dec industrial production %yr ytd	2.3%	2.7%	-	Lower steel inventories point to strong production.
	Dec retail sales %yr ytd	-4.8%	-3.8%	-	Expansionary services PMIs suggest rebound will continue.
	Dec fixed investment %yr ytd	2.6%	3.2%	-	Mfg investment elevated in response to export growth.
US	Martin Luther King, Jr. day	-	-	-	Public holiday, markets closed.
Tue 19					
NZ	Q4 Qrtly Survey Business Opinion	-39	-	-	Early indicator of quarterly growth.
	Dec retail card spending	0.1%	-	-0.5%	Spending has risen above pre-COVID levels.
Aus	Weekly Payroll Jobs and Wages	-	-	-	For week ending 2 Jan 2021.
Eur	Jan ZEW survey of expectations	54.4	-	-	Investors continue to look through short-term headwinds.
Wed 20					
NZ	GlobalDairyTrade auction – WMP	0.5%	-	-	Dairy futures suggest a small gain.
Aus	Dec WBC-MI Consumer Sentiment	112	-	-	Sentiment coming off 10yr high. Sydney COVID outbreak to hit.
UK	Dec CPI	-0.1%	-	-	Inflation may pick up as VAT cut & low energy prices dissipate.
US	Nov total net TIC flows \$bn	-10.4	-	-	Net inflows have moderated considerably from 2020 highs.
	Jan NAHB housing market index	86	86	-	Eased from a record high in Nov, but remains robust.
Thu 21					
NZ	Q4 employment confidence index	87.4	-	-	Remained low in Q3 following COVID hit.
	Nov net migration	884	-	-	International borders remain closed.
Aus	Jan MI inflation expectations	3.5%	-	-	Have held at lower levels after falling during COVID nadir.
	Dec employment	90.0k	50.0k	60.0k	Victoria's recovery to drive another strong print ...
	Dec unemployment rate	6.8%	6.7%	6.7%	... offsetting a rise in participation and pushing down u/e rate.
Eur	ECB policy decision	0.0%	0.0%	-	Policy to remain on hold whilst ECB assesses Dec package.
US	Initial jobless claims w/e 16/1	965k	-	-	Last week's spike points to a softening labour market.
	Dec housing starts	1.2%	1.1%	-	Housing starts reached a nine month high in November ...
	Dec building permits	6.2%	-2.1%	-	... and building permits indicate a strong pipeline.
Fri 22					
NZ	Dec manufacturing PMI	55.3	-	-	Strong lift in Nov as economy moved past lockdowns.
	Q4 CPI	0.7%	0.2%	0.0%	Annual inflation to slow to 1%.
Eur	Jan Markit PMIs	-	-	-	Mfg and services PMIs for Euro Area, Germany and UK.
UK	Dec retail sales	-3.8%	1.5%	-	Lockdowns over the holiday period will hamper trade.
	Dec public sector borrowing £bn	30.8	-	-	Public sector to maintain elevated monthly borrowing.
US	Jan Markit manufacturing PMI	57.1	56.5	-	Both services and mfg should moderate in the face of ...
	Jan Markit service PMI	54.8	54.0	-	... rising case counts and underwhelming vaccine rollout.
	Dec existing home sales	-2.5%	-2.1%	-	Have eased off a peak in October.

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	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	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	0.01	0.02	0.02	0.02	0.02	0.04	0.06	0.10
10 Year Bond	1.09	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	1.11	0.90	1.00	1.10	1.20	1.30	1.40	1.50

Exchange rate forecasts	Latest	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Dec-22
AUD/USD	0.7771	0.76	0.78	0.79	0.80	0.82	0.82	0.80
USD/JPY	103.79	104	104	104	104	105	105	105
EUR/USD	1.2153	1.23	1.24	1.25	1.26	1.27	1.28	1.27
GBP/USD	1.3686	1.34	1.36	1.38	1.39	1.41	1.41	1.41
USD/CNY	6.4707	6.45	6.35	6.25	6.20	6.15	6.10	6.00
AUD/NZD	1.0781	1.06	1.07	1.07	1.08	1.11	1.11	1.11

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