Tīeke

Weekly Economic Commentary.

Economy quiet as housing market roars.

After rebounding sharply post the Covid lockdown, the tourist-less summer has since weighed on the economy. So much so that we expect GDP to decline over the December and March quarters. At the same time, the housing market has continued its red-hot run. However, an eventual lift in fixed-term mortgage rates should be enough to slow the housing market, and ultimately send it into reverse.

The New Zealand economy has been in a soft patch. Indeed, economic data has been hinting that the economy has been cooling since around October or November last year.

Recent data have cemented this trend. Business confidence fell in the preliminary March estimate, and the reading of businesses' own activity also dipped. Importantly, retail spending has also slowed for five consecutive months, with the February electronic card transactions showing a 2.5% decline.

The recent Covid lockdowns are certainly part of the weaker economic mix. Recall that Auckland has been at Covid Alert Level 3 twice over the past month, while the rest of the country has been at Level 2 at times. While Level 2 presents little-to-no disruption to aggregate business activity, Level 3 in Auckland does matter – even if the total impact is smaller than initially feared because much activity is delayed rather than cancelled.

However, the bigger driver of the economic slowdown has been the summer of no tourists. We have estimated that the impact of the absence of international tourists on economic activity will vary from as low as around 2% in the September quarter to as high as around 6% in the March quarter. Hence, the absence of international tourists has left a sizeable economic hole over the December and March quarters.

More subtly, the absence of international tourism has disrupted the seasonal patterns in the GDP data. GDP rose by 14% in the September quarter, more than reversing the 11% drop during the lockdown and taking it to slightly above its pre-Covid level. That whopper result was partly because of catch-up spending as Covid restrictions were lifted, but also because the loss of international tourism was less of an issue during the winter months. Over the summer quarters this tourism impact reverses, before flipping back the other way come the June quarter.

We expect that this tourism hole will culminate in falling GDP over the summer quarters. Specifically, we expect this week's data to show that December quarter GDP fell 0.3%.

A 0.3% December quarter GDP decline would leave GDP about the same level as a year ago. More significantly, the economy will remain about 3% shy of what we would have expected if Covid-19 hadn't happened.

Our forecast is at the low end of the market range. Many are picking a positive result, while the Reserve Bank assumed a zero in its most recent *Monetary Policy Statement*. A negative outturn may help to dampen the recent market enthusiasm towards 'inflation trades' and drag interest rates lower – indeed, they have already come some way off their highs in the last week.

In contrast to the recent cooling in the economy, the housing market continues to roar. House prices have leapt 8% over last three months, with this three-month price increase the fastest on record.

The February housing data also showed a strong lift in house sales, although not enough to fully recover from the sharp drop in sales in January. That said, house sales remain high, the number of days it takes to sell is extremely low, and other data shows a lack of inventory available for sale. These are all classic indicators of ongoing rapid price increases in the near future.

The driver of rising house prices at present is ultra-low mortgage rates. And movements in mortgage rates will largely determine where to from here for the housing market.

On the mortgage front, we expect longer-term fixed rates will rise this year, even though we don't expect OCR hikes until 2024. The catalyst for rising mortgage rates will be multi-pronged. Firstly, we anticipate that the Funding for Lending Programme (FLP) will not be renewed when it expires at the end of 2022. Secondly, we expect RBNZ will gradually scale back its quantitative easing programme (or LSAP). Thirdly, the RBNZ is going to require banks to hold more capital over coming years. And lastly, market expectations of future OCR hikes are enough for longer-term interest rates to begin rising.

Short-term fixed rates will probably rise later. We expect that the two-year fixed rate will start rising late this year, to about 4% at the end of 2022, and 4.5% at the end of 2023.

With mortgages as large as they are these days, mortgage rate increases in the order of what we expect will be enough to slow the housing market, and eventually send it into reverse.

At the current juncture, we forecast 17% house price inflation over 2021 as a whole, after a 12% increase in 2020. But we expect that the monthly pace of price increases will start gradually easing as longer-term mortgage rates rise.

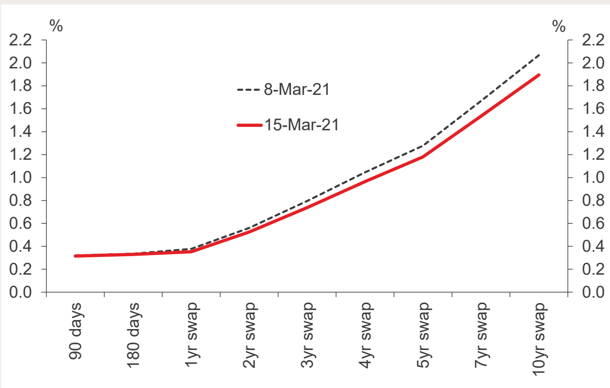
So we remain comfortable with our forecast for a 17% rise in house prices over 2021 (which is the highest in the market). And we forecast a 7.5% house price increase in 2022 – much slower than today, but nonetheless still a hot housing market.

Fixed vs Floating for mortgages.

We expect mortgage rates to rise over coming years. Based on our forecasts, taking a longer-term fixed rate (from three years to five years) will prove less expensive for borrowers than taking a short-term rate now and refixing later.

Longer-term fixed mortgage rates may rise soon, in response to a large increase in wholesale fixed rates over the past two months. We expect shorter-term fixed rates, and floating rates, will be stable over the coming months.

NZ interest rates



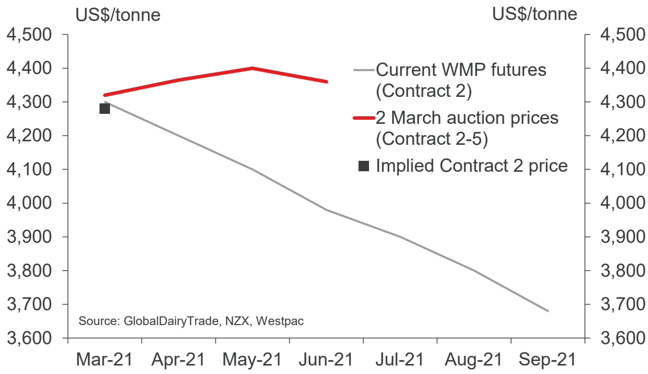
The week ahead.

NZ GlobalDairyTrade auction, whole milk powder prices

Mar 16, Last: 21.0%, Westpac: -2.0%

- We expect whole milk powder prices to recede following last auction's massive lift. Prices spiked 21% a fortnight ago, with the price rise the largest since 2010.
- Our pick is in line with current futures market pricing. However, given the magnitude of the lift at the last auction a wide range of results are possible.
- Following the last auction, we lifted our 2020/21 farmgate milk price forecast by 40 cents to $7.90/kg. This put our forecast at the top of Fonterra's forecast range of $7.30/kg to $7.90/kg.

Whole milk powder prices

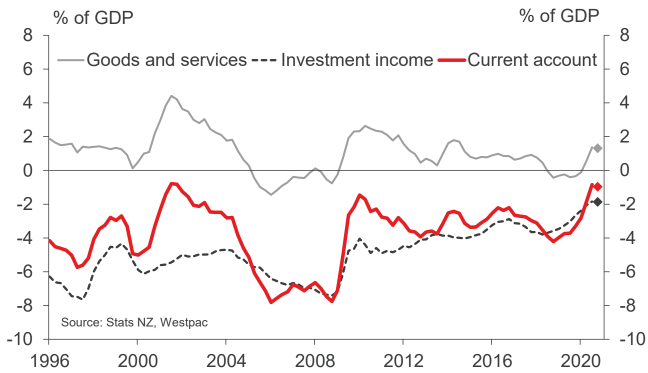


NZ Current Account Balance, % of GDP

Mar 17, Last: -0.8%, Westpac: -1.0%

- We expect the annual current account deficit to widen to 1.0% of GDP in the December quarter, after having narrowed to a 19-year low of 0.8% in September.
- The main factor this quarter is the lack of the usual lift in overseas visitor spending at this time of year. This will see the deficit widen further over 2021, with overseas travel not expected to begin in earnest until early next year.
- The balance of trade in goods remains – unusually – in surplus, although the gap is narrowing. Imports remain well below pre-Covid levels, while goods exports continue to hold up well.

Annual current account balance

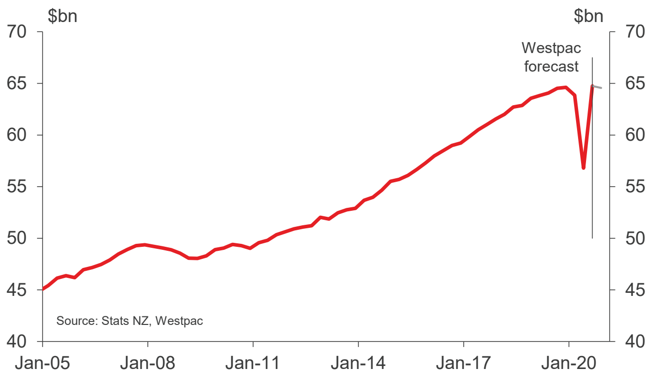


NZ Q4 GDP

Mar 18, Last: 14.0%, Westpac f/c: -0.3%, Mkt f/c: 0.1%

- We expect a 0.3% drop in GDP for the December quarter, following a 14% rebound in September as Covid-19 restrictions were lifted.
- Domestic activity has already returned to around pre-Covid levels, making further gains hard to come by while the international border remains closed.
- The absence of international tourism has disrupted the seasonal patterns in the data. We expect to see weaker outturns in the spring and summer months, and higher than normal growth in winter.

Production-based GDP



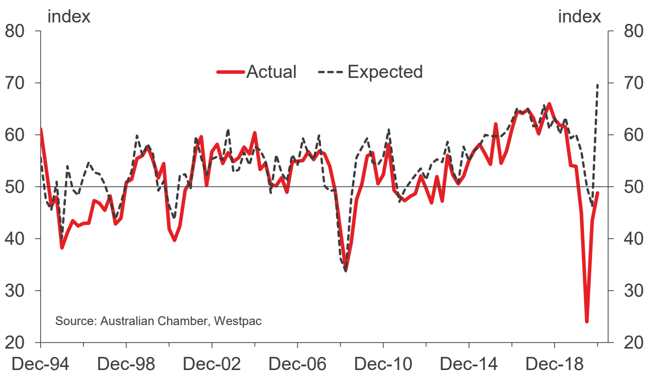
The week ahead.

Aus Q1 AusChamber–Westpac business survey

Mar 16, Last: 48.4

- The Australian Chamber–Westpac Survey of Industrial Trends, Australia's longest running business survey dating from 1966, provides a timely update on manufacturing and insights into economy-wide trends. The Q1 survey was conducted from 8 February to 1 March.
- In Q4, the Actual Composite improved to 48.4 in the December quarter after rising to 42.8 in the September quarter. This recovery followed the dramatic fall to 24.0 in the June quarter associated with the initial lockdown and the response to Covid.
- With the activity index nearing 50, the Q4 survey suggested conditions were stabilising. Output expanded for the first time in the calendar year, and new orders only contracted marginally.
- In the second half of the year, activity recovered briskly, with GDP advancing 3.4% and 3.1% in Q3 and Q4 respectively. This momentum in the real economy has carried into the first quarter of 2021.

Westpac-AusChamber Composite indexes

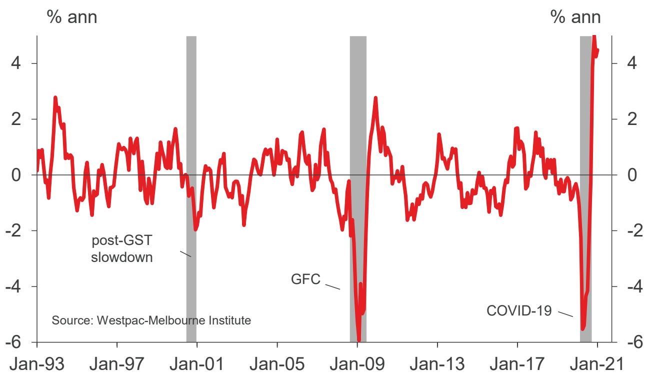


Aus Feb Westpac–MI Leading Index

Mar 17, Last: 4.48%

- The Leading Index growth rate rose to 4.48% in Jan from 4.24% in Dec – consistent with growth running well above trend through 2021.
- The index growth rate, which is a six month annualised measure, is likely to see a sharp loss in altitude in coming months as last year's COVID disruptions start to drop out of the picture. Where the growth rate settles will be an important gauge of how the economy will perform once the direct disruptions from the virus are over.
- For the Feb month, component updates are mixed with small gains for the ASX200 and consumer sentiment-based measures, solid months for US industrial production and commodity prices, and a notable steepening in the yield curve (usually a positive signal for growth) but dwelling approvals and hours worked both falling very sharply.

Westpac-MI Leading Index

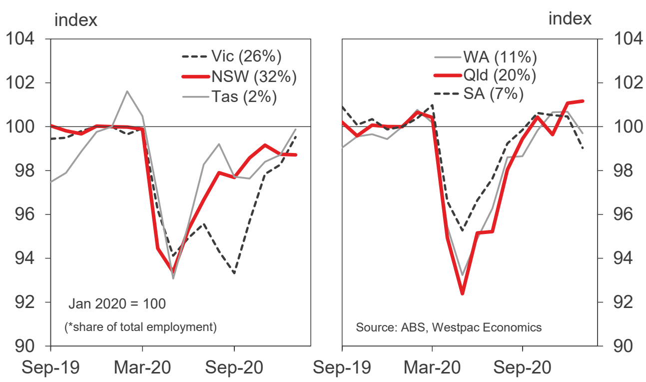


Aus Feb labour force survey, employment change

Mar 18, Last 29.1k; WBC f/c: 30k,
Mkt f/c 30.0k, range: 14.2k to 55.0k.

- Total employment has recovered 813.6k, or 6.7%, from the May low to be just 58.5k, or 0.5%, below the pre-COVID level.
- The labour market has had a sharp V-shaped recovery, much stronger than anticipated. However, the state data reveals the impact of further lockdowns, and re-openings, with employment surging in Victoria while it stalled in NSW. In addition, the recovery has been dominated by male part-time employment.
- Victoria is still running behind the recovery seen in other states while NSW should bounce back from the temporary lockdowns in January. However, these positives are tempered by the payrolls data which suggests overall employment growth slowed in February.
- Our forecast gain will see February employment down just 28.5k, or -0.2%, on the March 2020 level.

Level of employment by state



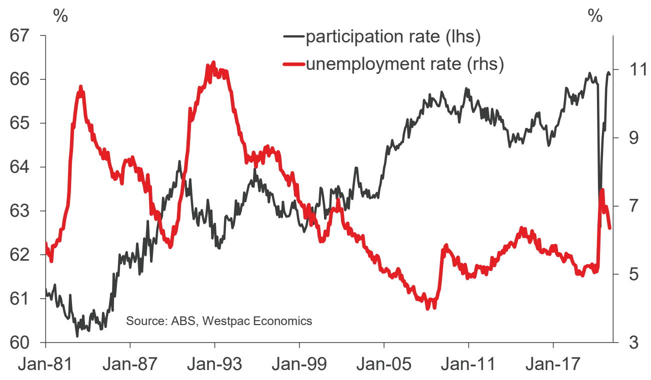
The week ahead.

Aus Feb labour force survey, unemployment %

Mar 18, Last 6.4%; WBC f/c: 6.3%,
Mkt f/c 6.3%, range: 6.4% to 6.2%.

- In January the sound 29.1k gain in employment drove an outsized 0.2ppt fall in the unemployment rate to 6.4% due to a surprising 0.1ppt fall in the participation rate. It is unusual for participation to fall with a sound print on employment.
- So far the improvement in unemployment has not been as solid as the improvement in employment – the 6.4% print still 1.1ppt higher than it was in March 2020. This is due to solid participation which at 66.1% is just 0.5ppt below where it was in March and thus it has not fully offset the gap in employment.
- Our forecast for +30k on employment (based on a NSW bounce and a softer Victoria) with a 0.1ppt rise in participation results in a 0.1ppt fall in unemployment to 6.3%.

Participation recovered with employment

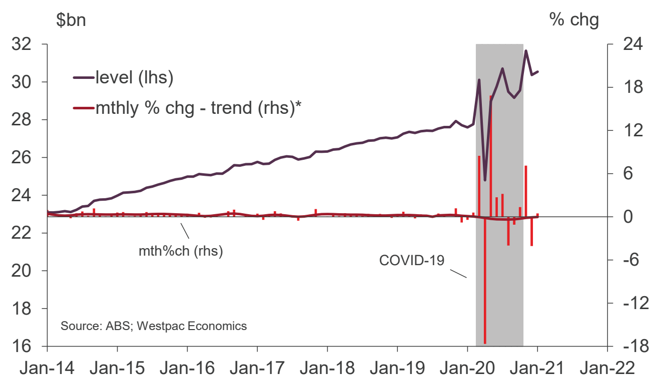


Aus Feb retail trade

Mar 19, Last: 0.5%, WBC f/c: 1.0%
Mkt f/c: 0.6%, Range: -0.5% to 2.5%

- Final estimates showed Jan retail sales up a modest 0.5% in the month and still well above pre-COVID levels (up an impressive 10.6%yr). Sales have been choppy through Nov-Dec-Jan due to both COVID disruptions ('mini-lockdowns' in several states) and shifts relating to 'Black Friday' sales and catch-up spend in Vic following the state's reopening.
- Feb saw yet more COVID disruptions, this time with Qld and Vic both instituting week-long lockdowns. Our Westpac Card Tracker suggests these had limited impact for the month as a whole. On balance we expect Feb to show a decent 1% gain.
- It should be noted that retail is likely to see some softening in sales as the economy fully reopens and consumers shift more of their spending back towards areas previously affected by restrictions – many of which are services that are outside the scope of the retail survey (e.g. tourism, travel and entertainment).

Monthly retail sales

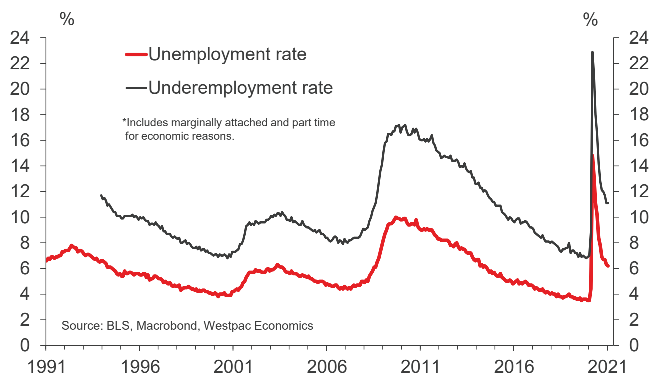


US Mar FOMC policy meeting

Mar 16-17, fed funds rate, last: 0.125%, WBC: 0.125%

- The FOMC will most certainly look to revise up their growth and labour market views for the forecast period at the March meeting following the safe passage of President Biden's stimulus package through Congress.
- However, given the substantial degree of labour market slack still to work through, and the decade-long inflation underperformance of the US, participants are unlikely to materially revise up their views on inflation.
- As a result, we expect that, while some members of the Committee will look to bring forward their anticipated timing for the first fed funds rate hike(s), the median will remain at or very close to zero to the end of the forecast period.
- While not included in the forecast table, any guidance on triggers for the tapering of asset purchases will also be closely scrutinised.

Stimulus to drive U/E towards full employment

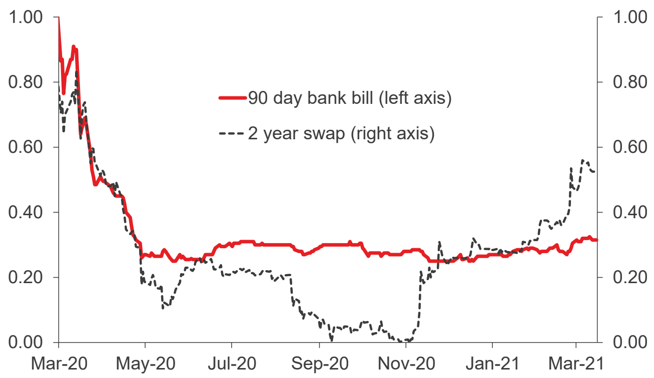


New Zealand forecasts.

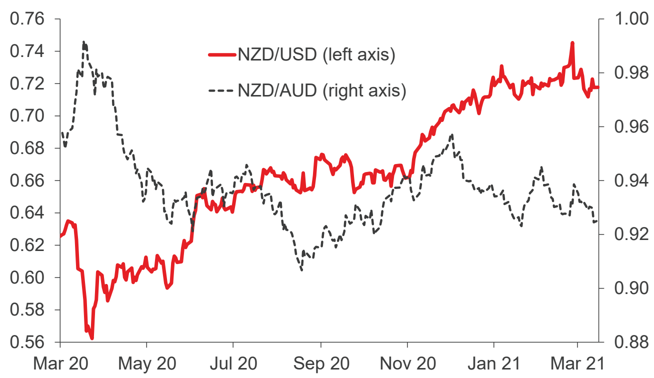
Economic forecasts	Quarterly				Annual			
	2020		2021					
% change	Sep (a)	Dec	Mar	Jun	2019	2020f	2021f	2022f
GDP (Production)	14.0	-0.3	-0.4	1.9	2.3	-2.7	4.4	3.8
Employment	-0.7	0.6	-0.1	0.2	1.3	0.7	1.0	3.0
Unemployment Rate % s.a.	5.3	4.9	5.0	5.1	4.1	4.9	4.9	4.2
CPI	0.7	0.5	0.8	0.6	1.9	1.4	1.9	0.9
Current Account Balance % of GDP	-0.8	-1.2	-1.5	-2.1	-3.3	-1.2	-2.7	-3.0

Financial forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.30	0.30	0.30	0.30	0.30	0.30
2 Year Swap	0.40	0.40	0.40	0.45	0.50	0.55
5 Year Swap	1.00	1.00	1.05	1.10	1.20	1.30
10 Year Bond	1.90	1.90	1.95	2.00	2.10	2.20
NZD/USD	0.74	0.75	0.76	0.78	0.78	0.77
NZD/AUD	0.94	0.94	0.93	0.92	0.92	0.92
NZD/JPY	80.7	82.5	84.4	87.4	86.6	85.5
NZD/EUR	0.62	0.62	0.62	0.62	0.62	0.61
NZD/GBP	0.53	0.54	0.54	0.55	0.55	0.54
TWI	76.6	77.0	77.1	78.2	77.8	76.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 15 March 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	0.29%	0.29%	0.28%
90 Days	0.32%	0.31%	0.29%
2 Year Swap	0.53%	0.48%	0.35%
5 Year Swap	1.18%	1.20%	0.81%

NZ foreign currency mid-rates as at 15 March 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7177	0.7238	0.7214
NZD/EUR	0.6008	0.5998	0.5954
NZD/GBP	0.5156	0.5192	0.5209
NZD/JPY	78.23	77.14	75.75
NZD/AUD	0.9252	0.9385	0.9298
TWI	75.16	75.57	74.93

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 15					
NZ	Feb BusinessNZ PSI	47.9	–	–	Border closure weighing more heavily on services sector.
	Jan net migration	451	–	–	Border restrictions keeping net migrant flows near zero.
Aus	RBA Governor Lowe (10:15am)	–	–	–	Opening Remarks, Melbourne Business Analytics Conference.
Chn	Feb industrial production ytd %yr	2.8%	32.6%	–	Output, investment and retail...
	Feb fixed asset investment ytd %yr	2.9%	41.5%	–	... are all set to spike in year-ended terms on base effects...
	Feb retail sales ytd %yr	–3.9%	32.0%	–	... and China's booming economic recovery.
UK	Mar Rightmove house prices	0.5%	–	–	Prices continue to be supported by record low rates.
US	Mar Fed Empire state index	12.1	14.0	–	Capex intentions an outperformer in Feb survey.
Tue 16					
Aus	RBA minutes	–	–	–	Further colour around the March Board Meeting decision.
	Q1 AusChamber-Westpac survey	48.4	–	–	Business conditions improving as economy reopens.
	Weekly Payroll Jobs and Wages	–	–	–	Week ending 27 February - revisions can be significant.
Eur	Mar ZEW survey of expectations	69.6	–	–	Eased back into yearend; now approaching post-COVID high.
US	Jan total net TIC flows	–0.6	–	–	Selling in Japan offset by purchases in UK and China.
	Feb import price index	1.4%	1.1%	–	Fuel and industrial supplies driving recent growth.
	Feb retail sales	5.3%	–0.3%	–	Discretionary surged in Jan on stimulus and vaccine rollout.
	Feb industrial production	0.9%	0.6%	–	Fourth consecutive mthly advance in Jan signals recovery.
	Jan business inventories	0.6%	0.3%	–	Winding down from October peak.
	Mar NAHB housing market index	84	84	–	Remains firmly above pre-COVID levels.
Wed 17					
NZ	GlobalDairyTrade auction, WMP	21.0%	–	–2.0%	Auction prices receding after monster lift a fortnight ago.
	Q4 current acct balance, % of GDP	–0.8%	–0.8%	–1.0%	Current account to widen on missing tourist exports.
Aus	Feb Westpac–MI Leading Index	4.48%	–	–	To lose altitude sharply as COVID disruptions drop out.
	RBA Assist Governor Kent speaking	–	–	–	Small Businesses Finance in the Pandemic, 10:30am.
US	Feb housing starts	–6.0%	–0.6%	–	Recent pullback highlights volatility inherent in construction.
	Feb building permits	10.4%	–8.7%	–	Single family permits have been the driver of recent strength.
	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	New forecasts to incorporate benefit of stimulus.
	Fed Chair Powell	–	–	–	Post-FOMC meeting press conference.
Thu 18					
NZ	Q4 GDP	14.0%	0.1%	–0.3%	Loss of tourism weighing after post-Covid rebound.
Aus	Feb total employment	29.1k	30k	30k	Boosted by the reopening of NSW the further gains in ...
	Feb unemployment rate	6.4%	6.3%	6.3%	... employment will see a fall in unemployment.
	RBA Assist Governor Kent speaking	–	–	–	The End of LIBOR and the Australian market.
	RBA Bulletin	–	–	–	Includes RBA research articles.
Eur	Jan trade balance €bn	27.5	–	–	Surplus widened on pre-Brexit hoarding and China demand.
UK	BoE policy decision	0.10%	0.10%	–	May receive commentary around recent bond selloff.
US	Initial jobless claims	712k	–	–	Expect downtrend to become entrenched.
	Mar Phily Fed index	23.1	24.0	–	Business outlook will be supported by stimulus prospects.
	Feb leading index	0.5%	0.3%	–	Hours worked and new orders the strongest components.
Fri 19					
Aus	Feb retail sales	0.5%	0.6%	1.0%	Buffeted by 'mini-lockdowns' but with underlying strength.
UK	Mar GfK consumer sentiment	–23	–	–	Success with vaccine rollout remains a key support.
	Feb public sector borrowing £bn	8.0	–	–	2021 Budget will see record peacetime borrowings.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	5.2	3.6
CPI inflation %yr	1.9	1.8	1.8	0.9	2.6	2.1
Unemployment rate %	5.5	5.0	5.2	6.8	6.0	5.3
Current account % of GDP	-2.6	-2.1	0.7	2.5	3.7	1.8
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	5.3	4.4
CPI inflation %yr	2.1	2.4	1.9	1.2	1.8	1.9
Unemployment rate %	4.4	3.9	3.7	8.1	5.7	4.5
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	-5.5	2.2	2.2
Euro zone						
Real GDP %yr	2.6	1.8	1.3	-6.8	4.2	3.9
United Kingdom						
Real GDP %yr	1.9	1.3	1.5	-10.5	5.0	5.5
China						
Real GDP %yr	6.9	6.8	6.1	2.3	10.0	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.6	5.0	4.9
World						
Real GDP %yr	3.8	3.5	2.8	-3.2	5.9	4.7
Forecasts finalised 10 March 2021						

Interest rate forecasts	Latest	Jun–21	Sep–21	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22
Australia								
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.04	0.02	0.02	0.02	0.04	0.06	0.08	0.10
10 Year Bond	1.70	1.85	1.85	1.90	2.05	2.20	2.35	2.50
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.54	1.65	1.70	1.80	1.95	2.10	2.25	2.40

Exchange rate forecasts	Latest	Jun–21	Sep–21	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22
AUD/USD	0.7780	0.79	0.80	0.82	0.85	0.85	0.84	0.82
USD/JPY	108.75	109	110	111	112	111	111	110
EUR/USD	1.1968	1.20	1.21	1.23	1.25	1.26	1.27	1.27
GBP/USD	1.3980	1.40	1.40	1.41	1.41	1.41	1.42	1.42
USD/CNY	6.4826	6.40	6.30	6.20	6.15	6.10	6.05	6.00
AUD/NZD	1.0777	1.07	1.07	1.08	1.09	1.09	1.09	1.09

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