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Weekly Economic Commentary.

Time to rise.

Last week we released an update of our economic forecasts, which underpinned our change of call for the Reserve Bank. We now expect the OCR to start rising from August next year, with a gradual series of hikes at three- or six-month intervals, reaching 2% by the end of 2024.

Our forecast track over the next few years is similar to what the RBNZ laid out in its May *Monetary Policy Statement*. We're not dogmatic about the exact start date for hikes; when you're looking more than a year ahead, a few months either side is neither here nor there. But August seems like a reasonable starting point, since it will serve as an anchor for the RBNZ's thinking as it assesses the incoming data.

Previously we expected OCR hikes to be delayed until early 2024. Our concern was that rate hikes as early as next year would lead to unacceptably low inflation and employment outcomes for the RBNZ. But the downside risks for the domestic economy have now abated, and we're more confident that economic conditions will be resilient to the removal of the 'emergency' policy settings that were brought in last year.

The economy appears to have endured the 'touristless summer' better than we expected, and has come out of that phase with considerable momentum. The 1.6% rise in March quarter GDP was much higher than forecast, and while we have questions about how much of this surprise will be sustained, we think at least some of it was genuine. More recent data on business activity and retail spending have also been positive for the June quarter.

Similarly, we're seeing good progress towards what the RBNZ consider to be 'maximum sustainable employment'. The unemployment rate dropped to 4.7% in the March quarter, and the rise in job advertisements shows that demand for workers is strong. Based on the decline in Jobseeker Support benefit numbers, we've revised down our forecast of the June quarter unemployment rate to 4.5%, and we expect it to drop to around 4% by mid-2022.

We've also upgraded our house price forecasts, reflecting a stronger than expected starting point and a review of our modelling of mortgage rates. We still expect house price growth to cool significantly over the next year, in response to the recent changes to the tax treatment of property investors. However, we don't expect prices to tip over into outright declines until late 2022, once OCR hikes are already under way.

Finally, we've brought forward our rate hike forecasts for the US Federal Reserve (late 2022) and the Reserve Bank of Australia (early 2023). That removes the risk of a sharp rise in the New Zealand dollar if the RBNZ hiked rates well ahead of its peers. In fact, we've revised down our NZD/USD forecast a little, though we still expect it to rise over the next year.

Importantly, our change of call is not motivated by the inflation concerns that have gripped financial markets in recent times. On the contrary, we think that the RBNZ has plenty of time on its side when it comes to keeping inflation on target.

There's no disagreement that inflation will spike higher this year. That's partly because of base effects – some prices are much higher than they were at the same time last year, when the world was in Covid-19 lockdown conditions – and partly because of supply chain disruptions, which have seen a spike in prices for things such as raw materials and machinery parts, as well as shipping costs.

In many ways, Covid-19 has been a supply-side shock to the economy – especially in New Zealand's case, as the demand shock proved to be relatively brief. It's long been recognised that central banks should not tighten monetary policy in response to supply shocks (though nor should they try to soften the blow to activity by easing further).

The key for the RBNZ, in terms of its medium-term inflation target, is whether the initial spike translates into an ongoing series of price increases. And we're just not convinced that the conditions are in place for that. The economy is still operating some way below its non-inflationary potential, with domestic demand not fully compensating for the loss of overseas travel. Businesses are facing a range of cost pressures in the near term, but if anything the evidence is that it's quite a difficult environment in which to raise prices.

So we still think that the RBNZ can take a gradual path towards reducing stimulus. A year from now, the initial spike in inflation will have passed, and we expect inflation to drop back into the lower half of the RBNZ's target range. However, the economy will be running closer to full capacity by that point, making it appropriate to start withdrawing stimulus in order to keep inflation in check in the years ahead.

Last week we released the latest Westpac-McDermott Miller confidence surveys. Consumer confidence rose by 1.9 points to 107.1, and has now recovered most of the drop that we saw after last year's lockdown. Households are feeling more confident about their own financial position and the near-term outlook for the economy. However, there was still some trepidation around making major purchases for the home.

Employment confidence saw a similar increase, led by perceptions about current job opportunities. However, households were slightly less confident about their future earnings prospects and job security compared to the March survey. We've been hearing a lot lately from businesses about labour shortages, but not much from the perspective of workers and jobseekers. Our survey suggests that workers don't feel like they're gaining the upper hand at the bargaining table.

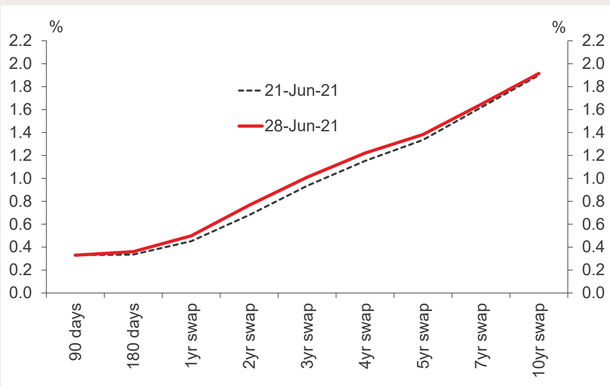
Michael Gordon, Acting Chief Economist
+64 9 336 5670

Fixed vs floating for mortgages.

We expect that floating rates, and shorter fixed-term rates, will be stable over the coming months. Inflation is set to spike higher this year, but the Reserve Bank will not need to respond to this.

Longer-term interest rates are now rising in response to the improved economic outlook. Given our forecasts, longer-term fixed rates (three to five years) no longer offer good value, relative to taking a short-term rate now and refixing later (albeit at a higher rate).

NZ interest rates



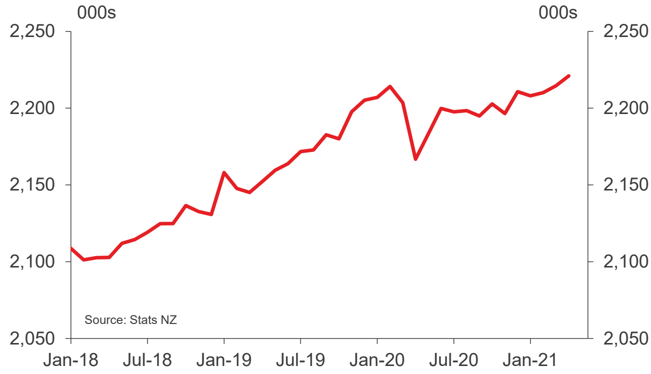
The week ahead.

NZ May employment indicators

Jun 28, Last: 0.3%, Westpac f/c: 0.0%

- The monthly employment indicator is based on data from income tax filings. It provides a less detailed but more timely snapshot of employment trends compared to the quarterly surveys.
- The number of filled jobs held up surprisingly well in the absence of international tourists over the summer period, and has continued to grow at a moderate pace in recent months.
- We've assumed a flat outcome for May. Job advertisements have soared to new highs, but the extent to which these jobs are being filled is unclear given concerns about skills mismatches.

NZ Monthly Employment Indicator filled jobs

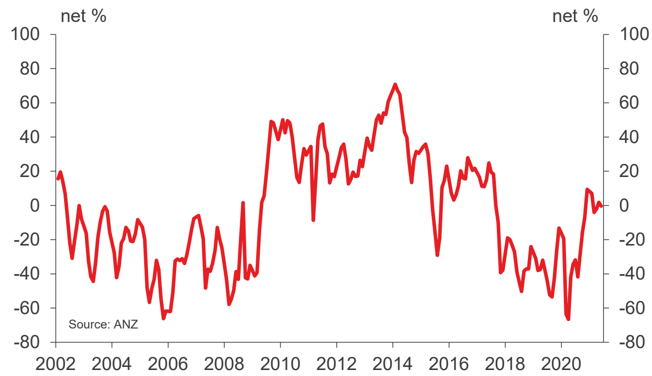


NZ June ANZBO business confidence (Final)

June 30, Last (Preliminary June): -0.4%

- The early read on business conditions for June showed that expectations for trading activity continued to hold firm despite a small drop in confidence.
- The final release of the June business survey will give us a closer look at the breakdown of conditions across industries. Over the past month economic news has continued to be positive. Notably the housing market has shown ongoing strength. This is despite tighter lending restrictions and the Government's earlier changes to the tax treatment of property. That's likely to have flow on impacts for other parts of the economy. There's also been continued firmness in household spending and commodity prices.
- Underlying inflation gauges will again be worth watching. Inflation expectations rose to 2.3% in the preliminary read, continuing the uptrend seen for about the last year.

NZ business confidence

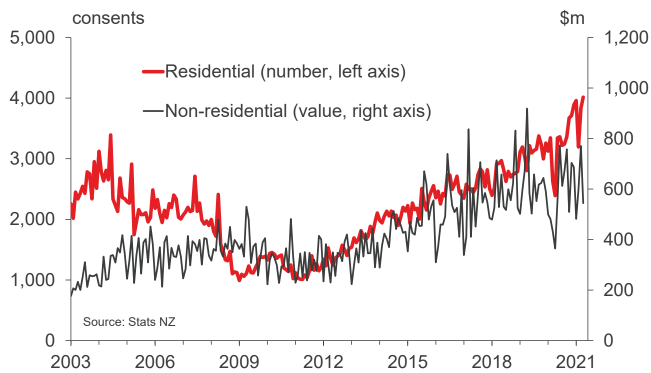


NZ May residential building consents

Jul 1, Last: +4.8%, Westpac f/c: -5%

- Residential consent issuance rose 4.8% in April, with ongoing firmness in both medium density dwellings and standalone homes.
- We expect that monthly issuance will ease by 5% in May following strength in recent months.
- Residential consent issuance has been charging higher. And with last year's Covid related softness dropping out of the annual calculation, annual consent issuance is set to rocket higher in the 12 months to May. We expect annual consent numbers to rise to around 46,000 (compared to the previous record of 42,800 seen last month).

NZ building consents



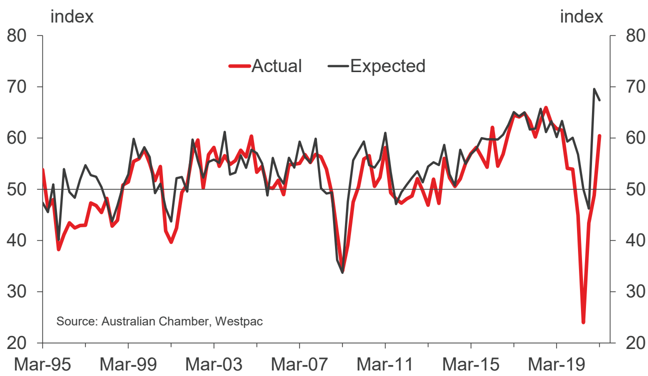
The week ahead.

Aus Q2 AusChamber-Westpac business survey

Jun 29, Last: 60.4

- 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 18 May to 15 June (after 11 May Federal Budget).
- The Westpac–AusChamber Actual Composite improved to 60.4 in the March quarter after rising to 48.8 in the December quarter and 43.4 in the September quarter. The recovery follows a dramatic fall to 24.0 in the June quarter associated with the initial lockdown and the response to Covid.
- With the index above 50, this suggests conditions are expanding. The survey reported that output started 2021 on a strong note. New orders lifted for the first time since Q4 2019. This momentum in the real economy has carried into the second quarter.

Westpac-AusChamber Composite indexes, sa

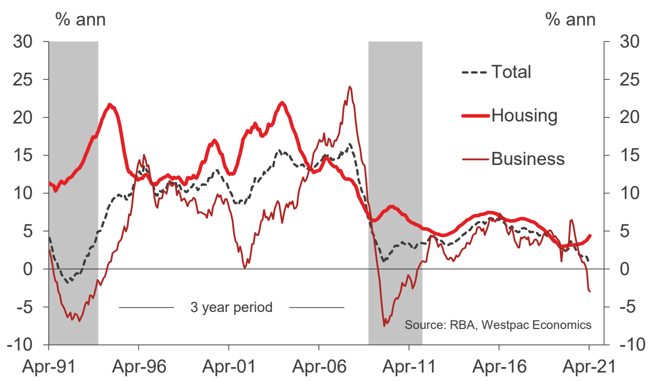


Aus May private credit

Jun 30, Last: 0.2% WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: 0.3% to 0.4%

- Credit to the private sector is emerging from a period of softness associated with the covid recession. Credit was in outright decline over the 7 months to October, falling 0.3%.
- An improving trend is evident in 2021 and is set to continue as the economy reopens and supported by substantial policy stimulus. That said, the monthly profile is a little uneven.
- Credit growth averaged 0.3% over the past five months, including a 0.4% gain in March and then a softer 0.2% outcome for April, dented by a 0.3% dip in business.
- For May, we expect a 0.3% rise, with a flat read for business, which is at a turning point. Housing credit is in a strong upswing, responding to record low rates and government incentives.

Aus credit

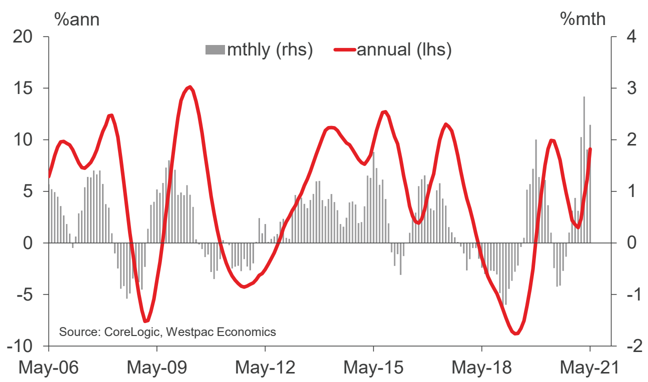


Aus Jun CoreLogic home value index

Jul 1, Last: 2.3%, WBC f/c: 2.0%

- Australian house prices continued to surge strongly in May, rising 2.3% in the month, after posting gains of 1.8% in Apr, 2.8% in Mar and 2% in Feb. Prices are up 9.4%yr. The surge is also notable for its breadth – over 85% of the 90-odd detailed sub-categories covered recording gains running at a double-digit annualised pace over the last six months and none recording declines.
- The CoreLogic daily index points to another strong 2% gain in June, Sydney dwelling prices up closer to 2.5%. Annual price growth is set to tip over into double digits this month with a gain of just over 12%yr.

Aus dwelling prices



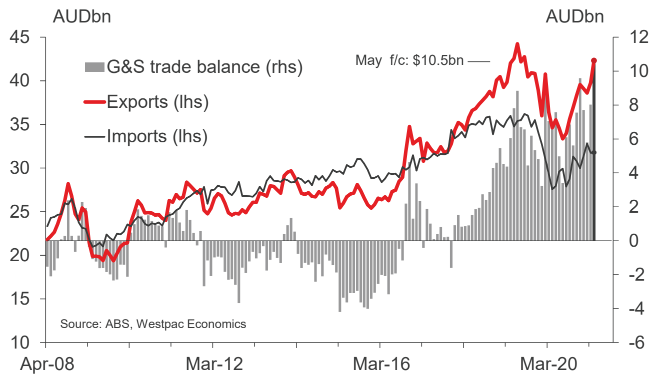
The week ahead.

Aus May trade balance, AUDbn

Jul 1, Last: 8.0, WBC f/c: 10.5
Mkt f/c: 10.5, Range: 9.0 to 12.4

- Australia's trade account has been in surplus for 40 consecutive months, from the start of 2018. The annual surplus swelled from $23bn for 2018 to $74bn in 2020.
- For May, the surplus rises to a forecast record high of $10.5bn, up $2.5bn on April, led by export strength. The previous high was $9.7bn in March 2020, with a $9.6bn for January 2021.
- Export earnings increased by a forecast 6.4% in the month, +$2.6bn. Customs data reports that iron ore was again a stand-out, up strongly in May on higher prices and volumes.
- Imports largely marked time, up a forecast 0.3%, $0.1bn. This represents a consolidation following the strong 19% rebound from last May through to March.

Aus trade balance

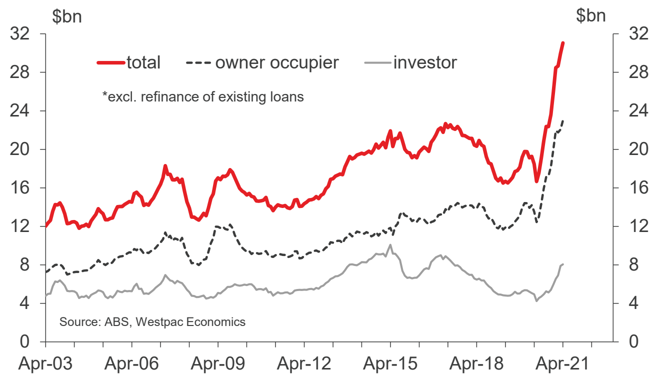


Aus May housing finance approvals

Jul 2, Last: 3.7%, WBC f/c: 5.0%
Mkt f/c: 2.0%, Range: 0.0% to 5.0%

- Housing finance approvals posted a 3.7% rise in April, to a new high 57% above pre-pandemic levels. The mix was a little surprising with owner occupier loans outstripping investor loans despite a large pull-back in construction-related loans as a pull-forward associated with the Federal government's HomeBuilder scheme started to unwind. The value of new investor loans rose just 2.1%.
- We expect May to show something similar with a further decline in construction-related finance associated with the Federal HomeBuilder scheme more than offset by an uplift in investor lending. The wider picture on established housing markets remains positive with both sales volumes and prices sustaining strong gains through April and May. Overall we expect a 5% rise in total approvals, investors up 6% and owner-occupiers up 4% the latter dragged down by a 10% decline in construction-related loans. There are significant risks on both sides of the May numbers.

Aus new finance approvals*

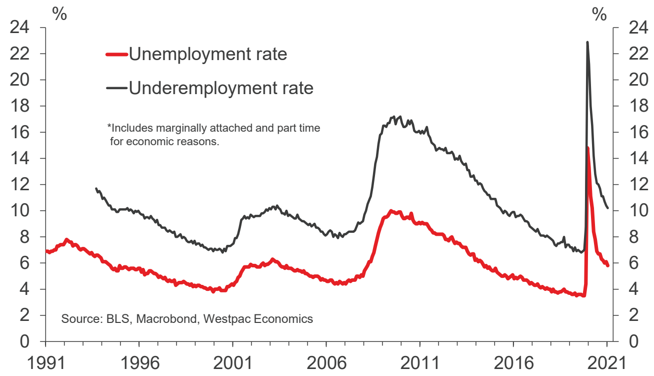


US Jun employment report

Jul 2, nonfarm payrolls Last: 559k, WBC f/c: 750k
Jul 2, unemployment rate Last: 5.8%, WBC f/c: 5.7%

- The past two employment reports have materially disappointed market expectations. Authorities and the market have, after the fact, rationalised this as being due to the restricted supply of labour as a result of the pandemic.
- Labour supply is expected to begin to improve from June as the vaccine drive takes effect and those on expanded unemployment benefits recognise this support is nearing its end.
- We look for 750k jobs to be created in the month of June, with further strong gains to follow in the second half. This will drive unemployment and underemployment lower over the period, despite a rise in participation as supply heals.
- Over the course of the next 12-18 months, we expect the unemployment rate to head near its full employment level.

US employment level

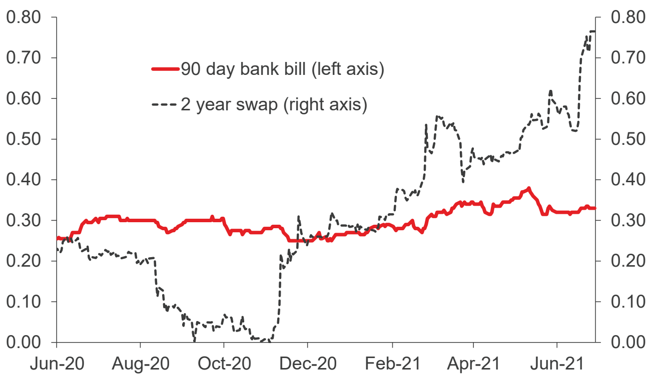


New Zealand forecasts.

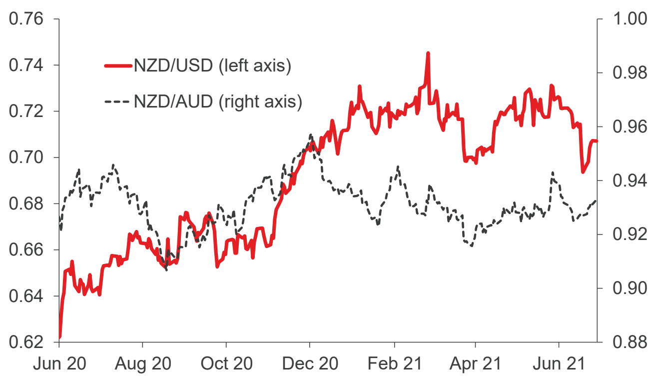
Economic forecasts	Quarterly				Annual			
	2021							
% change	Mar (a)	Jun	Sep	Dec	2019	2020	2021f	2022f
GDP (Production)	1.6	0.6	0.9	1.3	2.4	-2.9	5.8	4.5
Employment	0.5	0.3	0.4	0.4	1.2	0.8	1.7	2.1
Unemployment Rate % s.a.	4.7	4.5	4.4	4.2	4.1	4.9	4.2	3.9
CPI	0.8	0.4	0.7	0.2	1.9	1.4	2.2	1.7
Current Account Balance % of GDP	-2.2	-3.3	-4.1	-4.4	-3.3	-0.8	-4.4	-3.4

Financial forecasts	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Dec-23
Cash	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.50
90 Day bill	0.35	0.35	0.35	0.45	0.70	0.85	1.20	1.60
2 Year Swap	0.60	0.70	0.80	0.90	1.05	1.20	1.50	1.70
5 Year Swap	1.30	1.45	1.60	1.75	1.90	2.00	2.20	2.40
10 Year Bond	1.90	2.05	2.20	2.35	2.50	2.60	2.80	2.90
NZD/USD	0.72	0.74	0.76	0.78	0.78	0.77	0.75	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.92	0.92	0.91	0.92
NZD/JPY	78.5	80.7	83.6	85.8	86.6	85.5	81.8	77.8
NZD/EUR	0.59	0.60	0.61	0.62	0.61	0.61	0.59	0.57
NZD/GBP	0.51	0.52	0.53	0.54	0.54	0.53	0.52	0.50
TWI	74.0	75.2	76.6	77.7	77.5	76.4	74.7	72.2

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 28 June 2021

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	0.30%	0.30%	0.30%
90 Days	0.33%	0.32%	0.33%
2 Year Swap	0.77%	0.52%	0.60%
5 Year Swap	1.38%	1.17%	1.34%

NZ foreign currency mid-rates as at 28 June 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7071	0.7135	0.7252
NZD/EUR	0.5926	0.5893	0.5947
NZD/GBP	0.5090	0.5060	0.5112
NZD/JPY	78.32	78.24	79.67
NZD/AUD	0.9329	0.9266	0.9403
TWI	74.36	74.23	75.33

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
NZ	May employment indicators	0.3%	–	0.0%	Weekly releases suggest a steady result for May.
US	Jun Dallas Fed index	34.9	32.5	–	Will be looking for signs of bottlenecks and price pressures.
	Fedspeak	–	–	–	FOMC's Williams takes part in BIS panel.
Tue 29					
Aus	Q2 AusChamber-Westpac survey	60.4	–	–	Business conditions improving as economy reopens.
Eur	Jun economic confidence	114.5	116.0	–	Success on the health front to buoy confidence.
US	Apr FHFA house prices	1.4%	1.7%	–	Prices rising at a brisk clip across the nation...
	Apr S&P/CS home price index	1.6%	1.8%	–	... although affordability constraints may be crimping sales.
	Jun consumer confidence index	117.2	119.0	–	Has lagged the recovery, but picking up over recent months.
Wed 30					
NZ	Jun ANZBO business conf (final)	–0.4%	–	–	The strength of inflation expectations will be a key focus.
Aus	May private sector credit	0.2%	0.3%	0.3%	An improving trend, reopening + substantial stimulus.
Chn	Jun non–manufacturing PMI	55.2	55.5	–	Recent uplift in services PMI indicates that...
	Jun manufacturing PMI	51.0	50.8	–	... the recovery is balancing out.
Eur	Jun CPI %yr	2.0%	1.8%	–	Energy costs behind the recent rise in prices.
UK	Q1 GDP	–1.5%	–1.5%	–	Final read; no change expected.
US	Jun ADP employment change	978k	530k	–	Can be an unreliable guide to the official employment report.
	Jun Chicago PMI	75.2	69.9	–	Business barometer continues to accelerate.
	May pending home sales	–4.4%	–1.0%	–	Tight supply continues to serve as a constraint on turnover.
	Fedspeak	–	–	–	FOMC's Barkin takes part in MNI event.
Thu 01					
Aus	Jun CoreLogic home value index	2.3%	–	2.0%	Prices continuing to surge, annual growth to hit 12%yr.
	May trade balance $bn	8.0	10.5	10.5	Surplus widens, exports jump led by iron ore.
Chn	Jun Caixin China PMI	52.0	51.9	–	Stabilising after coming off peak in late-2020.
Eur	May unemployment rate	8.0%	8.0%	–	Furlough schemes holding down job losses.
US	Initial jobless claims	411k	–	–	Recent uptick indicates ongoing churn as jobs market heals.
	May construction spending	0.2%	0.5%	–	Strength concentrated in residential; non-res lagging.
	Jun ISM manufacturing	61.2	61.0	–	Prices paid, employment components to be closely watched.
Fri 02					
NZ	Jun ANZ consumer confidence	114.0	–	–	Consumer confidence has been trending higher.
Aus	May housing finance	3.7%	2.0%	5.0%	Booming established mkt partially offset by HomeBuilder unwind.
US	Jun non–farm payrolls	559k	695k	750k	To be followed by further strong gains in H2, which should...
	Jun unemployment rate	5.8%	5.7%	5.7%	...see u/e rate fall to near full employment in 12-18mths.
	Jun average hourly earnings %mth	0.5%	0.4%	–	Hourly earnings have held up.
	May trade balance US$bn	–68.9	–70.9	–	Imports strong on rebounding demand.
	May factory orders	–0.6%	1.3%	–	Transport sector remain a drag on headline orders growth.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	5.4	3.8
CPI inflation %yr	1.9	1.8	1.8	0.9	2.6	1.8
Unemployment rate %	5.5	5.0	5.2	6.8	5.0	4.7
Current account % of GDP	-2.6	-2.1	0.7	2.6	4.2	2.6
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	6.5	4.1
CPI inflation %yr	2.1	2.4	1.9	1.2	2.9	2.2
Unemployment rate %	4.4	3.9	3.7	8.1	5.3	4.3
Current account % of GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
Japan						
Real GDP %yr	1.7	0.6	0.3	-4.8	2.7	2.1
Euro zone						
Real GDP %yr	2.6	1.9	1.3	-6.6	4.2	4.0
United Kingdom						
Real GDP %yr	1.7	1.3	1.4	-9.9	5.8	5.5
China						
Real GDP %yr	6.9	6.7	5.8	2.3	10.0	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.4	4.9	4.9
World						
Real GDP %yr	3.8	3.6	2.8	-3.3	5.9	4.6
Forecasts finalised 9 June 2021						

Interest rate forecasts	Latest	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Dec-23
Australia									
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.50	0.75
90 Day BBSW	0.03	0.04	0.07	0.10	0.15	0.20	0.40	0.70	0.95
10 Year Bond	1.56	1.95	2.10	2.20	2.30	2.40	2.50	2.70	2.90
International									
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.375	0.875	0.875
US 10 Year Bond	1.50	1.85	2.00	2.10	2.20	2.30	2.40	2.60	2.80

Exchange rate forecasts	Latest	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Dec-23
AUD/USD	0.7592	0.78	0.80	0.82	0.85	0.85	0.84	0.82	0.78
USD/JPY	110.85	111	111	112	112	113	113	114	115
EUR/USD	1.1941	1.22	1.23	1.24	1.23	1.22	1.21	1.20	1.19
GBP/USD	1.3933	1.42	1.43	1.43	1.44	1.45	1.45	1.44	1.43
USD/CNY	6.4654	6.30	6.20	6.15	6.10	6.05	6.00	6.00	5.95
AUD/NZD	1.0735	1.08	1.08	1.08	1.09	1.09	1.09	1.10	1.08

Contact the Westpac economics team.

Michael Gordon, Acting Chief Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Gregorius Steven, Economist
+64 9 367 3978

Any questions email:
economics@westpac.co.nz

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