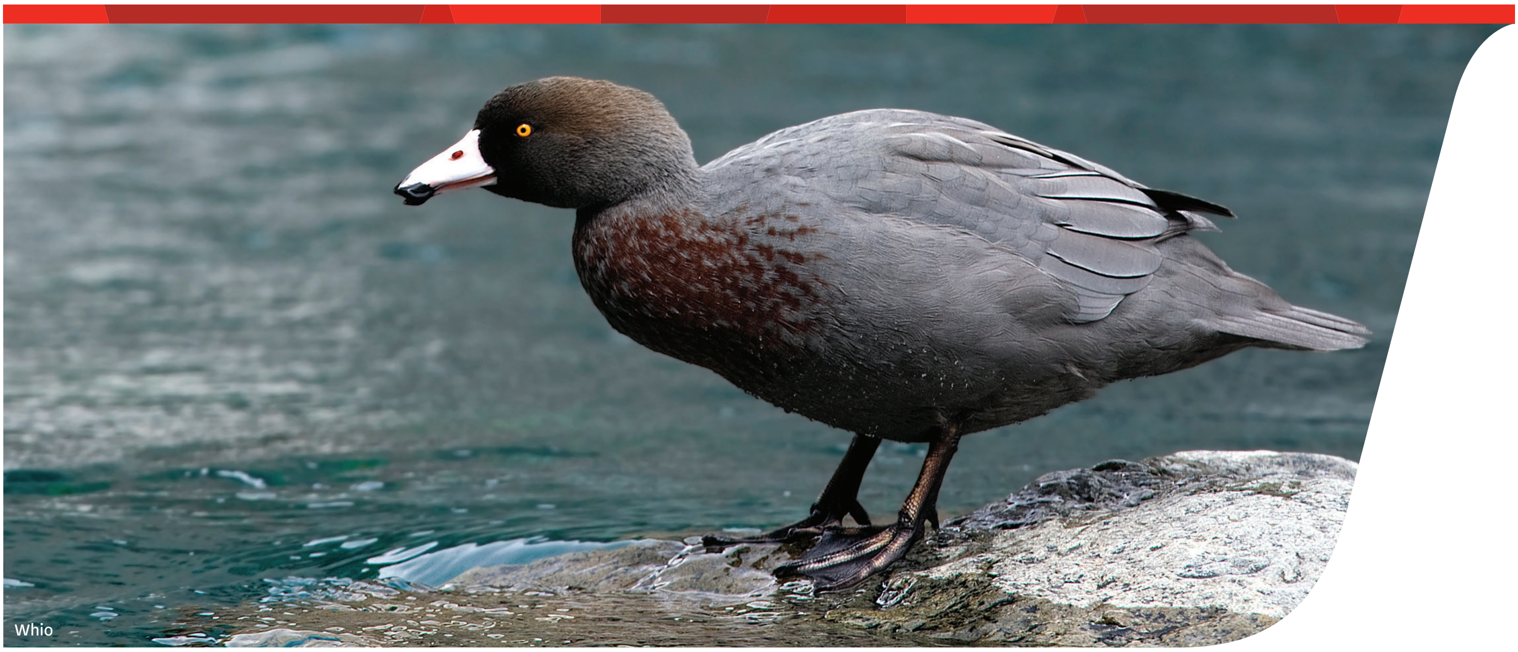
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Weekly Economic Commentary.

Déjà vu all over again for the RBNZ.

This week will be the RBNZ's first turn at bat since the Delta outbreak. We expect that the central bank will raise the cash rate by 25bps and that this will be followed by further hikes in November, February and May. Domestic demand is showing signs of resilience in the face of Delta headwinds, and inflation pressures are bubbling away. Against this backdrop, the RBNZ can start to ease its foot off the accelerator sooner than its peers in other regions. But the stance of policy is still dependent on the health situation.

The RBNZ was actually ready to hike the cash rate back in August. At that time, we were seeing strong activity and rising inflation pressures. That led the RBNZ to conclude (and we agreed) that the economy no longer needed the degree of emergency monetary stimulus that was introduced in the wake of last year's outbreak.

However, the RBNZ's August policy statement came the day after the country was thrust back into Alert Level 4 lockdown. And the potential disruptions to activity saw the RBNZ ultimately choosing to stand pat.

Seven weeks later (and for those of us in Auckland, after a lot of home baking), a lift in the OCR is back on the cards at Wednesday's *Monetary Policy Review*.

The big uncertainty in recent weeks has been how the economy would track in the wake of the Delta outbreak. And there have definitely been some tough times for many households and businesses in recent weeks, especially for those in customer facing industries like hospitality.

But despite the dialling up of the Alert Level, the economy as a whole still looks like it's on solid footing. Since the RBNZ's last outing, we've learned that the economy was running much hotter than expected prior to the lockdown, with GDP rising by a massive 2.8% in the June quarter. And while lockdown has dented economic activity in recent weeks, the impact looks like it will be relatively limited. In fact, in August (when the Alert Level was at its most restrictive) we actually saw a solid 0.7% lift in the number of filled jobs. Furthermore, since lockdown conditions have been eased in some regions, we've seen firmness in business sentiment (including plans for hiring and investment spending), while retail spending outside of Auckland has now retraced its earlier falls. Putting this altogether, it's looking very likely that there will be a rapid recovery in activity when the remaining health restrictions are eventually eased.

In addition to the firmness in demand, the past few weeks have seen cost pressures in the economy continuing to build. Much of this is a result of ongoing supply-side factors, such as disruptions to global manufacturing and shipping. That's resulted in shortages of some items and has seen the landed prices for many consumer goods and productive inputs rising rapidly in recent months.

Importantly, we think that those supply side disruptions are set to become more pronounced. Manufacturers globally are reporting ongoing difficulties sourcing chips and other components. And on top of that, shipping companies are expected to divert capacity towards markets in the Asia and Northern Hemisphere ahead of the Black Friday, Christmas and Lunar New Year shopping periods. Here in New Zealand, that combination signals ongoing difficulties sourcing some goods ahead of the holiday shopping season, along with continued upwards pressure on shipping costs and goods prices.

Globally, the extent of supply disruptions has raised questions about whether the current lift in inflation will be transitory or persistent, and there are related questions about how central banks should respond. Supply disruptions are a particular challenge for central banks as there's little that monetary policy can do to offset the inflationary impact of shocks that have already occurred. As a result, central banks will often treat cost shocks as 'look through' events.

However, New Zealand is in a different position to many other regions. The combination of very supportive monetary and fiscal policy, a housing market that's on fire and a strong labour market has supercharged domestic demand. That's given businesses greater scope to pass on cost increases into output prices. It also means that we're likely to see inflation holding firm even when supply disruptions eventually ease (though that could be some time away).

Against this backdrop, the RBNZ can start to ease its foot off the accelerator sooner than its peers in other regions. And with inflation pressures here looking like they will be enduring, we expect this week's policy decision will be the first in a series of rate hikes from the RBNZ over the next year.

Given the strength of demand and inflation, markets had been leaning towards the possibility of a 50 basis point move in recent weeks (as they had ahead of the August review). However, market pricing has now been wound back following comments from RBNZ Assistant Governor Hawkesby, which signalled a more measured approach from the central bank. While the RBNZ did take bold action in the wake of the initial outbreak, the risks for the economy are now more two-sided. Although we do expect that activity will rebound quickly as restrictions are relaxed, it's not a given. Indeed, as the spread of cases over the weekend has shown, the Delta variant is proving to be much trickier to rein in and the current outbreak is likely to have a long tail.

We don't expect this weekend's widening of the Alert Level 3 boundary will deter the RBNZ raising the cash rate this week. But it does provide a timely reminder of the powerful headwinds that are likely to continue buffeting the economy for some time. And that will have a bearing on the RBNZ's stance. As a result, while we do expect a run of rate hikes from the RBNZ over the coming year, that is likely to come in a series of small steady steps rather than in large bounds.

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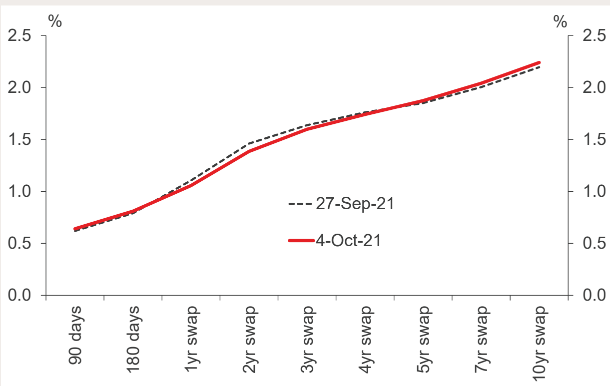
Fixed vs floating for mortgages.

We expect the Reserve Bank to start raising the OCR in October, with a series of increases over the coming months.

Based on our OCR forecasts over the coming years, we think there is value in moving beyond the currently popular one-year fixed term, towards terms of two to three years. Longer terms (out to five years) don't offer additional value, though they may be suitable for borrowers who value more certainty in their repayments.

NZ interest rates



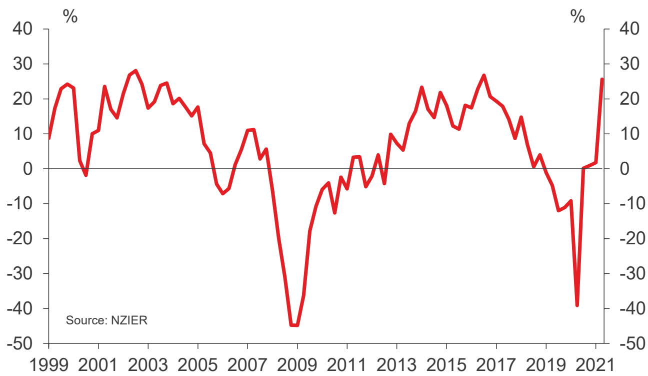
The week ahead.

NZ Q3 NZIER Quarterly Survey of Business Opinion

Oct 5, Domestic Trading Activity last: +25.6

- Business confidence improved in the June quarter, with firms feeling more upbeat about their own activity and employment. Notably, we saw much more evidence of firms being able to increase prices in response to rising costs, and of competition for workers in the face of labour shortages.
- It's likely that we'll see a sharp drop in current conditions in the Q3 survey, with the country moving back into Covid lockdown from 18 August. However, the forward-looking measures will be of interest, given that experience has shown that demand returns quickly once Covid restrictions are lifted.
- The pricing indicators in the survey will also be of interest, with concerns about cost pressures continuing to escalate in recent months.

QSBO domestic trading activity (past 3 mths)

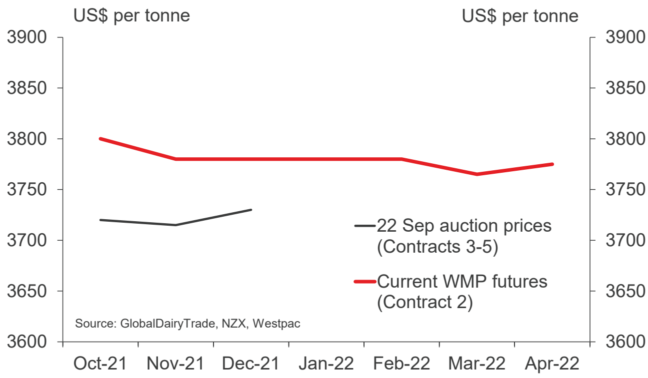


NZ GlobalDairyTrade auction, whole milk powder prices

Oct 6, Last: +2.2%, Westpac: +2.0%

- We expect whole milk powder prices to lift at the upcoming dairy auction. This lift would build on the circa 6% rise over the two September auctions.
- Our pick is in line with futures market pricing.
- Soft global supply has translated into higher global dairy prices of late. From here, New Zealand spring production will have a large bearing for the direction of global dairy prices. Data on this front will be available from the middle of the month.

Whole milk powder prices

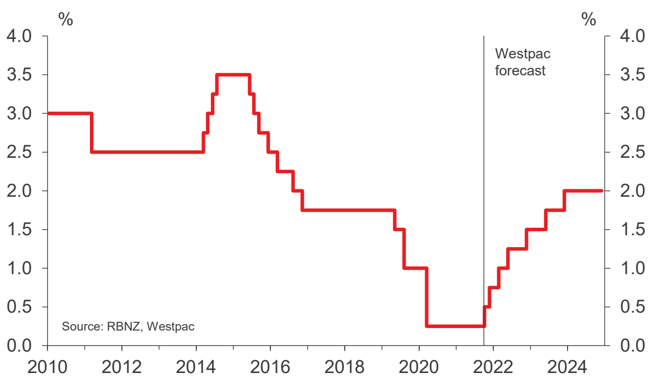


NZ RBNZ Monetary Policy Review

Oct 6, Last: 0.25%, WBC f/c: 0.50%, Market f/c: 0.50%

- We expect the Reserve Bank to lift the OCR by 25 basis points to 0.50%, and to endorse the path of future rate hikes that was projected in its August Monetary Policy Statement. This would be in line with current market pricing.
- The RBNZ was clearly poised to raise rates in August, until a fresh Covid-19 outbreak and a move back into lockdown just a day before the decision. However, it's likely that this will only constitute a delay to the RBNZ's plans.
- Experience has shown that demand tends to rebound rapidly once Covid restrictions are lifted. When that happens, the RBNZ will be back to facing the same situation as before – strong demand running up against cost pressures and capacity constraints.

RBNZ Official Cash Rate



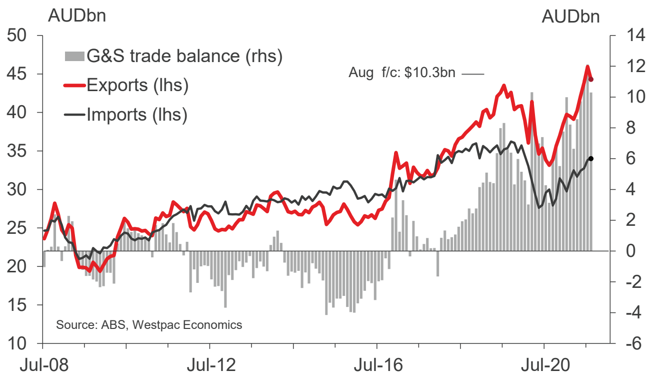
The week ahead.

Aus Aug trade balance, AUDbn

Oct 5, Last: 12.1, WBC f/c: 10.3
Mkt f/c: 10.0, Range: 8.5 to 12.5

- Australia's trade account has been in surplus for 43 consecutive months, from the start of 2018. The annual surplus widened to $74bn for 2020, with rising commodity prices the key driver.
- In July 2021, the monthly surplus hit a fresh record high, of $12.1bn.
- For August, the surplus is likely to pull-back from its high, to a forecast $10.3bn. The main mover, the reversal of the iron ore spot price, down by about 25%, from US$250 to around $160.
- Export earnings are expected to decline, down -3.6%, -$1.6bn. The lower iron ore price outweighing higher iron ore volumes and a likely lift in coal and LNG exports (a combination of prices and volumes).
- For imports, we have factored in a small rise, +0.5%, +$0.2bn, with considerable uncertainty associated with the lockdowns. The lower AUD, -1.7% on a TWI basis, made imports more expensive.

Aus trade balance

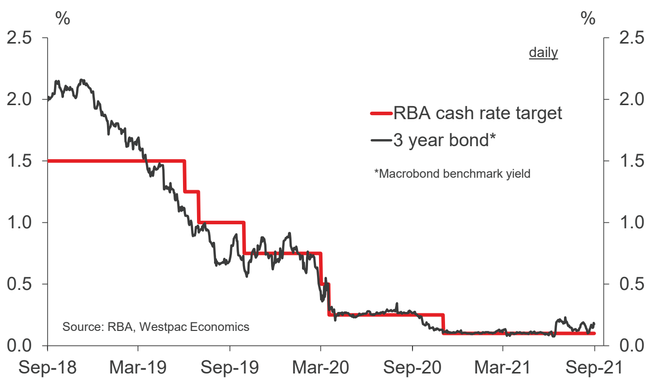


Aus Oct RBA policy decision

Oct 5, Last: 0.10%, WBC f/c: 0.10%
Mkt f/c: 0.10%, Range: 0.10% to 0.10%

- The RBA Board meeting for October is not expected to see any changes to policy settings.
- Recently, the main adjustment to policy has been around the weekly pace of government bonds. The pace was $5bn a week until early September. At the September meeting the Board confirmed the earlier decision to reduce that to $4bn a week - but now with the timing extended from November to at least mid February 2022.
- The cash rate target remains at 0.10%. The Governor in his speech on September 14 confirmed that "the Board ... will not increase the cash rate until actual inflation is sustainably within the 2-3% target range". Just how quickly inflation will return to the target range will be a key focus in 2022. Westpac remains of the view that rates are likely to rise in 2023, ahead of the timing currently envisaged by the RBA.

RBA cash rate and 3 year bonds

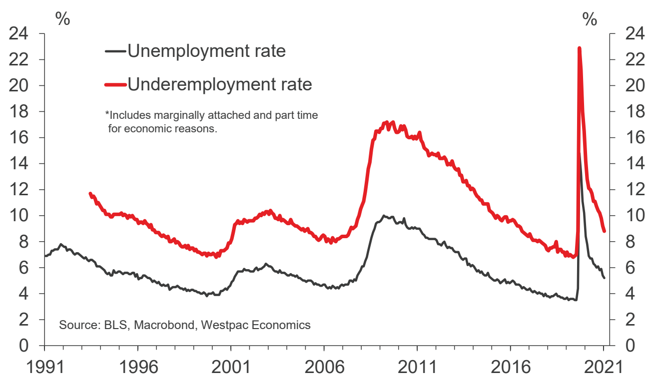


US Sep employment report

Oct 8 Last: 235k, Westpac f/c: 600k, Mkt f/c 500k

- Non-farm payrolls were surprisingly weak in August, printing at a fraction of the consensus estimate and the average of the three months prior. Considering all available data and anecdotes, it seems highly likely that this shock came as a result of supply restrictions stemming from the current delta wave sweeping the country.
- September is likely to see a robust bounce in job creation, we forecast a rise of 600k. However, part of this gain may instead come through revisions to August and July.
- To end 2022, if payrolls averages a gain of around 450k a month then, even with participation returning near its pre-pandemic rate, the unemployment rate will tend to its full employment level. We expect underemployment to also follow this trend, tightening up the labour market and supporting moderate gains in wages hence.

US heading for full employment by end 2022

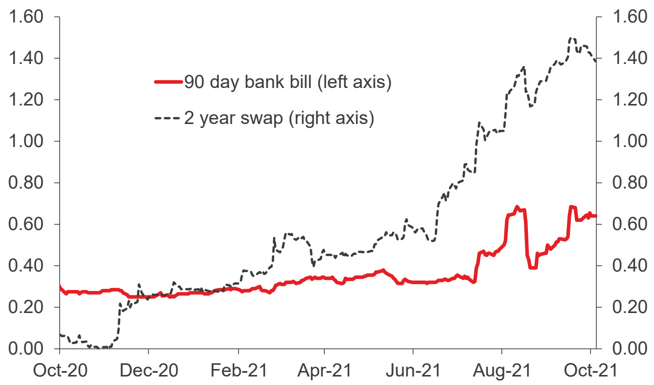


New Zealand forecasts.

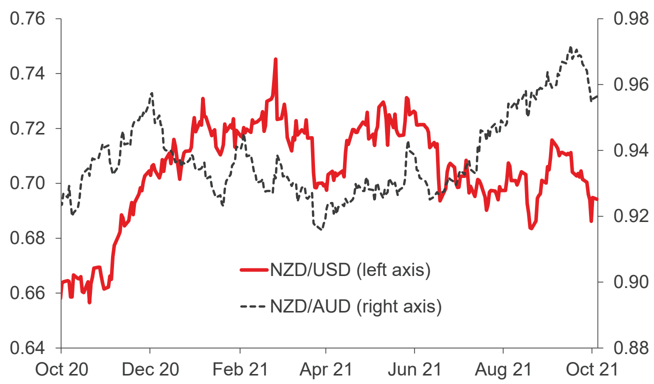
Economic forecasts	Quarterly				Annual			
	2021			2022				
% change	Jun (a)	Sep	Dec	Mar	2019	2020	2021f	2022f
GDP (Production)	2.8	-5.5	6.1	0.3	2.4	-2.1	5.2	4.2
Employment	1.1	0.0	0.5	0.7	1.2	0.7	2.2	1.8
Unemployment Rate % s.a.	4.0	3.8	4.2	3.8	4.0	4.8	4.2	3.5
CPI	1.3	1.2	0.3	0.7	1.9	1.4	3.7	2.5
Current Account Balance % of GDP	-3.3	-3.9	-4.5	-4.3	-2.9	-0.8	-4.5	-5.1

Financial forecasts	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Dec-23
Cash	0.75	1.00	1.25	1.25	1.50	1.50	1.75	2.00
90 Day bill	0.95	1.20	1.35	1.45	1.60	1.70	1.85	2.10
2 Year Swap	1.60	1.75	1.85	1.95	2.05	2.10	2.15	2.20
5 Year Swap	1.95	2.10	2.20	2.30	2.40	2.45	2.50	2.60
10 Year Bond	2.10	2.15	2.25	2.30	2.40	2.45	2.50	2.60
NZD/USD	0.71	0.72	0.73	0.74	0.74	0.74	0.74	0.73
NZD/AUD	0.95	0.95	0.95	0.95	0.95	0.94	0.93	0.94
NZD/JPY	78.8	80.6	81.8	82.9	83.6	83.6	84.4	84.0
NZD/EUR	0.58	0.59	0.60	0.61	0.61	0.61	0.62	0.61
NZD/GBP	0.50	0.50	0.51	0.51	0.51	0.51	0.51	0.51
TWI	73.9	74.1	74.8	75.4	75.3	75.1	75.0	74.2

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 4 October 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.46%	0.46%	0.32%
60 Days	0.55%	0.57%	0.40%
90 Days	0.64%	0.68%	0.48%
2 Year Swap	1.39%	1.50%	1.36%
5 Year Swap	1.87%	1.82%	1.74%

NZ foreign currency mid-rates as at 4 October 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6942	0.7035	0.7157
NZD/EUR	0.5988	0.5997	0.6023
NZD/GBP	0.5124	0.5118	0.5163
NZD/JPY	76.99	77.35	78.55
NZD/AUD	0.9564	0.9685	0.9597
TWI	74.21	75.01	75.56

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
Aus	Public holiday NSW, ACT, SA, Qld	–	–	–	Labour Day NSW, ACT, SA. Queen's Birthday Qld.
	Sep MI inflation gauge	2.5%	–	–	Up 0.9% in 3mths & lately has been a better guide to CPI.
Chn	Public holiday	–	–	–	National day from Oct 1st to 7th.
Eur	Oct Sentix investor confidence	19.6	19.0	–	Expected to remain firm on improving economic conditions.
US	Aug factory orders	0.4%	1.0%	–	Durable orders point to moderate investment g'th hence.
	Fedspeak	–	–	–	Bullard to speak on the economy.
Tue 05					
NZ	Q3 QSBO business opinion	25.6	–	–	Likely see a sharp drop in current conditons due to lockdowns.
	Sep ANZ commodity prices	–1.6%	–	–	Meat and dairy prices firmed over the month.
Aus	Aug trade balance $bn	12.1	10.0	10.3	Surplus to ease from record high on lower iron ore price.
	RBA policy decision	0.10%	0.10%	0.10%	Policy settings to remain unchanged at this meeting.
	Sep ANZ job ads	–2.5%	–	–	While vacancies remain at record highs lockdowns hit ads.
US	Aug trade balance US$bn	–70.1	–70.5	–	Consumer demand holding deficit wide.
	Sep ISM non–manufacturing	61.7	59.8	–	Delta a headwind, but consumer spend turning to services.
Wed 06					
NZ	GlobalDairyTrade auction (WMP)	2.2%	–	2.0%	Dairy prices strengthening on soft global supply.
	RBNZ policy decision	0.25%	0.50%	0.50%	Delta disruptions haven't offset broader firmness in conditions.
Eur	Aug retail sales	–2.3%	0.7%	–	Should rebound after healthy consumer confidence in Aug.
US	Sep ADP employment change	374k	430k	500k	ADP continues to lag payrolls on multi–month basis.
Thu 07					
Aus	Weekly payrolls, to 11 Sept	–0.7%	–	–	Covers the Labour Force reference weeks.
Chn	Sep foreign reserves $bn	3232.12	–		Have been stable in 2021.
US	Initial jobless claims	362k	–	–	Downtrend remains intact.
	Fedspeak	–	–	–	Mester to speak on inflation dynamics.
Fri 08					
Aus	RBA Financial Stability Review	–	–	–	The housing market and financial stability in focus.
Chn	Sep Caixin China PMI services	46.7	48.9	–	NBS services PMI saw a strong bounce in month.
US	Sep non–farm payrolls	235k	500k	600k	Aug was a one off. Job creation should surge back in Sep.
	Sep unemployment rate	5.2%	5.1%	5.0%	Participation lagging, putting downward pressure on U/E.
	Sep average hourly earnings	0.6%	0.4%	0.4%	Supply challenges a tailwind for hourly earnings.
	Aug wholesale inventories	1.2%	–	–	Inventories due for rebuild, but supply chain a constraint.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	3.0	5.0
CPI inflation %yr	1.9	1.8	1.8	0.9	2.6	2.2
Unemployment rate %	5.5	5.0	5.2	6.8	5.6	4.0
Current account % of GDP	-2.6	-2.1	0.7	2.7	4.3	2.6
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	5.8	4.2
CPI inflation %yr	2.1	2.4	1.9	1.2	4.3	2.8
Unemployment rate %	4.4	3.9	3.7	8.1	5.4	4.0
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	2.3	2.7
Euro zone						
Real GDP %yr	2.6	1.9	1.3	-6.6	4.6	4.4
United Kingdom						
Real GDP %yr	1.7	1.3	1.4	-9.9	6.7	5.5
China						
Real GDP %yr	6.9	6.7	5.8	2.3	8.5	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.4	4.2	4.9
World						
Real GDP %yr	3.8	3.6	2.8	-3.3	5.5	4.6
Forecasts finalised 8 September 2021						

Interest rate forecasts	Latest	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22	Mar–23	Jun–23	Dec–23
Australia									
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.50	0.75
90 Day BBSW	0.02	0.07	0.10	0.15	0.20	0.40	0.65	0.70	0.95
10 Year Bond	1.48	1.55	1.70	1.80	1.90	2.00	2.05	2.10	2.20
International									
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.375	0.625	0.875	0.875
US 10 Year Bond	1.48	1.60	1.70	1.80	1.90	2.00	2.05	2.10	2.20

Exchange rate forecasts	Latest	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22	Mar–23	Jun–23	Dec–23
AUD/USD	0.7215	0.75	0.76	0.77	0.78	0.78	0.79	0.80	0.78
USD/JPY	111.16	111	112	112	112	113	113	114	115
EUR/USD	1.1581	1.21	1.23	1.22	1.21	1.21	1.21	1.20	1.19
GBP/USD	1.3460	1.41	1.43	1.44	1.45	1.44	1.44	1.43	1.42
USD/CNY	6.4448	6.35	6.30	6.25	6.25	6.20	6.20	6.15	6.10
AUD/NZD	1.0467	1.06	1.06	1.05	1.05	1.05	1.07	1.08	1.07

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