



Mōhua

# Weekly Economic Commentary.

## In the good books.

After waning a little over summer, the economic recovery has regained momentum this autumn. In contrast and somewhat surprisingly, the housing market has maintained momentum through both seasons. Speaking of momentum, the government books have built up a head of steam and this week's Budget is going to make good reading when compared the gloomy updates over past year.

The New Zealand economy is regaining momentum after a soft patch over the summer months. Data over the autumn months to date have been firm, and last week was no different. Electronic card spending printed strong for April, while housing market data remained perky.

Digging into the housing market data, sales did slip a little over April, but they remain comfortably above their pre-Covid levels. Meanwhile, house price inflation has retained its momentum, with prices recording a further 1.9% jump over the month. That jump takes the annual house price change up to a whopping 26.8%.

Altogether, the latest report doesn't offer much evidence for a cooling in the housing market yet. At most, it's slowed from its previous white-hot pace back to just red-hot.

Moreover, there is no evidence yet that the Government's housing policy changes have cooled the market. Recall that the Government announced a suite of housing policy changes back in March. April was the first full month of these policies being in play.

Back in March, we labelled the changes as the biggest in 30 years. In particular, we viewed the removal of tax deductibility for landlords as a game changer in terms of easing upward pressure on house prices. But it appears that these policies have a lot of work to do to combat the appeal of record-low mortgage rates. Indeed, this is something that was already reflected in our forecast from before the recent policy changes which assumed continued solid rises in prices over the next two years.



With that in mind, the April results present an upside risk to our forecast that house prices would flatten off over the rest of this year. That said, continued house price strength would also increase the chances of a further policy response.

On the policy front, Finance Minister Grant Robertson will deliver the Budget on Thursday. Budget 2021 will show that the Covid hit to the Government's books has been significantly less than anyone feared. The Government's Covid response has been a resounding success. The benefits of last year's strict lockdown have flowed not only in a health sense, but also economically and financially. And economic policies like the wage subsidy have been similarly effective.

Putting some numbers on the success, we expect this year's operating balance to end up around \$8 billion higher than the Treasury forecast back in December. And from that point, we anticipate that the deficit will progressively narrow so that the operating balance approaches zero by 2025.

The prospect of an operating balance returning to near surplus should by no means be read as an obsession with balancing the books. On top of this, the Government is planning several billion dollars per year of capital spending (which it will top up further in this Budget). Altogether, it will still be spending much more money than it brings in over the next five years, and still has a significant borrowing requirement.

Some of the improvement in the accounts reflects that the Treasury's economic forecasts were the most pessimistic of the lot. For example, we expect 4.7% growth in the June 2021 year, whereas back at the end of last year the Treasury had projected just 1.5%. With that in mind, Treasury's large upward revisions will also ultimately flow through to a significantly smaller Government bond issuance programme.

Budget 2021 is also likely to be a case of the Government having its cake and eating it too. Such has been the magnitude

of the positive surprise, the Finance Minister will be able to present massively improved fiscal accounts on Thursday and at the same time announce an increase in spending and investment plans.

Indeed, the Government has the political capital to burn. Its handling of the pandemic and its outright majority in parliament have given it the mandate to unashamedly pursue its policy goals. This means that effectively, the Government has returned to its Wellbeing Budget goals from 2019, with Covid recovery goals added as appropriate.

Putting this into effect, the Finance Minister has foreshadowed that he will lift Budget operating and capital allowances beyond that announced in the Budget Policy Statement back in February. We have allowed for an additional \$1 billion and \$2 billion for the operating and capital allowances, respectively. That said and given the size of the improvement in the books, we wouldn't rule out larger increases.

We have no fixed view as to what the additional spending is earmarked for other than it will broadly align with the Government's Wellbeing priorities. That said, there isn't the same urgency to create jobs lost because of Covid, with the unemployment rate falling to a relatively low 4.7% over the March quarter. Recall that the unemployment was 4.0% pre-Covid and then peaked at 5.2% in the September 2020 quarter.

All up, we anticipate the Budget to show a relatively rosy picture of the economy and the Government's accounts. Indeed, so soon after the pandemic, the kinds of numbers presented will be the envy of many a nation.

**Nathan Penny**, Senior Agri Economist

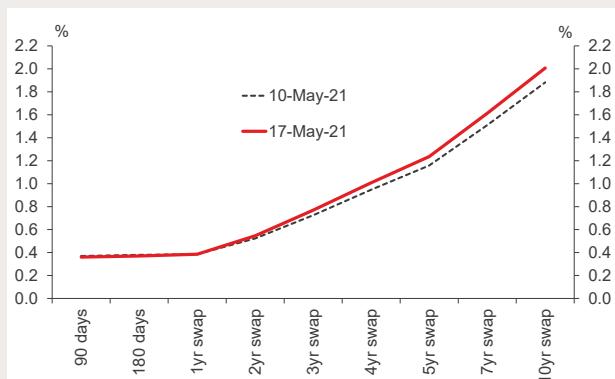
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## Fixed vs Floating for mortgages.

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. Based on our forecasts, taking a longer-term fixed rate (three to five years) will still be less expensive for borrowers than taking a short-term rate now and refixing later. However, the advantage is narrowing.

### NZ interest rates



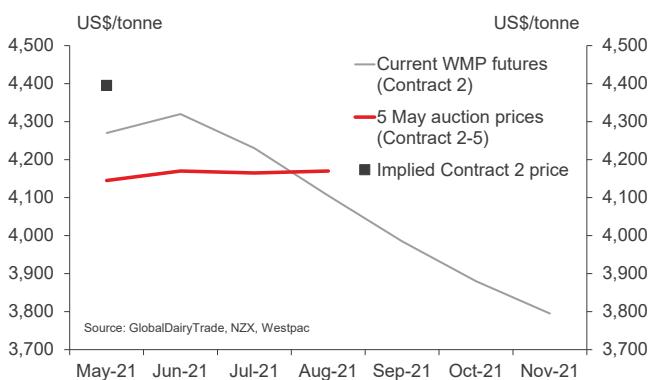
# The week ahead.

## NZ GlobalDairyTrade auction, whole milk powder prices

**May 19, Last: +0.7%, Westpac: +2.0%**

- We expect whole milk powder prices to lift 2% at the upcoming dairy auction. Prices trickled higher over both April auctions.
- Our pick is largely in line with current futures market pricing.
- With the New Zealand winter looming, we expect continued upwards pressure on dairy auction prices until the new season kicks off in the spring.

## Whole milk powder prices

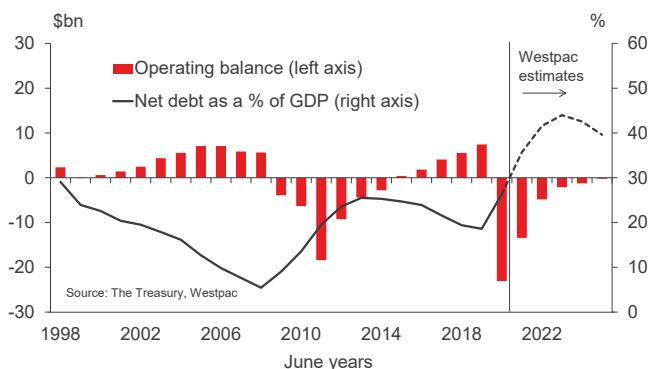


## NZ Government Budget 2021

**May 20**

- Budget 2021 will show a dramatic improvement in New Zealand's fiscal position compared to the Half-Year Update.
- Essentially, the Covid hit to the Government's books has been significantly less than anyone feared and particularly so for the Treasury.
- Tax revenue and the operating balance tracks will show large upward revisions, and with a sharply lower debt track, Treasury will pare back bond issuance plans.
- While banking some of this upside surprise, the Government has also indicated that it will dial up its spending and investment plans in Budget 2021.

## NZ fiscal position

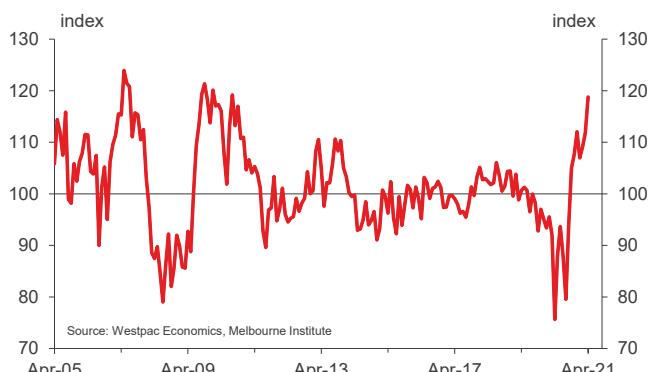


## Aus May Westpac-MI Consumer Sentiment

**May 19, Last: 118.8**

- Sentiment surged to a 10yr high in April. The result was all the more extraordinary given concerns about the end of the government's JobKeeper program and disappointing news around the vaccine roll-out locally. Positive news on jobs and a big pick-up in key sectors – 'recreational services', hospitality and construction – look to have been the main sources of strength.
- The May survey is in the field over the week to May 15. It will capture reactions to the Federal Budget – likely to be positive given stimulus measures and the over-arching aim of 'going for growth'. Other developments also look likely to be mostly positive with another strong jobs report (the unemployment rate dropping to 5.6% in March), the ASX pushing towards new highs on a surge in iron ore prices, and housing markets continuing to boom (although this can be a 'wedge' issue for sentiment). The vaccine roll-out also looks to be gaining more traction. Concerns about worsening trade relations with China may take some of the gloss off.

## Aus Consumer Sentiment Index



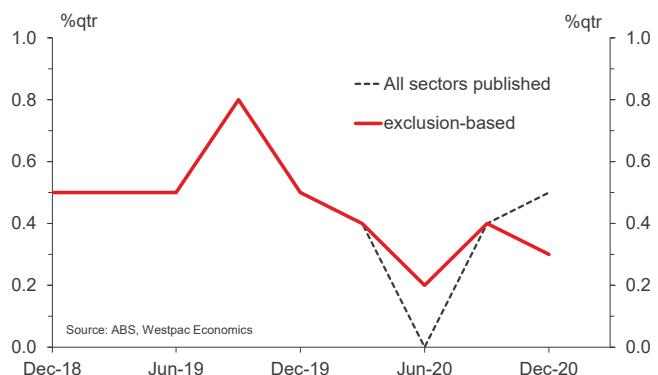
# The week ahead.

## Aus Q1 Wage Price Index (WPI)

**May 19, Last: 0.6%, WBC f/c: 0.6%**  
**Mkt f/c: 0.5%, Range: 0.4% to 0.7%**

- The WPI lifted 0.6% in the December quarter. However, base effects saw the annual pace hold at a record low of 1.4%/yr.
- Private sector wages led the rise in December. In contrast, wage growth in the public sector has been muted.
- The ABS produced a special "exclusion-based measure" of the WPI. This series removes the impacts of the short-term wage cuts and subsequent reinstatements that occurred throughout 2020, giving us a measure of "underlying" momentum in wages. In original terms, exclusion-based wages rose by 0.3% in Q4.
- We think the underlying momentum, seasonally adjusted, for wages was around 0.4% in December. Assuming the same pace in March, and allowing for a further catch up in wages lost in the Covid period, we have penciled in a 0.6% rise.

## Aus Wage Price Index

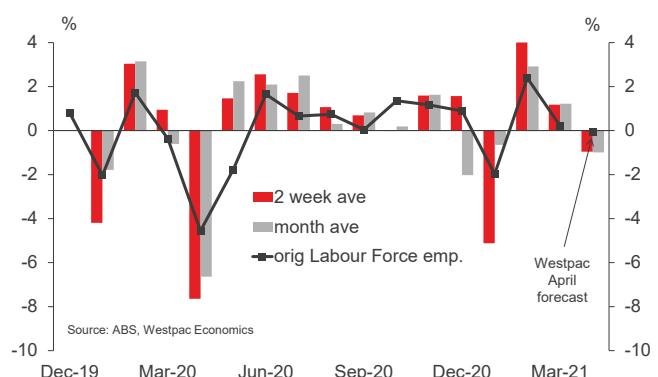


## Aus Apr Labour Force employment '000

**May 20, Last: 70.7, WBC f/c: 10.0**  
**Mkt f/c: 20.0, Range: -40.0 to 60.0**

- Total employment rose 70.7k in March, firmly above our estimate of 32.0k and the market median of 35.0k (the upper end of the market range was 65.0k). Job gains were concentrated exclusively in part-time employment, which advanced 91.5k and more than offset a 20.8k fall in full-time. This leaves part-time employment up almost 77k compared to a year ago, while full time is 2.5k below March 2020.
- For April, there are number of factors pulling in opposite directions. On the positive side is the robust jobs vacancies data and surging employment indicators pointing to strong demand for labour. On the negative side is the ending of Jobkeeper and the languishing of tourism and hospitality industries in the CBDs in particular. Add to this, those industries that are growing are finding it hard to recruit labour.
- Weekly Payrolls are pointing to a soft patch in employment but caution is needed here as the Easter Holidays fell in the reference period and the ABS will seasonally adjust for this.

## Aus employment growth

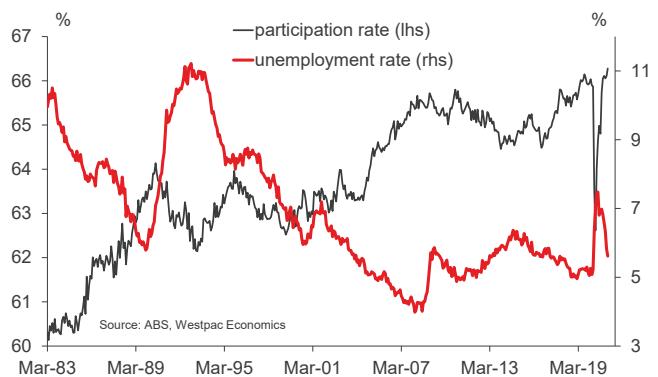


## Aus Apr unemployment rate

**May 20, Last: 5.6%, WBC f/c: 5.6%**  
**Mkt f/c: 5.6%, Range: 5.8% to 5.4%**

- In March the 70.7k gain in employment was enough to push the unemployment rate down to 5.6%, from 5.8%, despite participation rising 0.2pps to a record 66.3%. This saw a 43.6k jump in the labour force.
- The fall in the unemployment rate was accompanied by significant reduction in underemployment, which was down an outsized 0.6pps to 7.9%. This leaves underemployment 1.1% below its pre-Covid (March 2020) level. Underutilisation also came off 0.8pps to 13.5%.
- For April, if the participation rate is flat at 66.3% this will generate a 12.8k rise in the labour force thus holding the unemployment rate flat at 5.6% with a 10k rise in employment.
- For the balance of risks, assuming flat participation if employment rose 30k unemployment would be 5.5%, if employment -10k fell unemployment would be 5.8%.

## Aus labour market participation and unemployment



# The week ahead.

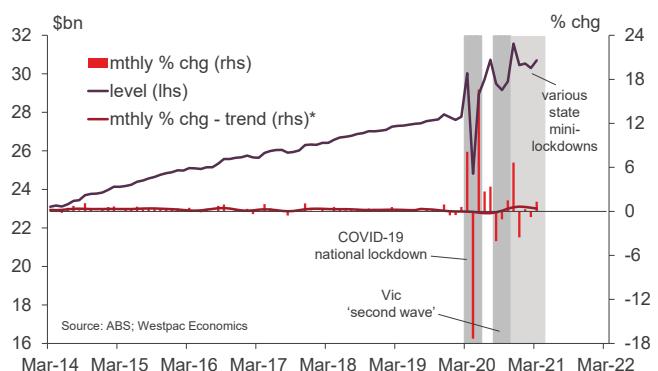
## Aus Apr preliminary retail trade

**May 21, Last: 1.3%, WBC f/c: 0.8%**

**Mkt f/c: 0.5%, Range: -1.2% to 1.5%**

- Retail sales rose 1.3% in the March month, a decent gain in an otherwise mixed quarter affected by 'mini-lockdowns' in several states and floods across parts of eastern Australia. The rise in the month was driven by reopening rebounds in Vic and WA and a strong lift in cafes and restaurants. Note that retail was starting the year at a high level, having surged 9.7% over 2020, boosted by expenditure switching during COVID.
- Consumer sentiment hit an 11yr high in April as the further relaxation of COVID restrictions and a strong housing upturn more than offset concerns about the expiring JobKeeper scheme and setbacks to vaccine rollouts. However, this may not see much of a boost to retail reopening rebounds are driving a big switch back in spending to service sectors outside the scope of the retail survey. Our Westpac Card Tracker suggests retail sales posted a modest gain in April but was a poor guide in March. On balance we expect sales to be up 0.8%, annual growth set to spike to an extraordinary 24%yr on base effects from last year's lockdown.

## Aus monthly retail sales

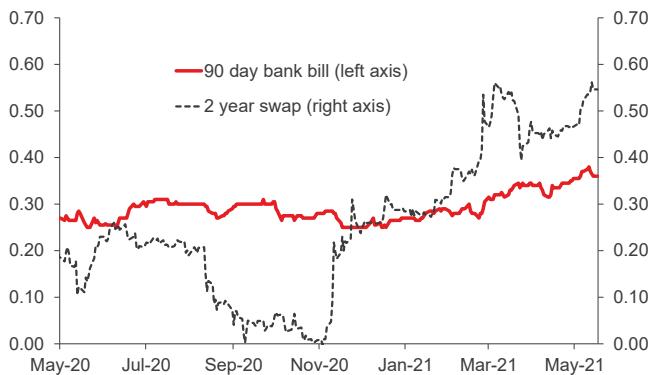


# New Zealand forecasts.

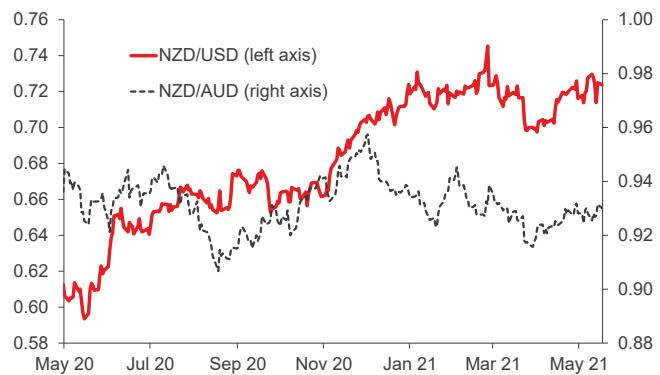
Economic forecasts	Quarterly				Annual			
	2020	2021			2019	2020	2021f	2022f
% change	Dec (a)	Mar	Jun	Sep				
GDP (Production)	-1.0	-0.4	1.8	0.4	2.4	-2.9	3.9	4.0
Employment	0.6	0.5	0.1	0.4	1.2	0.8	1.4	2.1
Unemployment Rate % s.a.	4.9	4.7	4.7	4.6	4.1	4.9	4.5	4.1
CPI	0.5	0.8	0.5	0.7	1.9	1.4	2.4	1.3
Current Account Balance % of GDP	-1.0	-1.4	-2.1	-2.5	-3.3	-1.0	-2.5	-2.2

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	0.35	0.35	0.35	0.35	0.35	0.35
2 Year Swap	0.45	0.45	0.45	0.45	0.45	0.45
5 Year Swap	1.00	1.00	1.00	1.00	1.05	1.10
10 Year Bond	1.80	1.85	1.90	1.95	2.00	2.10
NZD/USD	0.73	0.73	0.74	0.76	0.76	0.76
NZD/AUD	0.92	0.91	0.90	0.89	0.89	0.89
NZD/JPY	79.6	80.3	82.1	85.1	84.4	84.4
NZD/EUR	0.61	0.60	0.60	0.61	0.60	0.60
NZD/GBP	0.52	0.52	0.52	0.54	0.54	0.54
TWI	75.6	74.9	75.0	76.1	75.7	75.5

## 2 year swap and 90 day bank bills



## NZD/USD and NZD/AUD



## NZ interest rates as at market open on 17 May 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.26%	0.26%
60 Days	0.32%	0.31%	0.30%
90 Days	0.36%	0.36%	0.34%
2 Year Swap	0.55%	0.47%	0.45%
5 Year Swap	1.24%	1.07%	1.05%

## NZ foreign currency mid-rates as at 17 May 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.7238	0.7170	0.7140
NZD/EUR	0.5961	0.5958	0.5965
NZD/GBP	0.5136	0.5188	0.5163
NZD/JPY	79.12	78.29	77.67
NZD/AUD	0.9301	0.9293	0.9247
TWI	75.36	74.96	74.86

# Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 17</b>					
NZ	Apr BusinessNZ PSI	52.4	-	-	Upside risk as Alert Level 1 resumed for the whole month.
	Mar net migration	674	-	-	Still at low levels due to the border closure.
Chn	Apr industrial production	24.5%	21.1%	-	Coming off pandemic rebound peak, but momentum...
	Apr fixed asset investment ytd %/yr	25.6%	19.8%	-	... will remain strong, with capacity and income...
	Apr retail sales YTD %/yr	33.9%	31.9%	-	... gaining at a robust pace, and with it retail spending.
UK	May Rightmove house prices	2.1%	-	-	Driven by record-low interest rates and monetary stimulus.
US	May Fed Empire state index	26.3	23.9	-	April showed mfg was expanding at its fastest pace since 2017.
	May NAHB housing market index	83	83	-	Eased off series record, but still remains elevated.
	Mar total net TIC flows	72.6	-	-	China Tsy holdings at record highs on rising yields.
	Fedspeak	-	-	-	Vice Chair Clarida and Bostic to speak.
<b>Tue 18</b>					
Aus	RBA minutes	-	-	-	Upcoming July decisions on yield curve control & QE in focus.
Eur	Mar trade balance €bn	18.4	-	-	Surplus pared back in Feb on rising imports.
	Q1 GDP	-0.6%	-0.6%	-	Second estimate; more detail on components.
UK	Mar ILO unemployment rate	4.9%	-	-	Extended furlough scheme to hold down u/e.
US	Apr building permits	2.7%	0.6%	-	Strong growth in family home permits as hhds seek space.
	Apr housing starts	19.4%	-2.0%	-	Set to ease back after catch-up surge in March.
	Fedspeak	-	-	-	FOMC's Kaplan in Panel Discussion at Atlanta Fed Conf.
<b>Wed 19</b>					
NZ	GlobalDairyTrade auction (WMP)	0.7%	-	2.0%	Dairy prices rising as NZ production slows over winter.
Aus	May WBC-MI Consumer Sentiment	118.8	-	-	Sentiment hit an extraordinary 10yr high in April.
	Q1 wage cost index	0.6%	0.5%	0.6%	Q1 boosted by COVID wage cut reversals.
UK	Apr CPI	0.3%	-	-	To see strong year-on-year growth due to base effects.
<b>Thu 20</b>					
NZ	NZ Government Budget 2021	-	-	-	Budget will show a dramatic improvement in fiscal position.
Aus	Apr employment, 000'	70.7	20.0	10.0	Payrolls suggest weak print but ABS will adjust for Easter.
	Apr unemployment rate	5.6%	5.6%	5.6%	JobKeeper ending, improving unemployment stalls at 5.6%.
	May inflation expectations	3.2%	-	-	Expectations peaked in March at 4.1% flattening the trend.
US	May Philly Fed index	50.2	43.2	-	Signalling strong rise in prices paid and general activity.
	Initial jobless claims	473k	-	-	Hit another pandemic low last week as downtrend continues.
	Apr leading index	1.3%	1.2%	-	Jobless claims, ISM new orders will be sources of strength.
	FOMC Meeting Minutes	-	-	-	To talk around distribution of risks to the economic outlook.
	Fedspeak	-	-	-	FOMC's Bullard and Bostic to speak.
<b>Fri 21</b>					
Aus	Apr retail sales	1.3%	0.5%	0.8%	Retailers have had a mixed start to 2021.
Eur	May Markit PMIs	-	-	-	Mfg and Services PMIs for Euro Area and UK.
	May consumer confidence	-8.1	-7.5	-	Will find some support in the improvement of the rollout.
UK	May GfK consumer sentiment	-15	-	-	Nearing pre-pandemic levels. To rise as restrictions relax.
	Apr retail sales	5.4%	-	-	Pent-up demand will drive spending into second half.
US	May Markit manufacturing PMI	60.5	60.8	-	Manufacturing sector expanding briskly on reopening...
	May Markit services PMI	64.7	64.9	-	... and services spurred by stimulus and consumer spending.
	Apr existing home sales	-3.7%	0.8%	-	Elevated prices and lack of supply constraining turnover.

# International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
<b>Australia</b>						
Real GDP %oyr	2.4	2.8	1.9	-2.4	5.2	3.6
CPI inflation %oyr	1.9	1.8	1.8	0.9	2.2	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	2.5	3.5	1.9
<b>United States</b>						
Real GDP %oyr	2.3	3.0	2.2	-3.5	6.5	4.1
CPI inflation %oyr	2.1	2.4	1.9	1.2	2.9	2.1
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
<b>Japan</b>						
Real GDP %oyr	1.7	0.6	0.3	-4.8	2.7	2.1
<b>Euro zone</b>						
Real GDP %oyr	2.6	1.9	1.3	-6.6	4.2	4.0
<b>United Kingdom</b>						
Real GDP %oyr	1.7	1.3	1.4	-9.9	5.5	5.5
<b>China</b>						
Real GDP %oyr	6.9	6.7	5.8	2.3	10.0	5.7
<b>East Asia ex China</b>						
Real GDP %oyr	4.7	4.4	3.7	-2.4	4.8	4.9
<b>World</b>						
Real GDP %oyr	3.8	3.6	2.8	-3.3	5.9	4.5
Forecasts finalised 7 May 2021						

Interest rate forecasts	Latest	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
<b>Australia</b>								
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.04	0.05	0.07	0.09	0.10	0.10	0.10	0.10
10 Year Bond	1.79	1.85	1.95	2.10	2.20	2.30	2.40	2.50
<b>International</b>								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.65	1.75	1.85	2.00	2.10	2.20	2.30	2.40

Exchange rate forecasts	Latest	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
AUD/USD	0.7721	0.79	0.80	0.82	0.85	0.85	0.85	0.85
USD/JPY	109.57	109	109	110	111	111	111	110
EUR/USD	1.2085	1.21	1.21	1.23	1.25	1.26	1.27	1.27
GBP/USD	1.4044	1.40	1.40	1.41	1.41	1.41	1.42	1.42
USD/CNY	6.4450	6.40	6.30	6.20	6.15	6.10	6.05	6.00
AUD/NZD	1.0762	1.08	1.10	1.11	1.12	1.12	1.12	1.12

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