

WESTPAC WEEKLY ECONOMIC COMMENTARY

Here we go.

14 February 2022



Kākābeak/ngutukākā

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Spending appetites were perkier than we expected in the early part of 2022, as New Zealanders took advantage of an easing in Covid restrictions. But the Omicron wave is now firmly under way, and the experiences in other countries tell us what we have to look forward to over the coming weeks.

Spending on debit and credit cards rose 2.1% in January, a bigger lift than we had expected. Retail spending is now up 5.7% on a year earlier, although rising prices in that time mean that the volume of purchases has probably been more static.

Hospitality accounted for much of January's rise. Hospitality spending in the previous months had been constrained by Covid-related health restrictions. As those restrictions have eased, spending has surprisingly risen back to almost its pre-Delta levels (though again, with higher prices in that time).

That rebound is likely to prove short-lived. Confirmed Covid cases have surged higher in recent days, and with a string of public holidays and long weekends now out of the way, it seems that we're getting something closer to the true picture of the virus' advance.

Countries where the Omicron wave began earlier, such as Australia, give us a good idea of what to expect from here. Case numbers will continue to go near-vertical, reaching a peak 3-5 weeks after the spike began. Infections will far exceed the peaks seen in earlier waves, and there's likely to be a high degree of undercounting if testing capacity is strained. For

any individual the risk of severe illness is much lower than for previous variants, but the sheer number of cases means that hospitals could still be overwhelmed during the peak.

Recent anecdotes and higher-frequency spending data suggest that people have already been bracing for this wave, with city centres emptying out and spending on dining out starting to drop. Fear of Omicron itself will no doubt be a driver of that reduced activity. It also may be that New Zealand's relatively lengthy requirements for self-isolation mean that for many people, even becoming a close contact is an unattractive prospect. Covid infections and self-isolation requirements will mean abnormally high rates of worker absenteeism, and as we saw in Australia, this could put a strain on already-fragile supply chains.

From our perspective, the reality is that the economic data is going to be messy over the next couple of months. What's more, it won't tell us much about how things will look on the other side of the wave.

One thing that will certainly be waiting for us on the other side is the inflation issue. Stats NZ's cost of living index for the

December quarter showed that no groups have been spared from the increasingly broad-based rise in prices over the last year. Low-income households actually took the smallest hit, reflecting the fact that rents – which make up a larger share of their living costs – rose by less than the wider CPI. But that was an exception to wider trend that prices have tended to rise faster for those who are less able to protect themselves from inflation.

The Reserve Bank’s survey of expectations shows that businesses and forecasters are becoming less confident that inflation will be well-contained. Expectations for inflation a year from now jumped to 4.4% in the March survey, while expectations for two years ahead rose to 3.27%, both above the upper band of the RBNZ’s target range. Admittedly, responses over those horizons tend to follow the most recent inflation outturn more than they should. But expectations over the 5-year and 10-year horizons – which are less of a forecast and more a poll on the credibility of the inflation target – are also starting to drift away from the 2% midpoint.

The RBNZ’s next *Monetary Policy Statement* is on 23 February. We’ll release our full preview later this week, but it’s clear that there will be a lot for the RBNZ to digest since its last policy review three months ago.

On the one hand, December quarter inflation printed even higher than the RBNZ expected, and anecdotes also point to it becoming more persistent. That on its own would suggest a need for further monetary policy action. However, early signs that higher interest rates are having a cooling effect on the housing market will be welcome (the sales figures for January will be released on Tuesday). And as the RBNZ noted in November, it’s not clear how households’ spending appetites will adapt to living with Covid in the community – not least because the Omicron wave will be in full force at the time the RBNZ makes its deliberations.

There’s no question that the OCR has higher to go, with the debate now around the extent and pace of rate hikes. Our view remains for a 3% peak in the OCR by the second half of 2023, which can be reached in a series of 25 basis point steps. However, financial markets continue to price in a high chance of a 50 basis point move at this month’s review, and wholesale interest rates have risen further.

We suspect the local market is being dragged along by overseas trends, as speculation grows about interest rate hikes in the US and Australia in the near future. But these central banks are more at risk than the RBNZ of falling behind the curve on inflation – the RBA has only just ended its bond buying programme, the Fed is just starting to slow down its purchases, and neither have started lifting their policy interest rates yet.

Michael Gordon, Acting Chief Economist

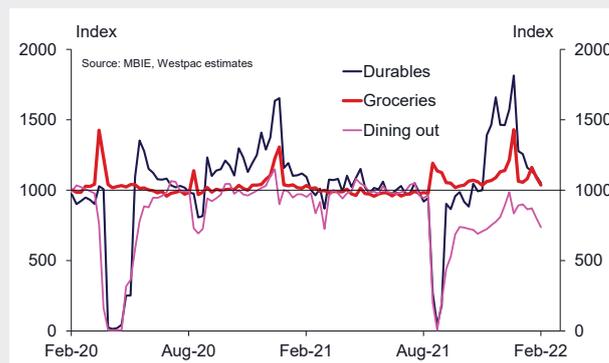
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Chart of the week

As New Zealand has moved away from elimination to living with Covid in the community, household spending is now starting to show the split that we’ve seen in other countries – less on services, more on physical goods. Card spending on durable goods has remained solid, with a particularly strong Christmas period, and supermarkets are benefiting from people stocking up and eating more at home. However, spending on dining out remains well down on pre-Delta levels, and is likely to fall further as Omicron gathers momentum.

NZ weekly retail spending

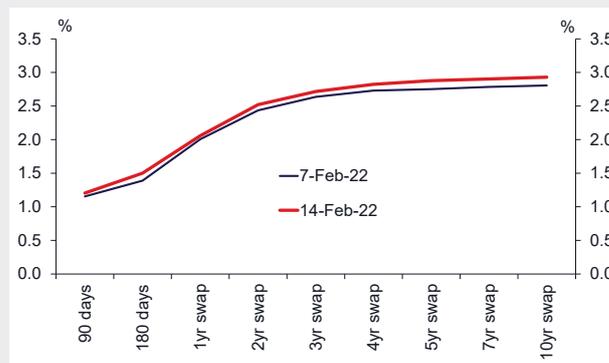


Fixed vs floating for mortgages

Wholesale interest rates are now largely in line with our forecast of a 3% cash rate by mid-2023. That suggests there is no longer an advantage to fixing for longer terms.

While the one-year mortgage rate is likely to rise further in the next couple of years, fixing and rolling for this term is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms are more suited to those who want certainty in their repayments.

NZ interest rates



The week ahead

NZ Jan REINZ house sales and prices

Feb 15, Sales last: -8.2%, Prices last: +23.3%/yr

Higher mortgage rates and tighter lending regulations are now having an impact on the housing market. Sales had fallen back below pre-pandemic levels by December last year, and the stock of unsold homes has started to lift from its lows. However, January data suggests that new listings have also slowed as sellers react to the cooling of the market.

The REINZ house price index fell 0.5% in the December month. That was largely due to volatility in the Auckland figures, but for the rest of the country the pace of increase has clearly slowed in the last few months. The annual rate of growth is now dropping sharply, reflecting the fact that the market was running white-hot a year ago.

Our view is that higher interest rates will see the housing market tip over into modest price declines from the second half of this year and into next year. However, even this wouldn't see prices fully unwind the gains they made in 2021 alone.

Whole milk powder prices



NZ GlobalDairyTrade auction, whole milk powder prices

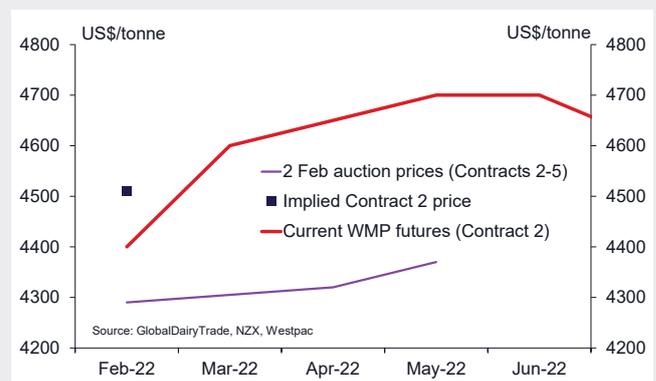
Feb 16, Last: +5.8%, Westpac: 2%

We expect whole milk powder prices (WMP) to lift a further 2% at the upcoming dairy auction. The lift would be on top of the circa 12% lift to date this year.

Our pick is slightly more modest than futures market pricing, where a lift of around 4% is expected.

Very weak New Zealand dairy production has given dairy prices fresh impetus this year. December production was 5.5% down on December 2020. We expect this weakness to continue and to support a lift in prices in the short term.

REINZ house prices and sales



Aus Jan Westpac-MI Leading Index

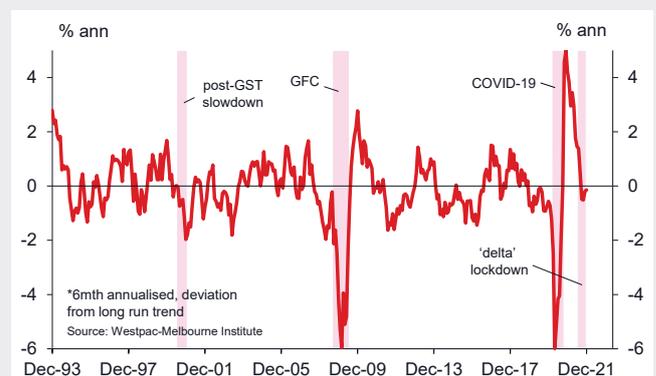
Feb 16, Last: -0.15%

The six-month annualised growth rate nudged up from -0.19% in November to -0.15% in December. Local momentum is mixed with a strong post-delta reopening running into some early drags from the spectacular omicron outbreak around the turn of the year.

The Jan read looks likely to see reopening rebound momentum dominate. Monthly updates will include some key positives: a significant further improvement in local labour market conditions, total hours worked up a further 1% in December and the Westpac-MI Unemployment Expectations Index improving sharply in Feb; a strong gain in dwelling approvals (up 8.2%) and a further lift in commodity prices, up 3.6% (in AUD terms). These are likely to more than offset patchier results for other components.

Importantly, the 'six month' growth rate headline measure will start to get a boost from delta shocks falling into the base of the calculation.

Westpac-MI Leading Index



The week ahead

Aus Jan Labour Force Survey, employment '000

Feb 17 Last: 64.8k, WBC f/c: 30k

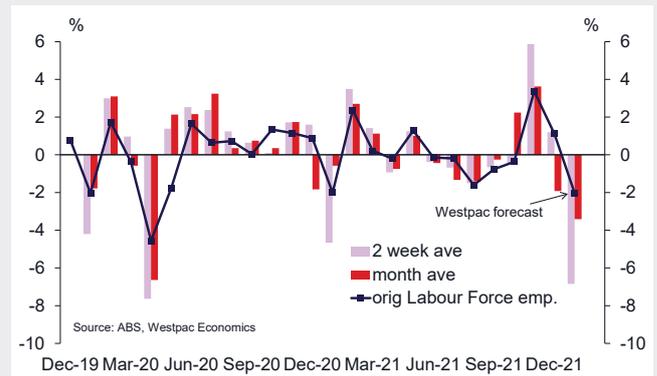
Mkt f/c: flat, Range: -60k to 59k

The big reopening driven surge in November was followed by a sound gain in December, highlighting a labour market significantly outperforming expectations. A solid 64.8k/0.5% gain in employment in December was stronger than Westpac's +30k but on par with market expectations of +60k.

Weekly payrolls over the 2wk reference period for the January labour force survey were down -6.8% vs December. Our +30k forecast for employment is equivalent to a -2.0% fall in original terms. Payrolls are not seasonally adjusted and measure jobs rather than people so can be skewed by changes in multiple jobholders. There are also definitional differences: workers that are employed but work zero hours and get zero pay are not counted in the payrolls data but are counted as employed in the Labour Force Survey (albeit with stand-downs captured in hours worked).

All up, this suggests downside risks to our +30k employment forecast.

Payrolls vs Labour Force Employment



Aus Jan Labour Force Survey, unemployment %

Feb 17, Last: 4.2%, WBC f/c: 4.0%

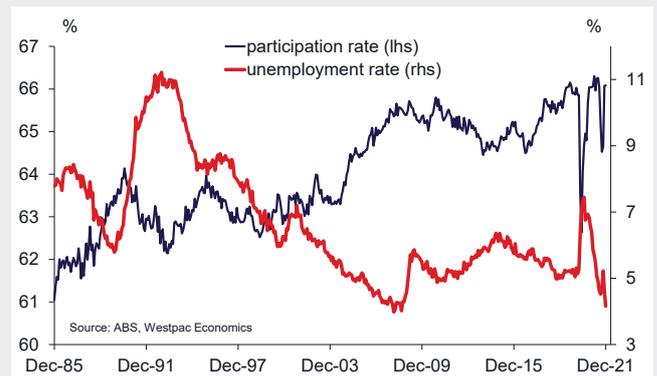
Mkt f/c: 4.1% Range: 4.0% to 4.4%

What surprised in December was that we did not see a jump in workers returning to the labour force. The participation rate instead held flat at 66.1%, generating an outsized fall in the unemployment rate to 4.2% from 4.6%. At the time our forecast for the unemployment rate to hit 4.2% was not until May. This is the lowest rate since August 2008, just before the GFC.

It is tempting to forecast a lift in participation in January but the Omicron outbreak just as Australians went on summer holidays is a clear complicating factor. We had a similar story last year that resulted in far more Australians than usual taking leave as well as some delaying their return to work. The labour force lifted just 5k with participation flat at 66.1% (employment lifted 29.2k).

We are forecasting a 5.5k rise in the labour force holding participation flat at 66.1%. The larger than usual number on leave will hit hours worked but there is a downside risk to both employment and participation, meaning a fall in unemployment is still possible.

Participation surges with employment



New Zealand forecasts

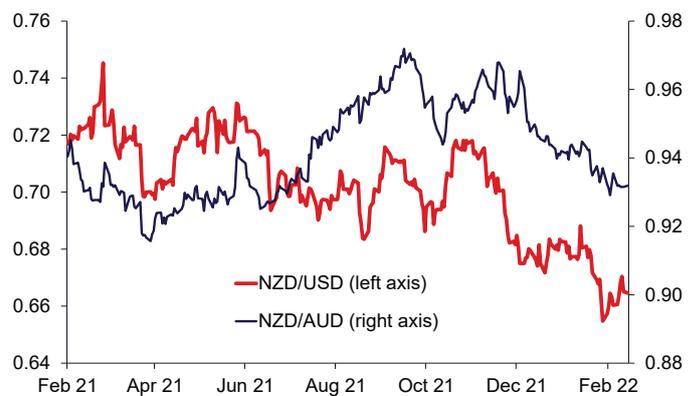
Economic forecasts	Quarterly				Annual			
	2021		2022		2020		2023f	
% change	Sep (a)	Dec	Mar	Jun	2020	2021f	2022f	2023f
GDP (Production)	-3.7	1.1	1.6	2.4	-1.9	5.1	4.4	4.7
Employment	1.9	0.1	0.5	0.1	0.6	3.7	0.9	1.0
Unemployment Rate % s.a.	3.3	3.2	3.1	3.0	4.9	3.2	3.0	3.3
CPI	2.2	1.4	1.1	0.7	1.4	5.9	3.1	2.7
Current Account Balance % of GDP	-4.5	-5.3	-5.4	-6.1	-0.8	-5.3	-5.7	-3.9

Financial forecasts	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	1.00	1.50	2.00	2.25	2.50	2.75	3.00	3.00
90 Day bill	1.40	1.90	2.20	2.45	2.70	2.95	3.10	3.10
2 Year Swap	2.55	2.75	2.90	2.95	3.00	3.00	2.95	2.90
5 Year Swap	2.80	2.95	3.05	3.10	3.15	3.15	3.15	3.10
10 Year Bond	2.80	2.85	2.90	3.00	3.00	3.00	3.00	2.95
NZD/USD	0.65	0.65	0.66	0.68	0.69	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.93	0.93	0.92	0.92	0.92	0.91
NZD/JPY	75.4	75.4	77.2	79.3	81.4	82.6	83.9	84.5
NZD/EUR	0.59	0.60	0.61	0.62	0.62	0.63	0.62	0.62
NZD/GBP	0.48	0.47	0.48	0.49	0.50	0.51	0.52	0.53
TWI	70.1	70.1	70.7	71.9	72.5	73.1	73.4	73.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 14 February 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	0.75%	0.75%	0.75%
30 Days	0.99%	0.85%	0.82%
60 Days	1.11%	0.98%	0.93%
90 Days	1.21%	1.10%	1.02%
2 Year Swap	2.52%	2.44%	2.24%
5 Year Swap	2.88%	2.76%	2.67%

NZ foreign currency mid-rates as at 14 February 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6646	0.6573	0.6810
NZD/EUR	0.5862	0.5886	0.5963
NZD/GBP	0.4904	0.4891	0.4978
NZD/JPY	76.65	75.91	77.95
NZD/AUD	0.9319	0.9323	0.9431
TWI	71.40	70.95	72.82

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 14					
NZ	Jan BusinessNZ PSI	49.7	-	-	Activity restrictions continues to be a headwind.
	Jan food price index	0.6%	-	0.4%	Grocery prices pushing higher, meat prices also firm.
Tue 15					
NZ	Jan REINZ house sales (TBC)	-8.2%	-	-	Higher mortgage rates and tighter lending regulations...
	Jan REINZ house prices %yr (TBC)	23.3%	-	-	...were starting to bite by the end of 2021.
	Dec net migration	130	-	-	Set to remain close to zero due to border restrictions.
Aus	RBA minutes	-	-	-	Colour around "plausibility" of rate hikes this year.
Eur	Feb ZEW survey of expectations	49.4	-	-	Expectations rebounded firmly above average.
	Dec trade balance €bn	-1.3	-	-	Surge in import prices induced first deficit in nearly 10 years.
	Q4 GDP	0.3%	0.3%	-	Second estimate to confirm the slowing of year-end activity.
UK	Dec ILO unemployment rate	4.1%	4.1%	-	Recovery continues to edge unemployment lower.
US	Feb Fed Empire state index	-0.7	10.0	-	To provide a timely update on NY manufacturing sector.
	Jan PPI	0.2%	0.5%	-	Ongoing supply issues will support producer prices.
Wed 16					
NZ	GlobalDairyTrade auction prices (WMP)	4.1%	-	2.0%	Dairy prices' hot start to 2022 to continue.
Aus	Jan Westpac-MI Leading Index	-0.15%	-	-	Local components still cycling out of 'delta' shock.
Chn	Jan PPI %yr	10.3%	9.5%	-	Persistent upstream price pressures...
	Jan CPI %yr	1.5%	1.0%	-	... yet to translate into consumer inflation.
Eur	Dec industrial production	2.3%	0.2%	-	Broad-based easing of supply pressures yet to come.
UK	Jan CPI	0.5%	-	-	Headline inflation remains at near 30-year highs.
US	Jan retail sales	-1.9%	1.8%	1.5%	Omicron concerns have temporarily subdued spending.
	Jan import price index	-0.2%	1.3%	-	Import prices set to remain elevated.
	Jan industrial production	-0.1%	0.4%	-	Supply issues and omicron continue to create volatility.
	Dec business inventories	1.3%	2.0%	-	Businesses are pushing through supply issues at robust pace.
	FOMC January meeting minutes	-	-	-	Focus on discussions of the path for rates in 2022.
Thu 17					
Aus	Jan employment	64.8k	flat	30k	NSW & Vic continue to reopen but Omicron during...
	Jan unemployment rate	4.2%	4.1%	4.0%	... summer holidays suggests greater than usual uncertainty.
US	Initial jobless claims	223k	-	-	Set to remain at a very low level.
	Jan housing starts	1.4%	-0.1%	-	Supported by robust underlying demand for housing.
	Feb Philly Fed index	23.2	20.0	-	Will offer a gauge of business activity in the region.
	Fedspeak	-	-	-	Bullard on the economic and policy outlook.
Fri 18					
Eur	Feb consumer confidence	-8.5	-7.6	-	COVID-19 concerns have weighed on confidence.
UK	Jan retail sales	-3.7%	-	-	Omicron has temporarily softened spending.
US	Jan existing home sales	-4.6%	-1.3%	-	Lack of inventory has hindered sales activity.
	Jan leading index	0.8%	0.2%	-	Robust economic momentum set to continue this year.
	Fedspeak	-	-	-	Evans and Waller take part in a policy panel. Mester too.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.2	4.4	4.4	4.0
CPI inflation %yr	1.8	1.8	0.9	3.5	3.3	3.5
Unemployment rate %	5.0	5.2	6.8	4.7	3.8	3.9
Current account % of GDP	-2.1	0.7	2.6	3.7	1.3	-3.1
United States						
Real GDP %yr	3.0	2.2	-3.5	5.7	3.4	2.5
CPI inflation %yr	2.4	1.9	1.2	5.1	5.2	2.5
Unemployment rate %	3.9	3.7	8.1	5.4	3.9	3.6
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	0.3	-4.8	2.3	2.7	1.5
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	4.1	2.5
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	7.0	4.5	2.0
China						
Real GDP %yr	6.7	5.8	2.3	8.1	5.7	5.6
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	3.9	4.7	4.7
World						
Real GDP %yr	3.6	2.8	-3.3	5.4	4.4	3.6

Forecasts finalised 4 February 2022

Interest rate forecasts	Latest	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Australia									
Cash	0.10	0.10	0.10	0.25	0.50	0.75	1.00	1.25	1.50
90 Day BBSW	0.08	0.10	0.10	0.35	0.60	0.95	1.20	1.45	1.70
10 Year Bond	2.19	2.15	2.40	2.40	2.50	2.50	2.40	2.30	2.20
International									
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375	1.625	1.875	1.875
US 10 Year Bond	2.03	2.00	2.30	2.40	2.50	2.50	2.40	2.30	2.20

Exchange rate forecasts	Latest	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7140	0.70	0.70	0.71	0.73	0.75	0.76	0.77	0.78
USD/JPY	116.10	116	117	117	118	118	119	119	119
EUR/USD	1.1395	1.13	1.11	1.12	1.13	1.14	1.15	1.15	1.16
GBP/USD	1.3540	1.36	1.37	1.38	1.38	1.38	1.37	1.37	1.36
USD/CNY	6.3611	6.35	6.35	6.30	6.25	6.20	6.15	6.15	6.10
AUD/NZD	1.0735	1.08	1.08	1.08	1.08	1.09	1.09	1.09	1.10

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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