Abel Tasman National Park, New Zealand

Weekly Economic Commentary.

RBNZ to introduce a Funding for Lending Programme by November.

We have changed our forecasts for monetary policy settings in New Zealand and now expect that the RBNZ will introduce a Funding for Lending Programme in November. The resulting fall in interest rates will boost asset prices and suppress the New Zealand dollar, thereby boosting inflation. We continue to expect that the cash rate will be reduced to -0.50% in April 2021 and that the RBNZ will purchase $100bn of assets as part of its Large Scale Asset Purchase Programme.

As expected, the RBNZ kept the cash rate and bond purchase programme unchanged at last week's Monetary Policy Review. What was more telling, however, was the downbeat tone of the accompanying policy statement and minutes. The RBNZ remains firmly focused on the downside risks for the economy. That's despite GDP falling by less than they had expected in the June quarter, as well as the lift in a number of recent economic indicators. Some members of the Monetary Policy Committee (MPC) also cast doubt on the durability of the housing market upturn. That's particularly notable as wealth effects associated with housing are an important influence on spending by New Zealand households and are a key channel through which monetary policy operates.

In light of their ongoing concerns about the outlook, the MPC noted that *"further monetary stimulus may be needed"* to achieve its inflation and employment goals. But for now, the RBNZ's toolbox is looking bare. In terms of the OCR, the RBNZ has reiterated that it remains prepared to take it below zero. However, this would only occur after 16 March 2021, when its one-year commitment to keep the OCR at 0.25% expires. Similarly, while the Large Scale Asset Purchase Programme (LSAP) has been expanded to $100bn, that limit will be reached by the middle of next year, long before the need for stimulus has evaporated.

Given those constraints, the RBNZ has been developing additional monetary policy tools, including a Funding for Lending Programme (FLP) with the September policy statement noting that the MPC *"preferred to launch an FLP before the end of 2020."*

We actually think that economic growth will surprise the RBNZ on the upside, and that the upturn in the housing market will prove to be more enduring. Nevertheless, we agree with the RBNZ that further stimulus will be needed. Even before the current downturn, inflation had been falling short of the RBNZ's forecasts. And now, with the massive hit to the economy from Covid-19, several measures of inflation expectations have fallen below 2% and inflation could remain below the RBNZ's target for years if left unchecked. On top of that, unemployment is likely to push higher through the back half of the year. In fact, our latest Westpac McDermott Miller survey of employment confidence[1] is pointing to a substantial rise in joblessness since June as the wage subsidy programme has rolled off.

The size of the monetary stimulus required for New Zealand to meet these challenges is hard to overstate. From as far back as April Westpac has been predicting that the RBNZ would have to loosen monetary policy much further. And the RBNZ has now also reached this conclusion.

The RBNZ has signalled that the FLP will be ready to be deploy before the end of this year, and we expect that this facility will be launched as part of the *Monetary Policy Statement* on 11 November. An FLP is essentially cheap loans for banks. Currently, banks source their funds from a mix of transactional deposits (at zero interest), term deposits (currently approximately 1.2%), and wholesale funds (currently about 1%). Under an FLP, the RBNZ would offer funding to banks at a low interest rate – perhaps close to the OCR, which is currently 0.25%, or close to current swap rates which are zero.

If banks can bring in money more cheaply, they can subsequently lend it out at lower interest rates while maintaining the same margin. Consequently, by providing these cheap loans to banks, the Reserve Bank will engineer a decrease in mortgage rates. There will also be an indirect effect – banks won't need to compete as vigorously for term deposits and wholesale funds, so the interest rates on these will also fall, further reducing banks' funding costs.

The introduction of this facility will cause a reduction in retail mortgage rates, term deposit rates and business lending and deposit rates. The main impact of this will be to further stimulate asset prices, particularly in the housing market (we're currently forecasting house prices will rise by around 4% through the back part of this year and another 8% over 2021). In turn, higher asset prices will stimulate consumer spending and therefore boost inflation and employment.

The secondary impact of the FLP will be to suppress the exchange rate, which also tends to boost inflation and employment.

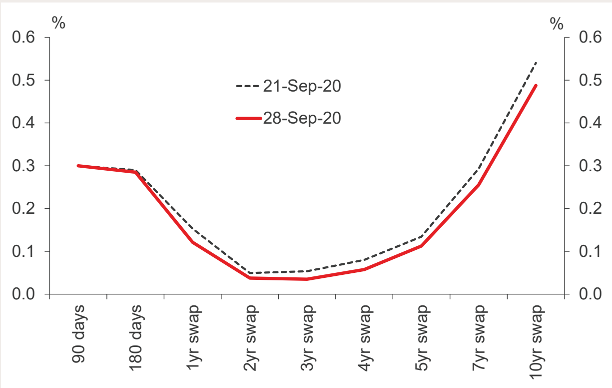
Even with the introduction of the FLP, we still expect that the OCR will eventually need to be reduced below zero and continue to forecast a cut to -0.5% in April 2021. The FLP and a negative OCR will complement each other. Assuming that the FLP interest rate is close to the OCR, then the OCR cut would reduce the interest rate at which the RBNZ lends to banks under the FLP. That would certainly increase the potency of the FLP, and arguably could increase the effectiveness of the OCR cut.

1 Available here: https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Bulletins-2020/Q3-Employment-Confidence-Sep-2020-Westpac-NZ.pdf

Fixed vs Floating for mortgages.

Fixed mortgage rates fell sharply over May and June, but are stable now and don't look likely to move much in the short run. However, in November we expect the Reserve Bank will introduce a Funding for Lending Programme, the aim of which is to reduce retail interest rates. At that time, we expect that both fixed and floating mortgage rates will fall. How far they fall will depend on the details of the Reserve Banks programme, which are not known at this stage.

NZ interest rates



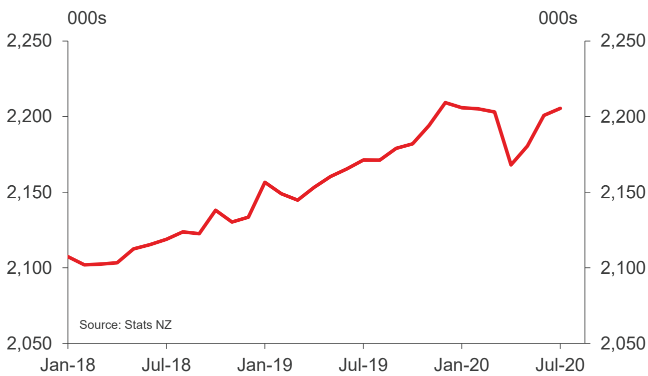
The week ahead.

NZ Aug Monthly Employment Indicator

Sep 28, Last: +0.2%

- The Monthly Employment Indicator is a relatively new release, 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 indicator shows fell sharply in April during the Covid-19 lockdown, but quickly bounced back to its previous levels. However, it has fallen short of population growth in that time.
- Stats NZ has also been providing weekly releases of the raw data, before adjustments for missing responses. These figures suggest a broadly flat result for the month of August.

NZ Monthly Employment Indicator filled jobs

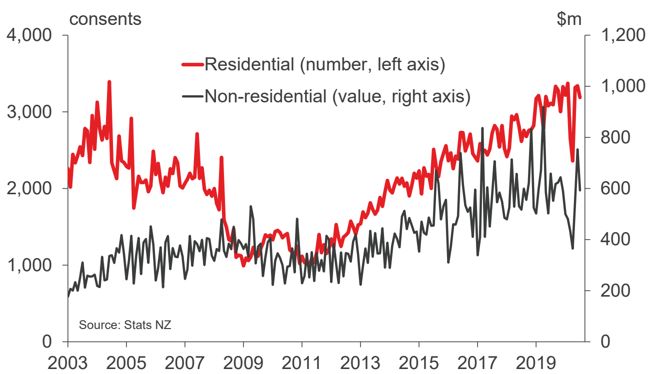


NZ Aug building consents

Sep 30, Last: -4.5%, Westpac f/c: -5%

- The number of residential dwelling consents fell by 4.5% in July. That drop was mainly related to a pullback in the retirement village segment. The number of stand-alone houses and townhouses being consented remains at firm levels.
- We expect residential consent numbers will fall by 5% in August. July's figure was boosted by a large number of medium density/multi-unit consents. As such consents tend to be issued in lumps, we expect a pullback in August. Such a decline would still leave consent numbers at very elevated levels.
- Non-residential consent levels have recently been boosted by consents for storage buildings. However, we expect they will trend down over the year ahead due to the downturn in economic conditions and low levels of confidence.

NZ building consents

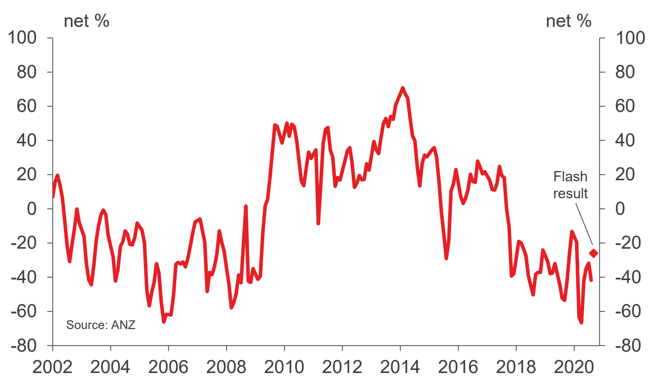


NZ Sep ANZBO business confidence (final)

Sep 30, Aug: -41.8, Sep flash: -26.0

- Business confidence unexpectedly rose in early September. That was despite the re-emergence of Covid-19 on our shores. Although business conditions remain subdued, they have not been as weak as feared. That's consistent with a range of other economic indicators which suggest that the New Zealand economy is weathering the Covid storm better than expected.
- Since the flash report, the Covid alert level has been eased back again. As a result, the final read for September is likely to be up or close to the flash result. However, we expect to see sizeable differences across sectors. In particular, the re-introduction of social distancing requirements will be a particular drag on businesses in the services sector.

NZ business confidence



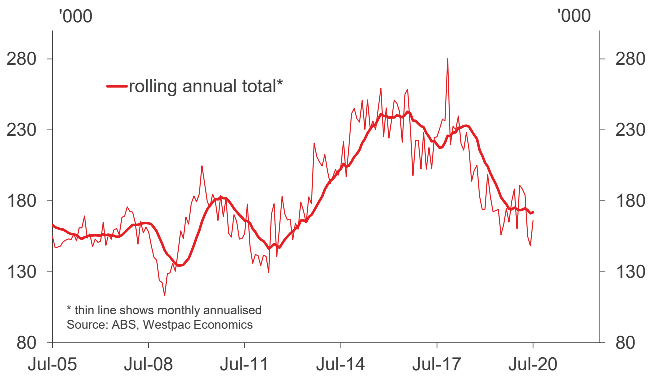
The week ahead.

Aus Aug dwelling approvals

Sep 30, Last: 12%, WBC f/c: 2%
Mkt f/c: -2%, Range: -5% to +2%

- Dwelling approvals surged 12% in July, a broad-based gain reversing about half of the 21% drop over the first half of the year (June was an 8yr low for monthly approvals). The detail indicated unwinding COVID disruptions were the main boost.
- There is considerable uncertainty around the August update stemming from more varied COVID effects (Vic moving into a 'second wave' lockdown but other states continuing to reopen) and from the Federal Government's HomeBuilder scheme which drove a big jump in new home sales through June-August (+60% for the three months combined compared to the three months to May). Added to this is uncertainty around lags, e.g. the April lockdown hit approvals a month later in May. Overall, that suggests approvals should hold up well in August, potentially posting a solid gain if we see a more meaningful HomeBuilder boost. On balance we expect a 2% gain with risks either side.

Aus dwelling approvals

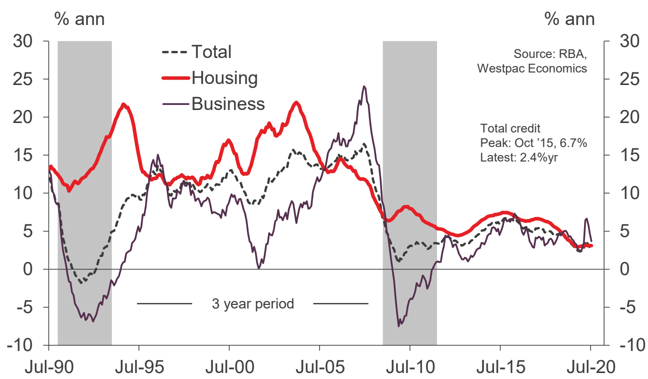


Aus Aug private credit

Sep 30, Last: –0.15%, WBC f/c: –0.1%

- Credit to the private sector is contracting with the prospect of further falls as the COVID recession reduces the appetite for debt. Credit has fallen for the past three months: –0.14%; –0.19% and –0.15% in July. We anticipate a –0.1% for August, which would see annual growth slow to 2.1%.
- Businesses are in survival mode and the economy is awash with excess capacity. That has firms looking to cut non-essential spending and reduce borrowings. Credit to the sector fell in each of the past three months, down 2% in total.
- Personal credit, 5% of total credit, plunged by a record 12% over the past year. Here too, weakness is set to continue.
- Housing credit grew by 3.1% over the past year, an historic low, including a rise of only 0.2% for July. New lending has swung from collapsing in April and May, on the initial COVID lockdown, and then snapping back over June and July, on the reopening and lower interest rates.

Aus credit growth

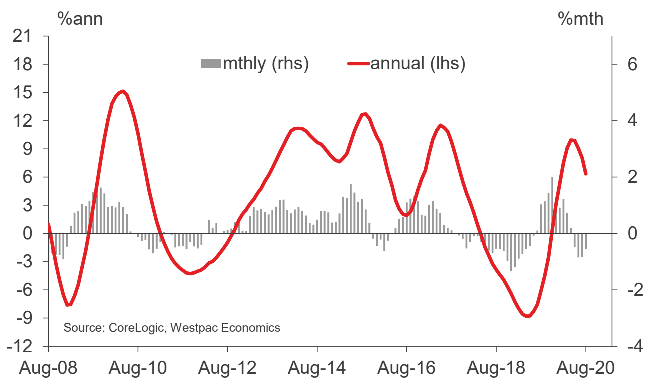


Aus Sep CoreLogic home value index

Oct 1, Last: –0.5%, WBC f/c: –0.3%

- Dwelling prices declined a further 0.5% in August to be 2.7% below their April peak. The detail showed weakness becoming more centred on Melbourne with moderating declines or tentative signs of stabilisation in other markets.
- This theme looks to have become more pronounced in September. CoreLogic's daily index points is down about 0.3% across the five major capital cities, but within this Melbourne looks to be significantly weaker, Sydney in line with the average move but prices up 0.3–0.5% in Brisbane, Adelaide and Perth. Note that there does seem to be some slight seasonal support to prices in September, associated with stronger demand at the start of Spring, a tailwind worth 0.1–0.2pts on prices nationally in the month.

Australian dwelling prices



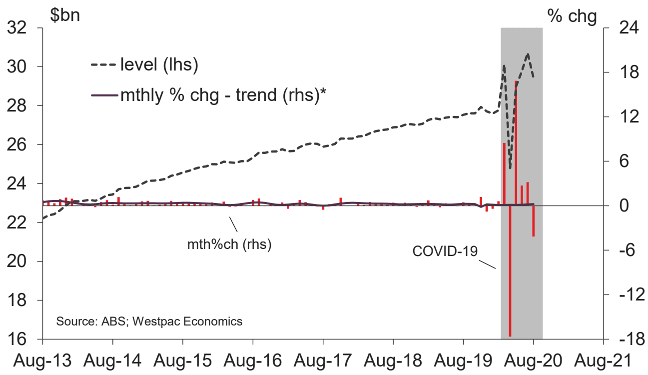
The week ahead.

Aus Aug retail trade

Oct 2, Last: 3.2%, WBC f/c: –4.2%
Mkt f/c: –4.2%, Range: –4.5% to –4.2%

- Preliminary estimates showed a 4.2% fall in retail sales in August, much weaker than we had anticipated.
- Final estimates will include additional store-type and state detail, as well as online sales and sales by business size.
- The early signs from our Westpac Card Tracker suggest retail sales are likely to hold flat in September although these understated the weakness in August.
- Note that retail is currently a poor guide to wider spending as it misses some of the largest negative impacts from the COVID-19 crisis and is skewed towards segments that are benefitting from expenditure switching.

Aus monthly retail sales

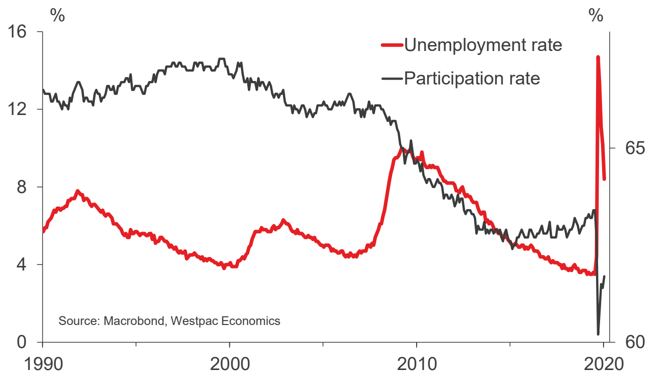


US Sep employment report

Oct 2, nonfarm payrolls: last: 1371k, WBC: 950k
Oct 2, unemployment rate: last: 8.4%, WBC: 8.2%

- Nonfarm payrolls have sustained a rapid recovery over the four months to Aug, gaining back roughly half the 22 million job losses of Mar and Apr.
- Employment growth is expected to remain strong in Sep at around 950k. However, combined with a partial recovery in participation, such a gain is unlikely to drive the unemployment rate materially lower. As this recovery matures, progress towards 'full employment' will become more and more difficult.
- In assessing the outlook for wages, it is also important to recognise that underemployment remains historically elevated as well. As a result, we have to expect a lengthy period of modest wage inflation, at best.

US labour market

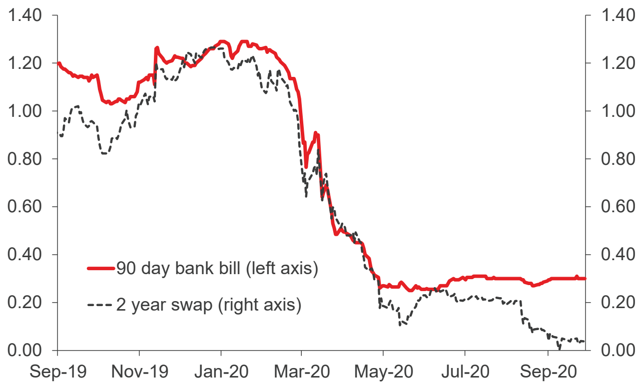


New Zealand forecasts.

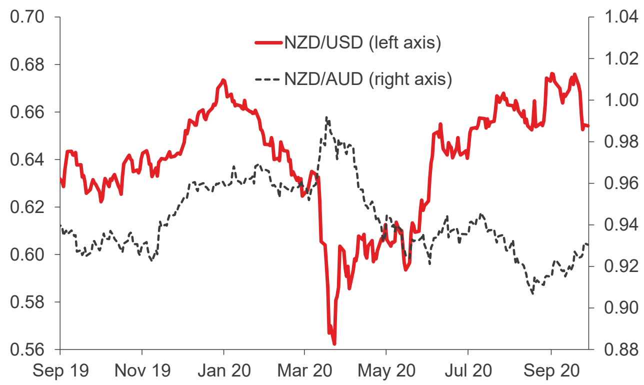
Economic forecasts	Quarterly				Annual			
	2020			2021				
% change	Jun (a)	Sep	Dec	Mar	2018	2019	2020f	2021f
GDP (Production)	-12.2	8.5	3.9	1.1	3.2	2.3	-5.1	6.0
Employment	-0.4	-3.8	-0.8	0.7	1.9	1.0	-4.0	2.8
Unemployment Rate % s.a.	4.0	6.5	7.0	6.9	4.3	4.1	7.0	6.4
CPI	-0.5	0.6	-0.1	0.1	1.9	1.9	0.8	0.5
Current Account Balance % of GDP	-1.9	-1.2	-1.0	-1.2	-4.3	-3.4	-1.0	-3.2

Financial forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
Cash	0.25	0.25	-0.50	-0.50	-0.50	-0.50
90 Day bill	0.30	-0.10	-0.20	-0.20	-0.20	-0.10
2 Year Swap	0.05	0.00	-0.10	-0.10	-0.10	0.10
5 Year Swap	0.20	0.20	0.20	0.25	0.35	0.55
10 Year Bond	0.60	0.65	0.70	0.75	0.80	1.00
NZD/USD	0.67	0.66	0.66	0.68	0.70	0.70
NZD/AUD	0.89	0.87	0.87	0.87	0.88	0.88
NZD/JPY	70.4	69.3	70.0	72.1	74.2	74.9
NZD/EUR	0.55	0.54	0.54	0.55	0.56	0.56
NZD/GBP	0.50	0.49	0.49	0.50	0.50	0.50
TWI	71.5	69.9	69.5	70.7	72.0	71.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 28 September 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.28%	0.27%	0.27%
60 Days	0.29%	0.29%	0.28%
90 Days	0.30%	0.30%	0.29%
2 Year Swap	0.04%	0.05%	0.09%
5 Year Swap	0.11%	0.13%	0.21%

NZ foreign currency mid-rates as at 28 September 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6542	0.6662	0.6732
NZD/EUR	0.5628	0.5629	0.5656
NZD/GBP	0.5119	0.5210	0.5045
NZD/JPY	69.05	70.69	70.99
NZD/AUD	0.9304	0.9152	0.9145
TWI	71.28	72.01	72.42

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
NZ	Aug Monthly Employment Indicator	0.2%	–	–	Bounced back after lockdown but has flattened out since.
UK	Sep Nationwide house prices	2.0%	–	–	Up 3.7%yr, tax holidays reversing May–June losses.
US	Sep Dallas Fed index	8.0	8.5	–	Solid growth in new orders and employment to continue.
	Fedspeak	–	–	–	FOMC's Mester will speak.
Tue 29					
Eur	Sep economic confidence	87.7	89.3	–	Industry performance supported by German activity...
	Sep consumer confidence	–13.9	–	–	...though Covid caseload will weigh on spending outlook.
US	Aug wholesale inventories	–0.3%	–	–	Healing of demand to support restocking.
	Jul S&P/CS home price index	0%	0.15%	–	Interest rates highly supportive of price growth.
	Sep consumer confidence index	84.8	90.0	–	Labour market slack & uncertainty holding confidence back.
	Fedspeak	–	–	–	FOMC's Williams, Harker, Clarida and Quarles to speak.
Wed 30					
NZ	Aug building permits	–4.5%	–	–5.0%	Expected to ease after earlier rise in multi–unit consents.
	Sep ANZ business confidence	–26.0	–	–	Confidence has picked up, but remains at low levels.
Aus	Aug dwelling approvals	12%	–2%	2%	Hit 8yr low in June on covid disruptions. Up in July, possibly Aug.
	Aug private sector credit	–0.1%	–	–0.1%	Business & personal contracting, housing weak.
Chn	Sep manufacturing PMI	51.0	51.5	–	PMIs to strengthen further as exports recover...
	Sep non–manufacturing PMI	55.2	54.9	–	...and pick–up in services and construction seen.
	Sep Caixin China PMI	53.1	53.3	–	Smaller firms should increasingly benefit from growth.
Eur	Sep CPI %yr	–0.2%	–0.2%	–	Inflation pressures to remain very weak.
	ECB President Lagarde	–	–	–	Speaking "The ECB and its Watchers" conference.
UK	Sep GfK consumer sentiment	–27	–27	–	Highly uncertain times for UK households.
	Q2 GDP	–20.4%	–20.4%	–	Second estimate; substantial revision not expected.
US	Sep ADP employment change	428k	650k	–	Job market momentum cooling.
	Q2 GDP	–31.7%	–31.6%	–	Third estimate.
	Sep Chicago PMI	51.2	52.0	–	To remain in expansionary territory.
	Aug pending home sales	5.9%	2.0%	–	Up 15.5%yr. Supply likely more of a concern than demand.
	Fedspeak	–	–	–	FOMC's Kashkari and Bowman.
Thu 01					
Aus	Sep AiG PMI	49.3	–	–	Aug, –4.2pts. Manuf'g stabilising after Vic lock–down hit?
	Sep CoreLogic home value index	–0.5%	–	–0.3%	Price movements becoming uneven – weakness in Melbourne.
Eur	Sep Markit manufacturing PMI	53.7	53.7	–	Euro Area manufacturing recovery has broad support.
	Aug unemployment rate	7.9%	8.1%	–	Policy transition & COVID–19 loom as risks.
UK	Sep Markit manufacturing PMI	54.3	54.3	–	Resurgence in virus could hit manufacturing ahead.
US	Initial jobless claims	870k	–	–	Claims holding up, suggest considerable churn.
	Aug personal income	0.4%	–2.1%	–	End of Federal claims supplement to hit incomes in Aug...
	Aug personal spending	1.9%	0.7%	–	.... and remain a lasting headwind for spending.
	Aug PCE deflator	0.3%	0.3%	–	Supply–side factors creating transitory upward pressure.
	Sep Markit manufacturing PMI	53.5	–	–	Activity recovery continuing at robust pace.
	Aug construction spending	0.1%	0.8%	–	Residential construction activity rebounding quickly.
	Sep ISM manufacturing	56	55.9	–	Current activity more positive than outlook.
	Fedspeak	–	–	–	FOMC's Williams and Bowman.
Fri 02					
NZ	Sep ANZ consumer confidence	100.2	–	–	Household sentiment remains at low levels.
Aus	Aug retail sales	3.2%	–4.2%	–4.2%	Spending in August hit by Victorian lock–down.
US	Sep non–farm payrolls	1371k	865k	950k	Job recovery to continue to slow...
	Sep unemployment rate	8.4%	8.2%	8.2%	... with participation also likely to hold U/E rate up.
	Sep average hourly earnings %mth	0.4%	0.2%	0.2%	Employment slack to keep pressure on wage growth.
	Sep Uni. of Michigan sentiment	78.9	79.0	–	Has lagged activity data.
	Aug factory orders	6.4%	1.0%	–	Boost driven by transport equipment, to moderate in Aug.
	Fedspeak	–	–	–	FOMC's Harker to speak.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.4	2.8	1.8	-3.3	2.3
CPI inflation % annual	1.5	1.9	1.8	1.8	0.4	2.2
Unemployment %	5.7	5.5	5.0	5.2	7.7	7.6
Current Account % GDP	-3.1	-2.6	-2.1	0.6	2.6	0.1
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-4.7	3.4
Consumer Prices %yr	1.4	2.1	2.4	1.9	1.1	1.8
Unemployment Rate %	4.9	4.4	3.9	3.7	8.8	7.9
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.5	2.2	0.3	0.7	-5.2	1.5
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	-7.6	5.4
United Kingdom						
Real GDP %yr	1.9	1.9	1.3	1.4	-11.0	7.0
China						
Real GDP %yr	6.8	6.9	6.8	6.1	2.5	10.5
East Asia ex China						
Real GDP %yr	4.1	4.6	4.4	3.7	-2.3	5.2
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.8	5.8
Forecasts finalised 9 September 2020						

Interest rate forecasts	Latest	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21	Jun–22
Australia							
Cash	0.25	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.08	0.05	0.05	0.05	0.05	0.10	0.20
10 Year Bond	0.81	0.80	0.90	1.00	1.05	1.15	1.25
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.67	0.60	0.65	0.75	0.75	0.85	0.95

Exchange rate forecasts	Latest	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21	Jun–22
AUD/USD	0.7054	0.75	0.76	0.76	0.78	0.80	0.80
USD/JPY	105.46	105	105	106	106	106	107
EUR/USD	1.1668	1.21	1.22	1.23	1.24	1.25	1.25
GBP/USD	1.2756	1.33	1.34	1.35	1.37	1.39	1.40
USD/CNY	6.8287	6.75	6.75	6.70	6.60	6.50	6.40
AUD/NZD	1.0771	1.12	1.15	1.15	1.15	1.14	1.14

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