

6 August 2021



### Overview

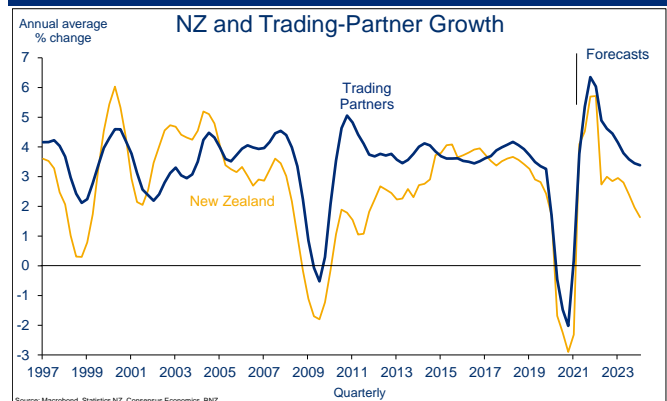
The New Zealand economy is overheating. Strong domestic demand is being driven by job and wage growth, asset price appreciation, elevated commodity prices, and fiscal and monetary stimulus. At the same time, supply chains are broken and labour supply growth is next-to-nothing. Consequently, the labour market is tightening aggressively, house prices are getting out of control and CPI inflation is bursting through the top end of the RBNZ's target band. The RBNZ will thus have no option but to attempt to settle things down. This is likely to result in a series of interest rate increases starting this month. While the strength of the economy is centre-stage, COVID remains ever-present as a potential threat. Keeping NZ COVID-free, until sufficiently vaccinated, remains the key to future success.

Key Indicators	December Years					
	2018	Actual 2019	2020	2021	Forecasts 2022	2023
GDP production (an avg %)	3.4	2.4	-2.9	5.7	2.9	2.0
Consumers Price Index (ann %)	1.9	1.9	1.4	4.1	2.1	2.6
Unemployment Rate (end qtr %)	4.3	4.0	4.8	3.7	3.3	4.1
Current Account (% of GDP)	-4.2	-3.3	-0.8	-4.0	-4.7	-4.0
Fiscal Balance (% GDP June Yr)	1.9	2.4	-7.3	-2.8	-3.6	-0.9
NZD/USD (Dec mth avg)	0.68	0.66	0.71	0.75	0.74	0.69
Overnight Cash Rate (Dec mth end %)	1.75	1.00	0.25	1.00	2.00	2.25
10 Year Govt Bond (Dec mth avg %)	2.40	1.60	0.90	2.40	3.20	3.30

### International

Expectations for global growth are under pressure as the delta variant of COVID-19 takes an ever-increasing toll on activity. The ASEAN region appears to be the epicentre of the current outbreak and manufacturing activity seems to be being hit more intensely than during COVID round one. China is also experiencing heightened virus headwinds. New Zealand is highly exposed to developments in Asia, particularly in terms of the increased pressure on supply chains. This will put further stress on the domestic economy both in terms of constraining activity and raising input costs. For financial markets, though, the bigger global influence will be reflected in the unwillingness of the major offshore central banks to raise interest rates any time soon. This will keep a cap on longer term interest rates.

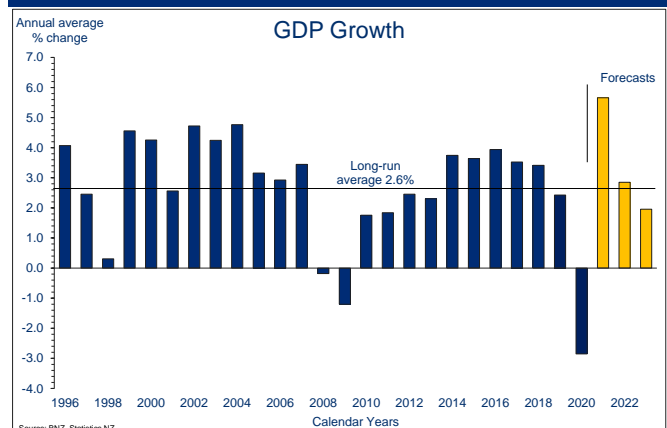
#### OK for now



### Growth

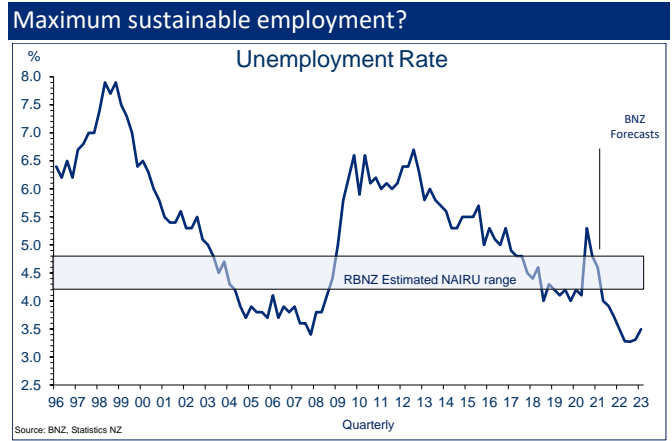
Q1 GDP growth of 1.6% surprised all and sundry and added strongly to our conviction that the economy is now operating at or above its potential. Momentum appears to have been maintained through into Q2 with activity seemingly up around a further 1.0%. We are forecasting the economy will have grown 5.7% across calendar 2021 more than offsetting the 2.9% decline in 2020. Growth is being driven by strong private consumption and investment activity. While residential building dominates the investment headlines, there is also strong growth in plant and machinery equipment. From 2022 onwards, the expansion will moderate thanks to a combination of the completion of the post-COVID bounce-back, severe capacity constraints and tighter monetary conditions.

#### Plenty of momentum



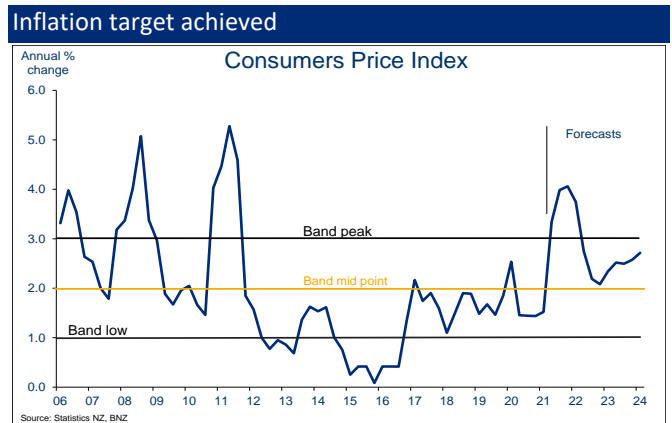
**Labour Market**

New Zealand’s unemployment rate has plummeted to just 4.0%. With employment intentions remaining lofty and economic growth robust, unemployment must fall further. We think it could be approaching a record low by this time next year. The current annual expansion in the labour force is just 46,000 people and it is expected to fall. Consequently, it will take only modest growth in employment to drive the unemployment rate lower. The missing link in the labour market had been wage growth but this is no longer the case. The annual increase in the key Labour Cost Index has risen to 2.2% and QES private sector average hourly earnings were up an annual 4.5%.



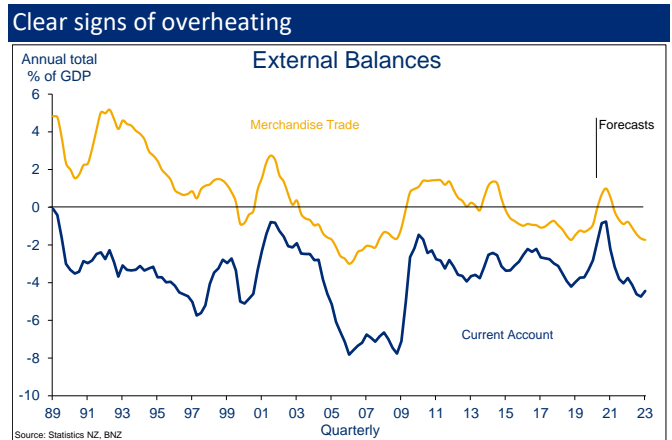
**Inflation**

Annual consumer price inflation jumped to a decade-long high of 3.3% in the June quarter. It will go higher yet. We are forecasting annual inflation in excess of 4.0% by years’ end. Sure there is an element of temporariness in the current inflationary pulse but, even after this pressure is alleviated, we still think it will settle towards the top of the Bank’s inflation band, and then only if the RBNZ tightens monetary policy to ensure this is the case. Substantial upward pressure on business input costs will drive CPI inflation for some time to come.



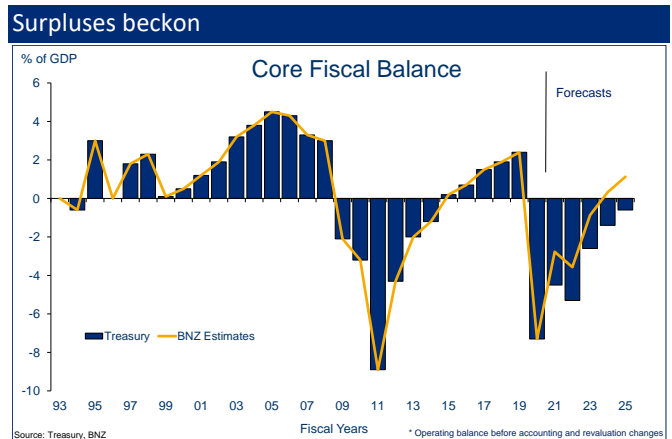
**External Accounts**

The New Zealand economy is overheating. This is reflected in developments in the country’s current account balance. In the first months of COVID the current account deficit contracted rapidly as commodity exports performed well and imports collapsed. The improvement came despite the destruction of tourism receipts. But it’s all very different now. Excess domestic demand is driving imports aggressively higher and the full extent of tourism’s demise is now being felt. As at the end of calendar 2020 the current account deficit was just 0.8% of GDP. By the end of this year we see it at 4.0% of GDP. Nonetheless, with nominal GDP performing so well, this uptick is still not sufficient to see a notable deterioration in New Zealand’s net international debt position. So the rating agencies should be unfazed.



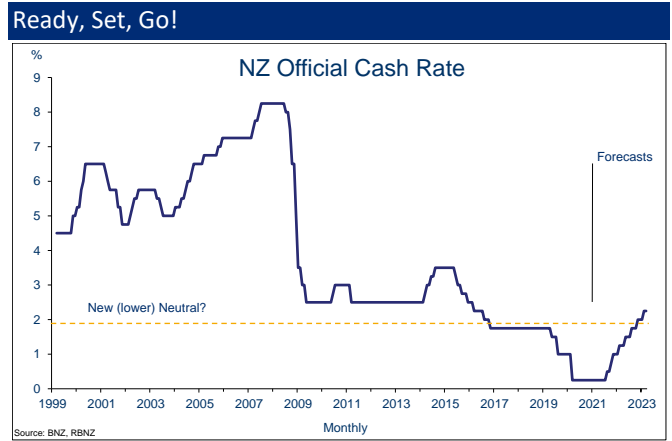
**Fiscal Policy**

The economy is proving much more robust than the government had anticipated. This is delivering the fiscal authorities significantly more revenue than anticipated which, in turn, will see reduced expectations for future deficits. Given the current run rate it looks like the government’s accounts could be in surplus by June 2024. This will, of course, be heavily reliant on New Zealand keeping COVID at bay. Moreover, it will require fiscal discipline from government. Not only will this fiscal discipline be important for the accounts, but it is also imperative that the Government does not add to current excess demand at this juncture.



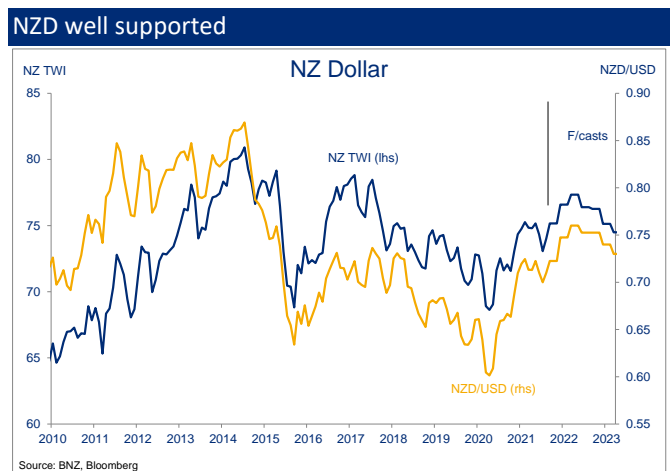
**RBNZ Policy and Interest Rates**

The RBNZ has achieved its employment and inflation targets. There is thus no need for monetary conditions to remain as stimulatory as they are. Consequently, we anticipate a series of cash rate increases starting with the August 18 Monetary Statement. Markets have belatedly accepted this prognosis, but we fear they have still not recognised that, ultimately, monetary conditions will have to return to neutral. There is substantive argument as to where neutral might be, but we think the cash rate will have to head to at least 2.0% to achieve neutrality. At the same time, the RBNZ has formally acknowledged house prices are above their sustainable level. In response, LVR restrictions will be tightened on October 1 with the very strong risk of further restrictions (and tools) being utilised before year's end.



**Exchange Rates**

The NZD has not strengthened in the manner we had expected but we maintain our view that further strength, particularly against the USD and Yen, is likely. In short, New Zealand commodity prices are strong, the world economy is strengthening and the RBNZ will be raising interest rates faster than its counterparts. All this means a stronger currency. The major immediate impediment is the rising fear of the economic impact of COVID's delta variant. If those fears grow, they will act as an initial headwind to NZD strength. It is worth noting that the RBNZ should not be bothered by a stronger currency as this would help contain inflation.



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# Quarterly Forecasts

Forecasts as at 6 August 2021

## Key Economic Forecasts

Quarterly % change unless otherwise specified

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Forecasts				
						Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
GDP (production s.a.)	-1.5	-10.8	14.1	-1.0	1.6	0.9	0.5	0.6	0.5	1.1
Retail trade (real s.a.)	-1.3	-14.8	27.7	-2.6	2.5	2.5	0.6	0.5	0.6	0.8
Current account (ytd, % GDP)	-2.8	-1.8	-0.8	-0.8	-2.2	-3.2	-3.8	-4.0	-3.8	-4.1
CPI (q/q)	0.8	-0.5	0.7	0.5	0.8	1.3	1.3	0.5	0.5	0.3
Employment	1.0	-0.4	-0.6	0.7	0.6	1.1	0.5	0.4	0.5	0.6
Unemployment rate %	4.2	4.1	5.3	4.8	4.6	4.0	3.9	3.7	3.5	3.3
Avg hourly earnings (ann %)	3.2	2.4	3.7	4.6	4.1	4.5	3.7	3.7	4.0	4.3
Trading partner GDP (ann %)	-2.4	-5.3	-0.9	0.7	6.3	9.8	5.4	4.6	4.8	4.9
CPI (y/y)	2.5	1.5	1.4	1.4	1.5	3.3	4.0	4.1	3.7	2.7
GDP (production s.a., y/y)	0.0	-11.2	0.4	-0.8	2.4	15.8	2.1	3.7	2.5	2.7

## Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor	US 10 yr	NZ-US
		Bank Bills						3 month		Ten year
2019 Dec	1.00	1.15	1.05	1.40	1.10	1.20	1.50	1.95	1.80	-0.40
2020 Mar	0.75	1.05	1.00	1.35	1.00	1.10	1.40	1.55	1.40	-0.03
Jun	0.25	0.30	0.40	0.85	0.25	0.40	0.80	0.60	0.70	0.15
Sep	0.25	0.30	0.25	0.65	0.15	0.25	0.60	0.25	0.65	0.02
Dec	0.25	0.25	0.25	0.70	0.15	0.30	0.75	0.20	0.85	-0.15
2021 Mar	0.25	0.30	0.75	1.40	0.40	0.85	1.50	0.20	1.30	0.09
Jun	0.25	0.35	1.00	1.75	0.55	1.20	1.90	0.15	1.60	0.17
Forecasts										
Sep	0.50	0.85	1.60	1.95	1.40	1.80	2.15	0.15	1.50	0.45
Dec	1.00	1.20	2.10	2.40	1.80	2.20	2.50	0.15	1.80	0.60
2022 Mar	1.25	1.45	2.40	2.70	2.10	2.50	2.80	0.15	2.00	0.70
Jun	1.50	1.70	2.60	2.90	2.30	2.70	3.00	0.15	2.20	0.70
Sep	1.75	2.00	2.80	3.05	2.50	2.90	3.15	0.15	2.35	0.70
Dec	2.00	2.25	2.95	3.20	2.65	3.05	3.30	0.15	2.50	0.70
2023 Mar	2.25	2.40	3.00	3.25	2.65	3.10	3.35	0.15	2.65	0.60

## Exchange Rates (End Period)

### USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.70	0.74	1.18	1.39	109
Sep-21	0.72	0.76	1.21	1.41	109
Dec-21	0.75	0.78	1.23	1.43	109
Mar-22	0.76	0.80	1.24	1.46	109
Jun-22	0.75	0.80	1.26	1.48	109
Sep-22	0.75	0.80	1.28	1.52	109
Dec-22	0.74	0.80	1.30	1.54	109
Mar-23	0.73	0.79	1.28	1.52	108
Jun-23	0.72	0.77	1.26	1.50	108
Sep-23	0.71	0.76	1.25	1.47	107
Dec-23	0.69	0.75	1.24	1.47	107

### NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.70	0.95	0.60	0.51	77.1	74.7
Sep-21	0.72	0.96	0.60	0.51	78.8	75.2
Dec-21	0.75	0.95	0.61	0.52	81.5	76.6
Mar-22	0.76	0.95	0.61	0.52	82.8	77.3
Jun-22	0.75	0.94	0.60	0.51	82.0	76.4
Sep-22	0.75	0.94	0.59	0.50	82.0	76.3
Dec-22	0.74	0.93	0.57	0.48	80.7	75.1
Mar-23	0.73	0.92	0.57	0.48	78.8	74.5
Jun-23	0.72	0.93	0.57	0.48	77.5	74.0
Sep-23	0.71	0.93	0.57	0.48	76.0	73.6
Dec-23	0.69	0.92	0.56	0.47	73.8	71.8

### TWI Weights

13.3% 19.2% 10.5% 4.1% 6.4%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

# Annual Forecasts

Forecasts as at 6 August 2021	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023
<b>GDP - annual average % change</b>										
Private Consumption	2.9	-0.7	9.6	3.3	2.0	3.6	-1.9	10.7	3.2	2.4
Government Consumption	6.1	6.3	4.5	1.8	1.3	5.4	6.4	5.3	2.2	1.2
Total Investment	1.3	-4.7	13.8	4.2	-0.6	3.2	-7.4	14.6	5.0	0.1
Stocks - ppts cont'n to growth	-0.5	-0.2	0.8	-0.1	0.0	-0.7	-0.8	1.6	-0.3	0.0
GNE	2.5	-0.5	10.2	3.1	1.3	3.0	-2.5	11.9	3.1	1.6
Exports	-0.3	-15.9	4.3	10.9	8.2	2.3	-11.8	-4.2	9.7	10.8
Imports	1.2	-16.2	17.8	10.0	5.4	2.2	-16.4	15.0	9.5	7.1
Real Expenditure GDP	2.1	-0.4	5.7	2.8	1.6	3.0	-1.2	6.0	2.7	2.0
<b>GDP (production)</b>	<b>1.7</b>	<b>-2.3</b>	<b>5.7</b>	<b>3.0</b>	<b>1.6</b>	<b>2.4</b>	<b>-2.9</b>	<b>5.7</b>	<b>2.9</b>	<b>2.0</b>
<i>GDP - annual % change (q/q)</i>	0.0	2.4	2.5	3.0	1.6	1.8	-0.8	3.7	3.1	1.4
Output Gap (ann avg, % dev)	1.6	-2.1	0.9	1.5	0.9	2.0	-2.2	0.8	1.4	1.0
Nominal Expenditure GDP - \$bn	322	325	355	371	384	319	322	350	367	380
<b>Prices and Employment - annual % change</b>										
CPI	2.5	1.5	3.7	2.3	2.7	1.9	1.4	4.1	2.1	2.6
Employment	2.5	0.3	2.5	1.7	1.1	1.2	0.7	2.6	2.0	0.9
Unemployment Rate %	4.2	4.6	3.5	3.5	4.2	4.0	4.8	3.7	3.3	4.1
Wages - ahote	3.2	4.1	4.0	4.0	2.8	3.8	2.6	4.6	3.7	4.1
Productivity (ann av %)	-0.3	-2.9	3.5	1.0	0.6	0.5	-4.1	4.1	0.7	0.7
Unit Labour Costs (ann av %)	3.5	5.3	0.7	3.1	2.7	2.5	6.9	-0.3	3.4	2.8
House Prices	7.8	20.7	9.6	2.3	2.0	4.6	15.5	17.2	2.8	2.0
<b>External Balance</b>										
Current Account - \$bn	-9.1	-7.2	-13.3	-16.5	-14.8	-10.6	-2.4	-14.1	-17.4	-15.4
Current Account - % of GDP	-2.8	-2.2	-3.8	-4.4	-3.9	-3.3	-0.8	-4.0	-4.7	-4.0
<b>Government Accounts - June Yr, % of GDP</b>										
OBEAL (core operating balance)	-7.3	-2.8	-3.6	-0.9	0.3					
Net Core Crown Debt (excl NZS Fund Assets)	26.3	34.0	43.0	48.0	48.0					
Bond Programme - \$bn (Treasury forecasts)	29.0	45.0	30.0	25.0	25.0					
Bond Programme - % of GDP	9.0	13.8	8.4	6.7	6.5					
<b>Financial Variables <sup>(1)</sup></b>										
NZD/USD	0.60	0.71	0.76	0.73	0.69	0.66	0.71	0.75	0.74	0.69
USD/JPY	108	109	109	108	107	109	104	109	109	107
EUR/USD	1.11	1.19	1.24	1.28	1.24	1.11	1.22	1.23	1.30	1.24
NZD/AUD	0.97	0.93	0.95	0.92	0.92	0.96	0.94	0.95	0.93	0.92
NZD/GBP	0.49	0.51	0.52	0.48	0.47	0.50	0.53	0.52	0.48	0.47
NZD/EUR	0.55	0.60	0.61	0.57	0.56	0.59	0.58	0.61	0.57	0.56
NZD/YEN	65.1	77.5	82.8	78.8	73.8	72.0	73.6	81.5	80.7	73.8
TWI	68.9	74.8	77.3	74.5	71.8	72.8	74.3	76.6	75.1	71.8
Overnight Cash Rate (end qtr)	0.25	0.25	1.25	2.25	2.25	1.00	0.25	1.00	2.00	2.25
90-day Bank Bill Rate	0.71	0.33	1.45	2.40	2.40	1.23	0.26	1.20	2.25	2.40
5-year Govt Bond	0.80	1.00	2.40	3.00	3.00	1.25	0.40	2.10	2.95	3.00
10-year Govt Bond	1.15	1.75	2.70	3.25	3.30	1.60	0.90	2.40	3.20	3.30
2-year Swap	0.65	0.50	2.10	2.65	2.65	1.25	0.28	1.80	2.65	2.65
5-year Swap	0.80	1.15	2.50	3.05	3.10	1.40	0.49	2.20	3.05	3.10
US 10-year Bonds	0.90	1.60	2.00	2.65	3.00	1.85	0.90	1.80	2.50	3.00
NZ-US 10-year Spread	0.25	0.15	0.70	0.60	0.30	-0.25	0.00	0.60	0.70	0.30
<sup>(1)</sup> Average for the last month in the quarter										

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

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