
Abel Tasman National Park, New Zealand

Weekly Economic Commentary.

New Zealand bucking the trend.

Last week's labour market reports reiterated what we have been saying for weeks – the New Zealand economy bounced back from lockdown in far better shape than was anticipated. The Treasury and RBNZ are going to have to adjust their forecasts, with interesting implications for Government debt projections, bond issuance, and monetary policy.

The surprising drop in the unemployment rate to 4%, announced last week, was a statistical artifact – people aren't counted as unemployed if they are not looking for work, and one cannot look for work during a lockdown. But the wider details of the labour market report reinforced what the Monthly Employment Indicator told us the week before – the labour market has taken much less of a hit than we originally feared. For example, employment growth for the quarter was down just 0.4%, and the underutilisation rate only rose from 10.4% to 12%, which is where it was eighteen months ago.

The fine details of the labour market report gave us a broader sense of the level of unemployment. A week-by-week breakdown of the survey responses tentatively indicated that unemployment had reached 6% by the end of June. Also, the number of people who have worked in the past five years but are not currently employed jumped by 50,000 compared to this time last year. After some statistical gymnastics, we conclude that this is also indicative of roughly 6% unemployment.

We expect unemployment will rise further in the coming quarters, to a peak of 7%. First, the measurement issues will disappear (unless there is another lockdown). And second, as the final stage of the wage subsidy scheme winds down more people will be laid off, especially from firms related to international tourism that have had little revenue other than the wage subsidy.

Indeed, the outlook for international tourism has taken a turn for the worse. The resurgence of COVID-19 in Australia has scuppered any realistic chance of a Trans-Tasman travel bubble, and a survey last week showed that the vast majority of New Zealanders favour strict border restrictions. Although the COVID downturn has been less severe than originally thought, it could prove more protracted.

In light of the recent stronger data, the Treasury and Reserve Bank are both going to have to revise up their near-term economic forecasts.

When the Treasury releases its Pre-Election Economic and Fiscal Update (PREFU) on 20 August, we are likely to see downgrades to their forecasts of deficits and Government debt – the new peak-debt forecast could be around 45% of GDP. The stronger-than-expected economy will mean more government revenue than previously forecast, and the Government's decision to hold back $14bn of previously-planned expenditure from the Covid Response and Recovery Package will mean less expenditure.

For financial markets, the immediate implication is that the Debt Management Office's plans for bond issuance may be reduced. Previously, the bond programme was $60bn this fiscal year and $40bn next, but we think those figures will be reduced to $50bn and $35bn.

The Reserve Bank will also have to revise up its near-term economic forecasts. Nevertheless, when the Reserve Bank releases its Monetary Policy Statement on Wednesday this week, we expect that it will keep the overall stance of monetary policy unchanged. The economy may be stronger than expected right now, but that is counterbalanced by three important negatives for the medium-term inflation outlook: (1) The likelihood that the borders will remain closed for longer than previously anticipated; (2) The rise in the trade-weighted exchange rate to 8% above the RBNZ's May forecast; and (3) The Government's decision to cancel some of its fiscal stimulus package is a negative for the medium-term economic outlook. Putting it all together, there have been both unders and overs recently, and there is no reason for the RBNZ to change its stance.

The RBNZ is currently holding the OCR at 0.25%, and is buying about $0.93bn worth of bonds per week in an effort to supress longer term interest rates. We expect Wednesday's primary message to be that both measures will continue for the foreseeable future. The RBNZ may simply repeat that the Large Scale Asset Purchase (LSAP) programme is unchanged at $60bn through to May 2021. An *equivalent* alternative would be for the RBNZ to say that the LSAP will be $70bn through to August 2021 – this is equivalent because it implies the same weekly pace of bond buying. We think the former is slightly more likely, because the RBNZ is under no pressure to make commitments about what it plans to do next year.

We have tweaked our forecast of the LSAP slightly. The RBNZ has been able to reduce the weekly pace of purchases by more than we expected, without causing an increase in interest rates. We still think the LSAP will last at least two years, but this slower pace of purchases implies that the total programme will be $90bn (previously $100bn).

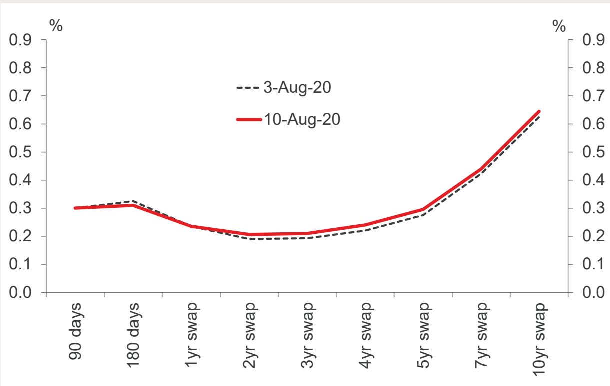
We have not changed our forecast that the OCR will drop to -0.5% in April 2021. The economic and inflation outlook clearly shows that there is a need for far more monetary stimulus than the LSAP alone is capable of providing – there simply are not enough Government bonds for the RBNZ to buy, while also maintaining a reasonable degree of market liquidity. The RBNZ does have a range of alternative options – a negative OCR, purchasing foreign government bonds, or providing direct loans to banks. We think that a negative OCR is the easiest and the most suited to the current situation. But the RBNZ has said that it will provide more detail about its own thinking on these possible future options on Wednesday, which we look forward to reading.

Fixed vs Floating for mortgages.

Fixed mortgage rates have fallen recently, but they may not drop much further in the near term. The drop in mortgage rates this year is now roughly commensurate with the drop in wholesale rates.

We are forecasting fairly stable interest rates this year, but early next year we expect that the RBNZ will lower the OCR to -0.5%. If that is correct, then both fixed and floating rates will fall next year.

NZ interest rates



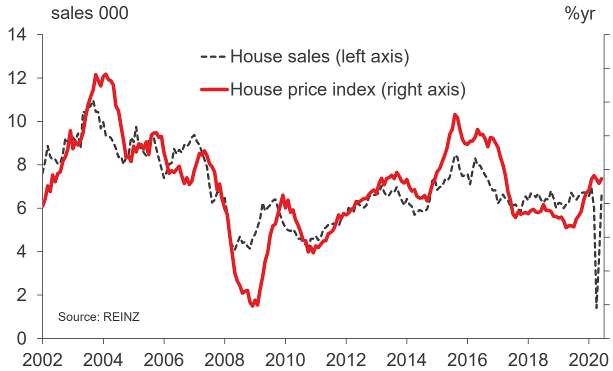
The week ahead.

NZ July REINZ House Price Index

Aug 10 (Due this week), Last: +8.6%

- The REINZ house price index rose by 1% in June, after falling roughly that amount in the previous two months. House price inflation has essentially been stopped in its tracks by COVID, and the market slowdown is widespread across almost all regions.
- House sales were very strong in June, and early indicators are that sales will also be high in July. However, the available stock of unsold properties is rising, which is an indication of weaker prices ahead.
- We expect house prices to decline over the second half of the year, although perhaps not as severely as our original forecast of a 7% decline. However the outlook is highly uncertain because it is a balance between two powerful forces – low interest rates and the COVID recession.

REINZ house prices and sales

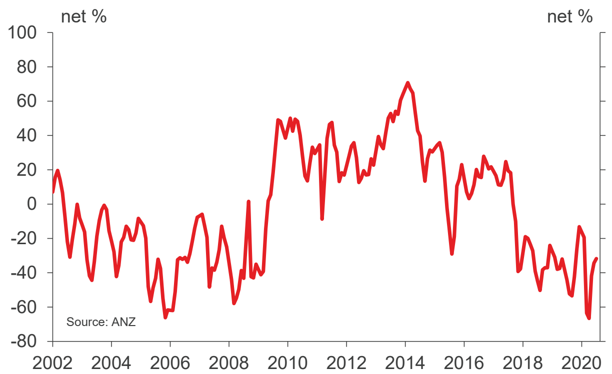


NZ Aug ANZBO business confidence (flash)

Aug 10, Last: –31.8

- Business confidence and expectations for trading activity have picked up again following their sharp declines during the Alert Level 4 lockdown. Nevertheless, they remain at low levels.
- While New Zealand has weathered the COVID storm relatively well thus far, businesses remain nervous about the outlook for the economy. Against this backdrop, we expect that August will see a further modest lift in confidence and trading activity. Even so, we expect that many businesses will remain cautious with regards to their plans for capital spending and hiring for some time yet.
- It will be worth keeping an eye on the inflation and pricing gauges which remain at very low levels despite the firming in activity.

NZ business confidence

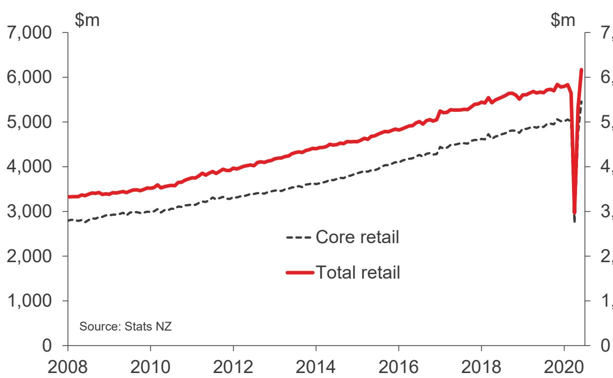


NZ July retail card spending

Aug 11, Last: +16.3%, WBC f/c: -2%

- As the COVID Alert Level was rolled back, New Zealanders opened up their wallets again. Retail spending on electronic cards rose 16% in June. Coming after a strong bounce after the lockdown, that left spending levels up 8% on the same month last year.
- Spending by New Zealanders has held up. However, the lack of international tourists remains a significant headwind in industries such as hospitality.
- We're forecasting a 2% drop in spending over July, as the June spending figures were boosted by a surge in spending on durable items.
- A key upside risk to our forecast is the diversion of spending from overseas holidays to holidays on shore.

Card transactions



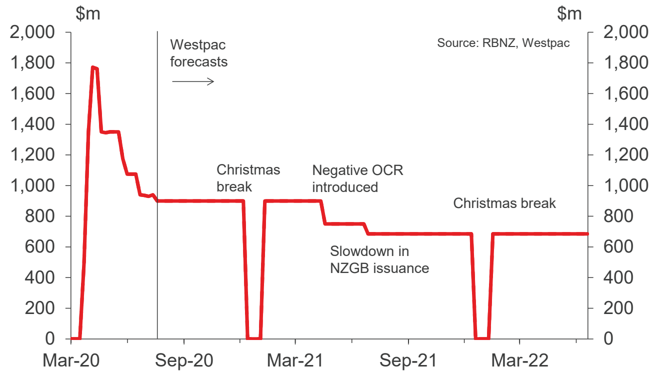
The week ahead.

RBNZ Monetary Policy Statement

Aug 12, Last: 0.25%, Westpac f/c: 0.25%, Mkt: 0.25%

- We expect the RBNZ will aim to keep the stance of monetary policy unchanged at the August MPS. There have been both positive and negative developments recently, and the overall balance has been roughly neutral so far as monetary policy is concerned.
- The OCR will remain at 0.25%, and the RBNZ will likely reiterate its commit to keeping it there until at least March 2021.
- The RBNZ may keep the LSAP at $60bn to May 2021, without any guidance on what will happen beyond then. An equivalent alternative would be to extend the LSAP to August 2021 and lift the cap to $70bn. We expect that the LSAP will last for two years and will eventually total $90bn (previously $100bn).
- The Reserve Bank has said that it will provide more details on the possible options if more stimulus is required.

RBNZ bond purchases

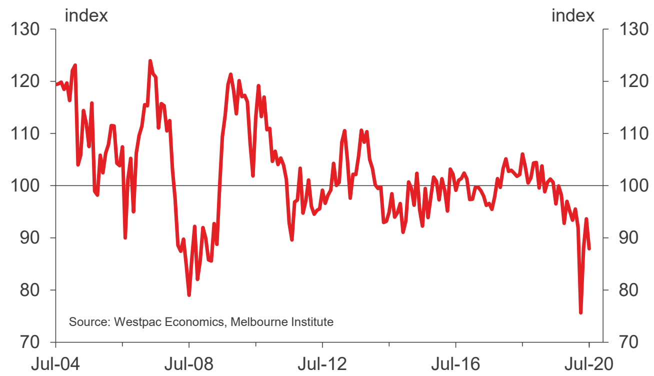


Aus Aug Westpac–MI Consumer Sentiment

Aug 12, Last: 87.9

- Consumer sentiment fell 6.1% in July, rocked by the resurgence in Coronavirus cases locally. The drop unwound all of the previous month's gain but still left the index 16% above April's extreme low of 75. The survey was in the field when a return to Stage 3 lock down was announced for Melbourne.
- August looks likely to see a further weakening. Victoria's outbreak has continued, prompting, the state government moving Melbourne to Stage 4 restrictions that are considerably tighter than those seen during the initial lockdown in March–April. New cases remain high with only very tentative signs of levelling out. Other states continue to record relatively low case numbers although NSW is on edge after seeing several significant clusters in recent weeks. Sentiment may also be affected by the Federal government's commitment to extend JobKeeper and JobSeeker payments beyond the end of September, albeit with modified programs that see support tapered and tiered.

Consumer Sentiment Index

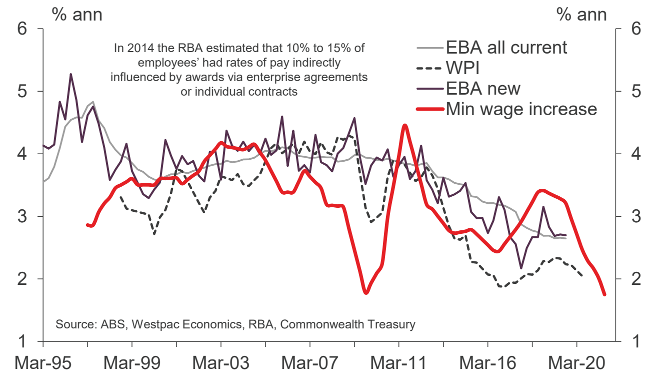


Aus Q2 Wage Price Index %qtr

Aug 12, Last: 0.5k, WBC f/c: 0.4%
Mkt f/c: 0.3% Range: -0.3% to 0.5%

- Wages lifted 0.5% in the Mar quarter, the fourth consecutive print of 0.5% and the fifth quarter to do so in the last six (the Mar 19 quarter rose 0.6%). The rate of increase in hourly wage rates have been very stable for the last year and a half and so is set to moderate as economic conditions weaken.
- Even before COVID there were reasons to expect wages growth to moderate through the second half of 2020. Underemployment remained elevated, the economy was growing at a sub trend pace and the increase in the minimum wage was reduced this year to 1.75%yr from the 3.0%yr granted in 2019.
- The adjustment to the minimum wage is not applied until the Sep quarter but given the factors above we think a modest step down in wage inflation was about to occur. Our 0.4% forecast takes the annual pace down to 2.0%yr from 2.1%yr.

Weaker min wage increase will drag on WPI



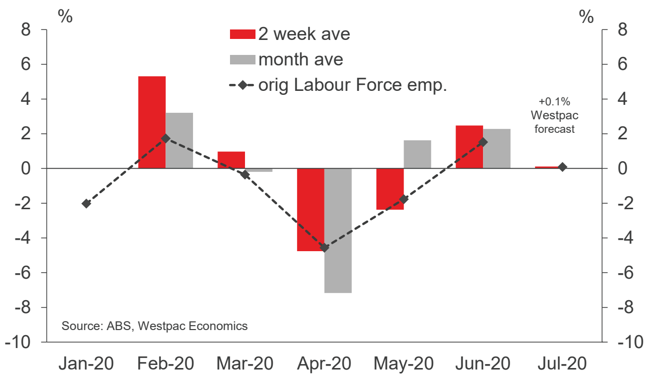
The week ahead.

Aus Jul Labour Force: total employment change

Aug 13, Last: 210.8k, WBC f/c: 40k
Mkt f/c: 30k Range: -120k to 150k

- Total employment increased by 210.8k in June, a robust if partial recovery from the sharp contraction in April and May (–872k). The bounce in employment reflected the reopening of the economy and saw a reversal of part-time job losses. In the month part-time employment rose 249k but full-time employment contracted further declining –38.1k in the month.
- In June the new Weekly Payrolls did provide a reasonable guide to the rise in total employment. Comparing weekly payrolls for the first two weeks in June to the first two weeks in May payrolls lifted 2.5%. This data is not seasonally adjusted. In original terms, total employment rose 1.5%.
- We have Weekly Payrolls to July 11 and comparing the first two weeks in Jul to the first two weeks in June payrolls were 0.1% higher. Our 40k forecast for employment is a 0.1% rise in original terms. But payrolls were weakening through the first two week in Jul and we get a critical update next week.

Payrolls vs Labour Force Employment

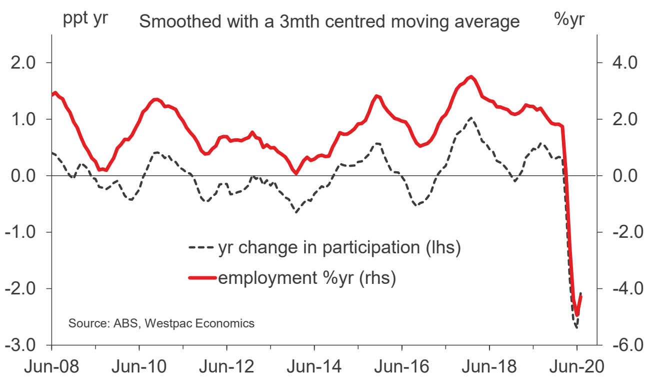


Aus Jul Labour Force: unemployment rate %

Aug 13, Last: 7.4%, WBC f/c: 7.8%
Mkt f/c: 7.8% Range: 7.3% to 8.2%

- The easing of the COVID restrictions resulted in a surge in activity with a focus on part-time employment. This reflected a surge in people re-entering the workforce. In Apr and May the focus of job losses in part-time employment led to a collapse in participation as less attached workers left the labour force. This reversed in Jun and an extra 280k entered the workforce lifting participation to 64.0% from 62.7%.
- With a larger rise in the labour force compared to employment, unemployment lifted to 7.4% from 7.1% in Jun. The ABS notes that around 70% of the newly unemployed people in Jun were not in the labour force in May.
- Our thoughts are that this process has further to run as the dip in participation is much larger than you would expect given the relative decline in employment. We are forecasting participation to lift to 64.4% which will boost unemploymet to 7.8%.

Participation & employment

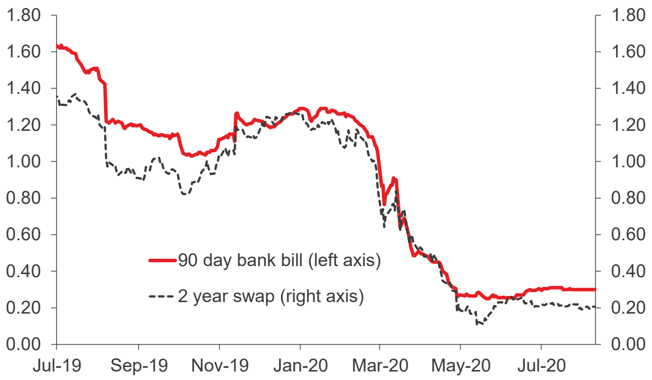


New Zealand forecasts.

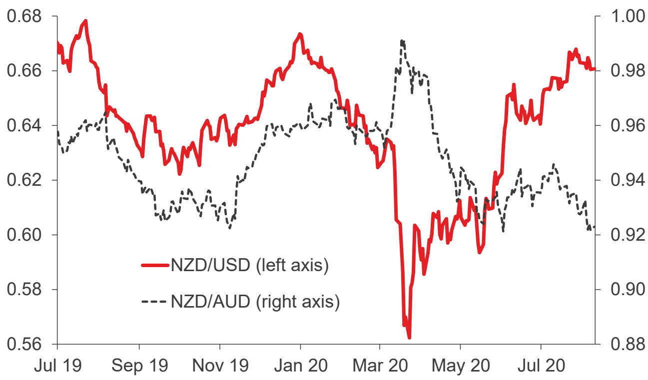
Economic forecasts	Quarterly				Annual			
	2020							
% change	Mar (a)	Jun	Sep	Dec	2018	2019	2020f	2021f
GDP (Production)	-1.6	-13.5	14.0	0.9	3.2	2.3	-4.6	5.1
Employment	1.0	-0.4	-3.8	-0.8	1.9	1.0	-4.0	2.8
Unemployment Rate % s.a.	4.2	4.0	6.5	7.0	4.3	4.1	7.0	6.5
CPI	0.8	-0.5	0.8	-0.3	1.9	1.9	0.8	0.4
Current Account Balance % of GDP	-2.7	-2.1	-1.7	-1.7	-3.8	-3.0	-1.7	-2.0

Financial forecasts	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Cash	0.25	0.25	0.25	-0.50	-0.50	-0.50
90 Day bill	0.30	0.20	-0.10	-0.20	-0.20	-0.20
2 Year Swap	0.20	0.00	-0.10	-0.10	-0.10	0.00
5 Year Swap	0.30	0.25	0.25	0.30	0.40	0.50
10 Year Bond	0.75	0.85	0.85	0.90	1.00	1.10
NZD/USD	0.66	0.66	0.66	0.65	0.66	0.67
NZD/AUD	0.93	0.92	0.90	0.88	0.88	0.88
NZD/JPY	69.3	70.0	70.6	69.6	71.3	72.4
NZD/EUR	0.56	0.55	0.55	0.54	0.54	0.54
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.50
TWI	71.9	71.4	70.9	69.2	69.8	70.3

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 10 August 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.27%
60 Days	0.28%	0.30%	0.30%
90 Days	0.30%	0.30%	0.31%
2 Year Swap	0.21%	0.22%	0.22%
5 Year Swap	0.30%	0.33%	0.35%

NZ foreign currency mid-rates as at 10 August 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6607	0.6639	0.6572
NZD/EUR	0.5605	0.5695	0.5817
NZD/GBP	0.5061	0.5188	0.5204
NZD/JPY	69.93	70.49	70.28
NZD/AUD	0.9230	0.9344	0.9455
TWI	71.91	72.75	72.64

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
NZ	Aug ANZ business confidence (flash)	–31.8	–	–	Has picked up, but activity gauges remains soft.
	Jul REINZ house sales	79.3%	–	–	Due this week. Repots of increased buyer interest...
	Jul REINZ house prices %yr	8.6%	–	–	...but increase in listings will provide a brake on prices.
Chn	Jul PPI %yr	–3.0%	–	–	Upstream price pressures to remain weak for some time.
	Jul CPI %yr	2.5%	–	–	Despite rapid rebound, inflation to remain modest.
	Jul M2 money supply %yr	11.1%	–	–	Credit supply and conditions highly supportive...
	Jul new loans, CNYbn	1810.0	–	–	... though focus on quality investment remains.
	Jul foreign direct investment %yr	7.1%	–	–	Necessary to maximise development and efficiency.
Eur	Aug Sentix investor confidence	–18.2	–	–	Sentiment recovering well, ahead of economy.
US	Jun JOLTS job openings	5397	–	–	Hires; fires; quits and job openings.
Tue 11					
NZ	Jul retail card spending	16.3%	–	–2.0%	Domestic spending back around trend.
Aus	Jul NAB business survey	–7	–	–	Conditions off lows but still weak – ahead of VIC lock-down.
	Weekly payrolls week ended 25 Jul	–1.1%	–	–	Weakened through Jun/early Jul & down –1.1% in 4 weeks.
Eur	Aug ZEW survey of expectations	59.6	–	–	Sentiment recovering well, ahead of economy.
UK	Jun ILO unemployment rate	3.9%	–	–	Underemployment will prove an enduring concern.
US	Jul NFIB small business optimism	100.6	98.5	–	Small business conditions vary greatly across nation.
	Jul PPI	–0.2%	0.3%	–	Upstream price pressures non-existent.
Wed 12					
NZ	Jun net migration	590	–	–	Border restrictions continue to keep net flows near zero.
	RBNZ Monetary Policy Statement	0.25%	0.25%	0.25%	RBNZ expected to keep policy stance unchanged.
Aus	Aug WBC–MI Consumer Sentiment	87.9	–	–	Sentiment knocked by deteriorating virus situation in Victoria.
	Q2 wage cost index	0.5%	0.3%	0.4%	Wages were set to moderate even before COVID hit.
Eur	Jun industrial production	12.4%	12.0%	–	External demand to remain a headwind for a while.
UK	Jun trade balance £bn	4296	–	–	Brexit terms to create another headwind for UK trade.
	Q2 GDP	–2.2%	–	–	UK economy was hit hard in Q2, particularly consumer.
US	Jul CPI	0.6%	0.3%	0.4%	Inflation unlikely to be a threat to target for quite a while.
	Jul monthly budget statement	–864.1	–	–	Deficits continue to mount.
Thu 13					
NZ	Jul food price index	0.5%	–	0.2%	Annual inflation running at about 3%.
Aus	Aug MI inflation expectations	3.2%	–	–	The recovery in petrol prices should support expectations.
	Jul employment	210.8k	30k	40k	Recovery continuing in early Jul before new shutdowns.
	Jul unemployment rate	7.4%	7.8%	7.8%	Rising partipation will drive unemployment higher.
US	Initial jobless claims, '000	1,186	–	–	Two weeks of increases reversed last week.
Fri 14					
NZ	Jul manufacturing PMI	56.3	–	–	Activity and orders have recovered, hiring subdued.
Aus	RBA Governor Lowe	–	–	–	Parliamentary Testimony – half yearly update, 9:30am.
Chn	Jul industrial production	–1.3%	–	–	Domestic and regiona recovery a big positive hence.
	Jul retail sales %yr	–1.8%	–	–	Momentum across China's economy is picking up...
	Jul fixed asset investment ytd %yr	–3.1%	–	–	... consumer spend to follow investment uptrend in H2.
Eur	Jun trade balance €bn	8.0	–	–	Global recovery offers promise, but not here yet.
	Q2 GDP	–12.1%	–12.1%	–12.1%	Second estimate, some detailed data to be provided.
US	Jul retail sales	7.5%	1.7%	1.2%	Rapid growth to normalise.
	Jul industrial production	5.4%	2.7%	–	Mixed conditions across nation a headwind for manuf.
	Jun business inventories	–2.3%	–1.2%	–	Business likely reluctant to build stocks for some time.
	Aug Uni. of Michigan sentiment	72.5	71.0	–	Consumers are unsure over recovery timing.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.8	1.8	-4.1	2.3
CPI inflation % annual	1.5	1.9	1.8	1.8	0.7	2.1
Unemployment %	5.7	5.5	5.0	5.2	8.6	7.4
Current Account % GDP	-3.1	-2.6	-2.0	0.6	2.4	0.8
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.8	2.9
Consumer Prices %yr	1.4	2.1	2.4	1.9	0.7	1.4
Unemployment Rate %	4.9	4.4	3.8	3.7	9.7	7.3
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	-5.0	1.0
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	-8.5	4.1
United Kingdom						
Real GDP %yr	1.9	1.9	1.3	1.4	-7.0	2.5
China						
Real GDP %yr	6.8	6.9	6.8	6.1	1.3	9.5
East Asia ex China						
Real GDP %yr	4.1	4.6	4.4	3.7	-2.0	5.4
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-4.3	5.0
Forecasts finalised 7 August 2020						

Interest rate forecasts	Latest	Sep–20	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21
Australia							
Cash	0.25	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.10	0.10	0.15	0.20	0.25	0.30	0.35
10 Year Bond	0.85	0.85	0.90	0.95	1.05	1.20	1.35
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.54	0.55	0.60	0.65	0.75	0.85	0.95

Exchange rate forecasts	Latest	Sep–20	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21
AUD/USD	0.7233	0.71	0.72	0.73	0.74	0.75	0.76
USD/JPY	105.59	105	106	107	107	108	108
EUR/USD	1.1876	1.19	1.19	1.20	1.21	1.22	1.23
GBP/USD	1.3139	1.30	1.31	1.31	1.32	1.33	1.35
USD/CNY	6.9536	6.93	6.90	6.85	6.80	6.70	6.60
AUD/NZD	1.0820	1.08	1.09	1.11	1.14	1.14	1.13

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