



Westland Tai Poutini National Park, New Zealand

Weekly Economic Commentary.

Picking up speed, despite strong headwinds.

As the New Zealand economy has exited lockdown, some key indicators have risen by more than expected and the downturn looks like it will be at the more moderate end of expectations. However, conditions are mixed across the economy, and we are encountering strong headwinds that will be a drag on growth as we head into the new year.

After falling sharply in the early part of the year, economic activity in New Zealand has been picking up again and some key economic indicators have been stronger than expected. This means, provided the virus remains contained, New Zealand is on track for a classic 'V' shaped recovery, with the sharp drop in the first half of 2020 followed by a bounce later in the year. We're forecasting the estimated 15% drop in GDP through the first half of the year will be followed by a 14% bounce in the September quarter. However, that would still leave the economy 3% smaller than it was at the end of 2019. In addition, we're seeing mixed conditions across the economy, as well as continued strong headwinds which will be a drag on growth as we head into the new year.

Taking a closer look at recent developments, one of the key areas where we're seeing strength has been household spending. During the lockdown in April, household spending on items other than groceries fell by 90%. But as the Alert Level

has been rolled back, New Zealanders have been giving their credit cards a good workout. Spending in June was up 8% on the same time last year. There's been particular strength in spending on household furnishings, which may have been boosted by the fact that we can't take overseas holidays. New Zealanders have also been returning to bars and restaurants.

Some of the recent strength in household spending is likely due to pent up demand after the lockdown, which might not be sustained. In addition, we expect some easing in spending later this year as the Government's wage subsidy schemes come to an end. Even so, the recent strength in household spending is an encouraging sign. It points to underlying strength in household spending appetites despite some powerful headwinds, including rising unemployment.

New Zealand's agricultural sector has also been weathering the COVID storm relatively well. The essential nature of food



items meant that agricultural production was not disrupted to the same extent as other industries. In addition, prices for many of our key exports have been resilient. In fact, dairy prices have surged higher recently, effectively wiping out their COVID-related falls earlier in the year. That's provided an important counterbalance to the softness in global economic conditions. As discussed in our inaugural Monthly Meat Matters report,¹ New Zealand's primary sector still faces a number of hurdles over the coming year as a result of the COVID downturn. Even so, we believe the sector is relatively well-placed to meet the economic challenges over the coming year.

While we are seeing some positive near-term indicators for demand, many businesses are still wrestling with some big challenges. Notably, businesses in the service sector have reported very weak activity in recent months, with the lack of international tourists a significant drag on demand for many firms. There is also evidence of broader business sector weakness, with many businesses in other sectors also reporting soft trading conditions in recent months.

With weakness in demand and nervousness about the outlook, businesses have cut back their plans for capital spending. We've also seen a sharp reduction in plans for hiring. In fact, in recent surveys a greater number of businesses have said that they are planning to shed staff than are planning to hire. Against this backdrop, the number of New Zealanders on the Jobseekers or Covid related benefit has risen by around 60,000 since late March, and we expect that number will continue to rise over the coming months as the Government's wage subsidy programmes wind down. However, while there

has been a sharp increase in unemployment, the extent of job losses has actually been more modest than we expected. We had been braced for the loss of more than 100,000 jobs through the middle part of this year, and both the RBNZ and Treasury expected even larger rises.

Recent weakness in activity has also dampened inflation through the middle part of this year. We expect the upcoming CPI report will reveal that prices fell by 0.5% during the June quarter. That would take annual inflation back to 1.5% (down from 2.5% in the March quarter). In part, the expected drop in inflation is due to earlier sharp falls in international oil prices. There has also been softness in prices more generally. A result in line with our forecast would be a little stronger than the RBNZ is expecting. However, much of the difference is due to changes in oil prices since the RBNZ finalised their forecasts in May.

Putting this altogether, the New Zealand economy is still facing some significant challenges over the coming months. Many businesses have been left with a hole in their earnings following the lockdown in late March and April. In addition, the combination of a weak global economy, the closure of our borders and increases in unemployment will be a significant drag on demand. Against this backdrop, we expect that GDP will remain below its pre-COVID trend for an extended period. However, given our success in limiting the spread of the virus and the signs of firmness in demand, it looks like the downturn in the New Zealand economy will not be as severe as we had previously feared.

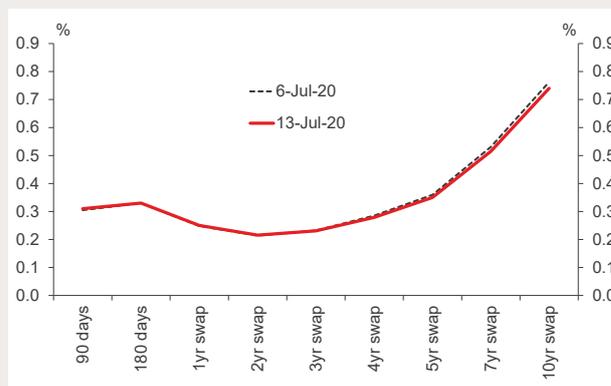
¹ Available here: <https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Monthly-Files-2020/Meat-Matters-July-2020-Westpac-NZ.pdf>

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 June REINZ House Price Index

Jul 14, Last: +7.9%/yr

- After falling sharply in April, homes sales picked up again in May. However, they remained around 40% below pre-COVID levels.
- Over the past month, we have seen a pickup in listings and anecdotes of firming demand. However, given the headwinds buffeting the economy, we expect that sales will remain below pre-COVID levels for some time yet.
- Prices have fallen 1.2% since April. While low interest rates are helping to support demand, we're forecasting a 7% drop by the end of this year as broader weakness in the economy weighs on prices.

REINZ house prices and sales

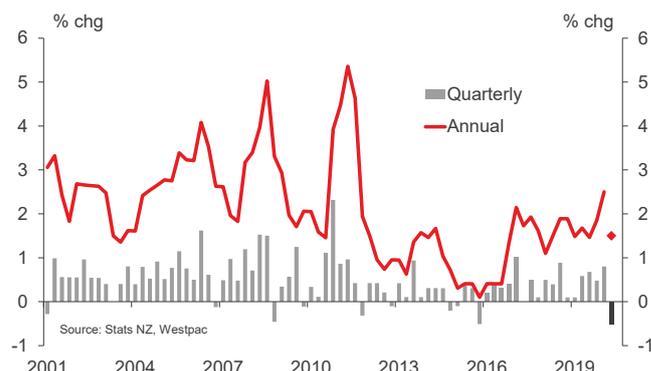


NZ Q2 CPI

Jul 16, Last: +0.8%, Westpac f/c: -0.5%
Mkt f/c: -0.5% Range: -0.9% to -0.4%

- Consumer prices rose by 0.8% in the March quarter, with annual inflation rising to 2.5%, its fastest pace since 2011. However, much of the stronger than expected March result was due to factors that will not be repeated (like the increase in tobacco taxes).
- We estimate that the CPI dropped 0.5% in the June quarter. That would take annual inflation back to 1.5%. Some of this soft result is due to the sharp fall in petrol prices over the quarter. However, we are also seeing more general softness in inflation, in part due to COVID-related disruptions. We will review that estimate after Monday's food price release.
- A result in line with our forecast would be a little stronger than the RBNZ is expecting. However, much of the difference is due to changes in oil prices since the RBNZ finalised their forecasts in May.

NZ CPI inflation

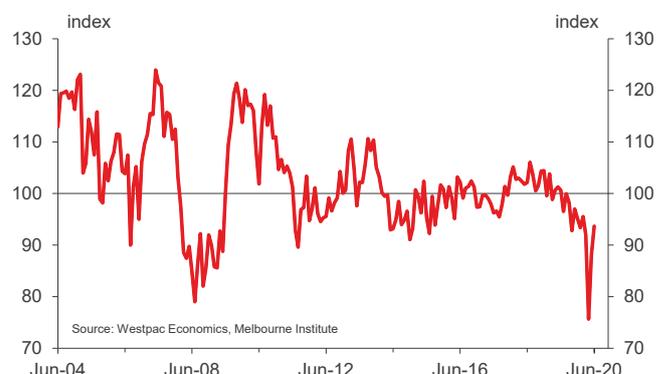


Aus Jul Westpac-MI Consumer Sentiment

Jul 15 Last: 93.7

- Consumer sentiment is set for another jolt in July. The index posted an impressive rally through May–June, recovering all of the extreme 20% drop seen when the COVID-19 pandemic hit in March–April. Australia's initial success in bringing the virus under control and an associated easing in social restrictions were clearly key factors driving the bounce.
- The last month has seen a significant setback on the virus front with a surge in cases in Victoria leading to the reintroduction of tighter restrictions including a full lockdown in Melbourne and controls on domestic travel.
- The July survey was conducted in the week these developments were coming to a head. While the resurgence in cases and tighter restrictions may only directly affect about a quarter of the country by population, they come against a run of positive virus news and make the further easing in restrictions planned in many states look more doubtful.

Consumer Sentiment Index



The week ahead.

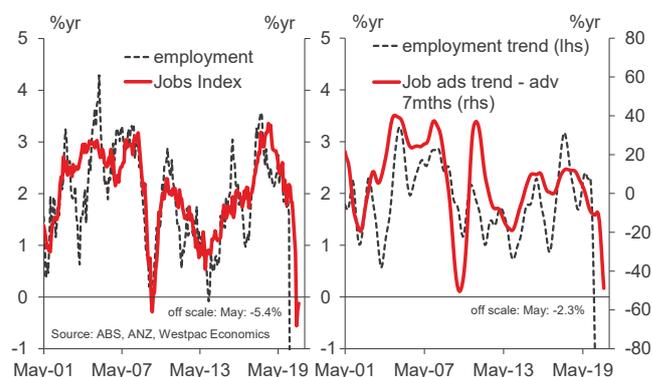
Aus Jun employment change

Jul 16, Last: -227.7k, WBC f/c: -30k

Mkt f/c: 104.ok Range: -30k to 170k

- Total employment fell -227.7k in May to be down -835k since March. This is closer to but still less than the circa 1 million drop reported in the new ATO/ABS Weekly Payrolls (an update due on July 14). As suspected, a large share of the 750k employed who reported working zero hours in April appeared to roll into unemployment in May with the number working zero hours falling to 360k. Total hours worked fell -0.7% in May while the number of employees working fewer hours than usual increased to 1.2 million from 1.1 million.
- Leading indicators have improved over the last month. The employment indicators in business surveys rose in June while Job Ads bounced 42% in May. Nevertheless, most of the improvement is likely going to hours worked rather than employment. With legacy definitional issues around unemployment, Westpac is forecasting a -30k contraction in employment.

Leading indicators of employment



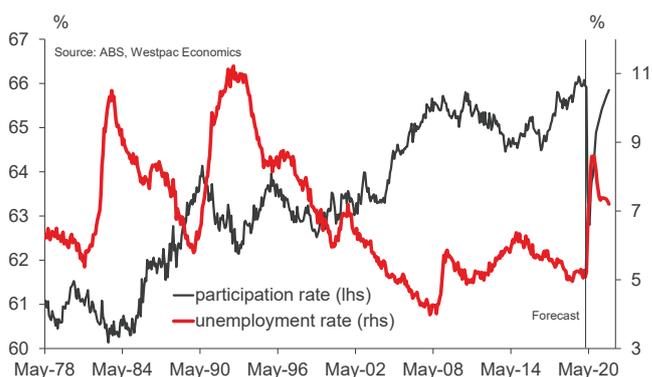
Aus Jun unemployment rate

July 16, Last: 7.1%, WBC f/c: 7.3%

Mkt f/c: 7.1% Range: 6.6% to 7.6%

- Significant weakness in the labour market is driving a fall in the participation rate to 62.9% in May from 63.6% in April. This resulted in -142k decline (-1.1%) in the labour force which limited the rise in unemployment rate to 7.1% from 6.4%. If the participation rate had been steady at 63.6% in May the unemployment rate would have been 8.1%.
- The large decline in participation can be tracked back to the larger falls in part-time female employment. This group has historically had a more marginal attachment to the labour force and tend to enter and exit the market depending on current conditions.
- We suspect that most of the correction in the hospitality, retail and services employment has already occurred so the forecast -30k fall in employment should have a marginal impact on participation. If participation rounds down to 62.8% in June then the unemployment rate will be 7.3%.

Falling participation buffers unemployment

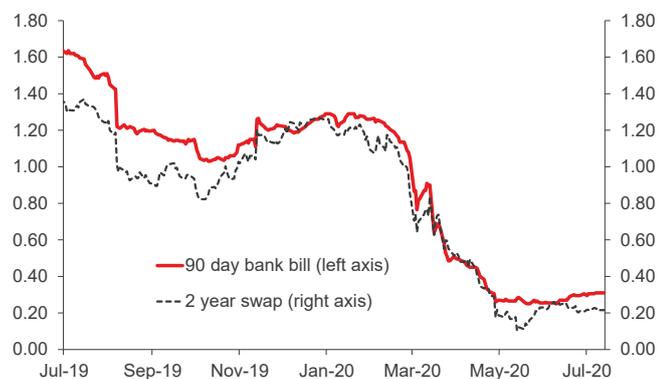


New Zealand forecasts.

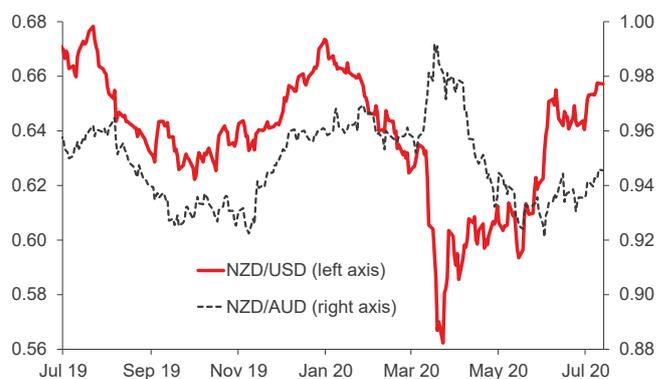
Economic forecasts	Quarterly				Annual			
	2020							
% change	Mar (a)	Jun	Sep	Dec	2018	2019	2020f	2021f
GDP (Production)	-1.6	-13.5	14.0	0.9	3.2	2.3	-4.6	5.1
Employment	0.7	-7.5	0.7	1.3	1.9	0.8	-4.9	3.4
Unemployment Rate % s.a.	4.2	7.0	8.0	7.5	4.3	4.0	7.5	6.6
CPI	0.8	-0.5	0.7	-0.3	1.9	1.9	0.7	0.4
Current 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	0.25	0.20	-0.10	-0.20	-0.20	-0.20
2 Year Swap	0.10	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	0.85	0.85	0.85	0.90	1.00	1.10
NZD/USD	0.65	0.65	0.64	0.65	0.66	0.67
NZD/AUD	0.93	0.90	0.88	0.88	0.88	0.88
NZD/JPY	68.9	68.9	68.5	69.6	71.3	72.4
NZD/EUR	0.58	0.57	0.56	0.56	0.56	0.57
NZD/GBP	0.52	0.51	0.50	0.51	0.51	0.52
TWI	71.5	70.6	69.1	69.7	70.2	70.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 13 July 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	0.30%	0.29%	0.27%
90 Days	0.31%	0.30%	0.27%
2 Year Swap	0.22%	0.21%	0.25%
5 Year Swap	0.35%	0.37%	0.38%

NZ foreign currency mid-rates as at 13 July 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6572	0.6417	0.6425
NZD/EUR	0.5817	0.5718	0.5716
NZD/GBP	0.5204	0.5209	0.5127
NZD/JPY	70.28	68.76	68.91
NZD/AUD	0.9455	0.9354	0.9400
TWI	72.64	71.50	71.51

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 13					
NZ	Jun food price index	-0.8%	-	0.8%	Seasonal gains in fruit and vegetable prices.
US	Jun monthly budget statement Fedspeak	-398.8	-	-	Mammoth relief package and revenue drop to hit deficit. FOMC Williams discusses LIBOR in webinar.
Tue 14					
NZ	Jun REINZ house sales %yr	-46.6%	-	-	Due this week. Sales picking up but still low.
	Jun REINZ house prices %yr	7.9%	-	-	Factors incl. low confidence still weighing on prices.
	May net migration	220	-	-	NZers returning home, but other arrivals blocked.
Aus	Jun NAB business survey	-24	-	-	Conditions +10pts in May. Pace of decline to ease in June.
	Jun 27 ATO/ABS Weekly Payrolls	0.0%	-	-	Stable in recent weeks but still down 6.4% vs pre-COVID level.
Chn	Jun trade balance USDbn	62.93	57.4	-	Market expects trade surplus to narrow slightly.
Eur	May industrial production	-17.1%	8.1%	-	Capturing industrial rebound.
	Jul ZEW survey of expectations	58.6	-	-	Growth outlooks on track to recover.
UK	May trade balance £bn	305	-	-	April saw the trade balance move into surplus.
US	Jun NFIB small business optimism	94.4	97.5	-	Optimism rising; small business looking to rehire.
	Jun CPI	-0.1%	0.6%	-	Headline and core price pressures remain weak.
	Fedspeak				FOMC's Bullard to speak.
Wed 15					
Aus	Jul WBC-MI Consumer Sentiment	93.7	-	-	Deteriorating COVID cases and partial lockdown in Vic to hit.
UK	Jun CPI	0.0%	0.0%	-	Flat inflation read to persist in the post-COVID recovery.
US	Jun import price index	1.0%	1.0%	-	May advance driven by higher fuel prices.
	Jul Fed Empire state index	-0.2	5.5	-	Regional surveys very positive.
	Jun industrial production	1.4%	4.8%	-	Bounce in factory output has yet to run its course.
	Federal Reserve's Beige book				Release time 6am (NZT).
	Fedspeak				FOMC's Harker and Logan.
Thu 16					
NZ	Q2 CPI	0.8%	-0.5%	-0.5%	Falls in petrol prices and weak demand during lockdown.
Aus	Jul MI inflation expectations	3.3%	-	-	Would not capture the impact of subsidised childcare.
	Jun unemployment rate	7.1%	7.1%	7.3%	Falling participation is buffering unemployment with some ...
	Jun employment	-227.7k	104.0k	-30k	... legacy definitional issues offsetting signs of stability.
Chn	Q2 GDP %yr	-6.8%	2.5%	2.0%	Rebound strengthening and broadening quickly.
	Jun industrial production YTD %yr	-2.8%	-1.5%	-	Production led this recovery....
	Jun retail sales %yr	-2.8%	0.2%	-	... but consumer demand is quickly coming back...
	Jun fixed asset investment ytd %yr	-6.3%	-3.4%	-	... and momentum in activity broadening.
Eur	May trade balance €bn	1.2	-	-	Trade surplus has narrowed since COVID-19 onset.
	ECB policy decision	0.0%	0.0%	-	At the zero-lower bound, has turned to PEPP for stimulus.
UK	May ILO unemployment rate	3.9%	4.0%	-	Unemployment to show marginal rise in May print.
US	Jun retail sales	17.7%	5.5%	-	Record surge in sales unsustainable, but Jun still robust.
	Jul Philly Fed index	27.5	20.0	-	Regional economies to see highly variable conditions.
	Initial jobless claims	1314k	-	-	Risks to employment growth await in July.
	May business inventories	-1.3%	-2.3%	-	Inventories have been falling since before COVID.
	Jul NAHB housing market index	58	60	-	Optimism soars as buyers return, June beat est. 45.
	May total net TIC flows \$bn	125.3	-	-	Demand for Treasuries remains strong.
	Fedspeak				FOMC Evans and Williams.
Fri 17					
NZ	Jun BusinessNZ PMI	39.7	-	-	Expected to rise, but remain at low levels.
Eur	Jun CPI	0.3%	0.3%	-	Inflation to remain capped at subdued levels.
US	Jun housing starts	4.3%	21.2%	-	Market envisions robust housing recovery.
	Jun building permits	14.4%	6.9%	-	Approvals jumped in May; growth to moderate in Jun.
	Jul Uni. of Michigan sentiment	78.1	80.0	-	Consumer sentiment may stumble on rising case count.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.8	1.8	-3.7	2.4
CPI inflation % annual	1.5	1.9	1.8	1.8	0.3	2.0
Unemployment %	5.7	5.5	5.0	5.2	8.4	7.3
Current Account % GDP	-3.1	-2.6	-2.0	0.6	1.9	0.5
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.6	2.6
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	16.2	6.3
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	0.1	10.0
East Asia ex China						
Real GDP %yr	4.1	4.6	4.4	3.7	-1.9	5.4
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-4.5	5.0

Forecasts finalised 10 July 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	0.87	0.95	1.00	1.05	1.15	1.25	1.35
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.61	0.70	0.75	0.80	0.85	0.90	0.95

Exchange rate forecasts	Latest	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
AUD/USD	0.6958	0.70	0.72	0.73	0.74	0.75	0.76
USD/JPY	107.17	106	106	107	107	108	108
EUR/USD	1.1282	1.13	1.14	1.15	1.16	1.17	1.18
GBP/USD	1.2605	1.26	1.27	1.27	1.28	1.29	1.30
USD/CNY	6.9940	7.00	6.90	6.85	6.80	6.70	6.60
AUD/NZD	1.0599	1.08	1.11	1.14	1.14	1.14	1.13

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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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