Weekly Economic Commentary.

Better to do it right first time.

In many of the world's hotspots, the number of daily new cases of Covid-19 is dropping away. Markets have taken cheer from this, and equity indexes rose sharply last week.

Daily new cases have dropped in New Zealand too, which is great for morale. Nevertheless, some epidemiologists are suggesting that the Level 4 lockdown will have to be extended beyond the original four weeks if we are to achieve the Government's goal of eradicating Covid-19. This would allow more time for the Government to build its ability to aggressively detect and stamp out isolated instances of the disease after the lockdown is lifted. The Government itself plans to review the end date of the lockdown on April 20th.

Extending the lockdown would be very costly for the economy, but a failed lockdown would be even more expensive. If the virus resurges later, the Government would have to return us to Alert Level 4. That would shake the confidence of businesses just getting back on their feet, create ongoing uncertainty, and would effectively extend the period of economic stasis. Even from a purely economic perspective, it is best to go early, go hard, and try to beat Covid-19 in a single push. With this in mind, we suspect that the Government will err on the side of extending the lockdown, unless the infection numbers drop to a very low level soon.

We have estimated that about a third of economic activity cannot happen during Level 4 lockdown, whereas at Level 3 the constraint on GDP is 8%. This implies that the direct cost of each fortnight at Level 4 is about $1.6bn, or 2% of quarterly GDP. However, the full costs are not linear over time. The longer the lockdown, the greater the risk of business failures and employee separations, which have greater long run costs.

In a longer lockdown there is also a greater threat of supply chain disruptions. Businesses that are deemed essential and are allowed to operate under level 4 still rely to some extent on inputs from firms that are currently deemed non-essential. Essential firms can get by for a while by running down stocks, deferring maintenance and otherwise improvising. But as the lockdown wears on that becomes less feasible. For example, shops are now having trouble supplying flour to households due to a shortage of flour bags.

If these issues were allowed to proliferate, the provision of essential services would be impaired. That is clearly not acceptable, so what will have to happen is a gradual expansion of what is classed as "essential." In effect, over time the Level 4 lockdown will become less stringent. We argue that cost-benefit analysis should be applied each time the Government faces a decision about whether to reclassify an industry as essential. The importance of the industry should be weighed against the additional risk of spreading Covid-19 associated with opening *that particular industry*.

Even after New Zealand comes out of Level 4 lockdown, it is very clear that the border will have to remain virtually shut for a longer period. Firms connected to international tourism still face a hard road ahead, as explained in a bulletin we published last week.[1] We are forecasting just 2.3m international visitors in 2021, down from 3.9m in 2019, as travellers will remain both cautious of Covid-19 and economically impaired for some time. The recovery in tourism will initially be led by Kiwis holidaying at home rather than abroad. Next we expect a faster recovery in the number of young international visitors, as young people are less fearful of Covid-19. One possibility is a stage during which travel is allowed only for people carrying "immunity passports" verifying that they have had Covid-19 or have been vaccinated. Such schemes are most likely to be developed in rich countries, meaning visitors from Europe, North America and Japan could bounce back earlier than visits from developing countries like India. During the unprecedented downturn ahead we do expect many small tourism operators to go out of business. However, we expect that tourism will eventually fully return, just as travel and trade rebounded after the Spanish Flu pandemic a hundred years ago. The recovery will be led by the emergence of nimble new small businesses, and the shape of the industry could be different to today.

Other export sectors are also feeling the pinch. Last week we reduced our forecast of Fonterra's farmgate milk price for the 2021/22 season to $6.30/kg (previously $7.30), which will dent rural incomes. That said, preliminary trade data up to the end of March suggests that exports have held up well through the crisis period, running about 4% ahead of a year ago. Exports to China have been softer in that time, but it appears that exporters have been able to successfully divert to other markets.

Turning to markets, the Reserve Bank last week announced that it would extend its quantitative easing program to include buying $3bn worth of local government debt. This was aimed at ensuring the smooth functioning of that particular market, but it is still an expansion of the program that will pump more cash into the financial system. Assistant Governor Christian Hawkesby also said that the RBNZ was open to expanding its purchases of government bonds, up to a limit of 40% to 50% of all bonds in the market. Government debt is going to be about $125bn by June 2021, so that puts the upper limit of RBNZ bond buying at roughly $60bn, double the $30bn they have already committed to. We remain of the view that in order to keep long-term Government bond rates low, the RBNZ will indeed have to up its bond buying above $30bn.

Finally, Australia's Federal Government has been put on negative credit watch by ratings agency Standard and Poor's. Negative watch is a more distant prospect for New Zealand, as it is starting from a lower credit rating and its debt/GDP ratio was lower before Covid-19 struck. Still, this serves as a reminder that there is a limit to the New Zealand Government's ability to bail the economy out.

1 Available here: https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Bulletins-2020/Tourism-Bulletin-April-2020-Westpac-NZ.pdf

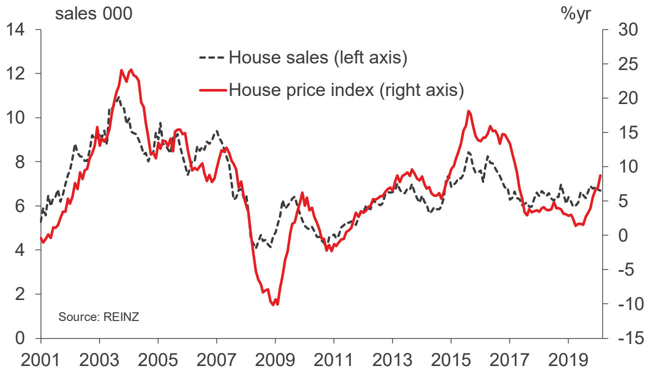
The week ahead.

NZ Mar REINZ House Price Index

Apr 15, Last: +8.7%yr

- House prices continued to charge higher in February, rising by 2% over the month in seasonally adjusted terms. That left prices up 8.7% over the past year, buoyed by the low level of interest rates and the cancellation of the proposed capital gains tax. But while prices have been rising at a solid pace, sales growth has been muted in recent months, constrained by a lack of listings.
- Reports for March point to solid demand and continued momentum in price growth. There are also reports of more homes coming onto the market. However, the number of sales will be constrained by COVID-19 restrictions, which have effectively reduced the number of trading days in the month.

REINZ house prices and sales

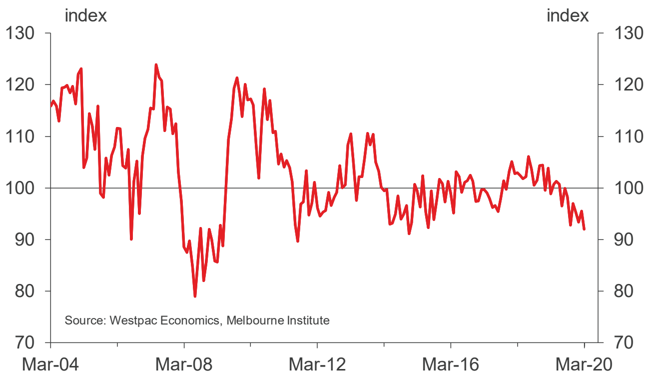


Aus Apr Westpac–MI Consumer Sentiment

Apr 15 Last: 91.9

- Consumer sentiment is poised to fall very sharply in April as the dramatic escalation in the Coronavirus outbreak hits hard. Sentiment has been under pressure in 2020 with bushfires impacting in Jan, the initial virus outbreak in China weighing in Feb and the worsening virus situation impacting in March.
- The March reading of 91.9 was the second lowest since the GFC. However, April update is shaping up as much weaker with virus threats and disruptions becoming large and pervasive. Here and abroad, the last month has seen: a surge in cases leading to the widespread introduction of social distancing restrictions; major disruptions to financial markets (ASX down 20%); and what looks to be a severe contraction in economic activity. Policymakers have mobilised: locally the RBA cutting the cash rate to 0.25% and deploying QE, and large scale fiscal measures rolled out including the government's JobKeeper Payment scheme. There are also clear signs that social distancing is slowing the spread of the virus. But these positives are unlikely to be enough to prevent a very large shock to confidence.

Aus Consumer Sentiment Index

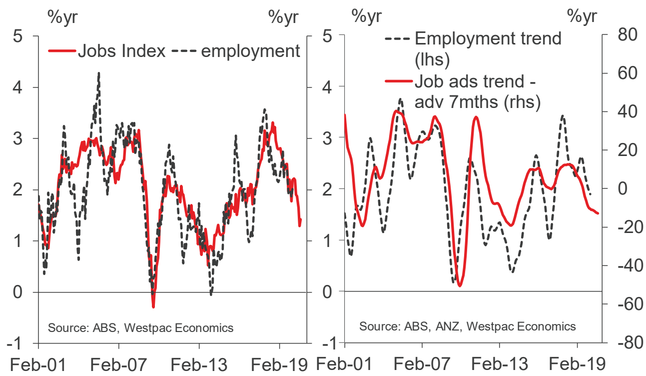


Aus Mar employment change

Apr 16, Last: 26.7k, WBC f/c: –20k
Mkt f/c: –30k Range: –105k to –15k

- The Feb survey was conducted when the COVID-19 outbreak was still to be declared a global pandemic. It revealed a sound trend with employment lifting 26.6k, exceeding expectations (Westpac +5k and the market +6.5k). Employment gained an average of +22.9k per month through the previous three months to be up 256k/2.0% in the year.
- When thinking about forecasting the monthly employment when there is such a clearly defined shock it is important to take into consideration that the reference period for the survey is the first two weeks of the month. The widespread shutdowns and social restrictions, including stay at home orders, were not implemented until the second half of the month, thus will have a greater impact in the April survey.
- Nevertheless, the tourism and hospitality sectors had been impacted by early virus disruptions so we are forecasting –20k in employment and acknowledge downside risks.

Aus leading indicators of employment



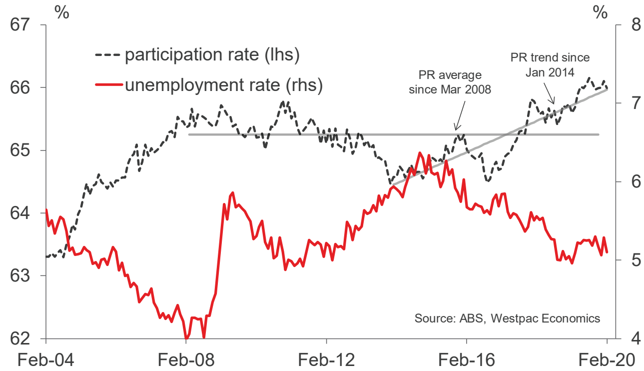
The week ahead.

Aus Mar unemployment rate

Apr 16, Last: 5.1%, WBC f/c: 5.3%
Mkt f/c: 5.4% Range: 5.0% to 5.9%

- Unemployment surprised in Feb, moderating to 5.1% from 5.3%. The participation rate eased back a touch to 66.0% from 66.1% due to a fall in female participation, male participation broadly flat. This fall in participation led to a flat print on the labour force, helping to drive a 0.2ppt fall in the unemployment rate.
- Going forward we are expecting male participation to be somewhat sticky and female participation to be more sensitive to the weakening labour market. Nevertheless a sharp fall in employment will still see a moderation in the participation rate – the magnitude being the main point of debate.
- Our forecast fall in participation to 65.9% should limit the rise in the labour force to just 2k, thus limiting the rise in unemployment to 5.3%.

Aus unemployment and participation rates

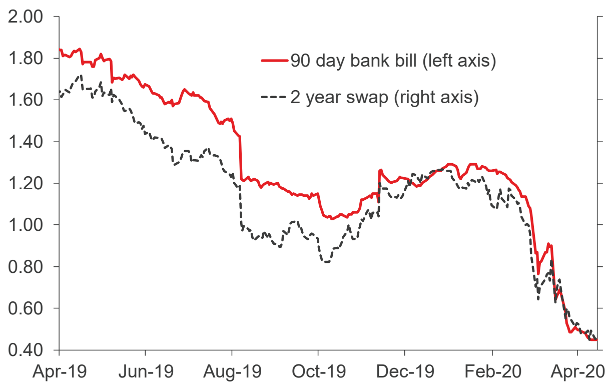


New Zealand forecasts.

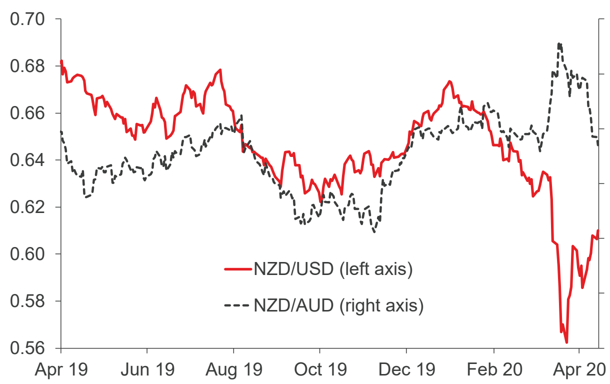
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Dec (a)	Mar	Jun	Sep	2018	2019	2020f	2021f
GDP (Production)	0.5	-1.0	-14.0	9.9	3.2	2.3	-5.6	6.7
Employment	0.0	-0.9	-6.8	3.6	1.9	1.0	-2.4	3.6
Unemployment Rate % s.a.	4.0	4.7	9.0	8.0	4.3	4.0	7.0	5.6
CPI	0.5	0.5	0.4	0.9	1.9	1.9	2.3	1.0
Current Account Balance % of GDP	-3.0	-3.0	-3.5	-3.7	-3.8	-3.0	-4.1	-3.3

Financial forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.40	0.40	0.40	0.40	0.40	0.40
2 Year Swap	0.60	0.60	0.60	0.65	0.70	0.80
5 Year Swap	0.70	0.75	0.80	0.90	1.00	1.10
10 Year Bond	1.00	1.00	1.00	1.05	1.10	1.20
NZD/USD	0.60	0.62	0.64	0.65	0.65	0.66
NZD/AUD	0.97	0.97	0.97	0.96	0.96	0.95
NZD/JPY	64.2	65.1	67.8	69.6	69.6	70.7
NZD/EUR	0.56	0.58	0.60	0.61	0.61	0.61
NZD/GBP	0.49	0.50	0.52	0.52	0.52	0.52
TWI	68.7	69.9	71.5	71.9	71.5	71.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 14 April 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	1.00%
30 Days	0.33%	0.36%	1.00%
60 Days	0.39%	0.43%	0.95%
90 Days	0.45%	0.49%	0.90%
2 Year Swap	0.46%	0.55%	0.84%
5 Year Swap	0.61%	0.66%	0.95%

NZ foreign currency mid-rates as at 14 April 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6100	0.6028	0.5961
NZD/EUR	0.5587	0.5421	0.5466
NZD/GBP	0.4873	0.4850	0.4854
NZD/JPY	65.67	64.90	63.98
NZD/AUD	0.9541	0.9802	0.9726
TWI	69.31	68.90	68.55

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 13					
NZ/Aus	Easter Monday, public holiday.	–	–	–	Markets closed.
US	Mar monthly budget statement $bn	–235.3	–120.0	–	Deficit will continue to grow rapidly year on year.
Tue 14					
NZ	Feb net migration	6490	–	–	Annual migration easing, pre–dates travel restrictions.
Aus	Mar NAB business survey	0	–	–	Conditions likely to deteriorate further.
Chn	Mar trade balance USDbn	–	20.00	–	Imports and exports both set for a material contraction.
US	Mar import price index	–0.5%	–3.0%	–	Tumbling oil prices have subdued the headline index.
Wed 15					
NZ	Mar REINZ house prices %yr	–0.9%	–	–	Reports of strong demand supporting prices ...
	Mar REINZ house sales	8.7%	–	–	... in the run up to the lockdown period.
	Mar food price index	0.0%	–	0.2%	Annual growth has accelerated in recent months.
	Min. of Finance Robertson speaking	–	–	–	Online speech to BusinessNZ.
Aus	Apr WBC–MI Consumer Sentiment	91.9	–	–	Coronavirus and shut–downs to hit hard.
US	Mar retail sales	–0.5%	–6.4%	–	Sharp decline for discretionary spending expected.
	Apr Fed Empire state index	–21.5	–29.0	–	New York activity and sentiment crushed by virus spread.
	Mar industrial production	0.6%	–4.1%	–	To be hit by supply chain disruptions and demand shock.
	Feb business inventories	–0.1%	–0.4%	–	Predates spread of the virus; further unwinding expected.
	Apr NAHB housing market index	72	60	–	A soft read should mark the start of a declining trend.
	Federal Reserve's Beige book	–	–	–	To reflect unprecedented economic conditions.
	Feb total net TIC flows	122.9	–	–	Highly volatile in a time of exceptional uncertainty.
Thu 16					
NZ	Prime Minister Ardern Speaking	–	–	–	Speaking on lockdown levels.
Aus	Apr MI inflation expectations	4.0%	–	–	Falling petrol prices should be driving expectations lower.
	Mar employment	26.7k	–30.0k	–20k	Timing of the survey limits the impact of the shutdowns in ...
	Mar unemployment rate	5.1%	5.4%	5.3%	... March so we expect to see a more significant hit in April.
Eur	Feb industrial production	2.3%	0.0%	–	Production expected to stall as headwinds mount.
US	Apr Phily Fed index	–12.7	–25.0	–	Set to contract as the business outlook weakens
	Mar housing starts	–1.5%	–17.7%	–	As lockdown measures bite ...
	Mar building permits	–5.5%	–10.5%	–	... activity will continue to seize up.
	Initial jobless claims	–	–	–	Job losses to persist.
Fri 17					
NZ	Mar manufacturing PMI	53.2	–	–	COVID–19 disruptions becoming increasingly evident.
Chn	Q1 GDP %yr	6.0%	–6.0%	–	Poised for a major contraction in Q1 given shutdown.
	Mar industrial production YTD %yr	–13.5%	–9.9%	–	Measures of production and retail ...
	Mar retail sales YTD %yr	–20.5%	–14.4%	–	... weak in Mar, but will bounce in coming months.
	Mar fixed asset investment ytd %yr	–24.5%	–15.0%	–	Investment will also improve in the months ahead.
Eur	Mar CPI %yr	0.7%	1.2%	–	Final print for Mar; inflation to slip further below target.
US	Mar leading index	0.1%	–7.0%	–	To reflect the marked souring of conditions.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	-5.4	4.0
CPI inflation % annual	1.5	1.9	1.8	1.8	0.9	2.0
Unemployment %	5.7	5.5	5.0	5.2	7.3	6.0
Current Account % GDP	-3.1	-2.6	-2.1	0.5	0.2	-0.6
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.0	1.0
Consumer Prices %yr	1.4	2.1	2.4	1.8	1.4	1.6
Unemployment Rate %	4.9	4.4	3.8	3.7	13.1	5.1
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.6	1.9	0.8	0.7	-5.0	1.0
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	-8.5	1.7
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.4	-7.0	2.5
China						
Real GDP %yr	6.7	6.8	6.6	6.1	2.5	7.3
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	-2.7	5.8
World						
Real GDP %yr	3.4	3.8	3.6	3.0	-1.5	3.9
Forecasts finalised 9 April 2020						

Interest rate forecasts	Latest	Jun–20	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	0.25
90 Day BBSW	0.22	0.25	0.25	0.25	0.30	0.35	0.40	0.45
10 Year Bond	0.97	0.75	0.75	0.80	0.85	0.95	1.10	1.20
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.77	0.60	0.65	0.70	0.75	0.80	0.90	1.00

Exchange rate forecasts	Latest	Jun–20	Sep–20	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21
AUD/USD	0.6237	0.62	0.64	0.66	0.68	0.68	0.69	0.70
USD/JPY	108.86	107	105	106	107	107	108	110
EUR/USD	1.0858	1.07	1.06	1.06	1.07	1.08	1.09	1.10
GBP/USD	1.2388	1.22	1.23	1.24	1.25	1.25	1.26	1.27
USD/CNY	7.0661	7.02	6.90	6.85	6.80	6.75	6.70	6.60
AUD/NZD	1.0365	1.03	1.03	1.03	1.05	1.05	1.05	1.06

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