Abel Tasman National Park, New Zealand

# Weekly Economic Commentary.

## I get knocked down, but I get up again.

This week's GDP figures will reveal just how big of a blow Covid-19 dealt to the New Zealand economy. But while the June quarter drop in GDP will be large, the key lesson from both the April and August lockdowns is that the economy is able to quickly bounce back from temporary and (hopefully) successful lockdowns.

### Through the looking glass

The past week saw an historic moment in New Zealand's financial markets with a number of wholesale interest rates dipping their toes into negative territory (albeit only by a small amount and for a brief period). On Wednesday 9 September, the 2023 New Zealand Government bond transacted at a yield of -0.025%, with the 2 and 3 year swap rates also dropping below zero.

Local interest rates have since risen back into positive territory. However, we have long expected that the OCR will drop to -0.5% in April 2021, and financial markets are now catching up with that view. Markets have been emboldened by recent comments from RBNZ Governor Orr who reiterated that the combination of a negative OCR and term lending facility are likely to be the next tools deployed if further stimulus is needed. As a result, a return to negative swap rates and bond rates is likely.

### I get knocked down, but I get up again

Thursday's GDP figures will reveal just how big of a blow Covid-19 dealt to the New Zealand economy. We estimate that economic activity fell 11.5% over the June quarter. That would be the largest drop on record.

While we are forecasting a sharp fall in GDP, Westpac's estimate is less bearish than those from most other private sector forecasters or the RBNZ. Our forecast is consistent with a range of recent economic indicators which have revealed that, although Covid-19 did knock economic activity, the impact was not as severe as was initially feared. It also reflects that key parts of the domestic economy, including household spending and construction activity, were able to bounce back faster than expected soon after the lockdown.

The June quarter decline in GDP was mainly a result of public health restrictions which prevented businesses from trading through much of April. Now that those restrictions have been rolled back, New Zealand is on track for a substantial lift in economic activity in the September quarter. However, the re-emergence of Covid-19 on our shores has sapped some of the momentum in the economy. For instance, retail spending fell by 8% in August following the reintroduction of restrictions on travel and social distancing requirements. We also saw falls in both manufacturing production and orders in last month's PMI. As a result, we've moderated our forecast for growth in the September quarter and now expect a gain of 8.1% (vs our previous forecast of 12.3%).

The big question is how quickly the domestic economy can get back to trend now that the Alert Level has been dialled down again. Following the first lockdown, we actually saw that large swathes of the domestic economy were able to get back up to speed quickly when restrictions were eased. And it looks like that's what's happened again after the August lockdown. Most notably, weekly spending has already returned to its previous level. We've also seen a recovery in both job ads and heavy traffic flows, along with steady electricity usage.

On top of those developments, the housing market appears to have shrugged off the latest lockdown. House prices rose 1.7% in August with sales up 24% over the past year. Those gains are clear signs that the RBNZ's cut in the cash rate and related falls in mortgage rates are working as expected to boost demand in spite of the headwinds buffeting the economy.[1] In light of this strength, we've revised up our house price forecast, and now expect an increase of 3.5% between March and December 2020 (previously we expected a fall of 2.5%). We are sticking with an annual increase of 8% for 2021.

While the above developments are encouraging, that's not to say the recent lockdown has had no impact. The number of people on the Job Seeker benefit or Covid-related support payment has risen by 2,455 since 7 August (just before the recent lockdown). In addition, many businesses are now wrestling with an even larger hole in their earnings, and there's been a growing number of vacancies for commercial property in the country's CBDs.

On balance, the recent lockdown has certainly added to the challenges for some households and businesses. However, it looks like the economy as a whole has been able to navigate this latest pothole on the road to recovery with only limited additional damage. In fact, the key lesson from both the April and August lockdowns is that the economy is able to quickly bounce back from temporary and (hopefully) successful lockdowns.

New Zealand is now in wait-and-see mode. A small number of new infections in the community are still being reported most days. And the longer that continues, the longer restrictions on activity are likely to remain in place (last time when New Zealand was at Alert Level 2, we went for several weeks with no cases in the community before the Alert Level was eased to level 1). Our forecasts for a gradual recovery in economic activity over the coming year actually allow for some temporary flare ups in infections and periods at Alert Levels 2 or 3. However, if social distancing requirements or other restrictions are used more frequently or for longer, the economic recovery could be more protracted and there would be a greater risk of economic scarring. That includes the possibility of further job losses or reduced investment spending by businesses.

It's also notable that while overall economic conditions have been resilient at Alert Level 2, we are seeing changes in the make-up of activity. For instance, while households spending is holding up, we're spending less on hospitality, but more on groceries and durable items. If this continues, it could have important implications for the jobs market, with potential job gains in goods producing sectors, but the risk of further job losses in the hospitality sector.

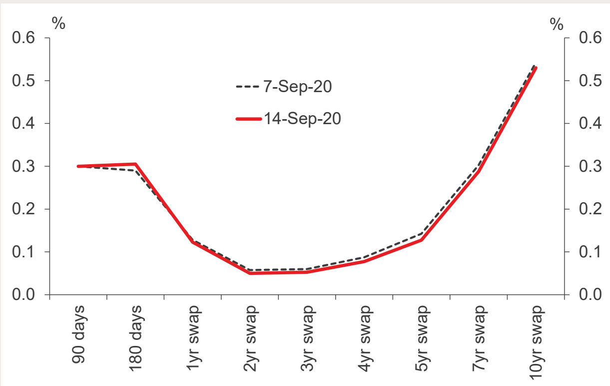
1 Our recent Bulletin looks at how low interest rates are affecting New Zealand's household debt levels. It's available for download here: https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Bulletins-2020/Household-debt-June-quarter-2020-Westpac-NZ.pdf

## Fixed vs Floating for mortgages.

Fixed mortgage rates fell sharply over May and June, and have been stable since. There is perhaps some scope for a further decline in fixed mortgage rates, but it isn't guaranteed and it isn't large.

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**



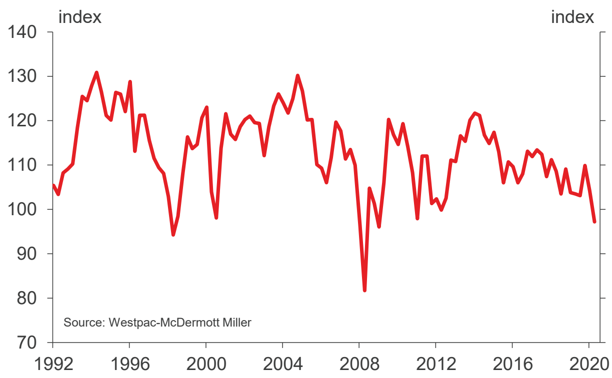
# The week ahead.

## NZ Q3 Westpac McDermott Miller Consumer Confidence

**Sep 15, Last: 97.2**

- Consumer confidence fell to low levels in June as Covid pushed the economy into a deep recession. However, given the extent of the economic downturn, the decline in confidence was actually surprisingly moderate.
- In the months since our last survey, we've seen a faster than expected recovery in economic activity, but also the re-emergence of Covid-19 on our shores and ongoing headwinds in some key sectors of the economy. Recent weeks have also seen an increasing focus on New Zealand's political environment ahead of October's election.

### Westpac-McDermott Miller consumer confidence

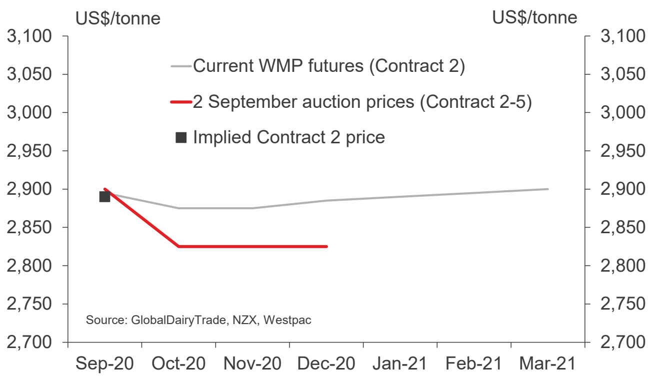



## NZ GlobalDairyTrade auction, whole milk powder prices

**Sep 16, Last: -2.0%, Westpac f/c: 0.0%**

- We expect that whole milk powder prices will be unchanged at this auction and thus begin to settle after recent weakness. Prices have dipped 10% over the last three auctions.
- We are marginally more bearish than the dairy futures market. It is pointing to a modest price lift of around 1% as at the time of writing.
- Over the coming months, we expect global dairy prices to drift lower as New Zealand production continues its seasonal rise and as the global recession continues to weigh on global dairy demand.

### Whole milk powder prices

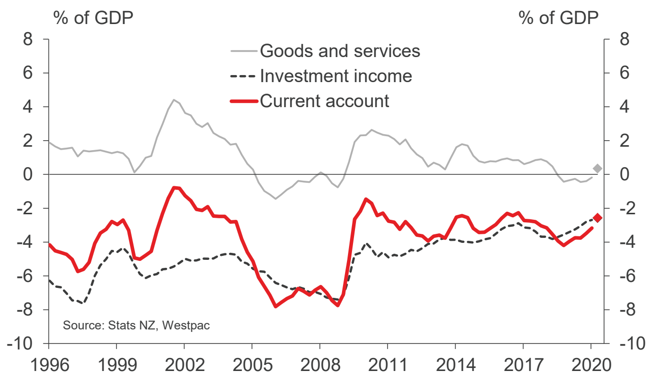



## NZ Q2 current account % of GDP

**Sep 16, Last: -2.7%, Westpac f/c: -2.6%, Mkt f/c: -2.3%**

- We expect New Zealand's annual current account deficit to narrow to 2.6% of GDP due to a sharp drop in import values (and a subsequent increase in the goods balance) over the quarter.
- Meanwhile, we expect a more modest narrowing in the services balance (with tourism dropping in both directions). In addition, we expect the income balance to fall, due to lower interest rates and lower profits for overseas-owned firms in NZ.
- Stats NZ has made large revisions to imports of services over the last few years, due to better measurement of areas such as digital imports (e.g. Netflix). This revision will widen the historic ratio by about 0.5% (i.e. March will be revised to -3.2%).

### Annual current account balance



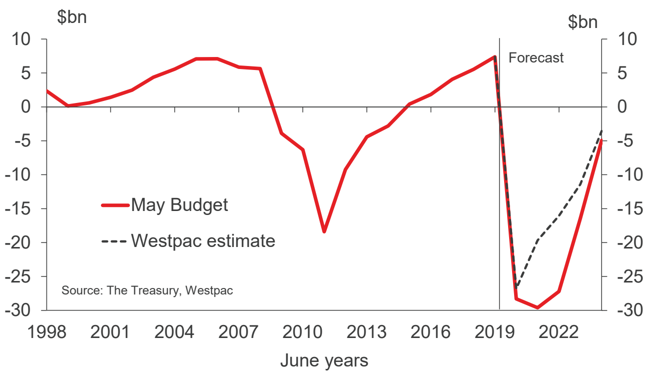
# The week ahead.

## NZ Pre-Election Economic and Fiscal Update

**Sep 16**

- The PREFU is a required update of the Treasury's projections ahead of the general election on 17 October. It does not normally include policy announcements.
- The May Budget forecasts were prepared while the country was still in Covid-19 lockdown. Since then, it has become apparent that the economy has bounced back more readily than expected, and the Government has deferred $14bn of the spending that it had approved for the Covid response. As a result, we expect the PREFU forecasts to show substantially smaller deficits and a lower peak in the net debt to GDP ratio.
- These forecast changes also imply a lower borrowing requirement for this year. However, the Government may choose to retain some issuance in order to pre-fund future spending, or as a precaution against the risk of future lockdowns.

### Operating balance (excluding gains and losses)

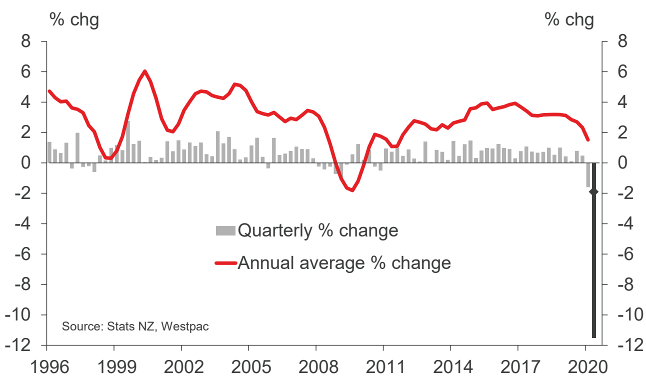



## NZ Q2 GDP

**Sep 17, Last: -1.6%, Westpac f/c: -11.5%, Mkt f/c: -12.5%**

- We expect an 11.5% drop in GDP for the June quarter.
- The Alert Level 4 lockdown effectively put about a third of the economy out of action during April.
- However, activity appears to have bounced back readily as the alert level was lowered.
- GDP will rise again sharply in Q3 and Q4, but the ongoing closure of the international borders will cap the extent of the rebound beyond this.

### Production-based GDP

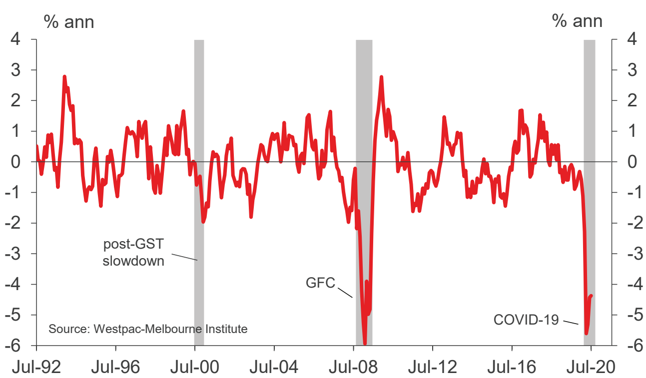



## Aus Aug Westpac–MI Leading Index

**Sep 16, Last: –4.37%**

- The Leading Index growth rate edged up from –4.43% in June to –4.37% in July. It continues to show a material improvement from the -5.61% read in April but remains in deep negative territory consistent with recession.
- The August update is likely to show a significant lift with sharp rebounds in several components that were particularly weak in the previous, including: the Westpac-MI Consumer Expectations Index, up 21% (-10.9% previously); the Westpac-MI Unemployment Expectations Index, down -14.8% vs 14.6% last month (falls indicate an improvement); and dwelling approvals, up 12% vs -4.2% last month. Other components have been more mixed. Note also that the big negative shock that accompanied the COVID outbreak back in March-April will start cycling out of the six month growth rate in coming months – indeed, all else being equal, the growth rate will swing into solid positive from September on as the extreme weakness in March-April moves into the base of the calculation.

### Aus Westpac-MI Leading Index



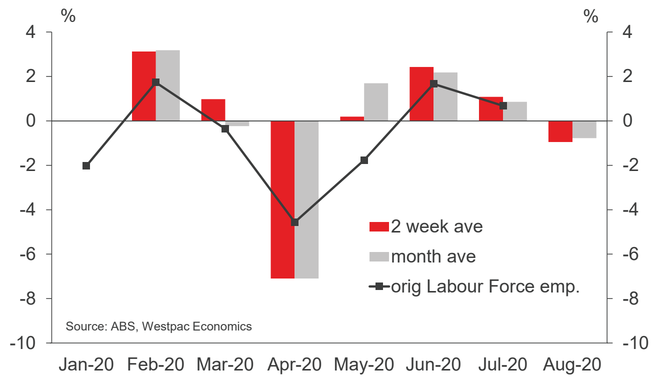
# The week ahead.

## Aus August Labour Force: total employment change

**Sep 17, Last: 114.7k, WBC f/c: -50k**
**Mkt f/c: -35k Range: -125k to +75k**

- The 114.7k gain in employment in July was a solid update but the larger 1.3% rise in hours worked highlights the impact of JobKeeper, how it has muted the employment hit from the COVID shock resulting in a much larger share of the adjustment coming via hours worked.
- As the hit to part-time employment was greater than full-time so too the recovery has been stronger; +71.2k/1.9%mth lift in part-time employment in July. There was also a solid 1.7%mth lift in hours worked per part-time employee which is now 0.3% higher than it was in March. Hours worked per full-time employee is still 2.1% lower than March.
- For August, the weekly payrolls reveal the Vic shutdowns having an impact, and that the recovery in NSW was levelling out, but that overall the hit to employment was not as bad as expected with a continuing recovery in the smaller states.

### Aus Payrolls vs Labour Force Employment

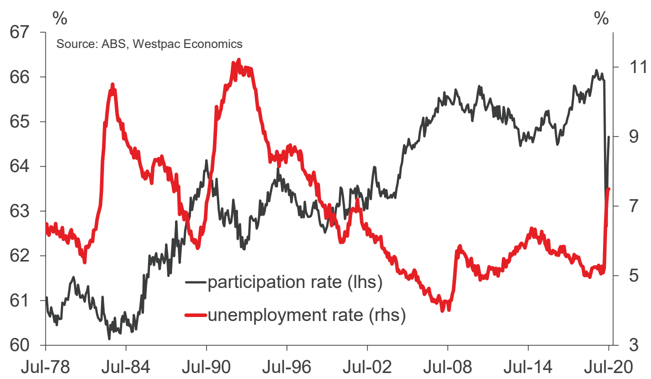



## Aus August Labour Force: unemployment rate %

**Sep 17, Last: 7.5%, WBC f/c: 7.7%**
**Mkt f/c: 7.7% Range: 8.0% to 7.4%**

- Through June and July the easing in COVID restrictions led to a recovery in activity and a surge in people re-entering the workforce. As the job losses, then recovery, were focused in part-time employment there was a rapid collapse, then bounce in participation as these less attached workers left the labour force only to quickly re-enter as employment conditions improved.
- In July an extra 130.5k entered the workforce following on from a +299.1k gain in June, lifting the participation rate to 64.7% from 64.1%.
- As a result of the larger rise in the labour force (+130.5k) compared to the rise in employment (+114.7k), in July the unemployment rate lifted to 7.5% from 7.4%.
- Westpac expects participation to moderate 0.2ppt to 64.5% limiting the rise in unemployment to 0.2ppts to 7.7%.

### Aus falling participation buffers unemployment

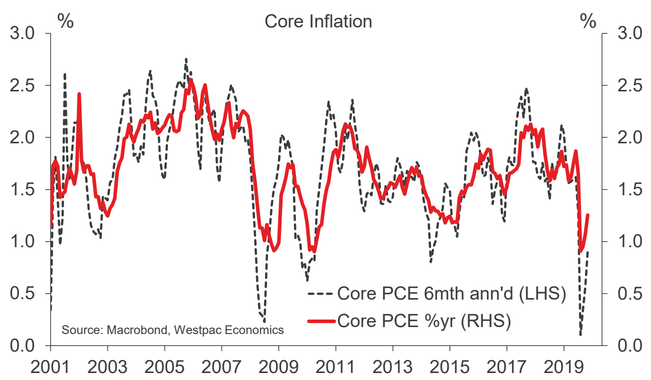



## US Sep FOMC policy meeting

**Sep 15-16, Fed funds rate: Last: 0.125%, WBC: 0.125%**

- At the Jackson Hole Symposium in August, FOMC Chair Jerome Powell made clear the Committee's intent to pursue the strongest labour market and economy possible.
- To improve the likelihood of achieving this aim, Chair Powell announced during his speech that the 2.0%yr inflation target would now be assessed on average over the cycle. This opens up the opportunity to run the economy 'hot' for a time to reduce or eliminate "shortfalls of employment from its maximum level".
- Inflation in the US has disappointed for a decade and is currently below 2.0%yr. Arguably, there is then cause for the current stance to be maintained for the foreseeable future, and potentially for more easing. Updated forecasts and the Committee's assessment of risks will therefore be closely scrutinised, despite policy remaining on hold this month.

### US core inflation, persistently below target

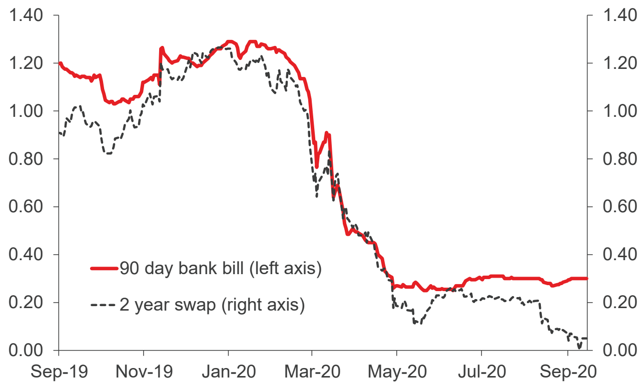


# New Zealand forecasts.

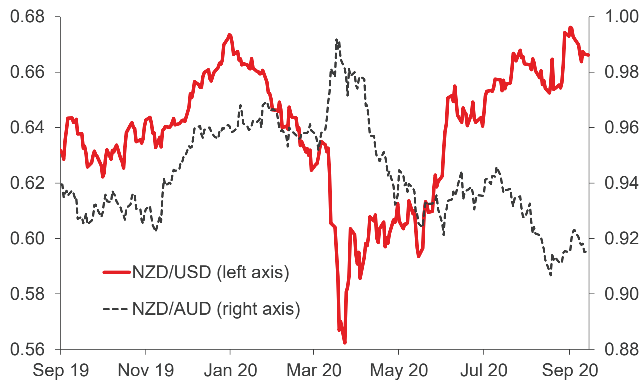
| Economic forecasts | Quarterly | | | | Annual | | | |
|---|---|---|---|---|---|---|---|---|
| | 2020 | | | | | | | |
| % change | Mar (a) | Jun | Sep | Dec | 2018 | 2019 | 2020f | 2021f |
| GDP (Production) | -1.6 | -11.5 | 8.1 | 3.8 | 3.2 | 2.3 | -4.8 | 6.0 |
| Employment | 1.0 | -0.4 | -3.8 | -0.8 | 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 | 6.4 |
| CPI | 0.8 | -0.5 | 0.6 | -0.1 | 1.9 | 1.9 | 0.8 | 0.5 |
| Current Account Balance % of GDP | -2.7 | -2.6 | -1.7 | -1.4 | -4.2 | -3.5 | -1.4 | -3.5 |

| 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 14 September 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 | 0.29% | 0.28% | 0.28% |
| 90 Days | 0.30% | 0.29% | 0.29% |
| 2 Year Swap | 0.05% | 0.09% | 0.14% |
| 5 Year Swap | 0.13% | 0.21% | 0.22% |

### NZ foreign currency mid-rates as at 14 September 2020

| Exchange rates | Current | Two weeks ago | One month ago |
|---|---|---|---|
| NZD/USD | 0.6662 | 0.6732 | 0.6543 |
| NZD/EUR | 0.5629 | 0.5656 | 0.5525 |
| NZD/GBP | 0.5210 | 0.5045 | 0.4995 |
| NZD/JPY | 70.69 | 70.99 | 69.77 |
| NZD/AUD | 0.9152 | 0.9145 | 0.9133 |
| TWI | 72.01 | 72.42 | 71.23 |

# Data calendar.

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---|---|---|---|---|---|
| **Mon 14** | | | | | |
| NZ | Aug BusinessNZ PSI | 54.3 | – | – | Renewed Covid-19 restrictions during August. |
| | Jul net migration | 760 | – | – | Border restrictions continue to keep net flows near zero. |
| Eur | Jul industrial production | 9.1% | 2.7% | – | Activity below pre-crisis norms. |
| **Tue 15** | | | | | |
| NZ | Q3 WBC-MM consumer confidence | 97.2 | – | – | Confidence fell in Q2 as Covid-19 dented activity. |
| Aus | RBA minutes | – | – | – | Colour around consideration of "further monetary measures". |
| Chn | Aug industrial production ytd %yr | –0.4% | 0.2% | – | Output comparable to pre-Covid levels. |
| | Aug retail sales YTD %yr | –9.9% | –8.8% | – | Retails sales still in recovery mode. |
| | Aug fixed asset investment ytd %yr | –1.6% | –0.4% | – | Investment recovery broadening across economy. |
| Eur | Sep ZEW survey of expectations | 64 | – | – | Investors remain very optimistic on outlook. |
| UK | Jul ILO unemployment rate | 3.9% | – | – | Jobs market bolstered by furlough program. |
| US | Sep Fed Empire state index | 3.7 | 4.4 | – | Higher operating costs and weak demand are headwinds. |
| | Aug import price index | 0.7% | 0.5% | – | July gains driven by commodity prices. |
| | Aug industrial production | 3.0% | 1.0% | – | Rebound constrained by domestic demand. |
| **Wed 16** | | | | | |
| NZ | GlobalDairyTrade auction (WMP) | –2.0% | – | 0.0% | We expect dairy prices to stabilise after recent falls. |
| | Q2 current account balance % GDP | –2.7% | –2.3% | –2.6% | Deficit narrowing on a steep fall in import values. |
| | Pre-Election Fiscal Update | – | – | – | Outlook less weak compared to the May Budget. |
| Aus | Aug Westpac-MI Leading Index | –4.37% | – | – | Remains in deep negative territory. |
| Eur | Jul trade balance €bn | 17.1 | – | – | Global recovery reflected in improving trade surplus. |
| UK | Aug CPI | 0.4% | – | – | Meal discount scheme keeping inflation pressures modest. |
| US | Aug retail sales | 1.2% | 1.0% | – | Rebound in consumer spending focused on select sectors. |
| | Jul business inventories | –1.1% | 0.2% | – | Uncertain demand outlook capping investment. |
| | Sep NAHB housing market index | 78 | 78 | – | Low interest rates supported record confidence in August. |
| | FOMC policy decision, midpoint | 0.25% | 0.25% | 0.25% | Rates on hold; baseline and view of risks the focus. |
| | FOMC Chair Powell | – | – | – | Post-meeting press conference. |
| **Thu 17** | | | | | |
| NZ | Q2 GDP | –1.6% | –12.5% | –11.5% | Activity fell sharply during the Covid-19 lockdown. |
| Aus | Aug employment, '000 chg | 114.7 | -35 | –50 | A (modest) step-back on Melbourne lock-down. |
| | Aug unemployment rate | 7.5% | 7.7% | 7.7% | Moves higher still. Part-rate edge lower, 64.7% to 64.5%. |
| UK | BoE policy decision | 0.10% | 0.10% | 0.10% | Rates to remain on hold. |
| Eur | Aug CPI | –0.4% | – | – | Inflation has dipped into negative territory since June. |
| US | Aug housing starts | 22.6% | –3.1% | – | Momentum in housing market moderating... |
| | Aug building permits | 18.8% | 3.2% | – | ...following rapid recovery from COVID lows. |
| | Sep Phily Fed index | 17.2 | 15.0 | – | Set for a slight moderation after June's recovery. |
| | Sep initial jobless claims | 884k | – | – | Claims points to labour market recovery slowing abruptly. |
| **Fri 18** | | | | | |
| UK | Aug retail sales | 3.6% | – | – | Food sales continue to drive recovery. |
| US | Aug leading index | 1.4% | 1.3% | – | Expected to be little changed in August. |
| | Sep Uni. of Michigan sentiment | 74.1 | 74.9 | – | Slight uptick in August, though still well below average. |

# 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 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 90 Day BBSW | 0.09 | 0.10 | 0.10 | 0.10 | 0.10 | 0.15 | 0.25 |
| 10 Year Bond | 0.91 | 0.90 | 0.95 | 1.05 | 1.20 | 1.35 | 1.45 |
| **International** | | | | | | | |
| Fed Funds | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 |
| US 10 Year Bond | 0.69 | 0.60 | 0.65 | 0.75 | 0.85 | 0.95 | 1.05 |

| Exchange rate forecasts | Latest | Dec–20 | Mar–21 | Jun–21 | Sep–21 | Dec–21 | Jun–22 |
|---|---|---|---|---|---|---|---|
| AUD/USD | 0.7270 | 0.75 | 0.76 | 0.76 | 0.78 | 0.80 | 0.80 |
| USD/JPY | 106.17 | 105 | 105 | 106 | 106 | 106 | 107 |
| EUR/USD | 1.1836 | 1.21 | 1.22 | 1.23 | 1.24 | 1.25 | 1.25 |
| GBP/USD | 1.2808 | 1.33 | 1.34 | 1.35 | 1.37 | 1.39 | 1.40 |
| USD/CNY | 6.8362 | 6.85 | 6.80 | 6.70 | 6.60 | 6.50 | 6.40 |
| AUD/NZD | 1.0918 | 1.12 | 1.15 | 1.15 | 1.15 | 1.14 | 1.14 |

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# Disclaimer.