
Westland Tai Poutini National Park, New Zealand

Weekly Economic Commentary.

Go hard, go early, then go shopping.

We have upgraded our activity, exchange rate and inflation forecasts in response to recent data. However, our monetary policy forecasts remain unchanged – stronger activity is counterbalanced by the higher exchange rate.

When New Zealand entered lockdown three months ago, we braced ourselves for a protracted period of stringent restrictions on economic activity, potentially extending through to the end of the year. However, the Government's "Go hard, go early" approach to combatting Covid-19 has halted the spread of the virus on our shores, allowing Covid-19 related restrictions on domestic activity to be rolled back sooner than expected. Consequently, the downturns in economic activity and employment might not be as pronounced as either we or the Government had previously feared. Consistent with that, recent weeks have seen a number of economic indicators lifting. Most notably, nominal retail spending in the week ending 7 June was back to the levels that we saw this time last year (that follows a more than 50% fall during the lockdown).

But make no mistake – while recent data has been better than expected, New Zealand still faces big challenges. Covid-19 related disruptions to economic activity, including the closure of large swathes of the economy in March and April, have pushed the economy into a deep recession. The resulting economic scarring, including increases in debt, business closures and a rise in unemployment, will be a drag on activity for an extended period. Furthermore, even though restrictions on domestic activity have been lifted, our borders remain closed. Many businesses in sectors like hospitality and tourism are continuing to struggle with severely reduced demand. In fact, the May retail spending report showed that spending on hospitality was down 40% on pre-Covid levels.

With the earlier than expected opening up of the economy, we have revised up our GDP forecasts. We now expect that when the economy emerges from the lockdown in the September quarter, GDP will be 2.8% lower than in the December 2019 quarter, before the virus arrived on our shores. We now forecast annual GDP growth for 2020 compared to 2019 will be -4% (previously -6%).

Turning to the labour market, the number of New Zealanders on the Jobseekers benefit has risen by more than 45,000 since late March, and we expect that number will continue to rise over the coming months as the Government's wage subsidy programme winds down.

But while there has been a sharp increase in unemployment, the earlier than expected rolling back of Covid-19 related restrictions on activity has meant that 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 in the early part of this year). Furthermore, the opening up of the economy has meant that the weekly pace of job losses has slowed considerably, from more than 6,000 each week through April to around 1,000 currently. As a result, we have revised our forecast for the peak in unemployment to 8% (down from our earlier estimate of 9.5%), with that peak expected to occur in the September quarter.

Our monetary policy forecast is that the Reserve Bank will gradually expand its Large Scale Asset Purchase Programme (LSAP) to $100bn, and will lower the OCR to -0.5% in April next year. The earlier than expected opening up of the economy and related upside surprises on activity do raise questions about whether so much further stimulus will be required.

However, from the RBNZ's point of view, the stronger economic outlook is counterbalanced by a higher exchange rate. The NZD has shot higher in recent times due to the predominantly risk-on sentiment in financial markets (Friday's share market rout excepted). We now expect that the NZD will rise to 0.65 cents against the US dollar by the end of this year. This compares to the RBNZ's May forecast for the exchange rate to fall, and to stay low for years. A higher exchange rate will tend to suppress inflation, requiring more monetary stimulus from the Reserve Bank.

It is also worth bearing in mind the size of the task the Reserve Bank faces in meeting its targets for inflation and the labour market. Economic activity remains weak and inflation is set to fall to 0.1% by September next year. (We have revised our near-term inflation forecast lower, mainly due to the high exchange rate and low global oil prices). Similarly, although the pace of job losses has slowed, the rise in unemployment will be substantial. The economy will need a powerful dose of monetary stimulus to offset these developments.

Given these considerations, we are sticking to our expectation that substantial further monetary easing will be required. We continue to forecast that the RBNZ will need to expand the LSAP to $100bn and cut the OCR to -0.50% by early next year, although we do have to acknowledge that there are uncertainties around the mix of monetary policy.

The key reason we are forecasting a negative OCR is that there are simply not enough NZ Government Bonds for the RBNZ to buy under the LSAP. Even if the RBNZ buys all the NZ Government Bonds except $60bn-$70bn required to maintain market liquidity, it still will not generate enough monetary stimulus to meet its inflation target. Hence we conclude that another tool will be required. The most likely candidate is a negative OCR.

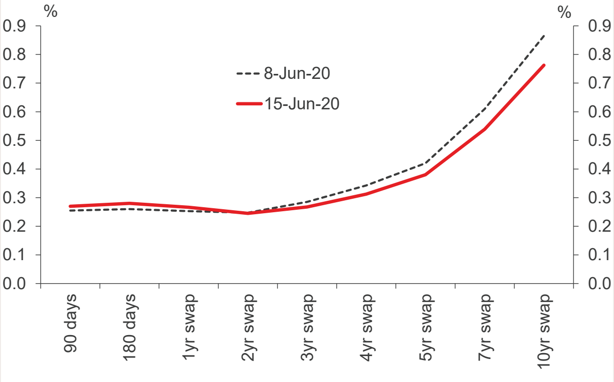
The other candidate tool is buying foreign government bonds under the LSAP, also known as unsterilised exchange rate intervention. We previously discounted that because the exchange rate was so low. Intervening in the exchange rate when it is already low seems like a solution in need of a problem. It also exposes the RBNZ to the risk of financial losses if the exchange rate subsequently rises. But if the exchange rate keeps rising, we would have to admit that the chances of the RBNZ opting for foreign bond purchases instead of a negative OCR are higher. For now we will put foreign bond purchases in the 'risk scenario' bucket, and we'll stick to our negative OCR forecast. But we will watch the exchange rate and signals from the RBNZ very carefully for any update on this.

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 May REINZ House Price Index

Jun 15, Last: +8.5%yr

- We expect that house prices will fall 7% over the last nine months of 2020, due to the Covid recession.
- April data was heavily impacted by the lockdown, with a massive 75% drop in sales. Price data is therefore less reliable than normal, but what it suggested was that prices fell the most in a single month since 2008, down 1.5% compared to March.
- The data still won't have settled down in May, so anything could happen. However, we expect to see further signs that house prices are now falling.
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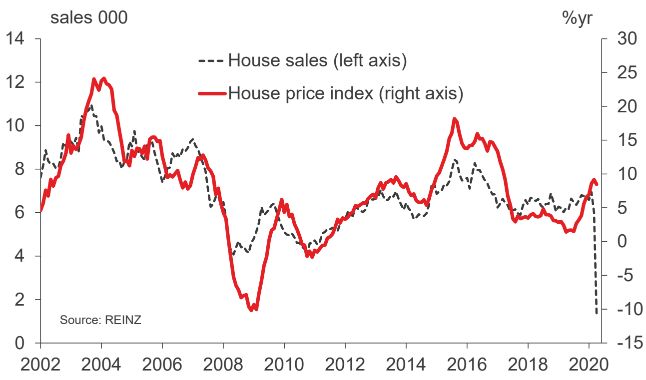
REINZ house prices and sales

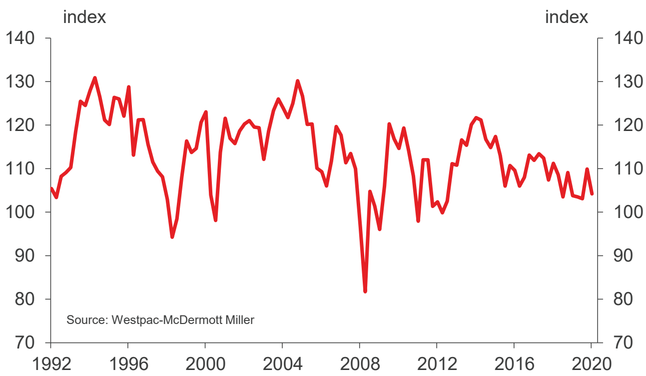


NZ Q2 Westpac McDermott Miller Consumer Confidence

Jun 16, Last: 104.2

- Consumer confidence fell to below average levels in March. At that time, the nation was wrestling with drought in some regions and we were in the early stages of the Covid-19 outbreak.
- The months since our last survey have been a roller coaster ride for the economy, with the rapid shift into lockdown, as well as the faster than expected rolling back of restrictions. The economy remains weak and unemployment has risen, but we are also seeing signs that activity is now recovering a bit faster than expected.

Westpac-McDermott Miller consumer confidence

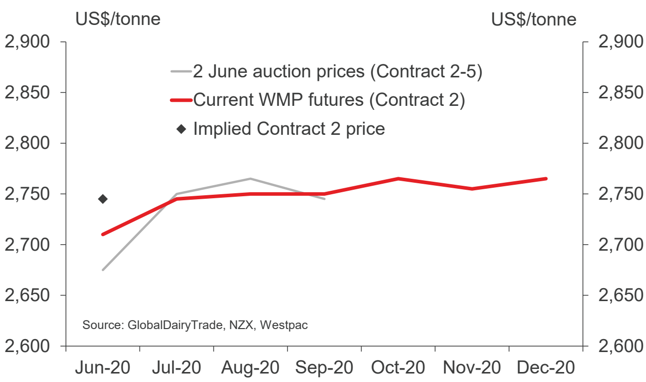


NZ GlobalDairyTrade auction, whole milk powder prices

Jun 17, Last: +2.1%, Westpac: +2%

- We expect that whole milk powder prices will post a modest gain of circa 2% at this fortnight's dairy auction as global dairy markets continue to stabilise. Whole milk powder prices rose 2.1% at the previous auction, after falling nearly 15% since January.
- For comparison, the dairy futures market points to a price lift of around 1%. We are slightly more bullish than the futures market given the market's established pattern of undershooting auction results.
- Over the next few months, we anticipate that dairy prices will continue to rebound modestly from the earlier COVID-related falls. However, later in the year and as the global economic recession bites, we expect global dairy prices will come under renewed downward pressure from weak global demand.

Whole milk powder prices



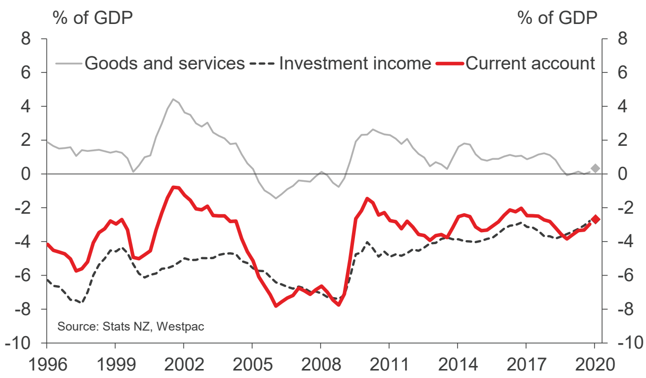
The week ahead.

NZ Q1 current account % of GDP

Jun 17, Last: -3.0%, Westpac f/c: -2.7%

- We expect the annual current account deficit to narrow from 3.0% to 2.7% of GDP in March.
- Goods exports rose slightly over the quarter. Despite some concerns about closures in China early on, New Zealand has largely maintained its access to export markets during the Covid-19 pandemic.
- In contrast imports fell sharply, likely due to a combination of weaker domestic demand and global supply chain disruptions.
- International travel restrictions saw both inbound and outbound tourism take a hit, with the net result a small reduction in the services trade surplus.

Annual current account balance

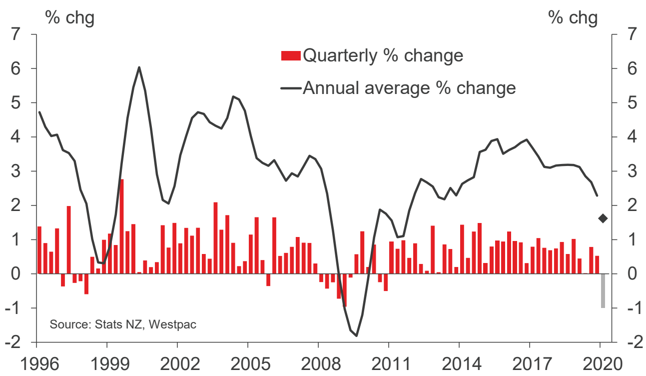


NZ Q1 GDP

Jun 18, Last: 0.5%, Westpac f/c: -1.0%, Mkt f/c: -1.1%

- We expect a 1% drop in March quarter GDP. The New Zealand economy started the year in reasonable shape, but as the Covid-19 pandemic escalated, the country went into lockdown in the last week of the quarter.
- The hit to activity will be greatest in those areas that were directly affected by travel restrictions (transport, hospitality, education) and those deemed non-essential during the lockdown (construction, non-food manufacturing, forestry, retail other than supermarkets).
- There's a wide band of uncertainty around our forecast, reflecting both the impact of the lockdown and how it will be reflected in the official statistics. Stats NZ has noted that it will look at making adjustments where the usual GDP inputs may not have captured the lockdown period.

Production-based GDP

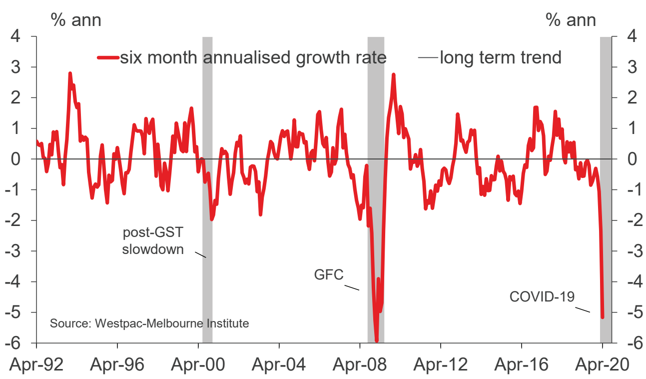


Aus May Westpac–MI Leading Index

Jun 17, Last: –5.16%

- The Leading Index growth rate plunged to –5.16% in April, easily the weakest reading since the GFC and comparable to the lows seen leading into Australia's recessions in the past.
- The May read is likely to see another big deterioration. While some components have recorded improvements (equities and consumer sentiment in particular), others such as hours worked and US industrial production remain at extreme lows and some are showing more signs of softening (dwelling approvals stand out).
- It should also be noted that the headline growth rate is a six month measure, so is becoming more dominated by the severe shock in March-April. Indeed the severity of the shock is such that the Leading Index growth rate is likely to reach record levels of contraction.

Westpac-MI Leading Index



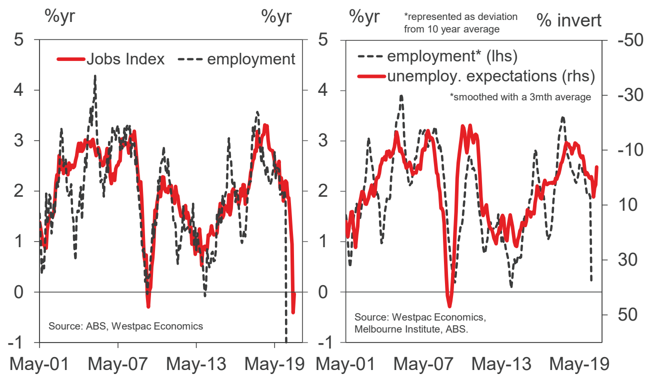
The week ahead.

Aus May employment change '000

June 18, Last: -594.3k, WBC f/c: –150k
Mkt f/c: -76.9k Range: –275k to 125k

- Employment fell 594.3k in April significantly less than the 1,000k drop estimated from the ATO/ABS Weekly Payrolls but a bit larger than Westpac's -450k and the market -550k.
- The 4.6% fall in employment was less than the 7.5% in Weekly Payrolls even adjusted for seasonality. JobKeeper may have been an issue. The ABS noted *'people who are paid through the JobKeeper scheme will answer the questions in a way that results in them being classified as employed, regardless of the hours they work (even if they are stood down)'.*
- Weekly Payrolls will be released on the 15th but we have seen an improvement in the business surveys, an improvement in employment in the ABS COVID-19 Household Survey and a sharp improvement in unemployment expectations to below the long run average. We have forecast -150k to incorporate some JobKeeper/JobSeeker reclassification to unemployed and while we can't be certain, the risks appear to the downside.

Westpac employment indicators

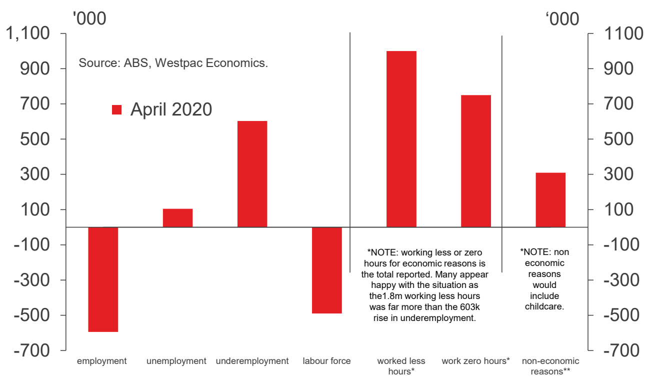


Aus May unemployment rate

June 18, Last: 6.2%, WBC f/c: 7.4%
Mkt f/c: 7.0% Range: 6.5% to 8.5%

- Despite a record fall in employment, unemployment gained just 1ppt to 6.2% due to participation collapsing 2.4ppt (a -489.8k drop in labour force). There was an outsized -2.9ppt fall in female participation.
- The ABS noted "people who receive the JobSeeker or other similar government payments are not automatically classified as unemployed (just as those classified as unemployed will not necessarily be in receipt of a government payment) & how they are categorised depends on how they answer questions around labour market activity". Also JobSeeker recipients don't have to meet mutual obligation requirements so there may have been a significant number who would normally be classified as unemployed classified as employed or not in the labour force.
- With an upside risk to participation for families getting some relief in childcare, and a downside risk on employment, we see an upside risk to our 7.4% forecast for unemployment.

Flows in the labour force

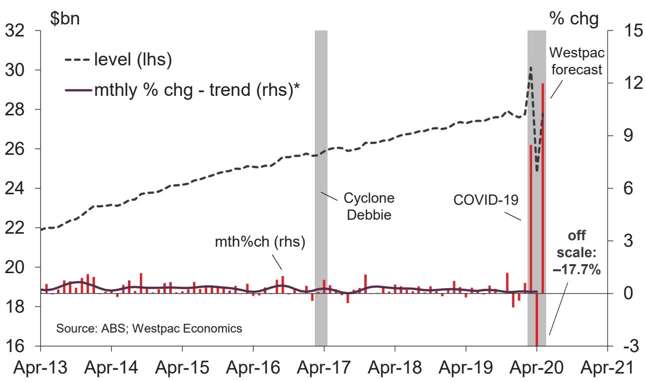


Aus May retail trade, preliminary

Jun 19, Last: –17.7%, WBC f/c: +12%

- Retail recorded an extraordinary 17.7% plunge in April as the COVID lockdown came into full effect – the move amplified by an 8.5% 'stockpiling' surge ahead of the lockdown in March. Sales in April were 10.7% below their Feb level and down 9.2%yr.
- May will be a very different story with an initial easing in restrictions in the month. High frequency indicators based on transaction flows point to a strong rebound in retail which is also getting an uplift from consumers shifting spending to areas more compatible with the lockdown (e.g. hardware and electronics), in part reflecting money that might otherwise have been spent on overseas holidays (out of scope for retail).
- Overall, we expect sales to rebound 12%, putting them back near their Feb level. Note that this is a preliminary estimate and does not include the full survey detail which will be released along with any revisions on July 3.

Monthly retail sales

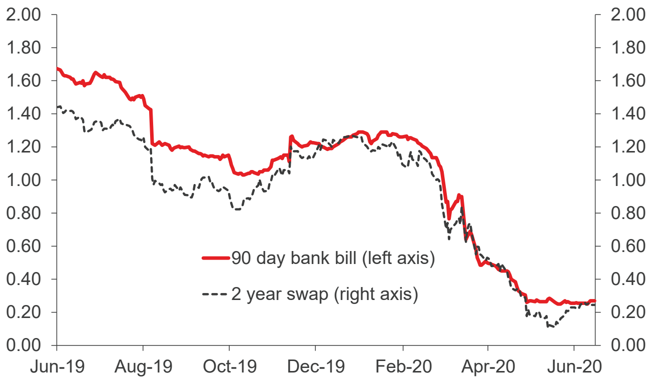


New Zealand forecasts.

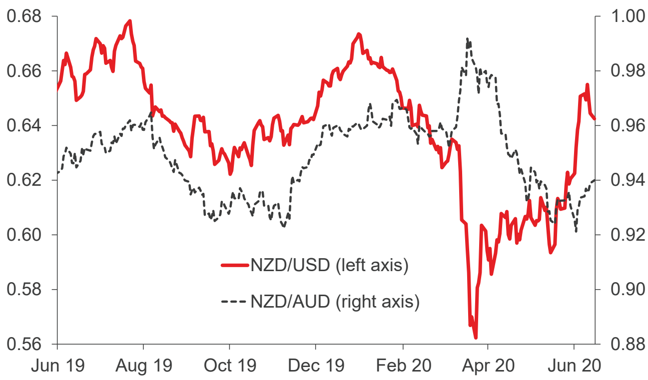
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Dec (a)	Mar	Jun	Sep	2018	2019	2020f	2021f
GDP (Production)	0.5	-1.0	-13.8	14.0	3.2	2.3	-4.3	5.0
Employment	0.1	0.7	-7.5	0.7	1.9	0.8	-4.9	3.4
Unemployment Rate % s.a.	4.0	4.2	7.0	8.0	4.3	4.0	7.5	6.6
CPI	0.5	0.8	-0.4	0.8	1.9	1.9	0.9	0.4
Current Account Balance % of GDP	-3.0	-2.7	-2.2	-1.9	-3.8	-3.0	-2.0	-2.1

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 15 June 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	0.27%	0.26%	0.27%
90 Days	0.27%	0.26%	0.28%
2 Year Swap	0.25%	0.23%	0.13%
5 Year Swap	0.38%	0.35%	0.21%

NZ foreign currency mid-rates as at 15 June 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6425	0.6295	0.5933
NZD/EUR	0.5716	0.5655	0.5486
NZD/GBP	0.5127	0.5039	0.4911
NZD/JPY	68.91	67.73	63.50
NZD/AUD	0.9400	0.9262	0.9248
TWI	71.51	70.51	67.56

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 15					
NZ	May REINZ house sales	–77.5%	–	–	Sales to lift after lockdown.
	May REINZ house prices %yr	8.5%	–	–	Risk to downside, low sales volume may affect average.
	May BusinessNZ PSI	25.9	–	–	Still low, some lift likely as the economy starts to open up.
	Apr net migration	9700	–	–	Border lockdown through April will pull down migration.
	May food price index	1.0%	–	0.0%	Measurement may be hampered by Covid-19 restrictions.
Aus	ABS Household Impacts of COVID	–	–	–	May 26-28; impacts of COVID on jobs, training, health etc.
Chn	May industrial production	–4.9%	–3.0%	–	Still down YTD %yr, but turned positive in year-end terms.
	May retail sales ytd %yr	–16.2%	–13.5%	–	Re-openings will support retail, but services PMI below Mfg.
	May fixed asset investment ytd %yr	–10.3%	–6.0%	–	Infrastructure spending & PMIs point to investment recovery
Eur	Apr trade balance €bn	23.5	–	–	Narrowing in Apr led by 22.1%mth fall in German exports.
UK	Jun Rightmove house prices	–0.2%	–	–	Last read in April saw marginal house price fall.
US	Jun Fed Empire state index	–48.5	–27.5	–	Recovery will reflect improving conditions in New York.
	Apr total net TIC flows	349.9	–	–	Mar saw strong demand as COVID-19 fears surged.
	Fedspeak	–	–	–	FOMC's Kaplan & Daly to speak.
Tue 16					
NZ	Q2 WBC–MM Consumer Confidence	104.2	–	–	Weak economy through the June quarter.
Aus	RBA minutes	–	–	–	Any comments around the AUD will be watched closely.
	May 30 ATO/ABS Weekly Payrolls	–	–	–	Rich source of labour data highlighting impact of COVID.
Eur	Jun ZEW survey of expectations	46	–	–	Posted strong recovery in May, surpassing pre-COVID levels.
UK	Apr ILO unemployment rate	3.9%	4.5%	–	Set to jump, and mark the start of an upward trend.
US	May retail sales	–16.4%	7.4%	–	After a record contraction in April, both retail sales...
	May industrial production	–11.2%	3.0%	–	... and production will begin the process of recovery.
	Apr business inventories	–0.2%	–0.7%	–	Vehicle & clothing inv. rose in Mar, offset by fall in food/bev.
	Jun NAHB housing market index	37	43	–	Record slump in April, but stabilised over May.
	Fed Chair Powell speaking	–	–	–	Chair Powell and Clarida.
Wed 17					
NZ	Q1 current account % of GDP	–3.0%	–	–2.7%	Imports down sharply, while goods exports held steady.
Aus	May Westpac–MI Leading Index	–5.16%	–	–	Recession signal likely to deepen further.
Eur	May CPI	0.3%	–0.1%	–	Sluggish inflation will continue to present a problem...
UK	May CPI	–0.2%	0.1%	–	... for both the UK and the Euro Area.
US	May housing starts	–30.2%	23.5%	–	Starts and permits are set to rebound off very weak base...
	May building permits	–20.8%	18.2%	–	... but will take time to recover to pre-COVID levels.
	Fed Chair Powell	–	–	–	Chair Powell and Mester.
Thu 18					
NZ	Q1 GDP	0.5%	–1.1%	–1.0%	NZ went into lockdown in the last week of the quarter.
Aus	May employment	–594.3k	–76.9k	-150k	Downside risk for employ. & rising female participation...
	May unemployment rate	6.2%	7.0%	7.4%	...present upside risk for unemployment.
	RBA Bulletin	–	–	–	Insights into the economy from teams throughout the RBA.
UK	BoE policy decision	0.10%	0.10%	–	Rates on hold; market expects the QE program to expand.
US	Jun Phily Fed index	–43.1	–	–	New orders, shipments, outlook began to recover in May.
	Initial jobless claims	1542k	–	–	Have continued to gradually trend downward.
	May leading index	–4.4%	2.2%	–	Expected to lift from series low as indicators rebound.
	Fedspeak	–	–	–	Mester at Global Interdependence Center.
Fri 19					
Aus	May retail trade, preliminary	–17.7%	12.0%	–	Indicators point to strong rebound from April's slump.
UK	May retail sales	–18.1%	5.0%	–	After a shocking decline, the recovery is set to begin.
	May public sector borrowing £bn	61.4	49.3	–	Spiked in Apr; another substantial print expected in May.
US	Fedspeak	–	–	–	Rosengren, Quarles, Powell.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.8	1.8	-3.6	2.5
CPI inflation % annual	1.5	1.9	1.8	1.8	0.2	2.3
Unemployment %	5.7	5.5	5.0	5.2	8.3	7.1
Current Account % GDP	-3.1	-2.6	-2.0	0.6	2.5	1.0
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-5.5	2.1
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	12.7	9.8
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	1.7
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	-2.6	5.5
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.0	4.9
Forecasts finalised 12 June 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	0.90	1.00	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	0.70	0.75	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	0.6840	0.70	0.72	0.73	0.74	0.75	0.76
USD/JPY	107.09	106	106	107	107	108	108
EUR/USD	1.1295	1.13	1.14	1.15	1.16	1.17	1.18
GBP/USD	1.2571	1.26	1.27	1.27	1.28	1.29	1.30
USD/CNY	7.0848	7.00	6.90	6.85	6.80	6.70	6.60
AUD/NZD	1.0656	1.08	1.11	1.14	1.14	1.14	1.13

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Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

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