
Fiordland National Park, New Zealand

Weekly Economic Commentary.

Recession inevitable.

This week we are issuing a truncated version of the *Weekly Commentary* with no numerical forecasts. We will issue new numerical forecasts, and a fuller written assessment, after the Government's announcement of a fiscal stimulus package tomorrow.

Over the past week the Covid-19 situation has escalated dramatically. New Zealand now faces a sharp recession that will last as long as the virus remains disruptive. The resulting damage to business balance sheets will compound the downturn, but the vigour of the response from the Government and the Reserve Bank has the potential to aid the speed of recovery. The recession will be sharp, but New Zealand's strong banking system and Government balance sheet should be enough to prevent it from snowballing into a financial crisis.

The number of Covid-19 cases in Europe and the United States has lifted rapidly. In response, many countries have moved to seal their borders or restrict travel. In New Zealand's case, all arrivals on international flights are now required to self-isolate for 14 days, and cruise ships are banned until the end of June.

This makes a severe recession inevitable. The travel restrictions alone are going to knock 2.4% off New Zealand GDP in the June quarter. Social distancing is going to disrupt economic activity within New Zealand and around the world. The result will be an unavoidable and dramatic drop in demand for the products produced by some businesses, while others will be caught up in the general downdraught.

This hit to business revenue is going damage their balance sheets. Firms will concentrate on preserving cash and surviving, rather than expanding. The first example was Air New Zealand's decision to axe 85% of its long-haul flight capacity and 30% of its domestic capacity. As businesses enter balance-sheet preservation mode, employment and investment will fall, compounding the economic downturn.

Governments and central banks are now firing back with everything they have. Efforts to "boost demand" during a period of virus-induced social distancing strike us as futile, or even counterproductive. Stopping the spread of the virus actually requires the suppression of some types of economic demand. Nevertheless, governments and central banks have a crucial role to play in supporting firms and households to tide themselves over during the period of containment. The idea is to prevent the collapse of otherwise-viable firms during this temporary period of virus-related disruption. Central banks will aim to ensure that the banking system remains able to extend credit so that firms don't run out of cash. Governments will aim to more directly help businesses, while ensuring that households have the means to meet their basic needs and service their debts.

Tomorrow the Government will announce its package of fiscal measures – we will make a fuller assessment after we have seen that.

The package of measures announced today by the Reserve Bank of New Zealand will help. The OCR was reduced by 75 basis points to 0.25%, and the RBNZ committed to holding it at this level for at least the next 12 months. This will reduce the cost of credit to firms, meaning they are more able to borrow their way through the period of virus-related disruption. The RBNZ noted that if any further easing is required it would begin large-scale purchases of government bonds. We expect that a bond-buying program will indeed be announced, probably before the RBNZ's next scheduled meeting, which is in May (the meeting that was scheduled for later this month has been cancelled).

The RBNZ is also looking at measures to ensure that credit continues to flow to businesses. Today it delayed for a year its plan to require banks to hold more capital. The next step, if required, would be a Term Auction Facility (TAF). This would involve lending to banks against collateral such as residential mortgage-back securities, and would aim to ensure that the banking system has funds available to continue lending.

While we are expecting a severe recession ahead, we are not expecting a repeat of the Global Financial Crisis. For a start, the GFC began as a household downturn whereas we are now entering a business-led downturn. The GFC really escalated when banks failed in the United States. The danger to New Zealand was that banks might lose the ability to fund themselves, in which case they would be unable to continue lending. Such a danger seems more remote at present. Today the banks are better capitalised, more securely funded, and the Reserve Bank seems more prepared to act as a backstop to the system.

The second stanza of the GFC was conniptions about whether Governments in Europe would be able to repay their debts. Again, New Zealand's ultra-low Government debt position leaves it well placed in this regard. We are very pleased that those who called for the Government to spend more over the past few years did not prevail – their prescription would have left the country in a much worse position to weather the Covid-19 storm.

So our conclusion is that the downturn will be sharp, but the strong position of the banks and the Government mean it will be more orderly than the last recession.

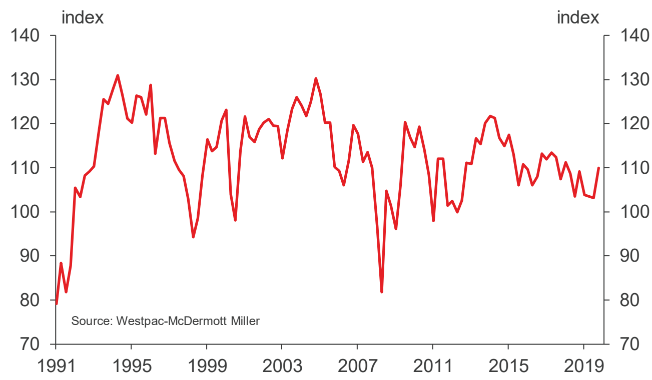
The week ahead.

NZ Q1 Westpac McDermott Miller Consumer Confidence

Mar 17, Last: 109.9

- The March Westpac McDermott Miller Consumer Confidence survey will be the first major read on how sentiment in New Zealand's household sector is shaping up in the face of the Covid-19 outbreak and droughts in some key agricultural regions.
- At the time of the previous survey in December, consumer confidence snapped higher, rising 6.8 points to 109. That completely reversed the drop seen earlier in 2019 and left confidence back around long-run average levels.
- However, since that time the headwinds battering the New Zealand economy have increased to gale force. In addition, recent weeks have seen extensive media reporting on the impacts of Covid-19, including the related downturn in financial markets.

Westpac-McDermott Miller consumer confidence

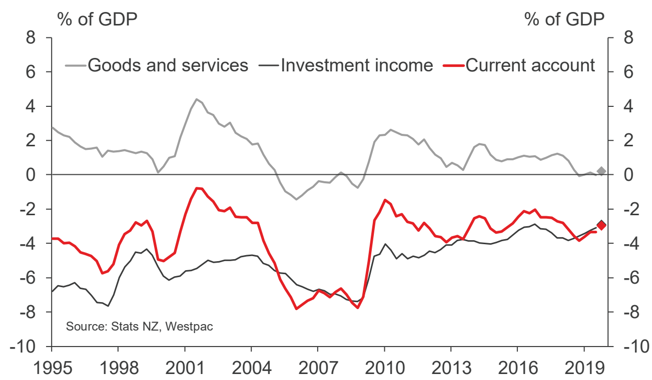


NZ Q4 current account % of GDP

Mar 18, Last: -3.3%, Westpac f/c: -3.0%

- We expect the annual current account deficit will narrow to 3.0% of GDP in December, compared to 3.3% in September.
- In seasonally adjusted terms, we expect the goods trade deficit to narrow to around $500m, compared to around $1.3bn in the September quarter. Export prices rose, and export volumes rebounded from a sharp drop in September (in large part, that was due to an issue with the timing of shipments last quarter). The services trade balance improved slightly, with tourist spending down but other services exports up.
- We expect the investment income deficit to be slightly larger compared to the September quarter, but substantially smaller than it was a year earlier. In particular, the outflow of profits from overseas-owned firms has come off its highs in recent quarters.

Annual current account balance

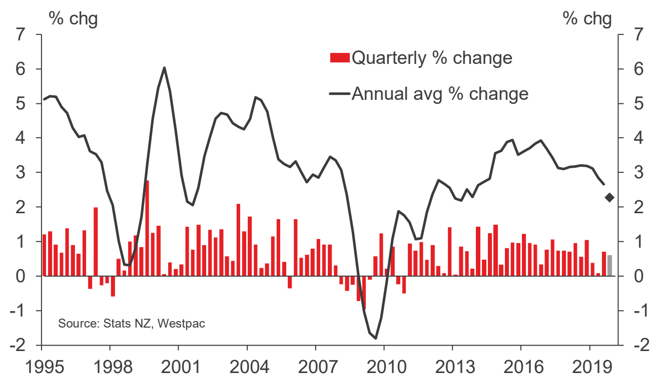


NZ Q4 GDP

Mar 19, Last: +0.7%, Westpac f/c: +0.6%, Mkt f/c: +0.6%.

- We expect a 0.6% rise in GDP for the December quarter, as the economy rebounded from a slowdown in the first half of the year. That would see growth slow to 2.3% for the 2019 year, compared to 3.2% growth over 2018.
- The performance across the economy was mixed, with softness in the primary and good-producing sectors. Balanced against that, we expect to see gains across a range of services including transport, finance and real estate services.
- Our forecast is stronger than the 0.4% increase that the Reserve Bank forecast in its February Monetary Policy Statement. However, their forecasts were finalised during the early phases of the Covid-19 outbreak, so any upside surprise on the economy's starting point will be far outweighed by a downgrade to the outlook for 2020.

Production-based GDP



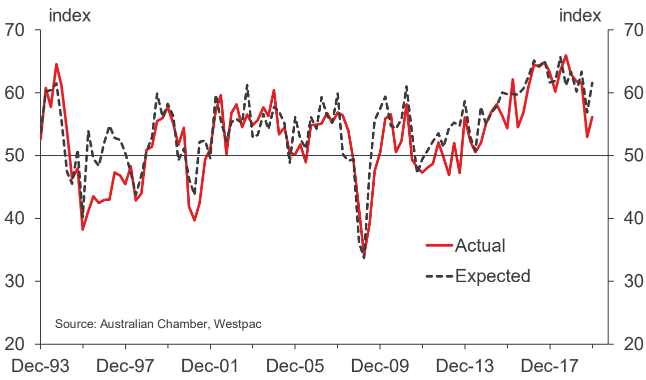
The week ahead.

Aus Q1 AusChamber–Westpac business survey

Mar 17, Last: 56.1

- The Australian Chamber–Westpac survey of the manufacturing sector provides a timely update on conditions in the sector and insights into economy-wide trends. The Q1 survey was conducted from February 10 to March 3.
- In Q4, the Actual Composite rose to 56.1 from 52.9 in September. Despite that, this is a still relatively modest read, down from 61.5 in June, to be at levels prevailing in 2015.
- Whilst new orders, output and backlog eased to more moderate levels over the second half of 2019, manufacturing firms felt optimistic about the outlook for their businesses.
- Roll forward to 2020 and the advent of COVID-19 has created a disruptive start to the new year, and home building activity remains in a downurn. Compounding this, the economy is still battling the drought and recovering from the bushfires.

Westpac-AusChamber Composite indexes

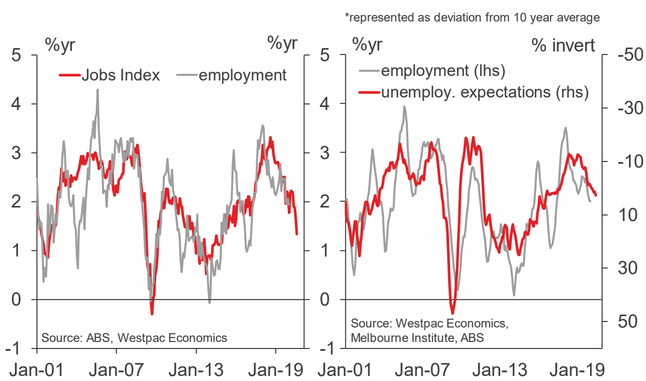


Aus Feb Labour Force Survey - employment '000

Mar 19, Last: 13.5k, WBC f/c: 7k
Mkt f/c: 8.5k Range: -5k to 20k

- Employment rose in January but unemployment jumped, reversing the recent surprise decline, while hours worked fell. The 13.5k gain in employment met our expectations (+15k) but was an upside surprise for the market (a median +10k). The annual pace was flat at 1.9%yr.
- The average monthly gain in the three months to February slowed to 20.2k from 27.7k in January and 30.7k in December.
- During February the COVID-19 outbreak was expanding outside of China and the first Australian case was reported on January 25. While you can see a clear impact on education, tourism and entertainment activity in February, most businesses were still hoping for it to be a temporary event.
- We expect the events to have slowed hiring, to a forecast gain of 7k, with a bigger hit to hours worked likely.

Westpac employment indicators

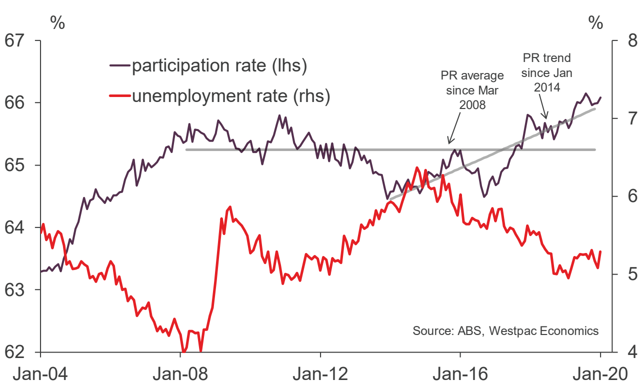


Aus Feb Labour Force Survey - unemployment %

Mar 19, Last: 5.3%, WBC f/c: 5.3%
Mkt f/c: 5.3% Range: 5.2% to 5.4%

- In January the unemployment rate surprised with a solid 0.2ppt gain to 5.3%. Both the market and Westpac had been expecting 5.2%. The reason for the jump in unemployment was an unexpected rebound in participation, from 65.99% to 60.09% which saw a large 44.7k gain in the labour force.
- In the year to January, robust participation has been led by females - their participation lifting 0.88ppt to 61.54% compared to a –0.17pt fall in male participation to 70.80%.
- As female employment has grown much faster than male employment (3.1%yr vs 0.9%yr), female unemployment is flat in the year (5.2%) and lower than male employment (+0.4ppt in the year to 5.4%.
- Allowing for a 0.1ppt drop in participation to 66.0% unemployment is forecasts to be flat at 5.3% in February.

Unemployment and participation rates



Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 16					
NZ	Feb BusinessNZ PSI	57.1	–	–	COVID–19 adding to the headwinds in the business sector.
	Jan net migration	3930	–	–	Annual in flow continuing to gradually trend down.
Chn	Feb industrial production	5.7%	–3.0%	–	Feb partial data will provide a first look...
	Feb retail sales YTD %yr	8.0%	–1.7%	–	... at consumption and...
	Feb fixed asset investment ytd %yr	5.4%	–0.3%	–	... business investment as COVID-19 hit.
UK	Mar Rightmove house prices	0.8%	–	–	A weak UK economy a heavy weight for housing.
US	Mar Fed Empire state index	12.9	5.1	–	Manufacturing to be hit in coming months by COVID-19 spread.
	Jan total net TIC flows $bn	78.2	–	–	US Treasury's in strong demand given risks.
Tue 17					
NZ	Q1 Westpac Consumer Confidence	109.9	–	–	Early read on how the economy is faring given COVID-19.
Aus	Q1 AusChamber-Westpac survey	56.1	–	–	A disjointed start to the year for the manufacturing sector.
	RBA minutes	–	–	–	Colour around likely further response to COVID-19.
Eur	Mar ZEW survey of expectations	10.4	–	–	Sentiment to be shocked lower.
UK	Jan ILO unemployment rate	3.8%	3.8%	–	Labour remains strong despite uncertainties faced by UK.
US	Feb retail sales	0.3%	0.2%	0.3%	Precautionary spending to offset late-month caution.
	Feb industrial production	–0.3%	0.4%	–	Manufacturing to be hit in coming months by COVID spread.
	Jan business inventories	0.1%	–0.1%	–	Likely to be run down into Q2.
	Jan JOLTS job openings	6423	6400	–	COVID effect likely two months away.
	Mar NAHB housing market index	74	74	–	Home building has strong economic support; COVID big risk.
Wed 18					
NZ	Q4 current acc'n balance (% of GDP)	–3.3%	–	–3.0%	Trade and investment balances both set to improve.
Aus	RBA Assist. Gov Economic	–	–	–	Luci Ellis, UDIA conference, Sydney 10:00am.
	Feb Westpac–MI Leading Index	-0.46%	–	–	Tracking well below trend. Components weakening further.
Eur	Jan trade balance €bn	22.2	–	–	External demand to remain a headwind to at least mid year.
	Feb CPI %yr	1.2%	1.2%	–	Inflation nowhere near target before COVID loss of demand.
US	Feb housing starts	–3.6%	–4.3	–	A clear positive for economy in recent months....
	Feb building permits	9.2%	–3.2%	–	... set to come under pressure from demand uncertainty.
	Fedspeak	–	–	–	Powell holds post-meeting press conference.
Thu 19					
NZ	Q4 GDP	0.7%	0.6%	0.6%	Firmer services sector activity, with softness in goods.
Aus	Feb employment	13.5k	8.5k	7k	COVID-19 was just breaking out of China in Feb so the...
	Feb unemployment rate	5.3%	5.3%	5.3%	... impact will be in hours worked rather than employment.
US	Mar Phily Fed index	36.7	10.0	–	Manufacturing to be hit in coming months by COVID spread.
	Initial jobless claims	211k	–	–	A key barometer of business response to COVID-19.
	Feb leading index	0.8%	0.1%	–	Will fall materially below trend in coming months.
Fri 20					
UK	Feb public sector borrowing £bn	–10.5	0.5	–	Public demand must accelerate to offset COVID-19 shock.
US	Feb existing home sales	–1.3%	1.1%	–	Supply the main issue, but demand also to create concern.

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