
Fiordland National Park, New Zealand

Weekly Economic Commentary.

Dry cough.

Drought and Coronavirus are going to deal the New Zealand economy a sharp blow over the first half of 2020. Both situations have gotten more severe recently, and we have updated our forecasts in response.

We are now forecasting zero economic growth in the March quarter of 2020, and 2.2% over the whole of 2020. If there were no drought and no Coronavirus, we would have forecast 0.8% for the March quarter and 2.7% annual growth in 2020. However, based on the assumptions outlined below, we expect economic activity will quickly rebound from its drought- and Coronavirus-affected levels. This means we can expect quite rapid rates of quarterly economic growth over the second half of 2020.

The evolving drought situation will severely impact rural communities in the worst-affected areas. We estimate that the peak impact on GDP will be 0.3 percentage points, occurring in the June quarter. The economy tends to recover very rapidly from droughts, so we expect a rebound in agriculture in the September quarter.

It now looks as though the initial assumptions that we used to estimate the impact of Coronavirus were too light. With the spread of the virus beyond China, the virus now looks likely to disrupt economic activity more broadly and for longer than we initially thought.

Our previous assumptions were that the ban on travel from China to New Zealand would last two months, China's factories would remain closed for one month, and there would be some reduction in travel from the rest of Asia.

If China were the only country materially affected by Coronavirus, then those assumptions would still look reasonable. The reported number of Coronavirus cases in China continues to fall steadily. China's factories are gradually re-opening. Previously we were hearing that banks and freight-forwarders in China were closed, disrupting New Zealand's ability to import goods, but now we hear that there has been some easing in that. Finally, although log exports remain extremely low, some ships carrying logs to China have left New Zealand ports, so exports are not quite zero.

But the dramatic development in recent days is the spread of Coronavirus to Iran, Italy, South Korea and Japan. This raises the spectre of more widespread travel bans, disruptions to trade with more countries, and a longer period of Coronavirus concern. There is now a greater probability of supply chain disruptions causing New Zealand firms to run out of the materials they need to operate.

We have updated our forecasts to incorporate assumptions of more widespread travel bans and disruptions to economic activity. We are still assuming that efforts to contain the virus will eventually be successful, but only at a severe economic cost.

Our new assumptions are:

- The ban on travel results in zero foreigners arriving from China until the end of March. Travel from China to New Zealand is 50% of normal in April, and gradually returns to normal after that.
- Either travel bans or travel wariness cause a 25% reduction in foreign arrivals from the rest of Asia until end of March. The reduction is 15% in April, gradually returning to normal after that.
- No change in travel between Australia and New Zealand.
- A 7.5% reduction in visitor arrivals from the world excluding Asia and Australia until end of April, followed by a gradual recovery.
- A 7.5% reduction in New Zealanders travelling abroad anywhere except Australia, until end of April with a gradual recovery after that.
- Disruptions to supply chains and confidence effects that impact business investment and consumer spending over the March and June quarters.
- Zero exports of logs to China for February, with a rapid rebound after that.

Under these conditions, Coronavirus would slash 0.7 percentage points off GDP in the March quarter. GDP growth would remain below par in the June quarter. The recovery from Coronavirus would begin in the September quarter, with more rapid rates of quarterly economic growth beginning at that time.

We expect drought and Coronavirus to have a net negative impact on inflation in the short run. Lack of international demand for key New Zealand exports is likely to reduce their domestic price. Rapid declines in airfares have already been observed, due to lower demand and surplus airline capacity. Lower hotel room rates will be the next step. And the reduction in global oil prices should translate to a lower domestic price of petrol. Retailers of imported products such as clothing and footwear may run short of stock owing to supply chains being disrupted, but we think that any increase in prices will be modest.

For the Reserve Bank, we are sticking with our forecast of an August OCR cut, but we regard a cut as early as the March review as a distinct possibility. The RBNZ's February *Monetary Policy Statement* assumed only a small temporary hit on GDP and regarded the outbreak as a look-through event. However, we know that the RBNZ is part of a whole-of-government group looking at the potential impacts of the outbreak, and the Finance Minister's speech last week indicated that that group's thinking has since moved on, with the base case now being a drawn-out impact on activity over 2020. We will continue to watch the Coronavirus situation and will update our OCR forecast as the evolving situation requires.

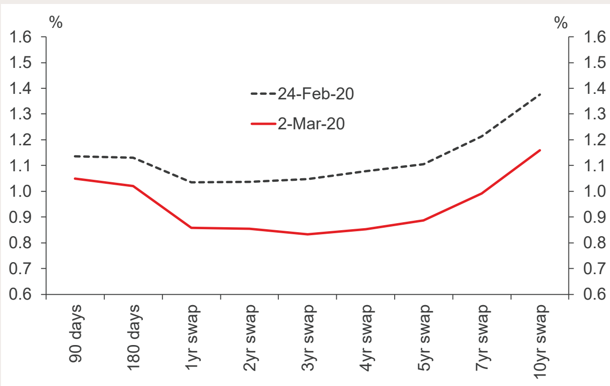
Fixed vs Floating for mortgages.

Borrowers looking to fix would be best to wait. Given the uncertainty around how the spread of Coronavirus plays out, there is a heightened chance that the RBNZ will cut rates further this year, and fixed-term mortgage rates may follow suit.

Among the fixed rates on offer, we think the best value is in the one- and two-year rates. Longer-term rates are high relative to where we think future short-term rates will go. That said, fixing for longer terms does offer security against future interest rate increases, and therefore may be preferred by those with low risk tolerance.

Floating mortgage rates are normally expensive for borrowers, but they may be the preferred option for those who require flexibility in their repayments.

NZ interest rates



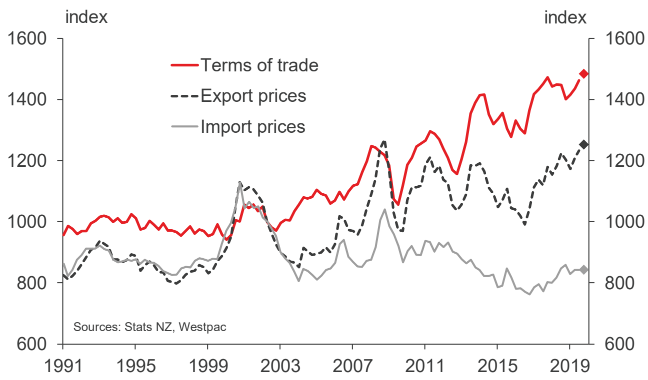
The week ahead.

NZ Q4 terms of trade

Mar 2, Last: +1.9%, WBC f/c: +1.5%

- We expect a 1.5% rise in New Zealand's terms of trade for the December quarter. This would take it to a new all-time high, beating the previous record that was reached in late 2017.
- Overall export prices were higher for the quarter. While prices for dairy products, New Zealand's largest export, were down slightly, there was a sharp rise in meat prices as China sought alternative proteins in the wake of its African Swine Fever outbreak, and log prices partly recovered from a sharp fall in the previous quarter.
- We estimate that import prices were flat. Oil prices were down for the quarter, but a lower New Zealand dollar is likely to have lifted prices for other imported goods.

NZ terms of trade

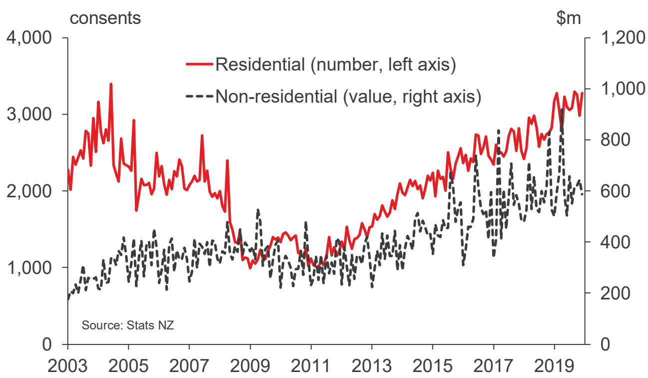


NZ Jan dwelling consents

Mar 4, Last: 9.9%, Westpac f/c: -3.0%

- Residential dwelling consent issuance rose by nearly 10% in December. That saw annual consent issuance rising to its highest level since 1974.
- We're expecting a 3% fall in consent numbers in January. However, the ongoing shift in New Zealand construction towards medium-density structures means that consent numbers have become increasingly volatile on a month-to-month basis.
- After trending higher in recent years, monthly consent issuance flattened off over 2019. We expect that will continue over 2020. It will also be worth watching the geographic breakdown of consents. In Auckland, which has accounted for much of the lift in consents in recent years, issuance is flattening off. However, issuance is picking up elsewhere.

NZ building consents

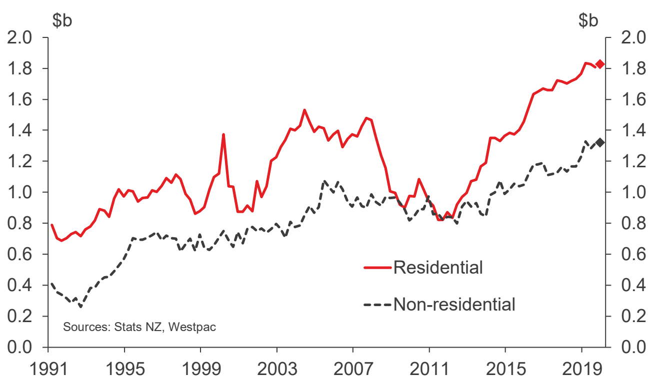


NZ Q4 building work put in place

Mar 6, Last +0.4%, WBC f/c: +0.6%

- Total construction activity rose by 0.4% in the September quarter. While non-residential building activity rose by 2.4%, residential building fell 1.1% with softness in Auckland and Canterbury
- We're forecasting a 0.6% rise in total building activity in the December quarter, with modest gains in both residential and non-residential building activity.
- While the level of building activity remains elevated, it has been flattening off. We're seeing a similar pattern in consent issuance. We expect these trends to continue over the year ahead.

NZ real building work put in place



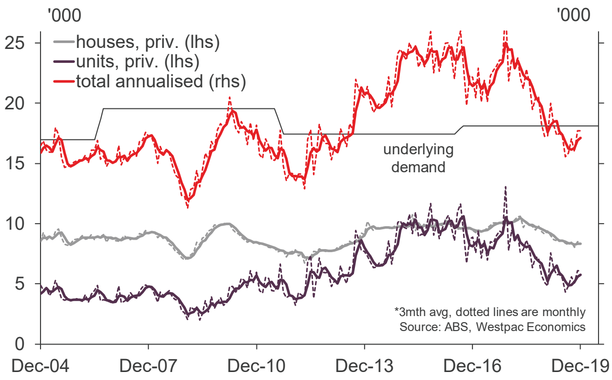
The week ahead.

Aus Jan dwelling approvals

Mar 3, Last: –0.2%, WBC f/c: 0.0%
Mkt f/c: +1.0%, Range: -4.0% to +4.0%

- Dwelling approvals are at a potentially important point, with coming months likely to clarify whether a lift late last year represents the beginning of an upturn, with building following the wider market turnaround, or a bit of volatility around the bottom of the cycle. Approvals posted a 0.2% dip in Dec but were coming off a sharp 10.9% jump in Nov that was heavily concentrated in NSW (+50%mth) and likely associated with regulatory changes. Dec saw a sharp reversal in NSW mostly negated by an even sharper high-rise-led jump in Vic.
- Jan may have some additional complicating factors from the bushfires. While we do not expect a discernible impact, the high seasonal factors applied in what is usually very quiet month means any volatility could be amplified.

Dwelling approvals

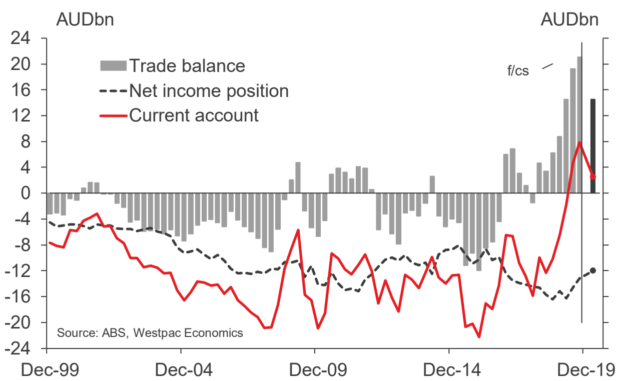


Aus Q4 current account, AUDbn

Mar 3, Last: +7.9, WBC f/c: +2.5
Mkt f/c: +2.3, Range: -1.0 to +5.0

- Australia has recorded back-to-back current account surpluses for the first time since 1973 - with the trade surplus having climbed to a record high as a share of the economy.
- The December quarter will see the 3rd consecutive surplus.
- For Q4, we anticipate a current account of +$2.5bn, narrowing by $5.4bn from $7.9bn for Q3.
- The trade position moderated in the quarter as the terms of trade fell, down by an estimated 4.7% on lower commodity prices. The ABS advise that the trade surplus was $14.5bn, down from the $21.1bn originally reported for Q3.
- As to the net income deficit, we've factored in a further reduction, down by $1.2bn to -$12.0bn.

Current account: a surplus, Q4 f/c +$2.5bn

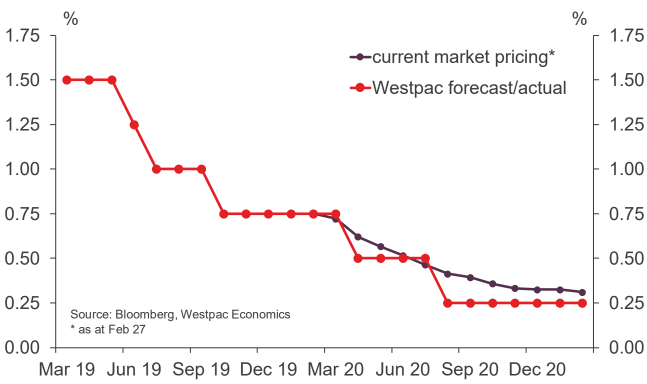


Aus Mar RBA policy decision

Mar 3, Last: 0.75%, WBC f/c: 0.75%
Mkt f/c: 0.75%, Range: 0.75% to 0.75%

- The Reserve Bank eased policy in 2019, lowering the cash rate in June, July, and October, down from 1.50% to 0.75%.
- The 2020 year has begun with the RBA in watch-and-wait mode, assessing the impact (the long and variable lags) of the recent round of rate cuts. The RBA expects growth to accelerate, lifting to above trend in 2021.
- The housing sector has clearly responded, with prices rebounding sharply in the Sydney and Melbourne markets.
- We see the risk that output growth is stuck below trend, with wages growth weak and the global backdrop subdued and uncertain, exacerbated by the coronavirus outbreak.
- We expect further easing in 2020, with 25bp rate cuts in April and August, followed by QE.

RBA: Westpac forecast and market pricing



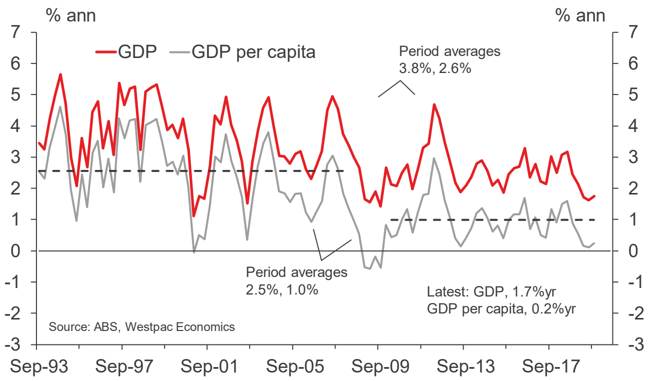
The week ahead.

Aus Q4 GDP

Mar 4, Last: 0.4%qtr, 1.7%yr, WBC f/c: 0.5%qtr, 2.1%yr
Mkt f/c: 0.4%qtr, 2.0%yr, Range: 0.2%qtr, 1.6%yr to 0.8%qtr, 2.4%yr

- The Australian economy appears to be stuck in the slow-lane, after decelerating through the second half of 2018.
- Key dynamics are: a cyclical downturn in construction; structural headwinds around waes and productivity (impacting consumers); and a subdued global economy.
- For Q4, we expect real GDP growth of 0.5%qtr, 2.1%yr, with risks tilted to the downside.
- Domestic demand is sluggish on our figuring, at 0.1%qtr, 0.9%yr. Private demand contracts further, -0.1%qtr, -0.5%yr, with home building falling, so too business investment, and consumer spending soft, at a forecast 0.3%.

Australian output per capita: 2019 Q3, 0.2%yr

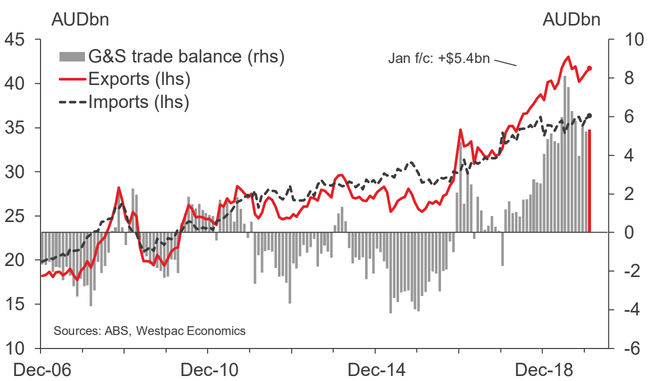


Aus Jan trade balance, AUDbn

Mar 5, Last: 5.2, WBC f/c: 5.4
Mkt f/c: 4.8, Range: 3.5 to 5.4

- Australia's trade surplus remains sizeable - albeit down from the June record high of $8.1bn.
- For the opening month of 2020, we expect a $5.4bn surplus, in line with the $5.5bn for November and $5.2bn in December.
- Export earnings rose by a forecast 1.0%, $0.4bn. Gains are anticipated across gold and iron ore (higher prices), with coal (volumes) and fuels (prices) likely lower in the month.
- Imports, a wild-card of late, is forecast to rise by 0.8%, on higher volumes and higher prices.
- The January snap-shot captures conditions ahead of Lunar New Year celebrations (from January 24) and ahead of the coronavirus outbreak.

Australia's trade balance

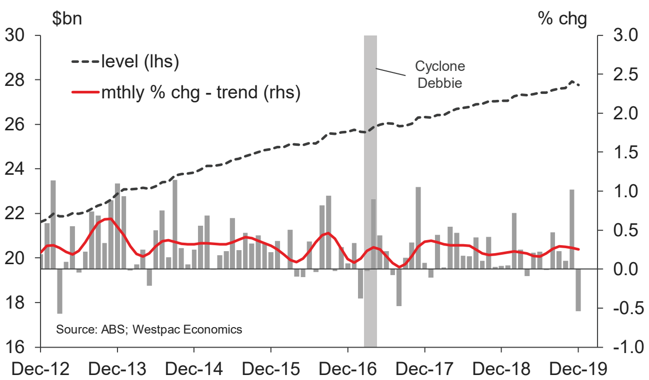


Aus Jan retail trade

Mar 6, Last: –0.5%, WBC f/c: –0.5%
Mkt f/c: 0.0%, Range: -0.7% to +0.4%

- The Dec retail report was a mixed bag with a sharper than expected pull-back in the Dec month but a better than expected wash-up for Q4 volumes. Importantly, the monthly pattern suggests that the strength in the quarter was more about a pull-forward in sales due to the increasingly popular 'Black Friday' event than policy stimulus. That in turn suggests the weakness apparent in Dec will extend into Jan.
- On top of this we are likely to see some impact from bushfires and associated smoke pollution which affected Sydney and Melbourne (both cities saw about a dozen days with hazardous air quality in Jan). There is an outside chance that we get a delayed stimulus-related lift as tax relief and interest rate cut cash 'parked' in the second half of 2019 is spent but there is no real evidence of this coming through to date.

Monthly retail sales

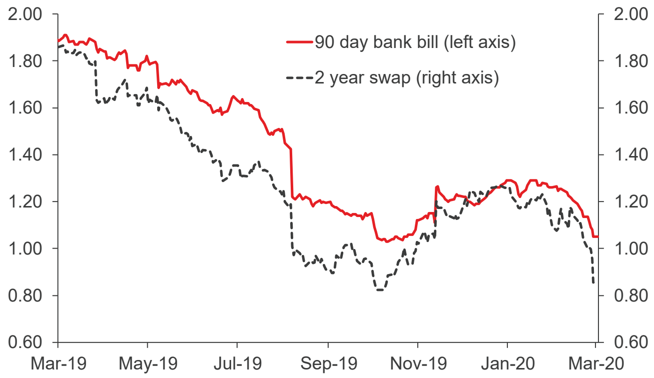


New Zealand forecasts.

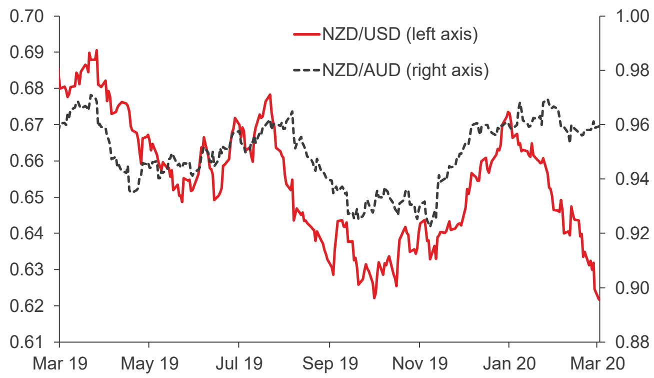
Economic forecasts	Quarterly				Annual			
	2019		2020					
% change	Sep (a)	Dec	Mar	Jun	2018	2019f	2020f	2021f
GDP (Production)	0.7	0.6	0.0	0.7	3.2	2.3	2.2	3.5
Employment	0.2	0.0	0.5	0.5	1.9	1.0	2.1	2.1
Unemployment Rate % s.a.	4.1	4.0	4.2	4.3	4.3	4.0	4.2	3.7
CPI	0.7	0.5	0.4	0.3	1.9	1.9	1.5	1.9
Current Account Balance % of GDP	-3.3	-3.0	-3.1	-3.4	-3.8	-3.0	-3.7	-3.4

Financial forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Cash	1.00	1.00	0.75	0.75	0.75	0.75
90 Day bill	1.10	1.05	0.90	0.90	0.90	0.90
2 Year Swap	0.90	0.90	0.90	0.95	1.00	1.05
5 Year Swap	0.95	1.00	1.05	1.15	1.25	1.35
10 Year Bond	1.00	1.05	1.10	1.20	1.30	1.40
NZD/USD	0.62	0.64	0.65	0.65	0.66	0.66
NZD/AUD	0.95	0.97	0.97	0.97	0.97	0.97
NZD/JPY	66.3	67.8	68.3	68.3	70.0	70.6
NZD/EUR	0.57	0.58	0.59	0.58	0.58	0.58
NZD/GBP	0.48	0.49	0.50	0.50	0.50	0.50
TWI	69.4	71.1	71.6	71.3	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 2 March 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.08%	1.14%	1.21%
60 Days	1.07%	1.18%	1.24%
90 Days	1.05%	1.21%	1.26%
2 Year Swap	0.86%	1.14%	1.09%
5 Year Swap	0.89%	1.23%	1.16%

NZ foreign currency mid-rates as at 2 March 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6217	0.6440	0.6471
NZD/EUR	0.5635	0.5947	0.5828
NZD/GBP	0.4857	0.4940	0.4895
NZD/JPY	66.76	70.74	70.06
NZD/AUD	0.9594	0.9580	0.9652
TWI	69.87	71.73	71.63

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 2					
NZ	Q4 terms of trade	1.9%	0.8%	1.5%	Expected to reach a new all–time high.
Aus	Q4 company profits	–0.8%	–1.3%	–4.2%	Mining profits down as commodity prices moved into reverse.
	Q4 inventories	–0.4%	–0.1%	–0.1%	Falls, but at a slower rate, on soft sales. Adds 0.1ppt to growth.
	Feb CoreLogic home value index	0.9%	–	1.1%	Upturn carrying into early 2020.
	Feb AiG PMI	45.4	–	–	Jan, –2.9pts. Manuf'g sector contracting on housing downturn.
	Feb MI inflation gauge	1.8%	–	–	Underlying inflation benign. Food prices, up on drought.
	Feb ANZ job ads	3.8%	–	–	A weaker trend of late.
US	Jan construction spending	–0.2%	0.7%	–	US business investment to remain weak.
	Feb ISM manufacturing	50.9	50.5	–	Markit measure highlighted COVID-19 risk for US manufacturing.
Tue 3					
Aus	Jan dwelling approvals	–0.2%	1.0%	0.0%	Unwinding high rise spike offset by uptrend in non high rise.
	Q4 net exports, ppts cont'n	0.2	0.2	0.2	Exports, modest uptrend & imports lower.
	Q4 current account	7.9	2.3	2.5	Surplus narrows, trade dented by lower export prices.
	Q4 public demand	1.7%	–	0.8%	Spending up, focus on health and investment.
	RBA policy decision	0.75%	0.75%	0.75%	Pause to continue – ahead of national accounts.
Eur	Feb CPI %yr	1.4%	1.2%	–	... across the world.
	Jan unemployment rate	7.4%	7.4%	–	Labour market in robust shape.
US	Fedspeak	–	–	–	Fed's Mester to Address UK Society of Professional Economists
Wed 4					
NZ	GlobalDairyTrade auction	–2.9%	–	–	Milk futures point to a further drop.
	Jan building consents	9.9%	–	–3.0%	Monthly issuance levels have been flattening off.
	Feb ANZ commodity prices	–0.9%	–	–4.0%	Dairy, meat, log prices down on COVID-19 disruptions.
Aus	Q4 GDP	0.4%	0.4%	0.5%	Modest growth, weak wages & construction contracting.
	Q4 GDP, %yr	1.7%	2.0%	2.1%	Annual growth up (base effects) but still well below trend.
	Feb AiG PCI	41.3	–	–	Up 2.4pts in Jan. Construction sector contracting.
Chn	Feb Caixin China PMI services	51.8	48.0	–	Service sector hard hit by COVID-19.
Eur	Feb Markit services PMI	52.8	–	–	Contagion in Europe to hit service economy Feb/Mar.
	Jan Retail Sales	–1.6%	0.5%	–	Pre-dates COVID-19 shock.
US	Fedspeak	–	–	–	Fed's Evans Takes Part in Moderated Q&A.
	Feb ADP employment change	291k	170k	–	Employment growth to soften in 2020.
	Feb ISM non–manufacturing	55.5	55.5	–	Markit measure highlighted US not immune from COVID-19.
	Federal Reserve's Beige book	–	–	–	Conditions across the 12 Federal Reserve districts.
Thu 5					
Aus	Jan trade balance, AUDbn	5.2	4.8	5.4	Little changed. Exports +1.0%, imports +0.8%. See textbox.
US	Initial jobless claims	219k	–	–	To remain very low.
	Jan factory orders	1.8%	–0.4%	–	Core durables surprised to upside in Jan.
	Fedspeak	–	–	–	Bullard makes opening remarks.
Fri 6					
NZ	Q4 building work put in place	0.4%	0.6%	0.6%	Modest gains in res and non–res work expected.
Aus	Jan retail trade	–0.5%	0.0%	–0.5%	Weak trend, timing of sales, and bushfires to see a further fall.
	Feb AiG PSI	47.4	–	–	Down 1.3pts in Jan. Service sectors to be hit by disruptions.
US	Jan trade balance US$bn	–48.9	–48.8	–	COVID-19 to affect trade from Feb.
	Feb non–farm payrolls	225k	195k	180k	Employment growth to soften in 2020...
	Feb unemployment rate	3.6%	3.5%	3.5%	... but only slowly, meaning the U/E will remain at lows.
	Feb average hourly earnings %mth	0.2%	0.3%	0.2%	Wages growth likely capped at circa 3.0%yr pace.
	Fedspeak	–	–	–	Williams, Kashkari and Kaplan speak during Asian session.
	Fedspeak	–	–	–	Various speakers at Shadow Committee Event in New York
	Jan wholesale inventories	–	–	–	Likely a negative in 2020.
Sat 7					
Chn	Feb trade balance USDbn	–	–	–	Trade likely to be highly volatile in coming months.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	1.8	2.6
CPI inflation % annual	1.5	1.9	1.8	1.8	1.8	2.0
Unemployment %	5.7	5.5	5.0	5.2	5.4	5.2
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.4	-2.0
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	1.6	1.5
Consumer Prices %yr	1.4	2.1	2.4	1.8	1.9	1.9
Unemployment Rate %	4.9	4.4	3.9	3.7	3.4	3.5
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	0.8	0.4	0.4
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	1.0	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.3	0.8	1.5
China						
Real GDP %yr	6.7	6.8	6.6	6.1	5.3	6.1
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.3	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	2.8	3.2
Forecasts finalised 12 February 2020						

Interest rate forecasts	Latest	Mar–20	Jun–20	Sep–20	Dec–20	Mar–21	Jun–21	Dec–21
Australia								
Cash	0.75	0.75	0.50	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.81	0.85	0.70	0.45	0.45	0.50	0.50	0.50
10 Year Bond	0.85	0.80	0.80	0.75	0.75	0.80	0.85	1.05
International								
Fed Funds	1.625	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.25	1.20	1.25	1.30	1.40	1.45	1.50	1.70
ECB Deposit Rate	–0.50	–0.50	–0.60	–0.60	–0.60	–0.60	–0.60	–0.60

Exchange rate forecasts	Latest	Mar–20	Jun–20	Sep–20	Dec–20	Mar–21	Jun–21	Dec–21
AUD/USD	0.6534	0.65	0.66	0.67	0.67	0.68	0.68	0.70
USD/JPY	109.11	107	106	105	105	106	107	109
EUR/USD	1.0988	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2871	1.30	1.30	1.30	1.30	1.31	1.31	1.32
USD/CNY	7.0102	6.95	6.90	6.85	6.80	6.80	6.75	6.60
AUD/NZD	1.0444	1.03	1.03	1.03	1.03	1.03	1.03	1.04

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