Weekly Economic Commentary.

How severe?

There was a definite bounce in the economy after the Alert Level 4 lockdown was lifted, but we are still in a deeply recessionary environment. Our forecast was that the economy would settle 6% below the pre-Covid level after the lockdown was lifted. But some recent data is tentatively suggesting that the economic situation may not be quite as severe as that. This has seen some easing in the risk-off sentiment that had permeated through financial markets in recent months.

Retail spending rebounded surprisingly vigorously after the lockdown was lifted. When New Zealand was at Alert Level 4, data from Paymark indicates that overall retail spending dropped 50% compared to pre-Covid levels, with spending in areas other than groceries down 90%. Now that we're back to Alert Level 2, spending levels are down only 2% on the same time last year. Some of that will be catch-up spending after the lockdown, and sectors like tourism and hospitality are still struggling with sluggish demand. Even so, that is a faster recovery than we were expecting and points to an encouraging degree of resilience in households' spending appetites.

Some key high-level indicators of activity are also pointing to a faster recovery than we had expected. For instance, during the lockdown electricity demand fell 15% but is now back around the levels we saw this time last year. Similarly, both heavy and light traffic movements have recovered most of their lockdown related declines, signalling that both people and goods are moving around the country again.

The pace of job losses has slowed in recent weeks, suggesting that the labour market has been more resilient than we expected. During the Alert Level 4 lockdown, we saw the number of New Zealanders on the Jobseeker benefit rising by more than 6,000 each week. In the week ending 22 May, that pace had slowed to 384. We've also seen some recovery in businesses' demand for workers, with a pickup in the number of job advertisements.

The number of people on the Jobseeker benefit has risen by more than 40,000 since Covid-19 restrictions were put in place. But while that is a very large increase, it has actually been more modest than we expected. In large part, that's because the Government's wage subsidy scheme has helped to keep many people in employment. We are likely to see further job losses over the coming months as the wage subsidy scheme comes to an end and businesses wrestle with weak demand. Even so, it looks like unemployment may not rise quite as high as our forecast of 9.5%.

It's a bit more of a mixed picture in the housing market. Now that the lockdown has been lifted, sellers are coming back to the market, with new listings rising at a steady pace over the past couple of weeks (though they remain below pre-Covid levels).

However, while sellers may be dipping their toes in the water, buyers are more circumspect. April's survey of housing market confidence showed a drop in the number of people who think now is a good time to buy, and a sharp fall in the number of people who think prices will rise over the coming year. That's despite extremely low interest rates and the removal of LVR mortgage lending restrictions. We've already seen a sharp fall in house prices in April, with the average sale price dropping by 1.1% just in one month (though the low number of sales during the lockdown means that sharp monthly drop does need to be taken with a grain of salt). We are forecasting a 7% house price decline between March 2020 and the end of the year.

While recent developments have on balance been a bit better than expected, the economy is still being buffeted by powerful headwinds. That's particularly evident in the business sector, with recent surveys like the PMI and PSI pointing to significant falls in demand and forward orders. There are also signs of stress on businesses' financial positions. For instance, over the past month, data from Re-Leased show that the number of commercial tenants who have been late making rental payments has risen sharply. There has also been a significant increase in the number of businesses that are seeking some form of rent relief, as well as a rise in vacant commercial premises.

We expect that the combination of weak demand, pressures on businesses' balance sheets and lingering nervousness about the economic outlook will be a drag on investment spending. In fact, surveys of businesses' investment intentions are currently around multi-decade lows. That will be very important for the construction sector. As discussed in our recently released Economic Insight report, [1] although construction has picked up as the lockdown has been lifted, we expect a second downturn in construction activity over 2021. That includes falls in both privately funded residential and non-residential projects. Those falls will more than offset the planned increases in public spending in areas like infrastructure.

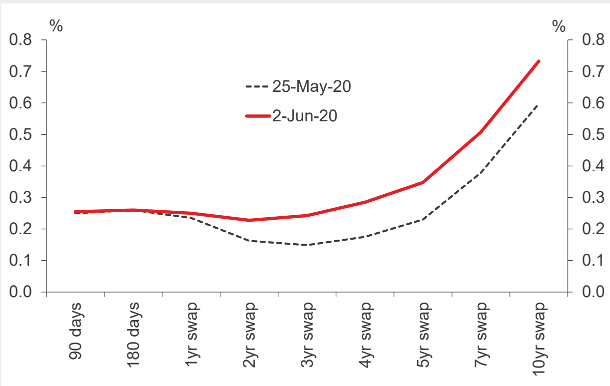
1 Available here: https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Bulletins-2020/Construction-Sector-Economic-Insight-May-2020-Final-Westpac-NZ.pdf

Fixed vs Floating for mortgages.

The interest rate outlook is highly uncertain, so trying to guess which fixed term will result in the lowest interest repayments is difficult. It may be better to keep it simple. Borrowers looking for certainty should aim to fix their mortgage rates, while borrowers who need flexibility should float.

Fixed mortgage rates have fallen recently, but they may not drop much further in the near term. We expect that the RBNZ will lower the OCR to -0.5% next year. If that is correct, then both fixed and floating rates will fall again next year.

NZ interest rates



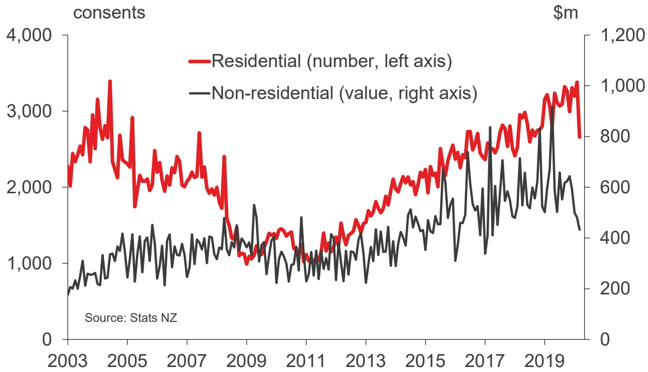
The week ahead.

NZ Apr dwelling consents

June 2, Last: -21.3%, Westpac f/c: -60%

- Dwelling consent numbers fell 21% in March. This large drop in consent numbers was mostly due to New Zealand's shift into Alert Level 4, which meant that around 5 working days were lost in March.
- New Zealand remained in lockdown through most of April. As a result, few consents will have been lodged. However, a number of regions had backlogs of consents that were awaiting processing prior to the lockdown, and many councils continued to process consents over this period with staff working remotely.
- We are expecting a 60% decline in consent numbers over the month. There is a much wider bound of uncertainty around this forecast than usual.

NZ building consents

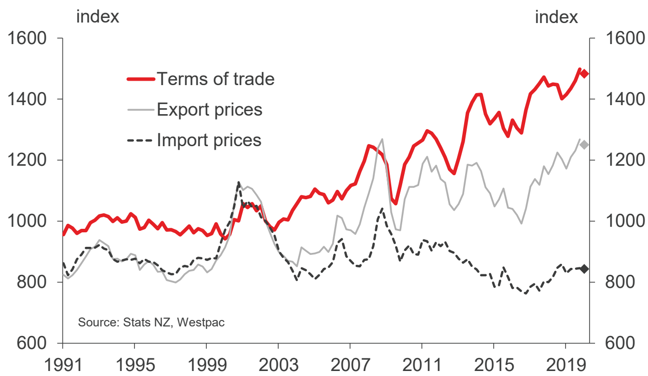


NZ Q1 terms of trade

Jun 2, Last: +2.6%, WBC f/c: -1.0%

- New Zealand's terms of trade fell slightly in the March quarter, after having reached a new all-time high at the end of 2019.
- We estimate that export prices were 1.4% lower over the quarter. While dairy prices saw a small rise, there were sizeable prices falls for meat, seafood, logs and crude oil. We expect a 0.4% drop in import prices, with lower world prices for manufactured goods outweighing the lower New Zealand dollar.
- The Covid-19 pandemic is likely to see a further dip in the terms of trade this year, although lower agricultural export prices will be partly balanced out by the sharp fall in oil import prices.

NZ terms of trade

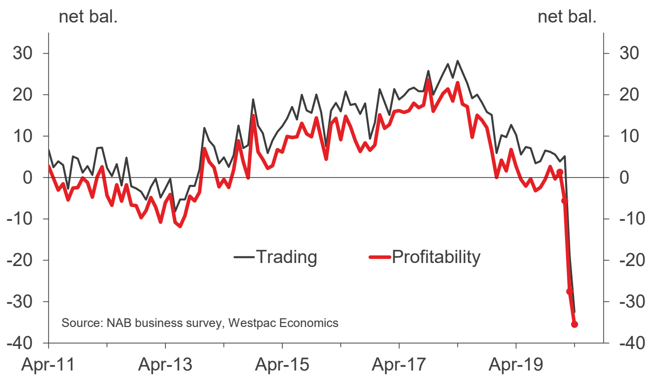


Aus Q1 company profits

Jun 2, Last: -3.5%, WBC f/c: flat
Mkt f/c: 0.5%, Range: -3.5% to 2.5%

- A mixed picture for profits in the opening quarter of 2020. Mining profits up but non-mining profits crunched by the shutdowns in response to the pandemic.
- For the Business Indicators survey, we expect a flat outcome. The headline - on this accounting measure - will be flattered in this quarter by the Inventory Valuation Adjustment (the price of inventories rose after falling at the end of 2019).
- For the National Accounts measure, we expect a 1.5% decline.
- Mining profits are up on higher commodity prices, which rose by around 3% in AUD terms.
- For the broader economic, business conditions collapsed in the month of March, falling to -22 from +1, as social distancing guidelines were progressively introduced. That sharp drop in sales hit cash flows and profits.

Aus trading conditions and profitability



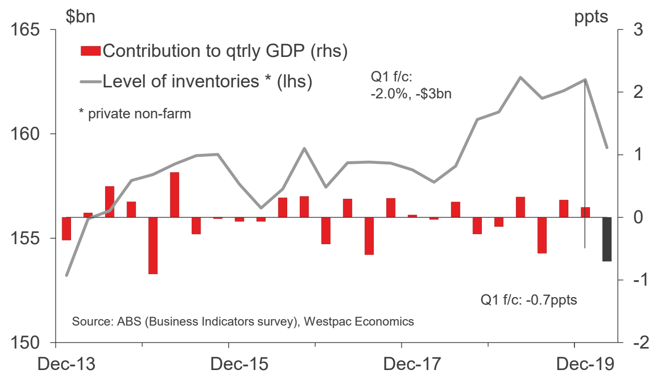
The week ahead.

Aus Q1 inventories

Jun 2, Last: +0.3%, WBC f/c: -2.0% (-0.7ppts cont'n)
Mkt f/c: -0.6%, Range: -2.0% to 0.3%

- The pandemic triggered a range of responses - one of which was a likely run-down of inventories.
- For Q1, we expect inventory levels to be down sharply, potentially by as much as 2% - although we note the degree of uncertainty around this figure. In dollar terms, that is a drop in the order of $3bn.
- Hoarding and panic buying led to the unusual sight of empty shelves at supermarkets with suppliers unable to keep up.
- Import volumes of goods fell by an estimated 5%, almost $4bn, on weaker demand and supply disruptions.
- On our forecast, inventories will subtract -0.7ppts from activity in the quarter.

Aus inventories

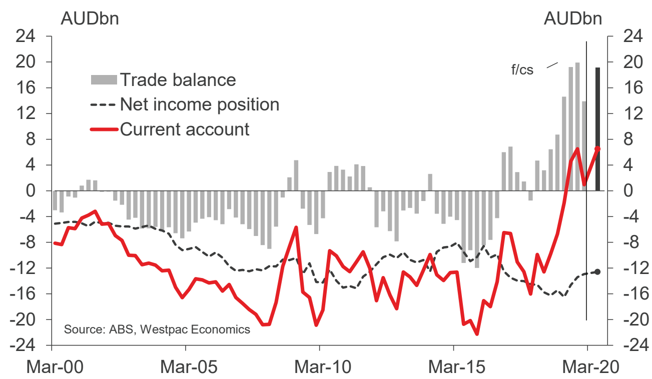


Aus Q1 current account, AUDbn

Jun 2, Last: 1.0, WBC f/c: 6.5
Mkt f/c: 6.2, Range: 5.0 to 7.5

- Australia's current account looks set to be in surplus for a fourth consecutive quarter.
- In the December quarter, the surplus printed at $1.0bn, a trade surplus of $13.9bn and a net income deficit of $12.9bn.
- In the March quarter, the current account surplus widened to an estimated $6.5bn on an improved trade performance.
- The trade surplus rose to $19.1bn in the quarter, up from a revised $13.5bn. This includes the boost from a higher terms of trade, up by around 2.5% we estimate.
- The net income deficit is a potential wildcard. We anticipate a consolidation, at $12.6bn. However, large swings on global markets, as well as the potential for revisions, could throw up some surprises.

Aus current account

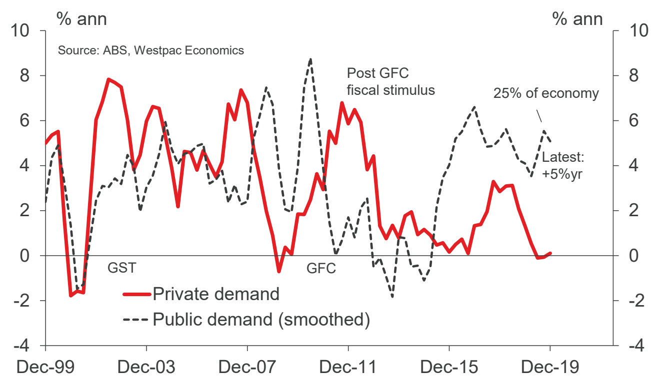


Aus Q1 public demand

Jun 2, Last: 0.1%, WBC f/c: 0.6%

- Public sector spending, in the form of public demand (directly accounting for a quarter of the economy) has been expanding at a brisk pace. It is a key growth driver and a key generator of jobs.
- Public demand grew by 5% in 2019, directly adding 1.2ppts to activity (which, along with net exports, +1.1ppts yr, more than fully accounted for total output growth, of 2.2%yr).
- The focus is on health care (the introduction of the NDIS and the pharmaceutical benefit scheme) and on investment (including transport infrastructure and the NBN roll-out).
- For Q1, we expect a rise of 0.6%. Investment, often volatile quarter to quarter, is forecast to be flat (on a dip in construction work) - but with upside risks.
- In upcoming quarters, spending on health will rise further, in response to the pandemic.

Aus public and private demand



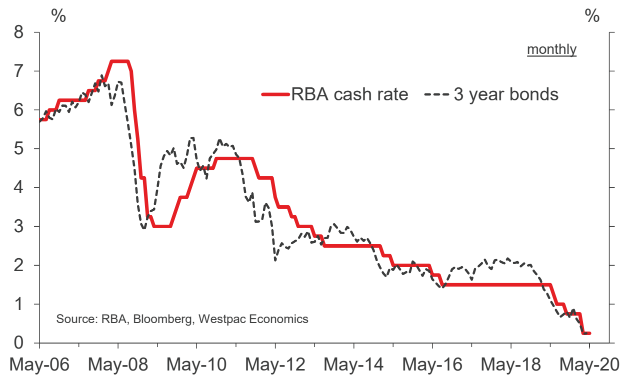
The week ahead.

Aus Jun RBA policy decision

Jun 2, Last: 0.25%, WBC f/c: 0.25%
Mkt f/c: 0.25%, Range: 0.25% to 0.25%

- The RBA cut the cash rate by 25bps at its March meeting and by another 25bps to 0.25% at an emergency inter-meeting move on March 19 that also saw the deployment of a range of QE measures including policies aimed at lowering key market rates (3yr bonds) and providing low cost term funding for banks. The RBA has also moved to provide large liquidity injections to stabilise increasingly dislocated financial markets.
- With the RBA continuing to rule out negative rates, the cash rate is set to remain at its current level for a very long time - we assess until at least the end of 2023 although the 3yr bond target rate will likely be lifted during 2022.

Aus RBA cash rate

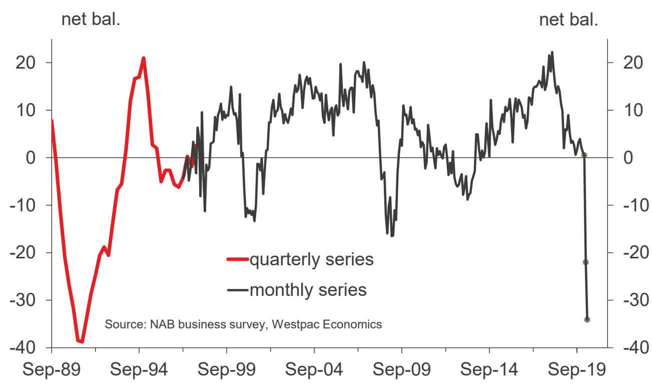


Aus Q1 GDP

Jun 3, Last: 0.5%qtr, 2.2%yr, WBC f/c: -0.7%qtr, 1.0%yr
Mkt f/c: -0.4%qtr, 1.4%yr
Range: -0.8%qtr, 1.0%yr to 0.2%qtr, 1.9%yr

- The opening quarter of 2020 was a tumultuous one, with the outbreak of the COVID pandemic. Social distancing guidelines (escalated from mid-March) and travel restrictions have disrupted activity.
- Business surveys reported a sharp drop in conditions in March, to -22 from +1, and ABS data reported employment fell by over 4% over the second half of March.
- For Q1, we are forecasting output to contract by 0.7%, moderating annual growth to 1.0% from 2.2%.
- The arithmetic is: domestic demand -0.2%; total inventories -0.7ppts; net exports +0.5ppts and stat. discrepancy -0.3ppts. Around demand: consumer spending -0.4%; housing -0.6%; business investment -0.5%; and public +0.6%.

Aus business conditions

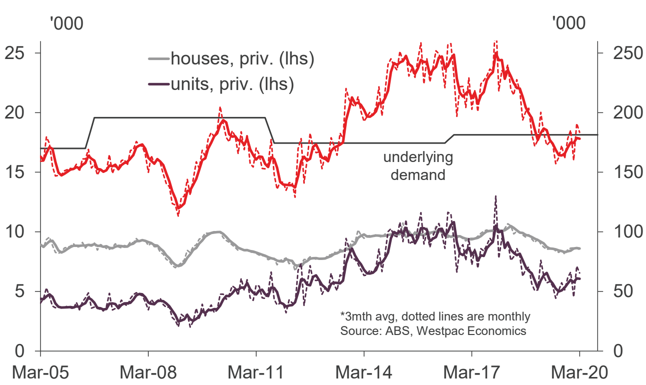


Aus Apr dwelling approvals

Jun 3, Last: –4%, WBC f/c: –15.0%
Mkt f/c: -10.8%, Range: -20.0% to -6.1%

- Dwelling approvals held up much better than expected in March considering the previous month had seen a 20% jump driven by a spike in high rise. The detail showed high rise approvals held up (still 40-50% above their Jan level). Other components were softer but the COVID-19 outbreak had no major impact.
- That will not be the case in April. The lockdown combined with a belated unwind of the February-March high rise jump could see an extremely sharp fall. We have pencilled in a 15% drop – partly on the basis that many councils may still have been processing applications from prior months in April and that the wider construction sector remained open through the shut down. However, there is some downside risk to this number.

Aus dwelling approvals



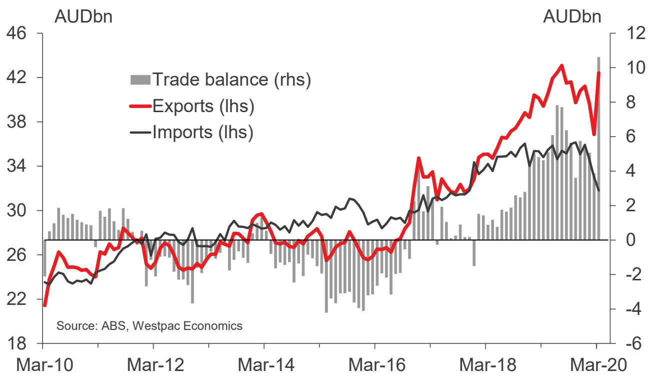
The week ahead.

Aus Apr trade balance, AUDbn

Jun 4, Last: 10.6, WBC f/c: 7.5
Mkt f/c: 7.5, Range: 4.0 to 8.0

- Australia's international trade account is in surplus, with the month to month figure impacted by the pandemic.
- In March, the surplus spiked to a record high of $10.6bn. Exports jumped 15%, up $5.6bn, rebounding from disruptions - including from Cyclone Damien.
- For April, the trade surplus is expected to moderate, easing to a still relatively high $7.5bn.
- Goods exports eased back, down by around 7½%, including an unwinding of a spike in gold shipments. That still leaves goods exports at a relatively high level.
- Imports look to be a little lower in the month of softer demand - continuing a trend evident in the year to date.
- Service exports and imports will both be sharply lower in the month as international travel comes to a halt.

Aus trade balance

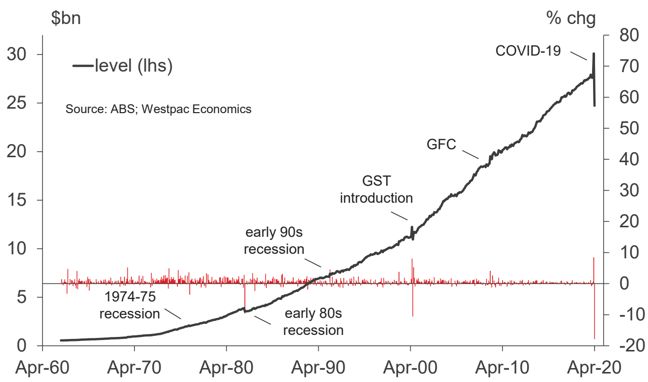


Aus Apr retail trade

Jun 4, Last: 8.5%, WBC f/c: –18.0%
Mkt f/c: -17.9%, Range: -18.0% to 5.4%

- The ABS has moved to releasing preliminary retail sales estimates as part of an effort to provide more timely information on the impacts of the Coronavirus. For April, these showed a dramatic 17.9% plunge. While the result was exacerbated by an 8.5% surge in March as people stockpiled ahead of the shutdown, the April fall is extreme nonetheless, taking sales 10.9% below their Feb level, the available detail suggesting retail ex basic food was over 20% below its Feb level.
- The preliminary figures are based on returns covering 80% of the sector. They are subject to revision, but proved fairly accurate in February and March, and there is little reason to expect a material change to the April estimate. The full release will include all the granular storetype, state and channel detail.

Aus monthly retail sales

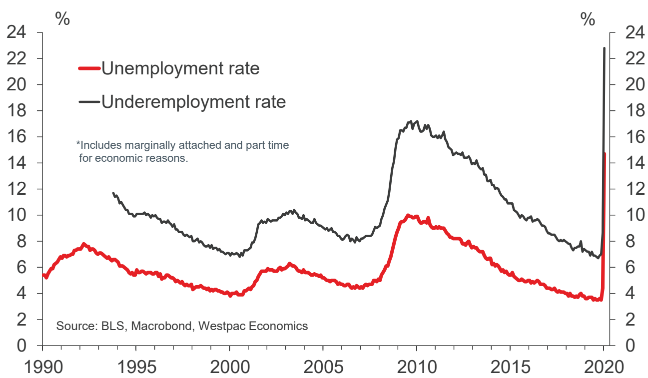


May US employment report

Jun 5, nonfarm payrolls: last: -20537k, WBC: –7500k
Jun 5, unemployment rate: last: 14.7%, WBC: 20.0%

- The Apr employment report saw the largest ever decline in employment in the US, with over 20 million jobs disappearing. Many more reported being employed but at home, or on materially reduced hours.
- As a result, the unemployment rate surged 10ppts to 14.7%, while underemployment increased by an even more dramatic 14ppts to almost 23%.
- Come May, job loss has been less severe, but will take both unemployment and underemployment to new never before seen levels.
- As was the case in Apr, participation and classification issues will be at play. There is therefore a greater than usual amount of risk around these outcomes.

US labour market

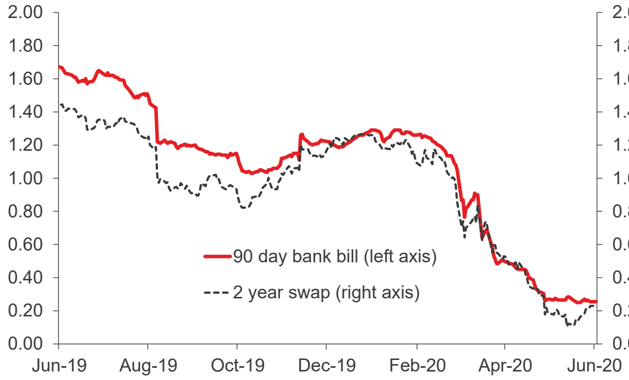


New Zealand forecasts.

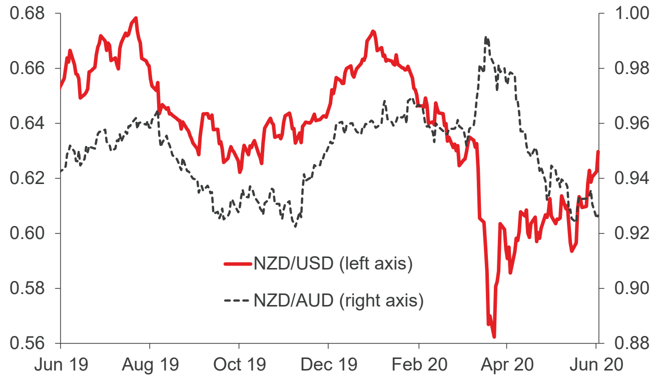
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Dec (a)	Mar	Jun	Sep	2018	2019	2020f	2021f
GDP (Production)	0.5	-1.0	-17.0	14.5	3.2	2.3	-6.3	6.5
Employment	0.1	0.7	-9.4	3.1	1.9	0.8	-4.2	3.4
Unemployment Rate % s.a.	4.0	4.2	9.5	8.5	4.3	4.0	7.5	6.3
CPI	0.5	0.8	-0.4	0.8	1.9	1.9	1.1	0.9
Current Account Balance % of GDP	-3.0	-2.6	-2.3	-1.9	-3.8	-3.0	-2.0	-2.7

Financial forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Cash	0.25	0.25	0.25	0.25	-0.50	-0.50
90 Day bill	0.25	0.25	0.20	-0.10	-0.20	-0.20
2 Year Swap	0.10	0.05	0.00	-0.10	-0.10	-0.10
5 Year Swap	0.20	0.20	0.20	0.20	0.25	0.30
10 Year Bond	0.60	0.55	0.55	0.55	0.60	0.70
NZD/USD	0.59	0.60	0.61	0.62	0.62	0.63
NZD/AUD	0.92	0.91	0.90	0.89	0.89	0.89
NZD/JPY	63.1	63.0	64.7	66.3	66.3	68.0
NZD/EUR	0.55	0.57	0.58	0.58	0.57	0.58
NZD/GBP	0.48	0.49	0.49	0.50	0.50	0.50
TWI	67.1	67.3	67.8	68.2	67.8	68.4

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 2 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	0.26%	0.27%	0.27%
90 Days	0.26%	0.28%	0.26%
2 Year Swap	0.23%	0.13%	0.20%
5 Year Swap	0.35%	0.21%	0.33%

NZ foreign currency mid-rates as at 2 June 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6295	0.5933	0.6058
NZD/EUR	0.5655	0.5486	0.5521
NZD/GBP	0.5039	0.4911	0.4850
NZD/JPY	67.73	63.50	64.72
NZD/AUD	0.9262	0.9248	0.9446
TWI	70.51	67.56	68.68

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Tue 02					
NZ	Apr building permits	–21.3%	–	–60.0%	Lockdown and nervousness will be a drag.
	Q1 terms of trade	2.6%	–	–1.0%	Small decline from last year's all–time high.
Aus	Q1 company profits	–3.5%	0.5%	flat	Mining up, non–mining down. See textbox for details.
	Q1 inventories	0.3%	–0.6%	–2.0%	Sharp run–down – hoarding of groceries, import slump.
	Q1 net exports, ppts	0.1	0.3	0.5	Import volumes fall faster than exports.
	Q1 current account balance, $bn	1.0	6.2	6.5	Current account improves on larger trade surplus.
	Q1 public demand	0.1%	–	0.6%	Advance further. Investment forecast flat - upside risk.
	RBA policy decision	0.25%	0.25%	0.25%	Rates to be held at record low.
Eur	May Markit manufacturing PMIs	–	–	–	For Germany and the Euro Area.
UK	Apr net mortgage lending £bn	4.8	1.4	–	Will decline as the housing market softens.
Wed 03					
NZ	GlobalDairyTrade auction	1.0%	–	–	Dairy prices may be stabilising as economies reopen.
Aus	Q1 GDP	0.5%	–0.4%	–0.7%	Risk that output fell as shut–downs impacted during March.
	Apr dwelling approvals	–4.0%	–10.8%	–15.0%	COVID-19 disruptions to show a more meaningful hit.
	May AiG PCI	21.6	–	–	Construction –16.3pts, led by apartments & commercial.
	RBA Asst. Governor Bullock	–	–	–	To speak on the evolution of banking & payments.
Eur	Apr PPI	–1.5%	–1.5%	–	Expected to drag annual PPI to –4.0%yr.
	Apr unemployment rate	7.4%	8.1%	–	April will see an upward turn in the U/E trend.
US	May ADP employment change	–20236k	–9500k	-8000k	Initial claims showed job loss continued at pace in May.
	Apr factory orders	–10.3%	–15.0%	–	Both orders and investment are set to crater in April ...
	Apr durable goods orders	–	–	–	... led by weakness in transportation.
	May ISM non–manufacturing	41.8	44.0	–	April saw a record monthly fall, but remains above GFC low.
Thu 04					
NZ	May ANZ commodity prices	–1.1%	–	–	Further falls in meat and dairy prices.
Aus	Apr trade balance, $bn	10.6	7.5	7.5	Surplus to ease from record high.
	Apr retail sales	8.5%	–17.9%	–18.0%	Preliminarily estimate showed extraordinary fall on virus hit.
Eur	May Markit services PMIs	–	–	–	For the Euro Area and Germany (final).
	Apr retail sales	–11.2%	–18.0%	–	Collapse in March will be compounded by April release.
	ECB policy decision	–0.5%	–0.5%	–	Interest will be around an expansion of the PEPP.
US	Apr trade balance US$bn	–44.4	–41.5	–	Underlying volatility from collapse in exports and imports.
	Q1 productivity	–2.5%	–2.5%	–	Fall in productivity reflects labour market deterioration.
	Initial jobless claims	2123k	–	–	Fall in continuing claims suggests peak U/E passing.
Fri 05					
Aus	May AiG PSI	27.1	–	–	Services –11.6pts, record low. Up in May as economy reopens?
UK	May GfK consumer sentiment	–34	–	–	Final; prelim particularly negative on the 12mth outlook.
US	May non–farm payrolls	–20537k	–8000k	-7500k	Job loss has continued at pace, but participation...
	May unemployment rate	14.7%	19.5%	20.0%	... as significant for U/E as jobs.
	May average hourly earnings %mth	4.7%	1.0%	–	To be hit by rising job loss and spare capacity.
	Apr consumer credit	–12.044	–15.000	–	Lockdown has caused credit card debt to plummet.

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	0.3	2.4
Unemployment %	5.7	5.5	5.0	5.2	7.6	6.3
Current Account % GDP	-3.1	-2.6	-2.1	0.5	0.5	-0.8
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.0	1.1
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	18.0	8.2
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	5.8
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.0	4.8
Forecasts finalised 8 May 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	0.10	0.10	0.10	0.15	0.20	0.25	0.30	0.35
10 Year Bond	0.88	0.85	0.90	0.95	1.00	1.10	1.20	1.30
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.67	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	0.6643	0.64	0.66	0.68	0.70	0.70	0.71	0.72
USD/JPY	107.41	107	105	106	107	107	108	110
EUR/USD	1.1088	1.08	1.09	1.10	1.11	1.11	1.12	1.12
GBP/USD	1.2329	1.22	1.23	1.24	1.25	1.26	1.29	1.30
USD/CNY	7.1484	7.02	6.90	6.85	6.80	6.75	6.70	6.60
AUD/NZD	1.0707	1.08	1.10	1.11	1.13	1.13	1.13	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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