



Westland Tai Poutini National Park, New Zealand

# Weekly Economic Commentary.

## No shelter for the smelter.

The removal of COVID-19 restrictions on domestic activity has continued to give the New Zealand economy a boost. The manufacturing sector is now joining in, with the PMI manufacturing index rising strongly a two-year high in June. However, as recent news demonstrates, the pandemic has brought to a head some long-running pressures within heavy manufacturing in particular.

After a lengthy review, Rio Tinto has announced that it will close its aluminium smelter at Tiwai Point in Southland by the end of August 2021. COVID-19 was the straw that finally broke the camel's back for Tiwai Point, but it also raises questions about the future viability of NZ Steel's Glenbrook steel mill, the oil refinery at Marsden Point, and Methanex's methanol plants in Taranaki.

For Southland, the closure of Tiwai Point will be devastating, sapping confidence in a region which is still coming to terms with the effects of COVID-19. The production of basic aluminium adds about \$500m to the region's economy annually. Without it, the region stands to lose a whopping 10% of its GDP. That is equivalent to 0.2% being shaved off New Zealand's GDP.

The hole left by Tiwai Point will mean job losses. The smelter currently provides direct employment to about 900 people in the region. A further 2000 jobs, mainly in supplier industries, such as engineering, rental leasing, and advisory services, are also at risk. Come August next year, up to 5% of the region's workforce, many of whom are highly paid and highly skilled, could be out of work. That could lead to an exodus of skilled workers to other provinces, which could mean lower house prices in the region.

The loss of the smelter will also mean a halt to basic aluminium exports, worth about \$1.2bn per year. Nearby Southport is already anticipating that it will be handling a third less volume when production comes to a stop. New Zealand's aluminium fabricators are also likely to be affected by the



loss of supply from Tiwai Point, and over time some may be displaced by imports of finished aluminium products.

However, while there are some big drawbacks from the loss of Tiwai Point, there are also opportunities and benefits. The removal of Tiwai Point is, after all, equivalent to building a massive amount of clean electricity, with little adverse environmental impact.

One benefit of closing the smelter is that it will make it easier and cheaper for New Zealand to meet its climate change obligations. Despite having one of the lowest carbon footprints of any aluminium smelter in the world, Tiwai Point is still a big carbon emitter that has benefitted extensively from subsidies in the form of emission trading scheme credits. That of course, will come to an end.

Meeting these obligations should also be made easier by a further 13% of electricity supply being added to the grid. That's how much of New Zealand's electricity Tiwai Point consumes. Additional supply creates the opportunity to early retire older, higher cost and less environmentally friendly generation capacity, such as coal- and gas-fired generators at Huntly, and the Combined Cycle Power Station in Taranaki. However, it also increases the chances that investment in renewable energy projects such as the 'shovel ready' Tauhara geothermal power station might be deferred.

Taking advantage of this additional electricity will require upgrades to the transmission network, which over time should lead to a reduction in the cost of transmitting power from

Manapouri's hydroelectric power station in the deep South to New Zealand's large population centres. Longer term, this will lead to lower electricity prices than we otherwise would have had, which will benefit industry in New Zealand. But in the short term, electricity prices may rise because Tiwai Point will no longer be paying transmission costs, and these will have to be shared across other users. Also, electricity users will have to pay the cost of upgrades to the transmission network.

Like any big change, the negative impacts of Tiwai Point's closure are likely to be felt upfront whereas the opportunities and benefits that might come from it will take a while to come through. With that in mind, and with Southland looking straight down the barrel, the Government has an essential role to play in ensuring a smooth and 'just' transition, with jobs top of the agenda. The challenge will be to do this while at the same time encouraging broader efforts to exploit the advantages of cheaper and more available electricity.

Whether this can be achieved is debatable, although initiatives currently underway in Taranaki (following the ban on offshore oil and gas exploration, a major industry for the region) may shine a light on how this could be done. Last year we reviewed the 'just transition' concept, including some case studies of attempted transitions overseas.<sup>1</sup> While there is no clear recipe for success, it appears that political buy-in and collaboration are critical factors. Having a vision and conducive culture are also important, as is having an inclusive process where all affected stakeholders have an equal say in defining and agreeing desired outcomes and how to get there.

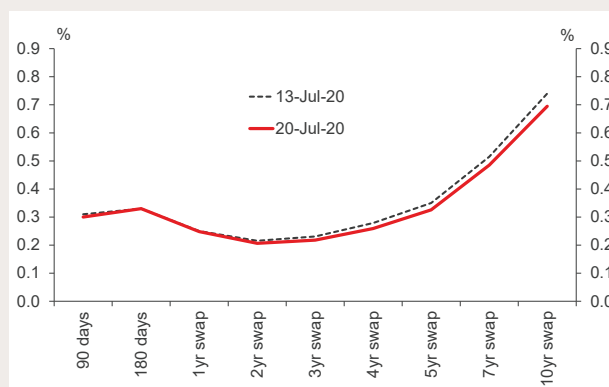
<sup>1</sup> Available here: <https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Taranaki-Economic-Insight-Oct-19-Westpac-NZ.pdf>

## 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



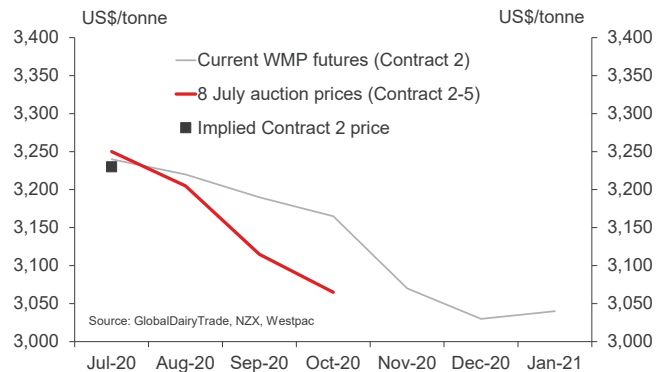
# The week ahead.

## NZ GlobalDairyTrade auction, whole milk powder prices

**Jul 22, Last: +14.0% chg, Westpac: 0.0%**

- We expect that whole milk powder prices will be unchanged at this auction and thus consolidate their price gains from the previous auction. Prices surged 14% on 8 July.
- For comparison, the dairy futures market is pointing to a price modest lift of around 1% as at the time of writing.
- Over the remainder of the NZ winter, we anticipate that global dairy prices may strengthen a touch further. However, in the NZ spring and as the global economic recession bites, we expect global dairy prices will come under renewed downward pressure from rising NZ production and weak global demand, respectively.

## Whole milk powder prices

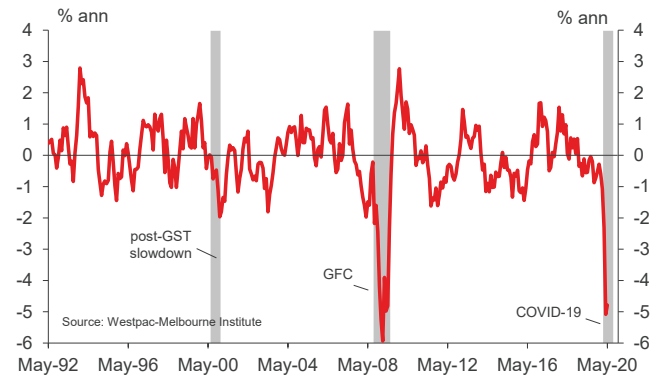


## Aus Jun Westpac-MI Leading Index

**Jul 22, Last: -4.79%**

- The Leading Index growth rate lifted from -5.1% in April to -4.79% in May but remained in deep negative territory consistent with a recession.
- The June read is likely to see a further improvement although again leaving a clear recession signal intact. The monthly update will incorporate an extreme mix of results.
- On the positive side are strong partial rebounds in US industrial production (+6.9% vs -11.5% last month) and total hours worked (+4% vs -10.4% in April-May), and a further rise in the ASX200 (+2.5% vs +4.2% last month).
- On the negative side is a sizeable new shock to sentiment components following the shutdown in Melbourne - the Westpac-MI Consumer Expectations Index down -10% and the Westpac-MI Unemployment Expectations Index spiking 12.1% - and a steep fall in dwelling approvals (-16.4%).

## Westpac-MI Leading Index

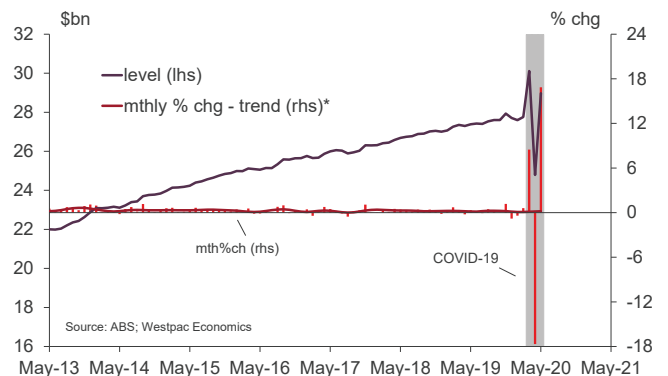


## Aus Jun preliminary retail trade

**Jul 22, Last: 16.9%, WBC f/c: 0.5%**

- The COVID outbreak has had a dramatic impact on monthly sales: an 8.5% stockpiling driven surge in March followed by an epic 17.7% plunge during the lockdown in April and an equally spectacular 16.9% rebound in May. That left monthly sales a touch above their pre-COVID levels in February.
- It should be noted that retail is currently a poor guide to total spending as it excludes some of the biggest negative impacts - on sectors like tourism, hospitality and services - and over-represents segments benefitting from expenditure switching.
- Volatility is likely to be much lower in June. Indicators point to a consolidation - we expect sales to be up 0.5% mth. July will clearly be a different story with the Melbourne lockdown set to see more choppy monthly results in coming months.
- This preliminary release only includes an estimate of total monthly sales. The full release on August 4 will give the full storetype and state detail, and the wash-up for quarterly real retail sales, the first partial for Q2 GDP.

## Monthly retail sales



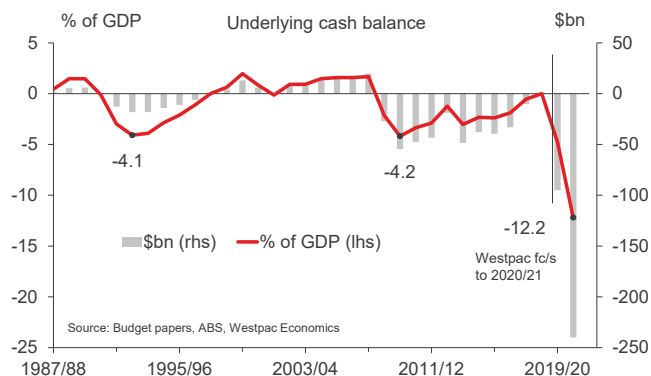
# The week ahead.

## Aus Federal budget update, budget balance (AUDbn)

**Jul 23, WBC f/c: 2019/20: -95, 2020/21: -240**

- The Federal government will provide an update on the Economic and Fiscal Outlook, the first since the pandemic.
- The economy has slumped into recession. Real GDP potentially contracted by 0.25% in 2019/20 and declined by a further 2.0% in 2020/21.
- That has shifted the budget from balance in 2018/19 to very large deficits. We estimate deficits of \$95bn, 4.8% of GDP, for 2019/20 and \$240bn, 12.2% of GDP, for 2020/21.
- The 2020/21 deficit includes \$90bn in already announced policy stimulus + our expectation for \$50bn of new measures. The new package may include: extensions to JobKeeper (\$24bn) and Jobseeker (\$11bn); bringing forward personal income tax cuts (\$7bn); as well as cash hand-outs and spending on health and infrastructure (\$8bn combined).

## Federal budget: to be hit by COVID-19 crisis

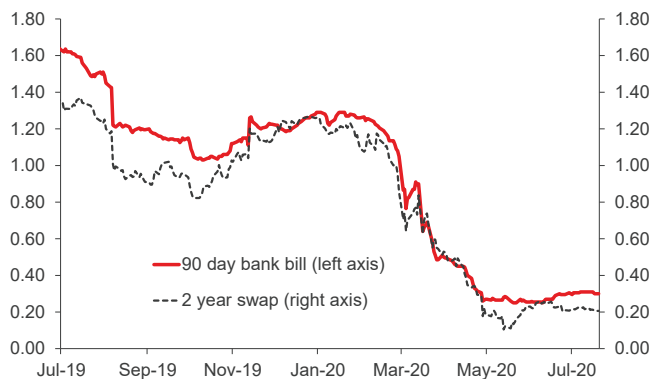


# New Zealand forecasts.

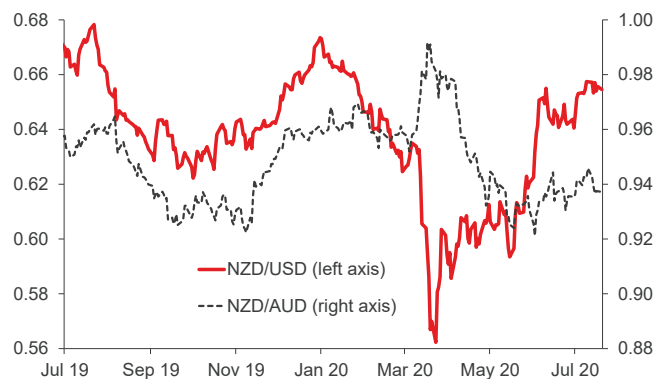
Economic forecasts	Quarterly				Annual			
	2020							
% change	Mar (a)	Jun	Sep	Dec	2018	2019	2020f	2021f
GDP (Production)	-1.6	-13.5	14.0	0.9	3.2	2.3	-4.6	5.1
Employment	0.7	-7.5	0.7	1.3	1.9	0.8	-4.9	3.4
Unemployment Rate % s.a.	4.2	7.0	8.0	7.5	4.3	4.0	7.5	6.6
CPI	0.8	-0.5	0.8	-0.3	1.9	1.9	0.8	0.4
Current Account Balance % of GDP	-2.7	-2.1	-1.7	-1.7	-3.8	-3.0	-1.7	-2.0

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	71.6	70.7	69.1	69.6	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 20 July 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.28%	0.27%
60 Days	0.30%	0.30%	0.28%
90 Days	0.30%	0.31%	0.29%
2 Year Swap	0.21%	0.21%	0.22%
5 Year Swap	0.33%	0.36%	0.36%

NZ foreign currency mid-rates as at 20 July 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6546	0.6528	0.6383
NZD/EUR	0.5735	0.5812	0.5705
NZD/GBP	0.5210	0.5238	0.5170
NZD/JPY	70.11	70.18	68.16
NZD/AUD	0.9372	0.9419	0.9374
TWI	72.33	72.49	71.33

## Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 20</b>					
NZ	Jun BusinessNZ PSI	37.2	-	-	COVID restrictions were removed in early June.
UK	Jul Rightmove house prices	-	-	-	Asking prices were declining prior to COVID-19.
<b>Tue 21</b>					
Aus	RBA minutes	-	-	-	Colour around the uncertain outlook & any policy implications.
	RBA Governor speaking	-	-	-	Labour Market & Public Sector Balance Sheets, 12:30pm.
UK	Jun public sector borrowing £bn	54.5	-	-	Peak in public sector borrowing has yet to be reached.
US	Jun Chicago Fed activity index	2.61	4.00	-	Regional surveys positive in June.
<b>Wed 22</b>					
NZ	GlobalDairyTrade auction, WMP prices	14.0%	-	0.0%	Prices stabilising after the surge at the previous auction.
Aus	Jun Westpac-MI Leading Index	-4.79%	-	-	Improving but still in deep recession territory.
	Jun retail trade, preliminary	16.9%	-	0.5%	Indicators suggest sales consolidated on May's big rebound.
US	May FHFA house prices	0.2%	0.4%	-	Market expects a small uptick in actualised home prices.
	Jun existing home sales	-9.7%	22.8%	-	After falling to lowest level since '10, sales to surge in June.
<b>Thu 23</b>					
Aus	Federal budget update	-	-	-	Update of fiscal position - post the pandemic.
	Q2 NAB business survey	-11	-	-	Conditions rebounding but weak, prior to Melbourne shut-down.
Eur	Jul consumer confidence	-14.7	-12.3	-	Depressed confidence levels indicate long road to recovery.
US	Initial jobless claims	1300k	-	-	Smallest decline yet hints at enduring economic pain.
	Jun leading index	2.8%	2.4%	-	Not a reliable indicator given nature of shock.
	Jul Kansas City Fed index	1	-	-	Edged into positive territory in Jun, first time since COVID.
<b>Fri 24</b>					
NZ	Jun trade balance \$m	1253	438	420	Exports holding up; imports rebounding after lockdown lows.
Aus	Jun merchandise trade, prelim	-	-	-	Data not in a user friendly form (not s.a., on customs basis).
Eur	Jul Markit manufacturing PMI	47.4	49.3	-	Both services and manufacturing expected to see a ramp...
	Jul Markit services PMI	48.3	50.6	-	... up in demand as the initial pandemic shock wears off.
UK	Jun retail sales	12.0%	9.0%	-	Large positive contrib. from non-food stores.
	Jul Markit manufacturing PMI	50.1	52.0	-	UK entered Phase 3 removal of restrictions; has...
	Jul Markit services PMI	47.1	51.0	-	... proven beneficial for manufacturing and services.
US	Jul Markit manufacturing PMI	49.8	52.0	-	July looks to set to be a pivotal point in recovery...
	Jul Markit service PMI	47.9	51.0	-	... with manuf. and services turning expansionary.
	Jun new home sales	676k	700k	-	Sales rose in May by 16.6%; buyer optimism appears robust.

## International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
<b>Australia</b>						
Real GDP % yr	2.8	2.5	2.8	1.8	-3.7	2.4
CPI inflation % annual	1.5	1.9	1.8	1.8	0.3	2.0
Unemployment %	5.7	5.5	5.0	5.2	8.4	7.3
Current Account % GDP	-3.1	-2.6	-2.0	0.6	1.9	0.5
<b>United States</b>						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.6	2.6
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	16.2	6.3
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	0.5	2.2	0.3	0.7	-5.0	1.0
<b>Euro zone</b>						
Real GDP %yr	1.9	2.5	1.9	1.2	-8.5	4.1
<b>United Kingdom</b>						
Real GDP %yr	1.9	1.9	1.3	1.4	-7.0	2.5
<b>China</b>						
Real GDP %yr	6.8	6.9	6.8	6.1	0.1	10.0
<b>East Asia ex China</b>						
Real GDP %yr	4.1	4.6	4.4	3.7	-1.9	5.4
<b>World</b>						
Real GDP %yr	3.4	3.9	3.6	2.8	-4.5	5.0

Forecasts finalised 10 July 2020

Interest rate forecasts	Latest	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
<b>Australia</b>							
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	0.87	0.95	1.00	1.05	1.15	1.25	1.35
<b>International</b>							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.61	0.70	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	0.6984	0.70	0.72	0.73	0.74	0.75	0.76
USD/JPY	107.25	106	106	107	107	108	108
EUR/USD	1.1386	1.13	1.14	1.15	1.16	1.17	1.18
GBP/USD	1.2566	1.26	1.27	1.27	1.28	1.29	1.30
USD/CNY	7.0011	7.00	6.90	6.85	6.80	6.70	6.60
AUD/NZD	1.0678	1.08	1.11	1.14	1.14	1.14	1.13

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