



Abel Tasman National Park, New Zealand

Weekly Economic Commentary.

Learning the lessons of lockdown.

New Zealand's strict lockdown to eliminate the spread of Covid-19 resulted in a steep drop in GDP for the June quarter. However, the damage was much less severe than some of the extreme forecasts that were put out back in April. What actually happened was broadly in line with our more moderate assessment of the impact of lockdown. This supports our view that early, effective control of the virus, allowing the economy to operate with fewer restrictions on an ongoing basis, is the right approach from both an economic and a health perspective.

New Zealand entered its Alert Level 4 lockdown in late March, with the restrictions gradually eased from late April through to early June as Covid-19 case numbers dropped to zero. With many services deemed 'non-essential' at Level 4, we estimate that about a third of the economy was effectively shut down for the first month of the quarter.

However, it's been clear for some time that as the alert level was reduced, economic activity quickly sprang back to life. We've been tracking a range of high-frequency indicators, including but not limited to electronic card spending, electricity demand, job advertisements, tax receipts, traffic volumes, house sales and business confidence. The overall picture is that by the time the country moved to Level 1 in early June, many parts of the economy were back to or near

their pre-Covid levels. Most of the lasting impact appears to relate to the closure of the international borders rather than the lockdown per se.

Consequently, our forecasts of the drop in June quarter GDP were consistently more moderate compared to some of the more severe forecasts in the market. Indeed, it was only in the last couple of weeks that market forecasts converged on something closer to our view, with the actual result of a 12.2% drop ending up close to the median forecast.

Government agencies have been notably on the pessimistic side. The Reserve Bank initially estimated a 21.8% decline in its May Monetary Policy Statement, later revised to -14.2% in August. In the May Budget the Treasury forecast a 23.5%



plunge, and even last week's Pre-Election Economic and Fiscal Update assumed a drop of 16%.

This is important for policy going forward. We now have solid evidence that the economy is more able to rebound from a lockdown than these agencies anticipated, which will have implications for forecasts of fiscal deficits, assessments of the costs and benefits of lockdowns, and even the RBNZ's assessment of monetary policy.

In its pre-election update the Treasury did upgrade its near-term economic assessment, and therefore downgraded its expected issuance of new Government bonds. However, we think that the Treasury remains overly pessimistic about the economy's post-Covid recovery path. The RBNZ may acknowledge the economy's resilience, but we don't expect any change to monetary policy or signalling at its Monetary Policy Review this week. The RBNZ's 'least regrets' approach suggests that it will bank the recent run of stronger data rather than respond to it.

How did we compare?

It's well known that New Zealand's lockdown was one of the strictest in the world at the time. However, it was also one of the most successful in terms of eliminating the spread of the virus, allowing the economy to restart quickly as the restrictions were lifted. Consequently, the 12.2% drop in GDP for the quarter was larger than the average across the developed world, but by no means the biggest.

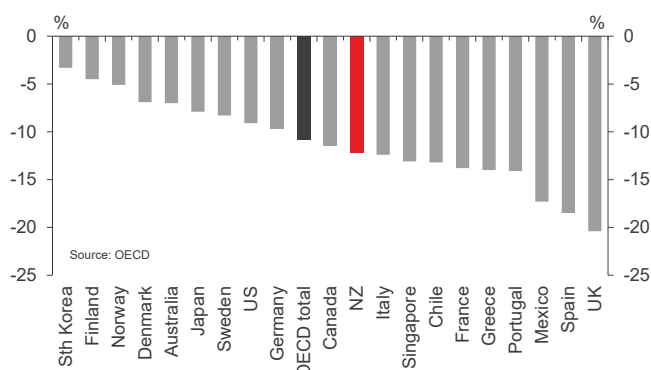
Cross-country comparisons need to be made with caution, not just because of the differences in how each country responded. Differences in the structure of the economy can matter – for instance, countries where tourism makes up a larger share of GDP will have been hit harder by border closures. There can also be differences in each country's methods of measuring activity – a particular issue in these circumstances, when statistical agencies have had to resort to non-standard data sources to try to capture the impact of Covid restrictions.

Moreover, the true test is not how far each country fell during lockdown, but how strongly they come out the other side. With New Zealand now operating under less restrictive conditions overall than Australia (though with some regional differences), we're expecting a more vigorous rebound here in the coming quarters. And we're likely to fare much better than countries that have responded too late or too weakly to manage the spread of the virus, and will face ongoing restrictions and self-imposed social distancing.

We are forecasting an 8.5% rise in GDP for the September quarter, with a further rise of 3.9% in the December quarter. That includes the impact of the most recent restrictions – if the country had remained at Level 1, we would have been expecting a number closer to 11% for the September quarter.

To be clear, this recession is far from over. We estimate that at Level 1 the economy will still be operating at about 5% below its pre-Covid trend – an even greater shortfall than we saw in the depths of the Global Financial Crisis. That gap largely relates to the closure of the international borders, which means that it's likely to persist for some time.

Change in Q2 GDP, selected countries

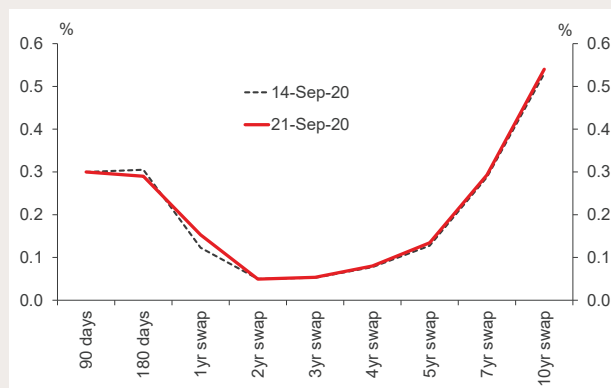


Fixed vs Floating for mortgages.

Fixed mortgage rates fell sharply over May and June, and have been stable since. There is perhaps some scope for a further decline in fixed mortgage rates, but it isn't guaranteed and it isn't large.

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



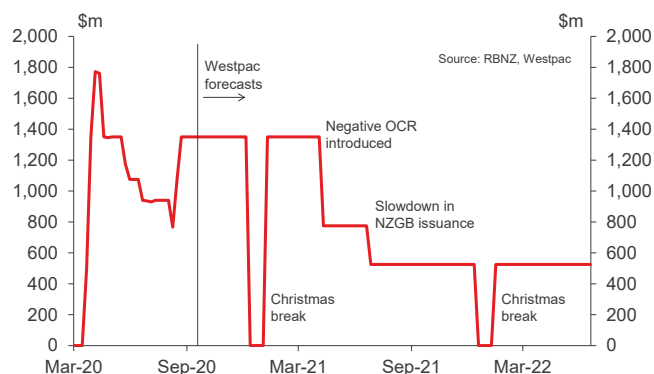
The week ahead.

RBNZ Monetary Policy Review

Sep 23, Last: 0.25%, Westpac f/c: 0.25%, Mkt: 0.25%

- We expect no change in monetary policy next week. The RBNZ will reiterate that it intends to provide substantial monetary stimulus for as long as necessary.
- There was a major change to the LSAP last month, making another change so soon unlikely. Also, the MPC has never altered monetary policy at an interim review. Recent data has been to the strong side, but the RBNZ's "least regrets" approach will mean it banks that without reaction.
- The RBNZ will remind markets that it is currently designing a package of a negative OCR plus a funding for loans scheme. We think the RBNZ will have to deploy this combination next year, because the LSAP is running out of ammo - there is no scope to buy more than \$100bn of bonds.

RBNZ bond purchases

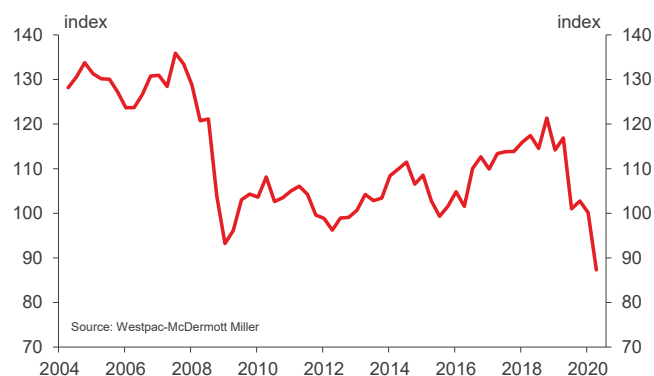


NZ Q3 Westpac-McDermott Miller employment confidence index

Sep 25, Last: 87.3

- New Zealand households' employment confidence fell sharply in June, as the country was emerging from the Covid-19 lockdown. Current job opportunities and earnings growth were seen to be particularly weak.
- The latest survey was conducted in early September, with the economy operating under a similar level of Covid restrictions as it was in early June.
- For this quarter we have included some additional questions about people's employment situation now compared to three months ago. This will provide a timely snapshot of the state of the labour market in between the official surveys.

Westpac-McDermott Miller employment confidence

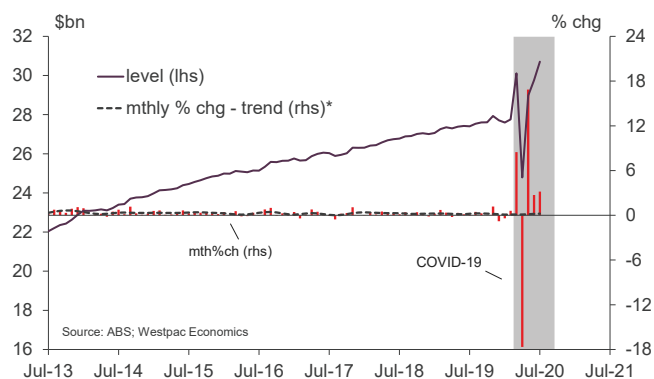


Aus Aug preliminary retail trade

Sep 23, Last: 3.2%, WBC f/c: -0.5%

- Retail sales extended on their impressive rebound from the COVID shock earlier in the year in July. Sales rose 3.2% to be up 12.0%yr and 10.6% above their pre-COVID level in February. Reopening and shifting expenditure patterns (away from COVID precluded segments towards key retail segments such as basic food and hardware in particular) continued to drive a strong lift in most states. Victoria was a notable exception, recording a 2.1% decline in the month on tightening restrictions (partially offset by a surge in stockpiling demand).
- More timely indicators such as our Westpac Card Tracker suggest this state divergence become more pronounced in August following Victoria's hard lockdown. That said, continued gains in other states suggest total retail sales is likely to record a relatively small decline. We expect the official data to show a 0.5% fall which will still have sales well above pre-COVID levels.

Aus monthly retail sales

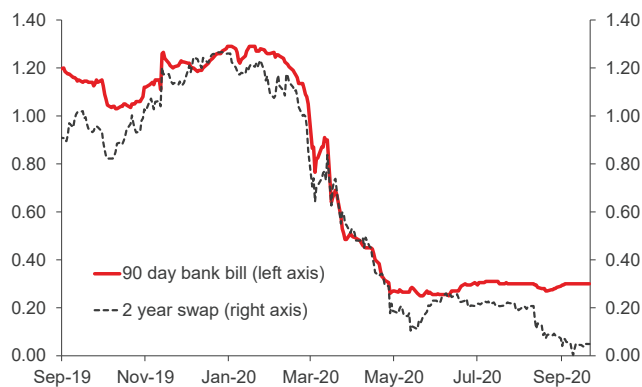


New Zealand forecasts.

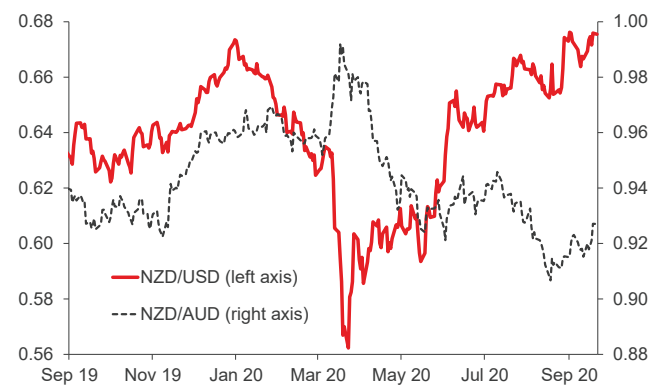
Economic forecasts	Quarterly				Annual			
	2020	2021			2018	2019	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	-12.2	8.5	3.9	1.1	3.2	2.3	-5.1	6.0
Employment	-0.4	-3.8	-0.8	0.7	1.9	1.0	-4.0	2.8
Unemployment Rate % s.a.	4.0	6.5	7.0	6.9	4.3	4.1	7.0	6.4
CPI	-0.5	0.6	-0.1	0.1	1.9	1.9	0.8	0.5
Current Account Balance % of GDP	-1.9	-1.2	-1.0	-1.2	-4.3	-3.4	-1.0	-3.2

Financial forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
Cash	0.25	0.25	-0.50	-0.50	-0.50	-0.50
90 Day bill	0.30	-0.10	-0.20	-0.20	-0.20	-0.10
2 Year Swap	0.05	0.00	-0.10	-0.10	-0.10	0.10
5 Year Swap	0.20	0.20	0.20	0.25	0.35	0.55
10 Year Bond	0.60	0.65	0.70	0.75	0.80	1.00
NZD/USD	0.67	0.66	0.66	0.68	0.70	0.70
NZD/AUD	0.89	0.87	0.87	0.87	0.88	0.88
NZD/JPY	70.4	69.3	70.0	72.1	74.2	74.9
NZD/EUR	0.55	0.54	0.54	0.55	0.56	0.56
NZD/GBP	0.50	0.49	0.49	0.50	0.50	0.50
TWI	71.5	69.9	69.5	70.7	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 21 September 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.28%	0.28%	0.27%
60 Days	0.29%	0.29%	0.27%
90 Days	0.30%	0.30%	0.27%
2 Year Swap	0.05%	0.06%	0.09%
5 Year Swap	0.13%	0.14%	0.14%

NZ foreign currency mid-rates as at 21 September 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6756	0.6719	0.6533
NZD/EUR	0.5703	0.5672	0.5540
NZD/GBP	0.5225	0.5074	0.4995
NZD/JPY	70.60	71.41	69.12
NZD/AUD	0.9271	0.9219	0.9124
TWI	72.70	72.48	71.03

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 21					
UK	Sep Rightmove house prices	-0.2%	-	-	Moderate correction following post-lockdown mini-boom.
US	Aug Chicago Fed activity index	1.2%	1.2%	-	Employment and production indicators remain weak.
Tue 22					
Aus	RBA Deputy Governor Debelle	-	-	-	Speech, "Australian Economy and Monetary Policy".
	Weekly Payrolls to 5 Sept.	-0.4%	-	-	Momentum was improving through August.
Eur	Sep consumer confidence	-14.7	-15.0	-	Resurgence of Covid across region to impact morale.
US	Aug existing home sales	24.7%	2.4%	-	Lower mortgage rates supporting housing demand.
	Sep Richmond Fed index	18	12	-	Improving conditions aiding manufacturing sentiment.
Wed 23					
NZ	RBNZ policy decision	0.25%	0.25%	0.25%	No change in cash rate or LSAP expected.
Aus	Aug preliminary retail sales	3.2%	-	-0.5%	A touch softer after impressive rebound from Covid shock.
Eur	Sep Markit manufacturing PMI	51.7	51.5	-	PMI data will moderate across the Euro zone...
	Sep Markit services PMI	50.5	51.0	-	...as sentiment is challenged by new Covid cases.
UK	Sep Markit manufacturing PMI	55.2	54.3	-	Companies have restarted operations following lockdown...
	Sep Markit services PMI	58.8	57.0	-	...with inflows of new work across retail and housing.
US	Jul FHFA house prices	0.9%	0.4%	-	Transactions picking up.
	Sep Markit manufacturing PMI	53.1	52.5	-	Business confidence was buoyed by business reopening...
	Sep Markit service PMI	55.0	54.5	-	...in August, with strong expansion in new orders.
	Fedspeak	-	-	-	FOMC Mester to speak.
Thu 24					
NZ	Aug trade balance \$m	282	-	-350	Import values remain very low on weak demand.
US	Initial jobless claims	860k	-	-	Gradual improvement, though claims remain elevated.
	Aug new home sales	901	875	-	Demand fuelled by low interest rates and desire for space.
	Sep Kansas City Fed index	14	-	-	Activity exceeded expectations, supported by new orders.
	Fedspeak	-	-	-	FOMC Evans and Rosengren.
Fri 25					
NZ	Q3 employment confidence	87.3	-	-	Fell sharply in June after the Covid-19 lockdown.
Chn	Q2 current account balance \$b	119.6	-	-	Surplus driven by reopening of world economy.
Eur	Aug M3 money supply %/yr	10.2%	10.0%	-	Monetary stimulus sustaining strong growth.
US	Aug durable goods orders	11.4%	1.0%	-	Lift in demand for vehicles drove improvement in July.
	FOMC Chair Powell	-	-	-	With Treasury Sec. Mnuchin at Senate Banking Committee.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.4	2.8	1.8	-3.3	2.3
CPI inflation % annual	1.5	1.9	1.8	1.8	0.4	2.2
Unemployment %	5.7	5.5	5.0	5.2	7.7	7.6
Current Account % GDP	-3.1	-2.6	-2.1	0.6	2.6	0.1
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-4.7	3.4
Consumer Prices %yr	1.4	2.1	2.4	1.9	1.1	1.8
Unemployment Rate %	4.9	4.4	3.9	3.7	8.8	7.9
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	-5.2	1.5
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	-7.6	5.4
United Kingdom						
Real GDP %yr	1.9	1.9	1.3	1.4	-11.0	7.0
China						
Real GDP %yr	6.8	6.9	6.8	6.1	2.5	10.5
East Asia ex China						
Real GDP %yr	4.1	4.6	4.4	3.7	-2.3	5.2
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.8	5.8

Forecasts finalised 9 September 2020

Interest rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
Australia							
Cash	0.25	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.09	0.10	0.10	0.10	0.10	0.15	0.25
10 Year Bond	0.86	0.90	0.95	1.05	1.10	1.20	1.30
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.68	0.60	0.65	0.75	0.75	0.85	0.95

Exchange rate forecasts	Latest	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Jun-22
AUD/USD	0.7317	0.75	0.76	0.76	0.78	0.80	0.80
USD/JPY	104.77	105	105	106	106	106	107
EUR/USD	1.1852	1.21	1.22	1.23	1.24	1.25	1.25
GBP/USD	1.2960	1.33	1.34	1.35	1.37	1.39	1.40
USD/CNY	6.7538	6.75	6.75	6.70	6.60	6.50	6.40
AUD/NZD	1.0806	1.12	1.15	1.15	1.15	1.14	1.14

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