



Westland Tai Poutini National Park, New Zealand

Weekly Economic Commentary.

You ain't seen nothing yet.

The New Zealand economy has entered a Covid-induced recession, but the official data so far captures only a fraction of the total impact. We expect more pain to come in terms of the hit to activity, employment and house prices. No part of the country will be spared from these impacts, though there are some differences across industries and regions that are worth highlighting.

New Zealand's GDP shrank by 1.6% in the March quarter, the biggest one-quarter drop in almost 30 years. The economy started the year in reasonable shape, but the Covid-19 pandemic rapidly escalated and in the last week of March the country entered a strict lockdown period. We've previously estimated that under lockdown the economy was running about a third below its potential, so even a single week of lockdown could have knocked about 2.5% off quarterly GDP.

The drop in March quarter GDP was large, but the June quarter result (due to be released on 17 September) will be off the scale. The country remained in a strict lockdown through to the end of April, with a steady easing of domestic restrictions since then. While daily and weekly data show that activity has bounced back strongly as the restrictions have been lifted, the length and severity of the lockdown make it almost inevitable that the drop in June quarter GDP will be in the double digits.

At this early stage there's a wide range of forecasts around the market. Our current forecast of a 13.5% decline is one of the milder estimates. In contrast, last month both the RBNZ and the Treasury estimated the Q2 decline at more than 20%, although stronger recent data makes it likely that those forecasts have been upgraded since then.

Looking further ahead, we expect an equally off-the-scale 14% rise in GDP for the September quarter (assuming that the country remains at Alert Level 1). But that would still leave GDP well below its pre-Covid trend. International travel will be out of action for some time, and the economic 'scarring' from the outbreak, including increases in debt, business closures and a rise in unemployment, will be an ongoing drag on activity. We expect the unemployment rate to peak at 8% this year, and a return to pre-Covid levels is likely to be many years away, even with the jobs-heavy orientation of the Government's \$62bn fiscal package.



Over the past few years there have been stark differences in the economic fortunes of New Zealand's regions. But as we highlight in our latest Regional Roundup, Covid-19 will be a great leveller. No region will be immune to the coming recession, and the economic outlook now looks more similar right across the country. We expect all regions to experience a deep recession and rising unemployment this year, followed by a recovery from late 2021 or early 2022.

The severity of the post-lockdown recession in each region, and the pace of recovery, will depend on the industry makeup of that region. Worst affected will obviously be the places that rely most heavily on overseas tourism – particularly the Queenstown-Lakes district, but the South Island in general will be hit much harder than the North.

Regions that are heavy on agriculture, forestry, and export manufacturing are also going to feel the effect of the global recession. Our expectation is that viticulture and forestry in particular will struggle. In contrast, the ongoing global demand for protein means that dairy, sheep and beef will be relatively resilient. Indeed, there has already been some uptick in world prices in recent weeks. We have upgraded our farmgate milk price forecast for this season to \$6.50/kg, slightly above the long-run average.

As we noted in a recent report, the construction industry faces another significant downturn in 2021. There is plenty of work in the pipeline right now, including projects that were halted during the lockdown period. But forward orders are drying up and some planned projects are likely to be

cancelled. Construction is a feature of all regional economies, but the upstream manufacturing, distribution and services that are associated with construction are more heavily concentrated in Auckland, Waikato and Canterbury.

Meanwhile, house prices are expected to fall in all regions. In fact this is already under way, with the REINZ house price index falling by 1.2% over April and May. The standout weak region so far is not surprisingly the Queenstown-Lakes district, where prices are already down by more than 6%. Based on past recessions, we expect nationwide house prices to fall by 7% by the end of this year.

The best prospects for recovery lie in urban industries like services, distribution, and digital technology. The most obvious way that Covid-19 will change the economy is greater digitisation. ICT, software development, and online service providers have had a real leg up, and we think that bodes relatively well for Wellington and Auckland. The other resilient industry will be government, which is a third of the economy and is stepping up to support the ailing private sector. While the Government provides services throughout the country, it is heavily represented in Wellington.

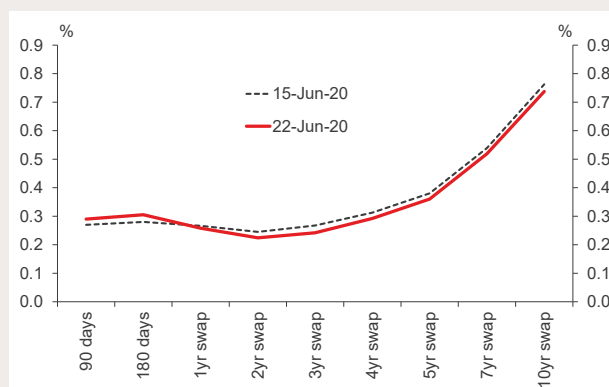
Putting all of this together suggests a weaker outlook for the south of the country and in regions with a lot of forestry, while Wellington and Auckland have the strongest prospects, followed by Bay of Plenty and Waikato. But this is only a relative picture – every part of the country is in for a rough ride this year.

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



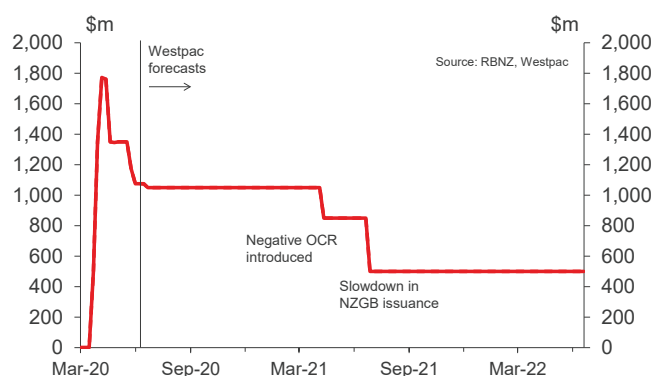
The week ahead.

NZ RBNZ Official Cash Rate review

June 24, Last: 0.25%, WBC f/c: 0.25%, Mkt f/c: 0.25%

- We expect the RBNZ to keep its monetary policy stance unchanged. The economy is proving more resilient than expected, but this is offset by a higher exchange rate.
- We expect that the weekly pace of bond buying under the LSAP will stay slightly above \$1bn for the foreseeable future.
- The RBNZ will have to lift the \$60bn cap on the LSAP at some point, just to allow headroom for that pace of bond buying to continue. There is a chance that the cap will rise to \$70bn next week. But more likely, the RBNZ will leave the cap unchanged this time, and lift it to \$80bn in Aug in a single hit.
- The RBNZ is likely to reiterate that it has other monetary tools available, but will not signal that these are necessary at this point.

RBNZ bond purchases



May US personal income and spending

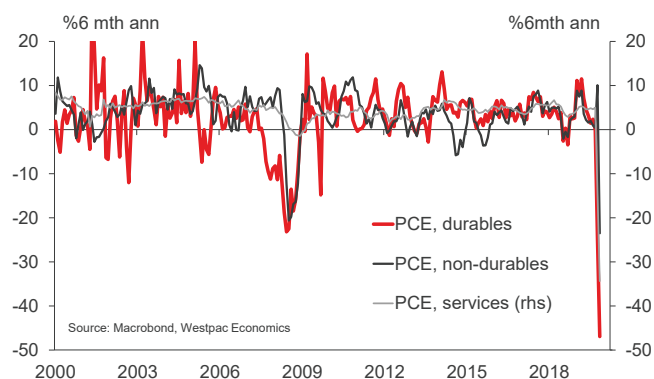
Jun 26, personal income: last: 10.5%, WBC: -4.5%

Jun 26, personal spending: last: -13.6%, WBC: 8.0%

Jun 26, PCE deflator: last -0.5%, WBC: 0.0%

- The personal income and spending data was materially affected by COVID-19 and authorities' response in Mar and Apr. Personal income initially dropped 2.2% in Mar, but then surged 10.5% in Apr as government payments more than offset the decline in income due to job loss. Spending meanwhile collapsed 13.6% in Apr, bringing the cumulative decline for the two months to over 20%.
- In May, a further decline in income seems likely given the degree of slack present in the labour market. As per the 18% rebound in retail sales already reported, spending should rally back in the month. Note though that social distancing will materially impede services, hence the gain for personal spending should be much smaller than for retail sales.

Hit to US consumption broadbased

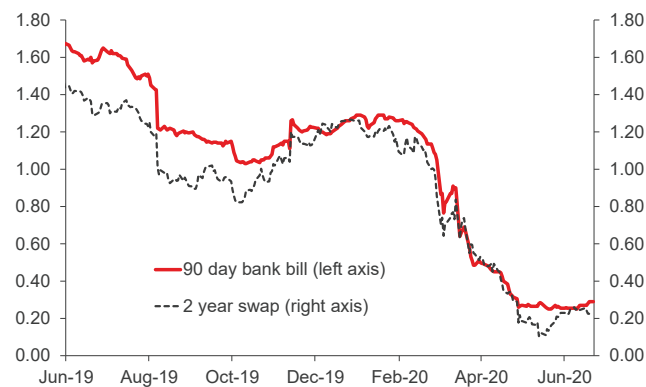


New Zealand forecasts.

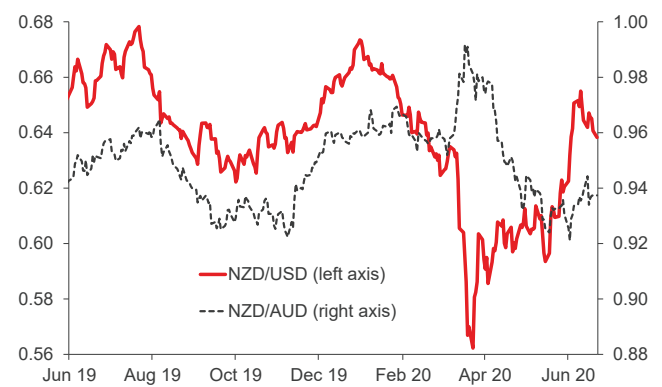
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019	2020f	2021f
% change	Dec (a)	Mar	Jun	Sep				
GDP (Production)	0.5	-1.6	-13.5	14.0	3.2	2.3	-4.6	5.1
Employment	0.1	0.7	-7.5	0.7	1.9	0.8	-4.9	3.4
Unemployment Rate % s.a.	4.0	4.2	7.0	8.0	4.3	4.0	7.5	6.6
CPI	0.5	0.8	-0.5	0.8	1.9	1.9	0.8	0.4
Current Account Balance % of GDP	-3.0	-2.7	-2.1	-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	71.5	70.6	69.1	69.7	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 22 June 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.26%
60 Days	0.28%	0.26%	0.26%
90 Days	0.29%	0.26%	0.25%
2 Year Swap	0.22%	0.25%	0.16%
5 Year Swap	0.36%	0.42%	0.23%

NZ foreign currency mid-rates as at 22 June 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6383	0.6500	0.6093
NZD/EUR	0.5705	0.5756	0.5592
NZD/GBP	0.5170	0.5123	0.5001
NZD/JPY	68.16	71.24	65.56
NZD/AUD	0.9374	0.9330	0.9329
TWI	71.33	72.13	69.16

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 22					
Aus	RBA Governor Lowe	-	-	-	Panel, Leadership Forum, "Global Economy & COVID".
Eur	Jun consumer confidence	-18.8	-14.5	-	A modest improvement on easing restrictions expected.
US	May Chicago Fed activity index	-16.7	-	-	Regional surveys point to strong confidence over outlook.
	May existing home sales	-17.8%	-4.2%	-	Turnover to remain low for a lengthy period.
Tue 23					
Aus	May merchandise trade, prelim	-	-	-	Data in "unfriendly format": customs basis, not seasonally adj.
Eur	Jun Markit manufacturing PMI	39.4	43.0	-	Euro zone as a whole is also experiencing the...
	Jun Markit services PMI	30.5	40.0	-	... beginning of a broad-based recovery.
US	Jun Markit manufacturing PMI	39.8	47.8	-	Regional surveys have surprised materially to the upside...
	Jun Markt service PMI	37.5	44.8	-	... but much of this strength has been due to expectations.
	May new home sales	0.6%	1.1%	-	Home sales unlikely to see strong rebound in near term.
	Jun Richmond Fed index	-27	-11	-	Regional surveys have been very positive this month.
Wed 24					
NZ	RBNZ policy decision	0.25%	0.25%	0.25%	RBNZ to maintain weekly pace of bond purchases.
Chn	Q1 current account balance, \$bn	-29.7	-	-	Services balance to be very supportive of g'th in 2020.
US	Apr FHFA house prices	0.10%	-	-	The index has recorded slight gains throughout COVID-19.
	Fedspeak	-	-	-	FOMC Evans and Bullard.
Thu 25					
NZ	May trade balance \$m	1,267	1,290	1,250	Imports remain subdued under COVID-19 conditions.
US	May wholesale inventories	0.30%	-	-	Likely to detract from growth through mid-20.
	Q1 GDP	-5.0%	-5.0%	-	Final estimate for the quarter. No revision expected.
	May durable goods orders	-17.7%	12.0%	-	A robust rebound anticipated as business re-opens.
	Initial jobless claims, '000	1,508	-	-	Downtrend seems to be losing momentum.
	Jun Kansas City Fed index	-19	-10	-	Regional surveys have been very positive this month.
	Fedspeak	-	-	-	FOMC Bostic.
Fri 26					
NZ	Jun ANZ consumer confidence	97.3	-	-	Has picked up as lockdown has eased, still very low.
Chn	Industrial Profits %yr	-4.3%	-	-	Stimulus necessary to support SOE and private business.
Eur	May M3 money supply %yr	8.3%	-	-	ECB actions have put money supply on strong uptrend.
US	May personal income	10.5%	-5.8%	-4.5%	Income was boosted by federal payments under CAREs Act.
	May personal spending	-13.6%	8.7%	8.0%	Savings rate at record 33% in Apr. Spending to rebound.
	May PCE deflator	-0.5%	0.0%	0.0%	Inflation to remain weak in coming months on oil...
	May core PCE deflator	-0.4%	0.0%	0.0%	... and given sharp increase in economic slack.
	Jun Uni. of Michigan sentiment, final	78.9	78.9	-	Sentiment climbed in June as employers restored jobs.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.8	1.8	-3.6	2.5
CPI inflation % annual	1.5	1.9	1.8	1.8	0.2	2.3
Unemployment %	5.7	5.5	5.0	5.2	8.3	7.1
Current Account % GDP	-3.1	-2.6	-2.0	0.6	2.5	1.0
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-5.5	2.1
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	12.7	9.8
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	5.5
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.0	4.9

Forecasts finalised 12 June 2020

Interest rate forecasts	Latest	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
90 Day BBSW	0.10	0.10	0.15	0.20	0.25	0.30	0.35
10 Year Bond	0.92	1.00	1.00	1.05	1.15	1.25	1.35
International							
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.75	0.75	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	0.6888	0.70	0.72	0.73	0.74	0.75	0.76
USD/JPY	107.39	106	106	107	107	108	108
EUR/USD	1.1262	1.13	1.14	1.15	1.16	1.17	1.18
GBP/USD	1.2572	1.26	1.27	1.27	1.28	1.29	1.30
USD/CNY	7.0862	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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