



Fiordland National Park, New Zealand

Weekly Economic Commentary.

A very deep recession, but hopefully brief.

The Covid-19 situation has escalated dramatically and New Zealand is heading for a severe recession. Financial markets stresses have already emerged and could exacerbate the downturn. Both the Government and the RBNZ have already responded aggressively, and further action is likely.

We are forecasting that the New Zealand economy will shrink by 3.1% over the first three quarters of this year as a result of disruptions stemming from the Coronavirus outbreak. In the June quarter alone, we expect GDP to fall 2.7%. In comparison, during the Global Financial Crisis it took eighteen months for the economy to shrink by 2.7%.

The downturn will be particularly stark in our export sectors. Restrictions on travel, including the closure of New Zealand's borders, are going to effectively eliminate international tourism and severely reduce export education. New Zealand's key goods exports will also be impacted, with weakness in the global economy weighing on demand for manufactured exports and forestry products. Prices of New Zealand's key food exports have already fallen and may fall further yet.

Closer to home, Coronavirus disruptions will result in consumer spending falling by about 4% within a few months,

with social distancing, job losses and falls in confidence all weighing on spending. Household spending will begin to recover as soon as gatherings and travel are allowed. However, a full recovery will take some time, as the labour market only slowly absorbs the unemployed and consumer confidence returns only gradually.

The currently-red-hot housing market will soon screech to a halt as people become more cautious about investments. How far house prices fall will depend on sentiment. At this stage we are pencilling in a 3% decline later this year, which would leave annual house price inflation for 2020 at about zero. However, once virus related disruptions pass, and both activity and confidence begin to recover, we expect that low interest rates will provide a powerful boost to asset prices, including New Zealand house prices. We have lifted our longer-term house price forecast and now expect house price inflation of 9% in 2021 and 7% in 2022.



In the business sector, weak demand will see investment plans shelved and job losses, especially in sectors like tourism and hospitality. Overall, we expect the unemployment rate to rise from 4% now to 5.5% by September, equating to 45,000 additional unemployed people. The firms in affected industries that survive this downturn will only do so by borrowing to get through. Once the recovery begins, they will be focused on debt repayment and balance sheet repair. That is why unemployment and investment spending will recover more slowly than other parts of the economy.

The crucial factor affecting how long the recession lasts is the health of the financial system. With investors globally flocking to the safety of cash, financial markets are showing signs of stress. Asset prices have fallen, and interest rates have been dragged higher, including those on New Zealand Government bonds. That's happening at the same time as the Treasury needs to issue more bonds to fund the Government's massive spending plans. Left unchecked, these conditions could result in the interest rates ordinary households and businesses face also pushing higher.

The RBNZ has responded aggressively. Last week, they cut the Official Cash Rate by 75bps to just 0.25% at an unscheduled inter-meeting decision. The RBNZ has said that the OCR will remain around this level for at least 12 months. We expect that it will remain there even longer.

The RBNZ went even further addition on Monday this week, announcing a **Large Scale Asset Purchase Programme** – otherwise known as quantitative easing (QE) or money printing. The RBNZ will purchase \$30bn of New Zealand Government bonds over the next 12 months. That would see the RBNZ owning about a third of the Government bonds on issue in twelve months' time, which is similar in size to overseas QE programmes. The RBNZ's QE announcement followed a sharp increase in the interest rate on New Zealand Government bonds. Mum and Dad investors around the world are dumping assets and stampeding into cash, creating massive price declines for everything including Government bonds. This caused the interest rate on Government bonds to rise, which left unchecked would have caused interest rates in the wider economy to rise – exactly the opposite of what the RBNZ needs in order to achieve its inflation and employment targets. Buying the Government bonds is necessary to reverse this situation.

The RBNZ has also announced a range of measures to support stressed financial markets:

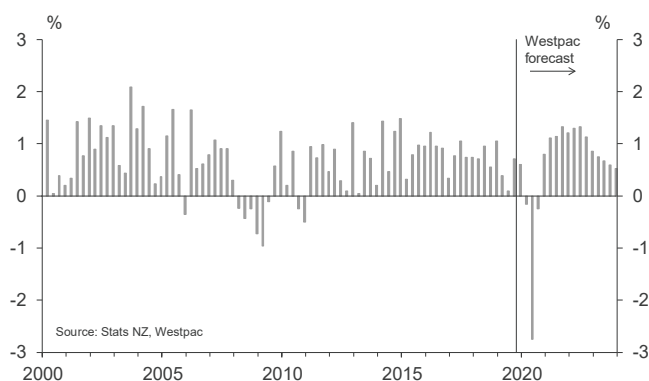
- A **Term Auction Facility** has been introduced. The RBNZ will lend to banks for up to 12 months, taking Government bonds, residential mortgage-backed securities, and other bonds as collateral. This will ensure banks are well-funded for the foreseeable future and will prevent an increase in the cost of bank funding. In turn, that will help ensure that short-term interest rates for businesses and households remain low.

- **FX swap market funding** has also been introduced to limit cost of funding increases for local banks.
- A **\$30bn US dollar swap line** has been established that will enable the RBNZ to borrow US dollars if needed.

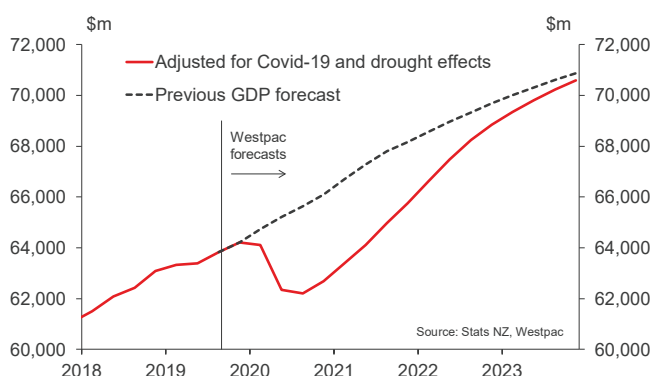
On the fiscal front, the Government has announced a massive fiscal stimulus package. That includes a massive wage subsidy which will help keep some small businesses afloat and will limit the inevitable rise in unemployment. The scheme is initially limited to 12 weeks, but we think the Government will have to extend.

This support for the economy is necessary, but could prove incredibly expensive. The Government debt to GDP ratio is currently 18.5%. Combined with existing spending plans, the support measures that have been introduced are likely to result in government debt rising to at least 30% of GDP by the end of this year or early next. Future Government stimulus plans should be demonstrably temporary, in order to reassure markets that the Government has a plan to repay the debt once Covid-19 has passed.

Quarterly GDP growth



Covid-19 and drought impact on the New Zealand economy – level of GDP

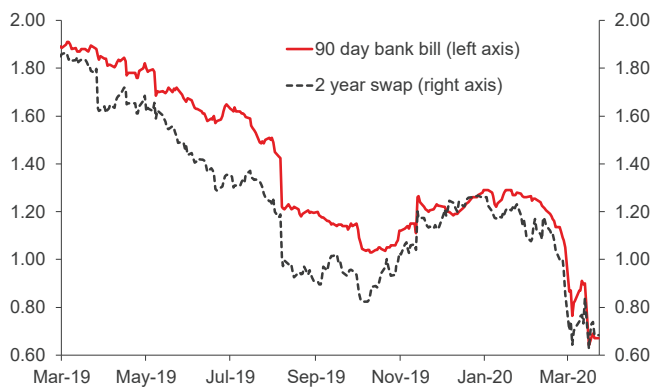


New Zealand forecasts.

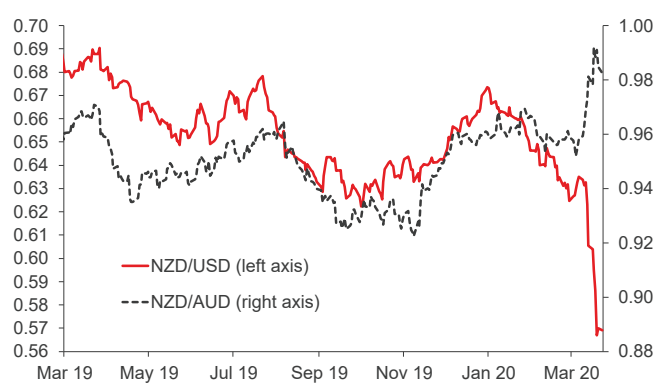
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019	2020f	2021f
% change	Dec (a)	Mar	Jun	Sep				
GDP (Production)	0.5	-0.2	-2.7	-0.2	3.2	2.3	-1.4	2.8
Employment	0.0	0.0	-0.7	-0.4	1.9	1.0	-0.7	2.8
Unemployment Rate % s.a.	4.0	4.3	4.9	5.4	4.3	4.0	5.3	4.7
CPI	0.5	0.5	0.1	0.9	1.9	1.9	1.9	1.4
Current Account Balance % of GDP	-3.0	-3.0	-3.5	-3.7	-3.8	-3.0	-4.1	-3.1

Financial forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.40	0.40	0.40	0.40	0.40	0.40
2 Year Swap	0.60	0.60	0.60	0.65	0.70	0.80
5 Year Swap	0.70	0.75	0.80	0.90	1.00	1.10
10 Year Bond	0.90	0.85	0.90	0.95	1.00	1.15
NZD/USD	0.61	0.64	0.65	0.65	0.65	0.66
NZD/AUD	0.96	0.97	0.97	0.96	0.96	0.95
NZD/JPY	64.4	67.2	68.3	68.9	69.6	70.7
NZD/EUR	0.58	0.62	0.62	0.61	0.61	0.61
NZD/GBP	0.53	0.54	0.54	0.53	0.53	0.53
TWI	69.1	71.5	72.0	71.4	71.2	71.3

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 23 March 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	1.00%	1.00%
30 Days	0.43%	1.00%	1.10%
60 Days	0.55%	0.91%	1.12%
90 Days	0.67%	0.83%	1.14%
2 Year Swap	0.68%	0.71%	1.04%
5 Year Swap	0.92%	0.77%	1.11%

NZ foreign currency mid-rates as at 23 March 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5691	0.6334	0.6349
NZD/EUR	0.5341	0.5582	0.5852
NZD/GBP	0.4894	0.4853	0.4893
NZD/JPY	63.13	66.09	70.86
NZD/AUD	0.9826	0.9579	0.9613
TWI	66.91	70.35	71.19

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 23					
Eur	Mar consumer confidence	-6.6	-14.0	-	Severe disruptions to weigh on confidence.
US	Feb Chicago Fed activity index	-0.25	-	-	US industry under significant pressure.
Tue 24					
Eur	Mar Markit manufacturing PMI	49.2	41.0	-	Sharp pullbacks expected across mfg and services...
	Mar Markit services PMI	52.6	43.0	-	... as Europe continues to grapple with the contagion.
UK	Mar Markit manufacturing PMI	51.7	49.0	-	... as COVID-19 spreads...
	Mar Markit services PMI	53.2	48.0	-	... and job losses mount.
US	Mar Markit manufacturing PMI	50.7	45.0	-	The US is expected to enter recession...
	Mar Markit services PMI	49.4	44.0	-	... through mid year. Downside risks clear.
	Feb new home sales	764k	750k	-	Demand to be hit hard by COVID-19.
	Mar Richmond Fed index	-2	-4	-	US industry under significant pressure.
Wed 25					
NZ	Feb trade balance \$m	-340	550	-	Largely predates the recent disruptions to global trade.
UK	Feb CPI	-0.3%	-	-	Inflation to be weak indefinitely.
US	Feb durable goods orders	-0.2%	-0.8%	-	Investment to deteriorate ahead.
	Jan FHFA house prices	0.6%	-	-	Will weaken with demand.
Thu 26					
Eur	Feb M3 money supply %yr	5.2%	5.1%	-	Credit data also due.
UK	Feb retail sales	0.9%	0.1%	-	Panic buying followed by jolt lower.
US	Feb wholesale inventories	-0.4%	-	-	To be wound down.
	Q4 GDP %qtr annualised	2.1%	2.1%	-	Third release of GDP is expected to be unchanged.
	Initial jobless claims	281k	-	-	An important barometer for the impact of COVID-19.
	Mar Kansas City Fed index	5	-	-	US industry under significant pressure.
Fri 27					
NZ	Mar ANZ consumer confidence	122.1	-	-	Likely to drop in response to COVID-19 concerns.
Chn	Feb industrial profits %yr	-6.3%	-	-	As for demand, will be weak.
	Q4 current account balance \$bn	40.1	-	-	Full detail on trade and financial flows.
US	Feb personal income	0.6%	0.4%	-	Income will come under pressure slowly...
	Feb personal spending	0.2%	0.3%	-	... as jobs are lost. Spending will be hit hard in March.
	Feb PCE deflator	0.1%	0.1%	-	Inflation to remain below target.
	Mar Uni. of Michigan sentiment	95.9	94.0	-	Final estimate for month.
Sat 28					
UK	Mar Nationwide house prices	0.3%	-	-	To deteriorate from here.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	1.5	2.7
CPI inflation % annual	1.5	1.9	1.8	1.8	1.5	2.4
Unemployment %	5.7	5.5	5.0	5.2	7.0	6.3
Current Account % GDP	-3.1	-2.6	-2.1	0.5	-0.5	-1.8
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	1.3	1.6
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	3.6
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	0.7	0.1	0.4
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	0.2	1.0
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.3	0.5	1.0
China						
Real GDP %yr	6.7	6.8	6.6	6.1	5.2	6.3
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.1	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	2.6	3.2

Forecasts finalised 20 March 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	0.65	0.60	0.55	0.50	0.50	0.50	0.50	0.50
10 Year Bond	1.31	0.80	0.75	0.75	0.80	0.85	0.90	0.95
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.14	0.75	0.70	0.75	0.80	0.85	0.90	1.00
ECB Deposit Rate	-0.50	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70

Exchange rate forecasts	Latest	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
AUD/USD	0.5684	0.64	0.66	0.67	0.68	0.68	0.69	0.70
USD/JPY	110.95	105	105	105	106	107	108	110
EUR/USD	1.0667	1.05	1.04	1.05	1.06	1.07	1.08	1.10
GBP/USD	1.1446	1.16	1.18	1.20	1.22	1.23	1.24	1.25
USD/CNY	7.1082	6.90	6.85	6.80	6.75	6.75	6.70	6.60
AUD/NZD	1.0115	1.04	1.03	1.03	1.05	1.05	1.05	1.06

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