Fiordland National Park, New Zealand

Weekly Economic Commentary.

The dry heaves.

Coronavirus has continued to dominate headlines. The key uncertainty for the New Zealand economy is how long the related disruptions to travel and trade persist. Our working assumption has been a two month ban on visitor arrivals from China, and one month of severely disrupted goods exports. That seems reasonable for now, given the way that the number of reported new cases of the illness has been declining. However, we did see a spike in the number of cases reported outside of China over the weekend, and it will be worth keeping an eye on how on conditions in our other trading partner economies (like South Korea) are evolving.

As discussed in our recently released *Economic Overview*,[1] disruptions related to the Coronavirus outbreak are expected to shave 0.6 percentage points off GDP growth in the March quarter. That's likely to give way to a period of firmer growth later in the year as those disruptions abate. However, if quarantine measures remain in place for an extended period, we could see further weakness in economic conditions through mid-2020. That would increase the risk of job losses in affected sectors.

Adding to the headwinds for the economy are the drought conditions affecting parts of the country. This is likely to have a significant impact in dairy intensive regions like the Waikato, as well as areas like Northland that have large sheep and beef sectors:

- Dairy prices have dropped a bit in recent weeks, with prices down around 8% over the past month. However, dry conditions will result in reduced milk collections over the tail end of the season. That will help to provide a floor under prices over the coming months, and we expect prices will remain around firm over the remainder of this season.

1 Available here.

- In contrast, dry conditions signal a bigger hit for sheep and beef farmers, as they will be trying to offload stock at a time that meat processors are booked up, and exports to China are constrained. The prices meat processing companies pay to farmers have already taken a step down recently. We expect that they will fall further in the next few months.
- Drought related disruptions to the agricultural sector will also have flow-on effects to sectors like transport, wholesaling, and business services. In essence, that will spread the economic impact of dry conditions to other regions.

We've already made some allowance for drought in our forecasts, by shaving 0.1 percentage points off GDP growth in the March quarter. As with Coronavirus, the key uncertainty is how long dry conditions persist. The drought in 2013 hit rural communities hard and knocked 0.6 percentage points off GDP. This year, although many areas are experiencing dryer than usual conditions, drought has only officially been declared in some parts of the country. It's also notable that these conditions are occurring later in the season than in 2013, so the eventual impact will probably be smaller than that year. Nevertheless, the longer conditions remain dry, the larger the effect on the economy will be. Between Coronavirus and drought conditions, there is certainly the risk that March quarter GDP could be negative.

Before Coronavirus broke out, we were seeing convincing signs that consumer demand in New Zealand was picking up. In part that's due to the large increases in government spending that are now being rolled out. It's also been supported by the low level of mortgage interest rates and related lift in house prices. We expect those factors will continue to buoy demand over the years ahead, and are forecasting GDP growth of 2.3% in 2020, rising to 3.4% over 2021.

Taking a closer look at the housing market, recent months have seen prices rocketing higher, with nationwide house price inflation rising to 7% in the year to January. Gains have been widespread, with the previously moribund Auckland market surging back to life and many other regions seeing continued strong gains. The one notable soft spot has been Canterbury, but even here price growth has been picking up.

The market's behaviour over the past year illustrates how financial factors can trump physical supply and demand in the housing market. Over the past year New Zealand construction activity has ramped up substantially while net migration has steadily declined. However, house prices have still shot higher. We think that has been due to a big reduction in interest rates combined with the cancellation of earlier plans to introduce a capital gains tax.

Regular readers will know that Westpac predicted this upturn long before other forecasters. And if anything, the market has proved slightly stronger than even our bullish expectations. We now expect the current upturn will continue over the coming months, with annual house price inflation set to rise to 10% in the middle of this year.

But while the housing market is on a tear for now, we don't expect this will last long. New Zealanders are keen to borrow, but less focused on saving. That's crimped the amount of funds coming back into the banking system, and has already resulted in upwards pressure on mortgage interest rates independent of a change in the Official Cash Rate. We expect a further rise in mortgage rates over 2020. At the same time population growth is continuing to gradually trend downwards. Together, those conditions are likely to see house price inflation slowing again through the back half of this year.

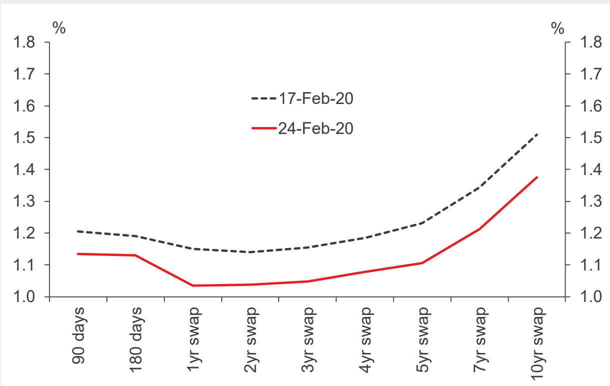
Fixed vs Floating for mortgages.

Now is a good time to take a fixed mortgage. Fixed mortgage rates have tumbled over the past six months, but they are now starting to creep higher again as the chances of further OCR cuts fade.

Among the fixed rates on offer, we think the best value is in the one- and two-year rates. Longer-term rates are high relative to where we think future short-term rates will go. That said, fixing for longer terms does offer security against future interest rate increases, and therefore may be preferred by those with low risk tolerance.

Floating mortgage rates are normally expensive for borrowers, but they may be the preferred option for those who require flexibility in their repayments.

NZ interest rates



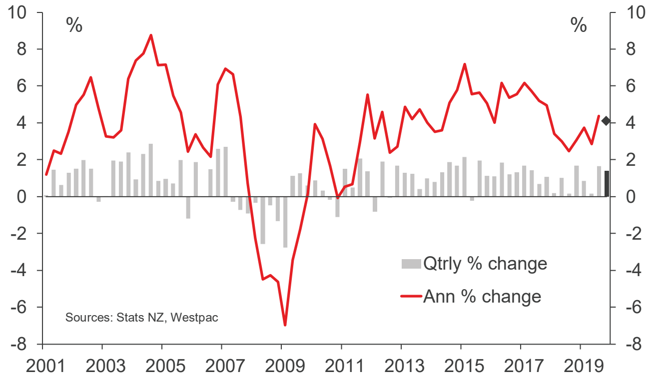
The week ahead.

NZ Q4 retail spending

Feb 24, Last: +1.6%, WBC f/c: +1.4%

- Retail sales rose by 1.6% in the September quarter with widespread gains. That strong increase in spending was supported by the boost to the housing market from low interest rates, increases in government spending, and continued growth in household incomes.
- Monthly spending gauges indicate that households' spending appetites remained strong in the December quarter. We're expecting a 1.4% increase in the volume of goods sold, underpinned by a solid rise in core (ex-fuel and motor vehicle) categories. As well as the boost to demand from the aforementioned factors, sales were boosted by the growing prevalence of global sales events like Black Friday in the New Zealand marketplace.

NZ real retail sales

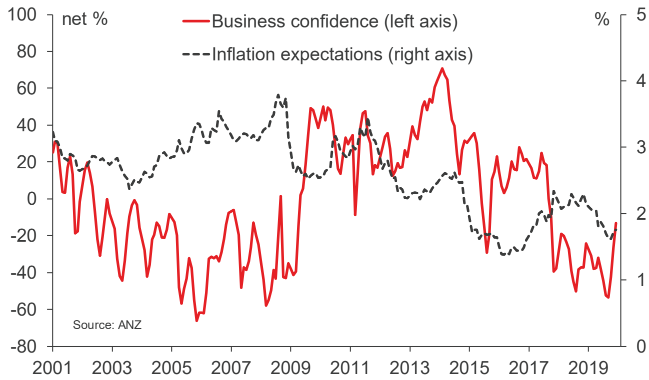


NZ Feb ANZ business confidence

Feb 27, Last: -13.2

- Late 2019 saw some signs that business sector conditions were starting to improve, with a lift in trading activity and general business confidence. However, that improvement still left us with a relatively soft picture of business sector conditions. And as the new year has gotten under way, we've seen renewed uncertainty about economic conditions, with Coronavirus related disruptions in some sectors, as well as continued concerns about regulation, rising costs and strong competitive pressures.
- Against that backdrop, we're likely to see business confidence dropping back again in February, along with weakness in investment intentions. However, it's likely to be a mixed picture across sectors. While there are clearly headwinds in sectors like manufacturing, areas like retail are likely to be benefiting from the resurgence in household spending appetites.

NZ business confidence and inflation expectations

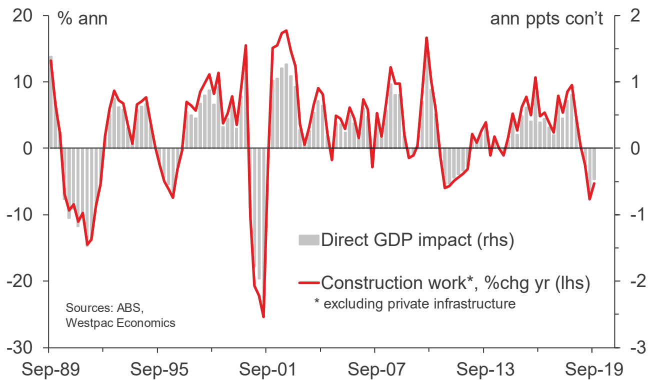


Aus Q4 construction work

Feb 26, Last: -0.4%, WBC f/c: -0.6%
Mkt f/c: -1.0%, Range: -3.0% to +0.6%

- Construction work weakened from mid–2018, with falls in each of the past five quarters, down 10% in total (-$5.7bn).
- However, the pace of decline appears to be moderating, with a -0.4% in Q3 and a forecast -0.6% for Q4. A potential downside for Q4 - disruptions due to bushfire smoke.
- Private new home building activity (–3.4%qtr, –10.7%yr in Q3) has further to fall (a forecast -2%) given the drop in approvals.
- Public works remains at a high level. In Q3, work rebounded by 5.4%, partially reversing an 8.6% moderation over the past year (reflecting a gap in the investment pipeline). We anticipate a small rise in Q4, +0.5%.
- Private infrastructure work (–4.6%qtr, –11.40%yr in Q3) may be at a turning point. In mining, a few projects have proceeded of late and the work pipeline has expanded. We've factored in a small rise for Q4, +0.4%.

Aus Construction cycles



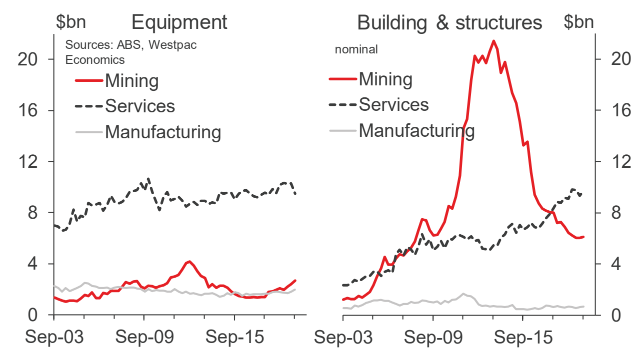
The week ahead.

Aus Q4 private business capex

Feb 27, Last: –0.2%, WBC f/c: –0.2%
Mkt f/c: +0.5%, Range: -1.5% to +1.5%

- Private business capex spending was mixed over the past year, including a Q3 outcome of –0.2%qtr, –1.3%yr.
- We expect a further broadly flat result, a forecast -0.2%.
- Building & structures capex was volatile around a flat trend over the past year, printing at +2.7qtr, -0.3%yr in Q3. Mining is at or nearing a turning point and commercial is trending higher. On the back of a solid gain, we anticipate a consolidation in Q4, forecasting a broadly flat outcome.
- As to equipment spending, the uptrend evident over 2017 and 2018 faltered in the second half of 2019. In Q3, spending was cut, down by -3.5%qtr, -2.4%yr, led by the services sectors. Weakness potentially extended into Q4, with spending forecast to edge lower, down -0.5%. Of note, business confidence has evaporated in what is a challenging environment.

Aus CAPEX: by industry by asset

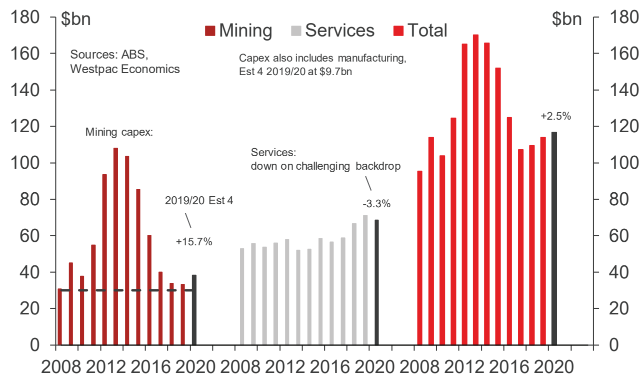


Aus 2019/20 capex plans

Feb 27, Last: Est 4 2019/20: $116.7bn, +2.5% vs Est 4 a yr ago

- This survey, conducted in January and February, includes the 5th estimate of 2019/20 capex plans, as well as the initial estimate for 2020/21.
- Est 4 printed at $116.7bn, 2.5% above Est 4 a year ago, with strength in the mining sector.
- We anticipate an Est 5 in the order of $119bn, 1% above Est 5 a year ago. Across the service sectors, business confidence has evaporated and in mining, we suspect that weak base effects flattered the Est 4 on Est 4 comparison.
- Est 1 for 2020/21 may be in the order of $94bn, some 2% above Est 1 a year earlier.
- The risk is that capex plans for 2020/21 are uneven. Strength is likely in mining, with an emerging uptrend underway. Services could be mixed - flat overall, with gains in building & structures (led by commercial) but softness in equipment (given a weak and uncertain outlook).

Aus CAPEX plans, by industry: Estimate 4

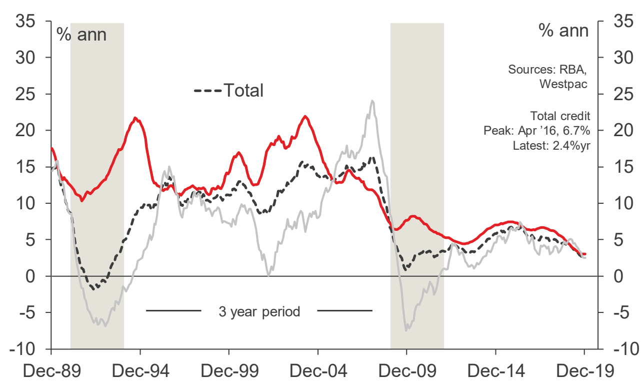


Aus Jan private credit

Feb 28, Last: +0.2%, WBC f/c: +0.2%

- Credit ended the 2019 year on a soft note, a tone that likely extended into early 2020.
- In December, credit grew by 0.23%mth, 2.4%yr. That is a moderation from 4.3% for 2018 and is the weakest annual pace since 2009 (when the low was 0.8%).
- For January, we anticipate a rise of 0.2%, ahead of a gradual improvement in coming months.
- Housing credit rose by 0.29%mth, 3.1%yr in December. The cycle has turned, with new lending rebounding in response to lower rates. Credit momentum is improving, gradually, with 3 month annualised growth at 3.4%, up from 2.7% in mid-2019.
- Business credit is soft, up 0.2%mth, 2.5%yr in December, moderating from 4.7% for 2018. Confidence has evaporated and investment is patchy. Personal credit (5.6% of total credit) is contracting, at -0.5%mth, -5.1%yr in December.

Aus Credit growth

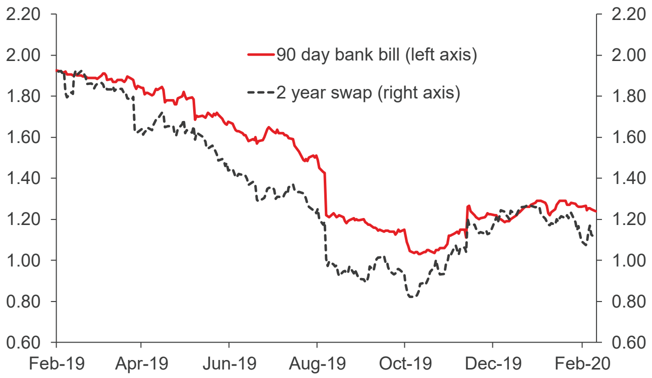


New Zealand forecasts.

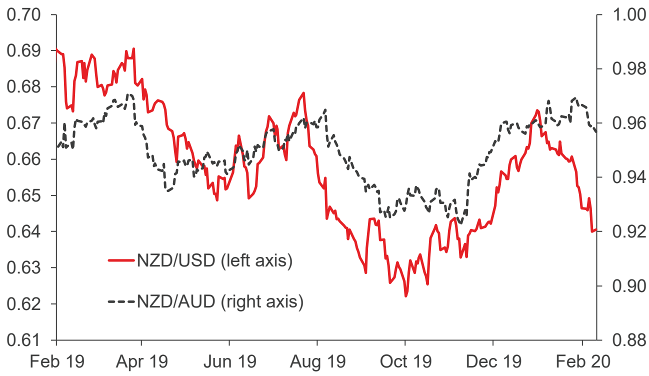
Economic forecasts	Quarterly				Annual			
	2019		2020					
% change	Sep (a)	Dec	Mar	Jun	2018	2019f	2020f	2021f
GDP (Production)	0.7	0.6	0.1	0.9	3.2	2.3	2.3	3.4
Employment	0.2	0.0	0.6	0.4	1.9	1.0	2.2	2.1
Unemployment Rate % s.a.	4.1	4.0	4.1	4.3	4.3	4.0	4.1	3.7
CPI	0.7	0.5	0.4	0.3	1.9	1.9	1.5	1.9
Current Account Balance % of GDP	-3.3	-3.0	-3.0	-3.2	-3.8	-3.0	-3.5	-3.3

Financial forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Cash	1.00	1.00	0.75	0.75	0.75	0.75
90 Day bill	1.20	1.10	0.90	0.90	0.90	0.90
2 Year Swap	1.10	1.05	1.00	1.00	1.00	1.05
5 Year Swap	1.25	1.20	1.20	1.25	1.30	1.35
10 Year Bond	1.35	1.25	1.25	1.25	1.35	1.40
NZD/USD	0.64	0.66	0.66	0.66	0.66	0.66
NZD/AUD	0.96	0.99	0.99	0.99	0.97	0.96
NZD/JPY	68.5	69.4	69.3	69.3	70.0	70.6
NZD/EUR	0.59	0.60	0.59	0.59	0.58	0.58
NZD/GBP	0.48	0.50	0.50	0.50	0.50	0.50
TWI	71.1	72.7	72.6	72.3	72.0	71.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 24 February 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.10%	1.19%	1.20%
60 Days	1.12%	1.22%	1.24%
90 Days	1.14%	1.25%	1.28%
2 Year Swap	1.04%	1.13%	1.19%
5 Year Swap	1.11%	1.19%	1.27%

NZ foreign currency mid-rates as at 24 February 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6349	0.6400	0.6551
NZD/EUR	0.5852	0.5846	0.5947
NZD/GBP	0.4893	0.4967	0.5018
NZD/JPY	70.86	70.25	71.42
NZD/AUD	0.9613	0.9583	0.9688
TWI	71.19	71.46	72.40

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 24					
NZ	Q4 real retail sales	1.6%	0.7%	1.4%	Late 2019 saw a strong lift in monthly spending gauges.
US	Jan Chicago Fed activity index	–0.35	–	–	Pointing to growth a little below trend.
	Feb Dallas Fed index	–0.2	0.0	–	NY & Phily both jumped in Feb on US/China trade deal.
	Fedspeak	–	–	–	Mester on economy.
Tue 25					
US	Dec FHFA house prices	0.2%	0.4%	–	Modest house price gains continuing...
	Dec S&P/CS home price index	0.5%	0.5%	–	... aided by labour market and financial conditions.
	Feb consumer confidence index	131.6	132.5	–	Conference board measure. Strength in present conditions.
	Feb Richmond Fed index	20	10	–	Saw strength in Jan; likely to ease back in Feb.
	Fedspeak	–	–	–	Clarida at NABE conference.
Wed 26					
Aus	Q4 construction work	–0.4%	–1.0%	–0.6%	Some further downside, led by housing.
US	Fedspeak	–	–	–	Fed's Clarida Speaks at NABE Conference in Washington
	Jan new home sales	694k	710k	–	Residential construction in upswing.
Thu 27					
NZ	Jan trade balance $m	547	–565	–800	Imports expected to rebound from a weak December.
	Feb ANZ business confidence	–13.2	–	–	Some of last year's improvement is likely to reverse.
Aus	Q4 private capital expenditure	–0.2%	0.5%	–0.2%	Led lower by a further fall in equipment spend (f/c –0.5%).
	2019/20 capex plans, AUDbn	116.7	–	119	Est 5 may be a little less positive than Est 4 (see preview box).
	2020/21 capex plans, AUDbn	–	–	94	+2% vs Est 1 a year ago. Mining strength, services mixed.
Eur	Jan M3 money supply %yr	5.0%	5.2%	–	Credit data also due.
	Feb economic confidence	102.8	101.5	–	Looks to be forming a base; well off 2018 highs.
	Feb business climate indicator	–0.23	–0.35	–	Business has doubts over global and domestic economy.
	Feb consumer confidence	–6.6	–		Households benefitting from labour market.
US	Q4 GDP	2.1%	2.2%	2.2%	Incremental upward revision expected in 2nd estimate.
	Jan durable goods orders	2.4%	–1.5%	–	Core orders continues to point to weak investment.
	Initial jobless claims	210k	–	–	Rate of firing remains very low.
	Jan pending home sales	–4.9%	2.0%	–	Supply remains major issue for established market.
	Feb Kansas City Fed index	–1	–2	–	Not expected to show gains of other regional surveys.
	Fedspeak	–	–	–	Fed's Evans Speaks in Mexico City
Fri 28					
NZ	Feb ANZ consumer confidence	122.7	–	–	Confidence will be challenged by negative headlines.
Aus	Jan private sector credit	0.2%	–	0.2%	Soft overall, although housing credit is lifting, gradually.
Eur	Feb CPI %yr	1.4%	1.2%	–	Preliminary estimate. Inflation well away from target.
UK	Feb GfK consumer sentiment	–9	–9	–	Outlook highly uncertain.
	Feb Nationwide house prices	0.5%	0.4%	–	Labour market continues to support modest gains.
US	Jan wholesale inventories	–0.2%	–	–	Likely to drag on growth in early 2020.
	Jan personal income	0.2%	0.3%	0.3%	Wage gains are solid, but non–wage income has softened.
	Jan personal spending	0.3%	0.3%	0.2%	Consumption slowing after period of outperformance.
	Jan PCE deflator	0.3%	0.1%	0.2%	Annual core PCE to remain below 2%yr in months ahead.
	Fedspeak	–	–	–	Fed's Bullard Discusses the Economy and Monetary Policy
	Feb Chicago PMI	42.9	46.3	–	Materially weaker than other regional surveys.
	Feb Uni. of Michigan sentiment	100.9	100.7	–	Present situation key sourse of strength.
Sat 29					
Chn	Feb manufacturing PMI	50.0	47.8	–	Manufacturing to be hit hard by virus in Feb.
	Feb non–manufacturing PMI	54.1	–	–	Consumption also hard hit; services to weaken as a result.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	1.8	2.6
CPI inflation % annual	1.5	1.9	1.8	1.8	1.8	2.0
Unemployment %	5.7	5.5	5.0	5.2	5.4	5.2
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.4	-2.0
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	1.6	1.5
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	3.5
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	0.8	0.4	0.4
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	1.0	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.3	0.8	1.5
China						
Real GDP %yr	6.7	6.8	6.6	6.1	5.3	6.1
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.3	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	2.8	3.2
Forecasts finalised 12 February 2020						

Interest rate forecasts	Latest	Mar–20	Jun–20	Sep–20	Dec–20	Mar–21	Jun–21	Dec–21
Australia								
Cash	0.75	0.75	0.50	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.89	0.85	0.70	0.45	0.45	0.50	0.50	0.50
10 Year Bond	0.95	1.00	0.95	0.90	0.80	0.80	0.85	1.05
International								
Fed Funds	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
US 10 Year Bond	1.50	1.60	1.50	1.45	1.40	1.45	1.50	1.70
ECB Deposit Rate	-0.50	–0.50	–0.60	–0.60	–0.60	–0.60	–0.60	–0.60

Exchange rate forecasts	Latest	Mar–20	Jun–20	Sep–20	Dec–20	Mar–21	Jun–21	Dec–21
AUD/USD	0.6604	0.67	0.66	0.67	0.67	0.68	0.69	0.72
USD/JPY	112.01	107	106	105	105	106	107	109
EUR/USD	1.0790	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.2892	1.30	1.30	1.30	1.30	1.31	1.31	1.32
USD/CNY	7.0288	6.95	6.90	6.85	6.80	6.80	6.75	6.60
AUD/NZD	1.0461	1.05	1.01	1.02	1.02	1.03	1.05	1.07

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