Weekly Economic Commentary.

Negative OCR expected.

With Covid-19 set to cause a massive downturn in economic activity, a massive monetary and fiscal response will be required. We now expect the RBNZ will reduce the OCR to -0.5% in November 2020. We also expect an expansion of the RBNZ's bond buying program, as well as further Government stimulus for the economy.

We have updated our economic and financial forecasts:

- We now expect a deeper decline in June quarter GDP of 16%, because the Alert Level 3 restrictions are tighter than we previously allowed for.
- The country may drop to Level 2 earlier than we previously thought, allowing a more vigorous rebound in GDP. We are now forecasting that GDP will rise 13% in the September quarter (previously 10%).
- However, beyond the initial bounce we now expect the recovery phase will be slower, as it will take longer to overcome the damage done by unemployment and business failures. Nevertheless, we still think the recovery will be more rapid than in past recessions.
- We are now allowing for more permanent damage to the economy as a result of Covid-19 due to factors including reduced investment, lost skills due to unemployment, domestication of supply chains and increased barriers to trade and travel, as well as higher taxation required to repay Government debt incurred during the crisis.
- We expect Government debt will rise to 50% of GDP by 2024.
- Unemployment will peak at 9.5%, and we anticipate only a slow return to below 5%.
- We expect house prices will fall 7% this year and will remain subdued throughout 2021. However, we expect house prices will rise very rapidly over 2022 and 2023 in response to ultra-low interest rates.

One key conclusion we drew from the above is that inflation will drop well below 1% unless the Reserve Bank and Government act very vigorously to stimulate the economy. The Government has ponied up with massive fiscal stimulus, and we expect roughly another $15bn of stimulus measures at May's Budget. But there is a limit to what the Government can provide before the debt projections become unacceptably high, especially with the aging population looming over our fiscal future.

Monetary policy not only needs to come to the party, it needs to spike the punch. So far, the Reserve Bank has reduced the OCR by 75 basis points to 0.25%, committed to keeping it at that level until March, and has committed to buying $33bn worth of government and local government bonds (the latter is known as Quantitative Easing or QE). However, the RBNZ's key decisions were made on March 16, before the Level 4 lock down was announced. In our assessment, the RBNZ is going to have to deliver much more monetary stimulus.

At the May MPS, we expect the Reserve Bank will almost double its QE programme to $60bn. We estimate that total Government debt will be over $130bn by June next year, so the Reserve Bank will be on track to own about 45% of the New Zealand Government Bonds on issue. In our assessment even more monetary stimulus will eventually be required. In theory the Reserve Bank could just continue with an even bigger QE programme. But based on RBNZ commentary, we think they would prefer to switch to a negative OCR at that point.

We forecast that the RBNZ will lower the OCR by 75 basis points to -0.5% in November this year. There are two impediments to the RBNZ reducing the OCR earlier.

The first is that trading banks' systems are not currently ready to deal with a negative OCR (for instance, changes to documentation and computer systems are required). Holding off on a negative OCR until November will give banks some time to prepare.

The second impediment is that lowering the OCR this year would break the RBNZ's commitment to keep the OCR at 0.25% until March 2021. The RBNZ could probably hold its head high by pointing out that the Level 4 lockdown was a truly extraordinary event, and we doubt they would come in for much criticism. However, any move to break an earlier commitment would have to be carefully explained and justified.

Forward guidance and a long lead time would help with both of the above problems. The RBNZ could signal earlier in the year that it intends to move to a negative OCR – or at least that it is open to such a move. This would have the effect of reducing wholesale term interest rates immediately, effectively amounting to a monetary stimulus. We expect that the RBNZ will signal either its intent or its willingness to move to a negative OCR at the August MPS.

We have previously written about the impact of a negative OCR.[1] The lower the OCR goes, the less marginal impact it would have on retail rates such as mortgage rates. Thus a 75 basis point OCR cut would bring mortgage rates down, but not by anything like as much as 75 basis points. We estimate that, in New Zealand, the OCR could go down to -1% before further cuts had zero impact on retail rates.

To clarify, we do not expect any of the interest rates paid or received by New Zealand households and businesses to go negative. We do, however, expect the 90-day bank bill to go slightly below zero. This is an interbank rate, but some business interest rates are expressed as a margin over the 90-day bank bill. Our forecast for the two-year swap rate is that it will reach a low-point of zero before rising again from September 2021.

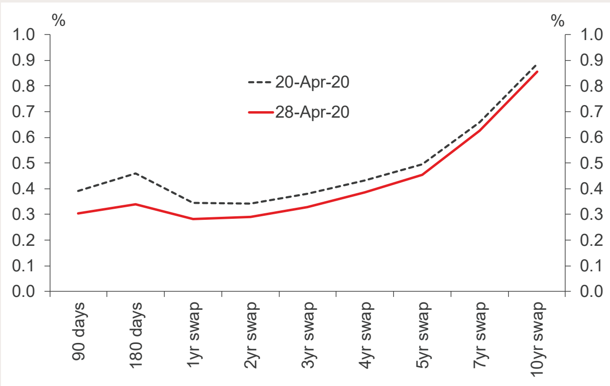
1 https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Quantitative-easing-economic-insight-WEB.pdf

Fixed vs Floating for mortgages.

The interest rate outlook is highly uncertain, so trying to guess which fixed term will result in the lowest interest repayments is difficult. It may be better to keep it simple. Borrowers looking for certainty should aim to fix their mortgage rates, while borrowers who need flexibility should float.

We expect that the RBNZ will lower the OCR to -0.5% in November 2020, although the timing of that is uncertain. If the RBNZ does intend to lower the OCR below zero, they will probably signal the move ahead of time. Fixed mortgage rates would fall shortly after the RBNZ's signal, while floating mortgage rates would fall around the time of the actual OCR change. When the OCR is extremely low or slightly negative, it has a less potent effect on mortgage rates. What all of this means is that we expect both floating and fixed mortgage rates to fall a small amount later this year. But once again, we emphasise that that forecast is uncertain.

NZ interest rates



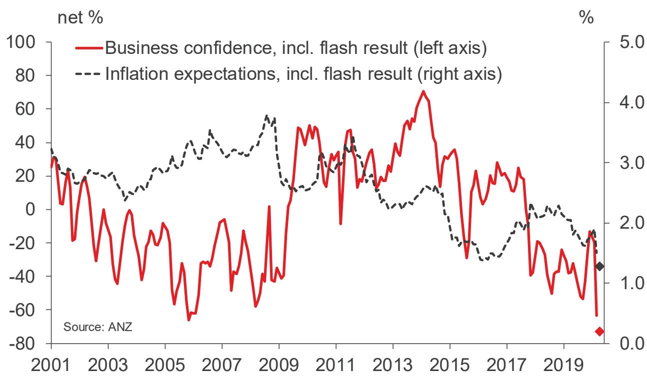
The week ahead.

NZ Apr ANZ business confidence

Apr 30, Last: –63.5, Preliminary result: –73.1

- Business confidence has fallen sharply in the face of Covid–19 disruptions to economic activity. The preliminary reading for April (based on results from the first week of the sample period) showed that overall confidence has fallen to –73.1, down from –63.5 in March. That was the lowest result since the survey began in 1988. In addition to the nervousness about the general economic backdrop, businesses expect weakness in their own trading conditions.
- Consistent with the significant downturn in confidence, plans for both hiring and investment have been curtailed. Weakness in economic conditions is also weighing on pricing decisions.
- The final results for April will cover the Alert Level 4 lockdown period and are certain to remain weak.

NZ business confidence

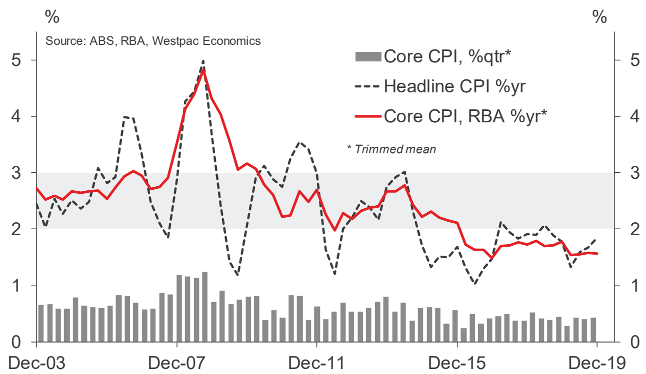


Aus Q1 CPI

Apr 29, Last: 0.7%, WBC f/c: 0.1%
Mkt f/c: 0.2%, Range: –0.3% to 0.5%

- Headline consumer inflation, as measured by the CPI, is volatile around a modest trend while underlying inflation is subdued. The COVID outbreak will see inflation slow in 2020.
- In Q4, headline CPI printed at +0.7%qtr, 1.8%yr – with price gains in the quarter centred on food (the drought), tobacco (taxes) and petrol (volatility).
- For Q1, headline CPI is a forecast 0.1%qtr, 1.9%yr – with falls in holiday travel (impacted by the bushfires and COVID disruptions) and in petrol prices (with an even sharper drop in fuel prices likely in Q2). Housing inflation (dwelling price purchases and rents) is expected to be broadly flat.
- The trimmed mean CPI printed 0.4%qtr, 1.6%yr in Q4 and is a forecast 0.3%qtr, 1.6%yr for Q1 – which would see the 6 month annualised pace slow to 1.4%. This subdued picture is consistent with: weak wages growth; patchy consumer spending; and softness in housing inflation.

Aus CPI

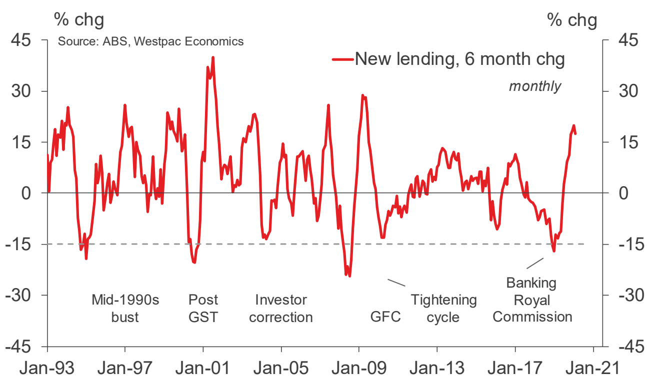


Aus Mar private credit

Apr 30, Last: 0.4%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: 0.2% to 0.6%

- Credit growth slowed to a weak pace in 2019, with annual growth of 2.4% moderating from 4.3% for 2018 – in what was a broadly based trend.
- The March quarter 2020 saw a firmer footing for credit. The housing sector rebound (pre–COVID) was a plus, so too a burst for the often volatile business segment.
- In February, credit grew by 0.4%, including a 0.9% for business. For March we expect total credit to rise by 0.3%.
- Measures to combat COVID–19 and the ensuing recession will see credit weaker over coming months. The housing sector will be hit and businesses will cut spending and borrowing in response to weaker demand and falling profits.

Aus housing finance cycles



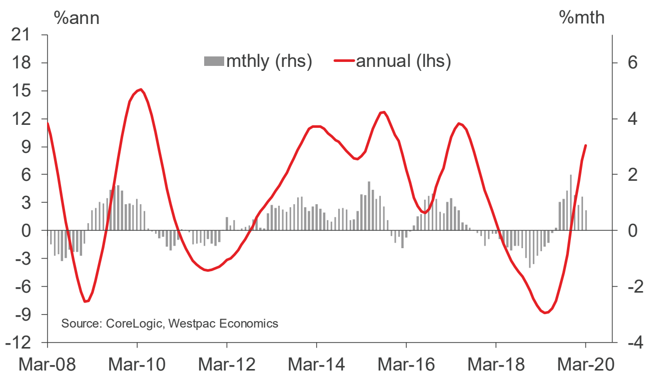
The week ahead.

Aus Apr CoreLogic home value index

May 1, Last: 0.7%, WBC f/c: 0.3%

- The Coronavirus shock is seeing a rapid cooling in housing markets although price momentum has held up so far. After a strong second half of 2019 and start to 2020, the CoreLogic home value index moderated a touch over the first quarter, posting gains of +1.2% in Feb and +0.7% in March but with annual growth still strong at 9.1%yr.
- Coronavirus effects become more dominant in April with shutdowns continuing and what looks to have been a very large round of layoffs and temporary stand downs for workers. Housing related sentiment also slumped sharply in the month – a large majority of consumers now expecting prices to record significant declines in the year ahead. That said, the fall out for actual prices has still been mild to date, the daily index still pointing to a reasonable 0.3% gain in the April month. Low transaction volumes and forbearance may both see the impact of the shock on prices come through slowly.

Australian dwelling prices

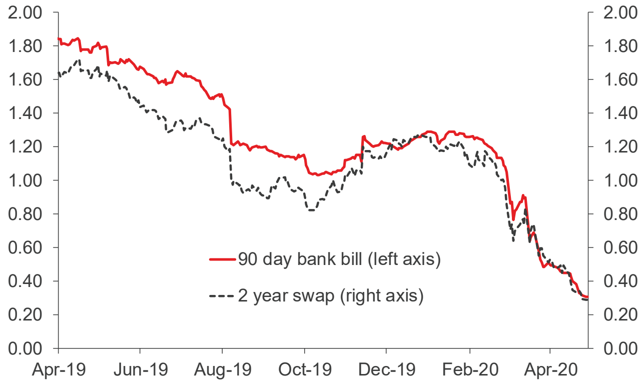


New Zealand forecasts.

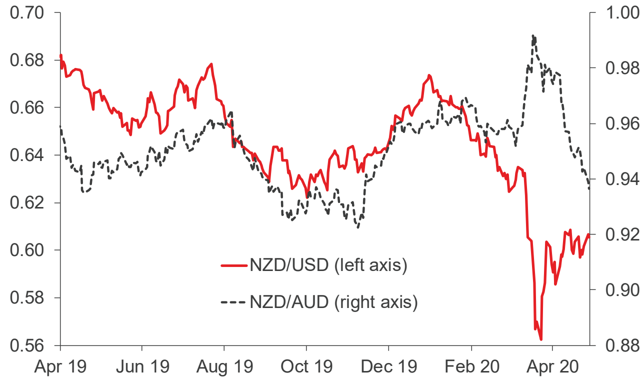
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Dec (a)	Mar	Jun	Sep	2018	2019	2020f	2021f
GDP (Production)	0.5	-1.0	-16.0	13.0	3.2	2.3	-6.3	4.7
Employment	0.0	-0.9	-8.2	3.1	1.9	1.0	-4.6	2.8
Unemployment Rate % s.a.	4.0	4.7	9.5	8.5	4.3	4.0	7.7	7.1
CPI	0.5	0.8	-0.4	0.8	1.9	1.9	1.3	1.0
Current Account Balance % of GDP	-3.0	-2.7	-2.7	-2.3	-3.8	-3.0	-2.4	-2.4

Financial forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Cash	0.25	0.25	-0.50	-0.50	-0.50	-0.50
90 Day bill	0.30	0.20	-0.20	-0.20	-0.20	-0.20
2 Year Swap	0.20	0.10	0.00	0.00	0.00	0.10
5 Year Swap	0.40	0.40	0.40	0.40	0.40	0.50
10 Year Bond	0.90	0.90	0.90	0.95	1.00	1.10
NZD/USD	0.60	0.61	0.61	0.63	0.64	0.65
NZD/AUD	0.97	0.95	0.93	0.93	0.94	0.94
NZD/JPY	64.2	64.1	65.0	67.6	68.5	70.2
NZD/EUR	0.56	0.57	0.58	0.60	0.60	0.60
NZD/GBP	0.49	0.50	0.49	0.51	0.51	0.52
TWI	68.7	68.8	68.5	70.0	70.4	71.0

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 28 April 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.28%	0.33%	0.36%
60 Days	0.30%	0.39%	0.43%
90 Days	0.31%	0.45%	0.49%
2 Year Swap	0.29%	0.46%	0.55%
5 Year Swap	0.46%	0.61%	0.66%

NZ foreign currency mid-rates as at 28 April 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6055	0.6100	0.6028
NZD/EUR	0.5590	0.5587	0.5421
NZD/GBP	0.4871	0.4873	0.4850
NZD/JPY	64.94	65.67	64.90
NZD/AUD	0.9365	0.9541	0.9802
TWI	68.81	69.31	68.90

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Tue 28					
UK	Apr Nationwide house prices	0.8%	–	–	Significant headwinds developing for house prices.
US	Mar wholesale inventories	–0.7%	–	–	Inventories set to continue their unwind.
	Feb S&P/CS home price index	0.30%	0.40%	–	Index will remain robust in Feb, but weaken thereafter.
	Apr consumer confidence index	120.0	90.0	–	Lockdowns and social distancing to suppress the consumer.
	Apr Richmond Fed index	2	–35	–	Set to collapse in Apr, in line with other regional surveys.
Wed 29					
NZ	Mar trade balance $m	595	700	670	Exports held up through China lockdown.
Aus	Q1 CPI	0.7%	0.2%	0.1%	Q4 was up on drought (food), petrol (volatility) & tobacco (tax).
	Q1 CPI %yr	1.8%	1.9%	1.9%	Q1 falls in petrol & holidays, while housing broadly flat.
	Q1 trimmed mean CPI	0.4%	0.3%	0.3%	Core inflation subdued – weak wages & soft housing.
	Q1 trimmed mean CPI %yr	1.6%	1.6%	1.6%	6 month annualised pace slows to a f/c 1.4%.
Eur	Mar M3 money supply %yr	5.5%	–	–	Has turned up as easing comes on line.
	Apr economic confidence	94.5	–	–	PMI's have highlighted the dark shadow over conditions.
US	Q1 GDP annualised	2.1%	–3.7%	–2.5%	Advance read will show a contraction in US GDP.
	Mar pending home sales	2.4%	–10.0%	–	Set to seize up amidst lockdown restrictions.
	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	FOMC have provided a lot of support; need time to assess.
	Fed Chair Powell	–	–	–	To hold post–FOMC meeting press conference.
Thu 30					
NZ	Apr ANZ business confidence (final)	–73.1	–	–	Flash result for April revealed a fall to record lows.
Aus	Mar private sector credit	0.4%	0.3%	0.3%	On a firmer footing in Q1, ahead of COVID led slowdown.
	Q1 import price index	0.7%	1.0%	1.0%	Prices generally higher on lower AUD. Fuel prices down.
	Q1 export price index	–5.2%	3.0%	3.0%	Prices up on lower AUD. Commodity prices flat in USD.
Chn	Apr manufacturing PMI	51.0	52.0	–	After recovering from a collapse in February...
	Apr non–manufacturing PMI	52.0	52.3	–	... PMIs should remain in marginally positive territory.
Eur	Mar unemployment rate	7.3%	–	–	Labour market to weaken in coming months...
	Q1 GDP	0.1%	–4.2%	–	... as activity contracts sharply...
	Apr CPI %yr	0.7%	–	–	... applying downward pressure to price inflation.
	ECB policy decision, deposit rate	–0.5%	–0.5%	–0.5%	ECB will call on fiscal authorities to do more.
US	Mar personal income	0.6%	–1.5%	–	Personal Income and spending will be squeezed...
	Mar personal spending	0.2%	–4.2%	–	... as activity contracts and the labour market weakens.
	Mar core PCE deflator	0.2%	–0.1%	–	Energy a significant negative in month.
	Initial jobless claims	4427k	–	–	Deterioration to date puts U/E above 15% in Apr.
	Q1 employment cost index	0.7%	0.7%	–	To hold in Q1, but will deteriorate through 2020.
	Apr Chicago PMI	47.8	40.0	–	Resilient in March, but should jolt lower in April.
Fri 01					
NZ	Apr ANZ consumer confidence	106.3	–	–	Confidence has fallen sharply, set to remain low.
Aus	Apr AiG PMI	53.7	–	–	Manuf'g spiked in Feb, +9.4pts on essentials – set to reverse.
	Apr CoreLogic home value index	0.7%	–	0.3%	Strong momentum early 2020, slowing in April as COVID impacts.
UK	Mar net mortgage lending £bn	4.0	–	–	Credit is poised for a major contraction across the board.
US	Mar construction spending	–1.3%	–3.6%	–	Construction cycle to come under pressure.
	Apr ISM manufacturing	49.1	37.5	–	Supply disruptions and demand shock to dampen manufacturing.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	-5.4	4.0
CPI inflation % annual	1.5	1.9	1.8	1.8	0.9	2.0
Unemployment %	5.7	5.5	5.0	5.2	7.3	6.0
Current Account % GDP	-3.1	-2.6	-2.1	0.5	0.2	-0.6
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.0	1.0
Consumer Prices %yr	1.4	2.1	2.4	1.8	1.4	1.6
Unemployment Rate %	4.9	4.4	3.8	3.7	13.1	5.1
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	-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	1.8	1.8	1.4	1.4	-7.0	2.5
China						
Real GDP %yr	6.7	6.8	6.6	6.1	2.5	7.3
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	-2.7	5.8
World						
Real GDP %yr	3.4	3.8	3.6	3.0	-1.5	3.9
Forecasts finalised 9 April 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	0.12	0.15	0.20	0.25	0.30	0.35	0.40	0.45
10 Year Bond	0.89	0.75	0.75	0.80	0.85	0.95	1.10	1.20
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.60	0.60	0.65	0.70	0.75	0.80	0.90	1.00

Exchange rate forecasts	Latest	Jun–20	Sep–20	Dec–20	Mar–21	Jun–21	Sep–21	Dec–21
AUD/USD	0.6362	0.62	0.64	0.66	0.68	0.68	0.69	0.70
USD/JPY	107.66	107	105	106	107	107	108	110
EUR/USD	1.0773	1.07	1.06	1.06	1.07	1.08	1.09	1.10
GBP/USD	1.2359	1.22	1.23	1.24	1.25	1.25	1.26	1.27
USD/CNY	7.0838	7.02	6.90	6.85	6.80	6.75	6.70	6.60
AUD/NZD	1.0607	1.03	1.03	1.03	1.05	1.05	1.05	1.06

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