Westland Tai Poutini National Park, New Zealand

Weekly Economic Commentary.

Better data, but negative OCR still required.

The evidence continues to suggest that the New Zealand economy is bouncing back from the COVID-19 lockdown more readily than was expected a couple of months ago. This doesn't necessarily mean that policymakers can take their foot off the accelerator though. Low inflation is likely to remain a feature in the years to come, and monetary easing will need to continue beyond the guidance that the Reserve Bank has given to date.

With the domestic lockdown restrictions effectively removed by early June, the June BusinessNZ Performance of Services Index rebounded to 54.1, compared to 37.5 in May. That brings the overall index back to around its pre-COVID levels, although not all of the details were quite as positive – for instance, the employment measure remained below the 50 mark (signalling contraction) for a fourth straight month.

The overseas trade surplus narrowed to $426m in June, largely due to a pickup in imports (including a $395m naval ship). Goods exports have remained fairly steady in recent months, albeit down slightly on the same time last year. Exports have been a steadying force for the overall economy, at a time when domestic activity has been forced through some wild swings as a result of the COVID lockdown.

The positive picture for exports was reinforced by last week's GlobalDairyTrade auction, where whole milk powder prices largely held on to the sharp 14% bounce seen in the previous auction. Our forecast for this season's farmgate milk price remains at an above-average $6.50/kg, though the risks are to the upside.

These, and other examples of data showing that the COVID impact has been less than feared, raise the question of whether the Reserve Bank and the Government will need to respond as aggressively as they previously thought. Indeed, this week the Government announced a major change to its COVID response and recovery programme. At the May Budget, the Government said that it had approved a combined package of $62bn, including the measures that had been announced since mid-March. Of that package, around $20bn was yet to be allocated, although the Government said that they intended to spend all of it in the coming years.

Last week the Minister of Finance said that while a further $6bn has now been allocated, the remaining $14bn will be set aside, to be used if there is a second wave of COVID-19 in New Zealand or if the global economy deteriorates by more than expected. Setting this aside is a sensible move. It does, however, mean that the fiscal stimulus will be smaller than previously expected, putting downward pressure on our economic forecasts.

This has two implications for the Reserve Bank. First, with less fiscal stimulus than expected, the need for monetary stimulus will be greater. And second, less borrowing by the Government will mean less scope to ease monetary policy through bond purchases. Both make it more likely that by next year the RBNZ will have to resort to other tools, such as a negative OCR.

Notwithstanding the better than expected starting point for the economy, our view remains that more monetary easing will indeed be needed, beyond what the RBNZ has signalled to date. Inflation is set to slow in the next few years as a result on COVID-19, with lower demand and slower wage growth outweighing factors such as supply chain disruptions. Our forecast is for inflation to slow to near-zero by early next year, similar to the RBNZ's view, but we think that inflation will be much slower to return to target after that.

One factor that will hinder inflation is that the New Zealand dollar has rebounded from its lockdown lows, which will dampen imported inflation. New Zealand's relative success in dealing with the pandemic has been reflected in a relatively stronger exchange rate compared to the likes of the US and Europe. In contrast, the RBNZ's most recent forecasts assumed that the currency would fall further, from a lower starting point.

It's also becoming apparent that New Zealand's borders are going to stay largely closed for longer than expected. Global case numbers are still accelerating, and even the hopes of a trans-Tasman travel bubble are disappearing as a second wave has emerged in Australia. With international travel taken out of the picture, the New Zealand economy is likely to be running below full capacity for even longer than previously thought. That in turn suggests lower inflation pressures and a more persistent period of unemployment.

To date, the RBNZ has provided guidance on monetary policy for around the first year of the COVID response: the OCR will remain at 0.25% through to March next year, and the $60bn of bond purchases will run through to May. We believe that ongoing stimulus will be needed beyond those dates, and that the RBNZ will have to signal this in the coming months in order to keep market interest rates under control.

First up, we expect that at the August *Monetary Policy Statement* the RBNZ will extend the bond purchase programme through to August 2021. Maintaining the programme for longer will require an increase in the cap on bond purchases, from $60bn currently to around $80bn.

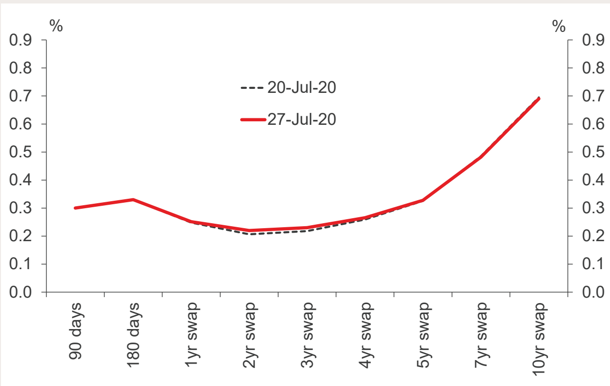
But by the middle of next year, the RBNZ will start running out of Government bonds to buy, meaning that it will need another method of delivering stimulus. We expect that the RBNZ will cut the OCR to -0.5% in April 2021, in order to maintain the overall level of monetary easing that the economy will need.

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



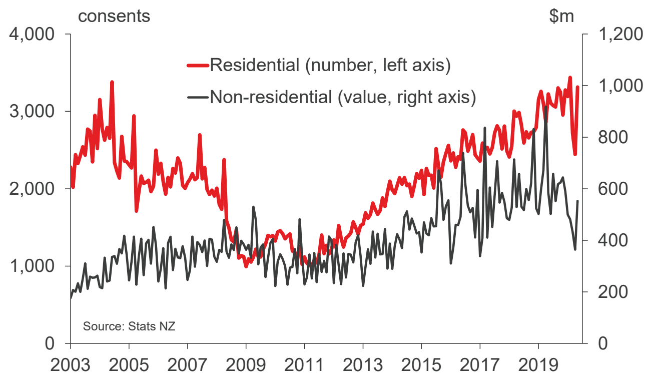
The week ahead.

NZ Jun dwelling consents

Jul 30, Last: +36%, Westpac f/c: -5%

- Dwelling consent numbers rocketed higher in May, climbing 36%. That followed a drop of 30% through March and April when consent processing was disrupted by New Zealand's shift to Alert Level 4. The lift in May left consent numbers a little below the levels that prevailed before the lockdown.
- We expect a modest 5% drop in consent numbers in June. Issuance in May was boosted by a large number of multi-unit consents in Canterbury. As such consents are often issued in 'lumps', it's normal to see an easing in the following month.
- Risks around the consent outlook are two sided. On the upside, there were some processing delays during the lockdown. On the downside, there is still uncertainty around the longer term outlook for the economy which is weighing on plans for spending.

NZ building consents

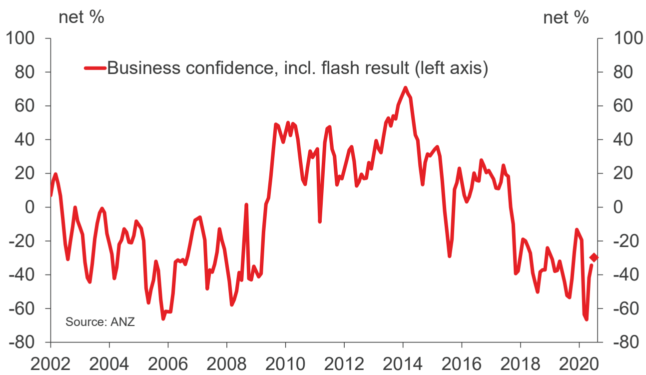


NZ Jul ANZBO business confidence (final)

Jul 30, Last: –34.4, Preliminary result for June: –29.8

- After falling sharply during the lockdown, business confidence and expectations for trading activity have picked up again over the past couple of months. Nevertheless, they remain at low levels.
- With positive indications for domestic demand, we expect a further modest lift in confidence and trading activity when the final results of the July survey are release. Even so, we expect that many businesses will remain cautious with regards to their plans for capital spending and hiring for some time yet.
- It will be worth keeping an eye on the inflation and pricing gauges which remain at very low levels. Despite concerns about demand, reports of supply disruptions are starting to mount.

NZ business confidence

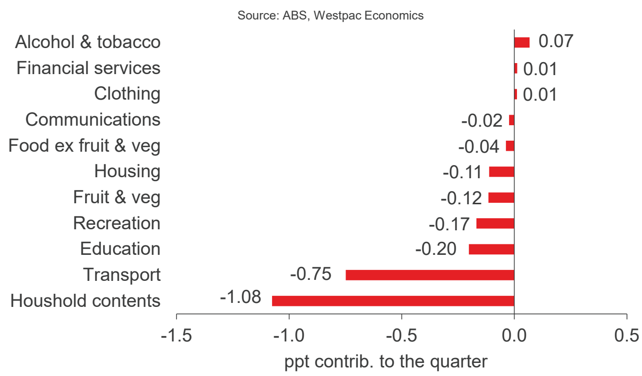


Aus Q2 CPI inflation

Jul 29, Last: 0.3%, WBC f/c: –2.4%
Mkt f/c: -2.0%, Range: -2.4% to 0.1%

- The COVID-19 shutdown will hit the CPI hard via a direct impact from the significant loss in demand which governent support (subsidies) for critical services will magnify driving record breaking quarterly declines in both the headline and core measures of inflation.
- Our -2.4% forecast decline in the CPI will see a rapid shift to deflation with the annual pace dropping to -0.9%yr from +2.2%yr. The trimmed mean to fall -0.2% taking the annual pace down to 1.1%yr from 1.8%yr. The six month annualised pace of the trimmed mean to fall to 0.5%yr from 1.9%yr.
- The largest negative contribution is the -12.6% fall in household contents & services (-1.08ppt) due to a 97% fall in childcare (-1.16ppt). Auto fuel falls a significant -21.4% (-0.74ppt) and education falls -4.5% (-0.20ppt).

Contributions 2020Q2 CPI -2.4%qtr forecast



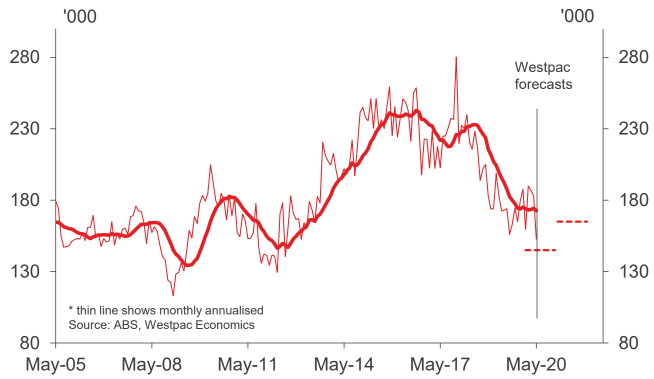
The week ahead.

Aus Jun dwelling approvals

Jul 30, Last: –16.4%, WBC f/c: –4%
Mkt f/c: -2.0%, Range: -6.0% to 10.0%

- After holding up surprisingly well in the early stages of the COVID lockdown dwelling approvals plunged sharply in May, dropping 16.4% to be down 11.6%yr, led by a steep 35% decline in 'unit' approvals.
- While large, the May fall is still much milder than the hit to turnover and listings, which dropped about 40% through March-April. This is partly due to the bigger direct disruptions from temporary bans on auctions and open homes. However, dwelling approvals also tend to be slower to respond to shifts due to lags between application and approval.
- That creates considerable uncertainty about the path forward. Approvals are likely to weaken further in June but unlikely to decline to the same extent as turnover and listings (both of which have recovered strongly since early June). On balance we expect a further 4% drop. Coming months will also see some additional support from the Government's HomeBuilder grant.

Dwelling approvals: actual vs forecast

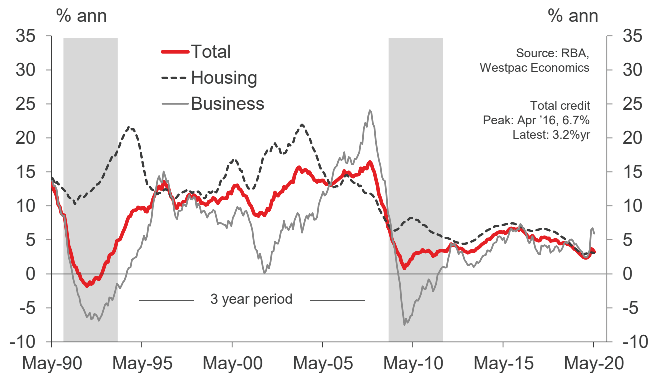


Aus Jun private credit

Jul 31, Last: -0.15%, WBC f/c: -0.2%
Mkt f/c: -0.1%, Range: -0.2% to 0.1%

- Credit to the private sector contracted in May, down by -0.1%. That was the first decline since June 2011 - with the prospect of further falls in the months ahead.
- For June, credit is forecast to fall by -0.2%. Housing is weak and slowing, while business is in decline, so too personal.
- Housing credit grew by 0.24%, 3.1%yr in May. The upswing pre-COVID, driven by lower interest rates and a bounce in confidence, has faltered. Housing turnover collapsed due to COVID restrictions, as well as the hit to income and to confidence. New lending slumped by 16% over April and May. The Melbourne lock-down will delay any turnaround.
- Businesses are in survival mode - looking to cut non-essential spending, including investment expenditure. Business credit is set to not only slow but contract, as is typical in recessions. There were signs of this in May, with business credit recording a fall of -0.6%.

Credit: weakness after one-off spike in March

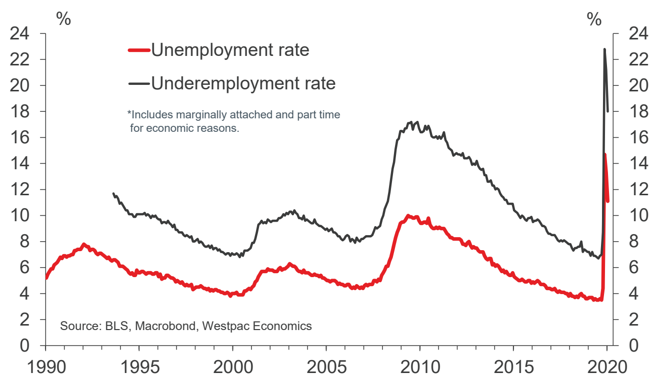


US Jul FOMC policy meeting

Jul 28-29, federal funds rate: last: 0.125%, WBC: 0.125%

- While the July FOMC meeting is not expected to see a change in the stance of policy, the Committee's assessment of risks and policy options will be critical for understanding the near and medium-term policy outlook.
- Very clearly, since the FOMC last met, risks associated with COVID-19's spread have continued to mount. Further, existing fiscal support is very near its end.
- Most critical to assess will be whether further discussions have been had by Committee members over the potential benefits of increasing the current pace of asset purchases, should conditions warrant. Or whether a change in focus could be seen, specifically the adoption of yield curve control. Chair Powell's press conference will be the focus for assessing these possibilites. In coming weeks, the minutes will provide additional colour.

It will be a long time before recent levels seen



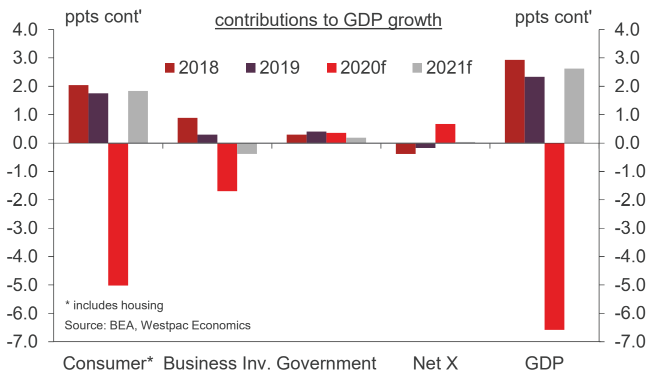
The week ahead.

US Q2 GDP

Jul 30, quarterly ann'd rate: last: -4.8%, WBC: -31.0%
Mkt f/c: -34.0%, Range: -40.0% to -26.2%

- Q2 GDP will usher in a never before seen decline in economic activity in the US, an annualised 19% decline over the six months to June. Annual growth will fall to -9.0% as a result.
- Principally this decline will come as a result of plunging household consumption which makes up more than two-thirds of total spending. That said, essentially every component of demand will experience a sharp fall in Q2.
- We must emphasise that growth is expected to only slowly return in the second half. While state economies began to re-open in the June quarter, the rapid rise in new cases since has raised many questions over the outlook. An extended period of little growth or further declines in activity are possible if the virus is not suppressed quickly.

Consumer to drive declines

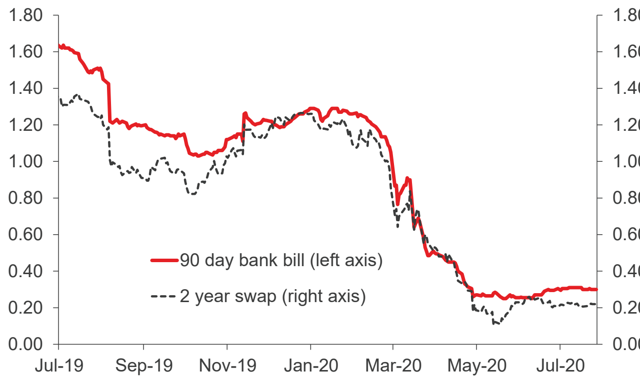


New Zealand forecasts.

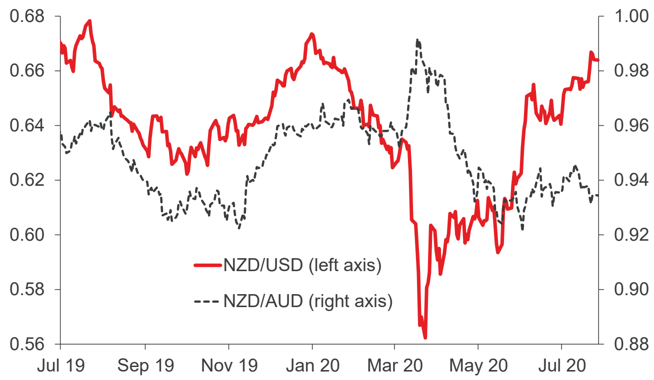
Economic forecasts	Quarterly				Annual			
	2020							
% change	Mar (a)	Jun	Sep	Dec	2018	2019	2020f	2021f
GDP (Production)	-1.6	-13.5	14.0	0.9	3.2	2.3	-4.6	5.1
Employment	0.7	-7.5	0.7	1.3	1.9	0.8	-4.9	3.4
Unemployment Rate % s.a.	4.2	7.0	8.0	7.5	4.3	4.0	7.5	6.6
CPI	0.8	-0.5	0.8	-0.3	1.9	1.9	0.8	0.4
Current Account Balance % of GDP	-2.7	-2.1	-1.7	-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	71.6	70.7	69.1	69.6	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 27 July 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.27%
60 Days	0.30%	0.30%	0.29%
90 Days	0.30%	0.31%	0.30%
2 Year Swap	0.22%	0.22%	0.21%
5 Year Swap	0.33%	0.35%	0.37%

NZ foreign currency mid-rates as at 27 July 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6639	0.6572	0.6417
NZD/EUR	0.5695	0.5817	0.5718
NZD/GBP	0.5188	0.5204	0.5209
NZD/JPY	70.49	70.28	68.76
NZD/AUD	0.9344	0.9455	0.9354
TWI	72.75	72.64	71.50

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
Aus	RBA Assist Governor Financial Mkts	–	–	–	Christopher Kent speaking at Kanga News.
Chn	Jun industrial profits %yr	6.0%	–	–	Strong momentum across economy supportive.
Eur	Jun M3 money supply %yr	8.9%	–	–	Increasing strongly as a result of monetary stimulus.
US	Jun durable goods orders	15.7%	7.0%	–	Surge in May beat est., led by aircraft & motor vehicles.
	Jul Dallas Fed index	–6.1	–4.8	–	Manufacturing improving but level remains weak.
Tue 28					
Aus	Weekly Payrolls week ended 11 Jul	–	–	–	A strong recovery faded in week ending 27 Jun.
UK	Jul Nationwide house prices	–1.4%	–	–	Annual house price growth ground to a halt in June.
US	May S&P/CS home price index	0.33%	0.30%	–	Housing momentum soft but gains continuing.
	Jul consumer confidence index	98.1	94.8	–	Sentiment souring as virus spreads.
	Jul Richmond Fed index	0	–	–	Uptrend to lead to first +ve read since COVID-19.
Wed 29					
Aus	Q2 CPI	0.3%	–2.0%	–2.4%	COVID-19 has shaken up the Aust. economy with falling...
	Q2 CPI %yr	2.2%	–0.5%	–0.9%	...fuel prices, free childcare & pre-schooling adding to...
	Q2 core CPI (trimmed mean)	0.5%	–0.1%	–0.2%	...a broader deflationary pulse resulting in a record fall in...
	Q2 core CPI (trimmed mean) %yr	1.8%	1.3%	1.1%	...the headline CPI & the trimmed mean.
US	Jun wholesale inventories	–1.2%	–	–	May saw largest decline since '09.
	Jun pending home sales	44.3%	15.6%	–	Real estate volumes are bouncing back.
	FOMC policy decision, midpoint	0.25%	0.25%	–	FOMC Chair Powell holds press conference.
Thu 30					
NZ	Jun building consents	35.6%	–	–5.0%	Moderation after last month's rise in multi-unit consents.
	Jul ANZ business confidence (final)	-29.8	–	–	Further modest rise expected, in line with firming activity.
Aus	Jun dwelling approvals	–16.4%	–2.0%	–4.0%	COVID hit milder than for sales but coming through more slowly.
	Q2 export price index	2.7%	–2.0%	–1.8%	Export prices lower on weaker commodity prices.
	Q2 import price index	–1.0%	–2.5%	–4.4%	Import prices fall on higher AUD (TWI) & slump in energy prices.
	AOFM Chief Executive Officer	–	–	–	Rob Nicholl speaking at ABE Webcast.
Eur	Jul economic confidence	75.7	82.0	–	Sentiment is improving as restrictions are eased...
	Jul consumer confidence	–15.0	–	–	... and summer rolls on.
	Jun unemployment rate	7.4%	7.6%	–	UE nudged higher in May, but less than expected.
US	Q2 GDP	–5.0%	–34.0%	–	Q2 GDP to capture brunt of COVID restrictions on activity.
	Initial jobless claims	1416k	–	–	Downtrend in claims looks to be fading.
Fri 31					
NZ	Jul ANZ consumer confidence	104.5	–	–	Consumer spending has been firming.
Aus	Jun private sector credit	–0.1%	–0.1%	–0.2%	Housing weak & slowing, business declining.
	Q2 PPI	0.2%	–	–	Falling energy prices will lead to a collapse in the PPI.
Chn	Jul manufacturing PMI	50.9	50.8	–	Manufacturing has led China's recovery...
	Jul non–manufacturing PMI	54.4	54.5	–	... broadening growth will support further gains.
Eur	Q2 GDP	–3.6%	–10.7%	–	Bulk of economic pain from COVID will be felt this quarter.
	Jul CPI %yr	0.3%	–0.5%	–	Inflation pressures to remain negligible.
UK	Jul GfK consumer sentiment	–27	–	–	New case rise may see sentiment take a step backward.
US	Jun personal income	–4.2%	–0.5%	–	Incomes fell after initial boost from gov. handouts.
	Jun personal spending	8.2%	5.5%	–	Services spending to remain at risk as states battle virus.
	Jun PCE deflator	0.1%	0.5%	–	Bounce is the result of energy prices; core benign.
	Q2 employment cost index	0.8%	0.6%	–	Soft wages growth a lasting consequence of COVID.
	Jul Chicago PMI	36.6	43.9	–	Production slow to recover.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.8	1.8	-3.7	2.4
CPI inflation % annual	1.5	1.9	1.8	1.8	0.3	2.0
Unemployment %	5.7	5.5	5.0	5.2	8.4	7.3
Current Account % GDP	-3.1	-2.6	-2.0	0.6	1.9	0.5
United States						
Real GDP %yr	1.6	2.4	2.9	2.3	-6.6	2.6
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	16.2	6.3
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	4.1
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	-1.9	5.4
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-4.5	5.0
Forecasts finalised 10 July 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	0.85	0.95	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	0.58	0.70	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	0.7094	0.70	0.72	0.73	0.74	0.75	0.76
USD/JPY	106.40	106	106	107	107	108	108
EUR/USD	1.1608	1.14	1.16	1.16	1.17	1.17	1.18
GBP/USD	1.2739	1.26	1.27	1.27	1.28	1.29	1.30
USD/CNY	7.0168	7.00	6.90	6.85	6.80	6.70	6.60
AUD/NZD	1.0704	1.08	1.11	1.14	1.14	1.14	1.13

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