
Fiordland National Park, New Zealand

Weekly Economic Commentary.

Virus in the ointment.

Events are quickly being overtaken by the coronavirus outbreak spreading from China. We estimate that the travel ban from China to New Zealand will dent quarterly GDP by 0.4% if it lasts two months. Before the travel ban was announced, the RBNZ was on track to shift to a neutral OCR outlook, but now the OCR outlook depends on how severe the coronavirus disruption turns out to be.

As the human toll of the coronavirus epidemic centred in China grows, so the economic impact on New Zealand intensifies. The SARS outbreak in 2003 was big news, but it had a vanishingly small impact on the New Zealand economy of around 0.1% of GDP. But that might not be the best guide to how severely this coronavirus will impact New Zealand. For a start, we simply do not know if the coronavirus will blow over like SARS and Swine Flu did, or whether it will turn into a more serious and long-lasting event. In any case, New Zealand's exports are more heavily concentrated toward the affected countries than they were during the SARS outbreak. In 2003 only 5% of our exports went to mainland China and 2% to Hong Kong; more broadly, 23% went to Asia ex-Japan. Today, 28% of our exports go to China alone, and 48% go to Asia ex-Japan.

The economic costs to New Zealand will arise not from the virus itself, but from the measures taken globally to try to contain it. Almost 60 million people are already effectively under lockdown in China, and people elsewhere in China are avoiding gathering in numbers. High-end New Zealand food exports destined for such gatherings have already been impacted. Crayfish was the first example, but we expect other seafood, fruit and meat exports will soon be seriously disrupted, as well as lesser disruptions to other exports stemming from the general slowing of economic activity in China.

The biggest impact on the New Zealand economy will stem from fewer people travelling between the two countries. Last week China banned all outbound travel booked through the

Chinese Tourism Bureau. Over the weekend, New Zealand announced it would deny entry to all foreign nationals arriving from China. The ban is currently in force for two weeks, but we can only really see two possible outcomes – either the travel ban lasts much longer, or the coronavirus enters New Zealand in force and the authorities give up on ideas of quarantine.

We have calculated a plausible scenario in which seasonally adjusted visitor arrivals to New Zealand drop by 11% over the coming three months. That, on its own, would reduce New Zealand quarterly GDP by around 0.4 percentage points. The assumptions underpinning that are that we receive zero visitor arrivals from China for two months, followed by half the usual number in the third month. We further assume that arrivals from the rest of Asia are dented by 20%. On top of the direct impact of restricted travel, the New Zealand economy will also face second-round effects such as reduced spending by furloughed tourism workers, and the GDP impact from disrupted goods exports.

The crucial factor is how long the virus remains disruptive to the economy. Should the epidemic recede quickly, then the hit to the economy will prove fleeting and the recovery very rapid. The hit to *annual* GDP would be far less than 0.4 percentage points, and the implications for the Reserve Bank and other economy-watchers would be limited. If the epidemic disrupts economic life for longer than SARS or Swine Flu did, then the consequences would be more severe. For example, would-be students travelling to New Zealand might cancel their plans altogether, rather than merely postponing their travel.

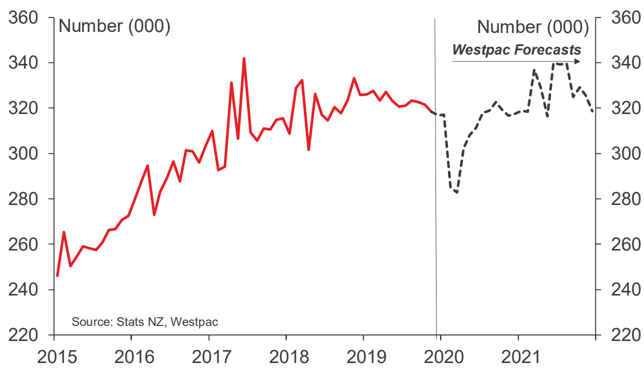
The Reserve Bank will issue its next Monetary Policy Statement (MPS) on February 12. Deliberations are occurring this week amid a moving feast of information on the coronavirus. The obvious strategy for the RBNZ is to keep the OCR on hold and say that the outlook depends on how the coronavirus situation evolves. If the coronavirus quickly blows over quickly then the outlook will be for the OCR to remain on hold. But the RBNZ will also say that it stands ready to cut the OCR should the coronavirus situation warrant it. Exactly how the RBNZ expresses these sentiments is uncertain.

Last week, before the ban on foreign nationals travelling from China to New Zealand, we announced that we expected the RBNZ would abandon its strong easing bias and move to a more neutral monetary policy outlook.[1] This was all based on our observations of the economy with no coronavirus impact. While events have obviously moved on since last week, it is still worthwhile considering what the "ex-coronavirus" base case was for the OCR outlook.

Instead of publishing a 0.9% OCR forecast, we expected the RBNZ's new OCR forecast would be flat at 1.0%. And we expected the language to shift from *"50/50 chance of a cut"* to something more like "*we expect to keep the OCR at its current level for an extended period, but will react to evolving data as necessary."*

The key reasons for our change of stance were that both inflation and unemployment are now close to the Reserve Bank's targets, giving little reason to shift the OCR. Since the last MPS, the housing market has heated up in a way the RBNZ can no longer dismiss; the Government has announced a major infrastructure spend-up which will stimulate the economy; and New Zealand economic data has been stronger than expected. The RBNZ will also have taken comfort from the general improvement in global economic sentiment over recent months, even though the actual economic data remains weak.

Figure 1: Total Visitor Arrivals into New Zealand assuming two-month ban on travel from China



1 https://westpaciq.westpac.com.au/wibiqauthoring/_uploads/file/New_Zealand/2020/January_2020/RBNZ_bulletin_January_2020_-_Westpac_NZ.pdf

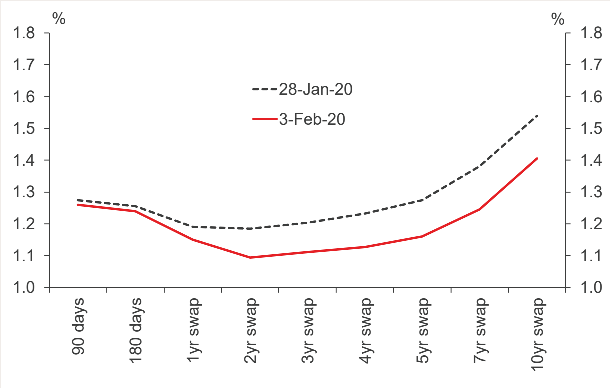
Fixed vs Floating for mortgages.

The mortgage rate outlook is now uncertain. 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



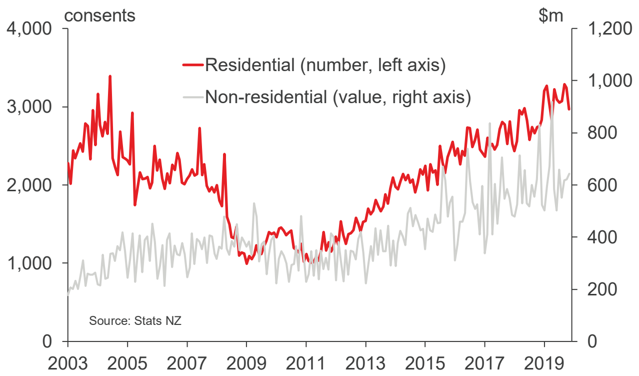
The week ahead.

NZ Dec dwelling consents

Feb 4, Last: -8.5%, Westpac f/c: +2%

- Residential dwelling consent issuance fell 8.5% in November. That decline followed strong issuance in the previous two months that was boosted by a large number of medium density dwelling consents.
- We're forecasting a modest 2% rise in total consents in December, with firmness in standalone dwelling consents and a recovery in medium-density numbers
- After trending higher in recent years, monthly consent issuance has flattened off over the past year. We expect that will continue over the coming year. It will also be worth watching the geographic breakdown of consents. In Auckland, which has accounted for much of the lift in consents in recent years, issuance is flattening off. However, issuance is picking up elsewhere.

NZ building consents



NZ Q4 Household Labour Force Survey

Feb 5, Employment last: +0.3%,
WBC f/c: +0.3%, Mkt f/c: +0.4%
Unemployment last: 4.2%,
WBC f/c: 4.2%, Mkt f/c: 4.2%

- We expect the unemployment rate to hold steady at 4.2% in the December quarter. The economy slowed from an above-trend pace of growth to around trend in 2019. That's consistent with a stalling in the rate of improvement in the labour market, rather than a softening.
- Indicators for the quarter were mixed. Job advertisements were down slightly, but business confidence surveys showed a mild improvement in hiring intentions and Stats NZ's new monthly employment indicator pointed to steady growth over late 2019.
- Our forecasts are in line with what the Reserve Bank expected in its November Monetary Policy Statement. At that time the RBNZ assessed the economy to be running at 'maximum sustainable employment' or even slightly on the hot side.

Household Labour Force Survey

NZ Q4 Labour Cost Index

Feb 5, Private sector last: 0.6%,
WBC f/c: 0.5%, Mkt f/c: 0.6%

- We expect a 0.5% increase in labour costs for the December quarter. This quarter was not affected by public sector pay agreements or minimum wage hikes, so it will provide a relatively clean read on the strength of wage pressures.
- An unemployment rate of 4.2% is close to what we would consider to be neutral – that is, consistent with neither a slowdown nor an acceleration in wage growth. Consequently, there has been only limited evidence of a pickup in wage growth so far outside of government-mandated increases.
- The QES measure of average hourly earnings tends to be more responsive than the LCI measure, and has seen a more notable pickup in the last couple of years. However, it can be volatile on a quarterly basis.

LCI and QES salary and wages, all sectors

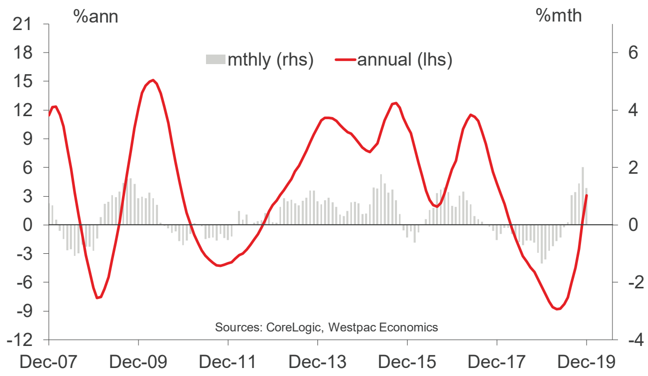
The week ahead.

Aus Jan CoreLogic home value index

Feb 3, Last: 1.2%, WBC f/c: 0.9%

- Australian dwelling prices have posted a clear recovery since mid-2019, prices rising 7.2% nationally over the second half of the year, retracing two thirds of the 10.7% decline over the previous two years.
- The daily index shows a further gain in January with the '5 capital city' measure tracking towards a 0.9% rise for the month. That will take annual price growth to just over 5% for the first time since Nov 2017. As always, January housing data should be treated with extra caution due to thin trading conditions during the holiday period. In general, prices gains tend to be more muted in Dec and Jan due to the dearth of buyers.

Australian dwelling prices

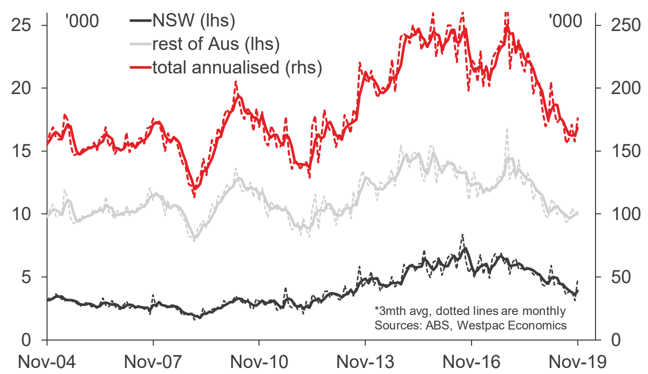


Aus Dec dwelling approvals

Feb 3, Last: 11.8%, WBC f/c: –5%
Mkt f/c: –5%, Range: –7% to 13%

- Dwelling approvals jumped 11.8% in Nov as a 35% spike in high rise combined with a strong 6% gain in non high rise. The detail showed a particularly strong 50%+ gain in NSW, suggesting state government policy changes aimed at improving building quality standards may have been a factor (approvals may have rebounded after being held back prior to the change). Total approvals ex NSW were down –0.9%mth, –8.3%yr.
- On balance we see the Nov jump as paring back some of the downside risks that were emerging in previous months but not as the beginning of a sustained rise. While Australia's housing markets are showing a clear improvement since mid-2019 the flow on boost to construction activity looks likely to come through slowly and be overshadowed by ongoing weakness in the high rise segment. As such we expect approvals to fall 5% in Dec, retracing much of the Nov gain.

Australian dwelling approvals

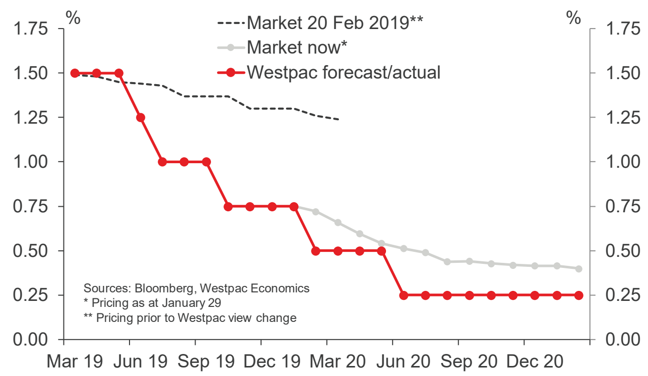


Aus RBA policy decision

Feb 4, Last: 0.75%, WBC f/c: 0.75%
Mkt f/c: 0.75%, Range: 0.50% to 0.75%

- The RBA left the cash rate on hold at its December meeting but retained a clear easing bias, the Governor's decision statement noting the Board "continues to monitor developments, including in the labour market", and "is prepared to ease monetary policy further if needed."
- Developments since December meeting – including a disappointing Q3 national accounts update, the bushfire emergency and the coronavirus outbreak – will reinforce the Bank's easing bias but with key labour market data holding up better than expected a February rate cut looks unlikely (see p2 for a full discussion). We continue to expect further cuts, with 25bp reductions in April and August followed by a move to quantitative easing measures sometime thereafter.
- Note that the RBA's February Statement on Monetary Policy is also due to be released on Feb 7 and will include updated economic forecasts. The RBA Governor is also due to speak on Feb 5, topic: "The Year Ahead".

RBA: Westpac forecast and market pricing



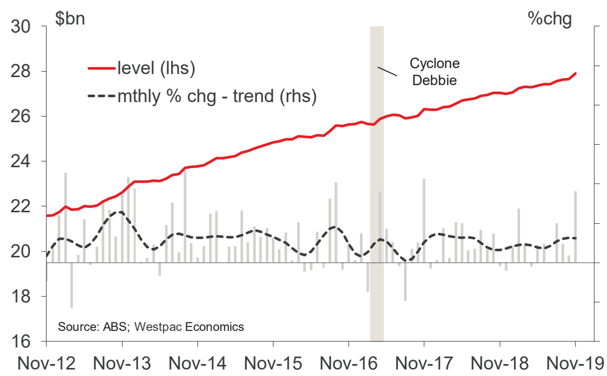
The week ahead.

Aus Dec retail trade

Feb 6, Last: 0.9%, WBC f/c: –0.2%
Mkt f/c: –0.2%, Range: –0.5% to 0.1%

- Retail sales posted a 0.9% gain in Nov, the biggest monthly rise in two years. Unfortunately, much of it looks to be a pull forward relating to the increasingly popular 'Black Friday' sales. There may also have been some delayed effect from policy stimulus measures – tax payments and interest rate cuts effectively adding about $4.5bn to disposable incomes in Q3 – although this looks to be marginal.
- We expect retail sales to decline 0.2% in Dec. While policy measures could continue to provide some slight support, the dominant drivers are likely to be an unwind of the 'Black Friday' pull-forward effect and an initial hit from worsening bushfire conditions in Australia's south east (which included widespread smoke pollution across major capital cities).

Australian monthly retail sales

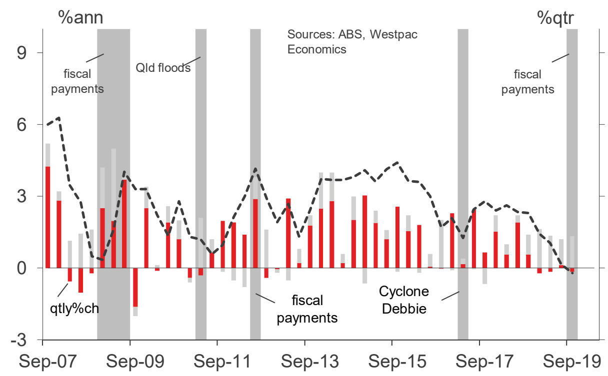


Aus Q4 real retail sales

Feb 6, Last: –0.1%, WBC f/c: 0.2%
Mkt f/c: 0.3%, Range: 0.1% to 0.6%

- Real retail sales dipped 0.1% in Q3, marking the third decline in four quarters and taking annual growth to –0.2%yr, the first annual contraction since the early 1990s recession. The result was particularly disappointing given significant policy stimulus in the quarter, the wider spending measures in the Q3 national accounts indicating that essentially none of the cash flow boost to disposable incomes was spent in the quarter.
- The December quarter looks set to show only a very slight improvement. Nominal sales are tracking towards a 1.0% gain vs 0.7% in Q3. On the price side the CPI detail showed a strong drought-related rise in food prices but more aggressive discounting reducing prices for non food items. The mix is likely to see a Q4 retail deflator rise similar to that in Q3. Overall we expect the quarter to show a slightly better outturn for volumes with a 0.2% gain but annual growth still very weak at 0.1%yr.

Australian quarterly retail volumes and prices

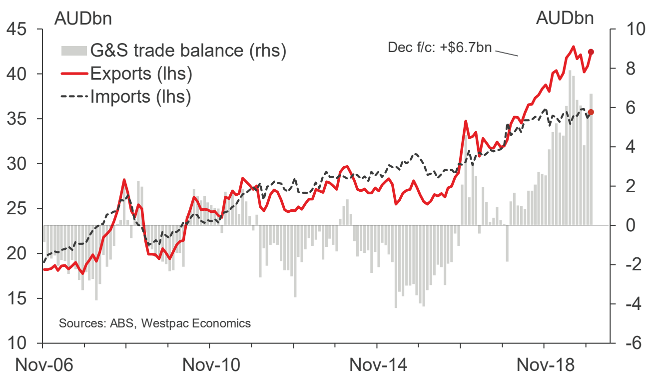


Aus Dec trade balance, AUDbn

Feb 6, Last: 5.8, WBC f/c: 6.7
Mkt f/c: 5.6, Range: 4.0 to 7.4

- Australia's trade surplus remains sizeable - albeit being down from the June record high of $7.9bn.
- For December, we anticipate a widening of the surplus, up by $0.9bn to $6.7bn, led higher by export strength.
- Export earnings rise a forecast 3.7%, +$1.5bn. Shipments of iron ore, LNG, and gold rallied in the final month of the year, to be at or around record highs. Gold shipments likely jumped as well, in the lead-up to Lunar New Year (January 25).
- Imports have been a wild-card of late - with average swings of 2% a month over the last half year. Coming off a 2.8% drop, we anticipate a partial rebound, up 1.7% ($0.6bn). Looking through the noise, the underlying picture is one of weakness, consistent with soft domestic demand.

Australia’s trade balance



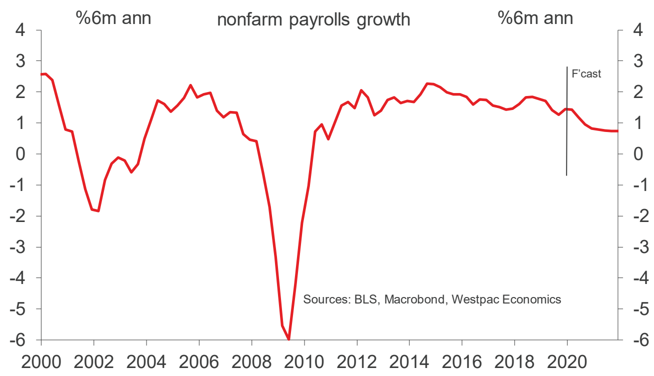
The week ahead.

US Jan employment report

Feb 7, nonfarm payrolls last: 145k, WBC: 170k
Feb 7, unemployment rate last: 3.5%, WBC: 3.5%
Feb 7, hourly earnings last: 0.1%, WBC: 0.3%

- During 2019, nonfarm payrolls growth clearly slowed, from an average of 223k in 2018 to 176k. Come 2020, we look for another step down to circa 130k per month, as GDP growth falls below potential. This deceleration will however be slow, beginning with a 170k gain in January.
- The 130k average gain expected through 2020 will, assuming an unchanged participation rate, be enough to hold the unemployment rate broadly steady at its 50-year low.
- Combined, slowing momentum in job creation and limited labour market slack is expected to see hourly earnings continue to grow at a robust pace around 3.0%yr. The lack of another uplift in wages however means that the deceleration in job growth will pass to total household income gains.

US employment growth

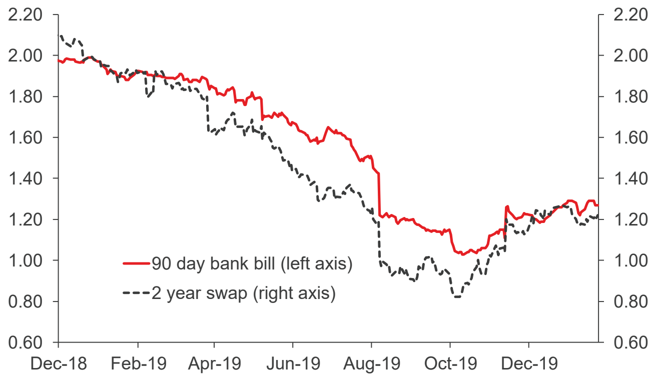


New Zealand forecasts.

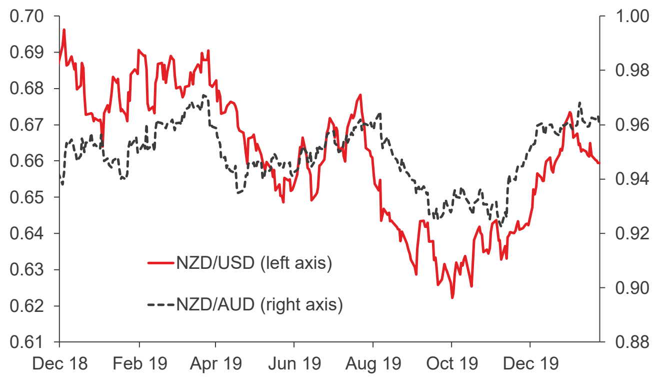
Economic forecasts	Quarterly				Annual			
	2019		2020					
% change	Sep (a)	Dec	Mar	Jun	2018	2019f	2020f	2021f
GDP (Production)	0.7	0.6	0.6	0.7	3.2	2.3	2.5	3.0
Employment	0.2	0.4	0.4	0.4	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	4.2	4.2	4.3	4.3	4.3	4.2	4.2	4.0
CPI	0.7	0.5	0.5	0.4	1.9	1.9	1.8	1.7
Current Account Balance % of GDP	-3.3	-3.1	-2.9	-2.8	-3.8	-3.1	-2.9	-3.2

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	0.66	0.66	0.66	0.66	0.66	0.66
NZD/AUD	0.97	0.99	0.99	0.99	0.97	0.96
NZD/JPY	70.6	69.4	69.3	69.3	70.0	70.6
NZD/EUR	0.61	0.60	0.59	0.59	0.58	0.58
NZD/GBP	0.50	0.50	0.50	0.50	0.50	0.50
TWI	73.1	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 3 February 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.21%	1.21%	1.19%
60 Days	1.24%	1.25%	1.20%
90 Days	1.26%	1.29%	1.20%
2 Year Swap	1.09%	1.22%	1.25%
5 Year Swap	1.16%	1.35%	1.36%

NZ foreign currency mid-rates as at 3 February 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6471	0.6615	0.6561
NZD/EUR	0.5828	0.5966	0.5934
NZD/GBP	0.4895	0.5083	0.5000
NZD/JPY	70.06	72.87	71.29
NZD/AUD	0.9652	0.9625	0.9596
TWI	71.63	72.64	72.76

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 3					
Aus	Jan CoreLogic home value index	1.2%	–	0.9%	Prices have now clawed back two thirds of their correction.
	Dec dwelling approvals	11.8%	–5.0	–5.0%	Nov jump driven by temporary spike in NSW.
	Jan ANZ job ads	–6.7%	–	–	Down 18.8%yr, job ads have been week since early 2019.
	Jan MI inflation gauge	1.4%	–	–	Up 0.3% in Dec, did this momentum continue in Jan?
	Jan AiG PMI	48.3	–	–	Dec was the second consecutive sub 50 reading.
Chn	Dec industrial profits %yr	5.4%	–	–	Industry ended 2019 on sound footing, but 2020 uncertain.
	Jan Caixin China PMI	51.5	51.0	–	Growth ahead of new year holidays was modest.
US	Dec construction spending	0.6%	0.4%	–	Business investment weak, and will remain that way.
	Jan ISM manufacturing	47.2	48.4	–	A bounce from Dec very weak level likely.
Tue 4					
NZ	Dec building permits	–8.5%	–	2.0%	Bounce after last month's fall. Issuance flattening off.
Aus	RBA policy announcement	0.75%	0.75%	0.75%	Pause for now. Rates to move lower, April and August.
US	Fedspeak	–	–		Fed's Bostic Discusses Big Data, AI and Machine Learning
	Dec factory orders	–0.7%	0.7%	–	Core durable orders disappointed again in Dec.
Wed 5					
NZ	Q4 unemployment rate	4.2%	4.2%	4.2%	Unemployment is likely to have remain unchanged...
	Q4 employment	0.2%	0.4%	0.3%	...with modest jobs growth in late 2019.
	Q4 labour cost index (pvt, ord time)	0.6%	0.6%	0.5%	Annual wage growth is running at a ten-year high.
Aus	RBA Governor Lowe speaking	–	–	–	The Year Ahead, National Press Club Sydney, 12:30pm.
	Jan AiG PCI	38.9	–	–	Construction sector sharp contraction, incl housing downturn.
Chn	Jan Caixin China PMI services	52.5	52.0		Services PMI may show initial impact of coronavirus.
Eur	Dec retail sales	1.0%	–0.5%	–	Euro Area domestic demand remains resilient.
US	Jan ADP employment change	202k	150k	–	Employment growth is clearly slowing.
	Dec trade balance US$bn	–43.1	–47.4	–	Imports fell sharply in Q4, to bounce into Q1.
	Jan ISM non–manufacturing	55	55.1	–	Services sector benefitting from strong labour market.
Thu 6					
NZ	Waitangi Day	–	–	–	Public holiday
Aus	Dec retail sales	0.9%	–0.2	–0.2%	'Black Friday' boost unwinds. Hit from bushfires?
	Q4 real retail sales	–0.1%	0.3	0.2%	Slightly better quarter but still very weak.
	Dec trade balance, AUDbn	5.8	5.6	6.7	Exports +3.7% (strong volumes), imports rebound, +1.7%.
	Q4 NAB business survey	–2	–	–	Dec mthly survey reported soft conditions, weak confidence.
Eur	ECB speak	–	–	–	President Lagarde in Brussels.
US	Initial jobless claims, '000	216	–	–	Very low, with firing remaining absent.
	Fedspeak	–	–	–	Kaplan, Economic Outlook in Dallas; Brainard on payments.
Fri 7					
NZ	Q1 RBNZ inflation expectations (2yr)	1.80%	–	–	Likely to remain a little below 2%.
Aus	RBA Governor Lowe	–	–	–	Testimony to Parliament Committee
	RBA Statement on Monetary Policy	–	–	–	Forecast update a key focus.
	Jan AiG PSI	48.7	–	–	Index choppy (-5pts in Dec). Service sectors subdued.
Chn	Jan trade balance USDbn	47.2	–	–	Lunar new year effect to be followed by coronavirus shock.
	Jan foreign reserves, $bn	3108	–	–	Broadly stable over past year.
US	Jan non–farm payrolls	145k	160k	170k	Employment growth will slow through 2020...
	Jan unemployment rate	3.5%	3.5%	3.5%	... resulting in stable unemployment rate....
	Jan average hourly earnings %mth	0.1%	0.3%	0.3%	... and modest wage gains.
	Fedspeak	–	–	–	Quarles on policy and economic outlook.
	Fed's Semi-Ann' Monetary Report	–	–	–	Released to Congress.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	2.0	2.5
CPI inflation % annual	1.5	1.9	1.8	1.8	1.7	2.1
Unemployment %	5.7	5.5	5.0	5.2	5.4	5.2
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.6	-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	0.5
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	5.8	5.8
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.7	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	3.0	3.2
Forecasts finalised 31 January 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	0.88	0.85	0.70	0.45	0.45	0.50	0.50	0.50
10 Year Bond	0.96	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	1.58	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	0.6710	0.68	0.66	0.67	0.67	0.68	0.69	0.72
USD/JPY	108.93	107	106	105	105	106	107	109
EUR/USD	1.1029	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.3092	1.30	1.30	1.30	1.30	1.31	1.31	1.32
USD/CNY	6.9109	6.95	6.90	6.85	6.80	6.80	6.75	6.60
AUD/NZD	1.0349	1.03	1.01	1.02	1.02	1.03	1.05	1.07

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Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

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