
Abel Tasman National Park, New Zealand

Weekly Economic Commentary.

A burden shared...

Employment has rebounded to about the pre-lockdown level after falling by 35,000 people in April, according to the latest Monthly Employment Indicator. We expect this week's Household Labour Force Survey will show that unemployment was 5% in the June quarter, which is much lower than we initially feared. Employers seem to have made more use of reduced hours and reduced pay than layoffs. This means that the impact of the COVID-19 recession will be more diffused than past recessions, which had a more concentrated impact on fewer people.

Stat's NZ's new Monthly Employment Indicator (MEI) has been extremely useful for tracking the impact of COVID-19 on the labour market. It is drawn from income tax data, giving it a very high level of coverage. It showed that the number of filled jobs fell by 35,000 in April. However, the June numbers, released last week, showed that filled jobs have recovered almost all of the earlier decline.

We are stunned by this apparent resilience in the labour market. However, it is consistent with other economic indicators showing that the economy was hit hard by the lockdown but has rebounded surprisingly readily. That said, zero employment growth for three months is still a poor outcome. It suggests that growth in the labour force hasn't been absorbed, and therefore unemployment has risen.

The main explanation for the resilience of employment is the Government's wage subsidy programme. At its peak, 1.7 million employees were covered by the scheme. Today there are 120,000 workers still covered by the final days of the original scheme, and an additional 440,000 covered by the extended wage subsidy programme. Those covered by the extended wage subsidy are the people most vulnerable to being laid off, given the dire revenue reductions that were required for a firm to qualify for the extended subsidy. Consequently, the true test for the labour market may come when the extended wage subsidy winds down over August and September.

The second reason for the resilient labour market is that employers have used reduced hours and/or reduced pay more frequently than in past recessions, meaning less need to resort to layoffs. If that trend continues, it suggests that the pain of the COVID recession will be more diffused and less concentrated than past recessions.

When the Household Labour Force Survey (HLFS) is released on Wednesday, we expect it to show that employment fell by 1.5% on average over the quarter, roughly consistent with the MEI discussed above. We estimate that the unemployment rate rose to 5% in the June quarter, from 4.2% in March. That's far lower than our previous forecast, which was 7%, and could surprise financial markets.

Our unemployment estimate is based on a range of indicators, but the most important is the number of people on benefits. On average over the June quarter around 183,000 people were receiving the Jobseekers Support benefit, an increase of 36,000 from the March quarter. Taken on its own, this would imply an unemployment rate of around 5.5%. However, we suspect that this overstates the case a little, as the eligibility criteria for receiving the benefit have been loosened since the start of the lockdown in March. In addition, the HLFS defines the 'unemployed' as those actively seeking work; not many people will have been actively job-hunting during the Level 4 lockdown in April, at a time when few businesses were hiring anyway.

The impact of the lockdown will probably show up more clearly in the underemployment rate, which counts people who are employed but would like to work more hours, and in the measure of hours paid from the Quarterly Employment Survey (QES).

We expect that the unemployment rate will rise much further in the September quarter, both because the labour market will weaken as the wage subsidy rolls off, and because the measurement issues associated with lockdown won't apply in the September quarter.

We have pencilled in a 0.3% quarterly increase in the key wage measures in the Labour Cost Index (LCI), which would take annual wage inflation to 2.2%. But frankly, the range of possible outcomes for the wage data is massive. Many employers put staff on reduced pay during lockdown, but it is unclear how much of this will be captured in the survey. What we can more safely say is that pay increases would have been hard to come by during the quarter. The exception to this was the minimum wage hike on 1 April, which we estimate added around 0.3% to the LCI.

The other key piece of data last week was building consents issuance. The number of residential dwelling consents rose by 0.5% in June, to be 8.1% higher than a year ago. Consent issuance has been running at levels not seen since the 1970s, and this points to ongoing strength in construction activity over the second half of 2020. However, as we look to the year ahead, we expect that uncertainty around the outlook will see fewer new housing projects being consented. That trend will be reinforced by the sharp downturn in net migration and population growth, which will reduce demand for new dwellings.

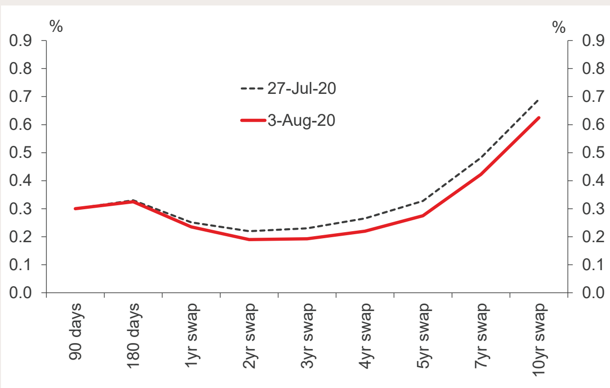
Consents for non-residential buildings have been in decline for some time, and fell further this month. This reinforces our expectation that non-residential construction activity will slow as the recession intensifies. Many of the construction businesses we have spoken to in recent weeks have highlighted concerns about the amount of planned work over the next few years.

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



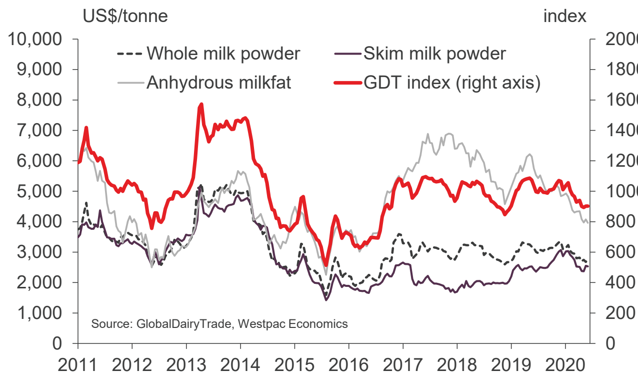
The week ahead.

NZ GlobalDairyTrade auction, whole milk powder prices

Aug 5, Last: +0.6% chg, Westpac: -1.0%

- We expect that whole milk powder (WMP) prices will fall modestly as auction volumes begin their seasonal increase. Auction volumes on offer are up nearly 50% from the previous auction.
- For comparison, the dairy futures market is pointing to a fall of around 2% as at the time of writing. We are less bearish as futures pricing tends to overstate potential auction price falls.
- WMP prices erased their COVID-related falls over June and July. Over coming months, we expect global dairy prices to come under renewed downward pressure from the seasonal rise in NZ production and as the deepening global recession weighs down dairy demand.

GlobalDairyTrade auction

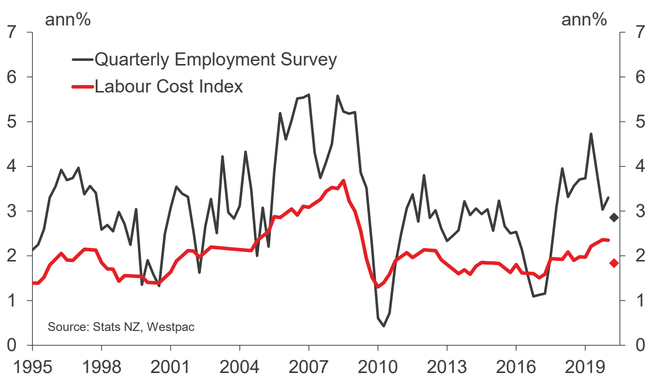


NZ Q2 Labour Cost Index

Aug 5, Private sector Last: 0.3%, WBC f/c: 0.3%, Mkt f/c: 0.4%

- We are expecting a subdued lift in the Labour Cost Index for June, but the range of possible outcomes is wide.
- Many firms took the option of reducing workers' pay during the COVID-19 lockdown. Stats NZ has advised that this will enter the LCI only if a lower hourly rate was explicitly agreed; otherwise it will be recorded as a drop in the number of hours paid.
- Setting aside measurement issues, it seems safe to say that pay increases would have been hard to come by during the June quarter. The exception was the minimum wage hike on 1 April, which we estimate added around 0.3% to the LCI.

LCI and QES salary and wages, all sectors

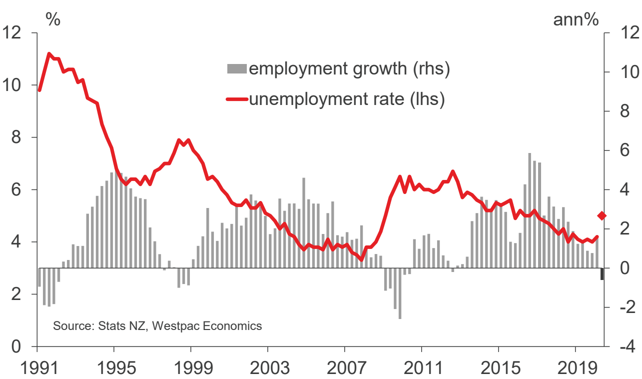


NZ Q2 Household Labour Force Survey

Aug 5, Employment Last:
+0.7%, WBC f/c: -1.5%, Mkt f/c: -1.7%
Unemployment rate Last:
4.2%, WBC f/c: 5.0%, Mkt f/c: 5.5%

- The impact of COVID-19 on employment so far, while large, has been much less than initially feared. The elimination of the virus allowing the removal of domestic restrictions, and the Government's wage subsidy scheme, has substantially softened the blow.
- Surveys suggest that businesses have adjusted through reduced hours and/or pay rates more so than through layoffs. Consequently, the impact on workers has been more diffuse than we typically see in recessions.
- Further job losses are likely in the coming quarters, with the wage subsidy scheme expiring in September and international borders likely to remain closed for many more months.

Household Labour Force Survey



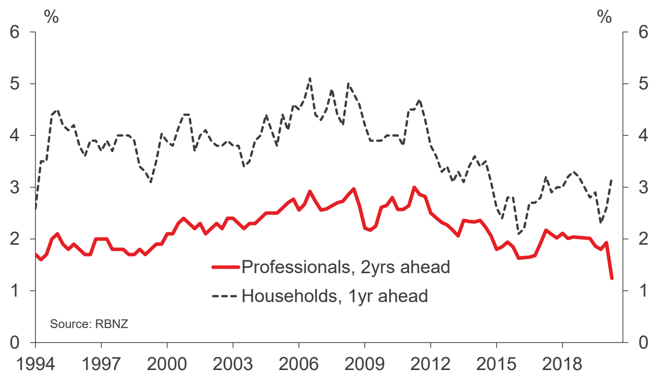
The week ahead.

NZ RBNZ two-year ahead inflation expectations

Aug 6, Last: 1.24%

- Inflation expectations fell sharply in June quarter. Notably, the RBNZ's closely watched two year ahead measure fell to a record low of 1.24%.
- The RBNZ has stressed that it is not beholden to one single measure of inflation expectations, and they instead look at a range of measures. Since lockdown conditions have been relaxed, we have seen a lift in a number of activity measures and some gauges of pricing activity. However, the number of businesses planning to increase prices remains low, and monthly measures of inflation expectations have not picked up. It appears that softness in demand is offsetting disruptions to supply in some sectors.
- We expect that the RBNZ's own survey will also show continued softness in inflation expectations. That will be an important consideration for the RBNZ ahead of the August policy statement, reinforcing the need for continued accommodative policy.

RBNZ survey of inflation expectations

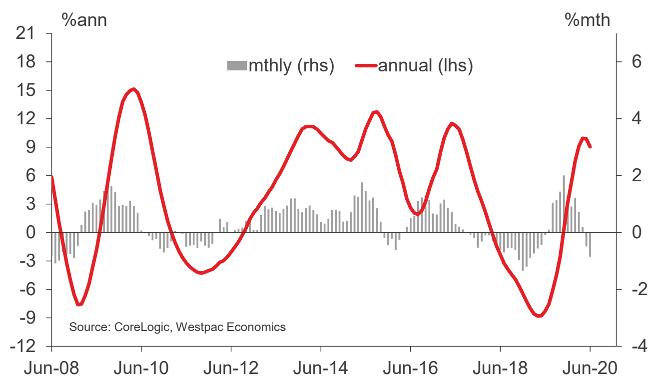


Aus Jul CoreLogic home value index

Aug 3, Last: –0.8%, WBC f/c: –0.8%

- The COVID-19 shock continues to filter through slowly to house prices. After a solid start to 2020, price momentum stalled through the first quarter, moving into negative as the lockdown impacted in April-May. That said, price declines have been relatively mild to date with a 0.5% fall in May and a 0.8% decline in June.
- While easing restrictions allowed for a strong rebound in turnover through May and June, price weakness has extended into July, accentuated by the renewed lockdown in Melbourne. CoreLogic's daily index points to another 0.8% decline nationally in July. We continue to expect a gradual price correction near term, accelerating as policy support starts to taper heading into Q4.

Australian dwelling prices

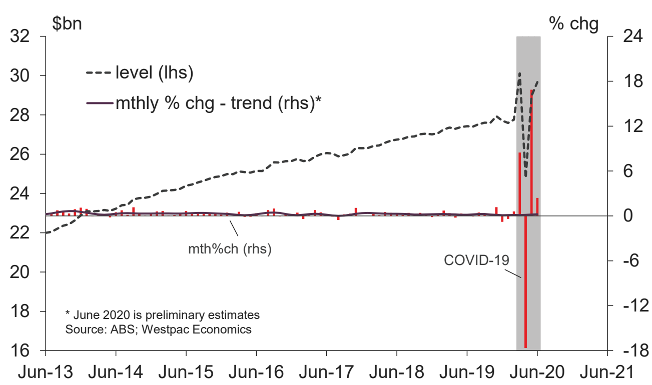


Aus Jun retail trade

Aug 4, Last: +16.9%, WBC f/c: +2.4%
Mkt f/c: 2.4%, Range: 1.4% to 2.8%

- Preliminary estimates showed a 2.4% rise in nominal sales in June, building on a 16.9% rebound in May from April's extraordinary 17.7% plunge. Annual growth lifted to 8.2%yr with monthly sales in June nearly 7% above their pre-COVID levels.
- Final estimates for June will include additional store-type and state detail – of particular interest will be the extent to which reopening boosted segments like cafes & restaurants and what already looked to be a diverging performance across states prior to the return to lockdown in Victoria.
- More generally, it should be noted that retail is a poor guide to wider spending as it misses some of the largest negative impacts from the COVID-19 crisis and is skewed towards segments that are benefitting from expenditure switching.

Monthly retail sales



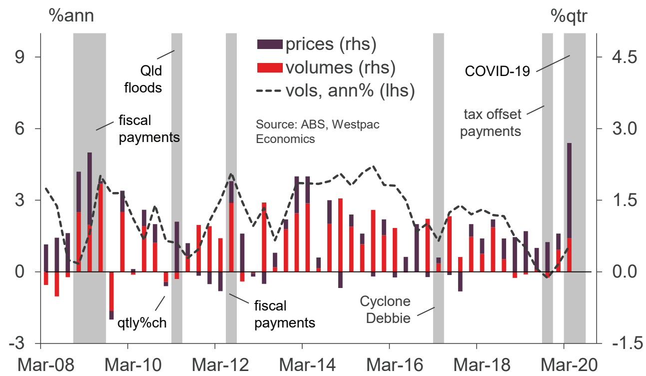
The week ahead.

Aus Q2 real retail sales

Aug 4, Last: 0.7%, WBC f/c: –3.2%
Mkt f/c: -1.5%, Range: -3.4% to 0%

- Real retail sales posted a 0.7% gain in Q1 driven by strong stock-piling demand ahead of the COVID-19 lockdown.
- The June quarter will be completely different story. Nominal sales have been extremely volatile month to month but are down 2.4%qtr on June's preliminary estimates. That compares to a 2.7% gain in Q1. Retail prices look to be up about 0.8%qtr judging by the CPI detail which would have real retail sales down 3.2%qtr – the largest decline since the GST introduction twenty years ago.
- Note that the wider consumption measures reported in the national accounts will be much weaker with many of the segments hit hardest by the Coronavirus not covered in the retail survey, including what is shaping up to be a particularly large impact on tourism along with big declines in vehicle sales and spending on fuel.

Quarterly retail volumes and prices

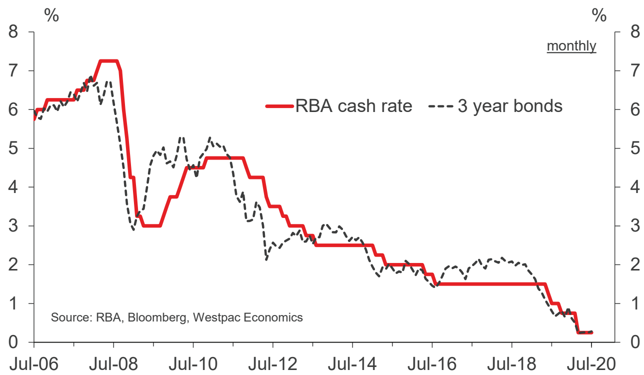


Aus Aug RBA policy decision

Aug 5, Last: 0.25%, WBC f/c: 0.25%
Mkt f/c: 0.25%, Range: 0.25% to 0.25%

- The RBA is expected to keep policy settings unchanged at its August meeting.
- The Bank is providing considerable support to the economy through a range of stimulus policies and will continue to do so for the foreseeable future. The key elements of the RBA's response to the pandemic are as follows: 1) lowering the cash rate to 0.25%; 2) targeting the 3 year government bond rate at 0.25%; 3) market operations, as needed, to provide ample liquidity to the banking system; 4) a Term Funding Facility for the banking system providing 3 year funding at 0.25%; and 5) setting the rate paid on Exchange Settlement balances at the RBA at 10bps.
- The RBA will also be releasing its August Statement on Monetary Policy on Aug 7, which will include an updated set of economic forecasts.

RBA cash rate and 3 year bonds

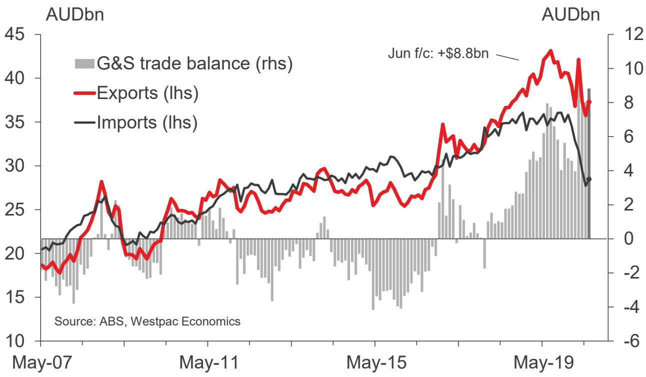


Aus Jun trade balance, AUDbn

Aug 4, Last: 8.0, WBC f/c: 8.8
Mkt f/c: 8.9, Range: 8.8 to 9.5

- Australia is running sizeable trade surpluses. The net impact of the pandemic, to date, has been to boost the surplus.
- Key to this, imports are down on falling domestic demand and the closure of the international border (grounding o/s travel), while goods exports have been more resilient. Also, the iron ore price is up on reduced supply from Brazil.
- The trade surplus hit a record high in March, climbing to $10.4bn, subsequently moderating to $8.0bn in May. For June, we anticipate another thumping surplus, at a forecast $8.8bn.
- Export earnings are up by around a forecast 4%, led higher by iron ore - on higher volumes and prices.
- Imports are expected to lift by a little under 3% following a 6% slump in May - thereby leaving the downtrend in place.

Australia's trade balance



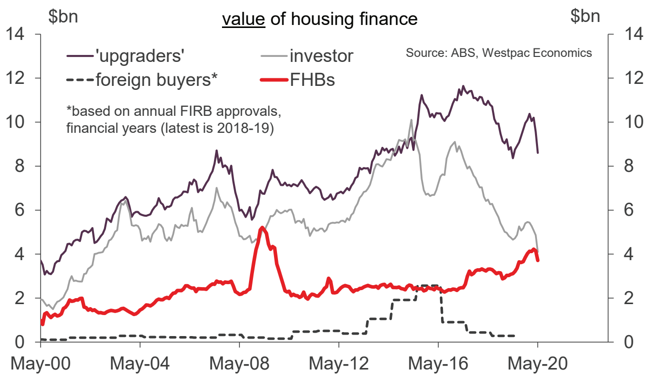
The week ahead.

Aus Jun housing finance approvals

Aug 7, Last: –11.6%, WBC f/c: –2%

- The COVID shock to housing finance activity became much clearer in May, the total value of approvals (excl. refi) slumping 11.6%, the biggest decline on records back to 2002. The result takes the two month decline to –15.8% – comparable to the slump seen ahead of the GFC in 2008 but still much milder than the 40% drop in turnover during the March-April lockdown.
- Turnover has since rebounded strongly with the reopening in May-June. However, there is clearly some disconnect between sales and finance activity, in part due to the more direct disruptions on turnover from virus lockdowns and the lags between application and approval.
- On balance we expect June finance approvals to show more delayed impacts with a further 2% decline in the total value of finance approvals. There are several sub-plots worth keeping an eye on as well, including a very strong surge in refi that has held finance approvals steady.

Housing finance approvals by segment

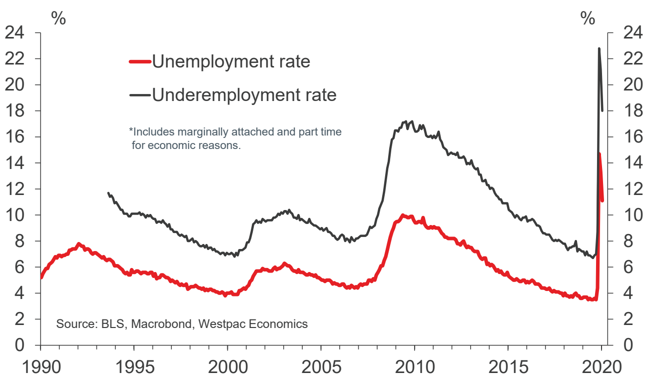


US Jul employment report

Aug 7, Nonfarm payrolls: Last: 4800k, WBC: 1300k
Unemployment rate: Last: 11.1%, WBC: 10.7%

- The recovery in jobs through May and June replaced roughly a third of the 22 million jobs lost in March and April. That still leaves the US economy almost 15 million jobs light.
- A further gain in employment is anticipated in July, though the stalling of the downtrend in initial claims highlights that job creation from here will be much more muted. Indeed, the most recent two weekly readings for initial claims have reported an increase in unemployment.
- All considered, we look for a gain of around 1300k jobs in July, with a stalling of employment growth (or a potential decline) instead a risk for August and beyond.
- The unemployment rate is also likely to fall further towards its GFC peak of 10% in July, we believe, to around 10.7%. Fluctuations in participation are a clear risk however.

US labour market slack historic

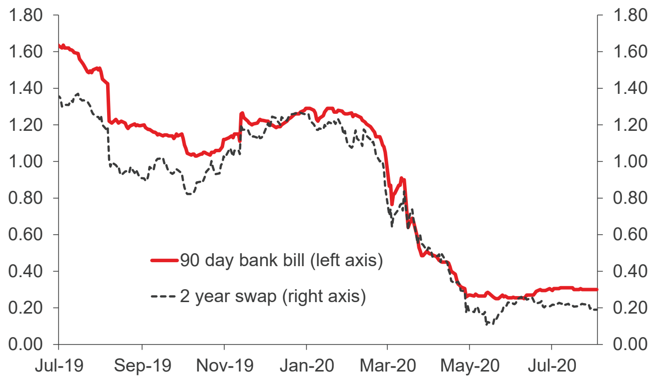


New Zealand forecasts.

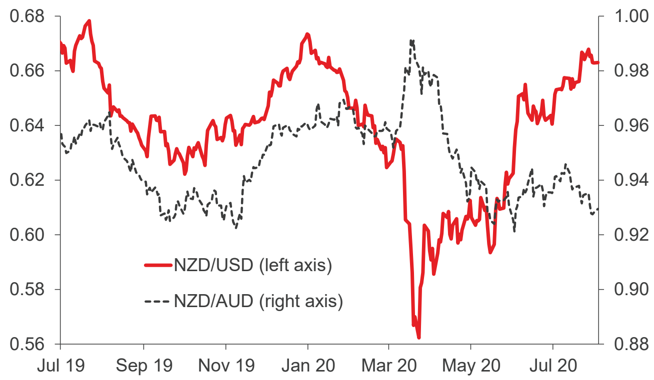
Economic forecasts	Quarterly				Annual			
	2020							
% change	Mar (a)	Jun	Sep	Dec	2018	2019	2020f	2021f
GDP (Production)	-1.6	-13.5	14.0	0.9	3.2	2.3	-4.6	5.1
Employment	0.7	-1.5	-2.4	-0.7	1.9	0.8	-3.9	2.7
Unemployment Rate % s.a.	4.2	5.0	6.5	7.5	4.3	4.0	7.5	6.7
CPI	0.8	-0.5	0.8	-0.3	1.9	1.9	0.8	0.4
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 3 August 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.28%
60 Days	0.29%	0.30%	0.30%
90 Days	0.30%	0.30%	0.31%
2 Year Swap	0.19%	0.21%	0.21%
5 Year Swap	0.28%	0.33%	0.36%

NZ foreign currency mid-rates as at 3 August 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6630	0.6546	0.6528
NZD/EUR	0.5629	0.5735	0.5812
NZD/GBP	0.5074	0.5210	0.5238
NZD/JPY	70.16	70.11	70.18
NZD/AUD	0.9295	0.9372	0.9419
TWI	72.33	72.33	72.49

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 03					
Aus	Bank holiday	–	–	–	Observed in NSW. (Picnic Day in NT.) Markets open.
	Jul AiG PMI	51.5	–	–	Manuf'g +9.9pts in June. Melbourne lock-down to hit in July.
	Jul MI inflation gauge	0.7%	–	–	Bounced out of the COVID lockdown – will it be sustained?
	Jul ANZ job ads	42.0%	–	–	Job ads surged as economy opened before Vic lockdown.
Chn	Jul Caixin China PMI	51.2	51.2	–	Rapid containment of localised outbreaks enable production.
Eur	Jul Markit manufacturing PMI	51.1	–	–	Germany and UK (services due Wed).
US	Jul Markit manufacturing PMI	51.3	51.3	–	Manufacturing has bounced back as...
	Jul ISM manufacturing	52.6	53.6	–	... economy re-opened. Clouds are on horizon though.
	Jun construction spending	–2.1%	1.0%	–	Set to turn positive for first time since COVID.
	Fedspeak	–	–	–	FOMC's Bullard, Barkin and Evans speaking.
Tue 04					
Aus	Jun retail sales	16.9%	2.4%	2.4%	Extreme swings due to COVID, volumes down sharply in Q2...
	Q2 real retail sales	0.7%	-1.5%	–3.2%	... but not as sharply as wider measures of spending.
	Jul CoreLogic home value index	–0.8%	–	–0.8%	Prices now down 2% since April, more weakness to come.
	Jun trade balance, $bn	8.0	8.9	8.8	Up on higher exports, led by iron ore (price & volume).
	RBA policy decision	0.25%	0.25%	0.25%	On hold. Focus on decision statement & SMP (Friday).
US	Jun factory orders	8.0%	5.0%	–	Known bounce in durable orders driven by vehicles.
Wed 05					
NZ	GlobalDairyTrade auction, WMP	–0.7%	–	-1.0%	Prices to fall modestly on rising seasonal production.
	Q2 employment	0.7%	–1.7%	–1.5%	COVID-19 lockdown had a sizeable impact on jobs...
	Q2 unemployment rate	4.2%	5.5%	5.0%	...but wage subsidies softened the blow.
	Q2 labour cost index (pvt, ord time)	0.3%	0.4%	0.3%	Impact of COVID pay cuts is unclear.
	Jul ANZ commodity prices	–0.7%	–	–	Dairy prices surged over July.
Aus	Jun housing finance	–11.6%	-0.8%	–2%	COVID shock working through slowly.
Chn	Jul Caixin China PMI services	58.4	57.9	–	Likely to pull back slightly from May's read, still expansionary.
Eur	Jun retail sales	17.8%	8.4%	–	Massive surge in sales to continue strong agins in June.
US	Jul ADP employment change	2369k	1200k	–	Last month's read was sub consensus; risk of a repeat.
	Jun trade balance US$bn	–54.6	–50.3	–	Exp. fell on crude, imp. on auto; trade deficit to narrow.
	Jul ISM non–manufacturing	57.1	55.0	–	Services to be more adversely impacted by high new cases.
	Fedspeak	–	–	–	FOMC's Mester will speak.
Thu 06					
NZ	Q3 RBNZ inflation expectations	1.24%	–	–	Gauges of inflation expectations lingering at low levels.
UK	BoE policy decision	0.10%	0.10%	0.10%	Policy needs to remain highly accommodative.
US	Initial jobless claims	1434k	–	–	Claims have risen for two weeks; risks loom large.
	Fedspeak	–	–	–	FOMC's Kaplan and Singh speak.
Fri 07					
Aus	RBA Statement on Monetary Policy	–	–	–	Forecast update - outlook remains challenging & uncertain.
	RBA Assistant Governor Economic	–	–	–	Luci Ellis at the ABE webinar, 11:45am.
	Jul AiG PSI	31.5	–	–	Services: -0.1pt Jun, very weak. Melb. lockdown to impact.
Chn	Jul trade balance USDbn	46.42	42.85	–	Upside trade surprise in Jun indicates return of int. demand.
	Q2 current account balance	–33.7	–	–	Provides useful trade and financial insights.
	Jul foreign reserves $bn	3112.33	–	–	Rose for third month as outlflows remained muted.
US	Jul non–farm payrolls	4800k	1635k	–	Elevated new case count and consequent restrictions...
	Jul unemployment rate	11.1%	10.5%	–	... to materially impede recovery; participation a clear...
	Jul average hourly earnings %mth	–1.2%	–0.5%	–	... risk for U/E rate. Wage growth to remain weak.
	Jun wholesale inventories	–2.0%	–	–	Business likely to limit stock levels given uncertainty.
	Jun consumer credit	–18.28	–10.00	–	Labour market and uncertainty to weigh.

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	0.84	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	0.55	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	0.7197	0.70	0.72	0.73	0.74	0.75	0.76
USD/JPY	104.72	106	106	107	107	108	108
EUR/USD	1.1847	1.14	1.16	1.16	1.17	1.17	1.18
GBP/USD	1.3098	1.26	1.27	1.27	1.28	1.29	1.30
USD/CNY	7.0088	7.00	6.90	6.85	6.80	6.70	6.60
AUD/NZD	1.0750	1.08	1.11	1.14	1.14	1.14	1.13

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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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