
Kahurangi National Park, New Zealand

Weekly Economic Commentary.

It's life, but not as we know it.

The economy is starting to open up again, but we're still a long way away from business as usual. Health and safety restrictions will be a handbrake on activity for some time. The coming months are likely to see restrained spending and job losses.

Over the past week, New Zealand's Covid-19 Alert Level was rolled back from Level 4 to Level 3. That's meant most businesses have been able to reopen (provided appropriate safety measures can be put in place) and around 400,000 New Zealanders have been able to go back to work.

Nevertheless, a return to business-as-usual is still a long way off. Around 13% of normal economic activity is still on hold with many businesses in the retail and hospitality sectors required to remain closed. In addition, health and safety requirements have placed a handbrake on activity in a number of other sectors, such as construction.

The alert level is due to be reviewed again on 11 May. But even when current restrictions are eventually eased, it will still be some time before they are removed altogether. Notably, border restrictions are likely to remain in place for an extended period, meaning businesses in sectors like hospitality and tourism have a long hard road ahead of them.

With restrictions on trading activity, as well as weak domestic and international demand, economic confidence has dropped sharply and large parts of New Zealand's business sector have moved into retrenchment mode. Unfortunately, there is a risk that some businesses might fail over the next few months.

Among those businesses that do survive, many will have to borrow heavily to get through, and once the recovery begins they will be focused on balance sheet repair. That's seen businesses cutting plans for investment spending to the bone, with investment intentions in the latest ANZBO survey falling to their lowest level since records began in 1988.

Businesses are also shedding workers. Wednesday's labour market report, covering the March quarter, will capture only a fraction of lockdown period. We expect it will show a modest rise in the unemployment rate from 4.0% to 4.3%, and jobs growth close to flat. However, we already know that the labour market has taken a further step down in April, with the number of people on job seeker benefits rising to 180,000, up sharply from 145,000 in March. Those losses would have been even larger if not for the Government's wage subsidy program. And as that program comes to an end, it's likely we'll see further job losses. We expect the unemployment rate will rise to 9.5% in June – its highest level in 27 years. Even with significant increases in fiscal stimulus now flowing through the economy, we expect the recovery in the jobs market will be gradual, with unemployment still above 7% by the end of next year.

This weakness in the jobs market will also be a drag on wage growth. We expect that wage inflation will fall from rates of over 2% per annum in recent years to around 1% in 2021. That would be the slowest pace of wage growth in more than two decades.

Together, job losses and weaker wage growth are going to be a significant drag on household spending. Even those households unaffected by the downturn in the labour market are likely to be more cautious about their spending, with consumer confidence falling to its levels last seen during the financial crisis.

One sector that is likely to face some big challenges over the coming years is manufacturing. As discussed in our recently released *Bulletin*,[1] falls in economic activity both domestically and abroad will cap demand and output growth, especially in sectors that rely on discretionary spending. That includes firms that manufacture consumer goods, as well as those that depend on private sector investment. In contrast, firms that rely more on government spending should do a bit better.

At the same time, manufacturers will also have to adapt to more stringent safety requirements. The need for physical distancing will mean some big operational changes, with many firms having to adopt new work organisation methods and revise their factory layouts. For smaller operators that do not have the deep pockets needed to make the necessary investments, this could prove to be the last straw, raising the possibility of further closures and job layoffs.

When Covid-19 eventually passes, and economic conditions both here and abroad begin to firm again, manufacturing activity should improve. However, this recovery is likely to take place in a world of increasingly protectionist trade policies and rising economic nationalism, both of which are likely to accelerate structural changes already in train. This includes an increase in the domestication of supply chains, facilitated by the uptake of new digital technologies such as 3-D printing, AI and robotics. For New Zealand manufacturers that have struggled with international competition, the domestication of supply chains is likely to mean more domestic opportunities. However, for those that have achieved export success, the global shift towards onshoring is likely to pose a direct threat.

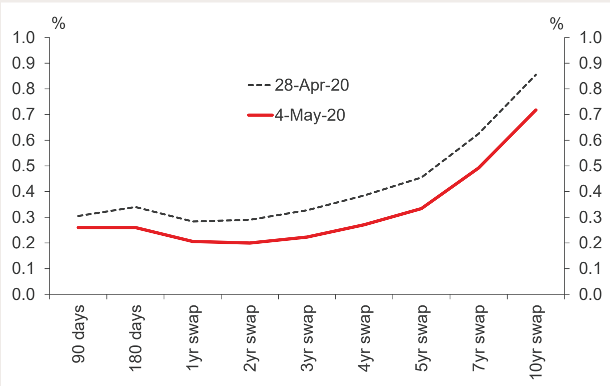
1 Available here: https://www.westpac.co.nz/assets/Business/Economic-Updates/2020/Bulletins-2020/Manufacturing-Bulletin-April-2020-Westpac-NZ.pdf

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



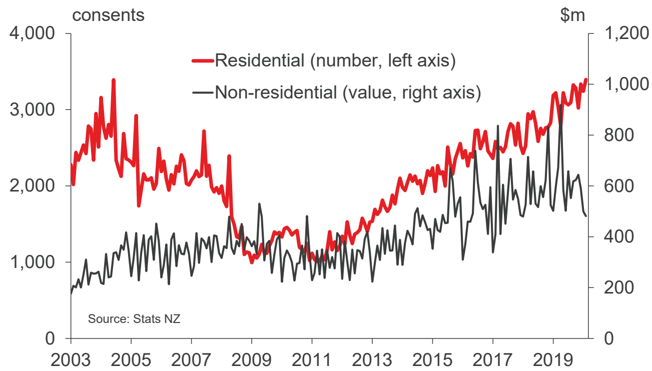
The week ahead.

NZ Mar dwelling consents

May 5, Last: -4.7%, Westpac f/c: -25%

- Dwelling consent numbers rose 4.7% in February, leaving consent issuance at a 45 year high. Strength in consent issuance has been widespread, with strong gains across much of the North Island and in major urban areas in the South Island.
- While consent issuance is likely to have remained firm through most of the month, New Zealand's entry into lockdown meant that there were 5 fewer working days in March. As a result, we expect consent numbers will be down 25% over the month.
- There is currently a large pipeline of planned building projects and there will be a period of catch up activity now that the country is exiting lockdown. However, we expect that fewer new projects will go through the consenting process over the coming month, and that there will be a related slowdown in building through 2021.

Building consents



NZ Q1 Household Labour Force Survey

May 6, Employment last: 0.0%, WBC f/c: -0.2%, Mkt f/c: -0.2%
Unemployment last: 4.0%, WBC f/c: 4.3%, Mkt f/c: 4.5%

- We expect a small drop in employment for the March quarter, and a rise in the unemployment rate to 4.3%.
- The HLFS is surveyed continuously over the quarter. Consequently, only a fraction of the March quarter result will cover the impact of the Covid-19 lockdown, which began in late March. Other labour market indicators suggest that employment was steady over January and February.
- We expect unemployment to peak at 9.5% in the June quarter, and without the Government's wage subsidy scheme we'd be looking at a much higher number.

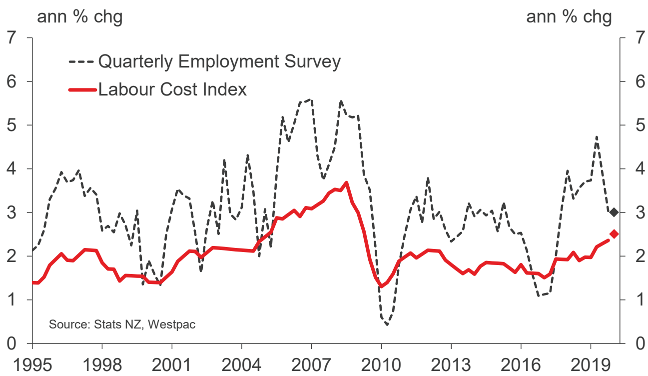
Household Labour Force Survey

NZ Q1 Labour Cost Index

May 6, Private sector last: 0.6%, WBC f/c: 0.5%, Mkt f/c: 0.5%

- We expect a 0.5% increase in labour costs in the March quarter. That would take annual private sector wage growth to 2.5%, the fastest pace since 2009.
- The Labour Cost Index (LCI) was measured in mid-February, missing the impact of the lockdown. Moreover, the LCI measures of wage growth tend to evolve slowly and with a lag to employment trends. Wage growth was noticeably picking up (and by more than expected) by the end of last year, suggesting that the labour market had truly moved into 'tight' territory.
- Going forward, it's likely that wage increases will be hard to come by, apart from government-mandated increases such as minimum wage hikes and public sector pay agreements.

LCI and QES salary and wages, all sectors



The week ahead.

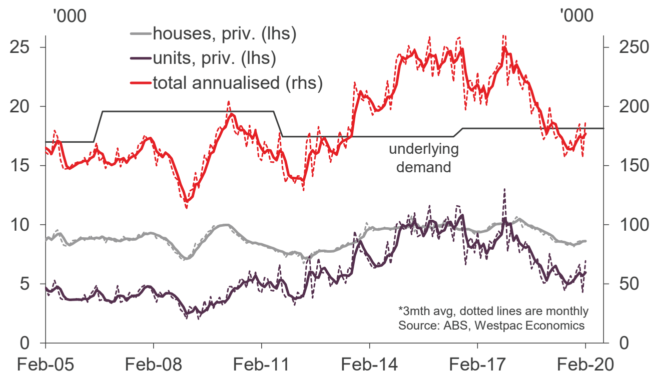
Aus Mar dwelling approvals

May 4, Last: 19.9%, WBC f/c: –15.0%
Mkt f/c: -15.0%, Range: -20.0% to 13.3%

– Dwelling approvals jumped 20% in February on a 60% spike in unit approvals, concentrated in Vic. The picture was softer outside of high rise, private detached house approvals down 0.8% and low rise and medium density unit approvals about flat.

– March will see this spike unwind just as initial effects from the Coronavirus shut-down start to come through. The latter will be relatively small given that social restrictions only came into full effect in the last week of the month, with April set to register a much bigger drop. Overall, we expect approvals to be down 15% in the month, noting that base effects mean the pull back in approval numbers is about a third bigger than the February spike, taking monthly approvals below their January level.

Aus dwelling approvals



Aus May RBA policy decision

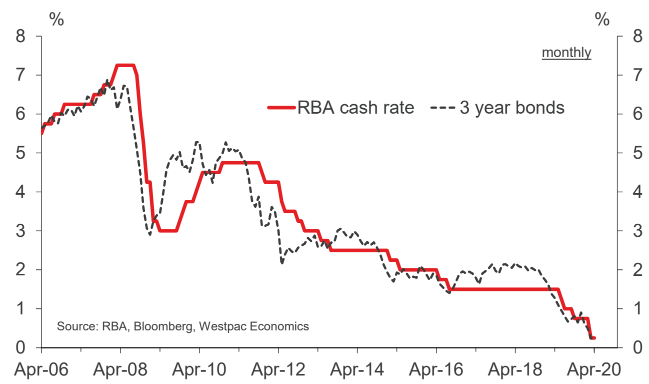
May 5, Last: 0.25%, WBC f/c: 0.25%
Mkt f/c: 0.25%, Range: 0.25% to 0.25%

– The RBA cut the cash rate by 25bps at its March meeting and by another 25bps to 0.25% at an emergency inter-meeting move on March 19 that also included the deployment of a range of QE measures including policies aimed at lowering key market rates (3yr bonds) and providing low cost term funding for banks. The RBA has also moved to provide large liquidity injections to stabilise increasingly dislocated financial markets.

– With the RBA continuing to rule out negative rates, the cash rate is set to remain at its current level for a very long time - we assess until at least the end of 2023.

– In the April decision, the RBA noted that: "If (market) conditions continue to improve, though, it is likely that smaller and less frequent purchases of government bonds will be required".

RBA cash rate and 3 year bonds



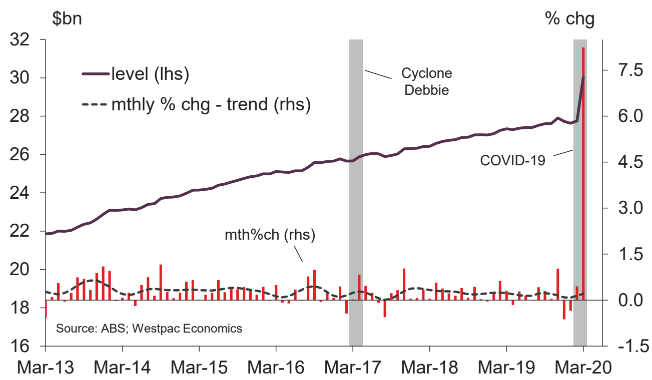
Aus Mar retail trade

May 6, Last: 0.5%, WBC f/c: 8.2%
Mkt f/c: 8.2%, Range: -5.0% to 8.6%

– The ABS has moved to releasing preliminary retail sales estimates as part of an effort to provide more timely information on the impacts of the Coronavirus. For March, these showed a huge 8.2% rise as a spectacular stockpiling-driven surge in segments like basic food more than offset weakness in segments hit hard by the Coronavirus shutdown.

– The preliminary figures are based on returns covering 80% of the sector. They are subject to revision, but proved fairly accurate in February and there seems little reason to expect a material change to the March number, particularly given the scale of the March move which was dominated by segments that would have had full coverage (i.e. the major supermarket chains).

Aus monthly retail sales



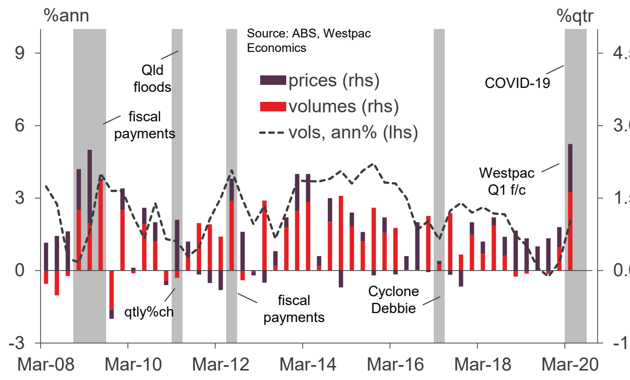
The week ahead.

Aus Q1 real retail sales

May 6, Last: 0.5%, WBC f/c: 1.6%
Mkt f/c: 1.8%, Range: 0.4% to 2.8%

- The wash up for Q1 is set to show a strong rise in real retail sales.
- The surge in the March month means nominal sales will be up 2.6% for the quarter as a whole. While the CPI detail showed some relatively strong price gains for food and household goods, the retail deflator as a whole looks to be up about 1%qtr, meaning real retail sales will be up about 1.6%qtr.
- Note that the wider consumption measures reported in the national accounts may still record a decline for the quarter. Retail makes up about 30% of total spending. Coronavirus effects are likely to see significant weakness in other segments, particularly discretionary services and vehicle purchases and operation (i.e. fuel) which combined make up about 20% of total spending. More generally, spending is set to fall heavily in Q2 as social restrictions impact more fully and stockpiling demand wanes.

Aus quarterly retail volumes and prices

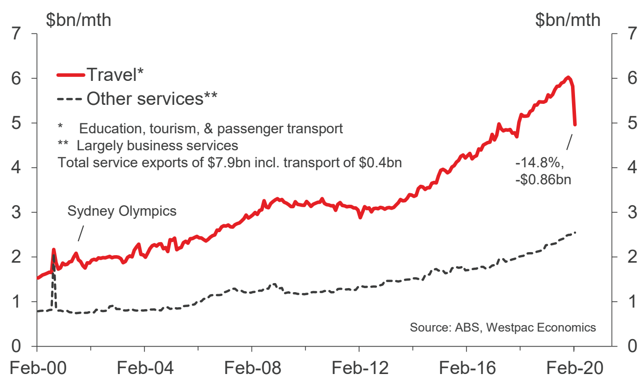


Aus Mar trade balance, AUDbn

May 7, Last: 4.4, WBC f/c: 6.8
Mkt f/c: 6.4, Range: 1.0 to 9.0

- Australia's trade surplus printed at $4.4bn in February, down from $4.95bn at the end of 2019.
- Exports fell 4.7% in February, with reduced international travel driving a near 10% fall in services (-$0.85bn) and Cyclone Damien leading to an 8% ($0.8bn) drop in metal ores.
- Imports were also disrupted in February, down 4.3% ($1.5bn). China's lock-down in February had a major impact on trade.
- For March, the surplus is expected to spike to $6.8bn.
- Goods exports have rebounded, as reported in preliminary customs data (not seasonally adjusted), boosted by the recovery of iron ore post Cyclone Damien. On the services side, COVID disruptions will continue.
- Goods imports also rebounded with China re-opening, as suggested by the preliminary customs data.

AUS service exports

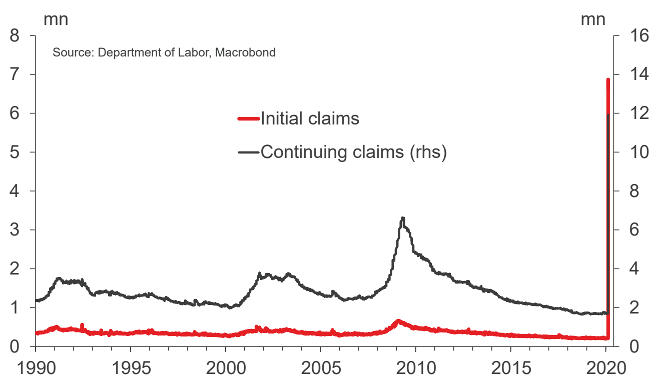


March US employment report

May 8, nonfarm payrolls: last: -701k, WBC: –23 million
May 8, unemployment rate: last: 4.4%, WBC: 17.0%

- Initial jobless claims have reported a never before seen loss of jobs over the past six weeks. The majority of this loss will impact the Apr employment report, coming before the survey date.
- Nonfarm payrolls are set to decline by around 23 million in just one month. The unemployment rate will consequently jump skyward to 17%. Underemployment will also be rampant across the economy given the ill effects of the shutdown.
- The risks to these outcomes lay heavily to the downside. Further declines will also be seen in May and June, likely seeing the unemployment rate rise to over 20% mid-year.
- While not affected immediately, wages will come under pressure in the second half of 2020 and remain weak thereafter.

US unemployment

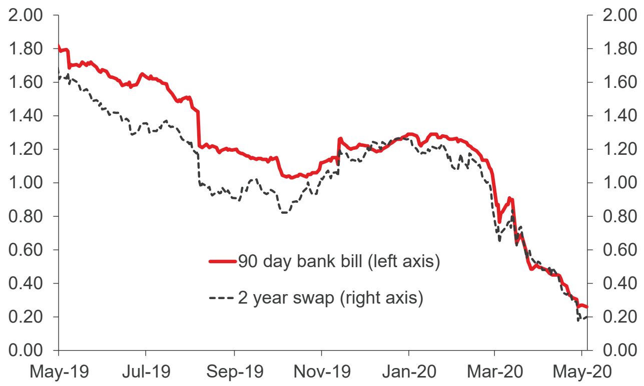


New Zealand forecasts.

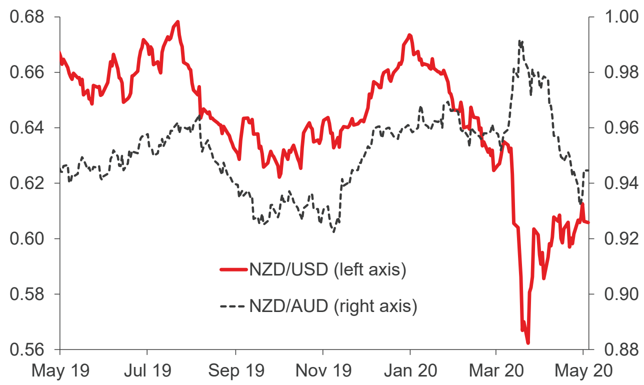
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Dec (a)	Mar	Jun	Sep	2018	2019	2020f	2021f
GDP (Production)	0.5	-1.0	-16.0	13.0	3.2	2.3	-6.3	4.7
Employment	0.0	-0.2	-8.8	3.1	1.9	1.0	-4.6	2.8
Unemployment Rate % s.a.	4.0	4.3	9.5	8.5	4.3	4.0	7.7	7.1
CPI	0.5	0.8	-0.4	0.8	1.9	1.9	1.3	1.0
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 4 May 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.31%	0.35%
60 Days	0.27%	0.35%	0.42%
90 Days	0.26%	0.39%	0.48%
2 Year Swap	0.20%	0.34%	0.49%
5 Year Swap	0.33%	0.50%	0.60%

NZ foreign currency mid-rates as at 4 May 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6058	0.6035	0.5870
NZD/EUR	0.5521	0.5553	0.5428
NZD/GBP	0.4850	0.4829	0.4796
NZD/JPY	64.72	64.91	63.62
NZD/AUD	0.9446	0.9479	0.9761
TWI	68.68	68.74	67.85

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
Aus	Apr MI inflation gauge %yr	1.5%	–	–	CPI jumped in Q1, but inflationary pressure will dissipate.
	Apr ANZ job ads	–10.3%	–	–	March read showed the sharpest decline since the GFC.
	Mar dwelling approvals	19.9%	–15.0%	–15.0%	Big drop on unwinding high rise spike & COVID disruption.
	Apr 22 Business impacts of COVID	–	–	–	ABS weekly update on COVID impacts by industry.
Eur	May Sentix investor confidence	–42.9	–26.0	–	Survey already at the lowest level on record.
US	Mar factory orders	0.0%	–9.2%	–	New orders to contract as economic activity stalls.
	Mar durable goods orders	–14.4%	–	–	Final read to confirm collapsing investment intentions.
Tue 05					
NZ	Mar building permits	4.7%	–	–25.0%	Lockdown conditions resulted in fewer working days.
	Apr ANZ commodity prices	–2.1%	–	–	Sharp falls in meat and dairy prices in April.
Aus	Apr AiG PCI	37.9	–	–	Mar -4.8pts. New orders -10.3pts to 35.4.
	Apr 18 Payroll Jobs & Wages	–	–	–	ABS, weekly update reveals sharp fall in employment.
	RBA policy decision	0.25%	0.25%	0.25%	Eased policy aggressively in March. Providing ongoing support.
Eur	Mar PPI %yr	–1.3%	–2.7%	–	Energy prices fell sharply in the February read.
US	Mar trade balance US$bn	–39.9	–41.0	–	February showed narrowest balance in 3 years.
	Apr ISM non–manufacturing	52.5	37.5	–	Expected to fall to a record low as service sector is hit hard.
	Fedspeak	–	–	–	Evans, Bostic and Bullard to speak.
Wed 06					
NZ	Q1 unemployment rate	4.0%	4.5%	4.3%	COVID-19 lockdown in late March to have small impact…
	Q1 employment	0.0%	–0.2%	–0.2%	…with employment trends steady up until then.
	Q1 LCI wages (pvte, ordinary time)	0.6%	–	0.5%	Wage growth momentum was building prior to lockdown.
Aus	Mar retail sales	0.5%	8.2%	8.2%	Preliminary est showed extraordinary stockpiling surge …
	Q1 real retail sales	0.5%	1.8%	1.6%	… that will drive biggest qtly volume gain since GFC.
Eur	Mar retail sales	0.9%	–11.3%	–	Flash GDP has already identified record collapse in activity.
US	Apr ADP employment change	–27k	–20000k	–22000k	Initial claims have shown an unprecedented rate of job loss.
	Fedspeak	–	–	–	Bostic, discuss the response to the virus.
Thu 07					
NZ	Q2 RBNZ inflation expectations	1.90%	–	–	Likely to drop sharply due to the economic downturn.
Aus	Apr AiG PSI	38.7	–	–	Mar -8.3pts. Hospitality, the arts, retail etc hard hit by COVID.
	Mar trade balance $bn	4.4	6.4	6.8	Exports sharp rebound. Services further COVID hit.
Chn	Apr Caixin China PMI composite	46.7	–	–	Official PMIs have already indicated that composite…
	Apr Caixin China PMI services	43.0	50.5	–	… and non-mfg held up in April.
	Apr trade balance USDbn	19.90	15.80	–	Set to narrow as the exports side contracts.
	Apr foreign reserves $bn	3,060	3,060	–	Expected to be broadly stable after surprise drop in March.
UK	BoE policy decision	0.10%	0.10%		Focus will be on assessment of asset purchase program.
US	Q1 productivity	1.2%	–5.4%	–	Productivity to stall as labour market deteriorates.
	Initial jobless claims	3839k	–	–	Rate of job loss moderating but still at a substantial level.
	Mar consumer credit $bn	22.331	26.500	–	Jumped in Feb, and another increase is expected.
	FOMC member Harker	–	–	–	Will discuss the response to COVID-19.
Fri 08					
Aus	RBA Statement on Monetary Policy	–	–	–	Forecast update post COVID the key focus.
Chn	Q1 current account balance	40.5	–	–	Full detail on trade in volatile quarter.
US	Apr non–farm payrolls	–701k	–22000k	–23000k	Initial claims are at never before seen levels…
	Apr unemployment rate	4.4%	16.3%	17.0%	… the unemployment rate is set to jump skyward.
	Apr average hourly earnings %mth	0.4%	0.3%	0.3%	Wages growth will suffer later on.
	Mar wholesale inventories	–1.0%	–	–	Final. Prelim showed fall in wholesale and nondurables.
Sun 10					
Chn	Apr M2 money supply %yr	10.1%	10.3%		Credit soared in Mar after the shut down. A more…
	Apr new loans, CNYbn	2850.0	1220.0		… modest follow up gain is expected in Apr.

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	0.3	2.4
Unemployment %	5.7	5.5	5.0	5.2	7.8	6.4
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	1.1
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	0.5	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	1.7
United Kingdom						
Real GDP %yr	1.9	1.9	1.3	1.4	-7.0	2.5
China						
Real GDP %yr	6.7	6.8	6.6	6.1	0.1	10.0
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	3.9	3.6	2.8	-3.0	4.8
Forecasts finalised 1 May 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	0.10	0.15	0.20	0.25	0.30	0.35	0.40	0.45
10 Year Bond	0.87	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	0.62	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	0.6464	0.62	0.64	0.66	0.68	0.68	0.69	0.70
USD/JPY	107.16	107	105	106	107	107	108	110
EUR/USD	1.0946	1.07	1.06	1.06	1.07	1.08	1.09	1.10
GBP/USD	1.2562	1.22	1.23	1.24	1.25	1.25	1.26	1.27
USD/CNY	7.0633	7.02	6.90	6.85	6.80	6.75	6.70	6.60
AUD/NZD	1.0617	1.03	1.03	1.03	1.05	1.05	1.05	1.06

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