Kahurangi National Park, New Zealand

Weekly Economic Commentary.

The Government, the virus and the QE program.

After a tumultuous few weeks, financial markets have calmed again. In part, that's due to signs that the daily number of new Covid-19 infections globally is flattening off. However, the major factor that has soothed frazzled nerves in financial markets has been the extraordinary level of fiscal and monetary stimulus that has been announced globally in recent weeks. Those measures have supported a rally in equity markets, though major indices are still well down on their pre-outbreak highs and they remain choppy.

Financial markets sentiment remains fragile and will be repeatedly tested over the months ahead as the extent of the downturn in economic conditions becomes clearer and weak economic data emerges. The strain on businesses' financial position is already evident, with growing reports of layoffs and some business closures already occurring. We expect to see more of this in the coming weeks.

The centre pieces of the Government's effort to backstop the economy are its wage subsidy scheme and its Business Finance Guarantee Scheme. Under the guarantee scheme, banks will provide loans to businesses but the Government will take 80% of the credit risk and the Reserve Bank will provide the funding, if needed, under a newly announced Term Loan Scheme. This is almost as though the Crown is lending directly to the business sector. Both the wage scheme and the business loan scheme appear to be working smoothly, with massive take up of both. The major banks are also providing mortgage repayment deferrals of up to six months for households, which we expect will also be heavily subscribed.

These schemes make sense. They will allow businesses and households to tide themselves over through a period of extreme disruption, but will not unduly stress the Government's balance sheet. The thing to remember, though, is that once Covid-19 has passed businesses will find themselves carrying more debt, and will be more focussed on balance sheet repair than expansion. For example, if the business loan scheme is fully taken up it would amount to about 5% of all current business lending (ex agriculture).

In addition to measures to cushion the economy through the Covid-19 disruption, the Government is also looking at policies that will support a recovery in activity and employment when the virus has passed. Details of this spending are still being determined. Thus far the Government has signalled its intention to significantly ramp up spending on infrastructure and building. That comes a top of the $12bn expansion of the Government's building program which was announced late last year.

This sort of state-led building program could help to address some of the coming increase in unemployment, and it also fits with the Government's aims of refreshing the nation's infrastructure stock. However, we do have some doubts about how fast such spending can realistically be rolled out. The Government is prioritising projects that will be 'shovel ready' within six months and has highlighted that the expected rise in unemployment will ease capacity constraints. But as we have often seen, infrastructure spending can take an extended period to get underway. We suspect that this spending will be introduced in conjunction with other measures to bolster demand and support the labour market after the lockdown period.

The Government's support packages will be expensive. Automatic fiscal stabilisers will further add to the pressure on the Government's books, as tax revenue drops and expenditure in areas like health and social welfare increases. We have calculated that the combination of automatic stabilisers and the support measures already announced will require the Government to increase its borrowing by $65bn over the coming four years. And with further measures likely to be introduced over the coming months, that figure will likely rise to around $70bn. That would result in the government debt to GDP ratio rising from 18.5% now to 40% by mid-2022. That is high by New Zealand standards, but still low by international standards and quite manageable at today's low interest rates.

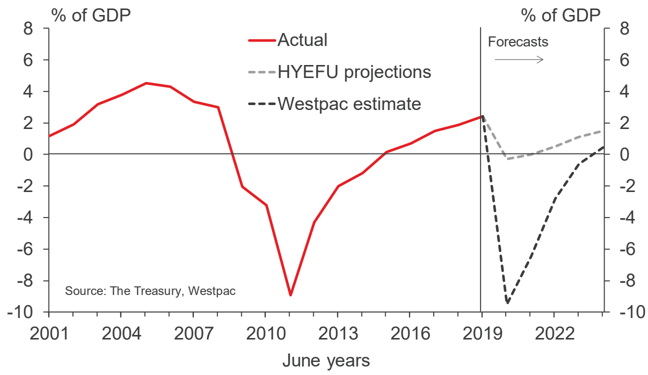
In order to fund this debt, the Government has announced that it is issuing $17bn of bonds over the coming three months, and we estimate that total issuance between now and June 2021 will have to be $48bn.

That is an awful lot of bonds for the market to swallow, but fortunately there is a ready buyer. The RBNZ has committed to buying $30bn worth of Government bonds over the coming year under its Large Scale Asset Purchase Program (i.e. Quantitative easing). The purpose of this program is to prevent an unwanted increase in interest rates. We believe that the RBNZ is aiming to keep longer-term Government bond rates at roughly 1%. In order to achieve that the RBNZ is probably going to have to increase its program beyond $30bn, as well as stepping up the weekly pace of purchases (currently running at $1.35bn).

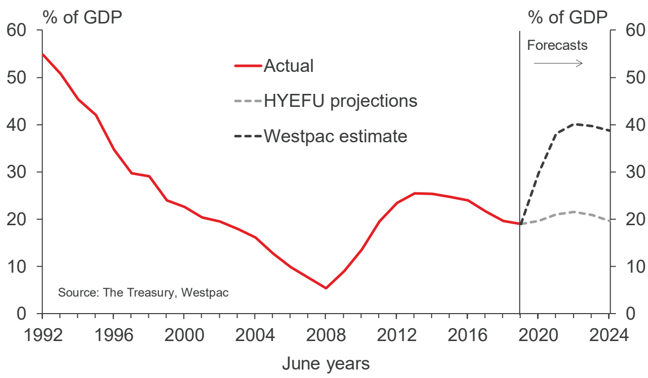
This raises the question of how long the RBNZ can continue to print cash to support increases in Crown spending? The key consideration on this front is the RBNZ's inflation target. Provided inflation remains low, the RBNZ can continue with asset purchases. And with a significant downturn in the economy now in train, we do expect that inflation will drop to low levels over the coming year.

However, it is conceivable that upward pressure on inflation could emerge over time, for example if permanent disruptions to global supply chains caused higher production costs. This could eventually force the Reserve Bank to curtail its QE program and allow interest rates to rise. In turn, that would hamper the recovery and would make it more difficult for the Government to continue borrowing. We view this as a risk scenario only, but it does illustrate why inflation will be important to watch.

Operating balance as a % of GDP



Net core Crown debt as a % of GDP



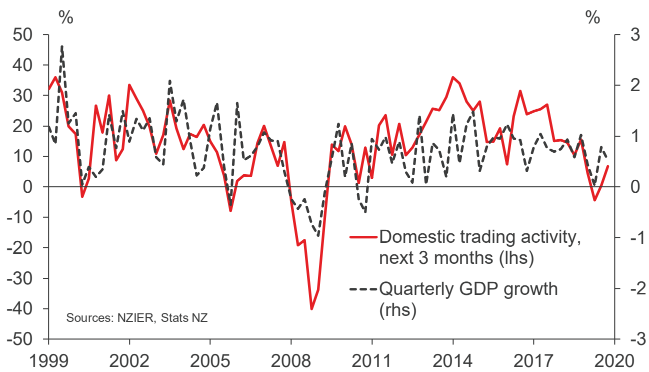
The week ahead.

NZ Q1 Survey of Business Opinion

Apr 7, General business situation, Last: -26
Domestic trading activity (past 3 months), Last: -11

- This quarter's survey includes responses up to 20 March. While that predates the country's shift to Level 4 COVID-19 restrictions, it still captures much of the recent disruptions to economic activity and related changes in business sentiment.
- Consistent with other recent surveys, we expect the March quarter survey will show a sharp drop in business confidence. We also expect a drop in the backwards looking trading activity questions, which tend to be a good gauge of quarterly GDP growth. Weakness is expected to be widespread, but especially pronounced in the manufacturing sector.
- We will also be watching the hiring and investment gauges, which are expected to record sizeable drops in the face of a deteriorating economic outlook.

QSBO domestic trading activity and GDP

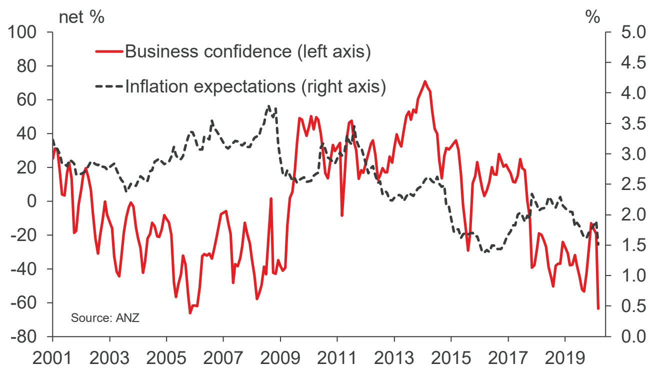


NZ Apr ANZ business confidence

8 Apr, Last: -63.5

- Business confidence has plummeted in the face of the Covid-19 outbreak and the related disruptions to economic activity. The number of businesses expecting weaker trading conditions over the coming year has dropped to a multi-decade low. Against this backdrop there has been a sharp drop in the number of businesses planning to take on new staff or undertake capital expenditure over the coming year. The fall in confidence has been broad based.
- A preliminary result for the April survey will be released this week. This survey will cover the first week of the lock down. The activity gauges will certainly be weak. We'll be watching to see how plans for hiring and investment are being affected in the face of both the lockdown and Government support packages.

NZ business confidence

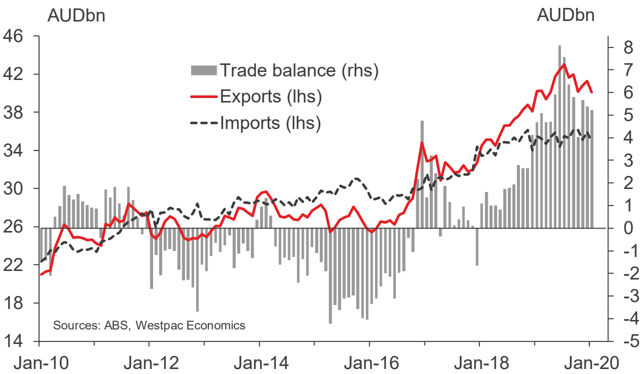


Aus Feb trade balance, AUDbn

Apr 7, Last: 5.2, WBC f/c: 3.5
Mkt f/c: 3.8, Range: 0.7 to 4.5

- Our forecast is for the trade surplus to narrow to $3.5bn in February, led lower by exports. However, there is extreme uncertainty around this forecast. Both exports and imports could move in a very large range.
- On February 2, Australia closed its borders to flights from China for non-residents. China was in lock-down in February, triggering a collapse in output. Australia sources 25% of goods imports from China - so this is a significant disruption.
- Domestically, exports were also dented by weather disruptions to iron ore shipments.

Aus trade balance



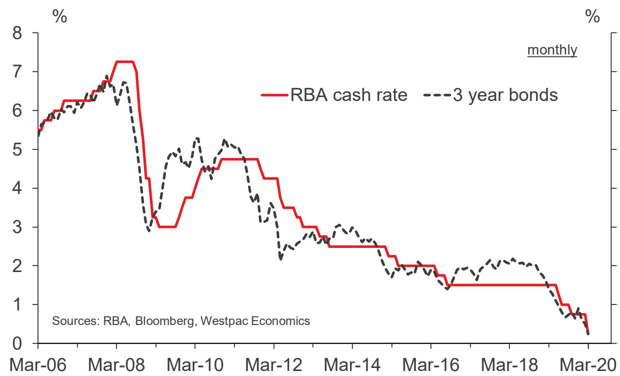
The week ahead.

Aus Apr RBA policy decision

Apr 7, 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. As such, the focus of RBA meetings will be on how the Board assesses its QE measures and whether they may require adjusting. For April we do not anticipate this requiring any adjustments.

RBA cash rate and 3 year bonds

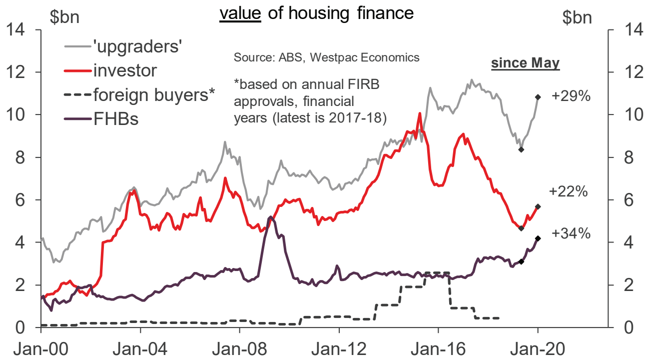


Aus Feb housing finance approvals

Apr 8, Last: 4.6%, WBC f/c: 1.5%

- Australia's housing market had started the year with good momentum ahead of the coronavirus shock, with prices posting solid gains in the first few months and turnover holding on to the strong gains in late last year, Q1 sales up 28% on the same time last year. In terms of housing finance approvals, Jan showed a robust broad-based gain, the total value of approvals surging 4.6%mth with gains in both volumes and average loan size, and across all segments, albeit with investor activity continuing to lag.
- We expect Feb to show a similar pattern with a more moderate pace, the total value of approvals rising a further 1.5%. This is ahead of what will be a steep drop through March and April as the sector moves into a virus-related shutdown. The outright ban on physical auctions and open homes that came into effect in late March coupled with wider social distancing requirements and health concerns and a deep shock to economic activity mean property market activity will be reduced to a trickle of online and private sales.

Aus housing finance by segment

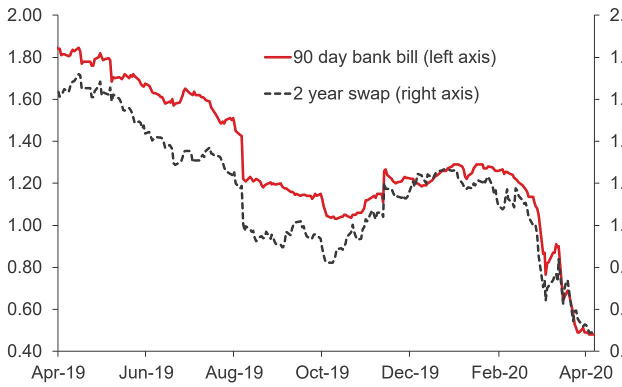


New Zealand forecasts.

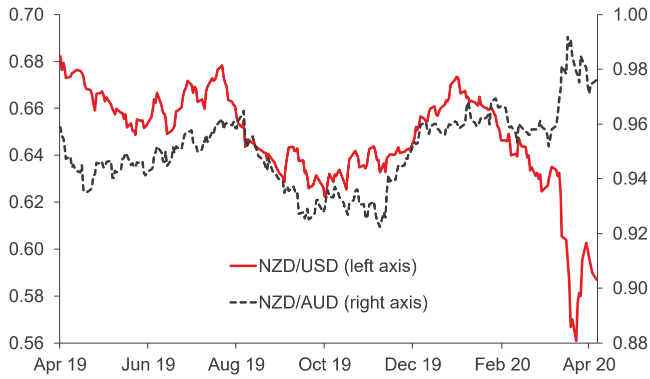
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Dec (a)	Mar	Jun	Sep	2018	2019	2020f	2021f
GDP (Production)	0.5	-1.0	-14.0	9.9	3.2	2.3	-5.6	6.7
Employment	0.0	-0.9	-6.8	3.6	1.9	1.0	-2.4	3.6
Unemployment Rate % s.a.	4.0	4.7	9.0	8.0	4.3	4.0	7.0	5.6
CPI	0.5	0.5	0.4	0.9	1.9	1.9	2.3	1.0
Current Account Balance % of GDP	-3.0	-3.0	-3.5	-3.7	-3.8	-3.0	-4.1	-3.3

Financial forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.40	0.40	0.40	0.40	0.40	0.40
2 Year Swap	0.60	0.60	0.60	0.65	0.70	0.80
5 Year Swap	0.70	0.75	0.80	0.90	1.00	1.10
10 Year Bond	1.00	1.00	1.00	1.05	1.10	1.20
NZD/USD	0.60	0.62	0.64	0.65	0.65	0.66
NZD/AUD	0.97	0.97	0.96	0.96	0.96	0.95
NZD/JPY	64.2	65.1	67.8	69.6	69.6	70.7
NZD/EUR	0.56	0.58	0.60	0.61	0.61	0.61
NZD/GBP	0.49	0.50	0.52	0.52	0.52	0.52
TWI	67.8	69.3	70.7	71.4	71.2	71.2

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 6 April 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	1.00%
30 Days	0.35%	0.43%	1.00%
60 Days	0.42%	0.55%	0.91%
90 Days	0.48%	0.67%	0.83%
2 Year Swap	0.49%	0.68%	0.71%
5 Year Swap	0.60%	0.92%	0.77%

NZ foreign currency mid-rates as at 6 April 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5870	0.5691	0.6334
NZD/EUR	0.5428	0.5341	0.5582
NZD/GBP	0.4796	0.4894	0.4853
NZD/JPY	63.62	63.13	66.09
NZD/AUD	0.9761	0.9826	0.9579
TWI	67.85	66.91	70.35

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 06					
NZ	Mar ANZ commodity prices	–2.1%	–	–5.0%	Sharp declines across all major commodity exports.
Aus	Mar MI inflation gauge	1.6%	–	–	A secondary consideration, but below target.
	Mar ANZ job ads	0.7%	–	–	Hiring freezes should see a sharp pullback.
Eur	Apr Sentix investor confidence	–17.1	–	–	Confidence evaporated in Mar. Another soft print expected.
Tue 07					
NZ	QSBO general business situation	–26	–	–	Confidence and trading activity set to fall.
Aus	RBA policy decision	0.25%	0.25%	0.25%	Policy rate on hold; QE will be the focus going forward.
	Mar AiG PSI	47	–	–	COVID-19 disruptions to hit hard.
	Feb trade balance A$bn	5.210	3.750	3.500	Exports and imports to be disrupted by COVID-19.
Chn	Mar foreign reserves $bn	3106.72	3096.25	–	Little changed despite market volatility.
US	Feb JOLTS job openings	6963	–	–	Pre-dates COVID-19 shock.
	Feb consumer credit $bn	12.021	13.500	–	Auto loans to come under pressure as COVID-19 shock hits.
Wed 08					
NZ	GlobalDairyTrade auction result	–3.9%	–	–	Futures markets signal another decline in prices.
	Apr ANZBO business confidence	–63.5	–	–	Early result, covers the first week of the lockdown.
Aus	Feb housing finance approvals	4.6%	2.5%	1.5%	Market was tracking well ahead of the virus shutdown.
Thu 09					
Aus	RBA's Financial Stability Review	–	–	–	Six-monthly update comes at a time of exceptional instability.
UK	Feb trade balance £mn	4212	–	–	Trade flows to exhibit significant volatility hence.
US	Mar PPI	–0.6%	–0.3%	–	Surprised to the downside in Feb.
	Initial jobless claims	6648k	–	–	To be watched closely following two record breaking weeks.
	Feb wholesale inventories	–0.5%	–	–	Final read; prelim showed solid unwinding.
Fri 10					
NZ, Aus	Good Friday	–	–	–	Public holiday, markets closed.
Chn	Mar PPI %yr	–0.4%	–1.3%	–	Upstream prices continue to decline.
	Mar CPI %yr	5.2%	4.8%	–	Disrupted demand, low oil prices to apply downward pressure.
	Mar foreign direct investment %yr	–25.6%	–	–	FDI flows to drop sharply and remain weak given COVID-19.
	Mar new loans, CNYbn	905.7	1775.0	–	Credit growth to accelerate in coming months ...
	Mar M2 money supply %yr	8.8%	8.7%	–	... as authorities encourage economy back to work.
US	Mar CPI	0.1%	–0.3%	–0.2%	Expected to fall as demand slows; well below target.

Contact the Westpac economics team.

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

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