



Westland Tai Poutini National Park, New Zealand

Weekly Economic Commentary.

A little less bad, for now.

The COVID hit to the economy over coming years is going to be very large, but initial data suggest that the hit may not be as large we first feared. Or put differently, the economic data to date have been a little less bad. The less bad data includes New Zealand trade data, and, for example, we now see upside risk to our 2020/21 farmgate milk price forecast of \$6.30/kg. The “less bad” theme is also a mark against our call for a negative OCR, although rising exchange rate is a countervailing force that favours our call.

Over the past week or two, we have noted that the first tranche of post-COVID data have come in better than we had expected. For instance, the circa 40,000 rise in the number of job seeker recipients post-COVID is more modest than we had pencilled in, and looking well short of the number required to reach our forecast unemployment rate peak of 9.5%.

On the trade front for New Zealand, things are also proving less bad. Last week’s dairy auction result, for example, saw prices largely tread water overall, with key whole milk powder prices posting a modest 2% gain. Similarly, April’s merchandise trade data showed a record monthly surplus, including a record start to the kiwifruit export season.

Notably, the dairy auction result contrasts with our expectations for prices to continue to drift lower over coming months. And on this basis, we now see some upside to our 2020/21 farmgate milk price forecast of \$6.30/kg.

Financial markets have noted the “less bad” theme and are currently on the front foot. Global sharemarkets have rallied as lockdown restrictions have eased, particularly in places like Europe – the Euro Stoxx 50 Index is up over 10% to date over June, while the NZX 50 is also up, albeit by a more modest 2.7%.

The New Zealand dollar has also gone along with this improved market sentiment. Over June to date, the NZD/USD



has jumped around 3 cents from 0.6200 to 0.6500 as at the time of writing.

And the less bad news is likely to keep coming for a while. In this vein, a move to Alert Level 1 this week is looking increasingly likely. The Prime Minister has acknowledged that Cabinet will consider an early move at its meeting today. Indeed, if the move to Level 1 is confirmed, then this will come nearly a full quarter earlier than our forecasts assumed.

But while these developments are a kind of welcome surprise, the COVID elephant is still in the room. Indeed, these developments have not changed the broader outlook and the global economy has entered an unprecedented recession. We have pencilled in a fall in global GDP of 3% over 2020. For comparison, the worst it got during the Global Financial Crisis (on a calendar year basis) was a 0.1% fall in 2009.

In addition, global political tensions have increased recently, with Hong Kong and China's handling of the COVID outbreak particular flash points. For New Zealand, these developments pose risks to our trade access to key markets. Australia, for example, has already seen its access to Chinese barley and meat markets hampered, following its calls for an inquiry into China's handling of the outbreak. And New Zealand's past experience has also been that Chinese market access can be sensitive to political tensions and or political missteps.

With the above in mind, the New Zealand economy is facing down its own unprecedented recession. The hole in economic activity is deep and the already weak labour market prospects for many workers are likely to worsen, particularly once the wage subsidy ends. Indeed, by the end of 2020 we expect the New Zealand economy to be 6% smaller than it would have been in the absence of the COVID pandemic. Granted, we now have to acknowledge that the actual hit to the economy may be a little less than that, but it is still going to be a deep and severe recession.

Our key calls that the RBNZ's quantitative easing (QE) programme will be ramped up and the OCR will be lowered into negative territory next year are predicated on a severe recession. Data and developments suggesting that the economic hit from COVID may be slightly less severe than anticipated is a clear mark against those forecasts of additional monetary stimulus.

However, the rising exchange rate is a countervailing force that favours our call. The RBNZ's May Monetary Policy Statement was based around an expectation that the exchange rate would fall, and then stay low for years. If the exchange rate rises instead, it will keep inflation suppressed, highlighting an ongoing need for monetary stimulus.

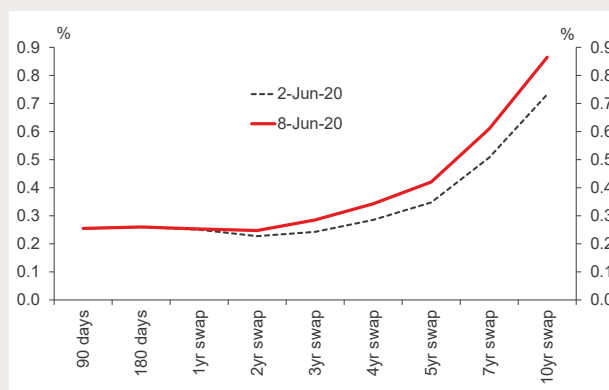
We therefore remain happy with our monetary policy forecasts. At the OCR Review later this month we anticipate an expansion of QE to \$70bn. Eventually, we expect QE will total \$100bn and the OCR will drop to -0.5%.

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.

Fixed mortgage rates have fallen recently, but they may not drop much further in the near term. We expect that the RBNZ will lower the OCR to -0.5% next year. If that is correct, then both fixed and floating rates will fall again next year.

NZ interest rates



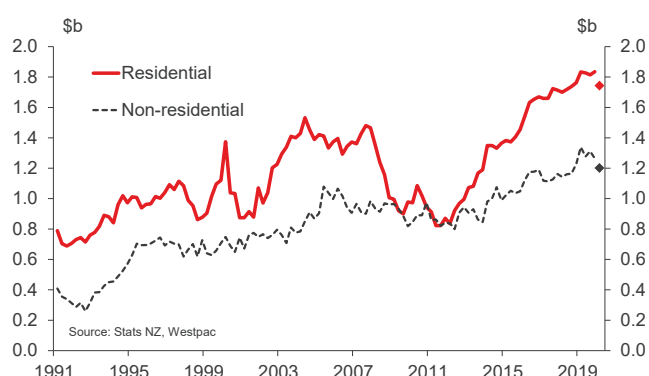
The week ahead.

NZ Q1 building work put in place

Jun 8, Last -0.8%, WBC f/c: -5.0%, Mkt: -3.0%

- Total construction activity fell by 0.8% in the December quarter. The main reason for drop was a 3.6% fall in non-residential construction. Residential construction rose by 1.2%, underpinned by continued strong activity in Auckland, with gains also seen in other areas.
- We expect a 5% decline in construction activity through March, with declines in both residential and non-residential activity. Although there is a large pipeline of planned building work, the country went into lockdown late in March, which meant 5 fewer trading days in the quarter.

NZ real building work put in place

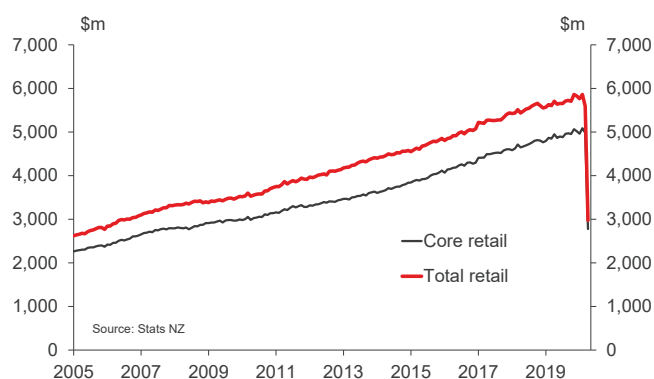


NZ May retail card spending

Jun 11, Last: -48%, WBC f/c: +60%

- Retail spending on electronic cards fell 47% in April as the Alert Level 4 restrictions brought much of the retail sector to a close. The largest drop in spending was in the hospitality sector, with spending on durable items and apparel also down sharply. Despite falling in April, grocery spending remained firm.
- With the Alert Level having been gradually rolled back, we expect spending to rise by around 60% in May. Even so, we don't expect a return to pre-Covid-19 levels for some time. That's due to job losses and general nervousness about the economic outlook, which will dampen spending appetites.
- Covid-19 disruptions means there is a wide range of uncertainty around this month's result.

Card transactions



NZ May REINZ House Price Index

Jun 12 (TBC), Last: +8.5%/yr

- We expect that house prices will fall 7% over the last nine months of 2020, due to the Covid recession.
- April data was heavily impacted by the lockdown, with a massive 75% drop in sales. Price data is therefore less reliable than normal, but what it suggested was that prices fell the most in a single month since 2008, down 1.5% compared to March.
- The data still won't have settled down in May, so anything could happen. However, we expect to see further signs that house prices are now falling.

REINZ house prices and sales



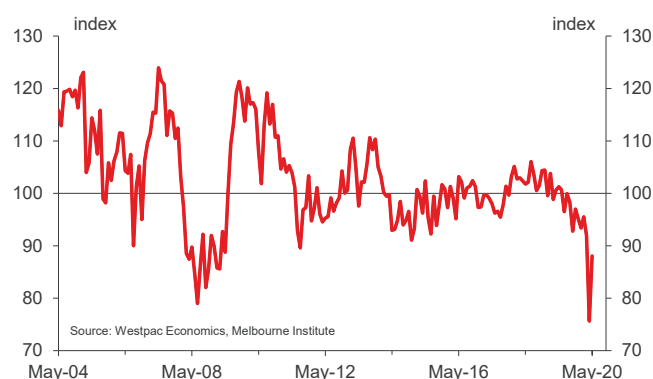
The week ahead.

Aus Jun Westpac-MI Consumer Sentiment

Jun 10, Last: 88.1

- Consumer sentiment rebounded 16.4% in May, an impressive recovery from an extreme fall in April but still leaving sentiment around GFC lows. Consumers were clearly heartened by Australia's success in containing the Coronavirus and the easing of some social restrictions.
- The June update is in the field over the week ending June 6. The last month has seen a further easing in restrictions locally, including a return to mostly normal operations for schools. The flow of new coronavirus cases has also been low with no evidence of a 'second wave' outbreak. Against this, news around the economy continues to confirm a major hit, with the contraction in Q1 GDP reported in the survey week likely to form the first leg of a 'technical recession' in H1 2020. Developments abroad have been less positive, particularly in the US where poorer public health and economic outcomes have combined with widening civil unrest.

Consumer Sentiment Index



Aus Apr housing finance approvals

Jun 10, Last: 0.2%, WBC f/c: -10%

- Total housing finance approvals ticked up 0.2% in March, despite a 2.5% dip in investor loan approvals, with no evidence of a Coronavirus impact.
- That will not be the case in April. While some parts of the sector held up surprisingly well in the month - dwelling approvals only declined 1.8% and prices still rose slightly - finance approvals are likely to pull back sharply. The lockdown saw a steep fall in total market turnover - down about 17% in the month, partly reflecting outright bans on auctions and open homes. These direct restrictions would not have impacted financing activity. Lags also mean finance approvals can be slower to reflect shifts in conditions. However, against this, many lenders saw major disruptions to back office functions located offshore as other countries imposed lockdowns. On balance, we expect finance approvals to record a relatively sharp 10% drop although clearly there are a number of major uncertainties at play.

Housing finance approvals

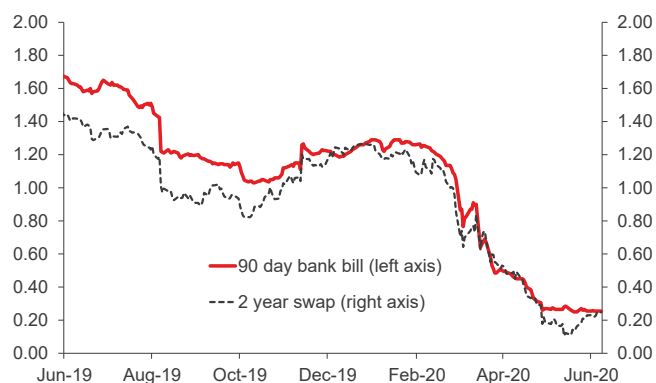


New Zealand forecasts.

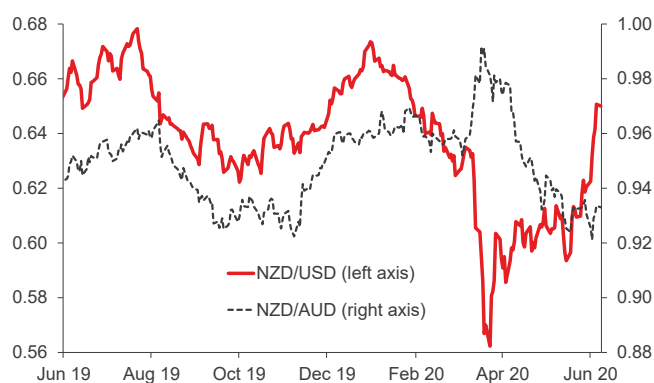
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019	2020f	2021f
% change	Dec (a)	Mar	Jun	Sep				
GDP (Production)	0.5	-1.0	-17.0	14.5	3.2	2.3	-6.3	6.5
Employment	0.1	0.7	-9.4	3.1	1.9	0.8	-4.2	3.4
Unemployment Rate % s.a.	4.0	4.2	9.5	8.5	4.3	4.0	7.5	6.3
CPI	0.5	0.8	-0.4	0.8	1.9	1.9	1.1	0.9
Current Account Balance % of GDP	-3.0	-2.6	-2.3	-1.9	-3.8	-3.0	-2.0	-2.7

Financial forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Cash	0.25	0.25	0.25	0.25	-0.50	-0.50
90 Day bill	0.25	0.25	0.20	-0.10	-0.20	-0.20
2 Year Swap	0.10	0.05	0.00	-0.10	-0.10	-0.10
5 Year Swap	0.20	0.20	0.20	0.20	0.25	0.30
10 Year Bond	0.60	0.55	0.55	0.55	0.60	0.70
NZD/USD	0.59	0.60	0.61	0.62	0.62	0.63
NZD/AUD	0.92	0.91	0.90	0.89	0.89	0.89
NZD/JPY	63.1	63.0	64.7	66.3	66.3	68.0
NZD/EUR	0.55	0.57	0.58	0.58	0.57	0.58
NZD/GBP	0.48	0.49	0.49	0.50	0.50	0.50
TWI	67.1	67.3	67.8	68.2	67.8	68.4

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 8 June 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.26%	0.27%
60 Days	0.26%	0.26%	0.27%
90 Days	0.26%	0.25%	0.26%
2 Year Swap	0.25%	0.16%	0.17%
5 Year Swap	0.42%	0.23%	0.31%

NZ foreign currency mid-rates as at 8 June 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6500	0.6093	0.6155
NZD/EUR	0.5756	0.5592	0.5684
NZD/GBP	0.5123	0.5001	0.4961
NZD/JPY	71.24	65.56	65.59
NZD/AUD	0.9330	0.9329	0.9419
TWI	72.13	69.16	69.54

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 08					
NZ	Q1 building work put in place	-0.8%	-	-5.0%	Several working days lost due to the COVID-19 lockdown.
Eur	Jun Sentix investor confidence	-41.8	-	-	Stabilised in May after falling to a record low in April.
Tue 09					
Aus	May ANZ job ads	-53.1%	-	-	Collapsed in April as employers froze recruitment.
	May NAB business survey	-34	-	-	Conditions collapsed March & April, partial rebound in May?
Eur	Q1 GDP	-3.8%	-3.8%	-	Prelim to confirm unprecedented decline shown by flash.
US	May NFIB small business optimism	90.9	-	-	Fell to 7yr low in Apr, led by job creation and expectations.
	Apr JOLTS job openings	6191	-	-	Have eased sharply amidst labour market deterioration.
	Apr wholesale inventories	0.4%	-	-	Final read; inventories jumped in prelim.
Wed 10					
Aus	Jun WBC-MI Consumer Sentiment	88.1	-	-	Impressive recovery in May but still at GFC lows.
	Apr total housing finance	0.2%	-15.0%	-10.0%	COVID shutdown to hit - smaller than the hit to turnover ...
	Apr investor finance	-2.5%	-	-10.0%	... but larger than the impact on dwelling approvals and ...
	Apr owner occupier finance	1.2%	-10.0%	-10.0%	... prices in the month - back office disruptions a big factor.
Chn	May PPI %yr	-3.1%	-3.2%	-	Both factory-gate and consumer prices...
	May CPI %yr	3.3%	2.6%	-	... are set to slow further on demand disruption.
	May M2 money supply %yr	11.1%	11.3%	-	Has accelerated in recent months.
	May new loans, CNYbn	1700.0	1550.0	-	Strong credit growth a result of policy impact and recovery.
	May foreign direct investment %yr	11.8%	-	-	Has recovered from a low in Feb, running at pre-Covid pace.
US	May CPI	-0.8%	0.0%	0.1%	Expected to tick up from the deflationary episode in April.
	FOMC policy decision, midpoint	0.125%	0.125%	0.125%	Has had great success with sentiment; on hold for now.
	Fed Chair Powell	-	-	-	To deliver the post-meeting press conference.
	May monthly budget statement	-737.9	-600.0	-	Virus-related benefits have begun to pass into the budget.
Thu 11					
NZ	May card spending	-48.0%	-	60.0%	Spending has lifted as lockdown restrictions have eased.
Aus	Jun MI inflation expectations	3.4%	-	-	Petrol prices are disinflationary but what of the shutdowns?
US	May PPI	-1.3%	0.1%	-	Prices are expected to pick up from April's low.
	Initial jobless claims	1877k	-	-	Rise in continuing claims points to slow recovery for jobs.
Fri 12					
NZ	May manufacturing PMI	26.1	-	-	Still low, some lift likely as the economy starts to open up.
	May food price index	1.0%	-	0.0%	Measurement may be hampered by Covid-19 restrictions.
	May REINZ house sales	-77.5%	-	-	Expected by end of week. Sales to lift after lockdown.
	May REINZ house prices %yr	8.5%	-	-	Risk to downside, low sales volume may affect average.
Eur	Apr industrial production	-11.3%	-20.0%	-	Record fall to reflect the epicentre of the virus impact.
UK	Apr trade balance £mn	-6676	-	-	Extremely volatile in recent months - should remain so.
US	May import price index	-2.6%	0.7%	-	To lift from April low; oil recovery will provide support.
	Jun Uni. of Michigan sentiment	72.3	76.0	-	Expected to stabilise; remain above GFC low.

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	8.3	7.1
Current Account % GDP	-3.1	-2.6	-2.1	0.5	0.5	-0.8
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	18.0	8.2
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	6.8	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	-2.6	5.8
World						
Real GDP %yr	3.4	3.9	3.6	2.8	-3.0	4.8

Forecasts finalised 8 June 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	0.10	0.10	0.15	0.20	0.25	0.30	0.35
10 Year Bond	1.08	0.90	0.90	0.95	1.00	1.10	1.20	1.30
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	0.83	0.65	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	0.6974	0.68	0.66	0.68	0.70	0.70	0.71	0.72
USD/JPY	109.16	107	105	106	107	107	108	110
EUR/USD	1.1347	1.11	1.09	1.10	1.11	1.11	1.12	1.12
GBP/USD	1.2613	1.25	1.23	1.24	1.25	1.26	1.29	1.30
USD/CNY	7.0961	7.02	6.90	6.85	6.80	6.75	6.70	6.60
AUD/NZD	1.0752	1.08	1.10	1.11	1.13	1.13	1.13	1.13

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