



Fiordland National Park, New Zealand

Weekly Economic Commentary.

Intensive care.

Over the last two weeks the coronavirus Covid-19 has spread to more countries, New Zealand has recorded its first cases, and travel bans have become more widespread. All of that has further dented economic confidence.

Financial markets have swooned, with major equity indices dropping more than 10% over a few days. Anecdotally, business and consumer confidence seem to have taken a severe hit in New Zealand. (ANZ is going to release early results of its monthly business confidence survey on Tuesday, which may put more substance around that assertion).

We have further reduced our GDP forecasts to reflect more severe effects on travel, export commodity prices, and confidence. We are now forecasting a 28% drop in visitor arrivals. We have reduced our March quarter GDP forecast to -0.2%, and our forecast of annual GDP growth over 2020 to 1.9%. Without Coronavirus and drought our annual GDP growth forecast would have been 2.7%. The currently-rampant housing market is likely to skid to a halt, with price growth slowing sharply in the June quarter. That, combined with job losses and lower farm and business incomes, will have a secondary impact on consumer spending that could last longer than the immediate disruption from the virus.

It is important to remember, though, that this is a temporary disruption to economic activity, not a new long-run trajectory for the economy. We anticipate a period of above-normal GDP growth after the worst of the virus-related disruptions have passed, as the economy returns to a normal level of economic activity, catch-up production to restore depleted inventories occurs, and even-lower interest rates stimulate asset prices. We are currently assuming that the recovery phase will begin in the second half of this year, although we will update that timing as we learn more about how the virus is playing out.

Overseas central banks have leapt into the fray with aplomb. The US Federal Reserve cut its rate 50 basis points outside of its usual meeting schedule. Canada also cut 50bps at a scheduled meeting, and the Reserve Bank of Australia cut by 25bps. Before Covid-19 struck, we were already expecting that the US Federal Funds Rate would drop 75bps this year. This week we have shifted to expecting three further 25bps cuts, in April, May and June, on top of the 50bps already delivered.



We are also expecting the RBA to cut again in April, and to begin some form of quantitative easing later in the year.

We expect the Reserve Bank of New Zealand will follow suit, although it will ease less than its US or Australian counterparts. We are now forecasting two OCR cuts of 25bps each, in March and May this year.

Markets are questioning whether the RBNZ might cut the OCR at an emergency meeting before March 25, or cut by 50bps on that date. We don't regard either scenario as likely. The RBNZ's take on Covid-19 has sounded distinctly more moderate than other central banks. In a brief communication last week the RBNZ emphasised that the next OCR decision would occur on March 25, a clear signal that no inter-meeting cut was under consideration. They went on to say that in their business continuity role they would ensure a stable financial system, including access to credit and cash and liquidity in the banking system. Our interpretation is that the RBNZ is thinking hard about Coronavirus, but has concluded that monetary easing is not the most important response.

We broadly agree with that. Stimulating demand right now, via monetary or fiscal policy, would have limited effect because demand is being impeded by such a specific force. The most important role for Government and the Reserve Bank right now is to focus on ensuring that the wheels of commerce keep turning where possible. Where commerce must stop, the focus should be on helping the economy get through. Government should use targeted measures to ensure that otherwise viable businesses are able survive a temporary loss of revenue. For example, Inland Revenue could ease its requirements for businesses to pay provisional tax or GST, essentially providing short-term credit to firms.

In a similar vein, the Government is asking private banks to ensure credit is provided to cash-strapped firms. Government should also ensure that people have the wherewithal to meet their basic needs during the period of disruption. For example, the recent move to eliminate the stand-down period before receiving a social welfare benefit was a good move.

The targeted measures suggested above are going to be costly for the Government. The books will also come under pressure from the automatic stabilisers – less tax and more benefit payments due to stalled economic activity. This is likely to send the Government into deficit this year. That is entirely appropriate. Governments should run surpluses in normal times precisely so that they can help the economy weather this type of storm.

Compared to the targeted Government measures we propose, monetary easing will play a relatively small role in ensuring the economy is able to weather this storm effectively. Nonetheless, we still think there will be some monetary easing. The Reserve Bank will be keen to ensure that it does not fall too far out of sync with its peers, lest the exchange rate rise unhelpfully.

The consequence of this monetary easing will be even more stimulus for the housing market once the disruption from the virus has passed. As mentioned above, both our house price inflation forecasts and our economic growth forecasts have been reduced in the short run, but increased from 2021 onwards. Consistent with that, we forecast that the Reserve Bank will begin increasing the OCR again from early 2022.

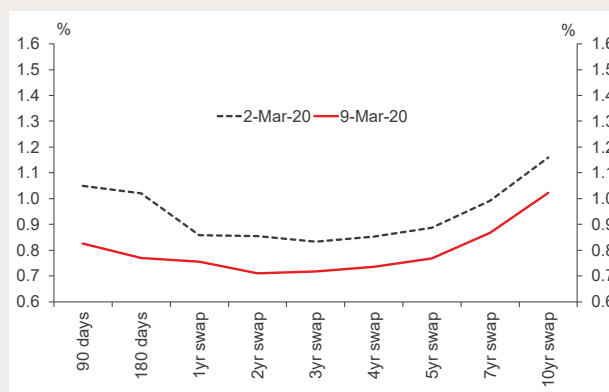
Fixed vs Floating for mortgages.

Borrowers looking to fix would be best to wait. The economic impact of Covid-19 is likely to see the RBNZ cut rates further this year, and fixed-term mortgage rates may follow suit.

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



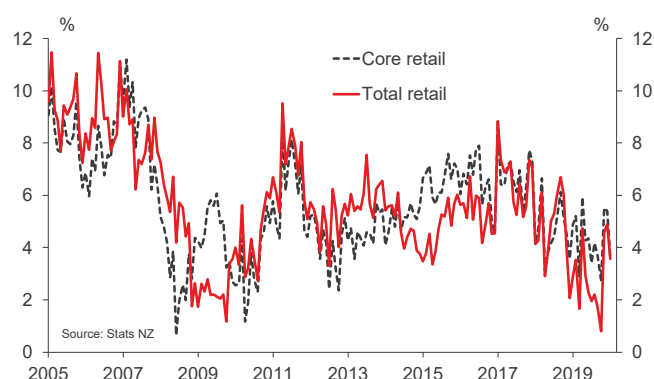
The week ahead.

NZ Feb retail card spending

Mar 11, Last: -0.1%, WBC f/c: -0.3%

- Retail spending on electronic cards nudged down just slightly in January, falling by 0.1% over the month. That followed a strong increase through late 2019 and left spending at an elevated level.
- We're expecting spending to take a step down in February and are forecasting a 0.3% drop. The outbreak of COVID-19 and the related restrictions on travel to New Zealand from China will be a significant drag on spending in areas in hospitality. That could be reinforced by a degree of nervousness among New Zealand consumers. Those downside factors are balanced against the boost to spending appetites from the strengthening in the housing market. There's also been stocking up on health care supplies and other essentials as concerns about the virus have increased.

Card transactions, annual % change

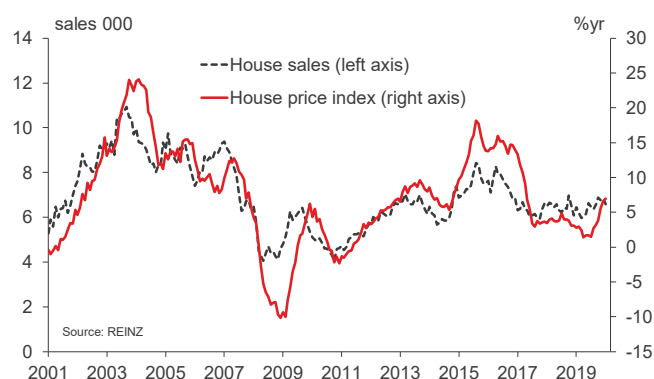


NZ Feb REINZ House Price Index

Mar 13, (tbc), Last: +7.0%yr

- House prices in January were up 7% on a year ago, a pace that we had been forecasting for some time on the back of lower interest rates and the cancellation of the proposed capital gains tax.
- For January itself the housing market was a little more subdued compared to previous months, with prices up 0.6% and sales down 3.7% in seasonally adjusted terms. The low level of listings likely remains a brake on the rate of turnover. That said, Auckland's largest realtor reported a sharp rise in sales in February.
- We expect house prices to lift further in February. However, we think that the COVID-19 outbreak will see the housing market lose momentum in the coming months, as buyer caution outweighs any further drop in mortgage rates.

REINZ house prices and sales

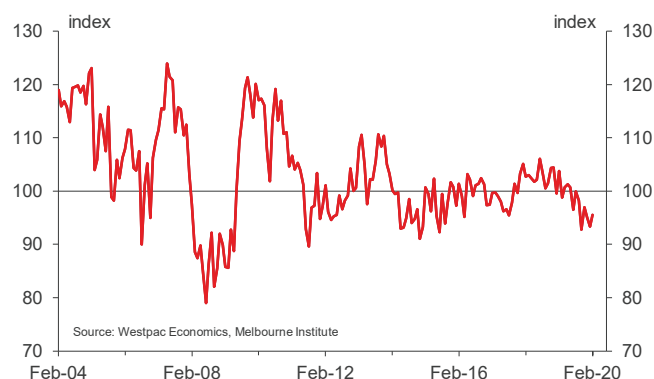


Aus Mar Westpac-MI Consumer Sentiment

Mar 11, Last: 95.5

- Consumer sentiment has had a weak start to the year, buffeted by bushfires and the emerging coronavirus outbreak. Sentiment posted a small 2.3% gain in Feb, mainly reflecting some easing concerns around bushfires and the drought. Despite this, the index level remained weak at overall at 95.5.
- The dramatic escalation in the coronavirus outbreak in recent weeks is likely to dominate in March. Whereas previously the virus appeared reasonably well-contained within China, it is now shaping as a much wider pandemic with a notable increase in cases in Australia as well. Financial markets have been hit hard, the ASX down nearly 9% over the last month. The RBA's decision to cut rates 25bps at its March meeting may soften the blow but is unlikely to prevent one altogether, particularly as it 'franks' the seriousness of the situation.

Consumer Sentiment Index



The week ahead.

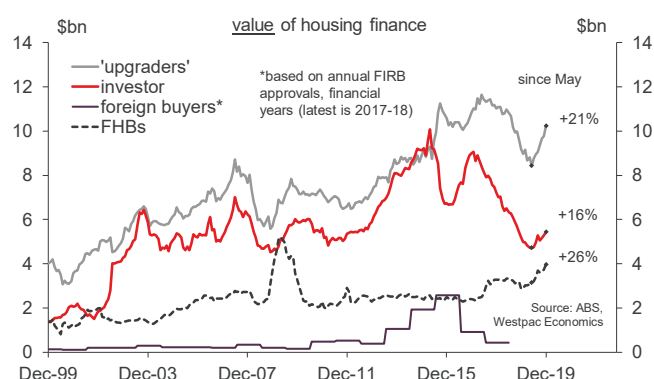
Aus Jan housing finance approvals

Mar 11, Last: 4.4%, WBC f/c: 2.0%

Mkt f/c 3.0%; Range 2.0% to 5.5%

- The Dec housing finance report showed a stronger than expected finish to 2019, the total value of housing loan approvals surging 4.4% mth to be up 14% yr. The detail highlighted several aspects of the upturn: that gains are coming across both prices and volumes; that owner occupiers are continuing to lead the way, with a more restrained upturn in investor activity; and that the picture around construction remains more mixed, suggesting any turnaround in non high rise building activity is coming through slowly.
- We expect a similar pattern in the Jan with a more moderate but still robust 2% gain in the value of approvals again skewed towards owner-occupiers. As always, Jan data should be treated with caution due to the summer low season which can amplify monthly volatility.

Housing finance approvals by segment

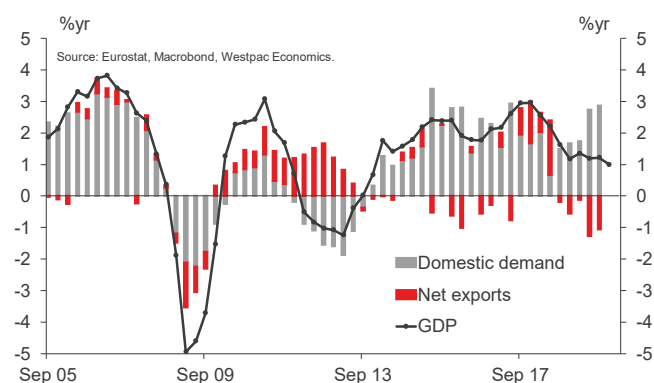


ECB March policy meeting

Mar 12, deposit rate: -0.50%, WBC: -0.60%

- Following the FOMC's 50bp cut at an unscheduled meeting last week, the ECB will almost certainly ease its policy stance at its scheduled March meeting.
- There are two reasons this is the case. (1) With the outbreak moving from external shock to domestic concern, the Euro Area economy is in need of support - particularly as GDP growth was already below trend ahead of the shock. And (2) if the ECB chose not to ease, then the Euro will almost certainly lift further, impairing the Euro Area's competitiveness and dampening inflation at a particularly inopportune time.
- The 10bp cut we forecast for the deposit rate is more a symbolic gesture than meaningful policy response. The latter will instead come via an increase in asset purchases or equivalently through a new TLTRO program. Given weak demand, purchases will prove more effective.

Euro Area GDP: ECB needs to act

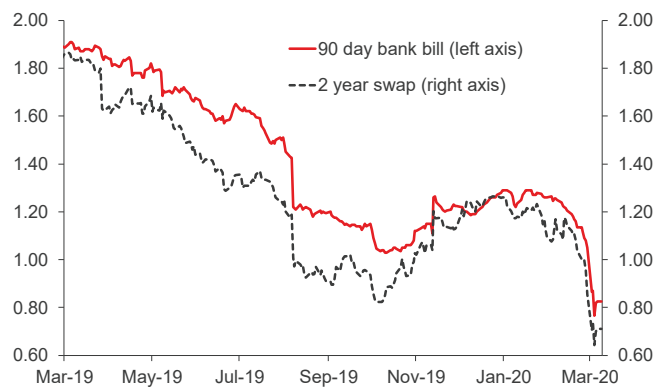


New Zealand forecasts.

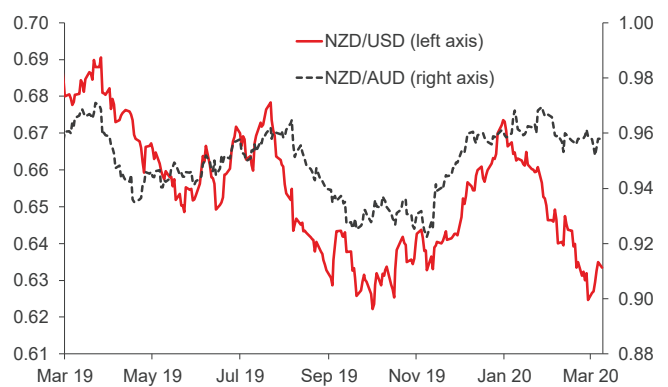
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Sep (a)	Dec	Mar	Jun	2018	2019f	2020f	2021f
GDP (Production)	0.7	0.6	-0.2	0.3	3.2	2.3	1.9	3.9
Employment	0.2	0.0	0.5	0.4	1.9	1.0	1.9	2.3
Unemployment Rate % s.a.	4.1	4.0	4.2	4.4	4.3	4.0	4.4	3.8
CPI	0.7	0.5	0.4	0.3	1.9	1.9	1.5	1.9
Current Account Balance % of GDP	-3.3	-3.0	-3.1	-3.5	-3.8	-3.0	-3.9	-3.5

Financial forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Cash	0.75	0.50	0.50	0.50	0.50	0.50
90 Day bill	0.80	0.65	0.65	0.65	0.65	0.65
2 Year Swap	0.65	0.60	0.60	0.65	0.70	0.80
5 Year Swap	0.75	0.70	0.75	0.80	0.90	1.00
10 Year Bond	0.90	0.80	0.80	0.90	1.00	1.10
NZD/USD	0.63	0.63	0.64	0.65	0.65	0.65
NZD/AUD	0.97	0.97	0.97	0.97	0.96	0.96
NZD/JPY	67.4	66.8	67.2	68.3	68.9	69.6
NZD/EUR	0.58	0.57	0.58	0.58	0.58	0.57
NZD/GBP	0.48	0.48	0.49	0.50	0.50	0.50
TWI	70.3	70.0	70.6	71.2	70.8	70.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 9 March 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.00%	1.10%	1.19%
60 Days	0.91%	1.12%	1.22%
90 Days	0.83%	1.14%	1.25%
2 Year Swap	0.71%	1.04%	1.13%
5 Year Swap	0.77%	1.11%	1.19%

NZ foreign currency mid-rates as at 9 March 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6334	0.6349	0.6400
NZD/EUR	0.5582	0.5852	0.5846
NZD/GBP	0.4853	0.4893	0.4967
NZD/JPY	66.09	70.86	70.25
NZD/AUD	0.9579	0.9613	0.9583
TWI	70.35	71.19	71.46

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 9					
Chn	Feb foreign reserves \$bn	3115.50	3109.00	-	To remain stable.
Eur	Mar Sentix investor confidence	5.2	-13.1	-	Uncertainty is rife across the world.
Tue 10					
NZ	RBNZ Governor Orr speaking	-	-	-	Speech on unconventional monetary policy tools.
Aus	Feb NAB business survey	3	-	-	Confidence & conditions to be hit by virus outbreak.
Chn	Feb PPI %yr	0.1%	-0.3%	-	Upstream price pressures are non-existent...
	Feb CPI %yr	5.4%	5.1%	- but food prices continue to hold CPI at elevated level.
	Feb foreign direct investment %yr	4.0%	-	-	Will be disrupted by travel bans and business closures.
	Feb new loans, CNYbn	3340.0	1100.0	-	Jan/Feb financial data a starting point to judge...
	Feb M2 money supply %yr	8.4%	8.5%	-	... coming monetary easing in response to COVID-19.
Eur	Q4 GDP	0.1%	0.1%	0.1%	Europe has slowed dramatically in '19 and is at risk in '20.
US	Feb NFIB small business optimism	104.3	102.7	-	Domestic focus likely to limit virus shock, for now.
Wed 11					
NZ	Feb card spending	-0.1%	-0.3%	-0.3%	Travel restrictions to weigh on areas like hospitality.
Aus	RBA Deputy Governor Debelle	-	-	-	Speaking, Business Summit, Sydney 9am
	Feb WBC-MI Consumer Sentiment	95.5	-	-	
	Jan housing finance	4.4%	3.0%	2.0%	
UK	Jan trade balance £mn	7715	-221	-	2019 a highly uncertain time for UK economy.
US	Feb CPI	0.1%	0.0%	0.0%	Energy a negative in Feb, core prices up 0.2% in month.
	Feb monthly budget statement \$bn	-234.0	-238.5	-	Deteriorating trend very clear.
Thu 12					
Aus	Mar MI inflation expectations	4.0%	-	-	
Eur	Jan industrial production	-2.1%	1.2%	-	To come under pressure from external & domestic forces.
	ECB policy decision, deposit rate	-0.50%	-0.60%	-0.60%	Deposit rate cut more about signalling than its effect.
US	Feb PPI	0.5%	0.2%	-	Upstream price pressures absent.
	Initial jobless claims	216k	-	-	Very low.
Fri 13					
NZ	Feb manufacturing PMI	49.6	-	-	Coronavirus concerns will add to existing headwinds.
	Feb food price index	2.1%	-	-	Sharp lift in meat prices in Jan, likely to be short-lived.
	Feb REINZ house sales	-3.7%	-	-	Due by end of this week. Tight listings limiting sales...
	Feb REINZ house prices %yr	7.0%	-	-	...but low interest rates are boosting demand.
US	Feb import price index	0.0%	-1.0%	-	Dollar has suppressed import prices over the past year.
	Mar Uni. of Michigan sentiment	101.0	96.4	-	COVID-19 to jolt confidence as US outbreak seen.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	1.8	2.6
CPI inflation % annual	1.5	1.9	1.8	1.8	1.8	2.0
Unemployment %	5.7	5.5	5.0	5.2	5.4	5.2
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.4	-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	0.4
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	5.3	6.1
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.3	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	2.8	3.2

Forecasts finalised 12 February 2020

Interest rate forecasts	Latest	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Australia								
Cash	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.55	0.45	0.45	0.45	0.50	0.50	0.50	0.50
10 Year Bond	0.68	0.70	0.75	0.80	0.85	0.90	1.00	1.10
International								
Fed Funds	1.125	0.375	0.375	0.375	0.375	0.375	0.375	0.375
US 10 Year Bond	0.82	0.90	1.00	1.10	1.15	1.20	1.30	1.40
ECB Deposit Rate	-0.50	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70

Exchange rate forecasts	Latest	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
AUD/USD	0.6601	0.65	0.66	0.67	0.68	0.68	0.69	0.70
USD/JPY	105.87	106	105	105	106	107	108	109
EUR/USD	1.1232	1.10	1.11	1.12	1.13	1.14	1.15	1.15
GBP/USD	1.2954	1.30	1.30	1.30	1.31	1.31	1.31	1.32
USD/CNY	6.9557	6.90	6.85	6.80	6.80	6.75	6.70	6.60
AUD/NZD	1.0453	1.03	1.03	1.03	1.05	1.05	1.05	1.06

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