



Kahurangi National Park, New Zealand

Weekly Economic Commentary.

More QE, more spending, more debt.

In response to the gale-force headwinds battering the economy, the past week saw significant further increases in both fiscal and monetary stimulus being rolled out.

First up was the Reserve Bank which, as expected, expanded its Long Term Asset Purchase programme from \$33bn to \$60bn. The scope of the programme has been expanded to include inflation indexed bonds alongside the already-included NZ Government Bonds and local government debt. The RBNZ also mentioned that, should more stimulus be required in the future, purchasing foreign bonds was a possibility.

The RBNZ left the Official Cash Rate on hold. That also was as expected and followed the RBNZ's comments in March that the OCR would remain at 0.25% for twelve months. However, since making that statement, the economic outlook has continued to deteriorate. We think that the weakness in inflation and unemployment will mean the RBNZ is going to have to eventually cut the cash rate to negative territory and have pencilled in a cut to -0.50% in November.

The RBNZ's commentary was supportive of an eventual reduction in the cash rate. In fact, the RBNZ published an

"unconstrained OCR forecast." This is the level of the OCR that would be necessary to achieve the RBNZ's goals in a theoretical world where the OCR could go as low as the RBNZ wanted. It is presumably what the RBNZ's models would spit out if they weren't "told" that a negative OCR is not possible right now. That unconstrained OCR forecast was -2%. This does not mean the OCR will actually go that low, but it illustrates that the RBNZ is aware that much more stimulus is needed.

But while the eventual need for a negative cash rate is apparent, the timing of any cut is more uncertain. The minutes of the policy decision indicated that the RBNZ is open to a negative cash rate in the future provide it is operationally feasible. But for now, there are still some hurdles. Most notably, trading banks still need time to update their IT systems and legal documentation.

The RBNZ noted that a negative OCR is not currently possible, so it "reaffirmed its forward guidance that the OCR would



remain at 0.25% until early-2021.” That is rather soft – it certainly wasn’t a promise or a commitment.

However, during the press conference the RBNZ revealed that it has asked the banks to prepare for a negative OCR “by the end of the year.” That suggested that, although a negative OCR may eventually be required, our forecast for a cut late this year might be a bit of a stretch. Instead, the RBNZ may prefer to wait until early in the new year. We’ll seek clarity around that comment and assess any further RBNZ communications before drawing any conclusions.

The day after the RBNZ’s policy statement, the Government released its ‘Rebuilding Together’ Budget. And it was massive. The Government significantly expanded its Covid-19 economic support and recovery package, bringing it to a combined \$62bn or around 20% of annual GDP. Of that spending, around \$26bn had already been announced before the Budget, and plans for another \$16bn of spending was unveiled on the day. That leaves around \$20bn still to be allocated.

Major spending initiatives announced in the Budget include \$5.6bn of spending on health, a \$4bn support package for businesses (including an extension to the wage subsidy scheme), as well as increased spending on housing and infrastructure. A consistent theme running through the Government’s spending plans was support for jobs and training.

The Government has chosen to go hard and go early in its response. On the whole we think this was the right thing to do. The economy needs support, and this big spend-up reduces the risk that Covid-19 causes permanent damage to the economy.

But this approach is not without its risks. New Zealand has long been staring down the barrel of massive increases in Government spending due to the aging population. That means future governments will either have to spend less or tax more. Taking on more debt now puts us in an even weaker position to deal with this challenge. We, and most other economists, expect interest rates to remain low for some time. But if interest rates were to unexpectedly rise, the debts being taken on today could become a very heavy burden to future taxpayers.

The increases in Government spending announced in the Budget were much higher than we or the RBNZ were expecting. That could help to accelerate the recovery in the economy, and provides scope for a further expansion in the RBNZ’s bond buying program if required. This also raises questions about whether further reductions in the OCR will be necessary.

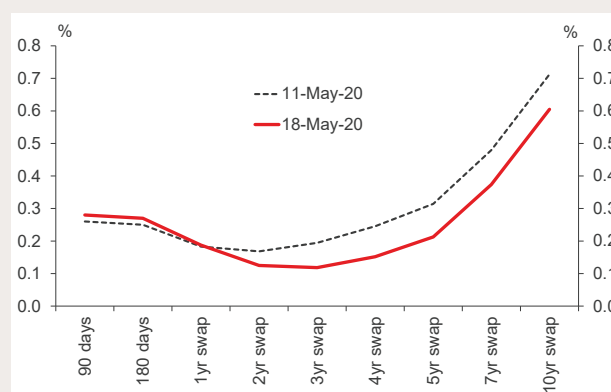
On this front, we’re more down beat on the longer term outlook for inflation than either the RBNZ or the Treasury. Weak activity – here and abroad – mean that inflation in New Zealand is set to remain low for a long time. We’ve already seen inflation lingering below 2% for most of the past decade, and inflation expectations have been slipping down to low levels. Even with a ramp up in fiscal spending, it’s likely that further stimulus will be required to get inflation back near 2% on a sustained basis.

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 been falling recently, and we think they may fall a little further as markets increasingly come around to the idea that the RBNZ could cut the OCR below zero late this year or early next year. If the RBNZ does lower the OCR below zero, as we expect, both fixed and floating mortgage rates would fall. However if the RBNZ moves away from the idea of further OCR cuts, fixed rates would rise. There will not be any certainty on this question until late this year.

NZ interest rates



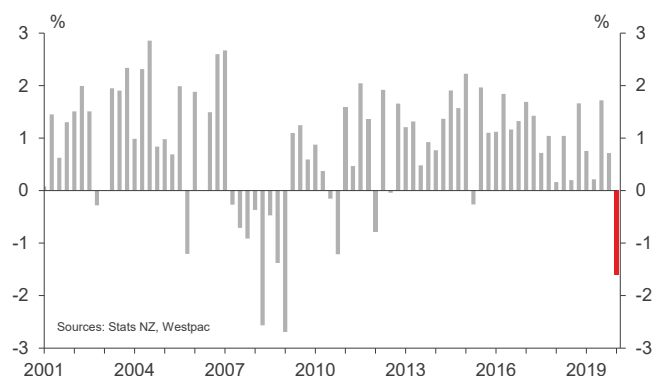
The week ahead.

NZ Q1 retail spending

May 22, Last: +0.7%, WBC f/c: -1.6%, Mkt: -1.5%

- Retail spending rose 0.7% in the December quarter. That followed a large 1.7% increase in September, which left us with a picture of firming spending growth through the back half of 2020.
- We expect that spending levels will drop by 1.6% in the March quarter. Monthly spending levels were essentially flat through January and February, before falling late in the quarter. During that time, efforts to contain the spread of COVID-19 and growing nervousness among households put the brakes on spending and saw many businesses prevented from trading for the last few days of the month. Areas like hospitality took a particularly large knock.
- Lockdown conditions only came into effect in late March. Spending will be much weaker in the June quarter.

NZ quarterly real retail sales

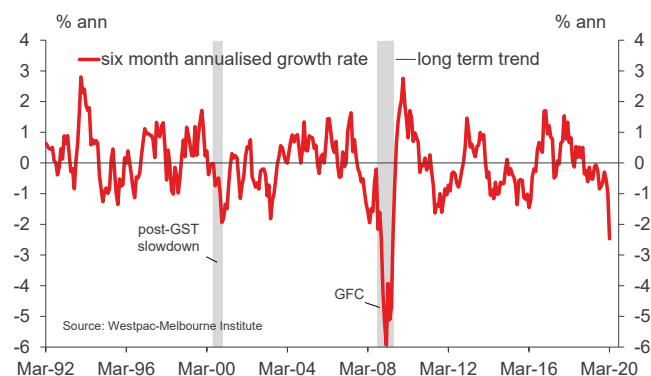


Aus Apr Westpac-MI Leading Index

May 20, Last: -2.47%

- The Leading Index growth rate fell to -2.47% in March, a sharp drop consistent with a deepening economic impact from the Coronavirus pandemic. The March read was the most negative seen since the GFC, albeit still well above the extreme lows seen then and during recessions.
- The April read is set to be much weaker. There have been impressive rebounds in some components - the ASX 200 up 8.8% (vs -21.2% last month) and both the Westpac-MI Consumer Expectations Index and the Westpac-MI Unemployment Expectations Index more than reversing the deteriorations last month. And some other components have remained quite mixed - commodity prices down only slightly in AUD terms (-0.3%) and dwelling approvals down -4%. However, the update will be dominated by April's outsized decline in total hours worked - the 9.2% drop more than two and a half times larger than the biggest monthly variation seen in the forty years the data has been collected.

Aus Westpac-MI Leading Index

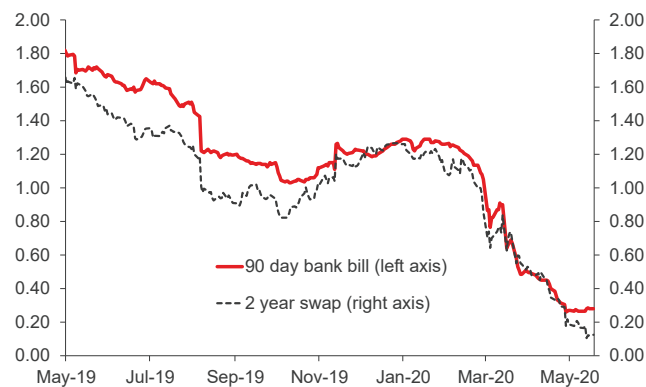


New Zealand forecasts.

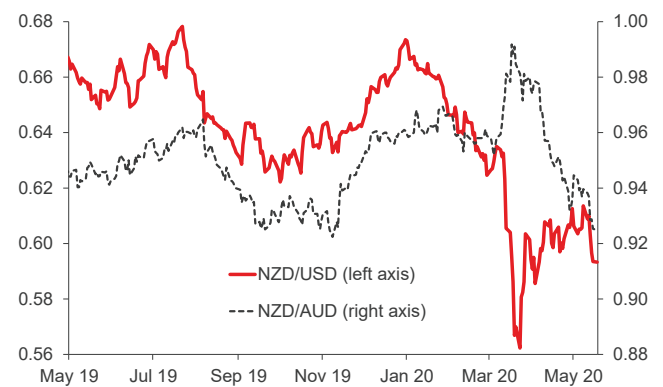
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019	2020f	2021f
% change	Dec (a)	Mar	Jun	Sep				
GDP (Production)	0.5	-1.0	-16.0	13.0	3.2	2.3	-6.3	4.7
Employment	0.1	0.7	-9.4	3.1	1.9	0.8	-4.4	2.8
Unemployment Rate % s.a.	4.0	4.2	9.5	8.5	4.3	4.0	7.7	7.1
CPI	0.5	0.8	-0.4	0.8	1.9	1.9	1.3	1.0
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	0.45	0.50	0.60
10 Year Bond	0.75	0.80	0.80	0.85	0.90	1.00
NZD/USD	0.59	0.61	0.61	0.63	0.64	0.65
NZD/AUD	0.95	0.95	0.93	0.93	0.94	0.94
NZD/JPY	63.1	64.1	65.0	67.4	68.5	70.2
NZD/EUR	0.55	0.58	0.58	0.59	0.59	0.60
NZD/GBP	0.48	0.50	0.49	0.50	0.51	0.52
TWI	67.5	68.9	68.5	69.7	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 18 May 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.27%	0.27%	0.31%
60 Days	0.27%	0.27%	0.35%
90 Days	0.28%	0.26%	0.39%
2 Year Swap	0.13%	0.20%	0.34%
5 Year Swap	0.21%	0.33%	0.50%

NZ foreign currency mid-rates as at 18 May 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.5933	0.6058	0.6035
NZD/EUR	0.5486	0.5521	0.5553
NZD/GBP	0.4911	0.4850	0.4829
NZD/JPY	63.50	64.72	64.91
NZD/AUD	0.9248	0.9446	0.9479
TWI	67.56	68.68	68.74

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Apr BusinessNZ PSI	52.0	-	-	Likely to fall sharply vs Feb (survey not run in March).
Aus	May 18 ABS household survey	-	-	-	ABS special survey on job situation, lifestyle changes etc.
	May ABS economic measurement	-	-	-	ABS special release on economic accounts (first issue).
UK	May Rightmove house prices	-0.2%	-	-	Housing market set to come under increasing pressure.
US	May NAHB housing market index	30	35	-	Homebuilder confidence at lowest level in seven years.
	FOMC's Bostic	-	-	-	To hold a discussion about the economy.
Tue 19					
Aus	May 2 ABS weekly payrolls	-	-	-	Special release on impacts of COVID on jobs and wages.
	RBA minutes	-	-	-	May provide a little more colour on views set out in SMP.
Eur	May ZEW survey of expectations	25.2	-	-	April saw a rebound from the collapse in March.
UK	Mar ILO unemployment rate	4.0%	4.6%	-	Set to mark an abrupt turning point in labour market trend.
US	Apr building permits	-6.8%	-25.9%	-	Both permits and housing starts are set to collapse...
	Apr housing starts	-22.3%	-21.9%	-	... amidst severe disruptions in April.
	Fed Chair Powell	-	-	-	To testify before Senate Banking Committee.
	Fedspeak	-	-	-	Kashkari and Rosengren to speak.
Wed 20					
NZ	GlobalDairyTrade auction	-0.8%	-	-	WMP futures are pricing a 0% to 2% drop in auction prices.
Aus	Apr Westpac-MI Leading Index	-2.47	-	-	To fall steeply, led by a deep contraction in hours worked.
Eur	Apr CPI	0.3%	0.3%	-	Final read set to confirm soft price growth from the prelim.
	May consumer confidence	-22.7	-19.0	-	Expected to fall to the lowest level in the survey's history.
UK	Apr CPI	0.0%	0.1%	-	Price growth to remain stagnant.
US	FOMC Meeting Minutes	-	-	-	Minutes for the April 29 FOMC Policy Meeting.
	FOMC's Bullard	-	-	-	To take part in a discussion on the economy.
Thu 21					
NZ	RBNZ Chief Economist speaking	-	-	-	Webinar on the May MPS by Chief Economist Yuong Ha.
Aus	RBA Governor Lowe speaking	-	-	-	'The Regulators: Priorities Updated', online.
UK	May Markit manufacturing PMI	32.6	33.5	-	Following a collapse in April, UK purchasing managers ...
	May Markit services PMI	13.4	15.0	-	... are expected to remain deeply pessimistic.
US	May Philly Fed index	-56.6	-40.0	-	Expected to recover slightly from the 40yr low in April.
	Initial jobless claims	2981k	-	-	Rate of job loss moderating, but remains at a high level.
	May Markit manufacturing PMI	36.1	37.8	-	A gradual recovery looks likely ...
	May Markit services PMI	26.7	32.5	-	... from very weak levels.
	Apr leading index	-6.7%	-5.7%	-	Labour market collapse has been a strong negative driver.
	Apr existing home sales	-8.5%	-18.4%	-	Lockdowns in April will lead to a collapse in turnover.
	Fedspeak	-	-	-	Williams, Clarida and Chair Powell.
Fri 22					
NZ	Q1 real retail sales	0.7%	-1.5%	-1.6%	Confidence fell in Q1, lockdown started late in quarter.
Eur	May Markit PMIs	-	-	-	Flash services and mfg PMIs for Eurozone & Germany.
UK	Apr retail sales	-5.1%	-12.5%	-	Expected to post a record monthly contraction.
	Apr public sector borrowing £bn	2.3	-	-	Volume will increase as stimulus comes online.

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	7.6	6.3
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 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	0.91	0.75	0.80	0.85	0.90	1.00	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	0.6454	0.62	0.64	0.66	0.68	0.68	0.69	0.70
USD/JPY	107.21	107	105	106	107	107	108	110
EUR/USD	1.0806	1.07	1.06	1.06	1.07	1.08	1.09	1.10
GBP/USD	1.2208	1.22	1.23	1.24	1.25	1.25	1.26	1.27
USD/CNY	7.1007	7.02	6.90	6.85	6.80	6.75	6.70	6.60
AUD/NZD	1.0775	1.05	1.05	1.08	1.08	1.06	1.06	1.06

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