



Fiordland National Park, New Zealand

Weekly Economic Commentary.

Going viral.

The novel coronavirus outbreak has stolen the show over the past week. New Zealand has announced that it will deny entry to all foreigners travelling from China. The ban is currently in force for two weeks, but we can only really see two possible outcomes – either the travel ban lasts much longer, or the coronavirus arrives in New Zealand and the authorities give up on ideas of quarantine. China accounts for 12% of visitor arrivals and is the largest source of overseas students, so this is going to take a serious toll.

Forestry is also heavily affected. 80% of New Zealand forestry exports go to China. As manufacturing in China has slowed due to the virus, log shipments out of New Zealand have suddenly been cancelled. Log exports out of New Zealand have ground to a standstill. Soon logs will start piling up on New Zealand wharves, and the next step will be a sudden reduction in harvesting activity with consequences for employment.

For many other export products we are seeing sudden declines in price as Chinese demand dries up. Crayfish prices have dropped by a third and last week's dairy auction saw prices drop 6%.

The economic impact of the coronavirus is wildly uncertain, but it is now obvious that we are looking at something more severe than SARS. China is much more important to the New Zealand

economy than it was in 2003, and the efforts to limit coronavirus via quarantine have been more draconian.

We are now working to a baseline scenario in which severe restrictions on travel between China and New Zealand remain in place for two months, and Chinese manufacturing remains disrupted for one month. The hit to New Zealand quarterly GDP would be around 0.65%. We have reduced our forecast of March quarter GDP growth to 0.1%, whereas without coronavirus we would have expected 0.7%.

However, in this scenario economic activity would be disrupted for only a short time, so there would be little lasting economic damage. As the economy rebounds to normal levels of economic activity, GDP growth rates later in 2020 would be higher than otherwise. In fact, there could even be a burst of extra demand



for products such as wood, as China's factories work double-time to rebuild inventories of finished goods that were run down during the factory shut-down. However, the longer quarantine efforts disrupt economic activity, the greater the likelihood of long-lasting economic damage.

Coronavirus will be front of mind when the Reserve Bank reviews the OCR at its Monetary Policy Statement on Wednesday this week. In late January we announced that we expected the RBNZ would abandon its strong easing bias and move to a more neutral monetary policy outlook. But forecasting is like a box of chocolates – you never really know what you are going to get next. In this case, coronavirus has stolen the show.

The obvious strategy now is for the Reserve Bank to signal that the OCR is most likely to remain on hold, but that they stand ready to cut the OCR should that be required by the coronavirus situation. If coronavirus quickly blows over like SARS did, then the Reserve Bank can revert to an on-hold outlook for the OCR at its next communique. Should economic disruptions from coronavirus intensify, the RBNZ may consider cutting the OCR to help offset any negative impact on employment.

The Reserve Bank will want to convey three separate messages at the MPS:

- 1) The New Zealand economy and housing market have exceeded the RBNZ's expectations recently, to the point that the OCR outlook would have shifted to "on hold" had coronavirus not emerged.
- 2) If the coronavirus has a sharp but short disruptive impact on the economy, followed by a rapid recovery, then there would be little requirement for monetary policy to respond. This would constitute a "look through" event.
- 3) Should coronavirus have a longer-lasting or more severe disruptive impact on the economy, then the RBNZ would probably cut the OCR.

This would all be fairly simple for the RBNZ to express in words. The RBNZ's key phrase could be something like "While we expect

to keep the OCR on hold, we stand ready to reduce the OCR if warranted." This would amount to a conditional easing bias.

What the RBNZ does with its economic and OCR forecasts is trickier to anticipate. Most likely, the RBNZ's economic forecasts will be based on the coronavirus having a short, sharp disruptive impact followed by a rapid recovery, similar to our scenario. In this case the RBNZ's OCR forecast would probably be 0.9%, same as the November MPS, reflecting a risk possibility of future OCR cuts.

An alternative option for the RBNZ would be to publish "ex coronavirus" economic forecasts. These would feature an OCR forecast of 1.0%. This could be accompanied by much verbiage about the range of possible coronavirus impacts.

Last week's unemployment data added to the plethora of factors driving the "ex coronavirus" OCR outlook higher. Both we and the Reserve Bank expected unemployment to rise slightly in the December quarter, following an economic slowdown earlier in the year. Although employment growth was weak, the unemployment rate still fell to 4.0% in December, from a downwardly revised 4.1% in September. This equalled the lowest unemployment rate since the Global Financial Crisis. The underutilisation rate – which includes part-time workers seeking more work and people who could potentially be brought into the labour force – fell to an 11-year low of 10.0%. And wage inflation accelerated to a 10-year high of 2.6%, again above expectations.

The Reserve Bank has been saying that the labour market is in roughly neutral territory, but we are starting to wonder if it is slightly tighter than that. Certainly, if the economy negotiates coronavirus and then picks up in the way we anticipate, the labour market will move convincingly into tight territory, which in turn would weaken the rationale for OCR cuts.

The final factor driving the "ex corona-virus" OCR outlook higher was last week's RBNZ inflation expectations report. Two-year ahead inflation expectations rose from 1.8% to 1.93%. That is significant, because falling inflation expectations were an important cause of the Reserve Bank cutting the OCR last year.

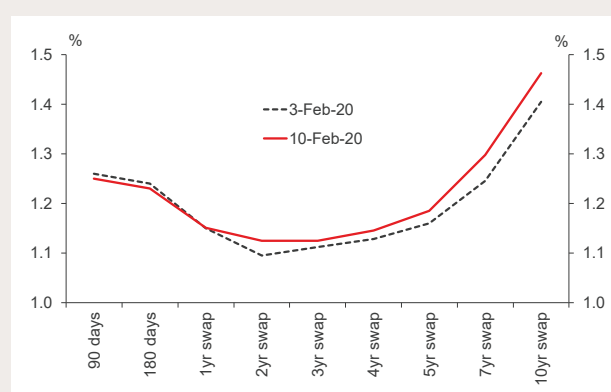
Fixed vs Floating for mortgages.

Now is a good time to take a fixed mortgage. Fixed mortgage rates have tumbled over the past six months, but they are now starting to creep higher again as the chances of further OCR cuts fade.

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



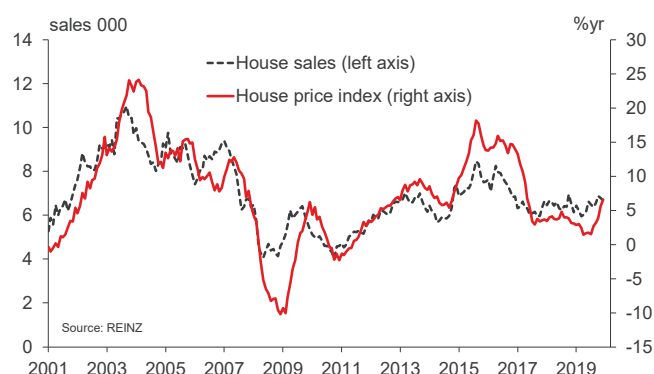
The week ahead.

NZ Jan REINZ House Price Index

Feb 10 to 14 (TBC), Last: 1.2%

- The December housing market update from the REINZ confirmed Westpac's long held view that currently low interest rates would see house prices rocketing upwards. Based on our seasonal adjustment, house prices rose 1.2% in December with widespread gains. That continues the run of strong gains we've seen in recent months, leaving nationwide house prices up 6.6% over the past year.
- We have been forecasting that low interest rates and resurgent demand would see annual house price inflation rising to 7% by April. That now looks likely to occur even sooner than we expected.
- We expect another month of solid price increases in January. Reports indicate that the number of homes available for sale remains low. At the same time, low mortgage interest rates are encouraging demand from both owner occupiers and investors.

REINZ house prices and sales

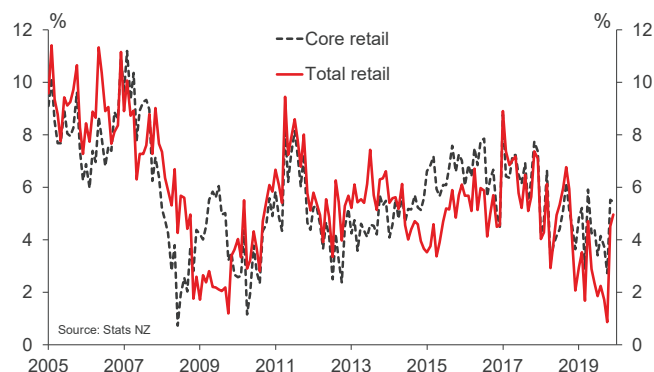


NZ Jan retail card spending

Feb 12, Last: -0.8%, WBC f/c: +0.4%

- Retail spending fell by 0.8% in December. But rather than reflecting any weakness in households' spending appetites, December's fall reflected the growing prevalence of international sales events (like Black Friday) in the New Zealand marketplace. That saw many households' bringing purchases forward from the traditional December shopping period.
- Looking at spending through the latter part of 2019 as a whole, we're actually left with a picture of solid household spending growth.
- We are expecting a return to trend in January, with retail sales expected to be up 0.4% over the month. Given the recent surge in spending on durables, spending in this category could be subdued. However, the pick-up in the housing market and lift in consumer confidence is supporting spending appetites more generally.

Card transactions, annual % change

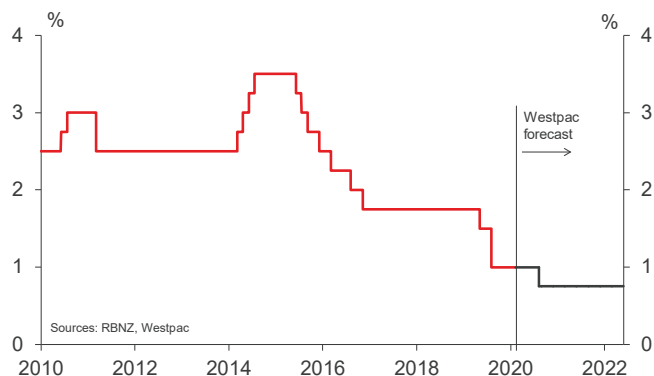


NZ RBNZ policy decision & Monetary Policy Statement

Feb 12, Last: 1.00%, WBC f/c: +1.0%, Mkt f/c: +1.0%

- We expect the RBNZ will keep the OCR on hold at next week's Monetary Policy Statement. The OCR outlook will be on-hold with a risk of cuts if coronavirus severely disrupts the economy.
- Before coronavirus broke out, the RBNZ was probably ready to abandon its easing bias and switch to a neutral stance.
- A range of economic indicators have been stronger than the RBNZ has been expecting including inflation, unemployment and wage growth. We've also seen the housing market picking up by more than the RBNZ anticipated. On top of those developments, the Government has announced a significant increase in infrastructure spending.
- But coronavirus is a huge unknown in terms of its duration and impacts on the economy. This has rekindled the risk of a lower OCR.

RBNZ Official Cash Rate



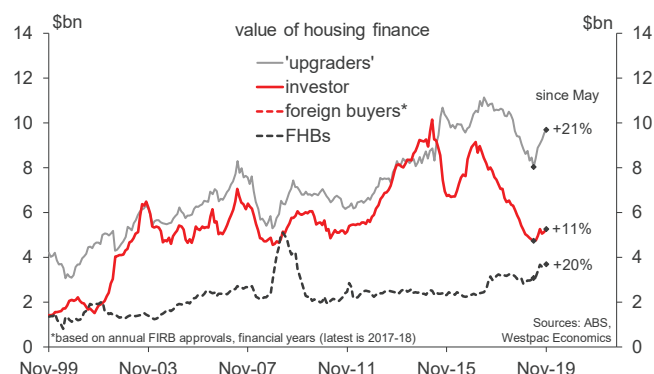
Aus Dec housing finance approvals

Feb 11, Last: 1.8%, WBC f/c: 1.6%

Mkt f/c: 1.6%, Range: 0.2% to 2.0%

- Housing finance approvals rebounded further in Nov, up 1.8% in total value terms (including investor loans) and up 0.7% in number terms (owner occupier loans only).
- The recovery continues to be led by owner-occupiers, the value of loans to this segment up 20.5% since May, with investor loans lagging but still up a robust 10.9%.
- We expect a similar pattern in the December month with the value of approvals forecast to rise 1.6%, owner-occupiers likely to continue outstripping investors slightly.

Housing finance approvals by segment

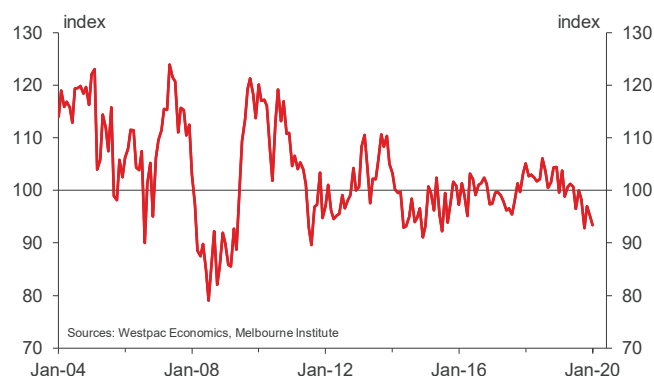


Aus Feb Westpac-MI Consumer Sentiment

Feb 12 Last: 93.4

- Consumer sentiment declined 1.8% to 93.4 in Jan from 95.1 in Dec, clearly impacted by the devastating bushfires affecting large parts of south eastern Australia. While the monthly fall was not large, it takes the Index to a low level – there have only been seven months in the last decade with weaker reads. Widespread rain in bushfire-affected areas during the survey week may also have softened the sentiment impact.
- This month's survey is in the field over the week beginning Feb 3. It will capture reactions to a new calamity – the novel coronavirus outbreak centred on China. The experience of the 2003 SARS outbreak suggests local sentiment impacts could be limited, particularly if we also see some rebound from bushfire impacts.
- Other factors that may impact sentiment include: the RBA's decision to leave the cash rate on hold in Feb and their confident tone on the economic outlook; more signs of a continuing upturn in housing markets; but sharp falls for the ASX (-1.6% since the Jan survey) and AUD (down 1.2¢ US).

Consumer Sentiment Index

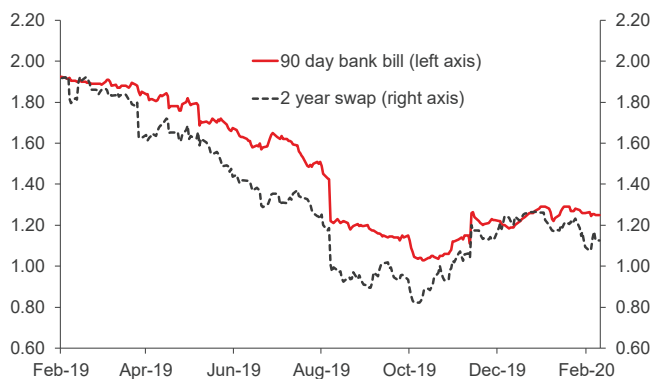


New Zealand forecasts.

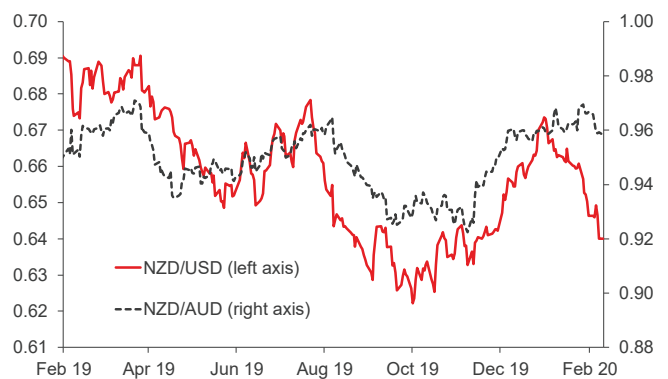
Economic forecasts	Quarterly				Annual			
	2019	2020						
% change	Sep (a)	Dec	Mar	Jun	2018	2019f	2020f	2021f
GDP (Production)	0.7	0.6	0.1	0.9	3.2	2.3	2.3	3.3
Employment	0.2	0.0	0.4	0.4	1.9	1.0	1.8	2.0
Unemployment Rate % s.a.	4.1	4.0	4.1	4.3	4.3	4.0	4.2	3.9
CPI	0.7	0.5	0.5	0.4	1.9	1.9	1.8	1.7
Current Account Balance % of GDP	-3.3	-3.0	-3.0	-3.2	-3.8	-3.0	-3.4	-3.3

Financial forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Cash	1.00	1.00	0.75	0.75	0.75	0.75
90 Day bill	1.20	1.10	0.90	0.90	0.90	0.90
2 Year Swap	1.10	1.05	1.00	1.00	1.00	1.05
5 Year Swap	1.25	1.20	1.20	1.25	1.30	1.35
10 Year Bond	1.35	1.25	1.25	1.25	1.35	1.40
NZD/USD	0.66	0.66	0.66	0.66	0.66	0.66
NZD/AUD	0.97	0.99	0.99	0.99	0.97	0.96
NZD/JPY	70.6	69.4	69.3	69.3	70.0	70.6
NZD/EUR	0.61	0.60	0.59	0.59	0.58	0.58
NZD/GBP	0.50	0.50	0.50	0.50	0.50	0.50
TWI	73.1	72.7	72.6	72.3	72.0	71.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 10 February 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.20%	1.17%
60 Days	1.22%	1.24%	1.18%
90 Days	1.25%	1.28%	1.20%
2 Year Swap	1.13%	1.19%	1.24%
5 Year Swap	1.19%	1.27%	1.42%

NZ foreign currency mid-rates as at 10 February 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6400	0.6551	0.6599
NZD/EUR	0.5846	0.5947	0.5933
NZD/GBP	0.4967	0.5018	0.4949
NZD/JPY	70.25	71.42	72.16
NZD/AUD	0.9583	0.9688	0.9586
TWI	71.46	72.40	72.71

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
Chn	Jan CPI %oyr	4.5%	4.9%	-	Food prices to keep CPI elevated for a while yet.
	Jan foreign direct investment %oyr	-	-	-	Continued FDI inflow necessary for development.
	Jan M2 money supply %oyr	8.7%	8.6%	-	Authorities will provide all necessary support for...
	Jan new loans, CNYbn	1,140	3,081	-	... markets and the banks throughout this crisis.
Eur	Feb Sentix investor confidence	7.6	-	-	To remain positive despite coronavirus concerns.
US	Fedspeak	-	-	-	Daly speaks in Dublin, Harker discusses economic outlook.
Tue 11					
Aus	Dec housing finance, value	1.8%	1.6%	1.6%	Lending upturn continues in response to lower rates.
	Jan NAB business survey	3	-	-	Slide in confidence, at -2; Conditions stabilise weak levels, +3.
UK	Q4 GDP	0.4%	-0.1%	-	Economy in a weak state and at risk at turn of year.
	Dec trade balance £bn	4,031	-950	-	Narrowing expected on export strength.
US	Jan NFIB small business optimism	102.7	-	-	Domestic economy the focus for small businesses.
	Dec JOLTS job openings	6800	-	-	Hiring, firing, quits and job openings.
	FOMC Chair Powell	-	-	-	Before House panel on Monetary Policy & Economy.
	Fedspeak	-	-	-	Bullard, Kaskari, Quarles and Daly.
Wed 12					
NZ	Jan card spending	-0.6%	-	0.4%	Households' spending appetites have been firming.
	RBNZ policy decision	1.00%	1.00%	1.00%	Coronavirus adding a layer of uncertainty to policy outlook.
Aus	Feb WBC-MI Consumer Sentiment	93.4	-	-	Down from 95.1 in December to an historically low level.
Eur	Dec industrial production	0.2%	-0.2%	-	External demand remains a weight for production.
US	Jan monthly budget statement, \$bn	-13.3	-	-	Deficit to keep growing, year on year.
	FOMC Chair Powell	-	-	-	Before Senate Banking panel.
	Fedspeak	-	-	-	Harker discusses economic outlook.
Thu 13					
NZ	RBNZ Governor Orr	-	-	-	Parliament Select Committee on MPS
Aus	Feb MI inflation expectations	4.7%	-	-	Official data highlights that inflation remains subdued.
	RBA Governor Lowe	-	-	-	Panel participant, Australia-Canada forum, 11:15am
US	Jan CPI	0.2%	0.2%	0.2%	Annual headline rate to lift, but core stable circa 2.3%/yr.
	Feb 8 initial jobless claims, 000	202	-	-	Remain historically low.
Fri 14					
NZ	Jan food price index	-0.2%	-	0.7%	Seasonal bounce in fruit and vegetable prices.
	Jan REINZ house sales	-1.7%	-	-	Tight listings limiting sales, but low interest rates are...
	Jan REINZ house prices %oyr	6.6%	-	-	...boosting demand, with solid price gains expected.
Eur	Dec trade balance €bn	19.2	-	-	Challenging global backdrop to remain in place.
	Q4 GDP	0.1%	0.1%	0.1%	Second release, will provide some underlying detail.
US	Jan import price index	0.3%	-0.2%	-	Dollar's strength holding down import costs.
	Jan retail sales	0.3%	0.3%	0.4%	A beat likely after two disappointing prints.
	Jan industrial production	-0.3%	-0.3%	-	Manufacturers to remain under pressure for some time.
	Dec business inventories	-0.2%	0.1%	-	Likely to be a drag on growth in Q1.
	Feb Uni. of Michigan sentiment	99.8	99.8	-	To remain above average.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	2.0	2.5
CPI inflation % annual	1.5	1.9	1.8	1.8	1.7	2.1
Unemployment %	5.7	5.5	5.0	5.2	5.4	5.2
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.6	-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	0.5
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	5.8	5.8
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.7	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	3.0	3.2

Forecasts finalised 31 January 2020

Interest rate forecasts	Latest	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Australia								
Cash	0.75	0.75	0.50	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.88	0.85	0.70	0.45	0.45	0.50	0.50	0.50
10 Year Bond	0.96	1.00	0.95	0.90	0.80	0.80	0.85	1.05
International								
Fed Funds	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
US 10 Year Bond	1.58	1.60	1.50	1.45	1.40	1.45	1.50	1.70
ECB Deposit Rate	-0.50	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange rate forecasts	Latest	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
AUD/USD	0.6710	0.68	0.66	0.67	0.67	0.68	0.69	0.72
USD/JPY	108.93	107	106	105	105	106	107	109
EUR/USD	1.1029	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.3092	1.30	1.30	1.30	1.30	1.31	1.31	1.32
USD/CNY	6.9109	6.95	6.90	6.85	6.80	6.80	6.75	6.60
AUD/NZD	1.0349	1.03	1.01	1.02	1.02	1.03	1.05	1.07

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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