

Economic Weekly

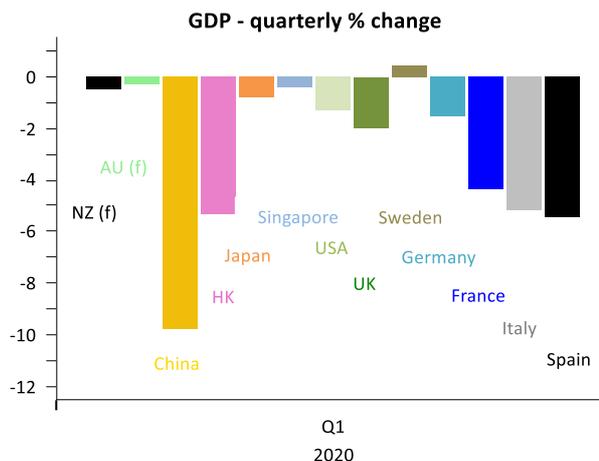
02 June 2020

Signs of life

Business confidence continued to lift throughout May (as confirmed by the full May results of the ANZ business outlook survey) and we expect to see further improvement in business confidence over June. **Recent developments can be described as marginally better than expected (albeit from some exceptionally low expectations)** with NZ looking like it eliminated the virus from our shores and real-time activity indicators – such as card spending, electricity demand and traffic volumes – suggesting activity may have bounced back more quickly than we had expected during Level 2. **ASB card spending data show that spending has recovered to around pre-COVID levels.** Certainly, there is a lot of lost ground that will never be recouped (i.e. all those missed weekend brunches and weekday coffees). Nonetheless, this quick recovery in spending, coupled with a turning point in both business and consumer sentiment, is certainly a positive development. This author can personally report that shops were very busy over Queen’s Birthday Weekend, with one customer service assistant noting Saturday morning had felt busier than Christmas.

Looking back to Q1 and the early days of the global pandemic, the first estimates of Q1 GDP from across the world have trickled in over recent weeks (see chart opposite) to give an early taste of the economic damage inflicted by the pandemic. We expect Australian Q1 GDP to be released this week (Wednesday 3 June) and for NZ Q1 GDP to be released later this month (Thursday 18 June). The virus outbreak reached NZ and Australia a little later than Europe, so the Q1 GDP impact will be relatively small. NZ’s lock down impacted only the last 4 business days of the quarter and we have a 0.5% contraction pencilled in for Q1, followed by a 17% contraction in Q2.

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Source: Macrobond, ASB

Recent COVID-19 publications

ASB Economic forecasts and monitoring:

[Quarterly Economic Projections](#)

[Housing Confidence](#)

[ASB COVID-19 Chart pack](#)

Financial market trends:

[COVID-19: Market stocktake and what we are watching](#)

[ASB Podcast for investors](#)

Policy response:

[RBNZ confirms increase to QE at May Monetary Policy Statement](#)

[Budget 2020 delivers huge support, huge debt](#)

Where to find support

[ASB financial support package](#)

[Government support package](#)

[COVID-19 alert system explainer](#)

For these publications and more COVID-19 research, see [here](#)

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6294	0.6126	0.6087	0.6598	FLAT/UP	0.6200	0.6370
NZD/AUD	0.9259	0.9320	0.9415	0.9455	FLAT/DOWN	0.9180	0.9375
NZD/JPY	67.74	66.07	65.18	71.30	FLAT/UP	66.50	68.10
NZD/EUR	0.5653	0.5610	0.5559	0.5869	FLAT /DOWN	0.5570	0.5800
NZD/GBP	0.5040	0.5014	0.4843	0.5210	FLAT /DOWN	0.4950	0.5150
TWI	70.5	69.2	68.7	72.36	DOWN	N/A	N/A

^ Weekly support and resistance levels * Current as at 9.30am today; week ago as at Monday 5pm

NZD Recap

The USD was slammed last week, lifting the NZD/USD to 2½ month highs around 0.6300. Most of the major currencies experienced a similar amount of lift against the ailing USD. The AUD was a notable outperformer, with a good bounce in commodity prices (iron ore prices are back above US\$100/tonne) adding support. The relatively larger gain in the AUD saw NZD/AUD dragged back towards 0.9250, from above 0.9350 earlier in the week.

Refreshed investor risk appetite remains the dominant theme across financial markets, as economies continue to slowly reopen, paving the way for a recovery in global growth. This is denting the appeal of traditional safe-haven currencies like the USD and JPY. For now, investors appear content to play up the positives. Some of the more worrisome news of late around rising US-China trade tensions, terrible economic data, and violent protests in the US have had little to no impact on market pricing.

Outlook

We've today released our second ever Corporate Hedging Toolbox (see [here](#)) - our practical guide for corporates managing foreign exchange and interest rate exposures.

In it, we note that NZD forecasts are being gradually nudged up now that the worst of the COVID-19 storm appears to have blown through. Medium-term risks indeed probably favour a higher NZD, but we're still cautious about the near term. We suspect recent NZD choppiness will continue through the coming quarter. Investors' risk appetite will remain fickle given the uncertain global and domestic backdrops. The RBNZ's aggressive easing stance and possible further falls in commodity prices will continue to anchor the currency.

Our short-term valuation model is designed to provide an objective estimate of where the NZD/USD roughly "should" be based on its usual fundamental drivers: commodity prices, global risk appetite, and NZ-US interest rate differentials. The model currently estimates a 0.6100-0.6500 range, meaning current NZD/USD spot is broadly "fair".

Economic data continue to be largely ignored by markets. This week will likely see more of the same, with the possible exception of Friday's May US Non-farm Payrolls data. There's also central bank decisions from the RBA, ECB and Bank of Canada to keep an eye on. mike.jones@asb.co.nz

ASB foreign exchange forecasts

(end of quarter)

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>					
NZD/USD	0.67	0.60	0.55	0.58	0.60	0.61	0.64	0.65
NZD/AUD	0.96	0.97	0.96	0.97	0.95	0.94	0.94	0.94
NZD/JPY	73	65	54	58	61	63	67	69
NZD/EUR	0.60	0.54	0.47	0.51	0.53	0.54	0.57	0.58
NZD/GBP	0.51	0.49	0.46	0.47	0.48	0.48	0.49	0.50
NZD/CNY	4.7	4.3	3.9	4.1	4.2	4.3	4.5	4.6
NZD TWI	73.8	68.8	63.7	66.6	68.1	68.8	71.5	72.4

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	0.25	0.25	1.50	UNCH	UP
90-day bank bill	0.26	0.26	0.26	1.67	UNCH	UP
2-year swap	0.24	0.21	0.19	1.45	UNCH/UP	UP
5-year swap	0.36	0.30	0.33	1.56	UNCH/UP	UP
10-year swap	0.75	0.67	0.72	1.92	UNCH/UP	UP
10-year govt bond yield	0.85	0.68	0.62	1.72	UNCH/UP	UP
Curve Slope (2s10s swaps)	0.51	0.46	0.53	0.48	UNCH	DOWN

* Current as at 9.30am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged

Market Recap

NZ yields edged up at the start of last week after Alert Level 2 restrictions were relaxed and a potential June/July move to Alert Level 1 flagged, which was much earlier than generally expected. Moves here have outpaced the climb in Australian yields, in contrast to broadly flat US Treasury yields. Market pricing for central bank cuts eased back in Australasia as RBA Governor Lowe (yet again) ruled out negative rates in Australia. May sentiment data, including the US manufacturing ISM (a still weak 43.5) and domestic business and consumer confidence gauges suggest that global and NZ activity likely troughed in April. Acting to push NZ yields higher was the tapering of purchases of NZ bonds, by the RBNZ who bought \$1.175bn of NZ Government bonds and \$50m of LGFA paper. The combination of extremely weak data, heightened US-China tensions, domestic unrest in the US and concerns over a flaring up of COVID-19 have capped global yields.

Near-term interest rate outlook

We expect NZ yields will drift higher as it emerges from its COVID-19 stasis more quickly than global peers. A decision by the NZ cabinet is due on 8th June and it is possible NZ could move to Alert Level 1 as soon as June 10, which should see NZ yields continue to outpace global counterparts. Current market pricing – OCR endpoint of 0.02% - looks to be a nod to the risk profile, but with retail mortgage and deposit interest rates down last week, the hurdle to RBNZ OCR cuts looks to be high. Continued RBNZ tapering (\$1.075bn of NZ Government bond purchases this week, the lowest since late March) will likely see NZ yields underperform, with a narrowing in spreads with (higher) Australian yields.

The short-term direction for global yields looks less clear-cut given geopolitical, rising internal tensions in the US and COVID-19 risks. Equity market sentiment will prove a useful barometer. Lagging data – including Q1 Australian GDP, inputs for Q1 NZ GDP and May Non-farm Payrolls are expected to be soft – and should cap sizeable lifts in yields.

Central bank decisions from the RBA (today), ECB and Bank of Canada are expected to affirm ultra-loose settings and the willingness to do all that it takes to boost respective economies. It has been almost a month since the RBA purchased bonds in the secondary debt markets and the RBA seems content to remain on the side lines as market dysfunction has reduced, with the 3-year bond yield still hovering around 0.25%.

Medium-term outlook

We don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. If more policy stimulus was needed the RBNZ will likely increase its \$60bn asset purchase programme before cutting the OCR. Weak global activity and RBNZ asset purchases should help to cap longer-term NZ interest rates despite a mountain of global public debt issuance. mark.smith4@asb.co.nz

ASB interest rate forecasts

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	1.29	0.51	0.30	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	1.26	0.53	0.25	0.30	0.35	0.40	0.40	0.60
NZ 5-year swap rate	1.45	0.63	0.30	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	1.78	0.93	0.65	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.65	1.03	0.65	0.75	0.85	0.95	1.05	1.15

Domestic events

Data	Date	Time (NZT)	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	02/06	Overnight	-	0.0

We expect whole milk powder (WMP) prices to be largely unchanged at the GlobalDairyTrade auction overnight Tuesday. Prices have been in a holding pattern over recent auctions and this theme is set to continue as dairy markets appear to lack enough confidence to bid prices higher. At the same time, the worst of the fallout from COVID-19 now appears behind global dairy markets.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Balance of Payments, Q1, \$AUDbn	02/06	1:30 pm	5.6
RBA Interest Rate Announcement, %	02/06	4:30 pm	0.25
Australia GDP, Q1, %qoq	03/06	1:30 pm	-0.3
BoC Interest Rate Announcement, %	03/06		0.25
Australia Retail Trade, April, %mom	04/06	1:30 pm	-17.6
Australia Trade Balance, April, \$AUDmn	04/06	1:30 pm	7,500
ECB Interest Rate Announcement, %	04/06		-

Originally published by CBA Global Markets Research on Friday 29th May at 2:59 pm

We expect **Australia to post a current account surplus** of \$5.6bn in Q1, up from \$1.0bn in Q4 19. We expect the current account surplus to dwindle over 2020 as COVID-19 causes global growth to wane.

We expect the **Reserve Bank of Australia (RBA)** to leave the cash rate and its bond yield target for 3-year Commonwealth Bonds at 0.25% in June. In recent weeks the RBA's asset purchasing program has ground to a halt with no purchases since 6 May 20. Further comment here bears close watching.

Australia's ABS Preliminary Retail Trade estimate indicates that a large monthly decline in monthly retail sales is imminent. This follows the record 8.5% rise in March retail trade data.

We expect **Australian Q1 GDP** to print between -0.5% and 0%, with our latest point estimate slightly upgraded to -0.3%qoq based on better actual capex volumes in Q1. We may refine our estimate again next week after receiving more data on Tuesday 2 June.

We expect another hefty \$A7.5bn **Australian trade balance** in April after a record \$A10.6bn surplus in March. We see exports driving the trade surplus with commodities like iron ore, coal and LNG rising in March. The closure of Australia's borders will continue to weigh heavily on services imports like tourism because imports fell more than our exports. This has seen the tourism balance increase. In line with the downturn in global trade we do still expect to see Australia's trade balance dwindle over 2020 and the return of the current account deficit.

The European Central Bank (ECB) is expected to maintain its ultra-loose monetary policy settings and signal again readiness to turn on the monetary policy tap further. Since March 2020, the ECB committed to buying €1.05tn in asset purchases by the year-end: €750bn via the pandemic emergency purchase programme (PEPP) and €300bn via the asset purchase programme (APP). The ECB has plenty of purchase headroom left considering it has so far accumulated about €320bn in asset purchases since mid-March. As such, we don't see any immediate reason for the ECB to increase the size of its asset purchase programmes.

This will be the first meeting of incoming **Bank of Canada (BoC)** Governor Tiff Macklem. No monetary policy changes are expected. The central bank is expected to keep the target for the overnight rate at its effective lower bound of 0.25% and maintain the size of its asset purchases facilities.

Key Forecasts

ASB NZ economic forecasts

	Dec-19 << actual	Mar-20 forecast >>	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.5	-0.5	-16.9	13.2	0.5			
GDP real - A%	1.8	0.9	-16.2	-5.8	-5.8	-5.6	2.7	4.8
GDP real - AA%	2.3	1.8	-2.8	-4.8	-6.7	-8.3	4.4	4.6
CPI - Q%	0.5	0.8	-0.6	0.3	-0.1			
CPI - A%	1.9	2.5	1.3	1.0	0.4	-0.1	1.2	1.6
HLFS employment growth - Q%	0.1	0.7	-5.6	-1.0	0.5			
HLFS employment growth - A%	0.8	1.6	-4.7	-5.8	-5.4	-5.8	2.9	2.7
Unemployment rate - %sa	4.0	4.2	8.8	8.7	8.0	7.9	6.8	5.9
Annual current account balance as % of GDP	-3.0	-2.7	-2.5	-2.1	-2.2	-2.7	-1.3	-0.2

Q% = percentage change on previous quarter

A% = percentage change since same quarter the previous year

AA% = percentage change for year ending quarter since the previous year

ASB interest rate forecasts

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NZ 5-year swap rate	1.45	0.63	0.30	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	1.78	0.93	0.65	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.65	1.03	0.65	0.75	0.85	0.95	1.05	1.15

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NZD/AUD	0.96	0.97	0.96	0.97	0.95	0.94	0.94	0.94
NZD/JPY	73	65	54	58	61	63	67	69
NZD/EUR	0.60	0.54	0.47	0.51	0.53	0.54	0.57	0.58
NZD/GBP	0.51	0.49	0.46	0.47	0.48	0.48	0.49	0.50
NZD/CNY	4.7	4.3	3.9	4.1	4.2	4.3	4.5	4.6
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