Economic Weekly

02 November 2020

US election: Clear result could still be on the cards

There are a few bits and pieces of domestic data out this week, but there's really only one game in town: the US elections. After an eighteen-month campaign, the wait is nearly over, as we look to find out whether President Trump will spend four more years in the White House, of whether he'll be defeated by his challenger, Joe Biden. The results will trickle in from around midday Wednesday NZT onwards, but how soon we'll know the outcome will depend on how close things end up. If it's a landslide, that should be apparent on the night, but with an unprecedented number of votes-by-mail that will take a while to count, we might be waiting a while longer if its closer. That means it's important to be careful when reviewing the returns – Reuters warns of a 'red mirage', with early returns favouring President Trump's Republican Party, before mail-in ballots favouring Biden's Democratic Party come in.

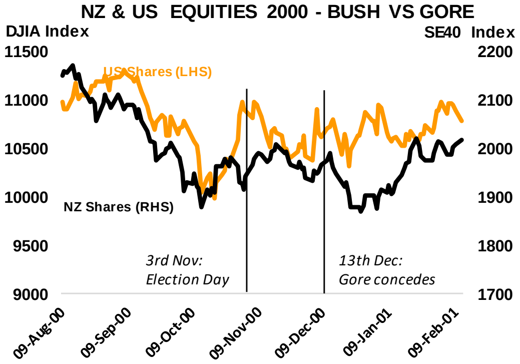
A drawn-out result could trigger considerable volatility everywhere from bonds and equities to commodities and FX. With President Trump refusing to commit to accepting defeat, and the prospect that things could end up in the courts, it's not at insignificant risk. The last time we had an unclear result, back in 2000 (Bush v. Gore), there was quite a lot of choppiness on Wall Street, which in turn led to volatility on the NZX (see chart below). Still, we shouldn't *overestimate* the chances of an ambiguous result – there is a good chance of a clearer outcome.

Indeed, the most likely outcome is still a comfortable win by Biden. Everyone remembers the shock in 2016, but there are a few reasons to believe an upset this time is a bit less likely. Biden's lead is wider than that enjoyed by Hillary Clinton three years ago (and ahead of the margin he probably needs to win America's convoluted electoral college system). The polls have been much more stable this year too, with some pollsters and modellers also adjusting their methods to fix things that went wrong last time – like the failure to weight their samples by education, or account for correlations in errors between states. The Democrats are also (widely) favoured to hold onto the House of Representatives and (more narrowly) favoured to win control of the Senate. Remember that whatever happens, the new President and Congress won't be sworn in until January, so the prospects for a new stimulus bill any time soon are still far from certain. nathaniel.keall@asb.co.nz

Recent key economics

ASB Economic forecasts and monitoring:
Quarterly Economic Projections
ASB COVID-19 Chart pack
Home Economics
Financial market trends:
Corporate Hedging Toolbox
Policy response:
RBNZ September MPR Review
Assessing the RBNZ's bag 'o' tricks
For COVID-19 research, see here

Chart of the week



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6621	0.6660	0.6635	0.6435	UP	0.6530	0.6790
NZD/AUD	0.9421	0.9366	0.9268	0.9314	FLAT	0.9170	0.9405
NZD/JPY	69.23	69.74	70.09	69.50	UP	69.00	72.00
NZD/EUR	0.5681	0.5645	0.5662	0.5763	FLAT	0.5600	0.5800
NZD/GBP	0.5123	0.5097	0.5158	0.4965	FLAT	0.5100	0.5270
TWI	71.5	71.4	71.6	70.83	FLAT/UP	N/A	N/A

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

NZD Recap

After pushing higher through the early part of last week, the NZD/USD was once again unable to sustain gains above 0.6700. Rising risk aversion and some heavy losses across equity markets saw the currency dragged back towards 0.6600 by the end of the week. Stepping back, the NZD/USD has been chopping around inside a 0.6550-0.6700 range for the best part of 1½ months.

But while NZD/USD has largely gone sideways, most of the NZD crosses (NZD/EUR, NZD/AUD, NZD/JPY) have gradually appreciated through this period as lofty NZ commodity prices and improving domestic economic data have encouraged NZD outperformance. This theme was again in evidence last week, with the NZD notching up gains against AUD, EUR, and CAD. NZD/AUD made a fresh three-month high of nearly 0.9420.

Outlook

As has been noted elsewhere, it's all about the US elections this week. Domestic and global economic data will pale into insignificance. There's potential for volatility and heightened risk aversion in markets if we get an unclear result, or if there are delays or challenges around announcing the winner. This sort of backdrop would be consistent with a stronger USD and NZD/USD sold back down to around 0.6500 or below.

A surprise Trump victory would also most likely see the USD rally, potentially aggressively, posing stiff headwinds for the NZD/USD and other major currencies.

But as we note in the Front Page above, the most likely outcome – the probability of which continues to increase – is for a Biden victory. Betting markets and polls are ascribing anywhere from a 65-95% chance of such. Fivethirtyeight, which relies heavily on statistical modelling, is at 89%. Betting markets also (more narrowly) favour the Democrats to win the Senate. Given it has been increasingly priced in, this outcome wouldn't see too much change in markets, particularly if it was delivered without a lengthy delay. It is likely that we would see risk appetite recover, bringing about a weakening in the USD and a likely NZD/USD push above 0.6700.

Last week's spike in risk aversion (driven not by elections but more so escalating worries about the third COVID wave) carved 1½ cents off our model's estimated short-term fair-value range. It now sees 0.6100-0.6500. An election outcome that saw the VIX index (the model's proxy for risk aversion) ease back to the low 20s from the current 38 would be consistent with a lift in the fair-value range back up to 0.6400-0.6800. mike.jones@asb.co.nz

ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.93	0.89	0.88	0.86	0.86	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.53	0.53
NZD/GBP	0.52	0.51	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.5	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	71.6	69.9	69.4	68.0	67.6	67.6

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	1.00	UNCH/DOWN	UP
90-day bank bill	0.28	0.27	0.29	1.12	UNCH/DOWN	UP
2-year swap	0.01	0.01	0.06	1.02	UNCH/DOWN	UP
5-year swap	0.11	0.13	0.14	1.09	UNCH/DOWN	UP
10-year swap	0.52	0.54	0.51	1.39	UNCH/DOWN	UP
10-year govt bond yield	0.54	0.61	0.51	1.28	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.51	0.53	0.45	0.37	UNCH	DOWN

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

Market Recap

NZ yields start the week little changed on a week ago. Positive signs on the NZ economy – strong housing lending, strengthening business and consumer confidence, a solid milk price auction and no new cases of community transmission of COVID-19 – triggered little reaction in the NZ rates market. There was strong demand for the $4bn 2028 NZ government bond syndication, with a yield of just 0.31%. The RBNZ purchased $880 in NZ government bonds, taking total asset purchases to a shade under $38bn.

Global longer-term yields pushed higher last week, and the curve steepened, likely driven by expectations of a Democratic clean sweep in the upcoming US elections. US 10-year Treasury yields hit their highest point since June (0.87%) late last week, with the US yield curve (2s-10s) its steepest since early 2018. Australian yields were also pushed higher, with the curve steepening and with swap spreads widening. This was despite soaring cases of COVID-19 in the US and Europe, which triggered lockdowns in France, Germany and the UK.

Near-term interest rate outlook

A volatile week for global (and potentially NZ) yields beckons as we approach the US elections (November 3). Markets look to be factoring in a Democrat clean sweep, which if clear-cut could push yields higher. However, an inconclusive result and delays until the result is confirmed (potentially weeks rather than days) could prompt a period of pronounced volatility and lower yields. This week's data - including Q3 NZ labour market data, the Q4 RBNZ survey of expectations, Q3 Australian retail trade and US Non-farm Payrolls – are unlikely to attract much market attention, notwithstanding the potential for a volatile Q3 HLFS reading. Higher RBNZ government bond purchases than the weekly tender ($870m versus $650m) should dampen yields at the margin.

We expect global central banks to increase policy stimulus to keep yields low. Tomorrow the RBA is expected to cut its cash rate, yield target for 3-year government bonds and the interest rate charged on the Term Funding Facility to a record low 0.1%. We also expect the RBA to unveil an AUD$100bn package to purchase ACGBs and Semi-government bonds on the 5- to 10-year part of the curve to dampen longer-term yields. The Bank of England is also expected to lift its asset purchasing program by £100bn (to £845bn). Given the US elections, we don't expect any surprises from this week's FOMC meeting, although the release of debt issuance plans by the US Treasury could impact yields.

Medium-term outlook

The RBNZ has signalled it will launch a Funding for Lending Programme by the end of the year, most likely shortly after the November MPS on November 11. This will only provide modest economic support in our view. We have pencilled in a 75bps OCR cut in April to take the OCR to -0.5%, but whether the RBNZ does cut to this extent will depend on the economic outlook and whether the Bank deems the OCR to be the preferable policy lever to pull. The Fed and RBA are expected to hold key policy rates over 2021, although we expect the ECB to expand asset purchases and the BoE to move its policy rate below zero. Low global inflation and the negatively skewed global risk profile should keep NZ longer-term yields low. mark.smith4@asb.co.nz

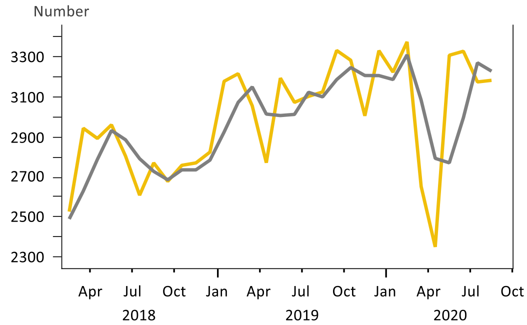
Domestic events

Data	Date	Time (NZT)	Market	ASB
Labour market data (unemployment rate), Sep quarter	04/11	10:45 am	-	5.4%
ANZ Business Outlook, Own act next 12 months, Nov p	05/11	1:00 pm	-	
RBNZ Survey of Expectations- Q4, 2-year ahead CPI inflation	06/11	3:00 pm	-	-

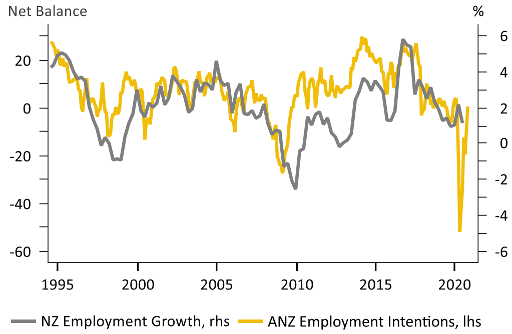
We expect the **Q3 labour market data** will provide a cleaner read on the unemployment rate and labour demand, following Q2's artificially low unemployment result. We expect a 0.7% fall in employment over the quarter. Coupled with a ½ percentage point rebound in the labour force participation rate (to 70.4%), this would deliver an increase in the unemployment rate from 4.0% to 5.4%.

ANZ releases the preliminary results of the November business outlook survey on the 5th of November. Business confidence continued to improve in October. Outright levels remain low, but the rate of improvement has been impressive, testament to the resilience of the NZ economy. Employment intentions lifted strongly in early October, an encouraging sign of the labour market's underlying strength, despite the wage subsidy extension ending in September. Pricing intentions also lifted strongly and, if recent business confidence trends continue over the coming months, it may suggest reduced need for further stimulus from the RBNZ (on top of the large stimulus already provided over 2020).

NZ New Residential Dwelling Consent



ANZ Employment Intentions & NZ Annual Employment Growth



Source: Macrobond, ASB

One- and two-year ahead inflation expectations from the RBNZ Survey of Expectations are likely to remain well below the midpoint of the 1-3% inflation target. Annual headline inflation ticked down to 1.4% in 2020Q3, with the short-term inflation outlook looking soft (we expect annual CPI inflation to cool to 0.5% in early 2021) despite brighter signs on the economic activity and house price front. Low inflation readings will continue to concern the RBNZ and will likely pave the way for more policy stimulus to be added. We expect the RBNZ to maintain a still-sizeable pace of asset purchases under the LSAP programme, introduce a Funding for Lending Programme by the end of the year to bolster bank lending, and flag the likelihood for OCR cuts in early 2021.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CoreLogic Dwelling Prices, October, %mom	02/11	1:30 pm	0.2
Australia Building Approvals, September, %mom	02/11	1:30 pm	0.0
Australia Value of Home Loans, September, %mom	03/11	1:30 pm	2.0
RBA Interest Rate Announcement, %	03/11	4:30 pm	0.1
Australia Retail Trade, September, %mom	04/11	1:30 pm	-1.5
US ISM Manufacturing, October, points	05/11	4:00 am	56.5
RBA Monetary Policy Statement	06/11	1:30 pm	-
UK Interest Rate Announcement, %	06/11	1:00 am	0.1
US Federal Reserve Interest Rate Announcement, %	06/11	8:00 am	0.00-0.25
US Non-farm Payrolls, October, 000s	07/11	1:30 am	600

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We expect **Australia's dwelling prices** across the eight capital cities to lift by 0.2% in October after falling by 0.2% in September. This would mark a turning point for dwelling prices which have declined 2.8% since their most recent peak in April 20. The record low cost of mortgages is providing support to the housing market.

We expect **Australian building approvals** were flat in September after falling by 1.6% in August. The collapse in net overseas migration and subsequently weak population growth rate is a significant headwind for building approvals.

We expect the value of all new **Australian housing-related lending** (excl. refinancing) to lift by 2% in September, after the incredible 12.6% rise in August which saw the annual growth rate step up to 19.3%. CBA's internal lending data have indicated that the demand for credit remained strong in September.

We think there is enough evidence in the **Reserve Bank of Australia's (RBA)** recent communication to expect that **they will now push key policy rates lower at the November Board meeting**. We expect a reduction in the cash rate, the yield target for 3-year Australian Government bonds and the interest rate charged on the TFF to 10 basis points.

The preliminary data showed a 1.5% fall **Australia's retail trade** in September. Falls in food, household goods and other categories drove the decline in September. Over the September quarter we expect that volumes rose by 5% following the 3.4% fall in Q2. Our forecasts imply a solid lift in retail prices in the quarter after a fall in Q2.

The **RBA's Statement on Monetary Policy (SMP)** is a quarterly release containing its updated economic outlook and forecasts. The RBA has recently flagged that it expects the data to show that the Australian economy expanded in Q3 20 and that the economy has exited the recessionary period. We expect that the RBA will revise its unemployment rate forecasts lower in the near term and revise up its GDP growth forecasts.

We forecast a strong lift in **the US ISM manufacturing index** to 56.5 points. This would be the highest reading since November 2018. On balance, already-released regional Fed surveys lifted sharply in October citing jumps in new orders and shipments.

We expect the Bank of England (BoE) to keep the Bank Rate at 0.10% and increase the total stock of asset purchases by £100bn to £845bn to ensure financial market stress remains contained amid slower growth.

We expect no policy changes from the US Federal Reserve. The meeting follows the US election and there is a risk the election results will remain unknown when the US Fed meets.

We expect to see an ongoing recovery in the **US labour market** in October. We forecast a 600,000 increase in employment and expect the unemployment rate to fall to 7.7%. However, we continue to expect the pace of recovery in the labour market will moderate because some job losses will have been permanent.

Key Forecasts

ASB NZ economic forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-12.2	11.0	0.7	0.5	0.3	0.4	0.8
GDP real - A%	-12.4	-3.4	-3.2	-1.3	12.7	1.0	3.4
GDP real - AA%	-2.1	-3.5	-4.8	-5.1	0.8	3.9	2.4
NZ House Prices (QV Index) - A%	6.8	6.9	9.1	9.0	11.3	7.0	4.9
CPI - Q%	-0.5	0.7	0.1	0.2	0.3	0.4	0.5
CPI - A%	1.5	1.4	1.0	0.5	1.3	1.5	1.3
HLFS employment growth - Q%	-0.3	-2.3	-1.1	0.1	0.5	0.5	0.5
HLFS employment growth - A%	1.5	-1.2	-2.6	-3.5	-2.7	2.2	1.8
Unemployment rate - %sa	4.0	5.6	6.5	6.7	6.7	5.9	5.8

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	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	0.25	0.25	0.25	0.25	-0.50	-0.50	-0.25
NZ 90-day bank bill	0.30	0.31	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.06	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.13	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.51	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.46	0.45	0.25	0.00	0.20	0.55

ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.93	0.89	0.88	0.86	0.86	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.53	0.53
NZD/GBP	0.52	0.51	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.5	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	71.6	69.9	69.4	68.0	67.6	67.6

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