

# Economic Weekly

03 February 2020

## Where to look for coronavirus impacts

With the world increasingly gripped by the coronavirus, last week's RBNZ speech provided a useful reminder of the three ways global 'shocks' affect NZ. Those key channels being trade, financial, and uncertainty. On trade, we see some [modest short-term risks](#). On financial, we'd note that the reaction so far in global volatility, equity, and credit market indicators has been relatively modest. However, we suspect things will get worse before they get better given it looks increasingly likely Chinese and global growth will take a decent hit in Q1. On uncertainty, clearly it's high, but it will be important to watch upcoming business confidence indicators for a sense on whether it is affecting the mindset and hiring/investing intentions of corporate NZ. Upcoming trade and commodity price data (including this week's GDT auction) will also be important to monitor for any impacts. We probably won't get a definitive sense of the hard global economic impact until February global PMI data begin rolling in around a month from now. Until then, financial market indicators, particularly those in China (see below), will be key to watch.

### Key events and views

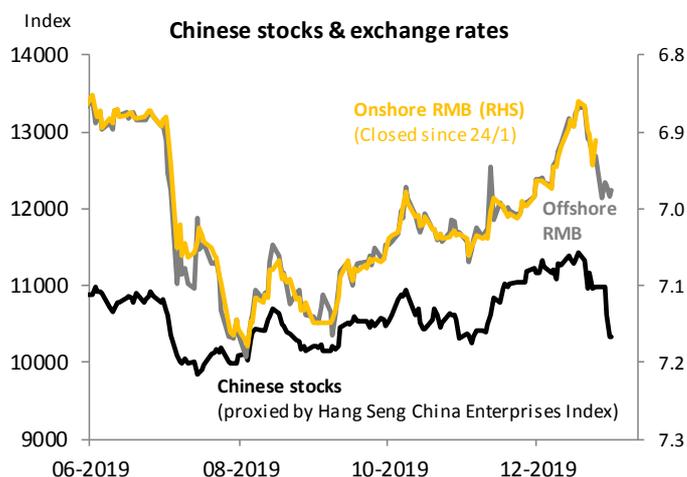
<a href="#">Foreign exchange</a>	NZD has fallen against the USD, JPY, GBP and EUR, but holding up against AUD
<a href="#">Interest rates</a>	Downward pressure on yields to remain
<a href="#">Domestic events</a>	Q4 labour market data the highlight (Wed). Also building consents and inflation expectations
<a href="#">International events</a>	Manufacturing PMIs, RBA meeting, Aussie retail sales, China trade balance, US employment

### Chart of the Week: Assessing Chinese Financial Impacts

A large chunk of Chinese financial markets have been closed ever since the coronavirus broke out. This has made it difficult to gauge what investors are pricing in in terms of virus impacts. We can gain some insight through proxy measures. For example, while the onshore renminbi (CNY) has not traded since 23 January, the offshore CNH remains open. As the chart shows, it points to a 1% odd depreciation against the USD when the CNY does reopen.

Similarly, the two main Chinese equity indices will reopen today, having been closed since the 23<sup>rd</sup>. The Hong Kong exchange (Hang Seng) has been open throughout. One of its key benchmarks – the China

Enterprises Index – tracks the performance of Mainland securities. The index has fallen around 10% since the virus broke out, pointing to a difficult reopening for the Shanghai and Shenzhen indices later this afternoon.



## Foreign Exchange Market

<u>FX Rates</u>	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6473	0.6575	0.6675	0.6913	DOWN	0.6300	0.6500	FLAT/UP
NZD/AUD	0.9673	0.9656	0.9575	0.9546	FLAT/UP	0.9600	0.9750	UP
NZD/JPY	70.21	71.69	72.21	75.25	DOWN	67.00	71.00	DOWN
NZD/EUR	0.5841	0.5960	0.5973	0.6042	DOWN	0.5700	0.5900	FLAT
NZD/GBP	0.4914	0.5035	0.5081	0.5279	DOWN	0.4800	0.5000	FLAT
TWI	71.7	72.4	73.0	74.42	DOWN	N/A	N/A	UP

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

### NZD Recap

Growing concerns around the global corona-virus outbreak has seen financial market participants move to safe-haven investments and has seen safe-haven currencies (i.e. the JPY & CHF) continue to outperform. The NZD has fallen against the USD, JPY, GBP and EUR, but continues to hold up against the AUD with the AUD also impacted by the risk-off tone in financial markets.

### Near-term outlook

This week, **domestic data may be overshadowed by corona-virus developments**. The NZ Government has followed moves by the US and Australia and placed a temporary ban on foreign visitors who have travelled from, or through, mainland China in order to contain the spread of the virus. This ban is likely to have some economic impact on NZ tourism and education providers, with Chinese visitor arrivals accounting for 11% of all visitor arrivals and given Chinese arrivals would have reached seasonal peak in February.

The **notoriously volatile Household Labour Force data are released on Friday** this week, and we expect the unemployment rate to remain unchanged over Q4.

The **Reserve Bank of Australia meets on Tuesday**. Although we expect the RBA to leave its cash rate unchanged at 0.75%, we can't rule out the risk of a rate cut this week. The pricing for RBA rate cuts has been building since the impacts of the Australian bushfires and coronavirus have escalated, and the probability of a rate cut this week currently stands at 18.6% (according to 30-day cash futures pricing).

We expect the **GBP to remain volatile** as the next stage of Brexit negotiations around the future of the UK EU trading relationship gets underway this week. GBP has opened Monday trading lower after PM Johnson said he is willing to walk away from EU trade talks. The EU accounts for 47% of all UK exports, but the UK is much less important to the EU, with the UK taking only 6% of all EU exports.

### Medium-term outlook

We expect the NZD to remain on a gradual uptrend through the first half of 2020, although our view of a still-strong USD is expected to cap the extent of NZD/USD strength.

We also expect the NZD/AUD to continue rising over 2020, as the NZ economy continues to outperform that of Australia. This is reflected in our central bank views and hence NZ/AU interest rate forecasts. In NZ we expect only one more OCR cut from the RBNZ while in Australia we expect two more RBA cuts.

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<b>ASB foreign exchange forecasts</b> (end of quarter)	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

## Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH	UP
90-day bank bill	1.26	1.28	1.29	1.93	UNCH	UP
2-year swap	1.10	1.23	1.23	1.92	UNCH/DOWN	UP
5-year swap	1.13	1.33	1.40	2.09	UNCH/DOWN	UP
10-year swap	1.43	1.61	1.72	2.50	UNCH/DOWN	UP
10-year govt bond yield	1.30	1.39	1.59	2.20	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.34	0.38	0.50	0.59	UNCH/DOWN	DOWN

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

### Market Recap

**Local and global yields have fallen for a second consecutive week, with more pronounced falls for longer-dated maturities.** The major trigger was the worsening coronavirus outbreak, with the World Health Organisation having declared it to be of international concern. Oil prices have slumped and 10-year government bond yields are currently around 2020 lows, with falls of 35-45bps to date for NZ, Australian and US yields. US 10-year Treasury yields (1.51%) fell to early October 2019 lows, with the US yield curve (10Y less 3 month) inverted. To help stabilise jittery markets, the People's Bank of China (PBOC) announced that it would inject additional liquidity to the banking system. The slide in local yields has occurred despite headlines signalling increases in NZ infrastructure spending and the stronger than expected NZ trade surplus, with the speech by RBNZ Assistant Governor Hawkesby on global links to NZ triggering minimal market impact. The Federal Open Market Committee (FOMC) held the Fed funds target rate at 1.50% to 1.75%, with some minor technical adjustments to keep the effective Fed funds rate on track. US Treasury yields were lower after FOMC Chair Powell voiced concern over persistently-low US inflation (core PCE at 1.6% yoy) and the potential impacts of the coronavirus. UK yields briefly ticked up after the Bank of England voted 7-2 to hold the policy rate at 0.75%, with outgoing Governor Carney pointing to more positive signs for the UK economy in early 2020.

### Near-term NZD interest rate outlook

Markets currently have around 15bps of OCR cuts priced in for 2020, which looks to be appropriate given our view of the risk profile. **The near-term direction of NZ and global yields will largely depend on how well markets have allowed for the (highly unknown) impact of the coronavirus and we suspect yields are likely to remain under further downward pressure.** Some volatility is to be expected after the Chinese market reopens this morning after the Lunar New Year holiday. Last week's Chinese PMI data showed no signs of a coronavirus-related impact, and we will be closely watching the Chinese dataflow and commodity prices (including forthcoming dairy auctions) for signs. NZ employment is expected to remain close to its maximum sustainable level, but the prospect of rising labour market slack over 2020 should keep the market erred towards OCR cuts. The Reserve Bank of Australia is expected to hold the cash rate at 0.75% and retain an explicit easing bias given low inflation. Recent bush fires and the coronavirus are additional wild cards for the RBA to consider.

### Medium-term outlook

We have pencilled in a 25bp RBNZ cut in May (to 0.75%), with risks of the OCR being on hold for longer. We then expect a series of gradual OCR hikes from 2022 (OCR endpoint of 2.25%). The RBA is expected to cut the 0.75% cash rate by 50bps in 2020 (April, Aug), taking it to the 0.25% effective lower bound. The 1.50%-1.75% Federal Funds rate is expected to be cut by 50bps in 2020 (Sep, Dec). Low inflation, moderate global growth and negative (but receding) risks should cap NZ and global long-term interest rates at low levels. [mark.smith4@asb.co.nz](mailto:mark.smith4@asb.co.nz)

### ASB interest rate forecasts

(end of quarter)	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZ OCR	1.00	1.00	1.00	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.2	1.3	1.2	1.0	1.0	1.3	1.8
NZ 2-year swap rate	0.9	1.3	1.1	1.0	1.0	1.3	1.7
NZ 5-year swap rate	0.9	1.4	1.2	1.1	1.2	1.5	1.9
NZ 10-year swap rate	1.2	1.8	1.4	1.3	1.4	1.6	2.0
NZ 10-year Bond	1.1	1.7	1.2	1.1	1.2	1.4	1.8

## Domestic events

Data	Date	Time (NZT)	Market	ASB
NZ Building Consents, Residential, Dec, %mom	04/02	10:45am	-	-
GlobalDairyTrade auction, WMP, % change	04/02	Overnight	-	No change
Q4 NZ labour market data, Q4 HLFS unemployment rate, %	05/02	10:45am	4.2	4.2
Q1 RBNZ Survey of Expectations, CPI inflation, 2-yr ahead	07/02	3:00pm	-	↑

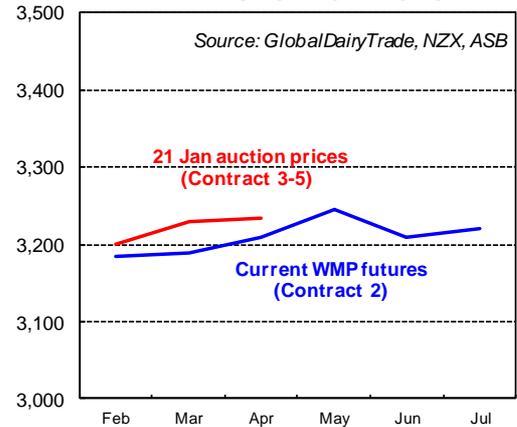
**Residential dwelling consents** have lifted strongly over the past few years and on an annual basis nationwide consent numbers are at their highest since the mid-1970s. The recent interest-rate induced pick-up in housing demand and house prices is likely to keep residential construction demand at high levels over 2020.

**We expect no change in whole milk powder prices at the GlobalDairyTrade auction overnight Tuesday.** At this stage, the dairy market reaction to the coronavirus outbreak has been mild. However, we wouldn't rule out a bigger reaction as the Chinese yuan has weakened (by around 1%) and developments are very fluid day to day. Also, note that Chinese buyers represent largest group on the dairy auctions.

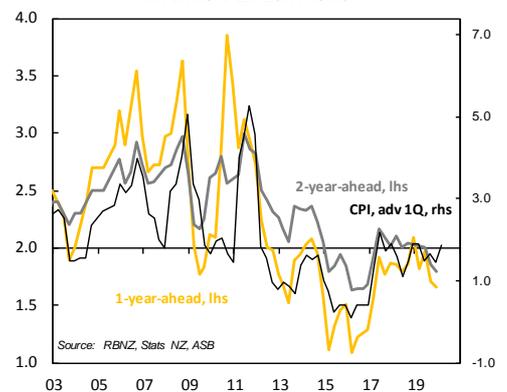
**Inflation expectations from the RBNZ survey are likely to move closer to midpoint of the inflation target, likely raising the hurdle to imminent moves in the OCR.** Annual headline CPI inflation firmed to 1.9% in the December quarter from 1.5% yoy in September. We are likely to see a larger jump in the 1-year ahead forecasts for inflation (1.66% in the Q4 survey) than for the 2-year ahead forecast (1.80%) given its lower starting point and the greater sensitivity of this measure to transitory movements in consumer prices. The information content of this survey is questionable given the low number of respondents who historically fill out this survey.

**We expect employment growth of 0.3% qoq (1.2% yoy) and an unchanged unemployment rate (4.2%) from Wednesday's Q4 NZ labour market data.** Notably, these numbers are all relatively similar to the RBNZ's own expectations. And, if our forecasts are correct, it would essentially confirm the RBNZ is continuing to meet its "maximum sustainable employment" objective – one half of its mandate. Last week's CPI figures confirmed the bank is also meeting the other half. This being the case, we doubt the RBNZ will be reaching for the interest rate lever anytime soon. But we don't think the Bank can rest easy just yet. We continue to forecast unemployment settling a little higher than the Bank's expectations over 2020.

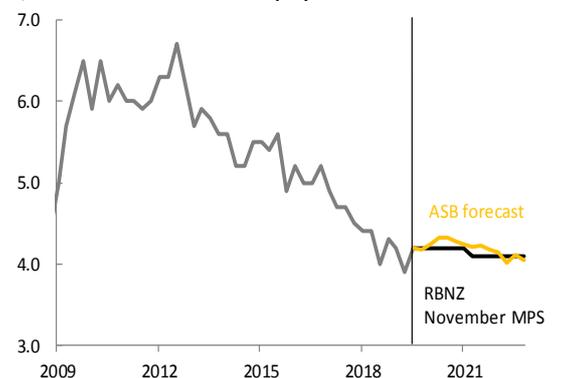
USD/MT **GLOBALDAIRYTRADE AND WMP FUTURES PRICES**



**CPI INFLATION & INFLATION EXPECTATIONS**



**NZ Unemployment Rate**



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
Building Approvals, December, %mom	03/02	1:30 pm	-5	-5
RBA Interest Rate Announcement, %	04/02	4:30 pm	0.75	0.75
RBA Lowe speech	05/02	2:30 pm	-	-
Australia Retail Trade, December, %qoq	06/02	1:30 pm	-0.2	-0.2
RBA Statement of Monetary Policy	07/02	1:30 pm	-	-
China Trade Balance, January, US\$bn	07/02	-	36.31	31
US Non-farm Payrolls, January, 000s	08/02	2:30 pm	160	165

\*Originally published by CBA Global Markets Research on Friday 31<sup>st</sup> January at 2:04 pm

**Residential building approvals in Australia** have lifted a little in recent months, particularly in the volatile multi-unit sector, driven by stronger approvals in NSW and Victoria. We are forecasting a 5% drop in approvals in December following an 11.8% lift last month. Lower interest rates, rising property prices and strong population growth are supporting demand for new residential property.

Given some stronger data over recent months **we think the Reserve Bank of Australia (RBA) will leave the cash rate unchanged at this week's meeting.** However we have two further cash rate cuts in our profile, one in April and one in August. The RBA has a clear easing bias with inflation continuing to run well short of target and the unemployment rate a fair way above the level that the central bank estimates to be full employment. New developments since the RBA last met include the widespread bushfires, the signing of the "phase one" trade deal between the US and China and the Coronavirus.

**RBA Governor Lowe will address the National Press Club** on "The Year Ahead" this Wednesday. This is the first monetary policy related speech since late November. Lowe is likely to run through any changes to the RBA's key forecasts ahead of the Statement of Monetary Policy on Friday. He will potentially also renew calls for assistance from other arms of policy.

**Australian retail trade** spiked by 0.9% in November, with spending receiving a boost from the Black Friday sales. We are expecting a 0.2% fall in retail trade in December as spending falls back to more normal levels and as internal credit card data show subdued spending over the Christmas period. We are forecasting a 0.3% lift in the volume of retail trade in Q4 after a 0.1% fall last quarter. Looking ahead, the bushfires are likely to have weighed on spending in early 2020 with tourist activity impacted.

The RBA's **Statement of Monetary Policy** will include bank's detailed forecasts for the economy over the next few years. The major economic variables, GDP, inflation and the labour market have evolved broadly as was expected at the time of the November SMP. However the RBA now has a few wild cards to consider including the bushfires and the new Coronavirus.

Seasonal effects thanks to the moving Lunar New Year and the virus outbreak weighed on **January Chinese trade data.** We expect exports to fall by 1%yoy and imports to grow by 3%yoy in January. This would see the monthly trade surplus ease to around US\$ 31bn.

The low level of jobless claims suggests **US jobs growth** picked-up slightly in January to 165,000 and unemployment stayed low at 3.5%. The solid labour market and the small lift in inflation expectations suggest earnings growth accelerated slightly to 3.0%yoy.

## Key Forecasts

### ASB NZ economic forecasts

	Sep-19 << actual	Dec-19 forecast >>	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.7	0.4	0.5	0.6			
GDP real - A%	2.3	1.6	1.7	2.2	2.7	2.8	2.7
GDP real - AA%	2.7	2.2	1.9	1.9	2.4	2.8	2.7
CPI - Q%	0.7	0.5	0.5	0.5			
CPI - A%	1.5	1.9	2.2	2.1	2.2	2.0	1.8
HLFS employment growth - Q%	0.3	0.3	0.3	0.3			
HLFS employment growth - A%	1.0	1.2	1.5	1.1	1.5	1.8	2.0
Unemployment rate - %sa	4.2	4.2	4.2	4.2	3.9	3.5	3.0
Annual current account balance as % of GDP	-3.3	-2.8	-2.4	-2.2	-2.4	-2.9	-2.7

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

	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.00	1.00	1.00	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.2	1.3	1.2	1.0	1.0	1.3	1.8
NZ 2-year swap rate	0.9	1.3	1.1	1.0	1.0	1.3	1.7
NZ 5-year swap rate	0.9	1.4	1.2	1.1	1.2	1.5	1.9
NZ 10-year swap rate	1.2	1.8	1.4	1.3	1.4	1.6	2.0
NZ 10-year Bond	1.1	1.7	1.2	1.1	1.2	1.4	1.8

### ASB foreign exchange forecasts

	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

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