Economic Weekly

03 August 2020

It's a long game

Victoria's weekend announcement of added measures to counter COVID-19 reinforces what a challenge the world is facing in combatting the virus and also how quickly a promising outcome can so easily be derailed. Melbourne has moved into Stage 4 lockdown (roughly equivalent to NZ's Level 4) and imposed a curfew. Regional Victoria is moving to Stage 3 restrictions. As a result, a quarter of Australia's population is facing fairly restrictive conditions.

For NZ, the recovery in our second-largest trading partner will be more drawn out. Australia overall has not (so far at least) been subject to the severity of NZ's lockdown, but its various restrictions are in place for longer. Duration matters for businesses' ability to hang in there, particularly if resilience is already stretched. In addition, NZ's border is unlikely to be opened up in any meaningful way for some time. That means up to a net 5% of GDP that flows through the economy from cross-border people movements will be missing for some time and hard to fill quickly.

NZ has been very fortunate that so much of its economy has got back to a new version of normal relatively quickly. Doing so has minimised the damage done by our restrictive lockdown – along with huge government support. But the flow-on impacts of both the border closure and the lockdown have yet to fully filter through to jobs and the property market, the topics getting a lot of media coverage at present. We expect the impacts to be more pronounced by the end of 2020, though much of the data showing the effects won't be published until we are into next year.

Meantime we need to be mindful that economic outcomes are not instant even in a world that demands instant gratification or verification, and that there are more challenges than normal in measuring some types of economic activity. This Wednesday's labour market releases are examples of both. Much of the focus will be on the unemployment rate: the Q2 figure is just a way point on a trend higher. But measurement challenges, wage subsidies, potential for job-seekers to give up looking mean a wide range of possible outcomes. nick.tuffley@asb.co.nz

Recent key economic publications

ASB Economic forecasts and monitoring:

[Quarterly Economic Projections]()
[ASB COVID-19 Chart pack]()
[NZ Sector outlook]()

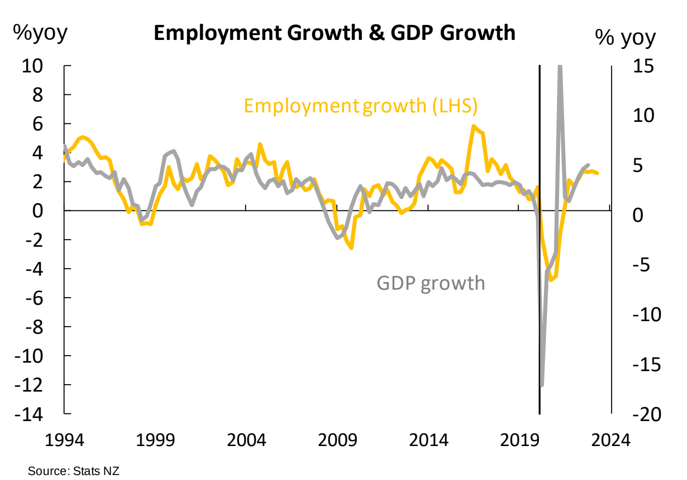
Financial market trends:

[Corporate Hedging Toolbox]()

Policy response:

[RBNZ leaves QE target unchanged in June]()

For COVID-19 research, see [here]()



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6628	0.6674	0.6512	0.6539	FLAT/UP	0.6580	0.6760
NZD/AUD	0.9293	0.9355	0.9402	0.9602	FLAT	0.9300	0.9460
NZD/JPY	70.16	70.47	70.01	70.01	FLAT	68.00	71.60
NZD/EUR	0.5628	0.5702	0.5800	0.5899	FLAT/DOWN	0.5560	0.5670
NZD/GBP	0.5067	0.5198	0.5226	0.5400	FLAT/DOWN	0.5000	0.5170
TWI	72.3	72.8	72.1	72.37	FLAT	N/A	N/A

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

NZD Recap

The NZD/USD finished last week almost bang-on where it started, around 0.6630. Given the broad weakening in the USD over the week, this was actually the weakest performance amongst G10 currencies. European currencies continue to benefit the most from the softer USD, following the historic agreement of the €750b European Recovery Fund. NZD/GBP and NZD/EUR fell to 1½ month lows around 0.5060 and 0.5630 respectively.

The USD managed to bounce off 2-year lows on Friday, even as ratings agency Fitch placed the AAA rating of the US government on Negative Outlook (S&P already rates the US lower at AA+). But spiralling COVID-19 cases and the fact there is still no Congressional agreement on how to replace the US unemployment benefit that expired last Friday are big risks to the US economic outlook. The US dollar thus remains suspectable to additional downside pressure.

The fallout for the AUD from the Sunday announcement that Melbourne will enter a Stage 4 lockdown for 6 weeks has been relatively limited so far, suggesting market participants partly expected such a move (the Aussie holiday today may also be a factor). The AUD opened the week only 10-20 pips lower around 0.7130 with NZD/AUD a smidge higher around 0.9300.

Outlook

We haven't changed our currency view. We still expect the NZD/USD to trade with a modest upside bias over the coming months, with plenty of volatility around this gradual uptrend. Risk appetite, proxied by equity market sentiment, will remain the key source of day-to-day volatility. Our short-term valuation model points to a 0.6450-0.6850 "fair-value" range for the NZD/USD.

There is some meaty, particularly offshore, event risk to look out for this week. Local unemployment figures on Wednesday will be all very interesting (6.4% expected) but the wide range of outcomes and inherent volatility in the series means we're not expecting a lasting markets reaction. Tonight's US manufacturing indices will be important for sentiment. They're expected to improve but risks are to the downside. The RBA meeting in Australia and Friday's US employment report will also be influential for currency markets.

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ASB foreign exchange forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	69	66	66	67	69	67
NZD/EUR	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	71.4	71.1	71.7	72.1	73.6	71.4

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	0.30	0.30	0.31	1.45	UNCH	UP
2-year swap	0.19	0.22	0.22	1.20	UNCH	UP
5-year swap	0.28	0.33	0.36	1.23	UNCH	UP
10-year swap	0.63	0.69	0.76	1.54	UNCH	UP
10-year govt bond yield	0.74	0.83	0.96	1.37	UNCH	UP
Curve Slope (2s10s swaps)	0.44	0.48	0.55	0.34	UNCH	DOWN

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

Market Recap

NZ and global yields start the week lower, with the curve flatter on fears of increasing economic disruption caused by COVID-19. Data was weak, with record falls to Q2 GDP in the US and the Eurozone, climbing US initial jobless claims, and weak Q2 Australian CPI. NZ 2-year swap yields fell to a 2-month low, with the levelling off in local business and consumer confidence readings over July suggesting a stalling in momentum.

The message from the US Federal Reserve was dovish, with the Fed signalling preparedness to use its full range of tools, maintain at least USD120bn in monthly asset purchases, and hold US policy rates at operational lows until it was confident the US economy was on the mend. The delay in further US fiscal stimulus going through Congress also likely pushed yields lower.

Government bond yields were also lower. Last week, US 10-year Treasury yields fell to a record low 0.52%. Yields for other sovereigns were generally lower, with NZ Government bond 10-year yields also falling to record lows (10Y 0.74%), helped by $940m in RBNZ Asset Purchases.

Near-term interest rate outlook

We expect yields to remain very, very low with few catalysts to push them markedly higher. Our worry is that the flaring up of COVID-19 cases may derail the global economic recovery and act to further dampen yields. The weekend saw the number of new global cases for COVID-19 hit a record high. With Melbourne going into a 6-week lockdown and with climbing cases in other Australian states, the NZ economy will remain hamstrung for a while yet.

The RBA and Bank of England will likely maintain current policy settings. Although the published forecasts from the RBA should be brighter than in May, the flaring up of COVID-19 infections suggest the need to tread cautiously. We expect a dovish tone to be adopted that will not rule out further policy easing if needed.

Forthcoming data such as this week’s US Initial Jobless Claims and forward gauges such as the manufacturing ISM for the US will be watched for further signs of slippage. Local Q2 labour market data look to be a lottery, with a wide range of surveyed expectations for the unemployment rate. Market reaction should be limited.

We still expect the RBNZ to continue to focus on its asset purchase programme given its effectiveness in lowering borrowing costs. On the face of it there are reasonable grounds for the Bank not to increase its $60bn RBNZ asset purchasing programme in August, but with the RBNZ having already prepared markets for a big announcement, we expect a modest upscale of the package. We do not, however, expect the RBNZ to alter the scale of weekly asset purchases.

Issuing more bonds via syndication has helped to cap the NZ weekly bond tender, with $950m in NZ Government bonds set to be tendered this week. With the RBNZ set to continue with $NZ940m of NZ Government bond purchases (and $30m of LGFA purchases), this should help keep the NZ yield curve flat relative to Australian curve.

Medium-term outlook

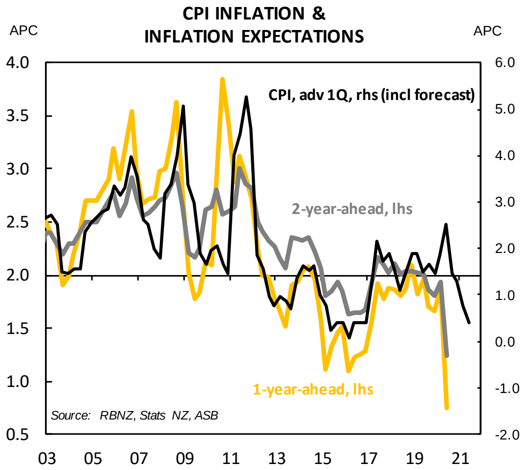
We don’t expect the OCR to move above its 0.25% operational lower bound until at least 2024. The RBNZ is likely to increase and broaden its $60bn asset purchase programme before cutting the OCR and we expect a modest QE upgrade in the August MPS. Sub-par global activity and RBNZ asset purchases should help to cap longer-term NZ interest rates and keep the curve flat despite high public debt issuance. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
Labour mkt data (unemployment rate), June 2020 qtr	05/08	10:45am	-	6.4%
RBNZ Survey of Expectations Q3, 2-yr ahead CPI inflation	06/08	3:00pm	-	1.24%

Notoriously choppy in 'normal' times, labour market data to be released next week could be even more of a handful this time around. We're expecting employment to contract 2.8% and the unemployment rate to jump from 4.2% in Q1 to 6.4% in June. The wage subsidy in place for most of the quarter will limit, or at least postpone, the damage. The COVID impact on labour supply is the big uncertainty. Depending on where the participation rate lands, the unemployment rate could conceivably print anywhere in a 5-8% range. Broader measures of labour market slack like hours worked and underutilisation will thus be important for context.

There is scope for inflation expectations to ease further given our softer near-term outlook for headline inflation, although firming petrol prices and the improving (albeit weak) outlook for the NZ economy should help temper falls. The June quarter saw a sharp fall in expected inflations from the RBNZ survey, with average expected inflation for one (0.74%) and two-years ahead (1.24%), the lowest on record. The June CPI report duly showed a sharp drop in annual CPI inflation (to 1.5% yoy), with sharp falls for petrol prices (which tend to be closely correlated with the RBNZ survey) a key castalyst. Growth expectations from the RBNZ survey are expected to be poor for 2020, with improving signs evident for 2021. Low inflation expectations will hold up real interest rates and could hamper the rebound in NZ's economic activity we expect for 2021.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
RBA Interest Rate Announcement, %	04/08	4:30 pm	0.25
Australia CoreLogic Dwelling Prices, July, %mom	04/08	1:30 pm	-0.8
Australia Trade Balance, June, $AUDbn	04/08	1:30 pm	9.0
Australia Retail Trade, June, %mom	04/08	1:30 pm	2.4
US ISM Manufacturing Index, July, points	06/08	2:30 am	54
Bank of England Interest Rate Announcement, %	06/08	11:00 pm	0.1
RBA Monetary Policy Statement	07/08	1:30 pm	-
US Non-farm Payrolls, July, Unemployment Rate, %	08/08	12:30 am	10.5

**Originally published by CBA Global Markets Research on Friday 31st July at 1:02 pm*

We do not expect the Reserve Bank of Australia (RBA) to make any policy changes to the 3-year yield target or the cash rate over our forecast horizon out to mid-2022. In a recent speech Lowe discussed other unconventional policy like “helicopter money” but he emphasised that it was unnecessary in Australia because the government can borrow easily and at very low interest rates. The RBA’s view on negative interest rates remains that they are “*extraordinarily unlikely”* in Australia. The statement accompanying the meeting may flag and key changes to the RBA’s latest economic forecasts ahead of the Statement on Monetary Policy on Friday.

Australian Corelogic’s daily dwelling price data is pointing to fall in July of around 0.8%mom. A collapse in net overseas migration, a soft labour market and falling rents are all weighing on house prices. A collapse in the value of new home loans of 15.7% from March to May indicates that dwelling prices are likely to move lower in the near term.

In June we have pencilled in **Australia’s exports and imports** to grow by 6.5%mom and 5%mom respectively. This will deliver a trade surplus of $A9.0bn in June compared with May’s $A8.0bn trade surplus. Services import and exports have fallen as border closures are stopping tourism flows. The iron ore price has remained elevated around $110/tonne over July and will continue to support exports.

We expect **Australian retail trade** to lift by 2.4%mom in June, in line with the ABS preliminary release. We expect volumes of retail trade to fall by 4.0%qoq. Retail trade fell in nominal terms and the CPI suggests retail prices rose in the quarter courtesy of price rises for groceries, takeaway and furniture and equipment to set up home offices.

The RBA’s Statement on Monetary Policy (SMP) will include their updated forecasts for the Australian economy. Since May, the central bank has said that the economy looks to be tracking better than their central forecast. As a result, we are likely to see some upgrade to the May forecasts.

We expect a further recovery in the **US ISM manufacturing index** to 54.0pts in July. Already-released regional US Fed surveys were broadly stronger over the month. However, there is a risk that the pace in the recovery slows moving forward if the coronavirus outbreak continues to constrain activity.

We expect the Bank of England (BoE) to leave interest rates at 0.1% and maintain its £745bn asset purchase target. The BoE’s updated forecasts are likely to show a more modest recovery from Q2’s trough. The BoE may also provide an update on its review of the effective lower bound, although no specific timing has been provided for when the review will be completed.

We forecast a more modest 1.6m increase in US jobs over July. The resurgence in coronavirus cases has dented the pace of the economic recovery. But a double-dip recession looks unlikely. As a result, jobs can continue to restart and the unemployment rate can drift lower. We expect the unemployment rate to fall to 10.5%. Average hourly wages look set to decline further. We forecast a 0.5%mom fall in wages in July.

Key Forecasts

ASB NZ economic forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-1.6	-16.8	14.7	1.1			
GDP real - A%	-0.2	-17.1	-5.7	-5.1	-3.8	2.7	4.9
GDP real - AA%	1.5	-3.3	-5.3	-7.0	-7.9	5.1	4.6
CPI - Q%	0.8	-0.5	0.5	0.0			
CPI - A%	2.5	1.5	1.3	0.8	0.4	1.4	1.6
HLFS employment growth - Q%	0.7	-2.8	-1.6	-1.1			
HLFS employment growth - A%	1.6	-1.8	-3.6	-4.8	-4.5	1.7	2.7
Unemployment rate - %sa	4.2	6.4	8.1	8.4	7.7	7.7	6.8
Annual current account balance as % of GDP	-2.7	-2.5	-1.9	-1.8	-2.1	-1.0	-0.5

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	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	0.51	0.30	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	0.53	0.21	0.30	0.35	0.40	0.40	0.60
NZ 5-year swap rate	0.63	0.35	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	0.93	0.74	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.03	0.91	0.75	0.85	0.95	1.05	1.15

ASB foreign exchange forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	69	66	66	67	69	67
NZD/EUR	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	71.4	71.1	71.7	72.1	73.6	71.4

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