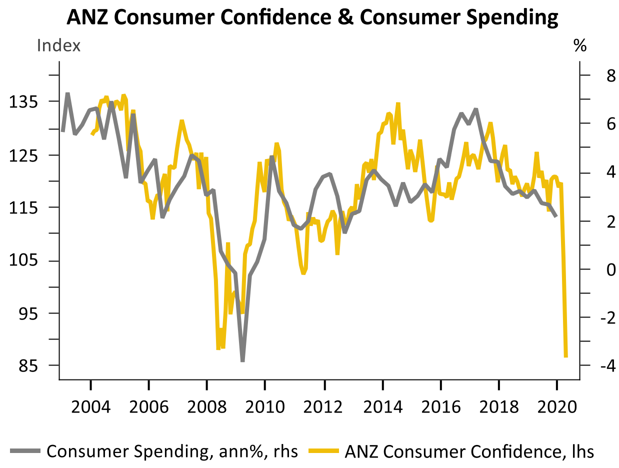
Economic Weekly

04 May 2020

Cheap thrills and comfort food

NZ wasted no time in consuming 5-weeks' worth of takeaways during the first week of Level 3. Fast food outlets were reportedly overwhelmed and faced unprecedented demand as NZ sought comfort food and cheap thrills in the form of Maccas and KFC. To see such a strong bounce in sales from pent-up demand signals some hope for many businesses grappling with the devastating impact of remaining closed as NZ fights to eliminate COVID-19.



Source: Macrobond, ASB

However, beyond this initial bounce-back in spending from pent-up demand, the outlook for household spending will be challenging for the rest of the year. ANZ consumer confidence plunged to a new record low in April – with confidence below levels seen during the 2008/09 Global Financial Crisis. In contrast to business confidence, which we expect to start to improve in May as lock down restrictions were eased, the worst may still be yet to come for consumer confidence. With the NZ economy set to contract around 7% over the coming year, we expect the unemployment rate to lift to 9.4%. Consumer confidence could potentially fall further as the casualties of the lock-down become clear and deterioration in the labour market starts to weigh. With tough times coming, NZ households are likely to stick with cheap thrills and comfort food but, with job security in mind, households will take a more cautious approach to big ticket items such as the purchase of a new house, new car or home renovations.

jane.turner@asb.co.nz

Recent COVID-19 publications

ASB Economic forecasts and monitoring:
Thinking about the new normal for housing
ASB COVID-19 Chart pack
COVID-19 and the economic path ahead (central forecasts)
COVID-19 possible paths in an uncertain future (alternative scenarios)
Financial market trends:
COVID-19: Market stocktake and what we are watching
ASB Podcast for investors
Policy response:
RBNZ QE upside likely in May

Where to find support

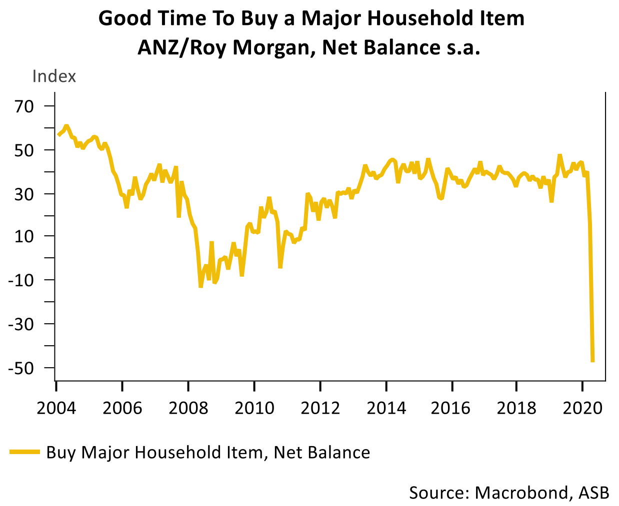
ASB financial support package
Government support package
COVID-19 alert system explainer

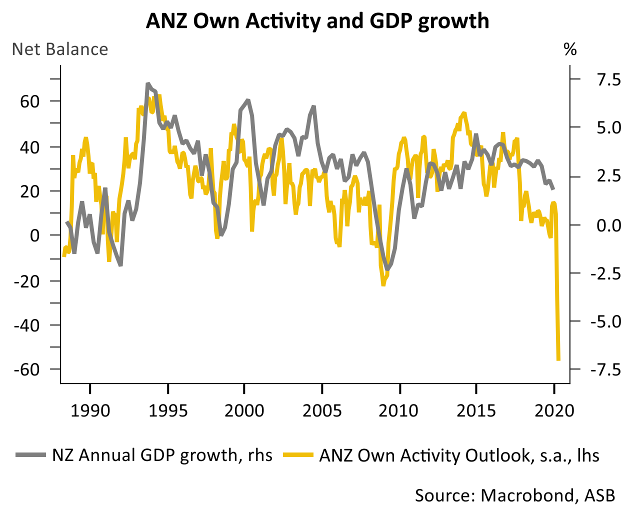
For these publications and more COVID-19 research, see here

Economic confidence in free fall

- Business and consumer confidence plunged to record lows in April and is consistent with our expectation of a 7% contraction in the economy over 2020.
- Around half of firms surveyed expect to cut staff numbers, and we expect the unemployment rate to rise to 9.4% over 2020.
- Eliminating the virus in NZ will improve NZ's medium-term economic prospects relative to those that are likely to face multiple waves of outbreaks.

Business confidence plunged unprecedented lows in April as businesses start to tally the financial cost of the Level 4 lockdown. The full April month results were a fraction better than the preliminary results and may indicate some stabilisation in business confidence (for now). Business confidence is consistent with our expectation of a 7% contraction in the economy over 2020. Meanwhile, consumer confidence also plunged to record lows in April, with households worried about financial prospects. With a sharp rise in unemployment predicted, households are concerned about job security and subsequently indicated they are less likely to purchase a major household asset (chart opposite).





As we move into level 3 – more business activity can take place but operating capacity will remain limited to maintain social distancing measures and muting the pace of recovery. Nonetheless, with NZ looking likely to be successful in eliminating the COVID-19 virus in NZ, the medium-term outlook for the NZ economy is likely to be more positive than many other countries which may have to face a return to strict lockdown conditions if a second wave takes off. Eliminating the virus provides certainty, and a certain degree of stability. However, the financial cost has been devastating for many firms and the Government must remain vigilant in ensuring the right support is available to help business stay afloat during 2020.

To recap key policy support measures, the RBNZ has slashed the OCR to its lower bound, started buying a variety of NZ bonds to keep interest rates low and introduced various market liquidity and credit support measures. Meanwhile, the NZ Government has moved to support households and businesses through the shutdown, announcing various spending measures totalling $16.2 billion (or around 6.7% of GDP). These measures include wage subsidies, business tax relief and income support. Separately, the Government has announced a $900 million loan facility for Air New Zealand and joined with the retail banks to guarantee a portion of home and business loans. jane.turner@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6052	0.5988	0.5908	0.6622	FLAT/DOWN	0.5850	0.6200
NZD/AUD	0.9449	0.9425	0.9738	0.9464	DOWN	0.9325	0.9540
NZD/JPY	64.65	64.44	63.81	73.82	DOWN	63.00	66.00
NZD/EUR	0.5516	0.5559	0.5447	0.5928	FLAT	0.5400	0.5650
NZD/GBP	0.4847	0.4849	0.4775	0.5079	FLAT	0.4760	0.4930
TWI	68.6	68.2	68.0	72.32	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 ended last week ½ cent higher than where it began at around 0.6050. It actually hit a 1½ month high on Thursday of 0.6150 before succumbing to Friday's global wobble in risk appetite. Corporate earnings results in the US are starting to disappoint. And the White House's seeming escalation in anti-China rhetoric isn't helping sentiment either.

Still, it's worth noting that, despite continued choppiness in equity markets, and extreme volatility in commodity (read: oil) markets, currencies have been relatively calm. The average daily range traded by the NZD/USD in April was 1.5%, well down from March's 2.8%. NZD/AUD traded a 0.7% range on average in April, down from 1.2% in March and bang-on the long-run average.

Outlook

Much more of the action has been in fixed income markets. Indeed, the most notable theme in NZ financial markets over the past fortnight has been the massive outperformance of NZ bonds (NZ bond yields falling much further than offshore peers). Usually this would take a heavy toll on the NZD as the kiwi's relative yield appeal shrinks. But, to date, we haven't seen much evidence of this, perhaps because the big fall in interest rates has been engineered (by RBNZ quantitative easing), rather than symptomatic of a large downgrading of NZ's economic prospects. What the big fall in relative NZ interest rates has done is alter the cost of dealing in forward NZD markets. For example, 12m NZD/USD forward points have increased (i.e. moved in importers' favour) from -30 in March to around -10 now.

For this week, we expect investors' more circumspect risk appetite to weigh a little further on the NZD. Friday's US employment report won't be particularly helpful in this regard. We expect it to be awful, with 25m jobs lost in April and a spike in the unemployment rate to 20% (from 4.4% in March). Rising tensions between the US and Chinese governments over the coronavirus may further weigh on risk sentiment.

In NZ, futures pricing points to a material fall of around 4% in whole milk powder prices at this week's GDT auction – not a friendly outcome for the kiwi dollar. The usually closely followed NZ labour market data on Wednesday will be ignored as its old news (March quarter data). Near-term NZD/USD support at 0.5925 stands a good chance of being tested this week. Deeper support around 0.5850 is expected to hold. mike.jones@asb.co.nz

ASB foreign exchange forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< 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	1.75	UNCH	UP
90-day bank bill	0.27	0.31	0.49	1.79	UNCH	UP
2-year swap	0.19	0.29	0.49	1.63	UNCH	UP
5-year swap	0.33	0.46	0.60	1.78	UNCH	UP
10-year swap	0.71	0.86	0.93	2.20	UNCH	UP
10-year govt bond yield	0.75	0.83	1.03	1.90	UNCH	UP
Curve Slope (2s10s swaps)	0.53	0.57	0.44	0.57	UNCH	DOWN

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

Market Recap

NZ yields have continued to regularly post record lows, with more prominent falls for NZ bond yields compared to NZ swaps and US and Australian bond yield counterparts. Speculation has grown that the weak economic outlook will prompt the RBNZ will move the OCR below the current 0.25% operational floor, with a major NZ bank calling the OCR to fall to -0.50% by the end of the year. Dampening longer-term yields has been the ratcheting up of tensions between the US and China over the origins and spread of COVID-19, along with the weak tone of recent data. There were with sizeable contractions in Q1 US and Eurozone GDP, an extra 3.8m jobless in the US, and very weak April NZ business and consumer confidence.

Policy support measures to lower yields for borrowers have continued to roll out. Last week, the RBNZ purchased an additional $1.35bn of NZ Government bonds and $130mn of LGFA bonds, taking cumulative RBNZ purchases to $8.23bn. Demand was strong, with NZ 10-year Government bond yields at close to records lows (0.74%), a massive 60bp drop from a month ago. The NZ Government announced a new lending scheme to support small businesses and the RBNZ have removed LVR restrictions on mortgage lending for at least the next 12 months. The ECB announced a new Pandemic refinancing operation for banks and called on governments for a coordinated fiscal response. The FOMC left rates unchanged and remained vague on forward guidance and its bond purchase programme but extended its Main Street lending programme to larger firms.

Near-term interest rate outlook

With most economies in the early stages of a severe downturn, market interest rates are expected to continue to test (or set) fresh record lows. Any pronounced lift in yields is expected to be fleeting, until signs emerge that the worst has passed. Market pricing from Overnight Index Swaps (OIS) has about 20bps of OCR cuts priced in, and the market will push for more if the RBNZ signal this is operationally feasible. We don't expect Q1 Labour Market data to show significant deterioration, but the RBNZ will be wary if there is a pronounced fall in inflation expectations, blunting the impact of the 0.25% OCR and bolstering rate cut expectations. This week, the RBNZ has stuck to its $1.35bn of NZ Government bond purchases, which should help cap NZ yields. Tomorrow, we expect the RBA to hold the cash rate and three-year bond yield target at 0.25%, with Friday's RBA Statement fleshing out the RBA's view. The Bank of England will likely hold the policy rate at 0.1% and may expand asset purchases. We expect global yields to be dampened by the worsening tone of data and the potential for tensions between the US and China to further ratchet up. US April payrolls are expected to decline by a record 25 million, with the US unemployment rate reaching 20%. Data should point to a Q1 contraction in Australian GDP, with Chinese April trade data to show weakness for both exports and imports.

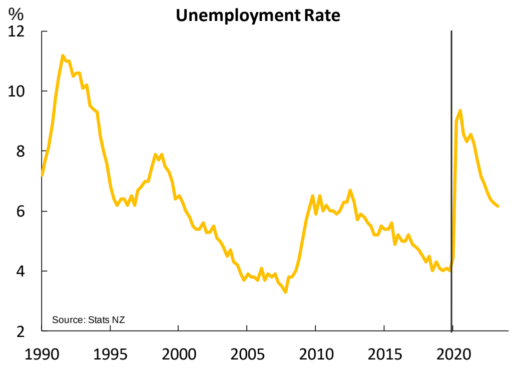
Medium-term outlook

Central bank policy rates are expected to maintain highly accommodative settings. Given the risks to the outlook we don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. The OCR could move lower if the RBNZ deemed this to be operationally feasible. Weak global growth, negative risks and the prospect of central bank asset purchases should cap long-term NZ interest rates. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
Residential building consents, March, mom%	05/05	10:45am	-	-
GlobalDairyTrade auction, whole milk powder, % change	05/05	Overnight	-	-4%
Labour market data (unemployment rate), March 2020 qtr	06/05	10:45am	4.4%	4.4%
RBNZ Survey of Expectations- Q2, 2-year ahead CPI inflation	07/05	3:00pm	-	↓
Electronic Card Transactions, Retail, April, % mom	11/05	10:45am	-	-30 to -35

Q1 labour market data are expected to reveal the beginnings of what we expect to be a material deterioration in the labour market this year. NZ went into full lockdown only four business days before the end of Q1, so the impact of such on these data will be limited. Still, we expect a small decline in employment for the quarter of 0.3%. A small fall in the participation rate is expected to limit the increase in the unemployment rate to 4.4%, from the cycle low of 4.0% in Q4. We expect the unemployment rate to peak at 9.4% in the September quarter. We also expect Q1 figures to confirm the end of the prior upturn in NZ wage inflation. Our preferred measure of such – the Labour Cost Index – is expected to ease from 2.4% to 2.3% in Q1 (0.3% qoq), on it's way to a forecast low of 1.0% in mid-2021.

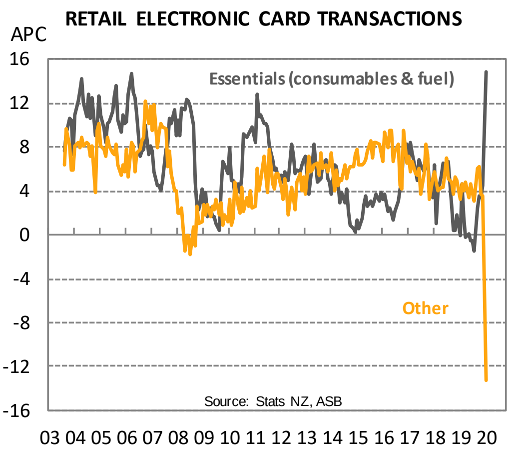


March consents will be impacted by the Alert Level 4 shut down, as consenting activity will be classified as non-essential. This likely impacted 4 out of 22 business days in March, so we are likely to see a decline in building consents of around 18% in March. However, prior to the global COVID-19 virus outbreak, the NZ housing market was enjoying a strong upswing which was feeding through into increased building demand. This pipeline demand is likely to provide some support to construction activity immediately after the lockdown. However, from the second half of the year, we expect that the weak economy will start to weigh on building demand.

Whole milk powder (WMP) prices are expected to fall at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, WMP prices fell 3.9%, following the unprecedented oil price plunge. At this juncture, futures pricing points to a further price WMP fall of circa 4%.

Despite annual headline CPI inflation rising to 2.5% in the March quarter, COVID-19 has been a gamechanger for both the growth and inflation outlook. **Expectations of inflation from the RBNZ Survey are expected to decline towards the lower part of the 1-3% CPI inflation target band**. Growth expectations from the survey will probably be anaemic at best. Our concern is that inflation expectations will continue to soften, lifting implied real interest rates in the process and hampering the modest rebound in NZ economic activity we have pencilled in for next year. This is the last thing that NZ needs at the moment and the RBNZ will step up and work towards bolstering policy stimulus, including doing more work to see if a lower effective OCR is feasible.

Retail card spending is set for a much larger tumble in April than the record 3.9% fall in March. With NZ being in Level 4 shutdown for 28 of the 30 days in the month, substantial falls are expected for most non-essential retail categories. Fuel retail was allowed to stay open during the level 4 shutdown, but lower retail fuel prices (down around 7% according to our estimates) and sharply reduced traffic volumes should trigger another sizeable monthly fall. The one bright spot will be consumable retail, where another double-digit monthly increase is likely. We expect pent up demand to drive a modest recovery as the Alert Level restrictions are gradually eased. Much of the retail sector is likely to remain in limbo for a while yet. Climbing unemployment, subdued consumer sentiment and weak household balance sheets point to a soft outlook for household spending over 2020.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
RBA Interest Rate Announcement, %	05/04	4:30 pm	0.25
Australia Building Approvals, March, %mom	04/05	1:30 pm	-15
Australia Retail Trade, March, %mom	06/05	1:30 pm	8.0
China Trade Balance, April, US$bn	07/05	-	3.5
Bank of England Interest Rate Announcement, %	07/05	11:00 pm	0.10
RBA Statement of Monetary Policy, May	08/05	1:30 pm	-
US Non-farm Payrolls, Unemployment Rate, %	08/05	-	20

Originally published by CBA Global Markets Research on Friday 1st May at 2:19 pm

In March we expect to see **Australian building approvals** fall by 15% after residential building approvals rose by 19.9% in February. Building approvals can be lumpy and volatile. Over the remainder of 2020 and into 2021, we expect to see building approvals continuing to trend lower after falling close to 30% since the peak in August 2016. The climate of high unemployment, falling dwelling prices and the ceasing of net overseas migration will weigh on approvals.

We expect the Reserve Bank of Australia (RBA) to leave the cash rate at 0.25% and expect it to remain there at the very least over our forecast horizon (mid-2022). The statement may provide an insight to forecasts provided in Friday's Statement on Monetary Policy. The RBA's central scenario appears to be that COVID-19 restrictions are lessened towards the middle of the year. The bank expects GDP and hours worked to fall by around 10% and 20% respectively over the first half of 2020. Any further update on the RBA's view of the economy will be closely monitored by the market.

In March, we expect a large lift in **Australian retail trade** of 8.0% after rising 0.5% in February. This will see the annual rate accelerate to 10%. The ABS preliminary estimate for the March saw a rise of 8.2%, driven by the doubling in turnover for products such as toilet and tissue paper, and rice and pasta. Retail sales were also strong in items related to home offices. This is the largest recorded rise in seasonally adjusted retail sales, comparable with the 8.1% rise in June 2000 when households brought forward expenditure ahead of the GST implementation. We also expect Q1 20 volume data to rise 2.2%qoq and will contribute to Q1 20 GDP.

The **RBA's May Statement of Monetary Policy** will contain updated forecasts and some scenario analysis. The RBA's central scenario sees: GDP likely to fall by ~10% over H1 20 with most of the decline taking place in Q2 20; GDP contract by 6% in 2020 and to rise by 6%-7% in 2021; the unemployment rate peak at ~10% by June; total hours worked down by ~20 per cent over H1 20; and year-ended headline inflation turn negative in Q2 20, but underlying inflation forecast to remain positive.

We expect the Bank of England to keep the Bank Rate at 0.10% and maintain the stock of asset purchases at £645bn. The BoE's updated Monetary Policy Report and Financial Stability Report will also be released on Thursday.

We expect measures of **US labour market** slack to surge to almost unbelievable levels in April. Continuing jobless claims during the reference week (12-18 April) hit 19 million. In our view, this is consistent with an unemployment rate around 20% and a shocking 25 million fall in US Non-farm Payrolls. We expect flat wages growth in April. Wages growth will decline in coming months.

Key Forecasts

ASB NZ economic forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>						
GDP real - Q%	0.5	-1.0	-17.3	11.6	1.8			
GDP real - A%	1.8	0.3	-17.0	-8.1	-6.9	-6.1	2.7	4.8
GDP real - AA%	2.3	1.6	-3.2	-5.8	-8.0	-9.5	4.9	4.6
CPI - Q%	0.5	0.8	0.0	0.5	0.0			
CPI - A%	1.9	2.5	1.9	1.7	1.2	0.8	0.9	1.4
HLFS employment growth - Q%	0.0	-0.3	-5.8	-1.5	0.6			
HLFS employment growth - A%	1.0	0.7	-5.8	-7.5	-6.9	-6.3	3.0	2.7
Unemployment rate - %sa	4.0	4.4	9.0	9.4	8.6	8.4	7.2	6.3
Annual current account balance as % of GDP	-3.1	-3.3	-3.7	-3.8	-4.3	-4.8	-3.4	-2.3

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	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	0.50	0.50	0.50	0.50	0.50	0.50
NZ 2-year swap rate	1.26	0.53	0.50	0.50	0.50	0.50	0.50	0.60
NZ 5-year swap rate	1.45	0.63	0.65	0.65	0.65	0.65	0.65	1.05
NZ 10-year swap rate	1.78	0.93	1.00	1.00	1.50	1.50	1.10	1.50
NZ 10-year Bond	1.65	1.03	1.40	1.40	1.40	1.40	1.40	1.45

ASB foreign exchange forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< 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

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets