

Economic Weekly

05 October 2020

Decisions, decisions

Another week begins and another big decision looms for the government as it reviews whether to move Auckland down to COVID alert level one from Thursday. No doubt, there will be many factors for Cabinet to weigh, but the news since Alert Levels were last reviewed has typically highlighted New Zealand’s good position internationally. The total number of active cases is now down to 41 (eight are community cases) and, according to the Ministry of Health, no-one in the country is currently hospitalised with the virus. By contrast, many of the overseas headlines are scary. Last week, lockdown measures were re-imposed in parts of Western Europe, the three largest Canadian provinces declared they were in a second wave and UK officials said things were ‘heading in the wrong direction.’ And of course, Friday saw the news that President Trump has been diagnosed with the virus...

Data out last week continued to suggest that the NZ economy is holding up better than many feared, though it has still taken a sizable hit. Last week’s building consents data showed construction broadly holding up to its pre-COVID levels, and we saw a solid lift in business confidence. Mobility data seems to suggest that the time Auckland has been above Alert Level 1 hasn’t reduced activity as much as anticipated. Still, it’s not entirely smooth sailing for the domestic economy, and as we tick over into a new month and get that little bit closer to summer, it’s a reminder that the closure of the border is going to put a big dent in economic activity, even if we do end up with a trans-Tasman bubble at some point (see our chart of the week below).

Border restrictions aside, New Zealand is in a comparatively good position globally, so its notable that the RBNZ has been more explicit in signalling the potential for a negative policy interest rate. Central bank policy releases this week from two of the more sceptical central banks on negative policy rates – the RBA and the US Federal Reserve – will be worth perusing for their favoured next steps. We are very much operating in an unprecedented environment, and it’s fair to say that central banks – like the rest of us – have differing opinions on the right responses. Interesting times indeed. 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](#)

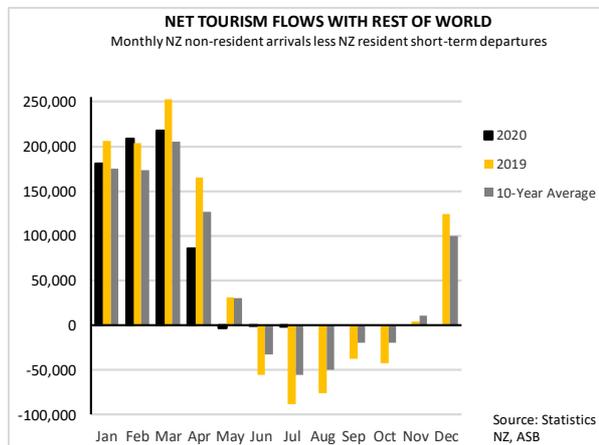
Policy response:

[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	0.6642	0.6560	0.6704	0.6320	FLAT	0.6520	0.6770
NZD/AUD	0.9266	0.9293	0.9218	0.9357	FLAT	0.9200	0.9330
NZD/JPY	69.93	69.10	71.14	67.47	FLAT	68.65	72.00
NZD/EUR	0.5670	0.5637	0.5655	0.5757	FLAT	0.5600	0.5750
NZD/GBP	0.5137	0.5135	0.5047	0.5119	FLAT	0.5100	0.5300
TWI	71.9	71.2	72.1	70.52	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 spent most of last week grinding higher, to finish the week around a cent higher than where it began around 0.6640. This performance left the NZD firmly ‘mid-pack’ amongst the G10 FX pairs, all of which benefitted from a softer USD over the week.

News after the NZ close on Friday that US President Trump had tested positive for COVID-19 had a relatively modest impact on financial markets. The biggest impact was on equity markets, and big tech stocks in particular, with the NASDAQ closing over 2% lower on Friday. Other movements were consistent with classic “risk off” trading, but there was little discernible impact on the NZD. Risk sentiment was probably propped up by various comments suggesting Congressional leaders are getting closer to a deal on more US fiscal stimulus.

Outlook

Trump’s illness does increase the uncertainty surrounding the US election outcome and hence boosts the likely volatility in markets as investors react to (frequently conflicting) headlines. Betting markets are already ascribing a slightly higher chance of a Biden victory, which is generally thought to be the less positive outcome for equity markets.

In any case, we suspect direction for the NZD will be more about developments in antipodean markets this week. We get two key measures of NZ business confidence – the QSBO and ANZ surveys. We’re picking a small lift in confidence for both, which would add to the recent encouraging data pulse.

It’s a big week in Australia. The RBA meets tomorrow and economists are increasingly split on whether it will leave the cash rate at 0.25% or cut it to 0.1%. The uncertainty means there will be volatility in NZD/AUD whatever the outcome. Our CBA colleagues expect monetary policy to be left unchanged. The Aussie budget will be handed down on the same day.

All up, we suspect we’ll see more sideways consolidation for the NZD/USD this week. The 0.6520-0.6770 range has become well entrenched. Our estimated short-term “fair-value” range of 0.6300-0.6700 also suggests there is no immediate catalyst for a range break.

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ASB foreign exchange forecasts

(end of quarter)

	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	<< 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	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.52	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	70.0	69.5	68.0	67.5	67.7

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	UP
90-day bank bill	0.29	0.30	0.30	1.05	UNCH	UP
2-year swap	0.06	0.04	0.06	0.82	UNCH	UP
5-year swap	0.14	0.10	0.14	0.83	UNCH	UP
10-year swap	0.51	0.47	0.54	1.12	UNCH	UP
10-year govt bond yield	0.52	0.46	0.60	1.00	UNCH	UP
Curve Slope (2s10s swaps)	0.45	0.44	0.49	0.29	UNCH	DOWN

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

Market Recap

NZ yields and global yields nudged slightly higher last week. Increases in NZ swap yields outpaced those in the US, but more steepening was observed in Australian yields. Global yields have crept higher on hopes of more fiscal stimulus despite signs the US economy may be losing momentum and with the hospitalisation of President Trump with COVID-19. The RBNZ purchased just \$1,144bn of NZ government bonds last week under their Large-Scale Asset Purchase Programme (LSAP), but this still outpaced the \$600bn tender of the NZ 2023, 2029 and 2033 government bond.

Near-term interest rate outlook

We have retained our downward bias for local yields but are cognisant that NZ yields could move higher before they move lower. Local data over the last month or so has been resilient and we could well see position-related flows push yields higher, particularly around the two to three-year part of the curve where yields are lowest. Nevertheless, we expect NZ yields to remain comfortably below US and Australian peers, with a flatter curve. The RBNZ has continued to pare back the LSAP, although the signalled \$1.05bn weekly pace of NZ government bond purchases is still well above the \$650m weekly tender.

Tomorrow, we have the RBA Board decision and the 2020 Australian Budget. We do not expect the RBA to cut the cash rate but it could signal increases in asset purchases (particularly for longer-dated tenors) or the Term Funding Facility, which could help flatten the curve and narrow spreads with (lower) NZ yields. The Australian Federal Budget is also out, which should show a large fiscal deficit, increased borrowing programme and fiscal stimulus measures including personal tax cuts and infrastructure spending.

The direction of risk appetite should influence local and global yields and the slope of the yield curve. US Treasury yields could push higher this week if the long-awaited fiscal deal is struck between Democrats and the White House. We are wary of the extent for political machinations to provide additional volatility, with elections looming in NZ (October 17) and the US (November 3). September Fed Minutes, speeches by Fed, ECB and BOE policymakers and this week's local and offshore data and events – including the NZIER QSBO – may impact yields at the margin.

Medium-term outlook

We expect the RBNZ to launch a funding for lending programme by the end of the year, most likely at the November MPS on November 11. The earlier launch of the FLP reduces the risk of an earlier OCR cut, but we still expect the RBNZ to move the OCR lower in 2021. The RBNZ are expected to continue to front-load asset purchases and employ dovish forward guidance to dampen yields. Low global inflation and subdued global growth prospects should keep NZ yields low and the curve reasonably flat despite high public debt issuance. mark.smith4@asb.co.nz

ASB interest rate forecasts

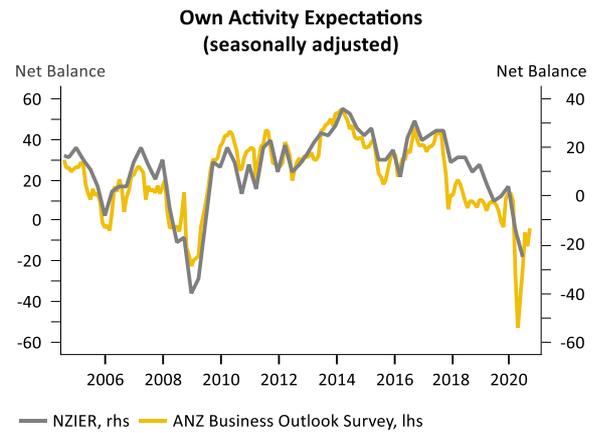
(end of quarter)	Jun-20 << actual	Sep-20 forecast >>	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
NZ OCR	0.25	0.25	0.25	0.25	-0.50	-0.50	-0.25
NZ 90-day bank bill	0.30	0.25	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.10	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.15	0.10	0.00	-0.15	-0.15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

Domestic events

Data	Date	Time (NZT)	Market	ASB
NZIER QSBO, Experienced trading activity, s.a., Q3	6/10	10:00am	-	-
ANZ Business Outlook, Own activity next 12 months, Oct p	8/10	1:00pm	-	-

The **NZIER Quarterly Survey of Business Opinion** may show a small a recovery in business confidence over Q3. Over Q2, QSBO business confidence did not fall as far as the monthly ANZ business confidence survey (see chart opposite). We typically place more emphasis on the Quarterly Survey by NZIER as it has a more reliable performance in predicting GDP growth. However, given the highly unusual circumstance of the COVID-19 pandemic, the relationship between reported trading activity and GDP growth has broken down. In addition, the quarterly survey may not be able to accurately account for economic activity over the quarter due to the cycling through Alert Levels creating volatility in trading conditions from month to month. Throughout Q3, NZ spent about half the quarter under Alert Level 1, but an outbreak in August saw Alert Level restrictions reinstated during the second half of August and throughout September.

ANZ monthly business confidence lifted in September, with confidence in relation to businesses own activity now the highest since the COVID-19 pandemic hit NZ in March. ANZ release the preliminary results for October, and we hope to see further increase. The lift in business confidence is further evidence that the post-lockdown NZ economy is performing much better than we and the RBNZ had expected.



Source: Macrobond, ASB

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Trade Balance, August, \$bn	6/10	1:30 pm	5.8
RBA Board Meeting, Cash Rate %	6/10	4.30 pm	0.25
Australian Federal Budget, Cash Balance 20/21, \$bn	6/10	9:30 pm	-220
Australia Weekly Payroll Jobs	7/10	1:30 pm	-
US Federal Reserve FOMC Meeting Minutes	9/10	7:00 am	-
RBA Financial Stability Review	9/10	1:30 pm	-
UK GDP, August, % qoq	9/10	7:00 pm	-

*Originally published by CBA Global Markets Research on Friday 24 September at 4:21 pm

We expect a **larger Australian trade surplus of \$A5.8bn in August**, after a \$A4.6bn trade surplus in July. During Q2, trade surpluses were elevated as imports fell dramatically more than exports. We expect this trend to continue in August.

We do not expect the Reserve Bank of Australia (RBA) to cut the cash rate nor to shift its 0.25% target for 3-year Commonwealth Bonds at the October Board meeting. Our CBA colleagues believe the market has overreacted to the content of RBA Deputy Governor Guy Debelle's speech on the Australian Economy and Monetary Policy. At this stage, CBA believe an increase in the rate of government bond purchases is the most likely next step from the RBA on the monetary policy front.

Our **CBA colleagues forecast an underlying cash deficit for the Commonwealth Budget of \$A220bn in 2020/21**. The deficit is projected to be \$A110bn in 2021/22. More stimulus is expected to be announced, including personal income tax cuts, infrastructure spending and a business investment allowance.

We expect to see this recovery in **Australian Weekly payrolls** later in the year once the wind back in restrictions in Victoria is well underway.

The **Reserve Bank of Australia's Financial Stability Review** is issued half-yearly and provides an assessment of the current economic condition of the financial system. We will be watching closely for their updated assessment on how home loan deferrals and SME loan deferrals will affect the financial stability of the banking industry and the broader economy

In September the **Federal Reserve** officially adopted a new 2%, on average inflation targeting framework. As a result, we expect a lot of the minutes will correspond to discussions around the new framework. Given there have been numerous Federal Reserve speeches post the September meeting, we expect little new information will be contained within the minutes.

UK GDP collapsed by a record 19.8% qoq in Q2 driven by a plunge in private consumption. The monthly UK GDP prints suggests the economy is on track to recover in Q3 along the lines of the Bank of England's 18% qoq GDP growth projection. UK GDP grew by 6.6% in July and the composite PMI points to another solid GDP expansion over August.

Key Forecasts

ASB NZ economic forecasts

	Jun-20 « actual	Sep-20 forecast >>	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
GDP real - Q%	-12.2	10.1	0.8	0.3	0.1		
GDP real - A%	-12.4	-4.2	-3.9	-2.2	11.5	0.7	3.3
GDP real - AA%	-2.1	-3.7	-5.2	-5.7	-0.1	3.4	2.3
CPI - Q%	-0.5	1.0	0.0	0.1	0.2		
CPI - A%	1.5	1.8	1.3	0.7	1.3	1.3	1.3
HLFS employment growth - Q%	-0.4	-2.6	-1.2	0.1	0.5		
HLFS employment growth - A%	1.1	-1.9	-3.3	-4.1	-3.2	2.1	1.8
Unemployment rate - %sa	4.0	6.4	7.3	7.5	7.3	6.7	6.6
Annual current account balance as % of GDP	-1.9	-1.6	-1.8	-2.4	-3.2	-3.3	-3.6

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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(end of quarter)							
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

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(end of quarter)							
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
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NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.52	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	70.0	69.5	68.0	67.5	67.7

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