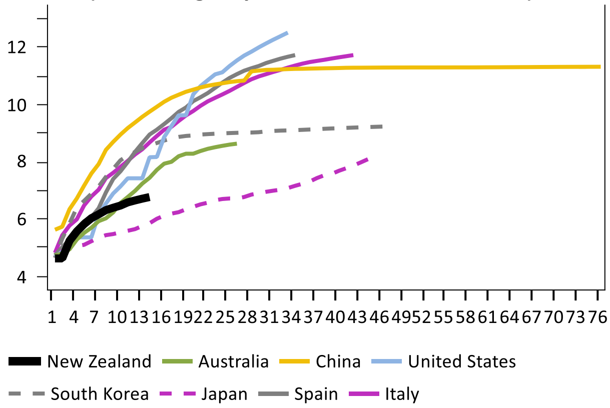
Economic Weekly

06 April 2020

The curve is flattening

NZ's bold move to go hard and go early looks to be paying off, with early signs indicating NZ is flattening the curve faster than many of the other countries hit hard by the COVID-19 outbreak (see chart below). We can all (tentatively) breathe a sigh of relief to see that our efforts, of staying home and sitting on the couch watching Netflix, are really starting to pay off. On a more serious note, a huge thank you from all our team to all essential workers on the front line looking after us, ensuring that we all have the goods and services needed to keep NZ healthy and safe.

COVID-19 Total Cases
(Natural log, days since 100 cases confirmed)



Source: Macrobond, ASB

Further confirmation of NZ's lockdown success, Google released a summary of its own location service data over the weekend, revealing a dramatic drop in movement. Comparing NZ figures to other countries such as the US and Australia, the secret to NZ's success at flattening the curve is clear - NZ has seen a much greater drop in non-essential trips.

It is important to keep these victories in mind as over the coming weeks as we must brace ourselves for some bad economic data. NZ business confidence has plunged, and likely to fall further in coming months. Times ahead will be tough, but NZ is well placed to weather this storm. Policy makers have stepped up - the NZ Government has moved to aggressively support households and businesses through the shutdown, announcing various spending measures totalling $16.2 billion (or around 5% of GDP). More may come.

On Page 2 of our weekly, Senior Economist Mark Smith outlines his thoughts on the three key phases of the Pandemic for the NZ economy. We remain in the crisis phase, but once the NZ outbreak is under control the NZ economy moves onto the transition phase. Picking up where we left off may not be straight forward and firms will need to be ready to tweak (or potentially rewire) their current business models. Stay safe NZ – jane.turner@asb.co.nz

Recent COVID-19 publications	Where to find support
COVID-19 and the economic path ahead	ASB financial support package
RBNZ policy actions	Government support package
Fiscal fights back	COVID-19 alert system explainer
RBNZ OCR cut March 16	
Housing immunity about to be tested	
COVID-19: Market impacts, responses, and ideas	
Thinking about coronavirus impacts on business: Be prepared – it doesn't hurt	
Government support – quick guide to accessing it	

The next 3 phases for the NZ economy

- We see the NZ economy going through 3 distinct phases. We are just starting phase one.
- Significant challenges and economic upheaval lie ahead.
- We have a choice. Rewiring the economy to make it more resilient will have an economic cost.
- We highlight some key take-outs from the last few months that may shape the economic landscape ahead.

COVID-19 has been a major shock that has hit the NZ and global economy hard. Our core view is that the NZ economy will experience a much larger hit to economic activity than it did during the Global Financial Crisis. This is despite the efforts of policymakers to cushion the economy. There are a number of paths ahead. Here, we set out what we view to the various phases through which the NZ economy will go through over the period ahead.

There are 3 distinct phases:

1) **The crisis phase.** This is very much the here and now. The NZ economy will be going into a deep but (hopefully) short-lived contraction. We still do not know exactly how deep the hole will be or the duration of the downturn. Factors such as the duration of the lockdown, the portion of economic activity that has been disrupted, and how well firms and households have adapted to the new environment matter. Incomes have been hit. Firm closures and job losses are inevitable. Balance sheets – household, business and government – are much weaker than they were prior to the outbreak.

2) **The transition phase.** This is after the economy troughs. The next 12 to 18 months are going to be tumultuous and there will be winners and losers. The winners will be those that are set up to thrive in a challenging environment. Supermarkets and other essential services are doing a fantastic job in keeping people fed and having their essential needs met. Other firms will spot opportunities and will thrive. There will be a number of industries that have suffered greatly as a result of COVID-19 and the viability of their current business models may need to be tweaked or totally rewired.

3) **The new normal**. This is the longer-term outlook for the economy. Here, we see two potential outcomes. First, a return to the status quo, where policy settings are further ratcheted up, growth is being brought forward and the economic can kicked down the road. Even if this eventuates, longer-term growth rates for the economy will be lower than what they were pre-crisis given that incomes and balance sheets will take time to repair. The second outcome would be a fundamental rewiring of the NZ and global economies to increase economic resilience. It could mean greater restrictions on the movement of good, people and services. There are additional economic costs to increasing resilience and it will not completely recession-proof the economy.

What are some key take-outs that will shape the economic landscape ahead?

- **The power of mother nature.** For all of humankind's accomplishments, recent events are a reminder of how vulnerable we are. Greater challenges lie ahead. Climate change remains the elephant in the room. We have been warned.
- **Co-ordination and co-operation**. If we work together, much can be accomplished. The greater good needs to come first before self-interest and populism.
- **Back to basics.** People will be a whole lot poorer for some time to come. Tapping into niche markets could likely prove more of a challenge.
- **Value of diversification.** While it may not be the optimal strategy all of the time, having more options provides an economy with greater resilience.
- **Keeping it local** – globalisation has helped lift billions out of poverty, but we are more dependent on each other than ever before. A balance needs to be struck between opting for the lowest cost (and most efficient) option versus one that focuses on sustainability, resilience and safety.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.5890	0.6021	0.6306	0.6754	FLAT/DOWN	0.5600	0.6070
NZD/AUD	0.9770	0.9811	0.9557	0.9483	FLAT/UP	0.9670	0.9900
NZD/JPY	63.54	64.76	66.70	75.44	FLAT/DOWN	62.00	65.00
NZD/EUR	0.5420	0.5438	0.5613	0.6016	FLAT/UP	0.5380	0.5500
NZD/GBP	0.4791	0.4867	0.4866	0.5160	FLAT	0.4700	0.4900
TWI	67.9	68.9	70.0	73.28	FLAT	N/A	N/A

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

NZD Recap

US dollar sentiment remains the driving force behind global foreign exchange markets. The USD lifted again on Friday, capping a strong week in which it notched up gains of 1.5-3.0% against most of the major currencies. The NZD/USD was caught up in the stronger USD mix, falling around 2.5% to end the week around 0.5860. Amongst the crosses, the NZD made weekly gains against the EUR and AUD but lost out to the GBP and JPY.

Generally speaking, markets are still in "shelter mode" which is favouring the relative safe-haven of the USD, JPY and CHF. This is why the USD appreciated on Friday even as US employment figures revealed a materially worse picture of the US labour market than investors had expected. A full 701k jobs were lost, and the unemployment jumped to 4.4%.

Near-term outlook

There are a few cross currents affecting the NZD at present. Global financial market sentiment has become a little less negative of late, reflected in falls in risk aversion indicators like the VIX index. This has helped the NZD/USD stabilise a little.

At the same time, NZ commodity prices (in global terms) are still falling – we expect another 1% fall in this week's GDT milk auction – and NZ interest rate differentials with the rest of the world have also turned down again, thanks to the impact of RBNZ quantitative easing on local interest rates.

The net of these factors means we think further NZD/USD rallies above 0.6050 will be met with strong selling. But in the absence of another wave of global risk aversion we also doubt we'll see falls below 0.5500. So, overall, we're left bracing for another week of volatile trading in a relatively wide range. Within that, we may see further NZD progress against some of the crosses, particularly AUD and EUR, reflecting the fact NZ's economy is relatively well placed compared to some of our peers.

In terms of event risk for this week, the minutes from the US Federal Reserve's two emergency meetings in March will be watched for any options that it may deploy in future for supporting the economy and markets (Thursday). We expect the RBA to leave monetary policy unchanged (Tuesday). In NZ, the NZIER Quarterly Survey of Business Opinion for Q1 won't attract quite as much attention than usual given it is a little dated. We'll be paying more attention to the preliminary release of the April ANZ Business Outlook later this week. 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	62.1	64.8	66.2	66.7	69.0	69.9

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	0.25	1.00	1.75	UNCH	UP
90-day bank bill	0.49	0.49	0.83	1.82	UNCH	UP
2-year swap	0.50	0.52	0.71	1.65	UNCH	UP
5-year swap	0.60	0.60	0.77	1.83	UNCH	UP
10-year swap	0.93	0.90	1.02	2.27	UNCH	UP
10-year govt bond yield	1.34	1.03	0.95	2.00	UP	UP
Curve Slope (2s10s swaps)	0.43	0.38	0.32	0.63	UNCH	DOWN

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

Market Recap

Concerns over the impact of COVID-19 on the global economy **pushed NZ and global swap yields lower, with yield curves also flattening.** The response to the outbreak – widespread economic shutdowns – is starting to generate an economic toll. US 10-year Treasury yields ended the week below 0.60% following a soft set of US March labour market figures (payrolls -701k, mkt: -100k, unemployment rate 4.4%, prev 3.5%).

Policymakers have also pulled out most of the stops. In the weekend, the People's Bank of China instigated a range of interest rate cuts and quantitative support measures. NZ yields eased after RBNZ Governor Orr highlighted potential future options, including the RBNZ expanding its $30bn asset purchase programme (i.e. QE) and further OCR reductions. RBNZ Assistant Governor Hawkesby noted the RBNZ could extend its asset purchases to local council and Local Government Funding Agency (LGFA) debt. The RBNZ also introduced a Term Lending Facility (TLF), designed to ensure funding for banks to lend to businesses at low interest rates for up to 3 years duration.

Despite this, NZ Government bonds have nudged higher and are now trading at higher yields than equivalent yields on NZ interest rate swaps. Driving this was higher bond issuance, with the NZ Debt Management Office significantly upping the 2019/20 NZ Government Bond Programme to $25bn, with $17bn to be raised in the June quarter. Of this, $4bn is due to be raised via April bond tenders ($800m per week).

Near-term NZD interest rate outlook

COVID-19 continues to dominate market attention and we expect periodic bouts of volatility. Policy actions to provide additional stimulus and weakness in the global outlook should continue to dampen yields**. We will be closely watching across the Tasman tomorrow at 4.30pm to see if the RBA announces any further policy support measures.** NZ business confidence readings – tomorrow's Quarterly Survey of Business Opinion for Q1 and Wednesday's preliminary ANZ April Business Outlook – are expected to be weak but will largely be ignored.

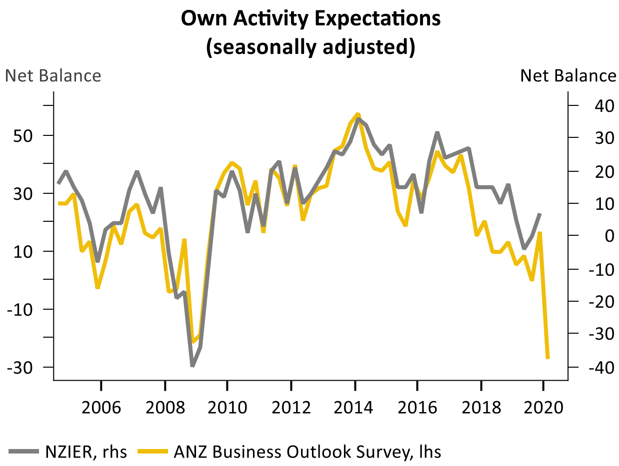
In bond markets, the tug-of-war continues between Quantitative Easing (QE) and weak data and increased debt issuance. Large fiscal deficits globally are expected and Quantitative Easing in various guises has been employed by a host of central banks. The RBNZ is set to purchase $1.8bn in NZ Government bonds this week, on top of the $1.35bn last week. Details of the syndication for the sale of the 2029 NZ Government bond will also be announced. We expect $4-5bn to be sold via syndication, given that the DMO still needs to sell $13bn on top of the $4bn earmarked for the April tender. This will not be easy. Even if the syndication is successful (say for $4bn), it still leaves a huge tender schedule of around $1.125bn per week for May and June. **The RBNZ balance sheet is set to get bigger, sooner.**

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 this was feasible operationally to do so. Weak global growth, negative risks and the prospect of central bank asset purchases should cap long-term NZ interest rates, although we are wary over the impacts of sizeable global and NZ debt issuance on bond yields. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
NZIER Quarterly Survey of Business Opinion, Q1	07/04	10:00 am	-	-
GlobalDairyTrade auction, whole milk powder, % change	07/04	overnight	-	-1.0
ANZ Business Outlook, April preliminary results	08/04	1:00 pm	-	-
Electronic Card Transactions, retail, March, % mom	09/04	10:45am	-	-1.0



Source: Macrobond, ASB

NZIER releases its March Quarter business confidence survey results on Tuesday, and the extent of the fall in business confidence in this survey will largely depend on when NZIER cut off responses to the quarterly survey. The ANZ's release of partial results of its monthly survey in early March showed that early March respondents were less pessimistic than late March respondents - as the full extent and impact of the rapidly developing pandemic became clearer.

ANZ released the full results of its March month business confidence survey last week, which showed firms' expectations for own activity over the year ahead at the lowest level ever. **ANZ releases the preliminary results of the April survey on Wednesday,** and we expect to see further falls in confidence compared to March as firms reflect on the likely impact of the full month lock down.

We expect whole milk powder (WMP) prices to post a modest 1.0% fall at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago WMP prices slid 4.2% as COVID-19-generated ructions in financial markets that spilled over into global dairy markets. At this juncture, futures pricing points to a circa 4% WMP fall. However, futures have been overshooting actual auction price falls over recent auctions.

Picking monthly retail outturns is becoming something of a lottery given the tectonic shifts in retail spending that have occurred as a result of the COVID-19 outbreak. Anecdotes and weekly data from Paymark point to a very strong month for consumable spending (which include supermarket purchases) given precautionary consumer buying. Durable retail should also lift in March. With NZ going into Level 4 shutdown on March 25, large falls are expected for non-essential retail (hospitality, apparel), with a sizeable fall also expected for fuel retail (lower fuel prices will also impact). Beyond the short-term volatility, we expect a more subdued overall retail outlook, given the hit to household incomes and balance sheets. Within the retail sector, we expect a "back to basics" approach by consumers as they focus on essential purchases.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
RBA Interest Rate Announcement, %	07/04	4:30 pm	0.25
Australia Trade Balance, February, $bn	07/04	1:30 pm	4.0
Japan Current Account Balance, ¥bn	08/04	11:50 am	2,000
Australia Home Loans Value, February, %	08/04	1:30 am	3.0
RBA Financial Stability Review	08/04	1:30 am	-
China CPI, March, %yoy	10/04	1:30 am	4.8
US CPI, March, %yoy	11/04	12:30 am	-0.5

**Originally published by CBA Global Markets Research on Friday 3rd April at 14:57 pm*

The **Reserve Bank of Australia (RBA)** cut the cash rate twice in March to the effective lower bound of 0.25%. We do not expect the RBA to change monetary policy settings this week. The second round of RBA Minutes for March stated that the target for three-year government bond yields will be maintained until the unemployment rate is falling and inflation is rising to target. Three-year government bonds are currently very close to the RBA's target of 0.25%.

We are expecting a narrowing of **Australia's trade balance** to $A4bn in February from $A5.21bn in January. Commodity prices held up over February but it's likely that volumes have fallen. Tourism and education exports will be hit too with the ban on Chinese tourists and students which began 1 February.

We expect **Japan's current account surplus** in March to have jumped to ¥2,000bn driven by strong goods trade surplus in March.

Australia's three cash rate cuts over 2019 and government incentives for first home buyers have supported new **lending for housing**. A range of indicators show that the housing market was strong in February. As a result, we are expecting a 2.5% lift in lending to investors and a 3% rise in owner-occupier lending in the month.

The **RBA's Financial Stability Review** is issued half-yearly and provides the central bank's assessment of the current economic condition of the financial system. In October 2019 the risks to the housing market and household debt were on clearly on the RBA's radar. Now that an external shock has materialised, their updated assessment will be even more relevant.

We expect **China's CPI inflation** to slip to 4.8%yoy in March because of falling food prices and plunging oil prices. PPI deflation will deepen because of falling commodity prices and virus-caused disruption to the global economy. We predict PPI inflation to fall to -1%yoy in March.

We expect the 7% fall in **US** gasoline prices in March will weigh on headline **inflation**. We expect core inflation was flat in March. However, with over 10m people losing their jobs in March and unemployment set to spike higher, we expect core inflation to fall 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	0.0	-14.7	8.5	1.8			
GDP real - A%	1.8	1.3	-13.6	-7.0	-5.9	-5.5	2.8	4.5
GDP real - AA%	2.3	1.9	-2.1	-4.4	-6.3	-8.0	4.8	4.3
CPI - Q%	0.5	0.4	0.1	0.6	0.2			
CPI - A%	1.9	2.2	1.7	1.6	1.3	1.4	1.2	1.4
HLFS employment growth - Q%	0.0	0.0	-5.4	-1.4	0.2			
HLFS employment growth - A%	1.0	1.0	-5.2	-6.8	-6.6	-6.2	3.2	2.6
Unemployment rate - %sa	4.0	4.4	8.7	8.8	8.4	8.2	6.8	6.0
Annual current account balance as % of GDP	-3.1	-3.2	-3.6	-3.8	-4.3	-4.8	-3.4	-2.4

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	0.55	0.55	0.55	0.55	0.55	0.55
NZ 2-year swap rate	1.26	0.53	0.60	0.60	0.60	0.60	0.60	0.60
NZ 5-year swap rate	1.45	0.63	0.70	0.70	0.70	0.70	0.70	0.85
NZ 10-year swap rate	1.78	0.93	1.05	1.05	1.50	1.50	1.10	1.30
NZ 10-year Bond	1.65	1.03	1.00	1.00	1.00	1.00	1.05	1.15

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	62.1	64.8	66.2	66.7	69.0	69.9

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