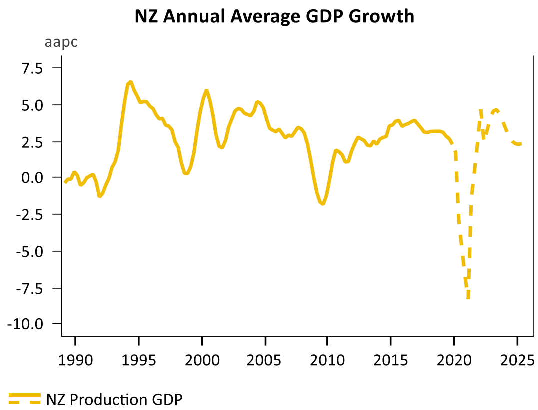
Economic Weekly

08 June 2020

A better prognosis, but symptom flare ups likely

This week's likely shift down to Alert Level 1 (see Nick's page 2 article), and associated shift up in the economy's speed limit, will join a string of other news suggesting the NZ economy is faring a little better than most expected in the post-lockdown world. A move from Level 2 to Level 1 would see NZ's economic capacity lift from 92% to roughly 95%. But even at Level 2, the high frequency data that we've been monitoring have been pointing towards a surprisingly rapid return to near normalcy (check out our weekly chart pack). Retail, housing, labour market, and construction figures have all impressed, admittedly relative to a low baseline. We'd happily admit that the risks to the more important economic forecasts we have on the board – a 6% fall in 2020 GDP and a 9.4% peak in the unemployment rate – have moved to the positive side of the ledger. We're also content to remain at the decidedly less-negative end of the forecasting spectrum when it comes to house prices. We still expect 'just' a 6% peak to trough fall.



Source: Macrobond, ASB

All this being said, we'd be remiss in our role as purveyors of the dismal science if we didn't warn about the come down. First, we're currently in the midst of the release of pent-up lockdown demand that clearly won't last forever. Second, the stimulus drugs are probably having their peak effect right now, but we'll have to be slowly weaned off them as we ratchet down through alert levels and conditions normalise. The staggered end to the wage subsidy will be particularly difficult. Finally, it's early days. The impact of COVID-19 on the labour and housing markets in particular was always going to be a story for the second half of the year. It's too soon to sound the all clear.

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Recent COVID-19 publications	Where to find support
ASB Economic forecasts and monitoring: Quarterly Economic Projections Housing Confidence ASB COVID-19 Chart pack **Financial market trends:** Corporate Hedging Toolbox ASB Podcast for investors **Policy response:** RBNZ confirms increase to QE at May Monetary Policy Statement Budget 2020 delivers huge support, huge debt	ASB financial support package Government support package COVID-19 alert system explainer For these publications and more COVID-19 research, see here

COVID-19 thoughts, observations – and being grateful

- NZ to date is doing well in getting on top of the COVID pandemic – but not without cost.
- The economic toll itself will cause substantial health costs, which increasingly need to be taken into account.
- Preserving jobs and setting up conditions for reimagining NZ's economy are the task for the team of 5 million.

This is a condensed summary of the Economic Note released earlier today

Summary

NZ has dodged a catastrophic COVID-19 death toll through its actions to contain its spread. However, COVID-19 will still take a toll on health outcomes via its impacts on the economy. Moving forward, the Government will increasingly need to balance the potential toll from COVID-19 illness and deaths against the range of health costs that come from long-term economic damage. It is an unenviable job to do and has potentially been made more difficult – ironically – by NZ's success to date in eliminating COVID-19.

The long-term impacts on New Zealanders' welfare mean getting the economy functioning is a high priority. Policy actions to preserve as many viable jobs as possible are important. Longer term, NZ will need to reimagine itself in a changed world.

NZ is financially a poorer country as a result of the COVID outbreak, as are many countries. Behaviours and priorities will also have changed. It is going to be important to resist the temptation to rush ahead with long-held plans, as they may no longer be relevant or the best use of funds in these straitened times. It is also a time to be grateful for what we still have and appreciate what is important to us as individuals and as a society.

It's not health vs. the economy – the economy is our health as well

Locking down countries is not a choice between our health and the economy. It is a more complex choice between different health outcomes, both in the present and over the next few generations for New Zealanders. The economic fallout from COVID will have huge health impacts, reducing our future living standards, with the lockdown also influencing the impacts. Some of the various costs of the economic recession (detailed in the full Note) are:

- Impacts on life expectancy;
- Increased incidence of mental health problems, including suicide (with unemployed people disproportionately represented in that toll);
- Increased poverty as more families face financial hardship and with reduced scope for fiscal support;
- Delayed critical healthcare during the lockdown to create capacity to deal with a potential COVID pandemic;
- A smaller future tax revenue base out of which to fund healthcare;
- Lost opportunities for people leaving education over the next few years, potentially reducing their lifetime earnings. That means a lower standard of living than otherwise for them, and for their kids.

"Stay at home you say, but all I got to say to you is time and time again I say, No! No! No! No!"[1]

Fear is a powerful motivator of self-preservation, with or without government edict. In NZ people were already starting to distance themselves, even prior to the Government imposing ever-stricter conditions. But we are a democracy, which limits the ability of a government to impose constraints on our freedom. Our success in limiting the COVID-19 death toll will make it more challenging to effectively impose future restrictions, particularly as the economic costs of NZ's strict very strict lockdown become increasingly apparent.

This is why world-leading track and trace capability and high levels of testing matter for stamping out the virus. And we need it now. Other countries have shown the way through applying cutting-edge technology for tracking contacts and screening people's temperatures before admission to premises. Meanwhile, we are relying on people to handwrite their life history in venues and keep a diary of their movements, along with scanning QR codes if they exist.

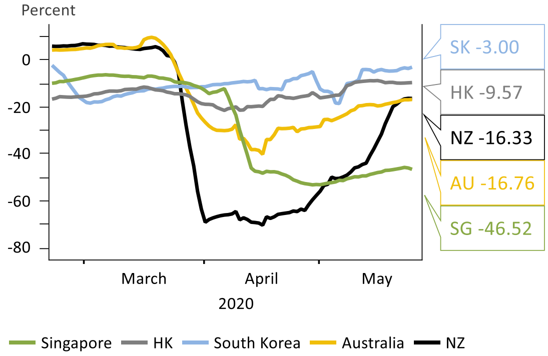
[1] Big apology to Twisted Sister

We need to make the tracking/recording capability as automated and user-friendly as possible if we are going to ensure we can get on top of any future outbreaks, backed up by rapid tracking.

Government response: timely, targeted and temporary

Our mantra for direct government financial support is for it to be: timely, targeted and temporary. We want policies to take effect quickly, we want to ensure that the help goes to those that need it. And we should avoid baking in permanent costs that will be borne by future generations from policies primarily intended to restart the economy.

Google Mobility Data- Average of Workplaces, Grocery, Pharmacy, Retail & Recreation



Source: Macrobond, ASB

Uncertainty is also a crippler. The Government can help by laying out its broad strategy and vision for the country, and how it would respond to different COVID scenarios. This latter point is really important right now for businesses, including those that are still closed that need to decide whether or not to open up. If a return at any point to Level 4 trading conditions remains a possibility, that may deter some businesses from reopening as early as otherwise or limit what they do for fear of financially over-extending.

Apply the team of 5 million to the economic crisis, too

Picking winners is challenging in this sort of environment, and the Government is unlikely to prove to be better at it than anyone else. There are so many uncertainties ahead (one of the perennial challenges with the future!) that it will be harder than ever to know right now what the right horses to back are. And, as the cliché goes, a camel is a horse designed by a committee. One way forward for the Government is to effectively unleash the 'team of 5 million'. As NZ moves out of survival mode, NZ businesses will need to adapt in a time of continued uncertainty and reimagine itself. Increasingly the Government's role can fall back to incentivising and enabling businesses to regather and grow.

But if the policy response is to do what we always intended to do, are we asking the right questions?

The saying is, never let a good crisis go to waste. Crises can provide a catalyst to significant and beneficial changes that reset the economy and society into a much better place. They can also give people a rationale to do exactly what they have spent their life yearning to do. And for politicians, those two things can often seem to be the same thing!

But what looked like the 'right' policy or project to politicians before the crisis may not be the right one now. We need to ensure that the Government applies the right solutions to the right challenges. Unfortunately, there will be uncertain shifts in pre-existing challenges, and new challenges will arise in short order. It will be harder to get things right. If the Government (and businesses) simply plan to do what they previously intended, then they need to make sure they have gone back and completely reassessed that the business case remains strong. Behaviours, priorities, and affordability have all changed – actions need to be well aligned with this new reality.

Infrastructure is a challenging one to get right. Infrastructure is expensive, it is a sunk cost once spent, and the costs (and benefits) fall on future as well as existing generations. NZ has a chequered history with expensive projects that seemed like a good idea but left a lasting financial hangover – we need to think smart rather than "Think Big".

Some infrastructure projects will be easier than others to get a sense of being 'right'. Sorting out our chronically-high cost of housing – particularly the role of central and local regulation – remains a clear 'right'. Projects such as the Drury development show what private/public collaboration can achieve.

But what about other infrastructure, particularly for commuter transport? The urban transport infrastructure focus has increasingly been on reducing congestion and improving the environment, a push towards public transport and bikes and away from cars. But do we really know how commuters' preferences will change? Even assuming we eradicate the virus and public transport doesn't require distancing, will CBD commuting be as commonplace now that people have a taste for working from home? What does that imply for getting bang for buck? nick.tuffley@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6521	0.6207	0.6119	0.6617	UP	0.6340	0.6660
NZD/AUD	0.9337	0.9334	0.9368	0.9489	FLAT/UP	0.9100	0.9500
NZD/JPY	71.52	66.53	65.12	71.76	UP	69.50	73.10
NZD/EUR	0.5769	0.5591	0.5643	0.5873	FLAT /UP	0.5620	0.5910
NZD/GBP	0.5137	0.5026	0.4939	0.5211	FLAT /UP	0.5010	0.5260
TWI	72.3	69.8	69.0	72.61	UP	N/A	N/A

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

NZD Recap

NZD shot up against the USD over the past week, from 0.6200 at the start of the week to 0.6500, levels not seen since February before the world fully understood the severity of the COVID pandemic. The NZD outperformed all of the major crosses, with similar large moves against the JPY and moderate moves against the GBP and EUR. The AUD also rallied hard against the USD, with the NZD outperforming the AUD at the margin.

The NZD rally is supported by a combination of factors. Improved global investor sentiment has supported both global commodity prices and the commodity currencies, the CRB global commodity price index has risen 15% since the end of April. The USD has weakened, with the DYX (US dollar) Index at 6-week lows. Relative interest rate moves have also been NZD supportive, with the NZ-US 2-year interest rate swap differential moving back to around zero, from negative**. These factors have seen the fundamental "fair-value" range implied by our short-term NZD/USD valuation model lift to 0.6200-0.6600**.

Outlook

There are two major highlights from NZ economic data this week, both of which are likely to be positive and continue to support the NZD's recent rally. We expect to see further improvement in business confidence when ANZ releases the preliminary June month business outlook survey results on Tuesday. Meanwhile, we are expecting a 70% recovery in NZ electronic card spending over May (released on Friday), following the previous months 50% contraction. Meanwhile, the offshore data calendar is lighter than usual with just the FOMC meeting on Thursday morning NZT.

We have recently revised our FX forecasts, although uncertainty remains high given the unknown nature of the global pandemic. **We expect recent NZD gains to be sustained**, and we see some risk that the NZD continues to trend higher above our year-end forecast of 0.65. A key downside risk to our updated NZD includes the possibility the RBNZ cuts the OCR below 0.25% beyond early 2021. Ongoing US-China tensions also presents a headwind for the NZD.

The weaker USD is supporting the higher NZD/USD and AUD/USD. The USD is easing as global investor sentiment improves, driving a reversal of safe-haven investment flows. An upside USD risk (and downside NZD risk) is a second wave of COVID infections severe enough to result in further lockdowns in major economies. jane.turner@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	0.63	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.96	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	73	65	66	66	66	67	69	67
NZD/EUR	0.60	0.54	0.56	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.51	0.49	0.53	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.7	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	73.8	68.8	70.8	71.1	71.7	72.2	73.7	71.5

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	0.25	0.26	0.26	1.63	UNCH	UP
2-year swap	0.25	0.23	0.17	1.42	UNCH/UP	UP
5-year swap	0.44	0.35	0.32	1.55	UNCH/UP	UP
10-year swap	0.90	0.73	0.72	1.92	UNCH/UP	UP
10-year govt bond yield	1.03	0.83	0.57	1.71	UNCH/UP	UP
Curve Slope (2s10s swaps)	0.65	0.51	0.55	0.50	UNCH/UP	DOWN

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

Market Recap

Increasing optimism over the economic recovery post government enforced lockdowns in April has pushed NZ and global yields higher, with yield curves steepening. Global equities and commodity prices (oil) have continued to rebound from lows in the past few months, pressuring yields higher. The RBA and Bank of Canada were more upbeat in their assessments of the economic outlook but pledged they would keep maintain expansionary settings until the economic recovery was well underway. More policy stimulus by the European Central Bank (ECB), via a by €600b boost in its bond buying program underscored the commitment from policymakers to get the global economy moving. Much stronger US labour market data – a 2.5m jump for non-farm payrolls (an 8m fall was expected) and a lower unemployment rate (13.3% from 14.7% in April versus 19.5% expected) – pushed 10-year Treasury yields to 2½ month highs (0.90%), with a close to 25bp lift last week. NZ longer-term rates were up close to 20bps, with the RBNZ tapering asset purchases ($1.075bn of NZ Government bonds and $50m of LGFA paper) to their lowest since they began quantitative easing.

Near-term interest rate outlook

We have maintained our upward bias for NZ yields, which should be supported by improved optimism as global economies are reopened and as NZ looks to kickstart more economic activity after COVID-19 disruptions. A decision by the NZ cabinet on when to move to Alert Level 1 is due today and it is quite likely that the shift will occur soon.

Current market pricing – OCR endpoint of 0.03% - looks to be a nod to the risk profile. The hurdle to an OCR cut looks to be high in our view given improved global sentiment, NZ looking to have contained COVID-19 and with the RBNZ still adding policy stimulus via Quantitative Easing. The RBNZ is set to purchase another $1.075bn of NZ Government bonds and $50bn of LGFA bonds this week, which should help temper upward pressure on NZ yields.

Simmering internal tensions in the US, concerns over US and Chinese relations and COVID-19 risks are likely to limit the rise in yields. Equity market sentiment will prove a useful barometer. We expect the FOMC will leave monetary policy unchanged in June, but there is the possibility they will introduce numerical- or time-based forward guidance to reinforce that monetary policy will remain expansionary for a long time.

Medium-term outlook

We don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. If more policy stimulus was needed the RBNZ will likely increase its $60bn asset purchase programme before cutting the OCR. Subpar global activity and RBNZ asset purchases should help to cap longer-term NZ interest rates despite a mountain of global public debt issuance. mark.smith4@asb.co.nz

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	0.30	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	1.26	0.53	0.25	0.30	0.35	0.40	0.40	0.60
NZ 5-year swap rate	1.45	0.63	0.30	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	1.78	0.93	0.65	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.65	1.03	0.65	0.75	0.85	0.95	1.05	1.15

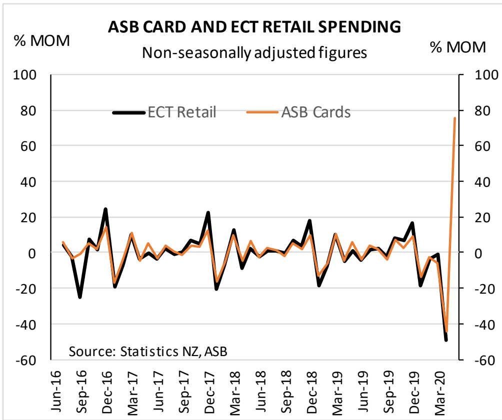
Domestic events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook Survey, June, Prelim, own activity net%	09/06	1:00 pm	-	-
Economic Survey of Manufacturing, Q1, %qoq	10/06	10:45 am	-	-
Electronic Card Transactions, Retail, May, % mom	11/06	10:45 am	-	+70

ANZ monthly business confidence continued to lift through May, as the Alert Level was relaxed from level 4 to 3 in late April, and then from level 3 to 2 in mid-May. **We expect to see further improvement in business confidence in June.** Recent developments can be described as better than expected, with NZ looking like it could be successful in eliminating the virus and real-time activity indicators (such as traffic volumes, electricity demand and card spending) suggesting activity may have bounced back more than we had expected during Level 2. Nonetheless, the level of confidence remains very low and we continue to expect GDP to contract 6% over 2020.

We use sales and inventory from the Economic Survey of Manufacturing as an indicator for Q1 GDP ex-meat and dairy manufacturing production**. We expect Q1 GDP ex-meat and dairy manufacturing production to contract 1.2% qoq**, largely due to reduced output as a result of the Alert Level 4 lockdown which impacted 4 working days at the end of March. However, **there is a higher degree of uncertainty than usual over this quarter's outcome due to COVID-19.** First, we are unsure what proportion of manufacturing was deemed essential. Second, StatsNZ uses a mixture of postal surveys and tax data for the Economic Survey of Manufacturing, and this methodology may not pick up the full impact of COVID-19 on Q1 production. StatsNZ has attempted to contact all survey respondents electronically for the Q1 survey.

Retail card spending is set for a sizeable May bounce as easing lockdown restrictions and pent-up demand drive a strong increase for non-essential retail. Our proprietary ASB card spending data, which has a very close fit with the ECT data, points to a 65-70% lift in May retail and core ECT spending. The strongest growth sectors will be in retail storetypes that had been hardest hit by the lockdown restrictions, with huge jumps in durable, apparel and hospitality retail expected, and with increasing traffic volumes boosting fuel spending. **Nevertheless, the level of retail spending will remain below pre-COVID-19 levels for most retail sectors.** Pent-up demand in the coming months could see a few more solid months of growth, but climbing unemployment, low overseas visitor numbers and weak household income growth and balance sheets point to a soft outlook for card spending over 2020.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Value of Home Lending, April, %mom	10/06	1:30 pm	-15
China CPI, May, %yoy	10/06	1:30 pm	2.8
US CPI, May, %mom	11/06	12:30 am	0.0
US Fed Interest Rate Announcement, %	11/06	6:00 am	0.0-0.25
UK GDP, April, %mom	12/06	8:30 pm	-

Originally published by CBA Global Markets Research on Friday 5th June at 2:22 pm

CBA **Australia's** lending data suggest there was a large fall in the **value of lending for housing** in April. The coronavirus restrictions were in full force in April and included a ban on open home and all but online auctions.

We forecast **China's CPI inflation** to decelerate to 2.8%yoy in May. The fall in food and pork prices accelerated in May. PPI inflation may remain steady at -3.1%yoy. A broad rebound in commodity prices signalled a possible pick-up in monthly PPI inflation.

We estimate **US headline CPI** was unchanged in May, reflecting a stabilisation in gasoline prices. We expect further mild disinflation in the core CPI. Extremely high levels of unemployment and consumer caution will continue to constrain demand and inflation in our view.

We expect the US Federal Reserve will leave monetary policy unchanged in June. However, there is a risk that the central bank introduces numerical or time-based forward guidance to reinforce that monetary policy will remain low for a long time. We do not expect the bank to announce yield curve control (YCC) but see a risk YCC is introduced later in 2020. Finally, we expect the US Fed will release updated economic forecasts for the first time since December 2019.

The April composite PMI points to a sharp contraction in **UK economic activity** over the month reflecting the large negative shock from COVID-19. The Bank of England projects GDP to fall by around 25% in Q2 followed by a recovery in the second half of 2020 as lockdown measures in the UK and globally unwind.

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	-0.5	-16.9	13.4	0.5			
GDP real - A%	1.8	0.9	-16.2	-5.7	-5.8	-5.6	2.7	4.7
GDP real - AA%	2.3	1.8	-2.8	-4.8	-6.7	-8.3	4.4	4.5
CPI - Q%	0.5	0.8	-0.6	0.3	-0.1			
CPI - A%	1.9	2.5	1.3	1.0	0.3	-0.1	1.2	1.7
HLFS employment growth - Q%	0.1	0.7	-5.6	-1.0	0.5			
HLFS employment growth - A%	0.8	1.6	-4.7	-5.8	-5.4	-5.8	2.9	2.7
Unemployment rate - %sa	4.0	4.2	8.8	8.6	7.9	7.8	6.8	5.9
Annual current account balance as % of GDP	-3.0	-2.7	-2.3	-1.6	-1.3	-1.6	-0.3	0.7

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

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