Economic Weekly

09 March 2020

Central banks move into action

Coronavirus panic continued to escalate over the past week, with toilet paper (inexplicably) becoming a hot commodity and offshore central banks moving to lower policy rates to buffer the economic shock. While **the Reserve Bank of Australia calmly lowered its Cash Rate 25 basis points** at its scheduled meeting on Tuesday, the **Federal Reserve managed to spook markets with its unscheduled "emergency" 50 basis point cut** to the Fed Funds rate on Wednesday morning. The subsequent fall in US equites (on a day when markets has started to stabilise) highlights the risk that large actions can potentially backfire and may cause more panic and fear, rather than helping to buoy confidence. **We now expect the RBNZ to (calmly) cut the OCR 25 basis points apiece in March and May**.

Key events and views

Key Insights	Be prepared: thinking about potential coronavirus impacts on business
Foreign exchange	Soft USD drives NZD/USD higher, but we doubt the gains will last
Interest rates	Yields lower on COVID-19 fears. We now expect 50bps of OCR cuts over 2020.
Domestic events	ANZ Business Outlook preliminary results for March released early on Tuesday
International events	ECB expected to lower rates

Chart of the Week: Weaker growth forecasts as COVID-19 outbreak spreads

We have updated our economic growth forecasts as the Coronavirus outbreak continues to spread and it has become apparent that the economic impacts are likely to be larger and longer lasting than we had previously assumed. **We now expect no economic growth over the first half of 2020.** The key hit to the economy is likely to come through disruption to the export sector, particularly tourism as we now assuming a **sharp drop off in demand for international travel.** We also expect a modest hit to NZ consumer spending as some avoidance behaviour begins to impact some activities. We also see a softening in investment growth as some businesses may postpone investment (or potentially see delays in importing equipment).

With our baseline forecasts very weak, it would not take much to bump the economy into a technical recession. Indeed, many overseas commentators are beginning to speculate that the Coronavirus outbreak will have knocked the US and other major economies into a recession over the first half of the year.

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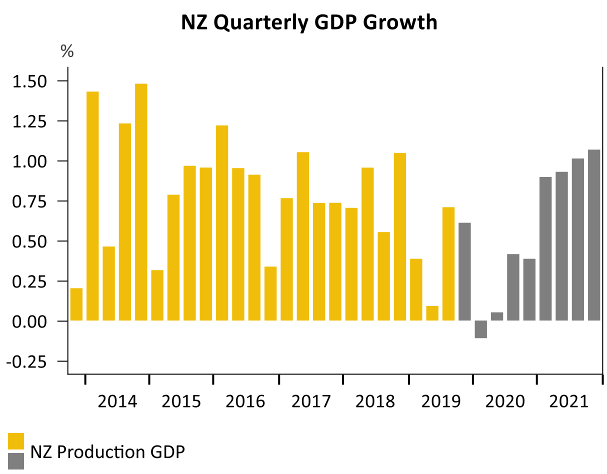

Source: Macrobond, ASB

Thinking about coronavirus impacts on business

- The COVID-19 virus outbreak – and its economic impact – is spreading.
- It is prudent for businesses to ensure they have made adequate preparation for NZ and global disruption.
- Here, we cover some key things for businesses to double-check they are on top of.

This article was earlier published as an ASB Economic Note on March 5th.

COVID-19 has started to spread globally, including confirmation of NZ's first cases. With that comes the growing likelihood that NZ (and other countries) put in place containment measures that disrupt normal business activity, and also the risk that the virus reaches the pandemic stage. **There is time in the here and now to get better prepared.**

Consider three broad types of business impacts

NZ is being affected by three channels of adverse impacts: export demand; supply chain disruptions, and; social distancing (which is increasing). Individual businesses will be affected in differing ways and degrees.

Export earnings: to date the primary source of NZ economic disruption in NZ is coming through China's efforts to contain the spread of the virus and NZ's border restriction on travellers from selected countries. China is NZ's biggest export market and often NZ's number one or number two revenue source for the main export sectors. Any containment efforts in other countries that experience a viral outbreak could also cause further disruption.

Supply chain disruption: China is effectively the world's factory. Many goods are either manufactured or assembled in China or rely on Chinese-made componentry. Lengthy factory closures will create shortages and disrupt other businesses reliant on Chinese goods. Furthermore, global logistics chains have also been disrupted, particularly to and from China but also as flight cancellations and border restrictions broaden to other countries.

Social distancing: Government quarantine policies, self-isolation or people's voluntary desire to minimise contact with other people can disrupt business staffing levels and change spending patterns. Employees may need to stay home to isolate themselves or care for their children if schools and early childhood facilities get closed. People may increasingly prefer to stay at home, eat delivered food and watch Netflix rather than going out for dinner and a movie.

There will also be some businesses that benefit from the virus outbreak. Some will be providing goods or services that are sought after in the fight against the virus. Others will benefit from a refocusing of spending. And domestic producers that compete with imported product may see greater interest in the short term and, potentially, the longer term as businesses rethink supply chain risks.

Understand trends in your business

Changes in your business are pretty obvious if major export shipments to China get abruptly cancelled. Not all impacts will be that cut and dried. It will pay to:

- Closely track sales and revenue, and dig deep into any unexplained declines.
- Closely monitor the health of your cashflows and overall financial position for warning signs of potential challenges.
- If you have been unable to receive shipments, check whether you have the financial capacity to make larger than normal orders to catch up once shipments resume.

Understand your supply chain

There are already a number of NZ anecdotes about shortages of critical inputs that are sourced from China. And some factories in other countries have been shut because they have run out of crucial parts. You may not directly depend on China for what you do, but it is quite possible some of your local or global suppliers do – or their suppliers in turn. And, with the virus now in at least 74 countries, production elsewhere could get affected as well. The disruption to global shipping and airfreight may also affect delivery times from a range of countries, even if manufacturing itself isn't disrupted.

- Make sure you are in regular contact with your key suppliers to understand their supply chains and any obvious weak points.
- Explore viable alternative options for key supplies that you can switch to if needed.
- Explore the feasibility of holding more inventory of inputs and finished goods to reduce the impact of any future disruption.

Clarify your options

Having a clear idea ahead of time of how to respond to various developments will aid rational decision-making in the heat of the moment and may help to get ahead of the curve.

Make or update contingency plans: most businesses (particularly large ones) will have made comprehensive contingency plans and – in particular – have a good idea of how to respond to a pandemic scenario. If you haven't got a written contingency plan, it would be wise to put one together – your trusted advisors such as your accountant may be able to help. The Ministry of Business, Innovation and Employment also has a resource here in addition to the above Ministry of Health pandemic guidance. Some key actions to consider are

- Understand what key risks your business has.
- Determine how you would respond to losing key customers because of the virus outbreak, even if only for a period. Know who your alternative customers are, and determine if there is any paperwork that would need to be completed to ensure you can ship to them – particularly if crossing a new international border.
- Understand your health and safety obligations to your staff and have a plan for if one of your staff were to contract COVID-19.
- Plan for how you will manage employee staffing disruptions, for example if school closures require parents to remain at home. Assess if remote working is possible, and (re)check its effectiveness.

Keep well informed: being on top of developments and reliably informed will help you to make better-quality decisions.

- Check with your industry body for advice, information and any engagement that is being made with Government ministries for assistance.
- Ensure you/your organisation understand the symptoms of COVID-19.
- The Ministry of Health (MoH) has coronavirus information here, including health precaution posters for displaying in workplaces. The MoH has a national pandemic plan prepared if the need arises, which will give you an idea of the responses the Government could make that affect you.
- Track the global geographic spread of coronavirus to check on the risks of global suppliers being directly affected.
- Read ASB Economics Weeklies and Economic Notes to keep track of our latest views on this rapidly-evolving situation.
- Make personal preparations in a calm and considered way. In addition to MoH advice, here is another perspective from a specialist in infectious diseases.

Seek help if needed: a number of businesses are already facing challenges, and others are likely to. There are learnings and support out there to leverage.

- Talk to your trusted advisors to see what helpful suggestions they have and perspectives they are seeing from other clients.
- If you are facing, or think you could face financial pressures, talk to your bank sooner rather than later. Sooner usually leaves more options available. Otherwise-healthy businesses are being affected, and simply need some support to get through until the impact of the virus abates.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6320	0.6229	0.6455	0.6757	FLAT/DOWN	0.6250	0.6390
NZD/AUD	0.9580	0.9548	0.9604	0.9634	FLAT	0.9500	0.9690
NZD/JPY	66.01	67.38	70.94	75.27	DOWN	65.00	67.00
NZD/EUR	0.5567	0.5637	0.5877	0.6034	DOWN	0.5395	0.5600
NZD/GBP	0.4833	0.4856	0.4989	0.5160	DOWN	0.4855	0.4930
TWI	70.1	69.5	71.6	73.60	DOWN	N/A	N/A

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

NZD Recap

Compared to the carnage in other financial markets, currency markets remained *relatively* calm last week. Despite a material worsening in a broad range of risk aversion indicators, the NZD/USD ground steadily higher for most of the week, finishing around 0.6350.

A broad-based weakening in the USD was the key driver of currencies. USD interest rates fell further than most major markets, materially narrowing the USD's prior interest rate advantage. This trumped all of the other usual currency market drivers (commodity prices, risk appetite, relative growth) in pushing G10 currencies higher against the USD last week.

Amongst the crosses it was a different story, with records being shattered everywhere. NZD/EUR fell to 5-year lows, NZD/GBP to 4-year lows, and NZD/JPY was slammed down to 8-year lows of almost 66.00.

Near-term outlook

Changes in relative interest rates have had a marked impact on currency market dynamics over the past week. NZ-US 2-year swap differentials have surged from -20bps to around +10bps. The widening in NZ-US rate spreads has seen NZD/USD forward points suddenly turn negative at all tenors, and this increased yield appeal helped insulate the kiwi from the otherwise negative effects of spiking global risk aversion. The VIX index (a risk aversion proxy) is up around the highest levels since 2011.

Worryingly, signs of stress in financial markets are starting to show up in credit markets. Short and long-term credit spreads widened noticeably last week. This is a key transmission channel from global financial markets to NZ and should be watched closely.

Looking ahead, we suspect the positive NZD impetus from widening NZ-US interest rate differentials will soon start to run out of juice, for no other reason than markets are already close to pricing US interest rates at zero. Spiking risk aversion and some big falls in NZ commodity prices present strong downside risk to the NZD. And any signs that the NZ economy is being heavily impacted and/or headed toward recession could be the catalyst for a renewed downtrend in the currency (NZD/USD, NZD/EUR, NZD/GBP, NZD/JPY). Keep an eye on this week's (early) business confidence read in this regard.

Medium-term outlook

The outlook is just too uncertain, and financial markets too whippy, to say anything sensible about the medium-term currency outlook at present (the near-term outlook is hard enough). All that can really be said is that the NZ dollar will rebound sharply once the market's intense focus on the global growth impacts of coronavirus eventually passes (and it will). Until such time, downside risks for the NZD will dominate, as they have done anytime we've seen a synchronised slowdown in global and NZ economic growth.

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Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH	UP
90-day bank bill	0.88	1.05	1.25	1.88	UNCH	UP
2-year swap	0.71	0.72	1.15	1.84	UNCH	UP
5-year swap	0.75	0.80	1.22	1.98	UNCH	UP
10-year swap	0.97	1.10	1.49	2.38	UNCH	UP
10-year govt bond yield	0.90	1.01	1.34	2.08	UNCH	UP
Curve Slope (2s10s swaps)	0.25	0.39	0.35	0.54	UNCH	DOWN

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

Market Recap

Market action last week was all about the continued spread of COVID-2019, which triggered heightened risk aversion in markets. Global equities and yields ended the week lower and oil prices slumped, with fresh record lows for various long-term sovereign bonds (US 10Y 0.76%, NZ 0.92%). NZ yields ended last week, either at, or close to record lows, with NZ 90-day bank bills earlier dipping to 0.76% lows on expectations of pending OCR cuts. **Last week we shifted our OCR call to expecting 25bp cuts in March and May, in recognition of the significant disruptions to NZ and global economic activity caused by the spread of the outbreak.** Credit spreads for NZ assets (as proxied by Australian iTraxx 5-year credit default swaps) have widened by close to 30bps over the last couple of weeks and represent a prospective tightening in financial conditions that may need to be offset by a lower OCR. Global central banks have become increasingly wary and have moved from observation mode (watch and wait) to action mode (i.e. cut). The Reserve Bank of Australia (-25bps) and Bank of Canada (-50bps) trimmed their policy rates on their scheduled decision dates, but it was the unscheduled 50bps emergency rate cut by the Federal Open Market Committee (FOMC) on Wednesday that caught the market on the hop. There was minimal market reaction to the strong +273k February US non-farm payrolls print at the end of the week.

Near-term NZD interest rate outlook

Current market pricing has close to 40bps of OCR cuts priced in for the March RBNZ decision, with around 65bps of OCR cuts priced in by the end of 2020. **We expect interest rate markets will remain highly sensitive to developments relating to the (highly uncertain) impact of COVID-1 9 and will likely take direction from equity markets.** Central bank speeches from RBNZ Governor Orr on Non-standard policy (tomorrow 2pm) and RBA Deputy DeBelle (11am Wednesday) may provide clues on future policy direction. This week, the European Central Bank are widely expected to trim the deposit facility rate by 0.1% to -0.6%, with 25bp rate cuts expected by the FOMC and Bank of England later this month. Markets are likely to ignore local and global data. Tomorrow's early release of the March ANZ business outlook could further steer market pricing towards OCR cuts.

Medium-term outlook

We expect 50bps of cuts over the next few months (25pbs in both March, May), taking the OCR to a record low 0.50%. We expect gradual policy tightening from mid-2021 and an OCR endpoint of 2% this cycle, with risks to our OCR view skewed to the downside. The RBA is expected to cut the 0.50% cash rate to the 0.25% effective lower bound in April. The 1.00%-1.25% Federal Funds rate is expected to be cut by 50bps in 2020 (Mar, Apr). Additional policy support globally looks set to be unveiled over the coming months to offset the impacts of the COVID-19 outbreak. Low inflation, subpar global growth and negative risks should cap NZ and global long-term interest rates at low levels.

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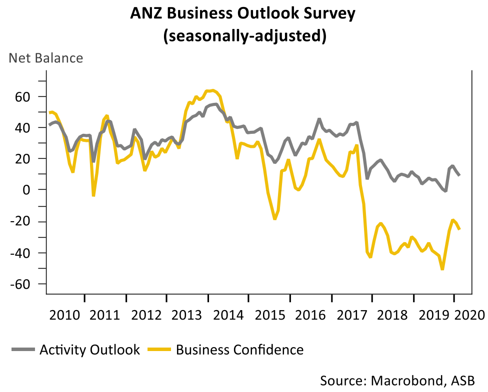
ASB interest rate forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.00	1.00	0.75	0.50	0.50	1.00	1.50
NZ 90-day bank bill	1.15	1.29	0.75	0.75	0.85	1.35	1.85
NZ 2-year swap rate	0.94	1.26	0.65	0.60	0.80	1.35	1.75
NZ 5-year swap rate	0.94	1.45	0.75	0.75	0.95	1.30	1.70
NZ 10-year swap rate	1.21	1.78	1.05	1.05	1.15	1.55	1.95
NZ 10-year Bond	1.10	1.65	0.95	0.95	1.05	1.45	1.85

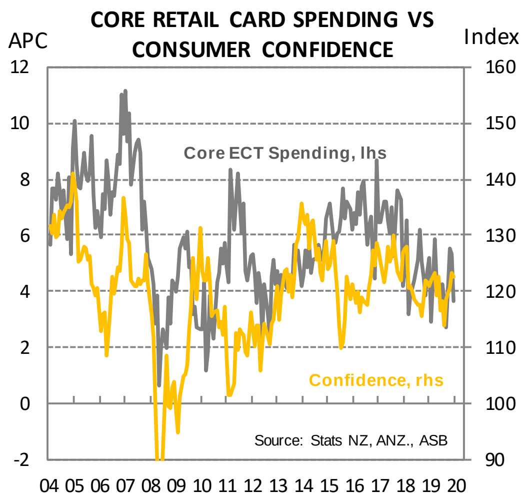
Domestic events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own activity next 12 months, March	10/03	1:00pm	-	⬇
Electronic Card Transactions, Retail, Feb, %mom	11/03	10:45am	-0.3	-0.3

ANZ will release preliminary results of the March business confidence survey on Tuesday 10th at 1pm. The results are likely to be very weak, as the survey period (early March) was in the midst of growing public panic around the global Coronavirus outbreak. Furthermore, the Chinese production shutdown and subsequent concerns and uncertainties about supply chain disruptions are likely to also rattle respondents. We urge readers to interpret these results (and any sensationalist headlines) with caution. We do expect a temporary hit to economic growth over 2020, largely as result of measures taken to limit the spread of the outbreak. But we also expect fiscal and monetary stimulus over the coming year to help to cushion the blow.



February card spending is expected to be a mixed bag overall. The imposition of travel restrictions as a result of the COVID-19 outbreak and concerns stemming from the viral outbreak are likely to heavily weigh on hospitality spending. However, consumables spending looks to have ended the month on a strong note, supported by precautionary consumer buying after the confirmation of a COVID-19 case in NZ. Reports of pending stock shortages from some retailers may also have encouraged consumers to bring forward purchases, although ongoing difficulties with retail supply chains could provide further headaches for consumers and retailers over the next few months.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Japan Current Account, January, ¥bn	09/03	12:50 pm	1,664	1,700
China CPI, February, %yoy	10/03	2:30 pm	5.2	5.0
RBA Deputy Governor Debelle speech	11/03	11:00 am	-	-
Australia Owner-Occupier Loan Value, January, %yoy	11/03	1:30 pm	2.8	-
US CPI, February, %yoy	12/03	1:30 pm	2.2	2.3
UK Government Budget Announcement	12/03	12:30 am	-	-
ECB Interest Rate Announcement, %	13/03	1:45 pm	0.00	-0.00

**Originally published by CBA Global Markets Research on Friday 6h March at 12:39 pm*

Already-released customs trade balance data suggests **Japan's current account surplus** remained large at ¥1,700bn.

High-frequency data in China suggest food prices peaked in mid-February before easing into end-February. We expect CPI inflation to slow to 5%yoy because of the gradual re-opening of businesses lessening supply constraints. We expect PPI inflation to fall to -0.3%yoy because of the severe impact of the coronavirus.

Reserve Bank of Australia's Deputy Governor Debelle is due to speak at the Australian Financial Review Business Summit. The speech is likely to have a heavy focus on the coronavirus and the impacts on the domestic and global economies. Speaking to a Senate estimates economics committee on Wednesday night, Debelle said the RBA was expecting lower tourism and education to subtract 0.5 ppts from Q1 GDP.

Australia's monthly lending data for housing has picked up, rising 4.4% in December and 14.0% over the last 12 months. Owner-occupiers (including first-home buyers) are driving lending growth. CBA's home buying component of the Household Spending Intentions data indicates that lending growth will be supported in January. We are forecasting a 3% lift in the value of lending in the month.

We estimate **US CPI inflation** remained stable at 2.3%yoy. In coming months, disruption to imports from China may lead to shortages of some consumer goods that pushes up inflation.

The **UK budget** is widely expected to be loosened. A large fiscal stimulus of at least 1% of GDP is needed to provide some offset to the headwinds facing UK economic growth. The two headwinds are uncertainty from the future UK-EU trade relationship and the disruption to the economy from fears of the coronavirus.

The already-soft Eurozone economy is being hit directly and indirectly from disruption caused by fears of the coronavirus. **We expect some policy easing from the European Central Bank (ECB)**. The central bank will consider policy easing from its existing tools: (i) cuts to its policy interest rates; (ii) increases to its asset purchase programs; and (iii) increase or extend its bank lending programs. We expect a small 0.1% cut to the deposit rate to -0.6%. The ECB may also introduce new tools that target support to businesses with cash-flow issues, via banks.

Key Forecasts

ASB NZ economic forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	0.7	0.6	-0.1	0.1			
GDP real - A%	2.3	1.8	1.3	1.2	1.8	3.8	2.8
GDP real - AA%	2.7	2.3	1.9	1.6	1.2	3.4	3.2
CPI - Q%	0.7	0.5	0.5	0.4			
CPI - A%	1.5	1.9	2.3	2.1	1.7	2.0	2.1
HLFS employment growth - Q%	0.2	0.0	0.2	0.1			
HLFS employment growth - A%	1.0	1.0	1.1	0.6	0.9	2.1	1.4
Unemployment rate - %sa	4.1	4.0	4.2	4.4	4.6	4.3	4.1
Annual current account balance as % of GDP	-3.3	-3.1	-3.1	-3.4	-4.0	-3.9	-3.3

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

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NZ 10-year Bond	1.10	1.65	0.95	0.95	1.05	1.45	1.85

ASB foreign exchange forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

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