Economic Weekly

09 November 2020

# And now for something completely different…

After four tumultuous years, a litany of eye-grabbing headlines and a countless number of tweets, the Trump era may now be nearing an end. After days of counting, most news agencies had seen enough in the key state of Pennsylvania and called the race for Joe Biden. As at the time of writing, Biden was building on his leads in both Pennsylvania and Georgia, and looked set to grab about 303 electoral college votes and win the nationwide popular vote by 4-6 million votes according to projections. That's a fair way short of what polls suggested, but we pointed out last week that Biden's lead was probably large and stable enough to withstand a substantial error and that's proved correct.

Democrats also held onto the House of Representatives but look like they'll be unable to overcome their geographic disadvantage in the Senate. For now, markets are taking that outcome in their stride, and the result saw a broad rally in equities after some pre-election anxieties (see chart below). Whilst the prospects for a big stimulus package are uncertain, markets are comforted by the fact that divided control will make big tax and regulatory changes unlikely. With a very different President in the White House, markets are probably hoping for a little more predictability too. Still, it's not quite over just yet. As at the time of writing, President Trump is determined not to accept defeat and is challenging the result by whatever means he can. And remember, if all else fails, there's always 2024…

This week, the domestic focus turns away from electoral politics and over to the very different world of monetary policy, with the RBNZ meeting on Wednesday. We expect the bank to leave its OCR, LSAP and forward guidance unchanged, but unveil further detail about its 'Funding for Lending Programme' or FLP, that will offer low-cost funding for banks. The bank is also likely to downplay the signs of life we've seen domestically, and highlight the headwinds facing global growth as COVID cases rise overseas. We still expect a negative OCR next year, but a lot will depend on the effectiveness of the FLP in delivering support, as well as the shape of the pandemic and its continuing economic impact. You can read our full preview here, and don't forget to stay tuned for our review. 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:**

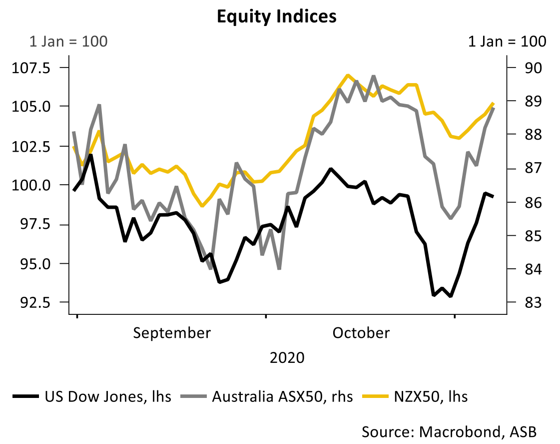
RBNZ September MPR Review

RBNZ November MPR Preview

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 | 0.6798 | 0.6683 | 0.6608 | 0.6365 | FLAT/UP | 0.6600 | 0.6800 |
| NZD/AUD | 0.9334 | 0.9375 | 0.9201 | 0.9245 | FLAT | 0.9170 | 0.9440 |
| NZD/JPY | 70.24 | 70.07 | 69.93 | 69.51 | FLAT/UP | 69.00 | 72.00 |
| NZD/EUR | 0.5718 | 0.5658 | 0.5610 | 0.5758 | FLAT | 0.5600 | 0.5800 |
| NZD/GBP | 0.5164 | 0.5132 | 0.5100 | 0.4966 | FLAT | 0.5100 | 0.5270 |
| TWI | 72.2 | 71.9 | 70.9 | 70.10 | FLAT/UP | 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 was swept higher last week as wave of more optimistic risk sentiment spread across global financial markets. The NZD/USD scaled 18-month highs near 0.6800, and most NZD cross rates also posted gains (ex-NZD/AUD). The 'safe-haven USD' and JPY were shunned, with the former pushed down to a 2½ year low (Bloomberg USD index).

The election of Joe Biden to the US Presidency, but without the Democrats taking the Senate (albeit there is still a chance of such), appeared to hit a sweet spot for equity markets. 'Big tech' soared on the reduced potential of the Democrats to enact tax/regulatory reform while, at the same time, the fact a large fiscal package is likely to be prioritised by Biden soon after taking office helped to float all boats. The S&P500 and NASDAQ share market indices ended the week 7.3% and 9% higher, respectively. By contrast, the Russell 2000 index of US small caps stocks was only up by 4.8%, indicative of large cap outperformance.

### Outlook

There's still some tail risk out there around Trump's various legal challenges and a path still being open for the Democrats to take the Senate. However, by and large the election event risk is behind us. Moreover, we expect the Democrats to prioritise a large fiscal package to lift the US economy back onto the recovery rails. All of this has the potential to further embolden risk appetite and push the NZ dollar higher.

Last week we flagged a scenario where falling risk aversion – proxied by the VIX index – lifts NZD/USD 'fair-value' into a new, higher range. This has more or less played out. Last week's sharp fall in the VIX from 38% to 24% has seen short-term fair-value lift to 0.6350-0.6750, two cents higher than last week. We'd focus more on the direction of travel than the precise range estimate though, and thus would not be surprised to see the NZD/USD spent some time in a 0.6800-0.6850 range this week.

The most obvious piece of NZD event risk is the Wednesday RBNZ meeting. We don't expect the Bank to talk tough on the currency, but past form means there is a chance of a dovish surprise knocking the NZD back a little. Conviction about negative interest rates has wavered a little in local interest rates markets. But a reiteration of the downside medium-term risks by the Bank could push both local yields and the currency lower again. Still, we'd expect dips to be shallow given upbeat global risk appetite. NZD/USD support at 0.6600 is expected to hold. mike.jones@asb.co.nz

| **ASB foreign exchange forecasts** (end of quarter) | Jun-20 | Sep-20 <<actual | Dec-20 forecast >> | Mar-21 | Jun-21 | Mar-22 | Mar-23 |
|---|---|---|---|---|---|---|---|
| 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 | 0.86 | 0.86 |
| NZD/JPY | 69 | 70 | 71 | 70 | 69 | 69 | 69 |
| NZD/EUR | 0.57 | 0.56 | 0.54 | 0.54 | 0.53 | 0.53 | 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 | 69.9 | 69.4 | 68.0 | 67.6 | 67.6 |

## 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/DOWN | UP |
| 90-day bank bill | 0.29 | 0.28 | 0.28 | 1.15 | UNCH/DOWN | UP |
| 2-year swap | 0.05 | 0.01 | 0.03 | 1.06 | UNCH/DOWN | UP |
| 5-year swap | 0.15 | 0.12 | 0.10 | 1.19 | UNCH/DOWN | UP |
| 10-year swap | 0.56 | 0.54 | 0.50 | 1.54 | UNCH/DOWN | UP |
| 10-year govt bond yield | 0.59 | 0.56 | 0.55 | 1.38 | UNCH/DOWN | UP |
| Curve Slope (2s10s swaps) | 0.51 | 0.53 | 0.48 | 0.48 | UNCH | DOWN |

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

### Market Recap

NZ yields shorter-term yields firmed over the last week as the general resilience of the NZ economy and changes to OCR calls by one major bank saw markets reassess the need for further RBNZ cuts. The RBA's trifecta of 15bp cuts to the cash rate, 3-year bond purchase target and term funding facility to 0.1% was broadly anticipated by the market, but yields ticked higher on headlines that further cuts were not under consideration.

US election uncertainties added to volatility in global interest rate markets. The US election proved to be much tighter than expected with the Democrats having a (smaller) majority in the House, the Republicans holding onto their Senate majority, and with President Trump refusing to concede the race for president thus far despite Biden being declared President-elect. US 10-year Treasury yields traded in a 0.72% to 0.94% range over the last week, with NZ 10-year bonds (0.50% to 0.55% range) and Australian 10-year bonds (0.74% to 0.82%) somewhat volatile. There was little reaction to the Fed decision. The improved tone of global data – stronger than expected US Non-farm Payrolls and unemployment data (6.9%) – helped push Treasury yields higher, notwithstanding surging COVID-19 cases in the US.

### Near-term interest rate outlook

The RBNZ is expected to stick to the script and hold current setting on the November MPS on Wednesday, but not rule anything out in future, including a negative OCR in 2021. We expect a dovish statement that could see the market reassess whether current market pricing (OCR of around zero by April 2021) looks a bit light. The MPS will also provide details on its Funding for Lending Programme (FLP), which we expect to be launched by the end of the year and to have a key bearing on future OCR settings. Local data are likely to be mostly ignored as will the major global data prints this week, including US October CPI, UK Q3 GDP, and the October NAB survey of Australian business confidence.

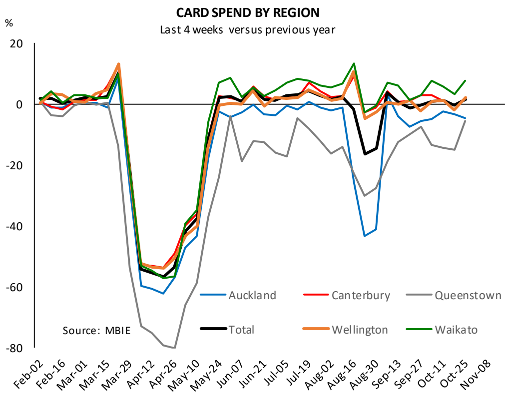
Global yields will largely take direction from US political developments. Equity markets will prove to be a useful barometer. There is still scope for volatility with the US vote count continuing and a number of legal challenges to contend with. With the Republicans holding onto the Senate it would be very difficult for the Democrats to push through a (larger) fiscal package, which may act to cap the upside for Treasury yields. We also expect COVID-19 headwinds to temper the improvement in the data, keeping yields low. Higher RBNZ government bond purchases than the weekly tender ($870m versus $600m) and the RBA's AUD150bn bond buying programme should dampen yields at the margin.

### Medium-term outlook

We have pencilled in a 75bp OCR cut in April to take the OCR to -0.5% but note the timing and extent of OCR moves will depend on the effectiveness of other policy measures and the labour market and broader NZ economic outlook. The Fed and RBA are expected to hold key policy rates over 2021, the ECB to expand asset purchases and the BoE to move its policy rate below zero. Low global inflation and the negatively skewed global risk profile should keep NZ longer-term yields low. mark.smith4@asb.co.nz

## Domestic events

| Data | Date | Time (NZT) | Market | ASB |
|---|---|---|---|---|
| Electronic Card Transactions, Retail, % mom | 10/11 | 10:45am | - | 3.0 |
| RBNZ November MPS, OCR | 11/11 | 2:00pm | - | 0.25 |




Our expectation is for another positive month for card spending, with a notable school holiday boost expected. Internal ASB card data were strong over October, with card spending data from MBIE showing a broad-based jump across most regions, particularly with destinations that would have been popular during the October school holidays. Fuel, apparel and hospitality spending are expected to be particularly strong in October, with a rebound in consumable spend expected. Provided NZ does not shift up Alert levels, the better-than-expected showing of the housing market could act to prop up the retail sector over the next few months. Nevertheless, challenges lie ahead. The unemployment rate is climbing, and this may instil more consumer caution. The border restrictions are expected to have a more acute impact over the summer months. All up, the retail environment will likely remain challenging over 2021.

In Wednesday's **Monetary Policy Statement**, the RBNZ is expected to hold its broad policy parameters, including the 0.25% OCR, reaffirm its March 16 guidance (on hold until March 2021) and maintain its $100bn Large Scale Asset Purchase (LSAP) package. The published projections are also expected to adhere to recent RBNZ practice and not publish the OCR beyond the March 2021 quarter (0.25%). **The RBNZ is expected to unveil the details of its funding for lending programme (FLP)**, which should be operational by the end of the year. Details will be key. The tone of the policy assessment will likely be cautious, downplaying potential (short-term) upside risks to the outlook (including the housing market) and focusing more on (predominantly downside) medium-term risks.

Moreover, we expect the RBNZ to signal the intent to increase policy accommodation and keep all policy options on the table, including pushing the OCR below zero after the period of forward guidance expires. Our current view is that the RBNZ will move the OCR below zero in April, although the timing and extent of OCR moves will depend on the effectiveness in the FLP in supporting the economy, the impact and duration of COVID-19 and the path of the NZ and global economies, all of which remain highly uncertain.

## Major International Events for the week ahead*

| Data | Date | Time (NZT) | ASB |
|---|---|---|---|
| CBA Credit and Debit Card Spend Data, w/e 6 Nov | 10/11 | - | - |
| UK ILO Unemployment, Sep, % | 10/11 | 8:00 pm | 4.5 |
| UK GDP, Q3, %yoy | 12/11 | 8:00 pm | -21.5 |
| US CPI, October, %mom | 13/11 | 4:30 am | 0.1 |

**Originally published by CBA Global Markets Research on Friday 6 November at 1:48 pm*

Our parent **CBA's Weekly Credit & Debit Card Spend data** for the week to 6$^{th}$ Nov will capture a full week of third step restrictions in Metropolitan Melbourne which were effectively enacted at midnight on 27 Oct 20. We expect a further recovery in Victoria's card spend data after the prior week's data showed a healthy lift in in-store spending. It has been disappointing that spending in New South Wales and Queensland has eased over October. We will be watching to see if this trend continues.

The **unemployment rate in the UK** rose to 4.5% in the three months to August. The increase in the unemployment rate has been less severe than the Bank of England (BoE) initially projected, reflecting support from government schemes and an increase in the number of people who are not actively searching for work. Nonetheless, unemployment is still expected to rise as firms continue to adjust to the lower level of demand. The Bank of England (BoE) projects the jobless rate to rise to 4.8% and 6.3% over Q3 and Q4, respectively.

The **UK economy** is projected to recover in Q3 as lockdown measures eased during this period. The Bank of England expects GDP to rise by 16.1%qoq in Q3 following a record 19.8%qoq plunge in Q2. Beyond Q3, the recent rise in the number of Covid cases and associated social distancing measures will weigh on economic activity in the near term.

We forecast a muted 0.1%mom lift in **US headline inflation** in October. A fall in gasoline prices will have dragged on overall prices. We also expect a mild 0.2% lift in core inflation. The recent weakening in US economic momentum will bear down on core inflation. The muted inflation outlook reinforces that monetary policy will remain accommodative in the US for a long time.

## Key Forecasts

| ASB NZ economic forecasts | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Mar-22 | Mar-23 |
|---|---|---|---|---|---|---|---|
| | << actual | forecast >> | | | | | |
| GDP real - Q% | -12.2 | 11.1 | 0.7 | 0.5 | 0.4 | 0.4 | 0.8 |
| GDP real - A% | -12.4 | -3.4 | -3.1 | -1.2 | 13.0 | 1.5 | 3.3 |
| GDP real - AA% | -2.1 | -3.5 | -4.7 | -5.0 | 1.0 | 4.3 | 2.6 |
| NZ House Prices (QV Index) - A% | 6.8 | 6.9 | 9.1 | 9.0 | 11.5 | 7.1 | 4.9 |
| CPI - Q% | -0.5 | 0.7 | 0.1 | 0.2 | 0.3 | 0.4 | 0.5 |
| CPI - A% | 1.5 | 1.4 | 1.0 | 0.5 | 1.3 | 1.5 | 1.3 |
| HLFS employment growth - Q% | -0.3 | -0.8 | -0.3 | 0.1 | 0.4 | 0.6 | 0.5 |
| HLFS employment growth - A% | 1.5 | 0.2 | -0.4 | -1.4 | -0.6 | 2.1 | 1.9 |
| Unemployment rate - %sa | 4.0 | 5.3 | 5.8 | 6.2 | 6.5 | 5.7 | 5.5 |

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 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Mar-22 | Mar-23 |
|---|---|---|---|---|---|---|---|
| (end of quarter) | | << actual | forecast >> | | | | |
| 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 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Mar-22 | Mar-23 |
|---|---|---|---|---|---|---|---|
| (end of quarter) | | << 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 | 0.86 | 0.86 |
| NZD/JPY | 69 | 70 | 71 | 70 | 69 | 69 | 69 |
| NZD/EUR | 0.57 | 0.56 | 0.54 | 0.54 | 0.53 | 0.53 | 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 | 69.9 | 69.4 | 68.0 | 67.6 | 67.6 |


| 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 Economist, Wealth | Chris Tennent-Brown | chris.tennent-brown@asb.co.nz | (649) 301 5915 |
| Economist | Nat Keall | nathaniel.keall@asb.co.nz | (649) 301 5720 |
| Publication & Data Manager | Judith Pinto | judith.pinto@asb.co.nz | (649) 301 5660 |

**www.asb.co.nz/economics**

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