Economic Weekly

10 February 2020

Coronavirus outbreak clouds RBNZ update

The week's release highlight is the RBNZ interest rate announcement on Wednesday. We expect the RBNZ to hold the OCR at 1.00%, but to signal its preparedness to lower the OCR, if necessary. At this point we doubt that the RBNZ will incorporate the potential impacts of the coronavirus outbreak into its central published forecasts and OCR track. The RBNZ will, however, note that the virus is a key risk to the OCR outlook.

Key events and views

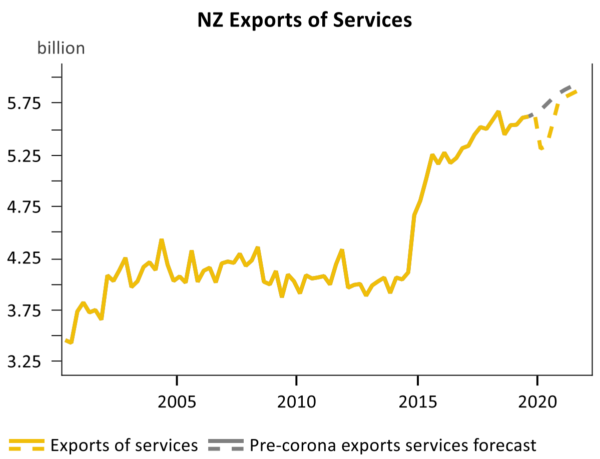
Key Insights	The potential impacts of the coronavirus outbreak on the NZ economy
Foreign exchange	We look for some stabilisation in the NZD this week.
Interest rates	Yields lift from previous week's levels but we continue to see near-term downside risks.
Domestic events	RBNZ expected to leave OCR on hold at 1% at the announcement this week.
International events	UK Q4 GDP, US CPI and retail sales.

Chart of the Week: Coronavirus to have temporary impact on GDP growth

We have lowered our Q1 GDP forecast by 0.6 percentage points as an early estimate of the economic impact of coronavirus. **We also assume economic activity returns to "normal" by Q3**, which provides a boost to growth as activity recovers back towards pre-outbreak levels. However, **it is still early days, the degree of uncertainty remains high** and our economic forecasts will continue to be updated as the spread of, and response to, the outbreak evolves. **We will be shortly releasing a note containing more detail on the likely economic impact**.

The brunt of the economic impact will be borne by exports of services, with tourism, education, forestry, seafood and mutton exports being the most at-risk export sectors. With Chinese visitors temporarily blocked from entry and accounting for 11% of visitor arrivals, tourism-related services will bear the brunt of the impact. $1.3bn in education exports to China will also be impacted, with China accounting for around 15% of student visa arrivals. Forestry and seafood exporters have also been impacted, but we believe most of NZ goods exports should remain in demand.

The overall GDP impact may be less if NZ residents in turn scale back overseas trips and spend more in NZ on holidaying or general consumption.



Source: Macrobond, ASB

Key insights: Coronavirus impacts

- Past viral outbreaks have typically had short-lived global and (NZ economic) impacts.
- It is early days, but we anticipate that disruptions associated with the coronavirus deliver an approximate 0.6% hit to Q1 NZ GDP.
- Should the coronavirus impact prove more widespread and longer-lasting, we'd expect more widespread and longer-lasting impacts on the NZ economy. OCR cut(s) and fiscal stimulus would follow.

Later today we will publish an economic note, setting out of the some of the potential impacts of the coronavirus on the NZ economy. Here, we include a short summary of the key points.

Key take outs

The situation is evolving very quickly. Close to 38,000 cases of the coronavirus have been confirmed in at least 28 countries since the start of the year. More than 800 persons have died. The vast majority of cases and deaths have been in mainland China.

Viral outbreaks typically result in a sharp, but relatively brief, shock to both the NZ and global economies. Outcomes are highly sensitive to the location, severity and duration of the outbreak and measures taken to control it. The mortality rate of the coronavirus looks to be low, but its long incubation period makes early detection and containment difficult. The virus is still spreading rapidly and the number of confirmed cases is well above that of the close to 8,000 cases reported in the 2003 SARS (severe acute respiratory syndrome) outbreak.

The epicentre of the outbreak, **China, is both the growth engine for the global economy and New Zealand's largest trading partner**. Already there are signs of a larger proportionate hit to global tourism from the virus. Economic impacts are also occurring because of the extensive (and disruptive) efforts to contain the virus that will impede the movement of goods and services.

So far, the coronavirus has not been confirmed in NZ. As such, the economic impacts of the outbreak are likely to be more prevalent for trade-exposed sectors. Extensive media coverage of the outbreak and the risk of it reaching NZ may also trigger more widespread economic impacts.

For the NZ tradable sector, the impacts are likely to be uneven. Given the timing of the outbreak around the timing of the Chinese New Year Holiday, the impacts are especially acute for the tourism and education sectors. The goods sector will be impacted to varying degrees. There could also be some disruption for NZ imports, given the impact of the outbreak on global supply chains.

All up, we expect a 0.6% hit to Q1 GDP relative to our baseline, primarily via lower services exports. We assume that growth quickly recovers but note the risk of longer-lasting disruptions to NZ exports and broader economic activity. The spread of the outbreak to NZ could significantly weigh on wider economic activity. The hospitality, retail and transport sectors will likely feel the brunt if an outbreak is detected here.

We are not detecting many adverse signs of the virus impact via financial channels. Many of the economic shock absorbers look to be working: the NZD and interest rates are lower than they would otherwise be. A severe outbreak of the virus in NZ could see the NZD fall and markets price in greater risk to the NZ economy.

For now, **we expect NZ policymakers will remain watchful and concentrate efforts on limiting the spread of the outbreak.** If, however, the virus reaches NZ, additional policy support will be required. The RBNZ will move the OCR lower. Fiscal policy will also have a key role to play

ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6403	0.6464	0.6612	0.6749	FLAT	0.6330	0.6500	UP
NZD/AUD	0.9606	0.9656	0.9623	0.9539	FLAT	0.9500	0.9715	FLAT
NZD/JPY	70.23	70.14	72.42	74.08	FLAT	69.00	73.00	FLAT
NZD/EUR	0.5849	0.5833	0.5952	0.5951	FLAT/UP	0.5830	0.6000	UP
NZD/GBP	0.4966	0.4912	0.5059	0.5212	FLAT/UP	0.4900	0.5100	UP
TWI	71.5	71.7	72.6	73.23	FLAT/UP	N/A	N/A	FLAT/UP

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

NZD Recap

The NZD/USD slipped to a fresh 2½ month low last week around 0.6400.

While it's tempting to link the NZD's woe's to coronavirus-related risk aversion, it's notable that most 'risk' indicators actually improved over the week. The VIX index (a risk aversion indicator based on the volatility of the S&P500) ended the week lower than where it began, US equities crested new highs, and 'safe-haven' currencies like the JPY and CHF were actually amongst the worst performers.

Broad-based strength in the USD was the driving force in currency markets last week, not on safe-haven flows, but on continued signs of economic outperformance. Friday's employment report was simply the latest evidence of such. Both employment (225k vs. 165k expected) and wage growth beat street expectations.

Near-term outlook

It's difficult to be confident about currency direction in the middle of a global shock. Things are moving rapidly and headlines and (mis)information are swirling. Still, we're looking for some stabilisation in the NZD this week. The currency has fallen steadily this year. It's now down over 3 cents and well into "oversold" territory according to the daily RSI.

We're also wary of the risk that the RBNZ is not as gloomy as market pricing implies, at its meeting on Wednesday. The economy is responding to last year's 75bps of OCR cuts and the Bank may nudge its published OCR track fractionally higher as a result. This would certainly help steady the NZD.

We're releasing our inaugural Corporate Hedging Toolbox today. It's our practical guide to what recent movements in financial markets mean for corporates managing FX and interest rate exposures. We also offer some hedging considerations to address some of the challenges facing corporate treasuries.

Medium-term outlook

We expect the NZD to remain on a gradual uptrend through the first half of 2020, although our view of a still-strong USD is expected to cap the extent of NZD/USD strength. We also expect the NZD/AUD to continue rising over 2020, as the NZ economy continues to outperform that of Australia. In NZ we expect only one more OCR cut from the RBNZ while in Australia we expect two more RBA cuts. mike.jones@asb.co.nz

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

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	1.25	1.27	1.24	1.91	UNCH/DOWN	UP
2-year swap	1.13	1.07	1.18	1.79	UNCH/DOWN	UP
5-year swap	1.18	1.11	1.31	1.95	UNCH/DOWN	UP
10-year swap	1.49	1.38	1.65	2.40	UNCH/DOWN	UP
10-year govt bond yield	1.29	1.24	1.49	2.11	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.37	0.31	0.47	0.61	UNCH	DOWN

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

Market Recap

Local and global yields remained volatile last week, with rates generally higher and curves steeper than this time last week. Earlier last week, signals that Chinese and global authorities were committed to controlling the coronavirus outbreak helped push global equity markets and interest rates higher. Local yields were supported by the climb in Australian yields after the Reserve Bank of Australia held the cash rate at 0.75%, with a speech by Governor Lowe reiterating that the Australian economy was "passing through a gentle turning point for the better". **Global yields ended the week on a softer note on heightened coronavirus fears as the outbreak continued to spread**, with more than 37,000 cases reported worldwide in at least 28 countries (including Australia) and with more than 800 deaths. US Treasury yields were lower despite strong US payrolls data. There was minimal impact on NZ yields from the lift in surveyed inflation expectations from Friday's RBNZ survey.

Near-term NZD interest rate outlook

Our near-term bias is for local yields to remain under downward pressure. The near-term direction of NZ and global yields will largely depend on how well markets have allowed for the (highly unknown) impact of the coronavirus and some volatility is to be expected. **No coronavirus cases have been reported in NZ yet, but the disruption from the outbreak represents a significant headwind to both local and global growth that could trigger more policy support.** The RBNZ is widely expected to hold the OCR at 1% on Wednesday, but local yields will likely decline and markets increase the probability of OCR cuts (12-13bps of cuts currently priced in) if the RBNZ talks up the risks to the policy outlook posed by the coronavirus. Overseas updates on the spread of the coronavirus will be watched closely, as will developments in the Chinese economy. We do not expect the virus impact to show up in the published data for a while yet. CPI inflation in China, US core inflation and retail sales data are unlikely to trigger much market reaction.

Medium-term outlook

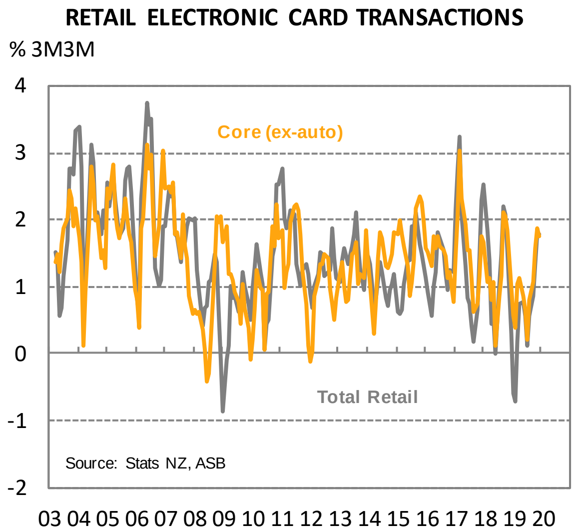
We have pencilled in a 25bp RBNZ cut in May (to 0.75%), with risks of the OCR being on hold for longer. We then expect a series of gradual OCR hikes from 2022 (OCR endpoint of 2.25%). The RBA is expected to cut the 0.75% cash rate by 50bps in 2020 (April, Aug), taking it to the 0.25% effective lower bound. The 1.50%-1.75% Federal Funds rate is expected to be cut by 50bps in 2020 (Sep, Dec). Low inflation, moderate global growth and negative (but receding) risks should cap NZ and global long-term interest rates at low levels. mark.smith4@asb.co.nz

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	1.00	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.2	1.3	1.2	1.0	1.0	1.3	1.8
NZ 2-year swap rate	0.9	1.3	1.1	1.0	1.0	1.3	1.7
NZ 5-year swap rate	0.9	1.4	1.2	1.1	1.2	1.5	1.9
NZ 10-year swap rate	1.2	1.8	1.4	1.3	1.4	1.6	2.0
NZ 10-year Bond	1.1	1.7	1.2	1.1	1.2	1.4	1.8

Domestic events

Data	Date	Time (NZT)	Market	ASB
Electronic Card Transactions, Retail, % mom	12/02	10:45 am	0.5	0.5
RBNZ February MPS, OCR, %	12/02	2:00pm	1.0	1.0
Food prices index, Jan, % mom	14/02	10:45 am	-	1.3

Both retail and core card spending declined sharply in December after earlier posting close to 3% monthly increases in November due to the Black Friday boost for electronics retail and rebounding consumable, apparel, and hospitality retail. **We expect a modest January monthly increase for retail spending which should see the 3-monthly growth in spending accelerate to around 2%.** Consumers are in a more positive mindset and are translating this into more spending. The perkier housing market, low interest rates, fiscal stimulus, low unemployment and higher wage growth look set to remain key supports to consumer spending over 2020. We will be watching over the next few months to gauge potential impacts to retail spending from the coronavirus outbreak.



We expect the RBNZ to hold the OCR at 1.00% and reiterate that developments do not warrant a change in the monetary policy outlook, but to signal preparedness to lower the OCR if needed. The coronavirus outbreak has increased uncertainty over the policy outlook. At this point we doubt that the RBNZ will incorporate the potential impacts of the outbreak into its central published forecasts and OCR track. The outbreak, however, will influence the RBNZ's characterisation of risks. We still expect the RBNZ to hold out the prospect of further policy stimulus and have pencilled in a 25bp cut in 2020. Provided the economy smoothly navigates various headwinds, however, 1% may be the floor in the OCR this cycle.

We expect a seasonal rise in January food prices of around 1.3%, driven by higher prices for food and vegetables, with meat and grocery prices typically rising in January as well. Strengthening global food commodity prices present some upside risk to our circa 2-3% annual food price inflation forecasts over 2020, although we will be closely watching for signs of coronavirus-driven impacts on global food prices.

Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
China CPI, January, %yoy	10/02	2:30 pm	4.9	4.8
Australia Value of Total Home Loans, Dec, %yoy	11/02	1:30 pm	1.6	2.0
UK GDP, Q4, %qoq	11/02	10:30 pm	0.0	-
RBA Governor Lowe panel participation	13/02	1:15 pm	-	-
US CPI, January, %yoy	14/02	2:30 am	2.4	2.4
Eurozone GDP, Q4, %qoq	14/02	11:00 pm	0.1	
US Retail Sales, January, %yoy	15/02	2:30 am	0.3	

**Originally published by CBA Global Markets Research on Friday 7th February at 2:12 pm*

We expect **China's CPI inflation** to rise to 4.8%yoy because of seasonal effects caused by the moving Lunar New Year. The Government's actions to contain the coronavirus spread have disrupted logistics and might also add to upward pressure on inflation.

Monthly **lending data for housing in Australia** have picked up, rising 1.8% in November and 17.6% since the trough in May 2019. Lending to owner-occupiers is rising faster than lending to investors. This pick-up in lending is helping propel gains in house prices. Leading indicators of the property market also suggest lending should continue to lift, including CBA's home buying component of the Household Spending Intentions data which is rising strongly and is close to record highs.

Reserve Bank of Australia (RBA) Governor Lowe delivered an upbeat message on the Australian economy in his speech *The Year Ahead* but he also set the condition for a further rate cut – "if the unemployment rate were to be trending in the wrong direction and there was no further progress being made towards the inflation target". It is expected that Lowe's patience and tone of 'no change' will be maintained. Of interest would be any more substantial comments on the impact of coronavirus after previously commenting that it was too early to assess the overall impact.

The Bank of England (BoE) projects the **UK's real GDP** to be flat in Q4 after expanding 0.4% over the previous quarter. Services sector output growth of 0.1% in the three months to November is expected to be offset by a 2% decline in manufacturing output.

The small fall in retail gasoline prices will modestly weigh on **headline US CPI**. But the solid labour market will keep core inflation above 2%yoy.

Growth in total **US retail sales** is likely to keep steady at a solid 0.3%. Growth in 'control' retail sales is likely to soften to 0.2% following December's strong 0.5% increase.

The first estimate of the **Eurozone's Q4 GDP growth** printed at 0.1%qoq. This was weaker than the ECB projection of 0.3%qoq. The second estimate is expected to confirm sluggish Q4 economic activity and detail the GDP variation by expenditure components.

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	0.8			
GDP real - A%	2.3	1.8	1.3	2.0	3.5	2.8	2.7
GDP real - AA%	2.7	2.3	1.9	1.9	2.6	3.0	2.7
CPI - Q%	0.7	0.5	0.3	0.6			
CPI - A%	1.5	1.9	2.1	2.1	2.3	2.0	1.8
HLFS employment growth - Q%	0.2	0.0	0.2	0.3			
HLFS employment growth - A%	1.0	1.0	1.2	0.8	1.7	1.6	1.4
Unemployment rate - %sa	4.1	4.0	4.2	4.3	4.1	3.8	3.8
Annual current account balance as % of GDP	-3.3	-2.9	-2.7	-2.7	-2.8	-3.0	-2.8

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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NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

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