

Economic Weekly

10 August 2020

RBNZ unlikely to fall for labour market dummy

We haven't materially changed our view of the NZ labour market following last week's "rogue" unemployment number. Despite what you might have thought, unemployment was revealed by Stats NZ to have *fallen* in the three months to June (to just 4% no less), a period encompassing nearly all of lockdown and in which we estimate the economy went backwards to the tune of 17%. Of course, unemployment didn't really fall. It's more that Stats had some trouble with measurement and laid-off workers were unable to "actively" seek work during lockdown.

Some of the broader indicators we'd suggested following (e.g. hours worked, underutilisation) deteriorated markedly, and about as much as expected. Underneath the veneer of the wage subsidy, the jobs market is softening. And as roughly 450,000 workers roll off the subsidy in coming weeks things will get tougher. We still expect unemployment to rise into the "7s" in coming quarters, but have nudged out the forecast peak in unemployment to March 2021, from December.

We doubt the RBNZ will fall for the "dummy" offered by the Q2 labour stats. The RBNZ is forward-looking and will be wary of the fact employment is likely to undershoot its Maximum Sustainable Employment target for some time. This is part of the reason we expect the Bank to maintain a cautious tone at Wednesday's meeting, despite NZ economic activity clearly exceeding its prior forecasts. We released a note last week [ranking](#) the options available to the Bank if it needs to ease monetary policy again. We argued that time is now on the Bank's side now and it doesn't need to announce further easing measures this week. But we could see some fine-tuning of its quantitative easing programme including a small lift in the current \$60b cap and an extension to its expiry.

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Chart of the week



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6594	0.6635	0.6547	0.6490	FLAT	0.6480	0.6800
NZD/AUD	0.9221	0.9293	0.9443	0.9532	FLAT	0.9100	0.9400
NZD/JPY	69.85	70.20	70.01	68.77	FLAT	68.20	71.70
NZD/EUR	0.5599	0.5632	0.5808	0.5796	FLAT	0.5460	0.5740
NZD/GBP	0.5054	0.5068	0.5203	0.5348	FLAT	0.4930	0.5180
TWI	71.9	72.1	72.3	72.01	FLAT	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/USD starts the week a touch weaker, mainly after pulling back on Friday as US labour market figures were stronger than anticipated, bolstering the USD. The weekend also started with a cloud over the US Congress' inability to agree on a new COVID support package even though the previous package has already expired. President Trump signed an executive order over the weekend, though it is unclear how workable it is (see Outlook below).

The AUD is holding its ground against the USD and NZD despite the COVID restrictions that Victoria is experiencing. Gold prices have hit record levels and iron ore prices are elevated, meaning the AUD is getting support from its commodity base even while 25% of the economy is dealing with constraints. The RBA's policy announcement on Tuesday and forecast details in Friday's Statement on Monetary Policy had little impact on the AUD, although detailed a lower for longer growth outlook.

Outlook

Over the course of the week the USD will be caught up in various tugs of war. US data have been encouraging in showing the US economy has been rebounding from earlier lockdown impacts. But the continuing spread of COVID-19 is raising concerns about the future path of growth. Fiscal support remains uncertain: the US Congress failed to reach agreement last week on a new support package. Over the weekend President Trump signed an executive order that requires state agreement (and contributions) for workers to receive further support, and it is unclear how workable this is given the states have precarious budget positions. And US-China trade tensions remain in the background as a risk-on/off driver.

Overseas events aside, the NZD's main guiding light this week will be the RBNZ's Monetary Policy Statement on Wednesday afternoon. There is no immediate urgency to deliver more stimulus, but the RBNZ indicated it will clarify the outlook for unconventional policy tools. The RBNZ could boost the ceiling of the Large Scale Asset Purchase programme to \$80bn from \$60bn, implicitly extending the duration for which the RBNZ could continue purchasing bonds. Doing so would take the market's focus off what will happen next May when the LSAP programme in its current form is due to end. Indicating that the programme is likely to continue for longer would help contain long-term yields. Any expansion of the LSAP, or talking up of the prospect of a negative OCR, are likely to weigh on the NZD.

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ASB foreign exchange forecasts

(end of quarter)

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>				
NZD/USD	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	69	66	66	67	69	67
NZD/EUR	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	71.4	71.1	71.7	72.1	73.6	71.4

Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	0.25	0.25	1.00	UNCH	UP
90-day bank bill	0.30	0.30	0.31	1.21	UNCH	UP
2-year swap	0.20	0.20	0.22	0.99	UNCH	UP
5-year swap	0.30	0.29	0.35	0.99	UNCH	UP
10-year swap	0.66	0.64	0.74	1.29	UNCH	UP
10-year govt bond yield	0.79	0.75	0.98	1.09	UNCH	UP
Curve Slope (2s10s swaps)	0.46	0.44	0.52	0.30	UNCH	DOWN

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

Market Recap

NZ yields start the week little changed, with moves in NZ rates sandwiched between slightly higher US yields and slightly lower Australian counterparts. There was very little movement in NZ swap yields, with those for the bellwether 2-year rate oscillating around 0.20%. 10-year yields for the 10-year swap look to be stabilising around 0.65% after earlier grinding lower. NZ Government bond yields rose fractionally, with the \$940m in RBNZ asset purchases and low NZ Government Bond issuance helping to keep yields very, very low. There was limited reaction in the rates market to the stronger than expected NZ Q2 unemployment print.

US 10-year Treasury yields start the week at the upper part of recent trading ranges (0.56%), with US yields nudging higher following the stronger than expected US labour market report. Both July Non-farm Payrolls (1,763k) and the unemployment rate (10.2%) beat market expectations. Over the weekend President Trump signed new executive orders to provide some stop-gap funding to temporarily extend unemployment benefits to USD400 per week.

Australian yields were lower, with yields for the 3-year bond at around 0.26% and the yield curve flattening. The RBA's economic forecasts were significantly different to those in May, with a later and more gradual rebound expected with the RBA acknowledging the "extreme uncertainty" over the outlook given COVID-19. The disruption and damage caused by COVID-19 has prompted central bankers to up their potential policy responses. The Bank of England held current policy settings but left the door open to pushing policy rates into negative territory, signalling a modest change in tone.

Near-term interest rate outlook

We expect yields to remain very, very low with few catalysts to push them markedly higher. Our worry is that the flaring up of COVID-19 cases and risk of a 2nd wave will derail the global economic recovery, dampen yields and further flatten curves. The global COVID-19 count is approaching 20 million and has now topped 5 million in the US, showing few signs of slowing.

We expect a dovish statement by the RBNZ that will not rule out further policy support, including the potential for the OCR to move lower once operational hurdles are cleared. We expect the RBNZ to increase the cap on their Large-Scale Asset Purchase programme from \$60bn to \$80bn, so as to allow the Bank to maintain the current pace of asset purchases for longer if need be (see our preview [here](#)).

A break though in the current stalemate between the Democrats and the White House over fiscal support packages would help push yields higher, but with talks having broken down at the end of last week an imminent breakthrough looks unlikely. Forthcoming data such as July Australian employment data (mkt: +30k), US CPI, and initial jobless claims and monthly Chinese retail sales, industrial production data will be watched.

Issuing more bonds via syndication has helped to cap the NZ weekly bond tender, with \$1bn in NZ Government bonds set to be tendered this week. Steady RBNZ bond purchases should help keep the NZ yield curve flat.

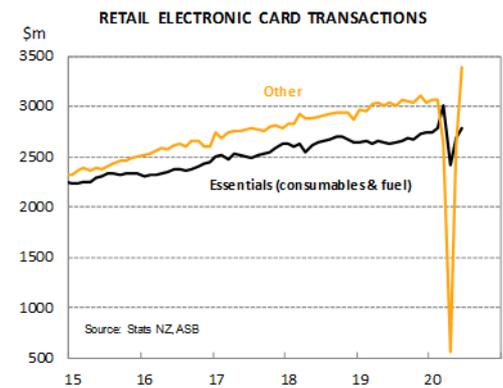
Medium-term outlook

We don't expect the OCR to move above its 0.25% operational lower bound until at least 2024. The RBNZ is expected to raise its \$60bn asset purchase programme to \$80bn in August, with expanding QE more likely than OCR cuts. Fears of a 2nd wave of COVID-19 should help to cap longer-term global and NZ interest rates and keep the curve flat despite high public debt issuance. mark.smith4@asb.co.nz

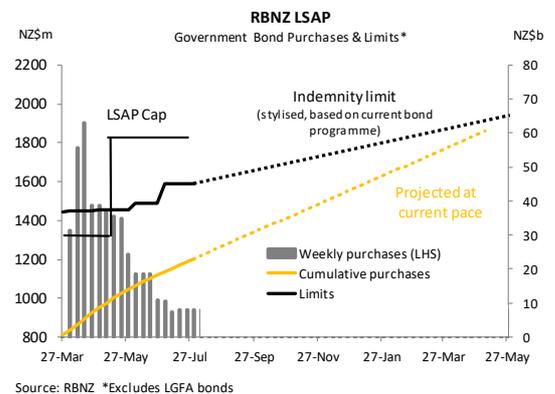
Domestic events

Data	Date	Time (NZT)	Market	ASB
Electronic Card Transactions, Retail, July, % mom	11/08	10:45am	-	+2%
RBNZ August Monetary Policy Statement, QE cab \$bn	12/08	3:00pm	-	80

We expect July to show the return to a more moderate pace of retail spending growth following two months of double-digit increases. The 2% monthly increase we expect will leave retail card spending about 10% above year-ago levels and up by a similar margin compared to February. Driving the moderation will be slowing retail growth in durables, hospitality and apparel spending after a frenetic couple of months. Pent-up demand, nest-building by households and the urge to support local retailers should underpin retail sales over the next few months. Our proprietary ASB card spending data suggest that consumers have not retreated into their shells. However, rising unemployment, few overseas visitors and weak household income growth point to a soft outlook for card spending towards the end of 2020.



The RBNZ is widely expected to hold the OCR at its 0.25% operational low and to pledge not to change OCR settings till early next year. **Focus will centre on the RBNZ Large Scale Asset Purchase programme** and other unconventional policy tools. To reassure markets, the **asset purchase cap could be lifted to \$80b as an interim step so as to allow the Bank to maintain the current pace of asset purchases for longer if need be.** We also hope to see further details on the timing of the programme clarified. We don't expect the scope of asset purchases to be expanded and the indemnity with the Finance Minister will likely be left where it is. The RBNZ is expected to reassure markets that it has a number of other policy options available (including a negative OCR if operational hurdles are cleared) that it will be prepared to exercise if needed.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Card Spending, week ended 7 Aug	11/08	-	-
Australia NAB Business Survey, July	11/08	1:30 pm	-
Australia Weekly Payrolls, week ended 25 Jul	11/08	1:30 pm	-
Australia Wage Price Index, Q2, %	12/08	1:30 pm	0.3
US CPI Inflation, July, % mom	13/08	12:30 am	-
RBA Gov. Lowe Appearance before the House of Reps	13/08	11:30 am	-
Australia Employment, July, 000's	13/08	1:30 pm	+50
China Industrial Production, July, % yoy	14/08	2:00 pm	5
US Retail Sales, July, % mom	15/08	12:30 am	2.5
US Industrial Production, July, % mom	15/08	1:15 a,	2.0

*Originally published by CBA Global Markets Research on Friday 7 August at 2:31 pm

This week's Australian card spending data will capture five days of the new lockdown and we expect a profound impact on consumer spending from the lockdown. Data for the week ending 31st July showed spending growth slowed over the week to be just 3% higher than a year ago.

In the June Australia NAB Business survey, both conditions and confidence continued to rebound but remained weak in level terms. The impact of the restrictions for Metropolitan Melbourne on 8 July may weigh on both conditions and confidence in the July survey.

The Australian weekly payrolls will likely offer a timely read on what is happening in the labour market and is for the week ending 25 July. The latest ABS payroll data to 11 July showed the direction of jobs and wages has turned and begun trending downwards since mid-June. The unfolding situation in Victoria, in particular the lagged effect of the Stage Three restrictions, will likely weigh on payroll data. In July, we expect monthly Australian employment to rise by 50k and the unemployment rate to lift to 7.9%.

We forecast quarterly wages growth to have stepped down to 0.3% in Q2 from 0.5% in Q1. We expect a number of workers to have had their pay frozen over Q2 and some may have taken a pay cut.

Governor Lowe will appear before the House of Representatives Standing Committee on Economics. Governor Lowe will deliver a speech followed by fielding questions from Parliament in a Q&A session. At this stage we still believe negative rates are off the table.

We estimate US CPI rose 0.4% mom in July, largely driven by a 3.3% rise in gasoline prices over the month. We estimate core inflation was more muted, rising just 0.2% mom. Excess capacity will constrain underlying inflation pressures for some time.

We forecast Chinese CPI inflation to lift to 2.7% yoy in June because of rising food and pork prices. Interim data pointed to a continued Chinese economic recovery in July. We expect Chinese retail sales to grow by 0.5% mom in July, the first annual growth this year. The better-than-expected July manufacturing PMI suggests Chinese industrial production growth may tick up to 5%/yr. Rising infrastructure investment and property investment may push the year-to-date contraction in overall fixed asset investment to 1.5% yoy in July.

We estimate a 2.5% mom increase in US retail sales in July, supported in part by higher gasoline prices. Daily US card spending data increased strongly in July, but by much less than in May and June. Meanwhile, we expect US industrial production continued to recover from its April trough in July. However, the pace of activity is slowing. The risk is industrial production slows further in coming months if US consumer demand remains weak.

Key Forecasts

ASB NZ economic forecasts

	Mar-20 << actual	Jun-20 forecast >>	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	-1.6	-16.8	14.7	1.1			
GDP real - A%	-0.2	-17.1	-5.7	-5.1	-3.8	2.7	4.9
GDP real - AA%	1.5	-3.3	-5.3	-7.0	-7.9	5.1	4.6
CPI - Q%	0.8	-0.5	0.5	0.0			
CPI - A%	2.5	1.5	1.3	0.8	0.4	1.4	1.6
HLFS employment growth - Q%	1.0	-0.4	-2.6	-1.1			
HLFS employment growth - A%	2.2	1.1	-1.9	-3.2	-4.2	2.1	2.7
Unemployment rate - %sa	4.2	4.0	6.6	7.1	7.4	6.9	5.9
Annual current account balance as % of GDP	-2.7	-2.4	-1.8	-1.7	-2.0	-0.8	-0.4

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

	Mar-20 << actual	Jun-20 forecast >>	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)							
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	0.51	0.30	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	0.53	0.21	0.20	0.20	0.20	0.35	0.55
NZ 5-year swap rate	0.63	0.35	0.30	0.30	0.35	0.55	0.75
NZ 10-year swap rate	0.93	0.74	0.75	0.80	0.85	1.05	1.25
NZ 10-year Bond	1.03	0.91	0.80	0.85	0.90	1.10	1.25

ASB foreign exchange forecasts

	Mar-20 << actual	Jun-20 forecast >>	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)							
NZD/USD	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	69	66	66	67	69	67
NZD/EUR	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	71.4	71.1	71.7	72.1	73.6	71.4

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