

# Economic Weekly

11 May 2020

## Three cheers for progress

In these bizarre and unpredictable economic times, businesses could use a little certainty. We're hopeful this week brings three doses. And by the end of the week we not only have a little more certainty about the outlook, but a little more confidence too. Certainly, this week's "Big Three" have massive potential to determine the economy's lockdown escape velocity. Today, Cabinet decides whether NZ will move to the Level 2 alert level later in the week. Wednesday brings the first 'COVID-edition' RBNZ Monetary Policy decision, and Thursday is the Budget. For a timely reminder of what's at stake, look no further than Friday's surge in US unemployment to 15%, and the mind-boggling 20.5 million jobs lost. That's for April, just one month into the COVID crisis.

For our detailed expectations of the RBNZ meeting and Budget, check out last week's previews ([here](#) and [here](#)). But for some high-level flavour of what's to come, see below:

- The Budget will show the Government's cash splash switching focus slightly, from one of support to one of stimulus, now that the economy is in re-start mode. We expect a near doubling of the COVID-19 response to date, bringing about more debt (up and over 60% of GDP) and a much larger bond programme.
- Infrastructure, health, education, and a possible extension of the wage subsidy are all likely targets for the extra spending.
- Treasury's economic forecasters might sound a bit more chipper; we look set to enter Alert Level 2 around two weeks earlier than the "best-case" scenario estimated by Treasury last month.
- The RBNZ will near double its bond buying (quantitative easing) programme, to \$60b, as it accommodates the larger debt issuance plans of the NZ government. The OCR will be left at 0.25% and, while we don't expect a negative OCR anytime soon, we doubt the Bank will rule this option out.

Finally, bear in mind that in a crisis such as this, the policy response is a moving feast rather than a one-off buffet. We won't get all the answers this week, and some ammunition will be stored rather than spent. That's appropriate given the economic worst is yet to come. But at least we'll have some progress. [mike.jones@asb.co.nz](mailto:mike.jones@asb.co.nz)

### Recent COVID-19 publications

#### ASB Economic forecasts and monitoring:

[Thinking about the new normal for housing](#)

[ASB COVID-19 Chart pack](#)

[COVID-19 and the economic path ahead \(central forecasts\)](#)

[COVID-19 possible paths in an uncertain future \(alternative scenarios\)](#)

#### Financial market trends:

[COVID-19: Market stocktake and what we are watching](#)

[ASB Podcast for investors](#)

#### Policy response:

[RBNZ QE upside likely in May](#)

### Where to find support

[ASB financial support package](#)

[Government support package](#)

[COVID-19 alert system explainer](#)

For these publications and more COVID-19 research, see [here](#)

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6137	0.6023	0.6015	0.6587	FLAT	0.6000	0.6310
NZD/AUD	0.9401	0.9427	0.9655	0.9425	FLAT/DOWN	0.9250	0.9600
NZD/JPY	65.43	64.28	65.55	72.25	FLAT	63.80	67.10
NZD/EUR	0.5665	0.5505	0.5536	0.5867	FLAT	0.5520	0.5810
NZD/GBP	0.4945	0.4839	0.4856	0.5064	FLAT	0.4830	0.5080
TWI	69.4	68.2	68.7	72.10	FLAT/DOWN	N/A	N/A

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

### NZD Recap

Both the NZD and the AUD rallied against the major currencies over the past week, up against the USD, JPY, EUR and GBP. The NZD was largely steady against the AUD, hovering around 0.94 for much of the week. Global investor sentiment started the week on a more cautious tone as US-China tensions escalated over a dispute on the origins of COVID-19. President Donald Trump and Secretary of State Mike Pompeo have pinned the blame for the coronavirus pandemic on China, with the latter claiming said there was “a significant amount of evidence” that the virus emerged from a laboratory in the central Chinese city of Wuhan. However, financial markets quickly shrugged off concerns, and instead focused on the positives, in particular an easing in lock-down restrictions across a number of countries including Italy, Finland, Denmark, Austria, Spain, Greece, Portugal and Germany and in most US states. Sentiment improved further heading into the weekend, boosted by reports of constructive trade talks between the US and China, enabling financial markets to shrug off the dire (but largely anticipated) US April employment figures. The US unemployment rate increased to ‘only’ 14.7% (vs. expectations of 16.0%). The unemployment rate would have been reported closer to 20% but for misclassification of workers who were temporarily laid off, along with the record monthly slump in the participation rate (it’s very difficult to look for a job when in lock down).

### Outlook

Global investor sentiment is likely to remain mixed this week. On one hand, we expect encouraging Chinese economic data may boost investor sentiment. But on the other, any further reports on escalating US-China tensions may undermine hopes for global recovery prospects. NZD/USD upside may be limited this week, particularly given the focus on the Reserve Bank of New Zealand’s (RBNZ) quantitative easing (QE) program and Budget 2020. On Wednesday, we expect the RBNZ will expand QE to \$NZ60bn from the \$NZ30bn initially announced. The increase in the QE program is necessary to keep up with large government bond issuance. Meanwhile, on Thursday the NZ Government’s Budget is expected to show net government debt tripling to above 60% of GDP in 2020.

The relative asset purchase trend between the Reserve Bank of Australia (RBA) and the RBNZ favours a weaker NZD/AUD. The RBA has so far bought A\$51.4bn (2.6% of GDP) of government bonds since QE started on 20 March, tapering its buying in recent weeks. Meanwhile, the RBNZ’s cumulative purchases of New Zealand government bonds currently stands at about NZ\$9.6bn (2.9% of GDP) but, unlike the RBA, the RBNZ has not tapered its bond purchases to date. [jane.turner@asb.co.nz](mailto:jane.turner@asb.co.nz)

### ASB foreign exchange forecasts

(end of quarter)

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>					
NZD/USD	0.67	0.60	0.55	0.58	0.60	0.61	0.64	0.65
NZD/AUD	0.96	0.97	0.96	0.97	0.95	0.94	0.94	0.94
NZD/JPY	73	65	54	58	61	63	67	69
NZD/EUR	0.60	0.54	0.47	0.51	0.53	0.54	0.57	0.58
NZD/GBP	0.51	0.49	0.46	0.47	0.48	0.48	0.49	0.50
NZD/CNY	4.7	4.3	3.9	4.1	4.2	4.3	4.5	4.6
NZD TWI	73.8	68.8	63.7	66.6	68.1	68.8	71.5	72.4

## 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	1.50	UNCH	UP
90-day bank bill	0.27	0.26	0.45	1.70	UNCH/UP	UP
2-year swap	0.18	0.18	0.45	1.62	UNCH/UP	UP
5-year swap	0.32	0.31	0.61	1.75	UNCH	UP
10-year swap	0.72	0.69	1.00	2.14	UNCH	UP
10-year govt bond yield	0.72	0.58	0.98	1.82	UNCH	UP
Curve Slope (2s10s swaps)	0.54	0.51	0.55	0.52	UNCH	DOWN

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

### Market Recap

NZ yields start this week a fraction lower from a week ago and around record lows. The last week was characterised by periodic bouts of volatility. There was little reaction to NZ's Q1 Labour Market data, with the decline in surveyed NZ inflation expectations to record lows pushing yields lower. RBNZ purchases of \$1.35bn of NZ Government bonds dampened yields. As was widely expected, the RBA held the cash rate and three-year bond yield target at 0.25%, but yields eased following the bleak RBA assessment of the economy on Friday's RBA Statement Monetary Policy. There was little reaction after the Bank of England held the policy rate at 0.1% and maintained its QE programme of £645m.

The economic reality of widespread global shutdowns is becoming increasingly evident and global yields are very low, with Treasury yields down this week. US Federal Fund futures briefly fell below zero and short-term Treasury yields eased as markets speculated on the possibility of cuts to the 0%-0.25% Federal Funds rate. At the end of the week, hopes of a thaw in US and Chinese relations and better than feared US labour market data – a record 20.5 million decline in Non-farm Payrolls and a surge in US unemployment rate to 14.7% - pushed Treasury yields up.

### Near-term interest rate outlook

The market is pricing in around 20bps of OCR cuts by the end of the year. However, this week we expect the RBNZ to maintain its forward guidance of holding the OCR at 0.25% for the time being, which could push NZ short-term yields higher. Countering this will be the RBNZ signalling a Quantitative Easing programme in the region of \$60bn, well above the current \$33bn package. RBNZ bond purchases of \$1.35bn this week should help cap yields at the margin.

The focus on Thursday will be the magnitude of future Crown borrowing signalled in Budget 2020. We anticipate an additional \$100bn or so in Government borrowing through till 2022/23 will be announced. So far, RBNZ QE has been sufficient to hold down local yields, but this could be tested over the next few months if the fiscal outlook and Government borrowing continues to deteriorate. We expect the NZ Government to announce an additional \$20bn in economic support on Thursday, which should support local yields.

The direction of yields will hinge on whether we see a flare-up in COVID-19 cases. With countries around the world easing restrictions, the hope is that the global economy can restart, pushing yields up. Fresh infections in China, South Korea and Germany highlight the risks of reopening the economy, with the return to shutdowns potentially pushing yields lower still. April data around the world are expected to be terrible. Australia is set to shed more than half a million jobs, with US retail sales expected to be down 12%, US CPI falling and Chinese retail sales down 5% yoy.

### Medium-term outlook

Central bank policy rates are expected to maintain highly accommodative settings. Given the risks to the outlook we don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. The OCR could move lower if the RBNZ deemed this to be operationally feasible to do so, but we view QE to be a more effective option at this stage. Weak global activity and continued central bank asset purchases should cap longer-term NZ interest rates despite a mountain of global public debt issuance. [mark.smith4@asb.co.nz](mailto:mark.smith4@asb.co.nz)

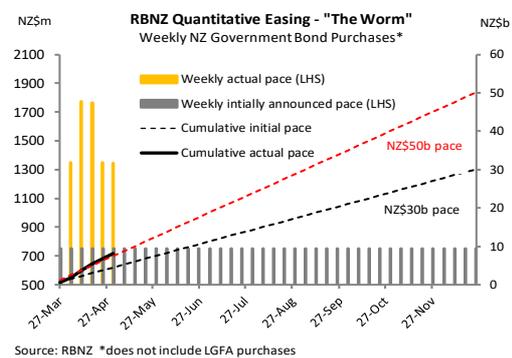
## Domestic events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook Survey, May, Prelim, own activity net%	11/05	1:00pm	-	-
RBNZ Quantitative Easing bond purchase programme	13/05	2:00pm	-	\$60bn
Budget 2020, Operating Balance 2020/21 % of GDP	14/05	2:00pm	-	-12.8%

**Business confidence plunged to unprecedented lows in April** and is consistent with our expectation of a 7% contraction in the economy over 2020. Business confidence may improve slightly in May as the NZ economy transitioned from Alert level 4 to Alert level 3 in late April. The shift to Level 3 will allow many in the ‘non-essential’ industries to return to work – but likely at a reduced operating capacity in order to maintain a safe distance between staff and customers. Meanwhile, others must remain closed until Level 2 starts, in particular some services (i.e. hairdressers) and arts and sports facilities.

### A key focus of the Reserve Bank of New Zealand’s May

**Monetary Policy Statement** will be by how much the Monetary Policy Committee (MPC) decides to lift its quantitative easing (QE) programme. We expect the size of the programme could be lifted to \$60b, from the \$30b initially announced. At the time the current \$30b QE programme was announced it was large enough to purchase approximately 50% of all NZ government bonds on issue over the coming 12 months. That is no longer the case. We now project nominal government bonds outstanding will rise to around \$70b by June 2020 and \$110b by June 2021 as the Government’s COVID package increases and broadens. Meanwhile, we and the consensus expect the OCR to be left at 0.25% as the RBNZ effectively pledged in March to keep the OCR at 0.25% for 12 months (which runs out in March 2021) due to bank operational issues over lowering it further.



We expect **Budget 2020** to show the government appropriately running large deficits over the forecast period. Subsequently, net government debt is likely to increase to over 60% of GDP by 2023. In turn, this will require a massive lift in bond issuance. We anticipate that the government will issue over \$40 billion over the next three fiscal years. Looking at just Budget 2020, we expect that the government will roughly double its COVID-19 response package i.e. add an additional \$15 to \$20 billion of new spending.

## Major International Events for the week ahead\*

Data	Date	Time (NZT)	ASB
China CPI, April, %yoy	12/05	1:30 pm	3.5
Australia Treasurer Economic Statement	12/05	-	-
US CPI, April, %mom	13/05	12:30 am	-0.4
Japan Current Account Surplus, March, ¥bn	13/05	11:50 am	1,500
UK GDP, Q1, %qoq	13/05	8:30 pm	1.1
Australia Unemployment, April, %	14/05	1:30 pm	8.0
US Retail Sales, April, %mom	16/05	12:30 am	-12.0

*Originally published by CBA Global Markets Research on Friday 8<sup>th</sup> May at 12:57 pm*

Falling oil prices will be a drag on **China's consumer and PPI inflation** in April. We expect CPI inflation to ease to 3.5%yoy because high-frequency data indicated a continued fall in food and pork prices. We forecast PPI deflation to worsen to 3%yoy. High frequency data suggested major industrial material prices fell in April.

**Australian Treasurer Josh Frydenberg will deliver an Economic Statement** on the same day the 2020/21 Budget is due to be handed down. Frydenberg this past week had noted that the shutdown measures were costing \$A4bn in economic activity each week. Treasury also confirmed its forecasts for Q2 2020. It expects the unemployment rate to reach 10% and GDP to fall by 10%. The market will monitor closely any comments on the timing and scope of easing in restrictions and any proposed tax changes, particularly around company tax and other productivity enhancing reform ideas.

We expect **Japan's March current account surplus** to fall to ¥ 1,500bn because of a narrowing in the merchandise goods trade surplus.

**Australia's April employment report will likely see employment fall** sharply, hours worked will plummet and the participation rate is set to fall by 1ppt. This is driving our forecast for a monumental fall of 550,000 jobs.

We expect headline **US CPI** fell by -1.5%mom in April. Gasoline prices fell by nearly 13% in April. We expect core CPI (ex. food and fuel) declined by 0.5%mom in April. Falling domestic demand amid surging unemployment weighed on prices.

The Bank of England projects **UK GDP** to fall by around 3% in Q1 2020. A bigger quarterly contraction of 25% is pencilled-in for Q2 2020. The central bank anticipates GDP to recover in the second half of 2020 as lockdown measures in the UK and globally unwind.

We expect **US retail sales** tumbled 12%mom in April. The 13% decline in gasoline prices will have subdued retail values. At the same time, surging unemployment and lockdown measures will have suppressed retail sales. We expect 'control' group sales declined by 6%mom in April.

## Key Forecasts

### ASB NZ economic forecasts

	Dec-19 << actual	Mar-20 forecast >>	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.5	0.0	-17.3	11.6	1.8			
GDP real - A%	1.8	0.3	-17.0	-8.1	-6.9	-6.1	2.7	4.8
GDP real - AA%	2.3	1.6	-3.2	-5.8	-8.0	-9.5	4.9	4.6
CPI - Q%	0.5	0.8	0.0	0.5	0.0			
CPI - A%	1.9	2.5	1.9	1.7	1.2	0.8	0.9	1.4
HLFS employment growth - Q%	0.1	0.7	-5.6	-1.5	0.6			
HLFS employment growth - A%	0.8	1.6	-4.7	-6.3	-5.8	-6.1	3.0	2.7
Unemployment rate - %sa	4.0	4.2	8.8	9.2	8.4	8.1	6.9	6.0
Annual current account balance as % of GDP	-3.1	-3.3	-3.7	-3.8	-4.3	-4.8	-3.4	-2.3

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

### 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	0.40	0.45	0.50	0.55	0.65	0.85
NZ 10-year swap rate	1.78	0.93	0.75	0.80	0.90	0.90	0.95	1.05
NZ 10-year Bond	1.65	1.03	0.80	0.90	1.00	1.00	1.05	1.15

### 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	0.55	0.58	0.60	0.61	0.64	0.65
NZD/AUD	0.96	0.97	0.96	0.97	0.95	0.94	0.94	0.94
NZD/JPY	73	65	54	58	61	63	67	69
NZD/EUR	0.60	0.54	0.47	0.51	0.53	0.54	0.57	0.58
NZD/GBP	0.51	0.49	0.46	0.47	0.48	0.48	0.49	0.50
NZD/CNY	4.7	4.3	3.9	4.1	4.2	4.3	4.5	4.6
NZD TWI	73.8	68.8	63.7	66.6	68.1	68.8	71.5	72.4

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