Economic Weekly

14 September 2020

Trying to stay positive

This week brings a potentially significant event for the NZ economic outlook. And it's not the Q2 GDP figures due Thursday. Today, Cabinet reviews NZ's Alert Level settings. Any change would take effect midnight Wednesday. We know from the first time around that any shift down in Alert Levels would be significant for parts of the economy. Business confidence is rebounding, but we're cognisant that operating at Level 2/2.5 is getting harder for some. Not only is the wage subsidy winding up, but balance sheets bruised in the first lockdown have less buffer now.

The GDP figures due Thursday will "officially" confirm NZ suffered a deep recession over the first half of the year. We're forecasting a quarterly contraction of 11% (preview here). A terrible outcome undoubtedly, and easily the largest decline on record, but still a lot better than the circa -20% forecasts that were doing the rounds in March/April. The general run of the economic green since the June quarter has also pleasantly surprised most economic watchers.

Still, for every day that goes by with no prospect of the borders re-opening, no proven vaccine, and ongoing global scrambling to contain COVID-19 flare-ups, the more the medium-term outlook gets foggier. This is what we're attributing to last week's further ramp up in market speculation of RBNZ OCR cuts. In fact, yields on several NZ fixed income instruments briefly fell into the negatives for the first time ever. One for the scrapbook. Keep your eyes peeled for two notes from ASB Economics this week that will lay out the effects of negative rates. Mark Smith will publish on the pros and cons and general issues associated with negative rates, while this author sets out some implications and recommendations for corporates exposed to interest rate risk in the upcoming Q3 Corporate Hedging Toolbox.

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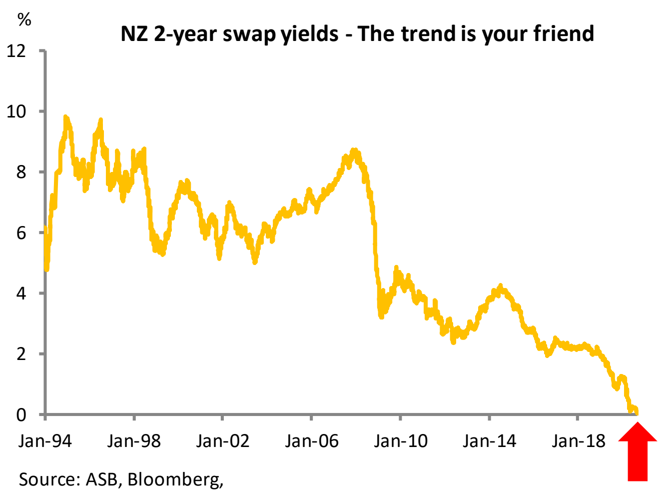
Recent key economics

ASB Economic forecasts and monitoring:
Quarterly Economic Projections
ASB COVID-19 Chart pack
Home Economics
Financial market trends:
Corporate Hedging Toolbox
Policy response:
RBNZ August MPS Review
Assessing the RBNZ's bag 'o' tricks
For COVID-19 research, see here

Chart of the week



Source: ASB, Bloomberg,

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6644	0.6704	0.6533	0.6404	FLAT/DOWN	0.6500	0.6800
NZD/AUD	0.9155	0.9201	0.9138	0.9316	FLAT/DOWN	0.9000	0.9300
NZD/JPY	70.71	71.22	69.82	69.24	FLAT/DOWN	69.00	72.50
NZD/EUR	0.5630	0.5665	0.5530	0.5784	FLAT/DOWN	0.5490	0.5770
NZD/GBP	0.5207	0.5067	0.5002	0.5186	FLAT/DOWN	0.5160	0.5340
TWI	72.0	72.1	70.9	70.98	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

NZD underperformed all the major crosses except the GBP over the past week. The NZD was weighed down by a bout of investor risk aversion during the week, with equities and commodity prices also easing back over the week. The fall in sentiment was particularly pronounced overnight Tuesday/Wednesday, and led by a correction in Technology stocks, with some partial recovery in sentiment and the NZD taking place the following night. Meanwhile, the GBP remains under pressure as progress on Brexit negotiations remains poor and financial market participants have resumed pricing in some risk of a hard Brexit. Reports that the UK Government was planning a draft bill that would override parts of the previously-agreed withdrawal agreement has many concerned. NZ economic data released last week were mixed - Q2 economic data released last week suggest the economic hit from COVID-19 may not be as large as initially feared. Housing market data from August was also surprisingly positive. However, card spending data showed an 8% fall over August, as the country moved into a higher Alert Level due from mid-August.

Outlook

NZD direction remains linked to investor risk appetites this week, and it's possible that the past week's risk-off tone may linger and continue to weigh on the NZD. However, it's also a big week for both domestic data and international releases, so event risk could see some additional volatility in the NZD this week. In NZ, the key data/event releases include the Government's review of the Alert Level restrictions (1pm Monday), the latest Global Dairy Trade auction (Tuesday night), the Pre-election Economic and Fiscal Update (Wednesday), followed by the first estimate of Q2 GDP on Thursday morning (see our full preview here). Offshore key events include announcements from several central banks, with the US Federal Reserve on Wednesday, followed by the Bank of Japan and Bank of England on Thursday – though policy settings are generally expected to remain unchanged for all three. Australian employment figures are also released on Thursday.

Our medium-term FX forecasts are underpinned by a weaker USD view, reflecting an expectation that the US current account deficit will widen, and the US Terms of Trade will decrease. However, NZD-specific factors are expected to limit NZD upside, particularly as the RBNZ is about to embark on a much more aggressive monetary easing campaign than many of its offshore peers. Although the RBNZ appears keen to cut the OCR into negative territory, the RBA remains reluctant, and we expect a widening interest rates differential will continue to weigh on the NZD/AUD.

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ASB foreign exchange forecasts (end of quarter)	Jun-20 << actual	Sep-20 forecast >>	Dec-20	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	0.90	0.89	0.88	0.86	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.54	0.54	0.54	0.53	0.52	0.53
NZD/GBP	0.52	0.50	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.6	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	69.6	70.0	69.5	68.0	67.5	67.7

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	0.30	0.30	0.30	1.14	UNCH/DOWN	UP
2-year swap	0.06	0.05	0.13	1.02	UNCH/DOWN	UP
5-year swap	0.13	0.15	0.22	1.09	UNCH/DOWN	UP
10-year swap	0.54	0.57	0.61	1.42	UNCH/DOWN	UP
10-year govt bond yield	0.63	0.63	0.67	1.33	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.48	0.52	0.48	0.40	UNCH	DOWN

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

Market Recap

Last week NZ swap yields touched record lows for most tenors as markets continued to factor in the increasing likelihood of a lower OCR. Yields on the 2- and 3-year swap briefly fell below zero and the 10-year swap dipped below 0.50% but all have subsequently firmed. There was little market reaction to generally positive local data and the mixed tone of global data. Global yields moved lower in step with global equity markets with solid demand pushing US Treasury yields lower (1OY 0.67%). Last week's NZ Government bond tender saw solid demand for the 2024 bond, but mixed signs for longer-dated tenors. Weighing down on NZ government bond yields have been $1,400m of RBNZ asset purchases, which took cumulative purchases under the LSAP programme to $30bn. The RBA was also back in the market, with AUSD2bn of purchases helping to keep 3-year Government bond yields close to the RBA's 0.25% target.

Near-term interest rate outlook

Current market pricing has the OCR moving below zero by early 2021 with an OCR ending 2021 at around -0.25%. Our view remains that the RBNZ will do what it can to achieve lower NZ yields, and we have retained our downward bias. Today's 1pm announcement by the Government on COVID-19 Alert Levels and week's local data – including the record 11% Q2 GDP contraction we expect for NZ GDP (mkt: -12.5%) – are likely to trigger modest market reaction given the historical nature of the figures and improving signs in the Q3 data. We also expect minimal market reaction from overseas data, including the Australian August labour market report, with improving signs expected from monthly Chinese retail, industrial production and fixed asset investment data for August.

Central bank announcements – including policy decisions by the US Federal Reserve, Bank of England, the Bank of Japan and the RBA Minutes – are expected to remain dovish and flag the prospect of more policy support. We don't expect the Fed 'dot plot' forecasts to shift from operational lows and will be watching for further details provided on the inflation targeting framework. The RBA Minutes may reveal what the Bank might do next to loosen monetary policy if required. Options could include increased quantitative easing, targeted at longer-dated bonds.

This week's Pre-election Economic and Fiscal Update will largely be perused for changes in the bond tender programme. The stronger starting point for the NZ economy points to a smaller 20/21 tender than the $60bn earmarked in Budget 2020 and the weaker economic outlook beyond that points to higher subsequent issuance. Given the uncertainties involved we are hoping NZ Debt Management Office signals only modest changes to the tender profile. The RBNZ has maintained a $1.35bn weekly pace of NZ government bond purchases for the 4th consecutive week that will outpace the $950m in weekly tenders. There is considerable scope for the RBNZ to front-load asset purchases over the next few months, helping to flatten the NZ yield curve and depress NZ yields.

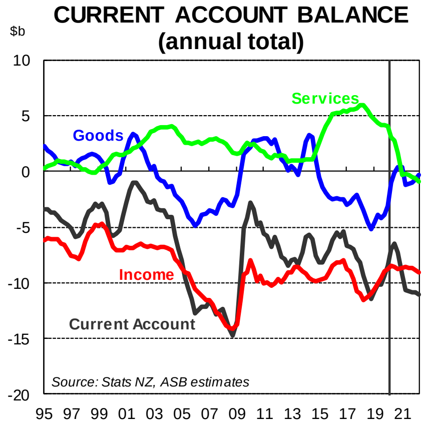
Medium-term outlook

Providing operational hurdles are cleared and the RBNZ sticks to its forward guidance, we expect to see the RBNZ cut the OCR to -0.50% by early 2021 (most likely April) and for a Funding for Lending Programme to be introduced at this time. Prior to then we expect the RBNZ to front-load asset purchases and employ forward guidance to dampen yields. Low global inflation and subdued global growth prospects should keep NZ yields low and the curve reasonably flat despite high public debt issuance. mark.smith4@asb.co.nz

Domestic events

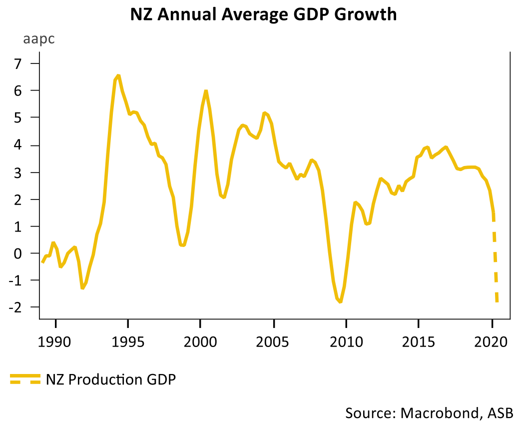
Data	Date	Time (NZT)	Market	ASB
Current Account annual balance, Q2, % of GDP	16/09	10:45 am	-	-2.3
Pre-Election Economic and Fiscal Update	16/09	1:00 pm	-	-
GDP, Q2, % qoq	17/09	10:45 am	-	-11

On Wednesday, the Balance of Payments data for Q2 are released. **We expect the annual current account deficit to further narrow to 2.3% of GDP.** The goods balance is likely to increase, with softer domestic demand weakening imports, but exports proving more resilient. A full quarter of border closures will be reflected through a large disruption in both services inflows and outflows, with the larger hit to tourism exports resulting in a services deficit for the quarter and a narrowing annual services surplus. Meanwhile, the deficit in the income balance is likely to narrow – but not for positive reasons. Lower domestic corporate profitability will cap equity investment outflows, whilst historically low interest rates will hold down debt servicing costs on foreign borrowing. Moving forward, we expect the current account deficit to remain comparatively small in the near term, before gradually widening again as COVID-driven trends begin to unwind.



In Wednesday's **Pre-election Economic and Fiscal Update**, we would expect to see a better 2020/21 economic outlook than was shown in the May Budget. But we expect to see some tempering of the Treasury's longer-term economic outlook, at least to factor in a longer border closure than envisaged for the Budget forecasts**. The upshot is the fiscal position should look slightly stronger over the June 2021 year, potentially a deficit of $23-24bn vs. $29.6bn in the Budget. But it is possible the Treasury forecasts boost the longer-term operating deficit forecasts.** Given heightened uncertainty over the outlook and the future direction of fiscal policy post-election, the NZ Debt Management Office will be wary of shifting the issuance profile too much. There is the risk that the 2021 bond tender programme will be a touch lower than the $60bn outlined in the Budget, given the stronger than expected fiscal starting point and the success of recent syndications. Conversely, the weaker longer-term fiscal profile could see subsequent issuance revised up.

We expect **Q2 GDP contracted by 11%**, adding to the 1.6% contraction in Q1 as a result of the COVID-19 pandemic. Data released to date suggest Q2 GDP held up much better than our earlier assumptions, with many sectors able to produce more output over Alert Level 3 and Level 2 than we assumed. Nonetheless, the uncertainty around our forecast is very high. StatsNZ has already highlighted the many difficulties it faces in modelling Q2 activity based off the data available on a quarterly basis. We strongly urge readers to take this first estimate as indicative only – this estimate will continue to be revised as StatsNZ gleans additional and more complete information over time.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Eurozone Industrial Production, July, PMI, points	14/09	12:00 pm	-
China Retail Sales, August, %yoy	15/09	5:00 pm	0.3
RBA Meeting Minutes, September	15/09	4:30 pm	-
UK Unemployment, July, %	15/09	11:30 am	-
UK CPI, August, %yoy	16/09	9:00 am	-
Australia Employment, August, 000s	17/09	4:30 pm	-50
Bank of Japan Interest Rate Announcement, %	17/09	-	-0.1
Bank of England Interest Rate Announcement, %	17/09	2:00 pm	-
UK Retail Sales, August, %yoy	18/09	9:00 am	-

**Originally published by CBA Global Markets Research on Friday 11 September at 2:05 pm*

We estimate China's domestic recovery continued in August. Retail sales growth may have lifted to 0.3%yoy, supported by an accelerating recovery in services. We predict industrial production growth ticked up to 5%yoy. Both domestic and foreign demand continued to improve. Year-to-date growth in fixed asset investment might have lifted to flat. Investment in infrastructure and property remains strong.

The **Reserve Bank of Australia (RBA)** maintained both the target for the cash rate and the yield on 3-year Australian Government bonds at 0.25% in September. The central bank also made changes to the Term Funding Facility (TFF) and added into its Board Statement "the Board will maintain highly accommodative settings as long as is required and continues to consider how further monetary measures could support the recovery". There remains debate about what could be the next easing measure so the **Minutes** will be heavily scrutinised for any information on this.

We expect **Australia** to see a 50k loss in **employment in August** and a 0.2ppt fall in the participation rate. This would see the unemployment rate rise to 7.7% from 7.5%. In Victoria, the lockdown measures enacted over July and August will weigh heavily on labour market outcomes in August.

We expect the Bank of Japan to maintain the policy status quo. Prime Minister Abe's stepping-down will not have major implications for monetary policy.

The **Eurozone composite PMI** rose in July to a 25-month high of 54.9 consistent with a solid expansion in industrial production over the month.

The **UK unemployment rate** was unchanged for a fourth consecutive month in June at 3.9% because of increases in people out of work, but not currently looking for work. The increase in economic inactivity suggests the jobless rate will remain well below the Bank of England's Q4 forecast of 7.5%.

UK headline and core CPI inflation quickened more than expected in July (1.0%yoy and 1.8%yoy, respectively). But the Bank of England (BoE) projects headline CPI inflation to ease over Q3 and average about 0.2% as the effects of Covid-19 on UK activity weighs on inflation.

We expect the Bank of England to make no monetary policy changes and maintain a dovish stance. Specifically, the Bank Rate and total stock of asset purchases will remain at 0.1% and £745bn, respectively. The BoE has so far accumulated over £680bn in UK government bond and sterling non-financial investment-grade corporate bonds.

UK retail sales volumes increased more than expected in July. UK retail sales volumes are now 3.0% above pre-pandemic levels in February. Going forward, the above average savings rate and continued uncertainty around the risk to health from Covid-19 remain major headwinds for consumer spending.

Key Forecasts

ASB NZ economic forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	forecast >>						
GDP real - Q%	-10.8	9.2	0.8	0.3	0.1		
GDP real - A%	-11.1	-3.7	-3.4	-1.5	10.6	0.8	3.2
GDP real - AA%	-1.8	-3.3	-4.6	-4.9	0.2	3.2	2.3
CPI - Q%	-0.5	1.0	0.0	0.1	0.2		
CPI - A%	1.5	1.8	1.3	0.7	1.3	1.3	1.3
HLFS employment growth - Q%	-0.4	-2.7	-1.3	-0.2	0.2		
HLFS employment growth - A%	1.1	-1.9	-3.4	-4.5	-3.9	1.9	1.8
Unemployment rate - %sa	4.0	6.5	7.4	7.9	8.0	7.3	7.3
Annual current account balance as % of GDP	-2.3	-2.1	-2.4	-3.1	-3.5	-3.5	-3.7

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	0.25	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.10	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.15	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.50	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.55	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	0.90	0.89	0.88	0.86	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.54	0.54	0.54	0.53	0.52	0.53
NZD/GBP	0.52	0.50	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.6	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	69.6	70.0	69.5	68.0	67.5	67.7

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