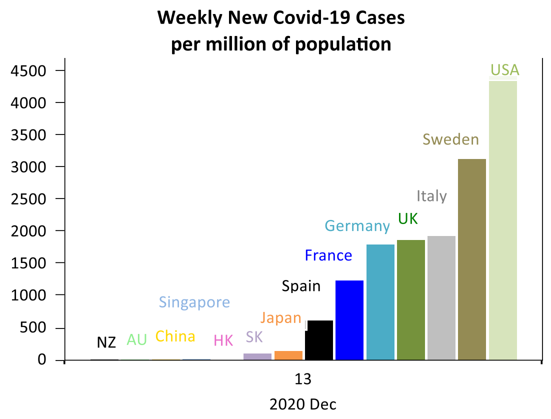
ASB

# Economic Weekly

14 December 2020

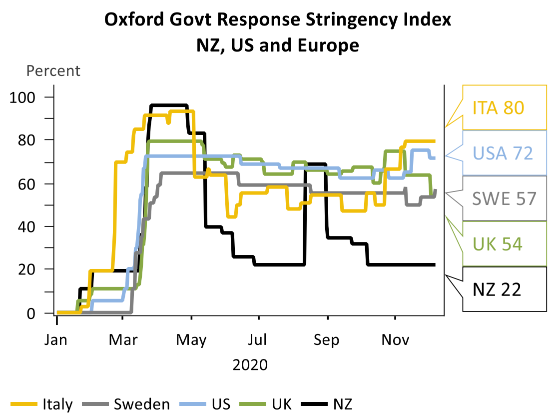
## Bouncing back

There is a fair bit of data out this week – it's a bit like the twelve days of Christmas, but for economic aficionados. Notably, we'll get an early Christmas present on Thursday morning from Stats NZ – the Santa Clause of the data world – with the release of the Q3 GDP result.




Source: Macrobond, ASB

We expect the result to show a 13% qoq lift, which would represent a solid bounce back after the 12.2% decline we saw last quarter. That will still leave the economy about 2.2% smaller than it was before the pandemic went global, but all up the New Zealand economy has proven much more resilient than most expected earlier in the year. Recent data has shown activity bounce back on a whole range of fronts over the course of Q3, from retail trade to construction and export activity.




Source: Macrobond, ASB

The result means NZ's economic performance over the first nine months of 2020 is likely to have proven one of the stronger performers amongst its major peers. You can read the full preview from our GDP guru Jane Turner here.

All up, it means there's plenty for kiwis to be thankful for these holidays. Our strong public health response to the pandemic – as well as our geographic isolation, and a fair bit of luck – mean we've had far fewer per capita COVID infections than our peers, and kiwi's activity has generally been less curtailed too.

That's not to say everything is hunky dory of course. With the New Zealand border likely to remain shut for a while to come yet, exports of services are likely to be disrupted for a while yet (we'll get a reminder of that in this week's BoP and GDP releases) . Still, the heart-warming scenes last week of the first vaccine recipients in the UK are a reminder that there is a light at the end of the tunnel – even if the timing around the global rollout remains uncertain.

This is our last Economics Weekly for 2020 – we'll be back in the New Year. Stay safe and enjoy the summer – we'll see you on January 11th. nathaniel.keall@asb.co.nz

## Foreign Exchange Market

| FX Rates | Current* | Week ago | Month ago | Year ago | ST Bias | Support^ | Resistance^ |
|---|---|---|---|---|---|---|---|
| NZD/USD | 0.7096 | 0.7037 | 0.6820 | 0.6615 | FLAT/UP | 0.6800 | 0.7120 |
| NZD/AUD | 0.9398 | 0.9472 | 0.9441 | 0.9548 | FLAT/DOWN | 0.9440 | 0.9600 |
| NZD/JPY | 73.85 | 73.18 | 71.57 | 72.48 | FLAT/UP | 72.00 | 74.00 |
| NZD/EUR | 0.5846 | 0.5798 | 0.5779 | 0.5918 | FLAT | 0.5780 | 0.5900 |
| NZD/GBP | 0.5303 | 0.5242 | 0.5200 | 0.4907 | FLAT | 0.5170 | 0.5300 |
| TWI | 74.3 | 73.7 | 72.6 | 72.49 | 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

Currency performance was mixed last week. For the first time in months, it wasn't the weaker USD in the driving seat. It was more a case of relative economic fundamentals returning to the fore. The AUD outperformed on the back of rising commodity (particularly iron ore) prices, squeezing NZD/AUD down to a one month low around 0.9400.

At the other end of the spectrum, the GBP was hammered as the prospect of a "hard Brexit" rose. NZD/GBP was sent soaring to 16-month highs above 0.5350 as a result. Meanwhile, NZD/USD largely remained in consolidation mode after its strong run, albeit it managed to (just) squeeze out a fresh 2½ year high near 0.7100 on Friday.

It's certainly been a remarkable road to recovery for the NZD/USD. Having troughed around 0.5700 during the depths of the COVID crisis in March, the currency looks set to end the year some 14 cents higher. The annual high/low range in the NZD/AUD has been a somewhat tighter 8½ cents. A volatile year by all accounts but, actually, far from unprecedented, particularly when set against a global pandemic. NZD volatility was larger in 2015 (NZD/USD +/- 18 cents), 2011 (+/- 17 cents), and particularly the GFC in 2008 (+/- 30 cents). The fact that volatility in 2020 didn't hit the heights of years past reflects the swiftness and size of the COVID policy response.

### Outlook

Markets won't be able to wind down for Christmas just yet as a busy week of political and economic drama beckons. Brexit is back in focus now that the deadline for a deal has been pushed out again. The scenarios facing GBP/USD and hence NZD/GBP are essentially binary in that either a deal is reached (GBP/USD soars towards 1.3600) or it isn't and a hard Brexit becomes the most likely outcome (GBP/USD slumps towards 1.2800).

We expect the US Federal Reserve to "enhance" its forward guidance at its meeting Thursday morning, formally linking the timeframe for continuing asset purchases to economic conditions. There's speculation the Fed could also "twist" its asset purchases in an attempt to lower long-term bond yields. We think the outlook is still tilted in favour of USD weakness (NZD/USD higher), given the medium-term global picture continues to improve and vaccines are now being administered in both the US and UK.

Domestically, the two big events this week are NZ GDP on Thursday and the government's HYEFU on Wednesday. We expect a 13% qoq rebound in Q3 GDP growth. We don't believe the data will be a big market-mover this time around. Everyone knows the kiwi economy bounced back to life in impressive fashion in Q3 – whether or not it was a 12% or 14% bounce is by the by. We expect the HYEFU to deliver an upgrade to economic forecasts and a reduction in the government's bond programme. mike.jones@asb.co.nz

## 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 | UP |
| 90-day bank bill | 0.26 | 0.26 | 0.28 | 1.20 | UNCH | UP |
| 2-year swap | 0.26 | 0.26 | 0.19 | 1.24 | UNCH | UP |
| 5-year swap | 0.45 | 0.48 | 0.37 | 1.43 | UNCH | UP |
| 10-year swap | 0.91 | 0.97 | 0.80 | 1.77 | UNCH | UP |
| 10-year govt bond yield | 0.89 | 0.95 | 0.83 | 1.58 | UNCH | UP |
| Curve Slope (2s10s swaps) | 0.65 | 0.70 | 0.61 | 0.52 | UNCH | DOWN |

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

### Market Recap

Local short-term yields were becalmed last week, with markets largely ignoring local data pointing to stronger than expected economic momentum. There was little reaction after the RBNZ formally responded to the Minister of Finance, asking that house prices not be added to the monetary policy remit and requesting that the Government consider adding debt-to-income limits to the RBNZ toolkit. Such a shift would reduce upward pressure to NZ short-term interest rates, all else equal. Australian short-term yields pushed higher, helped by improving business and consumer confidence data, surging prices for iron ore and the increasing conviction that the Australian economy will strengthen.

Long-term NZ and global yields were lower. COVID-19 cases, deaths and hospitalisations have soared in the US, with Germany announcing it will be imposing a hard lockdown this coming week. Last week saw little progress in pushing through a temporary US fiscal support package and the failure of the UK and European Union to strike a trade deal increasing the risk of a no-deal Brexit, although talks are continuing. Demand for NZ bonds returned with a strong $600m weekly tender pushing yields a couple of points below mid-market levels. There was little market reaction after the ECB held policy rates, expanded its Pandemic Emergency Purchase Programme (PEPP) by €500bn (to €1.85tr) and extended it by 9 months to March 2022.

### Near-term interest rate outlook

We expect little change in NZ short-term yields into early 2021 as markets consolidate after a frenetic November. Current market pricing has about 5-7bps of OCR cuts priced in and we expect short-term yields to remain close to the current OCR as rate cut expectations are trimmed further. Modest market reaction is expected from Q3 GDP data that should show a record rebound after the record Q2 fall. The RBNZ Funding for Lending Programme (FLP) (see D12) has had no take up thus far. We expect only a modest impact from the FLP but note the more effective it is in lowering lending interest rates, the less the need for OCR cuts, all else equal. The Half-Year Economic and Fiscal Update should deliver a better than expected fiscal outlook than the Pre-election Economic and Fiscal Update (PREFU), with a lower public debt and debt issuance profile. The same is expected from the Australian mid-year fiscal outlook. Lower issuance should cap upward pressure in yields as should the $800m of RBNZ bond purchases signalled for this week.

Global yields will hinge on whether the US politicians can broker a fiscal support package, and if a trade deal can get done to avoid a hard Brexit. This looks a tall order, and a period of volatility is to be expected. We don't expect markets to react strongly to this week's global data (November Australian employment, Chinese monthly data, global December PMIs) nor to central bank events (RBA Minutes, decisions from the BoE, the BoJ and FOMC), where the focus will be on whether the Fed will change its forward guidance for asset purchases.

### Medium-term outlook

We no longer expect the RBNZ to take the OCR below zero in 2021 and have pencilled in a 0.25% OCR until mid-2023, given the resilience being displayed by the NZ economy and the expectation that the RBNZ's Funding for Lending Programme will help lower interest rates for borrowers within the economy. The outlook is highly uncertain with scope for heightened volatility over the next few months. We expect local and global longer-term yields to subsequently grind higher, but to remain at historically-low levels over the next few years. mark.smith4@asb.co.nz

## Domestic events

| Data | Date | Time (NZT) | Market | ASB |
|---|---|---|---|---|
| NZ Current Account Balance, Q3, % of GDP | 16/12 | 10:45am | - | -1.2 |
| Half-year Economic & Fiscal Update | 16/12 | 1:00pm | - | - |
| NZ GDP, Q3, % qoq | 17/12 | 10:45am | - | 13% |
| Merchandise trade balance, November, $m | 18/12 | 10:45am | - | 252 |
| ANZ Business Outlook, Own Activity, net % | 18/12 | 1:00 pm | - | - |

**We expect New Zealand's annual current account deficit narrowed to 1.2% of GDP in Q3**. With NZ exports proving resilient, but imports subject to disruption, we expect the annual goods balance to tick into surplus. We expect service inflows will continue to be more disrupted than outflows, thanks to NZ's closed border, meaning the annual service balance will deteriorate. On the incomes side of things, lower domestic corporate profitability will dampen equity investment outflows, whilst historically-low interest rates will continue to be reflected in lower debt servicing costs on foreign borrowing. That will mean the annual income deficit shrinks to the lowest level seen in recent years.

**The Half-Year Economic and Fiscal Update (HYEFU) is expected to demonstrate the Government's commitment** to use the Crown's still-strong balance sheet to cushion the impact of COVID-19 and support the NZ economic rebound. Partly due to massive fiscal and monetary policy support, the NZ economy has been much more resilient than earlier expected. Stronger than expected tax revenues, and lower than expected fiscal deficits and public debt have resulted. Vaccine news are a positive development for the medium-term fiscal outlook. We expect Treasury to modestly revise up the fiscal outlook in the HYEFU. This should see the bond programme shaded down (perhaps $5-10bn) relative to the $155bn in gross issuance forecast over 2021/24 in the PREFU. Increases in syndicated issues could reduce the bond programme further still.

Fiscal support should help insulate the economy over the next year or two, with about $40bn of the $58.1bn set aside from the COVID-19 Response and Recovery Fund not spent in 2019/20. However, the fiscal outlook will remain challenging with still-sizeable fiscal deficits in the years ahead and with net core Crown debt still set to approach 50% of GDP. Fiscal consolidation beyond the passing of the COVID-19 crisis will be needed to restore the public finances to a sounder footing and to prepare for future challenges. This will help keep NZ interest rates very, very low over the next few years.

**We expect Q3 GDP lifted 13%**, following on from Q2's 12.2% contraction. Our forecast is very close to the RBNZ's November Monetary Policy Statement forecast of +13.4%. We estimate Q3 GDP was 2.2% below pre-COVID-19 levels (i.e. December 2019 quarter GDP). StatsNZ will release its first estimate of Q3 GDP on Thursday 17th of December at 10.45 am. In addition, StatsNZ is expected to revise its historical estimate of GDP.

**We expect the November merchandise trade release will show a surplus of $252m** – in contrast to the usual deficit New Zealand records at this time of year. The result means Zealand's annual trade balance (which has tipped into surplus over the course of the pandemic) will widen further to $3.3b – the largest on record by our estimations. We expect a sizable year-on-year fall in imports ($4.95b) over the quarter – down 17.5% - as global supply chain and logistics disruption, exacerbated by delays at NZ ports continue to weigh heavily on imports. Meanwhile, NZ's exports ($5.2b) should continue to prove resilient – down just 0.2% on this time last year.

**The ANZ Business Outlook** Survey December full month results are released on Friday 18th December, there was no preliminary release this month. The full November month results of the ANZ monthly business confidence survey showed the recovery in business confidence continued through November. The lift in November was largely underpinned by improved sentiment in manufacturing and construction sectors. The lift in services was more muted, while expectations for own business activity fell in agriculture and retail. The recovery in business confidence seen since August reinforces our view that further OCR cuts are no longer needed to support the economic recovery.

## Major International Events for the week ahead*

| Data | Date | Time (NZT) | ASB |
|---|---|---|---|
| China Retail Sales, Nov, %yoy | 15/12 | 3:00 pm | -5.5 |
| RBA Board Meeting, December | 15/12 | 1:30 pm | - |
| RBA's Jonathan Kearns speech | 15/12 | 1:40 pm | - |
| UK CPI Inflation, November, %mom | 16/12 | 8:00 pm | - |
| Australia Unemployment Rate, Nov, % | 17/12 | 1:30 pm | 6.7 |
| US FOMC Interest Rate Announcement, % | 17/12 | 8:00 am | 0.00-0.25 |
| Bank of Japan Interest Rate Announcement, % | 18/12 | - | -0.1 |
| Bank of England Interest Rate Announcement, % | 18/12 | 1:00 am | 0.10 |

*Originally published by CBA Global Markets Research on Friday 12 December at 11:53 am*

**We estimate China's recovery to remain solid in November**. Retail sales growth may accelerate to 5.5%yoy, boosted slightly by the Singles' Day online shopping festival. Industrial production growth may lift to 7.2%yoy in part because of recovering global demand. Year-to-date fixed asset investment growth may accelerate to 2.5%yoy, led by increased spending by state-owned businesses.

We do not expect any new information to be contained in the **Reserve Bank of Australia's (RBA) December Board Meeting minutes**. But the minutes may contain hints that the economic recovery is tracking ahead of its forecast profile which we expect to be upwardly revised at its February Statement of Monetary Policy. The RBA will not meet in January and the next Board Meeting is on 2 Feb 21.

**The RBA's Head of Financial Stability, Jonathan Kearns, will speak at the Australasian Finance and Banking Conference** from 11.40am AEST. We have published our view that the RBA is really focussed on the stock of private sector credit when it comes to financial stability (here). We do not see rising dwelling prices posing a risk to financial stability.

The **Australian labour market** has been healing at a rapid rate since May this year and 74% of the jobs lost from March to May were regained by October 20. We expect the improvement to continue and we forecast 50k jobs to be added in November. Assuming an unchanged participation rate, this would see the unemployment rate fall 0.3%pts to 6.7%.

Japan's Suga administration announced another economic stimulus package to support the recovery. **We predict the Bank of Japan (BoJ) to leave all monetary policy measures unchanged** at the December policy meeting. However, the BoJ is growing concerned about the impact of the recent surge in new COVID-19 infections.

**UK headline CPI inflation** rose in October at an annual pace of 0.7%. The Bank of England projects headline CPI inflation to remain muted at 0.6% over Q4 reflecting the temporary impact of lower energy prices and the cut in VAT, as well as some downward pressure from spare capacity.

**The Bank of England is widely expected to make no policy changes**. The Bank Rate and the total stock of asset purchases will remain at 0.10% and £895bn, respectively. The BoE has so far accumulated about £735bn in UK government bond and sterling non-financial investment-grade corporate bonds.

**We expect the US Federal Reserve to leave the Fed Funds rate and asset purchase program unchanged**. However, we expect the central bank will 'enhance' its forward guidance by moving to a qualitative outcome-based guidance for asset purchases. This form of guidance would link the timeframe for continuing asset purchases to economic conditions. We also see a small risk the FOMC announces it will expand its asset purchase program given the growing near-term headwinds and rising US yields.

## 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 | 13.0 | 0.7 | 0.5 | 0.4 | 0.4 | 0.8 |
| GDP real - A% | -12.4 | -1.7 | -1.4 | 0.5 | 14.9 | 1.5 | 3.4 |
| GDP real - AA% | -2.1 | -3.1 | -3.9 | -3.8 | 2.7 | 4.8 | 2.6 |
| NZ House Prices (QV Index) - A% | 6.8 | 6.9 | 9.3 | 9.3 | 12.1 | 7.4 | 4.9 |
| CPI - Q% | -0.5 | 0.7 | -0.1 | 0.4 | 0.0 | 0.4 | 0.5 |
| CPI - A% | 1.5 | 1.4 | 0.9 | 0.6 | 1.1 | 1.1 | 1.6 |
| 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 | 0.25 | 0.25 | 0.25 |
| NZ 90-day bank bill | 0.30 | 0.31 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| NZ 2-year swap rate | 0.21 | 0.06 | 0.25 | 0.25 | 0.25 | 0.25 | 0.45 |
| NZ 5-year swap rate | 0.35 | 0.13 | 0.35 | 0.35 | 0.35 | 0.35 | 0.65 |
| NZ 10-year swap rate | 0.74 | 0.51 | 0.80 | 0.80 | 0.80 | 0.95 | 1.15 |
| NZ 10-year Bond | 0.91 | 0.46 | 0.85 | 0.85 | 0.85 | 1.00 | 1.20 |

| 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 | 0.69 | 0.70 | 0.70 | 0.71 | 0.71 |
| NZD/AUD | 0.93 | 0.93 | 0.93 | 0.93 | 0.92 | 0.91 | 0.92 |
| NZD/JPY | 69 | 70 | 71 | 74 | 74 | 77 | 80 |
| NZD/EUR | 0.57 | 0.56 | 0.58 | 0.57 | 0.56 | 0.55 | 0.53 |
| NZD/GBP | 0.52 | 0.51 | 0.52 | 0.52 | 0.51 | 0.52 | 0.52 |
| NZD/CNY | 4.5 | 4.5 | 4.5 | 4.6 | 4.6 | 4.5 | 4.5 |
| NZD TWI | 71.4 | 71.6 | 71.5 | 72.1 | 71.7 | 71.5 | 71.5 |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