

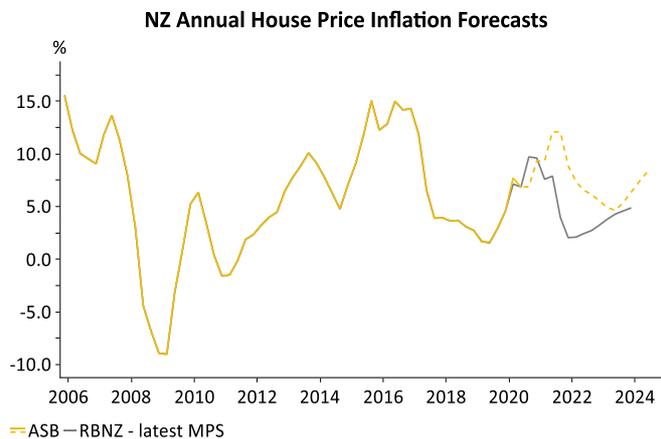
Economic Weekly

16 November 2020

Frenemies, and an update on our views

Bit on last week! We got updates on an avalanche of acronyms: OCR, FLP, LSAP, LVRs, REINZ..., there was some encouraging vaccine news, and the RBNZ and housing became official frenemies. We've briefly outlined below the net impacts on our views:

- **We no longer expect the RBNZ's Official Cash Rate to be taken into negative territory.** Instead, we think it will remain at 0.25% for the foreseeable future. This reflects our view that the RBNZ's Funding for Lending Programme (FLP) will be successful, as well as ongoing resilience on the part of the domestic economy.
- Consistent with the above, **we've fine-tuned our interest rate forecasts.** You will no longer find a negative sign anywhere in our swap forecasts and additional downside is expected to be limited. We're not sure if last week's 10-20bps lift in the swaps curve will be sustained, but the risks do seem to favour further curve steepening.
- By contrast, **we still expect retail interest rates to keep falling.** We've long held the view that the FLP would add to downward pressure on rates. We see 1- and 2-year mortgage rates falling towards 2% over the coming 12 months. Term deposit rates have more downside too.
- We think **last week's COVID vaccine news was indeed a positive development for the medium-term economic outlook.** Yes, it's only the first step with many regulatory and logistical hurdles still to be cleared. But the important part is we now have that first step. It's positive for confidence, and uncertainty has reduced a little (the same could be said for the US election). At the margin, this may help shore up hiring/investment intentions.
- Also notable on the global scene, our CBA colleagues now expect a **stronger Australian economic recovery.** The expected 2020 fall in GDP of 3.3% is forecast to be followed by a rebound of 4.2% in 2021, and 3.8% in 2022.
- Finally, house prices. They rose at the fastest pace in 17 years in October according to last week's REINZ data. **Having initially lauded the housing boom for helping to rescue the recovery, it's quickly become a headache for the RBNZ,** regardless of whether it believes it's responsible. We think it will get worse. We've been calling for LVR restrictions to be returned and they now will be, in March. But we suspect this will slow rather than stall house price acceleration. House prices look set to easily eclipse the RBNZ's latest forecast (see chart). mike.jones@asb.co.nz



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6846	0.6813	0.6593	0.6387	FLAT/UP	0.6700	0.7000
NZD/AUD	0.9416	0.9346	0.9315	0.9395	FLAT/UP	0.9220	0.9550
NZD/JPY	71.65	70.42	69.38	69.34	FLAT/UP	69.80	73.40
NZD/EUR	0.5782	0.5728	0.5633	0.5792	FLAT/UP	0.5640	0.5930
NZD/GBP	0.5196	0.5167	0.5113	0.4959	FLAT/UP	0.5060	0.5320
TWI	72.9	72.1	71.0	70.64	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

The NZD was up against all the major crosses on Wednesday afternoon following the release of the RBNZ's November Monetary Policy Statement. However, the NZD unwound some of these gains over the rest of the week.

Despite delivering additional stimulus through the introduction of the Funding for Lending Programme, the RBNZ was more upbeat than the market expected. The RBNZ's economic assessment improved significantly and as a result, market and economist expectations of further OCR cuts have been pared back. ASB and BNZ economists no longer expect additional OCR cuts, while other NZ economists also reduced the amount of forecast rate cuts and also signalled some doubt around the likelihood of a negative OCR.

The NZD/USD lifted from 0.6830 to sit just under 0.6900 Wednesday night. The NZD/AUD lifted from 0.9380, and sustained momentum throughout Thursday to almost break through 0.9500 on Thursday afternoon.

The RBNZ's Wednesday announcement came in the wake of a massive upswing in global sentiment on Tuesday on news that the Pfizer vaccine was over 90% effective.

Outlook

The vaccine news has buoyed financial market sentiment, and this upbeat tone in markets may continue this week. However, the risk going forward is that market focus returns to the short-term economic outlook and worries about the rising number of COVID-19 infections in the US and the economic impact of the second round of lockdowns in Europe. A moderation in US retail sales through October may highlight the near-term downside risks to the US economy. Nonetheless, the NZD/USD may continue to receive some support, given the market's reassessment of the NZ interest rate outlook.

Reserve Bank of Australia (RBA) policy settings are back in the spotlight this week, with the release of the RBA meeting minutes from the most recent meeting where it cut its policy rate 15 basis points to 0.1%. Given the shift in NZ-AU interest rate differentials, we expect the NZD/AUD will remain supported this week. jane.turner@asb.co.nz

ASB foreign exchange forecasts

(end of quarter)

	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.93	0.89	0.88	0.86	0.86	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.53	0.53
NZD/GBP	0.52	0.51	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.5	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	71.6	69.9	69.4	68.0	67.6	67.6

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	0.27	0.29	0.28	1.24	UNCH/DOWN	UP
2-year swap	0.20	0.05	0.03	1.18	UNCH/DOWN	UP
5-year swap	0.38	0.16	0.10	1.26	UNCH/DOWN	UP
10-year swap	0.80	0.57	0.46	1.55	UNCH/DOWN	UP
10-year govt bond yield	0.26	0.60	0.54	1.41	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.61	0.53	0.43	0.37	UNCH	DOWN

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

Market Recap

Last week saw a sizeable lift in local yields, outpacing more moderate moves in global counterparts. Market pricing has swung from pricing in an OCR endpoint of about -0.20% at the start of last week to just above 0% at present. The RBNZ maintained current settings at the November Monetary Policy Statement, and kept all options on the table, including a negative OCR. However, NZ yields shifted higher as market participants reassessed the need for OCR cuts given news that Pfizer had developed a vaccine for COVID-19 that was 90% effective, that the NZ economy had held up much better than earlier thought, and that the early December launch of the RBNZ Funding for Lending Programme provided another avenue to lower borrowing costs from bank lending in NZ without the OCR going lower. ASB has shifted its call and no longer expects a negative OCR.

Global yields were supported by the vaccine news, and while President Trump has yet to concede the White House, the US election result looks to be a Goldilocks result for markets, with the Senate remaining in Republican control. The climb in yields halted towards the end of the week as concerns over mounting COVID-19 cases in the Northern Hemisphere, another community outbreak in NZ, and guarded comments by central bank heads Powell, Lagarde and Bailey instilled more caution.

Near-term interest rate outlook

Current market pricing has about 20bps of cuts and an OCR endpoint slightly above 0% which seems reasonable in light of the risk profile and our new OCR view. Given the extent of NZ moves we might see a slight retracement in yields this week. The RBNZ has thrown down the gauntlet to banks, implicitly tying the OCR to moves in customer lending interest rates. The more the latter fall, the less likely the need for the OCR to go lower.

Global data will be key for seeing if improvement continues (consistent with rising yields and steeper curves) or the data hits a speedbump. Chinese monthly retail sales, fixed asset investment and industrial production data should be solid enough, but we are concerned that the worsening COVID-19 situation in the US and Europe could slow the global recovery. October retail sales and industrial production data for the US, employment and wage data for Australia and retail trade data in the UK feature, with Thursday's deadline to reach a Brexit trade agreement a mild distraction for markets. The RBA Minutes and various appearances by RBA Governor Lowe will be worth keeping tabs on.

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 Funding for Lending Programme will help lower interest rates for borrowers within the economy. The outlook is highly uncertain with scope for 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

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
RBA Governor Lowe Speech	16/11	9:40 pm	-
China Retail Sales, October, %yoy	16/11	3:00 pm	5.0
RBA Meeting Minutes, November	17/11	1:30 pm	-
Australia Wage Price Index, Q3, %qoq	18/11	1:30 pm	0.3
UK CPI, October, %yoy	18/11	8:00 pm	0.6
US Retail Sales, October, %mom	18/11	2:30 am	0.8
US Industrial Production, October, %mom	18/11	3:15 am	1.0
UK Retail Sales, October, %mom	20/11	8:00 pm	5.5

*Originally published by CBA Global Markets Research on Friday 13 November at 12:15 pm

Reserve Bank of Australia (RBA) Governor Philip Lowe will deliver a speech titled “Covid, Our Changing Economy and Monetary Policy” – at the CEDA Annual Dinner. This will be the Governor’s first public speech since the press conference following the November meeting where the official cash rate, three-year bond target and Term Funding Facility interest rate were all cut to 0.1% and the RBA embarked on a \$A100bn bond purchase program in the 5-10 part of the yield curve.

We estimate China’s solid recovery to continue in October. Retail sales growth may accelerate to 5.0%yoy, boosted by the Golden Week holiday. We predict industrial production growth to remain solid at 6.8%yoy, supported by both domestic demand and the global recovery. Year-to-date fixed asset investment growth may lift to 1.5%yoy.

The **RBA Board Meeting Minutes** are expected to contain a deeper explanation of the decision to cut interest rates and embark on a \$A100bn bond buying program. Given all the communication from the RBA post this meeting, it is unlikely any material new details will be uncovered. The next test for the RBA will be monitoring the recovery in early 2021 and to decide on the future of its bond buying program, which is due to last 6 months from November.

Wage growth in Australia slowed faster than expected in Q2 20 as COVID-19 heavily impacted employment and wages. We expect another soft wage growth outcome of 0.3%qoq, lowering the pace of annual growth to 1.5%, from the 1.8% pace in Q2 20. The risks lie to the downside, however, given both a slowdown in public sector wages growth and the private sector.

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 Value Added Tax, as well as some downward pressure from spare capacity.

We estimate the pace of **US retail sales growth** moderated in October. Headwinds facing additional retail sales growth include less fiscal support, fading pent-up demand and high unemployment. Recently imposed partial lockdowns can also constrain spending into the year-end. A vaccine next year is a major medium-term upside though.

We estimate a rebound in **US industrial production** after it unexpectedly declined in September. We expect inventory shortages continued to support industrial production, even as consumer demand fades from recent high levels. A rebound in activity is also consistent with the jump in the ISM manufacturing in October.

UK retail sales volumes are now 5.5% above the February pre-pandemic levels. The BRC retail sales monitor, the CBI retail sales monitor and the Gfk consumer confidence survey point to a moderation in consumer spending over the month.

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	11.1	0.7	0.5	0.4	0.4	0.8
GDP real - A%	-12.4	-3.4	-3.1	-1.2	13.0	1.5	3.3
GDP real - AA%	-2.1	-3.5	-4.7	-5.0	1.0	4.3	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	0.0	0.2	0.3	0.4	0.5
CPI - A%	1.5	1.4	1.0	0.4	1.2	1.3	1.3
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	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.93	0.89	0.88	0.86	0.86	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.53	0.53
NZD/GBP	0.52	0.51	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.5	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	71.6	69.9	69.4	68.0	67.6	67.6

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