Economic Weekly

17 August 2020

Go hard, go negative?

It's been a pretty epic week. We went from starting off by hitting 100 days without knowing about any community COVID-19 transmission to back into degrees of lockdown by mid-week. We'll be there for a couple of weeks.

Our estimate of the lost economic activity from the lockdown is around $440 million per week that Auckland is in Level 3 and the rest of the country is in Level 2. Against that of course, are the health benefits from continuing the elimination strategy. The cost of the lockdown is useful for starting a conversation about the value of taking actions to prevent and minimise COVID outbreaks. Our feature piece this week explores several themes: the value of investing in border and tracing/tracing measures; understanding the trade-offs of containment actions; better understanding the cost/benefits of different strategies, and; working on our flexibility and adaptability.

The RBNZ announced last week that it will boost the ceiling on its asset purchases, and will start preparing to be able to enact a negative OCR and direct lending to banks (Funding for Lending Programme). The RBNZ's economic outlook still seemed a touch on the strong side. That – and the extent of the latest lockdowns – means **we now expect the RBNZ will implement the Funding for Lending Programme and a negative OCR early next year.** We will update our forecasts very shortly to account for this view change. The RBNZ's 'unconstrained' OCR (see chart) continues to flag the need for unconventional policy measures, though asset purchases remain the go-to for now.

Meanwhile, for some of us it's back to running down the middle of the street, binge-watching Netflix, worrying about coffee supplies, and feeling less guilty about the cupboard full of toilet paper that has been gathering dust. Take care out there, whatever your level.

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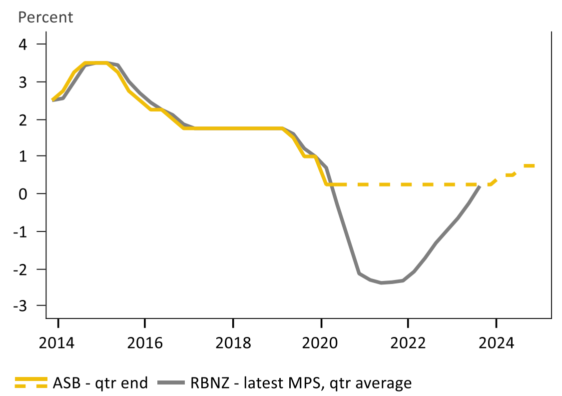
Recent key economics

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

Official Cash Rate Forecasts



Source: Macrobond, ASB

Improving our responses, decision-making and resilience for the COVID fight

- We need to get much better at preventing and responding to outbreaks.
- We also need to understand the risks/benefits of different strategies and containment measures.

Sequels are rarely as much fun as the original, so let's hope that Lockdown Part 2 will be mercifully short. This latest outbreak is a stark reminder that we need to:

1. Minimise the incidence of COVID outbreaks and the costs of getting on top of them;
2. Better understand the full economic and health costs/benefits of COVID-19 strategies;
3. Maximise the adaptiveness of our policies, work and home practices to minimise the impacts.

COVID-19 is creating a huge health and economic crisis. Without healthy people we don't have a healthy economy. Yet the health of our economy influences our health and quality of life. As we discussed in an earlier note in June, there are huge economic and broader health costs of combatting COVID-19. We need to better understand the trade-offs in what we are doing to prevent and contain COVID-19 so that we are making the best decisions we can. Nothing we do is without cost to the economy and our overall health and wellbeing. Unfortunately, the choices are hard.

Below are three things we need to be on top of to ensure we do our best over the coming years to minimise the health and economic impacts of the COVID-19 pandemic.

Minimise the likelihood of outbreaks and minimise the costs of containing them

We don't (yet) know the source of the latest COVID-19 outbreak, other than it appears a recent arrival carried by people or freight. But it is clear that our border and tracking/tracing processes have huge room for improvement. By our estimates the current lockdown is reducing economic activity (people's earnings) by nearly $900 million. On top of that are other costs, such as flow-on impacts to jobs and capital expenditure from any loss of confidence and non-COVID health impacts. Avoiding the need for lockdowns is well worth heavy investment given the high costs. And if lockdowns are going to remain a go-to, we need to refine them so that we are delivering the containment benefits while minimising all the other economic and health costs. In short, we need to:

- **Have a no-compromise and no-expense-spared approach to the border.** Get in external experts to design border/freight/isolation processes, audit compliance, and set up an accountability framework. Be transparent about exactly what is being done, both to help build national confidence and subject the process to a much-needed higher level of scrutiny than has been the case;
- **Boost the tracing/tracking technology and resources.** Globally the cutting-edge technology and know-how has been there for months. The huge costs of resorting to lockdowns should be reason enough for overcoming resourcing and any other hurdles that other countries evidently have. For example, Sam Morgan's COVID Card costs less than two days of the current lockdown losses.
- **Assess individual containment measures** for their containment effectiveness relative to the economic/broader health costs of them. That way we will respond in a way that continually keeps us on the sweet spot of maximising our containment effectiveness while minimising the economic costs.
- **In particular, refine lockdown processes** to better balance the containment benefits against the economic and other health costs. Similar to the above point, if we focus more on enabling commercial activities in a safe way, we can reduce near-term and long-term economic impacts while still preventing community spread of the virus. Each lockdown causes damage and leaves businesses less able to cope with the next one.

Get clarity about the costs and benefits of various COVID-19 strategies

Every choice we make around how we response to virus has impacts, whether we are explicitly aware of them or not. Containment measures reduce the harm from COVID-19. However, the costs of those measures show up in many ways, some of which are long-term rather than immediate, including:

- Economic impacts that reduce our long-term national wealth, including our ability to finance quality health, education, and retirement. Quality of life is enabled by high national income;
- More immediate health impacts from lockdowns such as deferred healthcare (we still haven't cleared the backlog of postponed medical treatment from the first lockdown), mental health, domestic violence etc;

COVID-19 has been with the world throughout 2020. There is now a plethora of medical and economic understanding of the impacts of the virus, and it is growing all the time. We need to be using this evolving body of knowledge to continually update our understanding of the benefits and costs of high-level strategies so we make the best possible decisions we can. As yet there is little public information on this, and the last set of official modelling of COVID-19 casualties was done prior to the first lockdown.

The Treasury, the Ministry of Health, and MBIE now have information they can use to enrich our understanding of several important issues. For example, we should have data on: NZ deaths (ideally also specific causes to assess differing impacts); medical procedures undertaken (and backlog size); domestic violence rates; the number of students impacted by disrupted learning. There is data on mortality rates from COVID-19 (Sweden, sadly, has detailed demographic data). Treasury could refine its Quality Adjusted Life Year measure so all the various health impacts can be quantified. Below are some areas to gain insights into.

Under various strategies (e.g. elimination, containment, 'leave it to the people') model/estimate:

- The likely COVID-19 casualties – number, mortality rates, demographic and socio-economic impacts;
- The short- and long-term economic impacts of these measures;
- The impacts on health outside of COVID-19.

The strategy endorsed by both of NZ's major political parties is elimination. We need to better understand what key assumptions need to play out for this path to ultimately be the right one in the long term. If we are relying on an effective vaccine, how likely is that? How long should we wait for it to be deployed? How will we keep up our engagement with the rest of the world (crucial for maintaining and developing export markets)?

All this may sound a bit bland or clinical. To put it more simply, what we essentially need to do is better understand the trade-offs in saving people from COVID-19 against the health impacts of combatting the virus such as increased deaths/illness from added cancer & cardio cases, suicide etc. as well as potential reductions in life expectancy amongst the wider population. And we need do the sums for outcomes spanning over decades. All of that is incredibly challenging in an environment of huge uncertainty. We are implicitly making these choices already. But the better we understand the choices, the more likely we are to make choices that stand us in good stead.

Let's get flexible, flexible

This latest COVID-19 outbreak is a reality check for all of us. Either we need to be prepared for further lockdowns to eliminate the virus any time there is another border breach. Or, if elimination is ever abandoned, we'll need to learn to cope on a more everyday basis with measures to suppress waves of community infection.

We have learned a lot from Lockdown One. But now is a reminder that flexibility, adaptability and resilience are extremely important. The more that businesses can proof themselves against lockdown restrictions the more we can minimise the costs of fighting the virus. That may include reconfiguring floor layouts, operating methods, and ensuring effective digital commerce and distribution platforms, if not already done. ASB has created BusinessHub to give some insights into actions businesses can take. Financial support from ASB and other banks is there for those in need. And more government support may come available if the lockdown endures – keep an eye out for announcements. An extended wage subsidy is already on the way.

And for all the political parties out there, we need to know what The Vision is. This is the greatest economic and health crisis we have faced for many decades. The decisions we make over the next few years are going to define our future in a way that we probably haven't seen since World War 2. We desperately need to see a sound contest of forward-looking goals and principles to guide our path forward.

Take care

We are in a marathon in combatting COVID-19, and endurance (emotional and financial) is key. We need to reach out if we need support of any kind and check in with people to make sure they are okay. There will be light at the end of the tunnel, we just don't know how long the tunnel is right now but we will get there together one-day-at-a-time. All the best. Kia Kaha. nick.tuffley@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6538	0.6605	0.6546	0.6442	FLAT/DOWN	0.6400	0.6710
NZD/AUD	0.9122	0.9221	0.9366	0.9479	DOWN	0.9095	0.9240
NZD/JPY	69.70	69.85	70.16	68.36	FLAT	68.00	71.60
NZD/EUR	0.5521	0.5600	0.5748	0.5802	FLAT/DOWN	0.5385	0.5650
NZD/GBP	0.4990	0.5054	0.5208	0.5327	FLAT/DOWN	0.4900	0.5150
TWI	71.2	71.7	72.1	71.63	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 RBNZ's surprisingly aggressive easing announcement last Wednesday saw the NZD/USD underperform last week. NZD was the weakest performing G10 currency over the week. NZD/USD slipped to one-month lows around 0.6530 and NZD/AUD hit 2-year lows around 0.9130. The fall in the former would have been larger if it weren't for another modest fall in the USD over the week.

Outlook

The key message from the RBNZ last week was that they are prepared to pull out all the stops to get NZ interest rates lower and support the economy. The Bank's quantitative easing (QE) programme was ramped up by more than anyone expected (to $100b) and the chances we see negative interest rates next year are now much higher.

These factors set the NZD up for additional near-term underperformance in our view. The RBNZ's approach to QE is much more aggressive than those in Australia or the US. Indeed, NZ-US 2-year interest rate (swap) differentials fell back into negative territory last week from levels around zero. This has seen the 'fair-value' range implied by our short-term NZD/USD valuation model fall a cent, to 0.6350-0.6750.

We'd expect any NZD weakness to continue to be most pronounced against the AUD. Indeed, the downside risks to our NZD/AUD forecasts continue to grow. The RBNZ's balance sheet is set to expand faster than the RBA's and, unlike NZ, the RBA has continued to stress that a negative cash rate in Australia is very unlikely. Relative commodity prices also continue to shift slowly in Australia's favour as iron ore prices surge. These factors suggest the NZD/AUD downtrend can extend further. Our CBA colleagues estimate an NZD/AUD 'fair-value' range of 0.8500-0.9200.

Near-term direction for the NZD will be driven much more by domestic factors than offshore this week. Not only is the offshore data calendar relatively light, but the evolving situation with Auckland's COVID outbreak is potentially a big deal for the local economic and monetary policy outlook, and by association the NZD. The daily 1pm COVID updates, and the GDT dairy auction on Wednesday are the local focus now that this week's Pre-Election Fiscal Update (PREFU) has been delayed.

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ASB foreign exchange forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< 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

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.00	0.25	0.25	1.00	UNCH	UP
90-day bank bill	0.29	0.30	0.30	1.21	UNCH	UP
2-year swap	0.14	0.21	0.21	0.93	UNCH	UP
5-year swap	0.22	0.30	0.33	0.93	UNCH	UP
10-year swap	0.61	0.66	0.70	1.19	UNCH	UP
10-year govt bond yield	0.67	0.78	0.90	1.01	UNCH	UP
Curve Slope (2s10s swaps)	0.47	0.45	0.49	0.26	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 fall in NZ yields. Proof of community-based transmission of COVID-19 in NZ saw the move up to Alert Level 3 in Auckland and the shift to Alert Level 2 for the rest of NZ. That will weigh on the NZ economic recovery, and the NZ General Election has been pushed out to 17 October. The RBNZ delivered a more dovish than expected Monetary Policy Statement last Wednesday, in which it raised its Large-Scale Asset Purchase Programme (LSAP) to $100bn through to June 2022 and raised the Crown Indemnity on conventional NZ government bond purchases to 60%. The RBNZ also signalled a scaled up weekly asset purchase programme, keeping NZ 10-year bond yields (0.65%) around 3-month lows. The RBNZ also noted risks as being downwardly skewed and explicitly flagged a package of further easing measures, including a funding for lending programme. Global yields were firmer with US 10-year Treasury yields up 13bps over the week (to 0.71%). Drivers included rising US debt sales, a generally improving tome of data (including rising US consumer prices) and hopes that the White House and House Democrats would agree to a new US support package. The Australian 10-year yield is around the highest in more than 2 months (0.93%) despite RBA asset purchases keeping the 3-year bond yield close to its target of around 0.25%.

Near-term interest rate outlook

We have formally changed our RBNZ call and have now pencilled in the OCR to be cut by 75bps to -0.50% by early 2021 (most likely April), with the OCR to remain at this level until the COVID-19 storm passes. This is on the proviso that COVID-19 continues to remain a strong headwind to NZ and global economies, that operational hurdles around a negative OCR are cleared, that the RBNZ do not shift their earlier guidance on not changing the OCR till early next year, and that the lower OCR will be in conjunction with a funding for lending programme that will provide stable, low cost funding to banks that can be lent out. We see NZ yields moving lower, particularly with markets currently pricing in an OCR of 0% by next April and an OCR trough of just -0.15% from late 2021.

In the interim, we also expect that the RBNZ will remain highly committed to using its beefed-up asset purchase programme and forward guidance to provide significant liquidity and keep yields low across the curve. NZ Treasury had scheduled the Pre-Election Fiscal and Economic Update (PREFU) for release this week, but along with the General Election, the PREFU is now delayed.

We see scope for global yields to retrace some of their earlier climbs and for global yield curves to flatten this week. This week's US FOMC minutes are likely to strike a dovish tone, with discussion around changing forward guidance to be of particular interest. A break though in the current stalemate between the Democrats and the White House over fiscal support packages has the potential to push yields higher, but this still looks a way off. In the ECB's July Monetary Policy Meeting Account, much like the RBA Minutes for August, we do not expect any new material information. The resumption of government bond purchases by the RBA to hold 3-year Australian Government Bond yields close to its 0.25% target will be monitoring closely.

Medium-term outlook

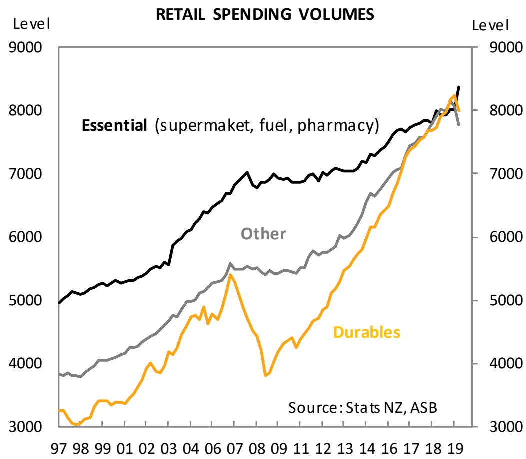
Providing operational hurdles are cleared and the RBNZ sticks to its forward guidance we expect to see the RBNZ cut the OCR to -0.50% by early 20121 (we have pencilled in April) and for a funding for lending programme introduced at this time. Low global inflation and subdued global growth prospects should keep NZ yields low and the curve flat despite high public debt issuance. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	19/08	overnight	-7.5	-
Retail Sales volumes, Q2, % qoq	24/08	10:45am	-	-20
Pre-election Economic and Fiscal Update **(now delayed)**	-	-	-	-

Treasury was scheduled to the release the Pre-election Economic and Fiscal Update (PREFU) on Thursday at 1pm. However, given the Election has been postponed to October 17, the PREFU release is also going to be rescheduled.

We expect a record Q2 fall in retail volumes given the impact of physical distancing, lockdown restrictions, and border/travel restrictions instigated to contain the COVID-19 outbreak. NZ was in Alert Level 4 at the start of Q2, with restrictions subsequently relaxed over the quarter. This resulted in physical store closures initially impacting the 60%+ of total retail deemed to be non-essential, with physical distancing requirements impacting wider economic activity. We expect to see approximate 50% falls in accommodation and hospitality retail, with fuel and motor vehicle retail copping major declines. Around 15-20% quarterly falls are expected for electronics, durable and apparel retail with a post-lockdown boost evident. Supermarket volumes should be little changed. More timely data, including proprietary ASB card spending information, has confirmed a solid rebound in spending in May, June and July, with pent-up demand, higher durables spending, the desire to support local retail and higher domestic tourism key supports. However, increasing COVID-19 restrictions following a community outbreak, the shut NZ border and widespread job losses looks set to scupper the retail recovery. A difficult Christmas shopping period looms for local retailers.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CBA card spend, week ending 14/8	18/08		-
Australia RBA Board Minutes	18/08	1:30pm	-
Australia Prelim Retail Trade, July, % mom	19/08	4:30pm	+1.5
UK CPI, July	19/08	6:00pm	-
EZ ECB July Monetary Policy Meeting Account	20/08	11:30pm	-
US FOMC Meeting Minutes	20/08	6:00am	-
UK Retail Sales, July, % mom	21/08	6:00pm	-
UK PMI, August	21/08	8:30pm	-
EZ PMIs, August	21/08	8:00pm	-

Originally published by CBA Global Markets Research on Friday 14 August at 1:49 pm

Over the period of stage 4 shutdowns in Metropolitan Melbourne we expect to see Victorian card spending lag behind the rest of Australia. We will be watching **CBA's internal card spending data** closely to see to what extent this materialises. Online spending continues to run at a high level.

As widely expected the **RBA** left monetary policy unchanged at the August Board meeting. But the RBA did resume purchasing Commonwealth government bonds in the secondary market to ensure that the yield on 3-year bonds remains consistent with the target of 0.25%. Given the Statement on Monetary Policy was released following the Board meeting we do not expect any new information of note from the **August minutes**.

The **ECB** made no policy changes at its 16 July meeting and there was no indication of any change soon. As such, we don't expect new material information from the **meeting account**.

The **FOMC meeting minutes** are likely to strike a dovish tone. US economic activity was slowing and FOMC members were growing more cautious over the economic outlook ahead of the July meeting. Any discussions around changing forward guidance, including adopting a flexible inflation target, will be closely monitored.

UK retail sales are likely to lift: the July British Retail Consortium retail sales monitor and the Gfk consumer confidence survey point to a further pick-up in consumer spending over the month. Going forward, above average savings rate and continued uncertainty around the risk to health from Covid-19 remain major headwinds for consumer spending.

The UK composite PMI rose to a 61-month high of 57.0 in July. The August **UK PMIs** will indicate whether the recovery in economic activity is starting to level off or gaining momentum.

The composite **Eurozone PMI** rose to a 25-month high of 54.9 in July. The August PMIs will indicate whether the recovery in economic activity is starting to level off or gaining momentum.

Key Forecasts

ASB NZ economic forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
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	Jun-20	Sep-20	Dec-20	Mar-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	0.51	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	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< 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

(Note: we are changing our interest rate forecasts to factor in a negative OCR)

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