Economic Weekly

18 May 2020

Willing to do all that it takes

Last week's Budget and Reserve Bank of New Zealand (RBNZ) review confirmed both the Government and the Central Bank are willing to do all that it takes to support the NZ economy through the COVID-19 pandemic.

The RBNZ remained committed to keeping interest rates low and confirmed it would purchase $60bn of (mainly) NZ Government bonds over the coming year (up from the $33bn previously announced). Over recent weeks, the RBNZ's approach looks to have been more aggressive than across the Tasman, with the RBA starting to taper asset purchases while the RBNZ's weekly purchase rate remains on full throttle. At the margin, this has provided additional stimulus to the NZ economy, with a lower NZD (particularly against the AUD) than would otherwise be the case. The RBNZ's Quantitative Easing programme looks to have been effective in helping to lower wholesale interest rates, **but the RBNZ does not look to be fully satisfied with the flow through into retail interest rates**. Expect closer scrutiny on borrowing rates from the RBNZ going forward, and if 'jawboning' alone does not work, there is potential for the RBNZ to dig further into its bag of tricks.

Meanwhile, the **Government has readied itself for war in the 2020 Budget**, with the $50bn COVID-19 Response and Recovery Fund (CRRF) package to support employment, households and firms. **We agree that borrow and spend on a massive scale is the best approach right now**. It is also important, however, that the Government articulates a plan that will help shape the future of the NZ economy. NZ's public finances stack up well in relation to overseas peers, giving us more options than many other economies. Down the line, however, future Governments may have to make some tougher trade-offs. The Treasury may not be able to get away with using flattering economic forecasts for long.

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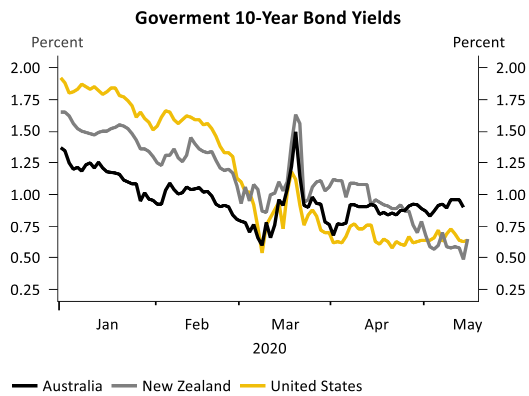

Source: Macrobond, ASB

Recent COVID-19 publications	Where to find support
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 confirms increase to QE at May Monetary Policy Statement Budget 2020 delivers huge support, huge debt	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	0.5927	0.6144	0.6018	0.6537	DOWN	0.5850	0.6200
NZD/AUD	0.9241	0.9372	0.9455	0.9489	DOWN	0.9200	0.9325
NZD/JPY	63.49	65.69	64.83	71.72	DOWN	61.85	65.00
NZD/EUR	0.5480	0.5663	0.5536	0.5847	FLAT /DOWN	0.5400	0.5600
NZD/GBP	0.4906	0.4943	0.4816	0.5109	FLAT /DOWN	0.4760	0.4930
TWI	67.5	69.2	68.4	72.14	DOWN	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 the weakest performing G10 currency last week. The NZD/USD shed around 1½ cents to finish the week under 0.6000. NZD/AUD closed at a six-month low around 0.9250. It's been a pretty rapid fall from grace for the cross. Recall, it briefly traded above parity as recently as mid-March.

The RBNZ meeting last week did most of the damage. The Bank not only increased it's quantitative easing programme to $60b, but also further oxygenated the debate around negative interest rates in NZ. Fixed interest markets have thus rapidly moved to price a strong chance of a negative OCR later this year. Set against a global backdrop of central banks generally tapering asset purchases (most notably the RBA and Federal Reserve), the contrasting policy stance of the RBNZ provided big headwinds for the NZD, particularly against the AUD.

Outlook

We expect the NZD to remain heavy this week. Any NZD/USD bounces above 0.6000 looks set to be met with stiff resistance and will ultimately run out of steam. NZD/AUD looks set to test 0.9200.

First, the RBNZ's dovish stance will keep downward pressure on NZ yields and the NZD. The Bank announced on Friday they will continue to aggressively buy government bonds this week (to the tune of $1.35b). Last week the RBA didn't buy any. And with the NZ Government delivering an enormous debt-fuelled spending bonanza of a budget, there will no doubt be speculation that the RBNZ will have to step up bond buying even further.

Second, we see scope for USD appreciation to drag the NZD/USD lower. Re-escalating US China tensions, risks of a second wave of coronavirus cases, and the Federal Reserve's reluctance to cut interest rates further should all support the USD in the short-term.

This week's economic data will continue to be largely ignored. Market participants are well aware the global economy is in a severe recession so data confirming such is not seen to be adding much value. This week's April data will be terrible. But in our view April may well prove to be the nadir of the global economic cycle, now that most nations are slowly reopening their economies mike.jones@asb.co.nz

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

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	1.50	UNCH	UP
90-day bank bill	0.27	0.26	0.39	1.71	UNCH/UP	UP
2-year swap	0.12	0.17	0.35	1.55	UNCH/UP	UP
5-year swap	0.21	0.32	0.51	1.68	UNCH	UP
10-year swap	0.61	0.73	0.91	2.07	UNCH	UP
10-year govt bond yield	0.66	0.59	0.95	1.79	UNCH	UP
Curve Slope (2s10s swaps)	0.49	0.56	0.56	0.53	UNCH	DOWN

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

Market Recap

Yields start the week lower across the curve and around record lows. As was widely expected, the Reserve Bank of New Zealand (RBNZ) Monetary Policy Committee agreed to expand the Large-Scale Asset Purchase programme, i.e. Quantitative Easing (QE), to a maximum of $60b of purchases over the next 12 months (from $33bn) and reaffirmed its forward guidance that the OCR will remain at 0.25% until early 2021. Yields fell around 10bps and OCR expectations for 2021 moved into negative territory as the RBNZ signalled its preparedness to use additional monetary policy tools, if and when needed, and did not rule out a negative OCR. Yields firmed after Thursday's NZ Budget announced a $62bn COVID-19 support package and signalled a total of $190bn in gross bond issuance over the next five years ($60bn in 20/21 alone). NZ yields fell at the end of last week, with strong demand at the NZ bond tender.

The combination of extremely weak data, the ratcheting up of US-China tensions and the cautious tone by central banks and other authorities weighed on global yields despite increasing global bond issuance. Market pricing for the major central banks is skewed towards policy rate cuts despite Fed Chair Powell and Bank of England Governor Bailey ruling out adopting negative policy interest rates.

Near-term interest rate outlook

Current market pricing (OIS) has a terminal OCR endpoint of around -0.12% which looks reasonable given the risk profile. NZ yields are expected to remain below US and Australian counterparts until views of the respective central banks on the effective lower limit of the policy interest rate and current appetite for QE come into closer alignment. Fed Chair Powell is set to testify before the US Senate Banking Committee on May 19, which along with the Fed's April Meeting Minutes may provide colour on policies under consideration, including QE and negative rates.

For now, we expect the RBNZ to remain an active buyer, signalling it will purchase a further $1350m in NZ Government bonds for the fifth consecutive week (about $12m of NZGB purchases to date). This and the RBNZ's easing bias should help to dampen NZ yields. We do not expect much new information from the April RBA Minutes, but Thursday's Panel Appearance by Governor Lowe may shed some light on the RBA's views. The RBA has scaled back bond purchases, but with Australian short-term yields still around 0.25% the RBA will likely be comfortable with progress. Published data is expected to be terrible, coinciding with the period in which COVID-19 restrictions were imposed and economies put on ice. With countries around the world easing restrictions, the direction of yields will hinge upon how successfully economies can be kickstarted without a flaring up of new infections and the subsequent clamp down.

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 expect the RBNZ to make more use of QE first. Weak global activity and RBNZ asset purchases should help to cap longer-term NZ interest rates despite a mountain of global public debt issuance. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
Retail Sales volumes, Q1, % qoq	22/05	10:45am	-	-1.5

Retail volumes ended 2019 on a solid note, with a 0.7% climb in December quarter and an approximate 3.5% increase over 2019. Retail spending at the start of this year looks to have continued in a similar vein but ran into a brick wall as the COVID-19 outbreak and associated restrictions took effect. **We expect the Q1 data to show a small portion of the circa 40% fall we expect for retail volumes in the first half of the year, with card spending data showing retail spending almost halving in April.**

Nevertheless, the Q1 data should show widespread falls for retail volumes. Particularly large falls are expected for accommodation, motor vehicle and apparel retail, which will be partly offset by a surge in supermarket retail volumes due to panic shopping. The easing of restrictions is expected to see retail volumes rebound in the second half of the year, but we expect retail volumes to be around 10% lower, on average, over 2020. Widespread job losses, falling house prices and a weak outlook for tourism means that 2020 will be a year to forget for most retailers.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Japan GDP, Q1, %qoq	18/05	11:50 am	-1.0
RBA Board Meeting Minutes, May	19/05	1:30 pm	-
UK CPI, April, Q2, %qoq	20/05	8:30 pm	0.5
Australia CBA Composite PMIs, May, points	21/05	11:00 am	21.7
Australia Retail Trade, April, %mom	21/05	1:30 pm	-11.0
US Fed Meeting Minutes, April	21/05	6:00 am	-
ECB Account of the April Monetary Policy Meeting	22/05	-	-
UK Retail Sales ex auto, fuel, April, %yoy	22/05	6:00 pm	-4.1

Originally published by CBA Global Markets Research on Friday 15th May at 2:45 pm

At the last board meeting the **Reserve Bank of Australia (RBA)** left the cash rate unchanged at 0.25%. They reaffirmed that the cash rate would not be increased "until progress is being made towards full employment and [the Board] is confident that inflation will be sustainably within the 2-3 per cent target band". Given the detailed scenario analysis released in the SMP on 8 May we do not expect any new information from them on the economy. The RBA's asset-purchasing program has seemingly ground to halt. In more than a week since 6th May no additional purchases have been made.

The **Australian CBA PMI Flash Estimate for May** provides an up-to-date read on around 75% of the economy. The pervasive shutdown enacted in late March saw the Composite index collapse in April, falling 17 points to 22.4. This was the sharpest and deepest decline in the survey's short history which commenced in 2016. The services PMI underperformed, plummeting by 18.9 points to 19.6. The manufacturing component has fared comparatively better, falling just 4.1 points to 45.6. But all three indexes are below the critical 50 level which separates expansion from contraction. When the recovery in economic activity commences, we would expect to see these indexes tick back above the critical 50 level.

Australian retail trade in March saw the largest recorded monthly increase of 8.5%. This was driven by higher prices and supermarket spend. Food spending surged 24.1% as households stockpiled grocery items because of concerns about COVID-19. Card spending has pointed to a substantial easing in retail expenditure over April. Given the base effect from the surge in March's retail trade, we expect an 11% fall in retail trade in April.

We estimate **Japan's GDP** contracted 1% in Q1 2020 and industrial production picked up slightly. However, consumption took a big hit and net exports fell because of the coronavirus.

The Bank of England projects headline CPI inflation to average about 0.5% in Q2 2020 and to ease towards 0% by the end of 2020. Still, the Office for National Statistics warned that the coronavirus will make it difficult to interpret CPI data in the next couple of months, in part, because of the technical challenges to measuring inflation during the containment period.

The **US Federal Reserve** left monetary policy unchanged at its April meeting. However, the central bank reinforced that it would do what was necessary to support the economy. Any discussions around any new policies the US Fed is considering will be closely monitored. Finally, market participants will be interested to see if the committee discussed negative interest rates given the recent focus on the topic.

At its 30 April meeting, the **European Central Bank (ECB)** maintained its ultra-loose monetary policy settings but boosted liquidity for Eurozone banks. The ECB also signalled readiness to turn to the monetary policy tap further.

The **British** Retail Consortium April retail sales monitor points to a significant decline in non-food **retail sales**.

Key Forecasts

ASB NZ economic forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>						
GDP real - Q%	0.5	-1.0	-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	-0.6	0.3	-0.1			
CPI - A%	1.9	2.5	1.3	1.0	0.4	-0.1	1.1	1.8
HLFS employment growth - Q%	0.1	0.7	-5.8	-1.5	0.6			
HLFS employment growth - A%	0.8	1.6	-4.9	-6.5	-6.1	-6.3	3.0	2.7
Unemployment rate - %sa	4.0	4.2	9.0	9.4	8.6	8.3	7.2	6.2
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

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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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