

# Economic Weekly

19 October 2020

## Muddle, Bubble, Toil, or Trouble?

The line above could almost be interpreted as the menu of economic outcomes available to the Reserve Bank, as it continues to ponder which alternative policy tool, if any, to deploy next. The show-stopper among these – a negative OCR – is looking a little less likely than it was a month ago. Not only has the economy continued to impress with its post-lockdown resilience, but certain sectors are positively humming. This highlights the uneven way COVID stimulus has filtered through the economy, and the care required in applying it. Beset by supply-side rigidities, stimulus has simply inflamed the excess demand obvious in the housing market (see ‘Chart of the Week’). Our latest [Home Economics](#) publication last week marked up our house price forecasts significantly. Equity markets, too, remain on a tear with the NZX50 up 46% since March. The risk is thus increasing we end up with “bubble”-like conditions in some sectors, even as others continue to “muddle”.

The weekend delivered an outright majority to the Labour Party. It’s the first time under the MMP electoral system that one party won enough seats (>60) to govern alone (acknowledging the results are not yet final). The result wasn’t a complete surprise given pre-election polling, and financial markets have taken the outcome in their stride. The emphatic result means we’re unlikely to see weeks of coalition wrangling as in past elections, something that can drag on business and financial market sentiment. Attention should move on quite quickly. We’ll provide a full run-down on our take in a note to be released later today.

Attention this week will be on the US election, and in particular the rising chances of a Democratic “clean sweep” of the White House, Senate, and House. Locally, Friday’s CPI and tomorrow’s QSBO will be worth watching. We expect the former to reveal a lift in annual inflation to 1.7% yoy. [mike.jones@asb.co.nz](mailto:mike.jones@asb.co.nz)

### Recent key economics

#### ASB Economic forecasts and monitoring:

[Quarterly Economic Projections](#)

[ASB COVID-19 Chart pack](#)

[Home Economics](#)

#### Financial market trends:

[Corporate Hedging Toolbox](#)

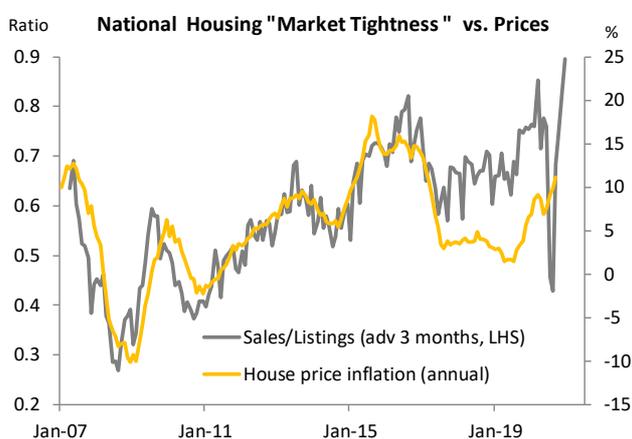
#### Policy response:

[RBNZ September MPR Review](#)

[Assessing the RBNZ’s bag ‘o’ tricks](#)

For COVID-19 research, see [here](#)

### Chart of the week



Source: ASB, REINZ

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6623	0.6664	0.6787	0.6371	FLAT/DOWN	0.6530	0.6790
NZD/AUD	0.9332	0.9218	0.9274	0.9324	UP	0.9280	0.9445
NZD/JPY	69.84	70.27	71.13	69.16	FLAT/DOWN	69.30	72.00
NZD/EUR	0.5652	0.5638	0.5727	0.5725	FLAT	0.5600	0.5800
NZD/GBP	0.5121	0.5112	0.5237	0.4957	FLAT	0.5100	0.5270
TWI	71.4	71.4	72.6	70.52	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 NZD finished the week lower against the USD and JPY, sideways against the EUR and GBP and up against the AUD. A cautious tone crept into financial markets over the past week, driven by Brexit concerns, rising numbers of COVID-19 cases in Europe and fading hopes of a US fiscal stimulus package being agreed on ahead of the US November General Election on November 3.

NZD rallied against the AUD over the past week, with strong NZ housing market data highlighting the resilience of the NZ economy. Weighing on the AUD was a speech by RBA Governor Lowe which portrayed a sense of urgency around reducing slack in the labour market. The AUD fell as interest rate markets moved to price in a rate cut in November. Our CBA colleagues now expect the RBA to trim the cash rate and 3-year bond yield target to 0.1% at their November meeting, with the decision released on November 3.

### Outlook

The decisive NZ General Election result over the weekend should see minimal impact on the NZD today.

It is a relatively quiet week ahead in terms of economic data releases NZ and offshore, with global market sentiment likely to be the key driver for currency direction. At home, the key focus will be on the Q3 CPI on Friday, although to some extent the result may be looked through by financial markets as the CPI result will be impacted by COVID-19 related volatility, COVID-19 related measurement challenges and the CPI basket rebase.

Without further US fiscal stimulus, the US economic recovery is at risk, and as a result we think the USD is vulnerable to additional strength in the short-term. This could see NZD/USD test support levels in the low 0.6500s this week.

Meanwhile, risks to the NZD/AUD are skewed higher with the NZ-AU relative interest rate differentials starting to narrow. A rate cut from the RBA is now widely expected in November, but strong NZ economic data is putting RBNZ rate cuts in doubt (at least in the minds of market participants, not so much RBNZ officials as yet).

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### 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	0.28	0.28	0.30	1.05	UNCH/DOWN	UP
2-year swap	0.03	0.03	0.05	0.94	UNCH/DOWN	UP
5-year swap	0.10	0.11	0.14	1.01	UNCH/DOWN	UP
10-year swap	0.47	0.50	0.54	1.34	UNCH/DOWN	UP
10-year govt bond yield	0.53	0.58	0.55	1.24	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.44	0.47	0.49	0.40	UNCH	DOWN

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

### Market Recap

NZ yields edged lower towards the end of last week, with the yield curve flattening and swap yields hovering around record lows. The RBNZ continued to flag the likelihood of a lower OCR, with Assistant Governor Hawkesby citing very weak inflationary pressure, and noting 'it was not a game of bluff' when talking about negative rates. The \$1,010m in RBNZ asset purchases from the LSAP took the cumulative total above \$36bn, outpacing the weekly tender. NZ General Election results were not unexpected, with Labour looking like it has won an outright majority.

Australian yields outperformed (i.e. registered larger falls), with a more pronounced flattening. RBA Governor Lowe was explicit in signalling more RBA easing is to come, with more focus on the (weak) short-term employment outlook and current (low) inflation. Longer-term Australasian yields were also lower after Lowe floated the idea of lengthening the maturity of RBA Government bond purchases. Our CBA colleagues expect the RBA to cut the cash rate and 3-year bond yield target from 25bps to 10bps in November. Other global yields were generally lower, with a curve flattening bias. US 10-year Treasury yields were down 3bps over the week, with equities also lower given the continued impasse on a new fiscal package, and with the ramping up of COVID-19 restrictions in Europe and Brexit uncertainties also tempering sentiment.

### Near-term interest rate outlook

We have kept our downward bias for local yields. Preliminary NZ election results are clear cut and we don't expect much of an impact on the local rates market. The RBNZ has continued to pare back the LSAP, but the signalled \$880m weekly pace of NZ government bond purchases this week remains well above the \$600m weekly tender and should help dampen NZ yields. Local data this week, including the Q3 QSBO and CPI, should attract modest market reaction. We still feel the RBNZ are preparing to go down the negative OCR route next year and would rather deploy LVR restrictions on investor lending to slow the resurgent housing market than refrain from cutting the OCR.

The direction of risk appetite should influence local and global yields and we could see some volatility leading up to the US elections (November 3). The flash PMI readings will give an early reading on how the global economy was tracking in October. We expect monthly Chinese data to show the solid recovery continuing in September. The Minutes from the October RBA 2020 Board meeting will be checked for consistency with Governor Lowe's speech as will other RBA speeches this week. This week also has a number of Fed speeches and the Fed beige book.

### Medium-term outlook

The RBNZ have signalled they will launch a Funding for Lending Programme by the end of the year, most likely shortly after the November MPS on November 11. This will only provide modest economic support in our view. We have pencilled in a 75bps OCR cut in April to take the OCR to -0.5%, but whether the RBNZ does cut to this extent will depend on the economic outlook and whether the Bank deems the OCR to be the preferable policy lever to pull. Prior to that, the RBNZ is expected to maintain asset purchases above the weekly NZ Government bond tender and will employ dovish 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](mailto:mark.smith4@asb.co.nz)

### ASB interest rate forecasts

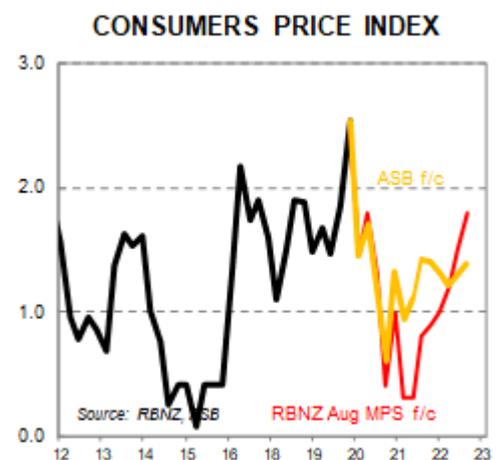
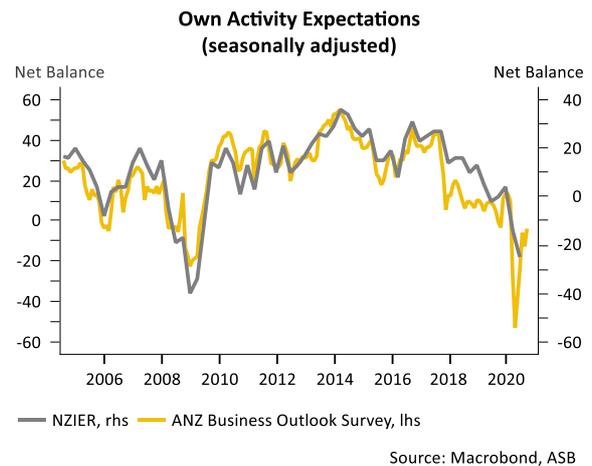
(end of quarter)	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZ OCR	0.25	0.25	0.25	0.25	-0.50	-0.50	-0.25
NZ 90-day bank bill	0.30	0.31	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.06	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.13	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.51	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.46	0.45	0.25	0.00	0.20	0.55

## Domestic events

Data	Date	Time (NZT)	Market	ASB
NZIER QSBO, Experienced trading activity, s.a., Q3	20/10	10:00am	-	-
Consumers Price Index, Q3, %qoq	23/10	10:45am	-	0.9

The **NZIER Quarterly Survey of Business Opinion** for Q3 was previously scheduled for released on the 6<sup>th</sup> of October, will now be released on the 20<sup>th</sup> of October. We expect the QSBO to show a small a recovery in business confidence over Q3. Over Q2, QSBO business confidence did not fall as far as the monthly ANZ business confidence survey (see chart opposite). We typically place more emphasis on the Quarterly Survey by NZIER as it has a more reliable performance in predicting GDP growth. However, given the highly unusual circumstance of the COVID-19 pandemic, the relationship between reported trading activity and GDP growth has broken down. In addition, the quarterly survey may not be able to accurately account for economic activity over the quarter due to the cycling through Alert Levels creating volatility in trading conditions from month to month. Throughout Q3, NZ spent about half the quarter under Alert Level 1, but an outbreak in August saw Alert Level restrictions reinstated during the second half of August and throughout September.

We expect a **0.9% qoq increase in Q3 headline CPI**, with annual headline inflation rising to 1.7%. This is marginally below RBNZ's August Monetary Policy Statement forecast (1.1% qoq and 1.8% yoy). Annual readings for core inflation are expected to be close to 2%. The Q3 outturn reflects an element of recoil from the very weak Q2 print, along with seasonality and our expectation that pricing pressures are not entirely dormant in some key pockets of the economy, notably housing. Risks are broadly balanced, but we admit a greater degree of uncertainty than usual around our CPI pick given the impacts of COVID-19 and the CPI rebase. Looking ahead, we expect annual headline inflation to dip at the start of next year but for annual CPI deflation to be avoided. The NZ economy has provided to be more resilient than we expected, and some of the downside risks for the economy and medium-term inflation look to have dissipated. Nevertheless, uncertainty is pronounced, and economic headwinds posed by COVID-19 remain sizeable. Entrenched low inflation provides a free hit and allows the RBNZ to deploy additional policy stimulus. We have pencilled in a negative OCR from April next year but note this is conditional on the economic outlook, operational hurdles being cleared and the RBNZ being confident this is the best policy option available.



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	ASB
China GDP, Q3, %yoy	19/10	3:00 pm	5.6
RBA October Board Meeting Minutes	20/10	1:30 pm	-
Australian Retail Trade, Sep prelim, %mom	21/10	1:30 pm	-2.5
UK CPI, Sep, %yoy	21/10	7:00 pm	-
US Federal Reserve Beige Book	22/10	7:00 am	-
UK Retail Sales, Sep, %mom	23/10	7:00 pm	-
UK PMI, Oct	23/10	9:30 pm	-
EU PMI, Oct	23/10	9:00 pm	-

\*Originally published by CBA Global Markets Research on Friday 16 September at 1:42 pm

We expect Chinese Q3 GDP growth to accelerate to 5.6% yoy because of strong net exports and recovering domestic demand.

The RBA Board meeting minutes released this week are from the 6 October meeting where the RBA left monetary policy unchanged. However, since that meeting Governor Lowe has given a speech suggesting that more monetary policy stimulus will be delivered. We expect further easing to take place in November in the form of a cut in the cash rate, term funding facility rate and three-year government bond target to 0.1%. The RBA Governor has also hinted that further government bond purchases in the 5- to 10-year part of the curve may take place.

CBA household card spending data is pointing to another fall in retail trade in September. We have a 2.5% decline in our forecasts for the month following the 4.0% fall in August. A drop in line with our forecasts in September would still see retail trade up around 6.5% over Q3 20. This would suggest a strong recovery in retail spending after contraction in Q2 20. While retail spending has lifted our internal data is showing that spending on services is still weak.

UK headline CPI inflation slowed to 0.2%/yr in August and is in line with the Bank of England's (BoE) Q3 projection. The 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.

The Federal Reserve's Beige Book provides an on-the-ground assessment of current economic conditions in Federal Reserve districts. Attention will be on the pace of the economic recovery and where the balance of risks lies. In our view there may also be some added caution because of the lack of progress in passing additional fiscal stimulus.

UK retail sales volumes increased for a fourth consecutive month in August. UK retail sales volumes are now 4% above pre-pandemic levels, driven by food and non-store retailing. The BRC retail sales monitor, the CBI retail sales monitor and the Gfk consumer confidence survey point to a further pick-up in consumer spending over the month.

The UK composite PMI declined in September to 55.7 reflecting weaker expansions in both manufacturing production (54.3) and service sector activity (55.1). The October PMIs will indicate whether the recovery in economic activity continues to level off or re-gaining momentum.

The EU composite PMI fell to 50.1 in September, a three-month low. The October PMIs will indicate whether the recovery in economic activity continues to lose traction.

## Key Forecasts

### ASB NZ economic forecasts

	Jun-20 « actual	Sep-20 forecast »	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
GDP real - Q%	-12.2	11.0	0.7	0.3	0.1	0.4	0.8
GDP real - A%	-12.4	-3.4	-3.2	-1.5	12.3	0.7	3.3
GDP real - AA%	-2.1	-3.5	-4.8	-5.1	0.7	3.5	2.3
NZ House Prices (QV Index) - A%	6.8	6.9	9.1	9.0	11.3	7.0	4.9
CPI - Q%	-0.5	0.9	0.0	0.1	0.2	0.5	0.6
CPI - A%	1.5	1.7	1.2	0.6	1.3	1.4	1.3
HLFS employment growth - Q%	-0.3	-2.5	-1.1	0.1	0.5	0.5	0.5
HLFS employment growth - A%	1.5	-1.4	-2.8	-3.7	-2.9	2.2	1.8
Unemployment rate - %sa	4.0	5.8	6.5	6.7	6.5	5.8	5.6

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 « actual	Sep-20 forecast »	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)							
NZ OCR	0.25	0.25	0.25	0.25	-0.50	-0.50	-0.25
NZ 90-day bank bill	0.30	0.31	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.06	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.13	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.51	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.46	0.45	0.25	0.00	0.20	0.55

### ASB foreign exchange forecasts

	Jun-20 « actual	Sep-20 forecast »	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)							
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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