

# Economic Weekly

20 July 2020

## Eyeing up a little more cream

In the midst of online field-days there was good news for dairy farmers. Fonterra has upgraded its milk price forecast for the 2021 dairy season to a range of \$5.90-\$6.90/kg of milk solids, from its initial \$5.40-\$6.90/kg range. That nudges the mid-point of the forecast range to \$6.40, from \$6.15. Our current forecast is \$6.50, which we will be reviewing after this Tuesday night's GDT dairy auction – as we noted in our [Commodities Weekly](#).

The bounce in prices at the last auction would certainly justify an upward revision if it is sustained. We have been mindful that the recent auction price jump was concentrated in the wholemilk powder contracts for delivery in the near term, which could be a sign that some purchasers are wary of the risk that the rise in global COVID-19 infections could trigger a further bout of logistics disruption. The upcoming auction results will give some idea of how durable that spike in near-dated contracts is or whether the longer-term prices also lift more strongly.

Fonterra's own media release pointed to encouraging signs that Chinese dairy demand is recovering. And last week's Chinese data releases also point to China getting back onto its feet after its lockdown at the start of the year. Q2 GDP rebounded 11.5% for the quarter (after falling 9.8% in Q1), putting the economy 3.2% up from its year-ago level. The recovery is still uneven, though. Industrial activity has led the way and is now back above its pre-COVID high. More important for NZ is retail spending: this is up, although still not quite yet back to pre-COVID levels. NZ exporters into the retail realm will need to take note of the huge and rapid shift in China to online sales – which now account for a whopping 30% of retail spending. Getting NZ's consumer-destined exports channelled into distributors that are heavily engaged in online sales will be important for helping NZ best leverage opportunities to grow. The long-term trend for sales channels is clear, and NZ also needs to do what it can to maximise its share of the weaker global economy.

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### Recent key economic publications

#### ASB Economic forecasts and monitoring:

[Quarterly Economic Projections](#)

[ASB COVID-19 Chart pack](#)

[NZ Sector outlook](#)

#### Financial market trends:

[Corporate Hedging Toolbox](#)

#### Policy response:

[RBNZ leaves QE target unchanged in June](#)

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



## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6558	0.6575	0.6418	0.6776	FLAT	0.6390	0.6600
NZD/AUD	0.9368	0.9420	0.9358	0.9588	FLAT	0.9300	0.9460
NZD/JPY	70.21	70.27	68.58	72.90	FLAT/UP	68.00	71.60
NZD/EUR	0.5733	0.5800	0.5723	0.6017	FLAT/DOWN	0.5650	0.5830
NZD/GBP	0.5216	0.5192	0.5162	0.5403	FLAT	0.5130	0.5260
TWI	72.4	72.3	71.2	73.89	FLAT	N/A	N/A

<sup>^</sup> Weekly support and resistance levels \* Current as at 9.30am today; week ago as at Monday 5pm

### NZD Recap

The NZD/USD snoozed through most of last week, holding inside a less than one cent range (0.6515-0.6590) for the whole week. The two big global themes confronting markets – rapidly recovering global growth, but with a worrying resurgence in COVID cases in some parts of the world – continued to play out, but there was evidently nothing new to surprise investors.

There were some more interesting moves amongst the crosses. The NZD slipped 1% against the AUD and around 1.4% against the EUR. Indeed, the EUR was one of the strongest performing currencies last week, with EUR/USD closing in on 18-month highs around 1.1440.

### Outlook

Hopes European leaders will soon agree on the size and form of the EU recovery fund appear to have bolstered sentiment towards the single currency. The package is important for Europe not just because of the size (~€750bn) but also as a sign of European togetherness, particularly as it would be a step towards fiscal integration. Parties are still negotiating on the terms of the deal but we suspect a compromise will be reached at some point which would probably provide another set of legs for the EUR. This should cap NZD/EUR at 0.5830 in the near term.

It's shaping up as another fairly quiet week as far as news/events go. July 'Flash' European PMIs, the Aussie July fiscal update & RBA Governor speech, the local GDT dairy auction, and tonight's release of the AstraZeneca and Oxford University vaccine trials are the things to keep an eye on. Positive trial results would further support risk appetite and hence NZD/USD.

It's worth noting, 'fundamentals' are not exerting any strong push or pull influence on the NZD/USD at present. This is likely contributing to the broader stasis in the currency. According to our short-term valuation model, NZD/USD 'fair-value' is currently 0.6350-0.6750 with spot more or less smack in the middle of this range.

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### ASB foreign exchange forecasts

(end of quarter)	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
		<< actual		forecast >>				
NZD/USD	0.60	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	65	69	66	66	67	69	67
NZD/EUR	0.54	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	68.8	71.4	71.1	71.7	72.1	73.6	71.4

## Interest Rate Market

<b>Wholesale interest rates</b>	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	0.30	0.30	0.29	1.52	UNCH	UP
2-year swap	0.21	0.22	0.23	1.34	UNCH	UP
5-year swap	0.33	0.36	0.37	1.42	UNCH	UP
10-year swap	0.69	0.76	0.74	1.77	UNCH	UP
10-year govt bond yield	0.90	0.98	0.90	1.58	UNCH	UP
Curve Slope (2s10s swaps)	0.49	0.54	0.51	0.43	UNCH	DOWN

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

### Market Recap

NZ yields were dragged lower last week, with larger falls for longer-dated tenors. This was in contrast to more modest moves in global yields, with the rising cases of COVID-19 in Australia and the US offsetting the improved tone of economic data. The light supply of NZ long-dated bonds on issue has been a factor in holding down NZ longer-term interest rates, with weekly tenders remaining low (\$850m last week). Syndication has proved to have been effective in enabling the NZ Debt Management Office to do this, with a sizeable \$4.5bn syndication of the May 2041 NZ Government bond announced last week.

There was little market reaction to the generally improving tenor of data, with yields little changed following last week's NZ Q2 CPI and June Australian labour market data.

### Near-term interest rate outlook

For markets and policymakers, the next few weeks still look to be a waiting game and we expect yields to remain very, very low. The tug-of-war between improving global data and the spread of COVID-19 is expected to continue and equity market direction should remain a useful guide for yields. With COVID-19 continuing to spread and threatening a 2<sup>nd</sup> wave of lockdowns, the risk of a 'W' type economic scenario has grown, which will likely push yields lower. Given the risk profile, market pricing – with the OCR set to approach zero by mid-2021 and with other central banks also pricing in policy easing – looks appropriate considering our view of the outlook.

Earlier concerns over the impact of higher NZ Government bond supply on yields have yet to be borne out, with NZ swap yields down 40-65bps across the curve since the RBNZ launched its Large Scale Asset Purchase programme in late March. Issuing more bonds via syndication has helped to cap the NZ weekly bond tender, with \$950m in conventional NZ Government bonds set to be tendered this week. With the RBNZ set to continue with \$NZ940m of NZ Government bond purchases (and \$30m of LGFA purchases), this should help limit the drift up in yields

The RBA has not actively purchased Australian bonds since May and while the 3-year Australian bond is close to the RBA's 0.25% target, the Australian yield curve is noticeably steeper than our own. With the Australian Government set to announce a 10% of GDP fiscal deficit on Thursday's July Economic and Fiscal Update (JEFU), increasing bond supply will likely add to the steepening pressure in the Australian curve. The RBA Minutes and the speech by RBA Governor Lowe will be looked for cues on future policy direction. Rising COVID-19 cases in Victoria and New South Wales suggest more policy support may be needed.

Dataflow this week, including the NZ June trade data and global manufacturing flash PMIs for July, will be perused for whether the improvement in economic activity is continuing, but should have little impact on yields.

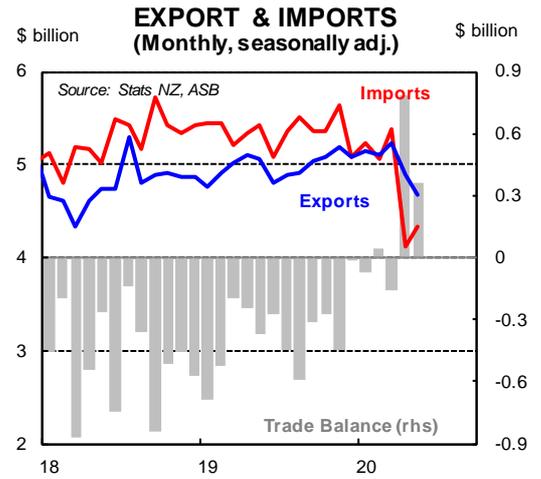
### Medium-term outlook

We don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. If more policy stimulus was needed the RBNZ will likely increase and broaden its \$60bn asset purchase programme before cutting the OCR. It seems highly likely that the RBNZ will expand the size and scope of its asset purchase programme in August. Subpar global activity and RBNZ asset purchases should help to cap longer-term NZ interest rates despite a flood of global public debt issuance. [mark.smith4@asb.co.nz](mailto:mark.smith4@asb.co.nz)

## Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, June, \$m	24/07	10:45 am	-	425

**We expect another larger-than-normal trade surplus in June,** following the large trade surpluses recorded in both April and May. The COVID-19 pandemic has resulted in a sharp fall in import demand in NZ, but export activity has held up relatively well. Our forecast is based on the already-released preliminary trade data. Imports appear to have picked up somewhat in June, but only to be in line with typical June levels. There is no evidence of ‘catch up’ for missed demand during April and June. There remain some anecdotes of importers facing supply shortages of certain goods due to COVID-19 lockdowns impacting overseas production. NZ’s food exports have likely continued to perform well – especially kiwifruit.



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	ASB
Australia CBA Card Spend, week ending July 17	21/07	1:30 pm	-
RBA Meeting Minutes	21/07	1:30 pm	-
RBA Gov Lowe speech	21/07	2:30 pm	-
Japan inflation, June, %yoy	21/07	11:30 am	0.1
Australia Retail Trade, June, %yoy	22/07	1:30 pm	3.0
Australia July Eco and Fiscal Update, 2019/20, \$Abn	23/07	1:00 pm	85
UK PMIs, July, index	24/07	8:30 pm	-
Eurozone PMIs, July, index	24/07	8:00 pm	-

\*Originally published by CBA Global Markets Research on Friday 17<sup>th</sup> July at 2:31 pm

The **Commonwealth Bank of Australia's (CBA) household card spending data** for the week ending 17<sup>th</sup> July will be released on Tuesday. Data for the week ending 10<sup>th</sup> July showed that spending growth eased, highlighting the damaging economic effects of the reinstatement of restrictions in Metropolitan Melbourne during that week. These restrictions mean that spending in Victoria is likely to continue to lag behind the other states. There is the risk that spending momentum eases further in other states too as confidence takes a hit from the situation in Melbourne. Coronavirus cases have started to rise in NSW too.

The **Reserve Bank of Australia's (RBA) July Meeting Minutes** will be released on Tuesday. The RBA, as widely expected, left monetary policy unchanged at its last meeting. In the Governor's statement, uncertainty around the economic outlook and the health situation was the dominant theme. The recent spike in COVID-19 cases in Melbourne has added to the uncertainty.

On Tuesday, **RBA Governor Philip Lowe** will speak at the Anika Foundation Luncheon (done via Webinar this year). His speech is titled *COVID 19, the Labour Market and Public-sector Balance Sheets*. Commentary around the outlook for the labour market will be monitored closely.

We forecast **Japan's headline and core inflation** was stable at 0.1%yoy and 0.4%yoy in June. Despite a rebound, oil prices remain low.

We expect **Australia's ABS Preliminary Retail Trade June** release to print around 3.0%mom (8.8%yoy). Our internal card spending data have pointed to a steady recovery through the month of June. However, the recent stage 3 shutdowns in Melbourne may weigh on retail trade in July.

On 23<sup>rd</sup> July **Australian Treasurer Josh Frydenberg will deliver the July Economic and Fiscal Update (JEFU)**. We expect a full suite of economic forecasts and fiscal projections out another two years. We expect the budget deficit to total \$A85bn in 2019-20 and to rise to \$A190bn in 2020-21. The future form of the JobSeeker and JobKeeper schemes from September onwards will also be eagerly awaited by the market. The Government has also flagged the possibility of bringing forward the already legislated personal income tax cuts.

The **UK's composite PMI** rose in June to a four-month high of 47.6. The July PMIs will indicate whether the recovery in economic activity is starting to level off or gaining momentum.

The **Eurozone's composite PMI** surged to 47.5 in June, the highest level since February. The July 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 << actual	Jun-20 forecast >>	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
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	-0.1			
CPI - A%	2.5	1.5	1.3	0.7	0.4	1.4	1.6
HLFS employment growth - Q%	0.7	-2.8	-1.6	-1.1			
HLFS employment growth - A%	1.6	-1.8	-3.6	-4.8	-4.5	1.7	2.7
Unemployment rate - %sa	4.2	6.3	7.4	7.7	7.0	7.0	6.0
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 << actual	Jun-20 forecast >>	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)							
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	0.30	0.35	0.40	0.40	0.60
NZ 5-year swap rate	0.63	0.35	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	0.93	0.74	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.03	0.91	0.75	0.85	0.95	1.05	1.15

### ASB foreign exchange forecasts

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

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