

Economic Weekly

21 September 2020

NZ enters recession – now for the recovery

GDP figures for the June quarter released last week were within economist expectations and suggest economic activity contracted around 12% as a result of the initial COVID-19 pandemic response (see our full write up [here](#)). The key learning from the Q2 data is that activity appears to have recovered faster and stronger over the second half of the quarter once alert level restrictions were gradually eased through May and June.

As mentioned in recent commentary, we believe more activity was able to take place under Alert Level 2 and 3 than we initially assumed. Using the Q2 GDP data, we have updated our estimates – while we still estimate that only 67% of activity was able to take place under Alert Level 4, we now estimate 88% of activity took place under Alert Level 3 (up from 80%) and 96% of activity took place under Alert Level 2 (compared to 93% previously).

Furthermore, movement data suggest the economy's ability to adapt to the Alert Level restrictions has continued to evolve. According to Google Maps movement data, there was more movement in Auckland's workplaces, retail and recreation during August's Level 3 restrictions compared to during May. Likewise, we are seeing less impact from Level 2 – with the rest of the country seeing very little overall reduction in movement/activity relative to Level 1.

As a result, we have revised our H2 2020 GDP forecasts higher. Other factors contributing to additional activity taking place include a higher number of international visitors remained in NZ than we initially expected. Over time, as these visitors do leave and are not replaced, the impact will be felt – and will likely be particularly noticeable to tourism operators over summer during the typical peak in international visitor numbers. However, we are also seeing some offset with New Zealander's taking holidays at home – so do your part for the economy and book a summer holiday (and preferably not all at the same time – spread the demand through the summer months!). jane.turner@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:

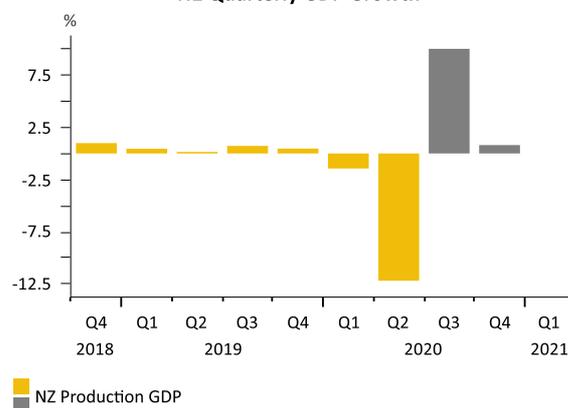
[RBNZ August MPS Review](#)

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

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

Chart of the week

NZ Quarterly GDP Growth



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6758	0.6695	0.6540	0.6293	FLAT	0.6530	0.6790
NZD/AUD	0.9270	0.9191	0.9080	0.9260	FLAT	0.9070	0.9315
NZD/JPY	70.62	70.98	69.07	67.86	FLAT	70.00	72.00
NZD/EUR	0.5706	0.5650	0.5506	0.5690	FLAT	0.5600	0.5800
NZD/GBP	0.5225	0.5222	0.4939	0.5010	FLAT	0.5100	0.5270
TWI	72.7	72.1	70.7	69.92	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/USD spent most of last week on the front foot, hitting a 14-month high just under 0.6800 on Friday. The currency rose against all of the major cross rates with the exception of the JPY.

There were several factors responsible for the NZD's gains. Global risk appetite generally improved, as encouraging economic data and renewed hopes a COVID vaccine will be found this year bolstered sentiment towards the global economy. The VIX index, a widely-used proxy for risk aversion, eased from around 27% to 25.8% over the week.

We suspect a paring of NZD/AUD short positions had an outsized impact on the currency too. The prior NZD/AUD downtrend has paused for breath lately. Speculation last week that the RBA may be on the cusp of announcing new easing measures saw the cross squeezed up to around 0.9280, conferring support on the NZD more generally. We expect the NZD/AUD downtrend to resume in coming months.

USD sentiment remains on the softer side, although last week's confirmation from the US Federal Reserve that interest rates will remain low for a long time (as it seeks a period of above-2% inflation) didn't introduce any fresh pressure on the USD.

Outlook

We suspect the NZD/USD uptrend will take a break at least in the early part of this week, ahead of the RBNZ meeting on Wednesday. Traders will again be nervous the RBNZ could come out swinging about the high NZD, which may limit enthusiasm to add fresh longs. We don't think the RBNZ will be too fazed – the NZ TWI is only ½% stronger than RBNZ forecasts.

The outcome of today's Alert Level announcement could have implications of the NZD. We could see a knee-jerk (small) lift in NZD/AUD on any confirmation of Alert Level relaxation. Other key pieces of event risk this week include a long line of Fed speakers as the Fed continues the communication effort around its new way of inflation targeting. We don't expect there will be anything USD positive from this lot. Finally, the September round of 'flash' PMIs for the US and Europe will give the usual timely read on whether the recovery in global activity continued in September. A solid set of numbers would add to the recovery in risk appetite and hence support the NZD.

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ASB foreign exchange forecasts

(end of quarter)

	Jun-20 << actual	Sep-20 forecast >>	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.90	0.89	0.88	0.86	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.54	0.54	0.54	0.53	0.52	0.53
NZD/GBP	0.52	0.50	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.6	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	69.6	70.0	69.5	68.0	67.5	67.7

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	0.30	0.30	0.27	1.14	UNCH/DOWN	UP
2-year swap	0.05	0.05	0.09	0.95	UNCH/DOWN	UP
5-year swap	0.14	0.13	0.14	0.97	UNCH/DOWN	UP
10-year swap	0.54	0.53	0.51	1.25	UNCH/DOWN	UP
10-year govt bond yield	0.56	0.60	0.62	1.16	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.49	0.49	0.42	0.31	UNCH	DOWN

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

Market Recap

NZ swap yields have risen fractionally but remain close to record lows. Global yields were slightly higher, with curves modestly steeper. There was modest interest rate market reaction to the in-line with market and record 12.2% fall in Q2 NZ GDP. Reaction in the Australian rates markets was modest despite the strong August jobs figures.

The messages from central banks emphasised the low for longer view on rates. The US Federal Reserve maintained current settings but under its new forward guidance of allowing a little more inflation, pledged to hold the 0% to 0.25% federal funds rate until 2024. The RBA Minutes confirmed the intent to maintain highly accommodative settings, with increases to the Term Funding Facility helping to keep interest rates low for borrowers and support credit provision. The Bank of England left policy interest rates unchanged, but UK yields eased after it surprised the market by saying they were exploring negative interest rates to counter ongoing risks to the UK labour market.

NZ bond yields have hit fresh record lows, with yields out to (and including) the five-year tenor falling below zero. This followed the NZ Debt Management announcing in the Pre-Election Economic and Fiscal Update that it will reduce gross bond issuance by \$10bn for 2020/21 (to \$50bn) and through until the 2023/24 period (\$155bn), with a syndicated tap of a new 2028 bond in the wings. Demand for NZ Government bonds has been strong, helped by \$1.35bn of RBNZ asset purchases and a light tender schedule, courtesy of past syndicated issues.

Near-term interest rate outlook

Wednesday's RBNZ Monetary Policy Review is the major local event for the local rates market. We [expect](#) the RBNZ to leave the OCR, forward guidance, and LSAP parameters unchanged. In our view, however, the RBNZ would like to see lower wholesale and retail interest rates and will purposely deliver a dovish statement to try to achieve this. There remains considerable scope for current market pricing – which has a negative OCR by April and around 45bps of OCR cuts prices in till late 2021 – to move lower still. The RBNZ has signalled a \$1.35bn weekly pace of NZ government bond purchases for the 5th consecutive week that will outpace the \$950m in weekly tenders. There is considerable scope for the RBNZ to continue to front-load asset purchases, helping to flatten the yield curve and depress NZ yields.

The direction of risk appetite and global equities will likely continue to impact local and global yields and the slope of the yield curve. Comments by global central bankers – including a key speech tomorrow by RBA Deputy Governor Debelle on Australian monetary policy – will be useful for investigating which options are available for increasing policy support and driving yields lower. We expect minimal market reaction from this week's local and offshore data, with global PMIs, US inflation data (August PCE) and the manufacturing ISM and Non-farm Payrolls released this week. Today's 1pm announcement by the NZ Government on alert level restrictions and the significant disruptions caused by damage to the Auckland Harbour Bridge could be other factors impacting NZ yields.

Medium-term outlook

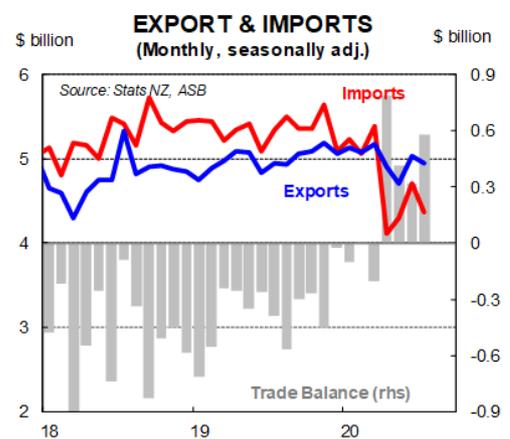
Providing operational hurdles are cleared and the RBNZ sticks to its forward guidance, we expect to see the RBNZ cut the OCR to -0.50% by early 2021 (most likely April) and for a Funding for Lending Programme to be introduced at this time. Prior to then we expect the RBNZ to front-load asset purchases and employ 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

Domestic events

Data	Date	Time (NZT)	Market	ASB
RBNZ Monetary Policy Review	23/09	2:00 pm	0.25%	0.25%, \$100bn QE
Merchandise trade balance, August, \$m	24/09	10:45 am	-	-353

We expect next week's **RBNZ Monetary Policy Review** to be relatively uneventful. Most of the grunty policy updates were done in the August Monetary Policy Statement (MPS). And with the deployment of alternative policy tools including a negative OCR a story for early 2021, this meeting will really be about marking time. We expect the RBNZ to leave the OCR, forward guidance, and LSAP parameters all unchanged. We continue to expect the OCR to be lowered from its current 0.25% to -0.5% in April 2021. A Funding for Lending programme is expected to be introduced at the same time, but we think it should come earlier.

The August merchandise trade balance release on Thursday is expected to show a trade deficit of \$353m. NZ typically reports a trade deficit at this time of year, but the size of the deficit this time around should be much smaller than in previous years - the average August deficit over the past four years has been at the \$1.4bn mark. Import demand has lagged over recent months, off the back of heightened economic uncertainty, lower energy imports and softer domestic demand. As we have highlighted over recent months, there remain anecdotes of importers facing supply shortages of certain goods due to COVID-19-related lockdowns and disruptions hurting overseas production. Meanwhile, food commodity exports have proved comparatively resilient, despite a pullback in dairy auction prices over recent times.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CBA Weekly Card Spend, w/e 18 Sep	22/09	1:30 pm	-
RBA Deputy Governor Debelle Speech	22/09	12:30 pm	-
Australia Retail Trade, August, %mom	23/09	1:30 pm	-4.0
Eurozone PMI, September, points	23/09	8:00 pm	-
UK PMI, September, points	23/09	8:30 pm	-

*Originally published by CBA Global Markets Research on Friday 18 September at 11:47 pm

Our Australian parent CBA's **internal card spend data** have been bouncing around 5%yoy over the past couple of months as the economic performance of Victoria has placed a lid on card spending at a national level. Victoria continues to underperform but in-store spending looks to have troughed around mid-August and the rate of recovery has accelerated over the past two weeks. In Victoria, in-store spending is down around 30% and we expect this to recover only gradually in line with the cautious easing of lockdown restrictions in the state.

Reserve Bank of Australia's Deputy Governor Guy Debelle is scheduled to speak at 10.30am AEST on Tuesday at the Australian Industry Group Conference. The speech is titled "*The Australian Economy and Monetary Policy*". We think it is a clear opportunity to address the issue of what further options are open to the RBA to ease monetary policy further. At this stage our view is that expanding the size and maturity of the RBA's secondary market government bond purchases is the most likely *next step* which they could take to ease financial conditions further. However, the RBA Board Minutes from the September meeting did suggest a further easing was not imminent after the expansion in the Term Facility Funding.

Australia's retail trade is likely poised for a solid 4% fall in August. This would see the annual growth rate step down to 7.1% from a stellar 12.0% in July. Retail trade has seen a volatile ride throughout the pandemic, with seasonally-adjusted retail trade touching an all-time record high in July.

The **Eurozone composite PMI** fell from a 25-month high of 54.9 in July to 51.6 in August. The September PMIs will indicate whether the recovery in economic activity will continue to level off or regain momentum.

The **UK's composite PMI** rose in August to an 82-month high of 60.3. The September PMIs will indicate whether the recovery in economic activity is starting to level off or gain more 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	10.1	0.8	0.3	0.1		
GDP real - A%	-12.4	-4.2	-3.9	-2.2	11.5	0.7	3.3
GDP real - AA%	-2.1	-3.7	-5.2	-5.7	-0.1	3.4	2.3
CPI - Q%	-0.5	1.0	0.0	0.1	0.2		
CPI - A%	1.5	1.8	1.3	0.7	1.3	1.3	1.3
HLFS employment growth - Q%	-0.4	-2.6	-1.2	0.1	0.5		
HLFS employment growth - A%	1.1	-1.9	-3.2	-4.1	-3.2	2.1	1.8
Unemployment rate - %sa	4.0	6.4	7.3	7.5	7.3	6.7	6.6
Annual current account balance as % of GDP	-1.9	-1.2	-1.1	-1.5	-2.1	-2.2	-2.5

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 « 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	0.25	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.10	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.15	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.50	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.55	0.45	0.25	0.00	0.20	0.55

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	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	0.90	0.89	0.88	0.86	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.54	0.54	0.54	0.53	0.52	0.53
NZD/GBP	0.52	0.50	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.6	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	69.6	70.0	69.5	68.0	67.5	67.7

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