

# Economic Weekly

22 June 2020

## NZ labour market pain still to come

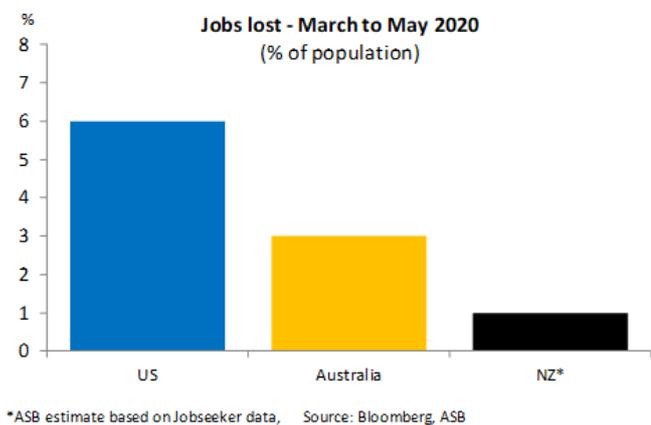
Economic activity – globally and in NZ – remains on a mostly recovering trend. COVID-19 flare ups in certain parts of the world may slow this tentative global recovery, but not stop it.

Increasingly, the spotlight is going on labour markets, the classic lagging indicators, as key to how things play out from here. Jobs, incomes, and livelihoods – this is where the recession rubber hits the road.

We’ve already seen some disastrous employment numbers out of the US, and last week’s Australian data showed May job losses almost three times what was expected (albeit there were a few [data anomalies](#)). Our view is that both the Aussie and US labour markets are past the worst though. By contrast, we think the big test for the NZ labour market will be the second half of the year, as the removal of the Government’s wage subsidy reveals some previously “hidden” unemployment. Our read on the weekly NZ Jobseeker numbers is that they are equivalent to a near ‘real-time’ unemployment rate of a little over 6%. We have that rising to a peak of around 8% by the end of the year. Falling employment and wage growth will have obvious implications for retail spending, the housing market, and general economic confidence.

All of this is partly why we think the RBNZ may yet have to do more to prop up the economy. That is a story for down the track though. For this week’s meeting, we expect a ‘steady as she goes’ message, with a hat tip to the fact things are probably recovering a little faster than prior RBNZ expectations. We don’t expect any change in policy measures.

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### Recent COVID-19 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 confirms increase to QE at May Monetary Policy Statement](#)

### Where to find support

[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	0.6396	0.6414	0.6101	0.6593	FLAT	0.6250	0.6550
NZD/AUD	0.9378	0.9399	0.9326	0.9511	FLAT/UP	0.9150	0.9550
NZD/JPY	68.30	68.66	65.54	70.58	FLAT	66.80	70.20
NZD/EUR	0.5717	0.5695	0.5582	0.5836	FLAT	0.5590	0.5870
NZD/GBP	0.5176	0.5124	0.4990	0.5191	FLAT	0.5060	0.5320
TWI	71.3	71.2	69.0	72.11	FLAT/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 relatively steady over the past week, trading within a one-cent range against the major crosses. The NZD appears to have settled into a new range after lifting strongly against the USD and JPY in early June. Global investor sentiment remained cautious on concerns of renewed COVID-19 outbreaks in parts of the US and in Beijing, and also rising tensions between North and South Korea. Helping to sooth investor concerns was further US Federal Reserve stimulus, signs of improved trade relations between the US and China, stronger than expected economic data (in particular US retail sales) and news that that an existing drug called Dexamethasone has been shown to drastically reduce the death rate for patients seriously ill with COVID-19. The Federal Reserve said it would now purchase individual corporate bonds on top of the of the exchange-traded funds (an index which tracks bonds across all grades) it already is purchasing. US Fed Chair commented that the purchase individual bonds vs. an exchange-traded fund was a better tool for supporting liquidity and market functioning,

The release of NZ Q1 GDP was largely shrugged off by financial markets, although the very weak Australian May jobs report briefly weighed on the AUD.

### Outlook

Global investor sentiment and FX moves will be influenced by competing forces once again this week. The USD will find support from safe-haven investment flows on reports of rising infection rates in parts of the US, stoking concerns of a second wave and a reinstatement of lockdowns in some US states. However, further indicators of thawing trade tensions between the US-China and positive economic data could help ease investor concerns.

The RBNZ announcement (Wednesday 2pm) may spark some volatility this week. The RBNZ is likely to try keep its options open, with the RBNZ indicating the door remains open to negative interest rates. However, there is a risk that that RBNZ sounds more upbeat than the market is expecting, supporting the NZD, in large part due to the earlier than expected move to Level 1 and the impact on the RBNZ's economic forecasts.

Meanwhile, the AUD is likely to remain weighed this week, amid concerns of growing coronavirus cases following a spike in infections in Australia. [jane.turner@asb.co.nz](mailto:jane.turner@asb.co.nz)

### 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	0.67	0.60	0.63	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.96	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	73	65	66	66	66	67	69	67
NZD/EUR	0.60	0.54	0.56	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.51	0.49	0.53	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.7	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	73.8	68.8	70.9	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	0.25	0.25	0.25	1.50	UNCH	UP
90-day bank bill	0.29	0.27	0.25	1.58	UNCH	UP
2-year swap	0.24	0.25	0.16	1.29	UNCH	UP
5-year swap	0.36	0.38	0.23	1.36	UNCH	UP
10-year swap	0.74	0.74	0.60	1.72	UNCH	UP
10-year govt bond yield	0.90	0.81	0.62	1.51	UNCH	UP
Curve Slope (2s10s swaps)	0.50	0.49	0.44	0.43	UNCH	DOWN

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

### Market Recap

Local and global yields have continued to oscillate on contrasting headlines, with local swap yields starting this week a touch lower on a week prior. The flaring up in COVID-19 cases globally and the emergence of new active cases in NZ has seen markets check some earlier optimism on the pending recovery and have kept yields low. Growing tensions over Hong Kong, and elevated US/Chinese frictions have added to the caution. The dataflow has remained mixed. Weak Q1 NZ GDP and Australian labour market data dampened Australasian yields, although more forward-looking data has tended to surprise to the upside.

NZ and global yields eased after the Federal Reserve presented a gloomy outlook. It pledged not to hike rates until at least 2023, maintained its current USD20bn weekly pace of Quantitative Easing (QE) and pledged to use its full range of tools to support the economy. The Bank of England added £100bn (to £745bn) to its QE programme. Demand for NZ bonds has remained strong, with the \$7bn in syndication of May 2024 NZ Government Bond being absorbed without a sizeable ratcheting up of NZ yields.

RBNZ signalling and its Large Scale Asset Purchase programme have remained very effective in holding down NZ yields (see our recent [research](#) for further details). RBNZ QE has helped compress swap spreads to OIS (overnight index swaps) and the financial system is flush with liquidity, with retail mortgage interest rates continuing to move lower.

### Near-term interest rate outlook

We have a neutral bias for yields. The RBNZ is [expected](#) to stick to the script, hold the OCR at 0.25% (and likely signal it will do so into early 2021), but also flag the possibility that the OCR could move lower still if needed. The RBNZ is also widely expected to stick with the \$60bn LSAP programme it outlined in May and retain the option to alter its size or coverage if needed. The RBNZ assessment will likely flag that NZ's efforts in containing COVID-19 has been more effective than the RBNZ had earlier assumed and the short-term outlook was a little brighter. However, a long road lies ahead and as Governor Orr noted last week, monetary policy is a 'poor cousin' relative to the fiscal support needed.

The RBNZ has taken the opportunity to reduce its weekly quantitative easing programme, with just \$NZ940m of NZ Government bond purchases and \$50m of LGFA purchases signalled for this week. The success of the syndication has helped to limit the size of the weekly NZ Government bond tenders (\$1050m this week), which should cap NZ yields.

We continue to expect that local and global yields will take their cues from global equities and swings in broader risk appetite. Global PMI data for June are widely expected to show further recovery but also flag how weak the underlying global backdrop is. The US Private Consumption Expenditure deflator this week (the Fed's preferred inflation measure) is expected to show further mild disinflation pressures in the US economy.

### 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. Subpar 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](mailto:mark.smith4@asb.co.nz)

## Domestic events

Data	Date	Time (NZT)	Market	ASB
RBNZ OCR Review, QE – planned purchase of govt bonds	24/06	2:00 pm	0.25%	0.25% 60b QE
Merchandise trade balance, May, \$m	25/06	10:45am	-	1,300

**We expect another larger-than-normal trade surplus in May,** following a near \$1300m surplus in April. The COVID-19 pandemic has resulted in a sharp fall in import demand in NZ, but goods export activity has held up relatively well. Our forecast is based on the already-released preliminary trade data, which shows that import activity was impacted by the restrictions on non-essential activity during the level 4 lock down. Weekly retail spending has climbed towards pre-covid levels, but we have yet to see any catch up for lost spending during the level 4 and level 3 lock down. Further ahead, we believe COVID-19 will likely to prompt a reassessment of spending plans within the economy that should continue to weigh on import demand. NZ’s food exports look to have performed well, with kiwifruit a standout. It’s a different story for services exports, however..



**We expect the RBNZ will leave its policy settings unchanged.** However, the bank will emphasise that it still has further options to tackle the weak outlook for the economy and inflation, should it be required to use them. But, for now, the economy appears to be improving at a slightly faster rate than the RBNZ assumed. And the fact we have moved to Alert Level 1 far earlier than the Bank assumed means this will continue in the short-term. The Bank has also plenty of headroom under its \$60b QE cap to keep buying around \$1b of government bonds per week. It will have to be raised at some point though, but this is a story for later in the year.

## Major International Events for the week ahead\*

Data	Date	Time (NZT)	ASB
RBA Gov Lowe participates in panel	22/06	11:00 am	-
CBA Australia Composite PMI	23/06	11:00 am	-
Australia Trade Balance, May, \$mn	23/06	1:30 pm	-
Australia Job Vacancies, May, %mom	25/06	1:30 pm	-
US PCE Deflator, May, %qoq	26/06	12:30 am	-

*Originally published by CBA Global Markets Research on Friday 19<sup>th</sup> June at 12:35 pm*

**Reserve Bank of Australia (RBA) Governor Lowe is due to speak** on a panel on the global economy and Covid-19. A focus on his current view of the global outlook will be important to watch as case numbers are rising in parts of the US and Beijing. Currently the RBA's outlook for Australia is slightly more optimistic than it was in early May.

The May readings for **Australia's CBA Composite PMI** remained in deeply contractionary territory. The Services PMI was 25.5 while the Manufacturing PMI was at 42.8. There could be some improvement in June as more parts of the Australian economy were reopened, but the services sector will lag the manufacturing sector in recovery.

**Australia's preliminary goods trade balance** will be released on Tuesday. We expect a decent surplus as the price of iron ore remains elevated over supply concerns and on stimulus-driven demand from China.

**Australian job vacancy data** will be released for the three months to May 2020. We should see a Covid-19 driven fall in job vacancies in the quarter but this should be no surprise given the job losses seen in labour market data already. The reference point is the third Friday in May, compared to the third Friday in February. We do expect the peak in job losses to have occurred in April and May and a lift in headcount from here.

We estimate the **US Personal Consumption and Expenditure (PCE) deflator** was flat in May, reflecting the stabilisation in oil prices. However, we expect further mild disinflation in May core PCE deflator. We expect inflation from the core PCE deflator to ease to 0.8%yoy. In our view, ongoing spare capacity in the US economy will depress inflation pressures for some time.

## 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	-1.6	-16.8	14.7	1.1			
GDP real - A%	1.8	-0.2	-17.1	-5.7	-5.1	-3.8	2.7	4.9
GDP real - AA%	2.3	1.5	-3.3	-5.3	-7.0	-7.9	5.1	4.6
CPI - Q%	0.5	0.8	-0.4	0.2	-0.1			
CPI - A%	1.9	2.5	1.3	1.0	0.3	-0.1	1.2	1.6
HLFS employment growth - Q%	0.1	0.7	-2.6	-2.0	-1.5			
HLFS employment growth - A%	0.8	1.6	-1.7	-3.8	-5.3	-5.3	1.7	2.7
Unemployment rate - %sa	4.0	4.2	6.2	7.5	8.3	7.7	7.8	6.9
Annual current account balance as % of GDP	-3.0	-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

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>					
(end of quarter)								
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	0.30	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	1.78	0.93	0.65	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.65	1.03	0.65	0.75	0.85	0.95	1.05	1.15

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(end of quarter)								
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NZD/EUR	0.60	0.54	0.56	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.51	0.49	0.53	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.7	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	73.8	68.8	70.9	71.1	71.7	72.1	73.6	71.4

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