Economic Weekly

23 March 2020

Hanging in

We are in the midst of the largest economic shock in generations. It is a shock caused, not by the COVID-19 virus itself, but by the proactive measures NZ is taking to limit the spread of the virus. They are entirely necessary. A quick look offshore shows what can happen if NZ does not make every attempt possible to #flattenthecurve. Unfortunately, the economic and social costs of doing so will be painfully high. The coming weeks will be challenging across all facets of life. Looking out for each other, being kind, and acting in the interests of the public health will be more important than ever.

In contrast, economic projections are of second order importance in these times, as we all do what we can do hang in and get through. We're in the process of updating our numbers to take into account the events of recent days. But it's fair to assume a steep decline in economic activity (deeper than the GFC), a rise in unemployment, and outright falls in national house prices will be part of the story. We're hopeful the eventual rebound will be just as rapid.

The 'good' news is that policy-makers have firmly grasped the nettle. The NZ government has already announced an enormous support package – we've summarised what it might mean for you here. And this morning the RBNZ confirmed it will make its quantitative easing debut (see our note later this afternoon). It's of comparable size (per capita) to those announced in other countries – the NZ$30b programme is just under 10% of NZ's nationwide annual GDP. Together, these actions are a good example of complementary government policy; the RBNZ's bond buying will cushion the impact on interest rate markets of the government's coming ramp-up in debt issuance. These measures are just the start, and more will likely be needed, such is the severity of COVID-19.

Finally, we'd encourage all of our readers to avail themselves of all the information and support packages available. We've detailed these below, including ASB's support package for our customers. Take care. mike.jones@asb.co.nz

Where to find support

ASB financial support package
Government support package
COVID-19 alert system explainer

Recent COVID-19 publications

Fiscal fights back
RBNZ OCR cut March 16
Housing immunity about to be tested
COVID-19: Market impacts, responses, and ideas
Thinking about coronavirus impacts on business: Be prepared – it doesn't hurt
Government support – quick guide to accessing it

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.5678	0.6053	0.6308	0.6886	DOWN	0.5950	0.6150
NZD/AUD	0.9801	0.9815	0.9552	0.9690	FLAT	0.9700	0.9990
NZD/JPY	62.93	64.69	70.66	76.27	DOWN	62.00	66.00
NZD/EUR	0.5309	0.5440	0.5846	0.6051	DOWN	0.5300	0.5500
NZD/GBP	0.4884	0.4904	0.4892	0.5240	DOWN	0.4600	0.5000
TWI	66.9	68.7	70.7	74.50	DOWN	N/A	N/A

*^ Weekly support and resistance levels * Current as at 9.30am today; week ago as at Monday 5pm*

Recap

There were some big moves in the FX market last week, with the NZD/USD starting at a high of around 0.61 last Monday morning, and reaching a low of 0.55 by Thursday evening. The NZD has opened around 0.57 this morning. The NZD saw similar large moves against the EUR and the JPY over the week. The NZD drop from the RBNZ's 75 basis point cut on Monday morning last week was short-lived with the Federal Reserve eclipsing the RBNZ's move with a 100 basis point cut to the Fed Funds target range. The NZD/AUD flirted with parity during the week, almost breaking 1.0 against the AUD on Thursday night/Friday morning

Financial markets have been extremely volatile, and the NZD has traded in wide daily ranges. On Thursday night the VIX index (a measure of volatility and risk aversion) broke its previous 80% peak from the 2008/09 Global Financial Crisis.

Central banks continue to rush to action, with the Federal Reserve, Reserve Bank of New Zealand (RBNZ) the and the Reserve Bank of Australia (RBA) all cutting policy rates as close to zero as possible. The RBA and RBNZ have both announced its first foray into Quantitative Easing (QE), while the Federal Reserve reinstated QE measures earlier this month and the European Central Bank and Bank of England have expanded their asset purchase programmes. Central banks have also enacted various market liquidity measures last used during the Global Financial Crisis and Governments have also been quick to announce support packages. Nonetheless, with many economies now heading into shutdown in efforts to slow the virus, market participants remain nervous.

Outlook

Near-term direction in currencies remains impossible to predict and volatility is at multi-year highs. We refer clients to our recent note on dealing with market uncertainty. Central banks have opened swap lines with each other to increase USD liquidity. However, we expect strong USD demand to continue to cause liquidity problems and keep volatility elevated. With the situation evolving so rapidly it's difficult to provide a steer on economic relativities at this time.

We put out a note a few weeks ago (here) outlining some of the impacts of the COVID-19 disruptions on corporates with financial markets exposures, as well as some of our own ideas on managing financial markets exposures during these increasingly uncertain times. Reiterating a key message from this note, **now is not the time to base a hedging strategy off forecasts for the NZ dollar or interest rates.** More important will be addressing any over-hedges in your business, stress testing exposures, and potentially pausing any hedging programmes until the fog clears a little. Trading conditions will remain difficult and volatility elevated – when dealing with financial market products please be aware that all market participants are navigating and managing the impacts of reduced liquidity along with rapid, unpredictable moves in prices.

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Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	1.00	1.00	1.75	UNCH	UP
90-day bank bill	0.67	0.64	1.14	1.90	UNCH	UP
2-year swap	0.69	0.63	1.05	1.82	UNCH	UP
5-year swap	0.92	0.70	1.11	1.92	UNCH/UP	UP
10-year swap	1.37	0.97	1.38	2.28	UNCH/UP	UP
10-year govt bond yield	1.52	1.01	1.26	1.98	UNCH/UP	UP
Curve Slope (2s10s swaps)	0.68	0.34	0.34	0.46	UNCH/UP	DOWN

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

Market Recap

Markets have remained skittish, with record-high volatility. The spread of COVID-19 shows few signs of stopping and is causing widespread disruption amongst financial markets. Earlier last week, global long-term yields had risen sharply as markets started to factor in the prospect of globally synchronised fiscal easing and increased government bond issuance. **The last week has seen global central banks step in the provide liquidity and put in place other measures to calm markets and to support the functioning of the financial system**. On Friday, the RBNZ announced it would offer 3,6 and 12 month funding through the Term Auction Facility (TAF), that it would relax credit tiers and provide more funding in FX swap markets (to ensure that more funding can be accessed at rates close to the OCR and that short-term interest rates move closer to the OCR). Other central banks have put in place similar measures. The US Federal Reserve has also extended USD swap lines to other central banks (including the RBA and RBNZ). This, and depressed risk appetite has seen rates markets rally (yields lower) with spreads (which spreads?) narrowing.

This morning the RBNZ confirmed that it will instigate a $30bn NZ Government bond purchase programme, purchasing government bonds in the secondary market across a range of maturities over the next 12 months. NZ yields have dropped sharply this morning, with the NZ yield curve flattening. There has also been a marked step up in programmes from other central banks, including last week's RBA announcement they will start purchasing bonds with a target rate of 0.25% for 3-year bonds, the March 15 announcement that the US Federal Reserve will be undertaking an additional USD700bn in asset purchases and more government bond purchases from the BOE and ECB.

Near-term NZD interest rate outlook

COVID-19 continues to cast a shadow over markets. Data this week will largely be ignored. Periods of illiquidity and volatility are likely and we expect markets to remain skittish until clarity emerges. NZ yields and spreads of various types - Libor-OIS – NZ bonds to swap, credit and corporate bonds have narrowed this morning but remain considerably wider than a few weeks ago. We will be closely watching for signs of stress in liquidity and funding markets. Actions by policymakers as well as the weakness in the global outlook should dampen yields, **but a flaring up of risk aversion and realisation that a mountain of government debt will need to be funded could see spreads widen and push government bond yields higher, steepening curves.** The NZ Government's $12.1bn fiscal support package is likely to get considerably larger, with NZ government bond issuance expected to step up considerably over the next few years. We will be publishing a note this afternoon, which sets out our thoughts.

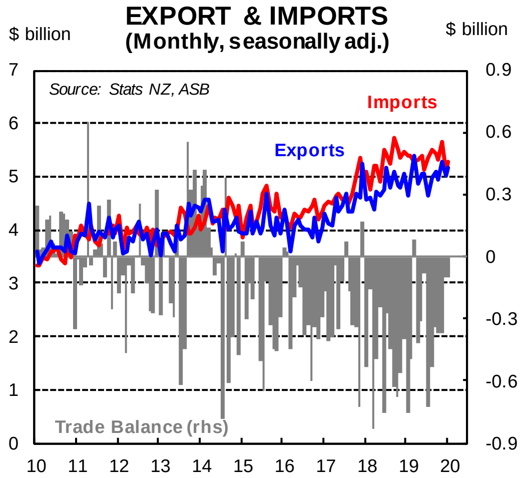
Medium-term outlook

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 2022 at the earliest. Markets are also likely to remain selective in pricing risks, with swap, credit and corporate bond spreads to remain elevated. Despite weak global growth, negative risks and the prospect of central bank asset purchases, we expect the sheer volume of public debt on offer to push long-term NZ and global bond yields higher. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, Feb, $m	25/03	10:45 am	-	-250

We expect a larger-than-normal trade deficit of circa $250m in February. This is likely to be due to both lower export prices and/or shipment delays. A wide range of results are possible this month and over the coming months as COVID-19 impacts trade flows in an uneven manner. Over time, we expect NZ's goods trade balance to prove relatively resilient as NZ's food export prices (and volumes) hold up relative to import prices such as oil.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CBA PMIs, March	24/03	11:00 am	-
US PMIs, March, points	24/03	2:45 pm	40
Eurozone PMIs, March, points	24/03	11:00 am	40
US Jobless Claims, March	26/03	-	-
BoE Interest Rate Announcement, %	26/03	2:00 pm	0.1
US PCE Deflator, February, yoy	27/03	2:30 pm	1.7

**Originally published by CBA Global Markets Research on Friday 20th March at 14:29 pm*

Australia's **CBA flash PMIs for March** will be a very timely piece of economic information as they will pick up some of the early impacts of COVID-19 on the Australian services and manufacturing sectors.

We expect a large fall in the **US PMIs in March** because of the disruption caused by fear of the virus. The US is in recession in our view.

We expect a large fall in the **Eurozone PMIs in March** because of the disruption caused by fear of the virus. The Eurozone is in recession in our view.

US jobless claims surged in the previous week. But the disruption caused by fear of the coronavirus likely understates unemployment because some states require people to enter an office to apply for benefits.

After the **Bank of England's** policy decisions in the past two weeks, we expect **no policy changes this week**.

We estimate headline **US Personal Consumption Expenditure (PCE) inflation** will edge slightly higher in February to 1.7%yoy, but will plummet in March because of the crash in petrol prices. We also expect core PCE inflation to ease further beyond February.

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