Economic Weekly

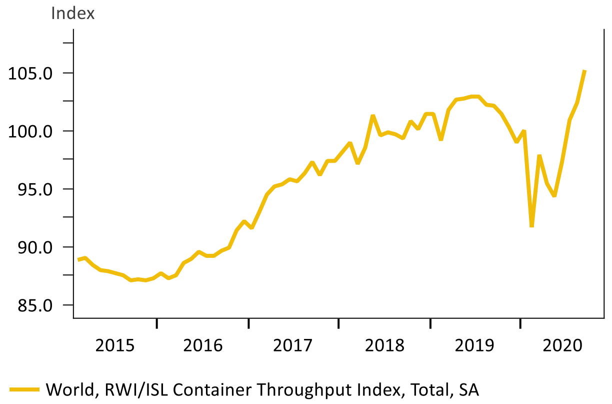
23 November 2020

Global trade recovery squeezes shipping capacity

One of the (many) surprising aspects of the economic impact of COVID-19 is how well NZ goods exports have held up relative to goods imports during the pandemic. As an exporter, NZ is vulnerable to a fall in global demand – although one of the key lessons is that the fall in demand has not been evenly shared across economic sectors. With countries resorting to lockdowns once the virus spread escalates, demand for types of goods have shifted. For example, from eating out to eating at home – putting pressure on wholesale supply chains to quickly divert food from restaurants to supermarkets and meal kit delivery services. Likewise, less money is spent on commuting, but more money has been spent on technology to improve the home office. With NZ's exports of goods skewed toward food, and given the world still needs to eat, NZ exports held up relatively well to date. In contrast, NZ's imports of goods plunged in April and have been slow to recover – and will only return to year-ago levels in November (see NZ trade indicators in our weekly chart pack)

But why have NZ imports been slow to recover, when electronic spending data point to a strong recovery in retail therapy? The answer may lie in a shipping capacity shortage. COVID-19 severely disrupted trade flows earlier this year and the logistics of global trade have faced a number of unprecedented challenges this year. Once the economic activity started to resume from the initial lockdown, the ability to send goods from A to B became complicated. With international boarders closed and air passenger demand collapsing, the ability to send goods by air freight has become severely impacted. Even with airlines repurposing passenger planes to be freight-only planes, the number of weekly global commercial flights in November remains 2/3 of February flights. This has seen shipping demand surge.

World, RWI/ISL Container Throughput Index
Seasonally Adjusted, Jan 2020 = 100



Source: Macrobond, ASB

The RWI/ISL Container Throughput index (chart opposite) can be viewed as an indicator of global shipping trade – while activity plunged during the early days of the global pandemic, by September container shipping activity has surged to be 5% higher than pre-COVID levels. This has spilled over into higher shipping costs and reports of delays getting goods out of key shipping hubs – such as China. These challenges are also underscored by a number of anecdotes in NZ of supply shortages of imported goods, such as car parts, construction materials and retail goods. With shipping indicators demonstrating that global demand is now running ahead of supply, the question is how quickly will cost pressures support a recovery in generalised inflation pressures – particularly in a country like NZ which is in a fortunate position to be largely COVID free. In the meantime, we suggest doing your Christmas shopping early this year to avoid missing out. jane.turner@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6927	0.6876	0.6660	0.6403	FLAT/DOWN	0.6800	0.6955
NZD/AUD	0.9475	0.9433	0.9366	0.9433	FLAT/UP	0.9400	0.9530
NZD/JPY	71.90	71.86	69.74	69.56	FLAT/UP	71.50	72.80
NZD/EUR	0.5843	0.5800	0.5645	0.5787	UP	0.5750	0.5870
NZD/GBP	0.5210	0.5197	0.5097	0.4958	FLAT/UP	0.5050	0.5270
TWI	73.6	72.8	71.4	70.90	FLAT/UP	N/A	N/A

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

NZD Recap

The NZ dollar outperformed again last week. The NZD/USD hit 2-year highs of 0.6950 while NZD/AUD rose to 7-month high a smidge above 0.9500.

The USD remained on the back foot as optimism about a global vaccine rollout and consequent global re-opening boosted risk appetite and sapped demand for safe-haven assets. At the same time, local interest rates either sustained or built-upon recent gains, bolstering the relative yield appeal of the currency. The local market continues to back-off the idea of negative wholesale interest rates, and now prices a terminal OCR of 0.10%.

Outlook

Our CBA colleagues lifted their NZD/USD forecasts last week, by up to five cents. The NZD/USD is now seen at 0.6900 by the end of the year, with NZD/AUD at 0.9325. The NZD/USD is expected to trend gradually higher over 2021 with NZD/AUD to slowly decline. These changes reflect both the ongoing resilience of the NZ economy, and the fact we no longer expect the RBNZ to cut the OCR into negative territory. NZ's terms of trade are also expected to remain elevated at levels close to record highs, conferring additional fundamental support on the currency.

The NZD has had a strong run, and our suspicion is that we see it pause for breath this week. After all, the daily RSI – a momentum indicator – is currently skirting "oversold" territory, and broader technical indicators are also consistent with consolidation.

But the broader picture is one where the NZD is trending higher as the recent brightening in the local and global backdrops are priced in. Forecasts and currency models don't do particularly well during periods where currencies trend, as they do have a tendency to 'overshoot'. For example, our short-term valuation model's estimated 'fair-value' range is currently 0.6400-0.6800, but we suspect fair-value will eventually catch-up with the spot rate rather than the other way around.

Event risk this week is light, relatively speaking. Global 'flash' manufacturing PMIs for Europe and the US will be the most interesting data. Signs global momentum is flagging in response to the imposition of new lockdown restrictions might cool global risk sentiment a little. Local data are second-tier in nature, but will maintain the recent encouraging tone. mike.jones@asb.co.nz

ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.69	0.70	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.93	0.93	0.92	0.91	0.92
NZD/JPY	69	70	71	74	74	77	80
NZD/EUR	0.57	0.56	0.58	0.57	0.56	0.55	0.53
NZD/GBP	0.52	0.51	0.52	0.52	0.51	0.52	0.52
NZD/CNY	4.54	4.50	4.52	4.56	4.55	4.51	4.47
NZD TWI	71.4	71.6	71.5	72.1	71.7	71.5	71.5

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	UP
90-day bank bill	0.25	0.26	0.27	1.21	UNCH	UP
2-year swap	0.22	0.20	0.01	1.14	UNCH	UP
5-year swap	0.40	0.38	0.13	1.22	UNCH	UP
10-year swap	0.82	0.80	0.54	1.51	UNCH	UP
10-year govt bond yield	0.82	0.84	0.61	1.35	UNCH	UP
Curve Slope (2s10s swaps)	0.60	0.61	0.53	0.37	UNCH	DOWN

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

Market Recap

Local yields started last week with a firmer tone as the notion of a lower OCR was watered down by markets. US and European yields eased and curves flattened last week. The spike in COVID-19 cases in the US (and the associated tightening of restrictions), refusal of President Trump to concede the presidency (hindering the transition to the Biden administration) and deadlock in the US over a fiscal relief package have seen Treasury and European yields retrace towards the end of last week. The reported stand-off between the US Federal Reserve and the US Treasury over when to cease emergency lending programmes and the softening tone of US data reinforced the cautious mood. Australian yields ended the week lower, with markets largely discounting the strong Australian employment report and solid rise in October preliminary retail trade given the outbreak of COVID-19 in South Australia and subsequent imposition of a 6-day lockdown.

Near-term interest rate outlook

Current market pricing has about 15bps of cuts and an OCR endpoint at around 0.10% which seems reasonable in light of the risk profile and our new OCR view. We expect forthcoming data to reveal a widening divide between steady momentum in the NZ economy and slower signs elsewhere, which could continue to push NZ yields higher relative to global peers. PMIs for the US and Europe are expected to show slowing momentum given the impact of tightening COVID-19 restrictions.

With the RBNZ signalling the loan-to-value restrictions on housing lending will be reimposed next March, Wednesday's Financial Stability Report is unlikely to provide much excitement for markets unless it reveals more details about the Funding for Lending Programme (FLP). The RBNZ has thrown down the gauntlet to banks, implicitly tying the OCR to moves in customer lending interest rates. The more the latter fall, the less likely the need for the OCR to go lower. Another tool in the kitbag means less reliance on the LSAP programme to keep yields down and bolster liquidity, with the RBNZ announcing a scaled back $800m in NZ government bond purchases this week.

We don't expect this week's speech by RBA Deputy Governor DeBelle on monetary policy to be particularly market moving. The next step for the RBA if more stimulus is required is via extending its AUD100bn asset purchase programme rather than cutting the cash rate. This week's FOMC Minutes will be perused for signs of whether the asset purchase program will be changed (i.e. increased) as soon as next month to support the US economy.

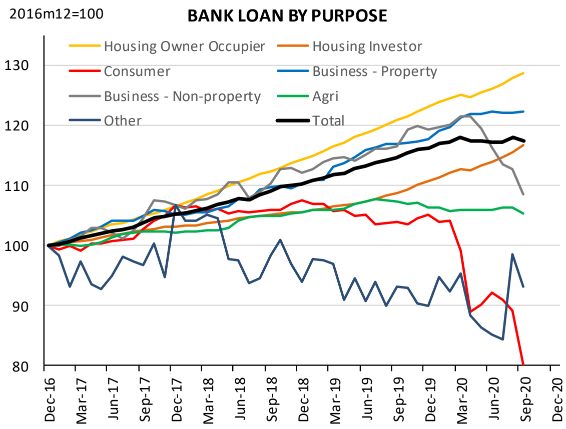
Medium-term outlook

We no longer expect the RBNZ to take the OCR below zero in 2021 and have pencilled in a 0.25% OCR until mid-2023, given the resilience being displayed by the NZ economy and the expectation that the RBNZ Funding for Lending Programme will help lower interest rates for borrowers within the economy. The outlook is highly uncertain with scope for heightened volatility over the next few months. We expect local and global longer-term yields to subsequently grind higher, but to remain at historically low levels over the next few years. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
RBNZ Financial Stability Report, November	25/11	9:00am	-	-
Merchandise trade balance, October, $m	26/11	10:45am	-	-501
ANZ Consumer Confidence, Headline, November	27/11	10:00am	-	Up

The **November RBNZ Financial Stability Report** (FSR) is expected to reaffirm that the financial system has remained resilient and banks are well capitalised despite the COVID-19 hit. Fiscal and RBNZ policy support has played a key role. However, the RBNZ will be concerned that credit growth has been highly uneven and property-centric (see chart) and will be wary of pockets of weakness in the economy (e.g. tourism). Despite the RBNZ having already signalled the LVRs on mortgage lending will be re-imposed next March, discussions on financial stability risks from housing are likely to heavily feature. The RBNZ will potentially try to talk the housing market down and may signal it is looking at other measures to slow housing lending. The message will be that banks will need to play their part to bolster business lending, not further ignite the housing market, and to maintain sound lending standards – a tricky balancing act.



Source: RBNZ, ASB

We anticipate **October merchandise trade** will show a deficit of $501m. New Zealand typically records a trade deficit at this time of year, but the result would be the narrowest deficit in seven years (by comparison, the October 2019 deficit was more than twice as large at $1,038m). The result will help push New Zealand's annual trade surplus to $2,248m, the largest surplus since the 1990s. Both exports ($4,784m) and imports ($5,285) are expected to fall when compared with the same time last year, amid the broad slowdown in international trade, global container shortages and soggy outlook for global growth. Still, we expect the decline in imports to be much larger than that for exports, with reports of lengthy delays in unloading at Ports of Auckland over recent weeks. NZ exports should be a bit more resilient, with the primary sector holding up relatively well and the Chinese recovery acting as a key support.

Consumer sentiment in the ANZ survey is expected to show continued improvement and move towards historical averages. NZ's efforts in containing COVID-19, the vaccine news, housing and equity market strength and the resilient domestic backdrop should see sentiment firm. We will be looking for further improvement on respondents' views on it being a good time to purchase a major item to signify the overall household sector are taking a glass half-full view of the outlook despite various headwinds.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Eurozone PMI's, October, points	23/11	11:00 am	-
UK PMI's, October, points	23/11	11:30 am	-
RBA Dep Gov Debelle speech	24/11	4:30 pm	-
Australia Construction Work Done, Q3, %qoq	25/11	2:30 am	-4.0
US PCE Deflator, Q3, %yoy	25/11	3:30 pm	1.2
US Fed Meeting Minutes	25/11	9:00 pm	-
Australia Private Capital Expenditure, Q3, %qoq	26/11	2:30 am	-1.0

**Originally published by CBA Global Markets Research on Friday 20 November at 12:03 pm*

Reserve Bank of Australia (RBA) Deputy Governor Debelle is due to speak to the Australian Business Economists on *Monetary Policy in 2020.* This is expected to largely be a factual summary of what has taken place and the impact of the decisions made. The next step for the RBA will be in early 2021 to decide if further support is required, most likely in the form of an extension to its $A100bn bond buying program. We are currently more optimistic than the RBA on the economic outlook for 2021.

We expect a fall in Australia's construction work done in Q3 20 of 4%. This would follow a fall of 0.7% in Q2 20. We expect falls in new residential construction to not be offset by improvements in renovation activity. Non-residential construction is also expected to be weak. The impact of the strict lockdown in Melbourne should also weigh on the numbers as there were limits to construction activity during the Stage 4 lockdown.

We expect to see a 1.0% fall in Australia's Q3 capex after a 5.9% contraction over Q2 20. We expect to see a fall in "other buildings & structures" while "machinery & equipment" investment is expected to be flat. Investment allowances by the Federal government could assist the latter.

The **Eurozone's composite PMI** fell to 50.0 in October, a four-month low. The November PMIs will likely point to a contraction in economic activity because of renewed restriction measures.

Likewise, the **UK's composite PMI** fell to 52.1 in October, a four-month low. The November PMIs will likely point to a contraction in economic activity because of renewed restriction measures.

We expect US inflation was flat in October. As a result, we expect the annual Personal Consumption Expenditure (PCE) deflator and core PCE deflator slowed to only 1.2%yoy and 1.4%yoy, respectively. The US economy is losing momentum and the risk is that inflation slows further without more fiscal stimulus to help prop up demand.

US Federal Reserve Chair Jay Powell suggested that the US Fed could change the composition, duration, and size of its asset purchases at his November press conference. At the same time, he reiterated that there were downside risks facing the economy. Market participants will be looking for any signs that the central bank will change its asset purchase program as soon as December.

Key Forecasts

ASB NZ economic forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-12.2	11.1	0.7	0.5	0.4		
GDP real - A%	-12.4	-3.4	-3.1	-1.2	13.0	1.5	3.3
GDP real - AA%	-2.1	-3.5	-4.7	-5.0	1.0	4.3	2.6
CPI - Q%	-0.5	0.7	0.0	0.5	0.1		
CPI - A%	1.5	1.4	1.0	0.7	1.3	1.3	1.5
HLFS employment growth - Q%	-0.3	-0.8	-0.3	0.1	0.4		
HLFS employment growth - A%	1.5	0.2	-0.4	-1.4	-0.6	2.1	1.9
Unemployment rate - %sa	4.0	5.3	5.8	6.2	6.5	5.7	5.5
Annual current account balance as % of GDP	-1.9	-1.2	-1.0	-1.4	-2.0	-2.3	-2.6

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	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	0.30	0.31	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	0.21	0.06	0.25	0.25	0.25	0.25	0.45
NZ 5-year swap rate	0.35	0.13	0.35	0.35	0.35	0.35	0.65
NZ 10-year swap rate	0.74	0.51	0.80	0.80	0.80	0.95	1.15
NZ 10-year Bond	0.91	0.46	0.85	0.85	0.85	1.00	1.20

ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.69	0.70	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.93	0.93	0.92	0.91	0.92
NZD/JPY	69	70	71	74	74	77	80
NZD/EUR	0.57	0.56	0.58	0.57	0.56	0.55	0.53
NZD/GBP	0.52	0.51	0.52	0.52	0.51	0.52	0.52
NZD/CNY	4.54	4.50	4.52	4.56	4.55	4.51	4.47
NZD TWI	71.4	71.6	71.5	72.1	71.7	71.5	71.5

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets