ASB

Economic Weekly

24 August 2020

Lockdown diaries… day 13 of lockdown lite

We have previously estimated that the current COVID Alert Level restrictions (i.e. Auckland Alert Level 3 and the rest of the country at Alert Level 2) would reduce weekly GDP by around 8%. Early data provide some insights into how NZ is responding. Data from Google show that NZ's movement in key economic areas (i.e. workplaces, grocery, pharmacy, retail and recreation) is down 20%, but for Auckland movement is down 43% (see chart below). Traffic data paint a similar story. Light traffic in Auckland is down significantly (42%) and heavy traffic has also been impacted by the Level 3 restrictions (down 10%). Throughout the rest of the country, heavy traffic looks largely unaffected and light traffic is only down a smidge (6-10%). Card spending is down, with the average weekly spend of ASB cardholders down 16% (week ended 22 August) compared to the average weekly spending a fortnight ago, prior to the discovery of the latest outbreak. Meanwhile, electricity demand appears largely unchanged. The contrast between light and heavy traffic, card spending vs electricity usage, highlights that the brunt of the impact from the current lockdown is borne by the services industries.

Last week we officially changed our OCR call, along with other NZ bank economists, and now expect the RBNZ to cut the OCR into negative territory next year. In saying this, we retain some reservations around the effectiveness of a negative OCR and remain unsure the benefits outweigh the costs. A negative OCR remains a contentious issue internationally. In our Economic Note released last week, ASB Senior Economist Mark Smith commented that the jury of experts remains out, with the international central banking community split on the effectiveness of using a negative OCR. Furthermore, Mark noted that the European experience does not inspire a lot of confidence. If the RBNZ does cut the OCR into negative territory it will be in direct contrast to the Reserve Bank of Australia, which, so far, remains staunchly against using a negative cash rate. This contrasting position is likely to have some currency implications, and we have also tweaked our FX forecasts as a result (see Page 2 of the Weekly). 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

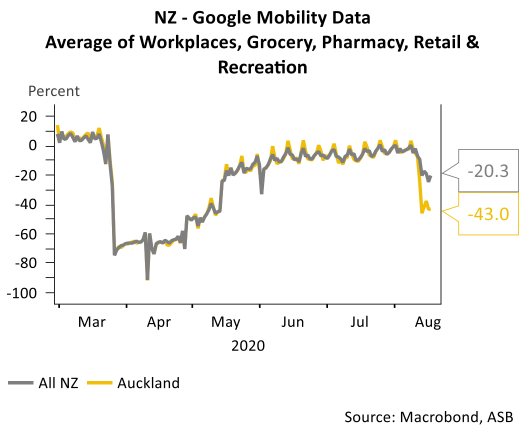
Policy response:

RBNZ August MPS Review

Assessing the RBNZ's bag 'o' tricks

For COVID-19 research, see here

Chart of the week



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6536	0.6530	0.6623	0.6387	FLAT/DOWN	0.6400	0.6710
NZD/AUD	0.9125	0.9095	0.9347	0.9454	DOWN	0.9095	0.9240
NZD/JPY	69.13	69.61	70.48	68.07	FLAT	68.00	71.60
NZD/EUR	0.5540	0.5506	0.5709	0.5769	FLAT/DOWN	0.5385	0.5650
NZD/GBP	0.4993	0.4989	0.5202	0.5222	FLAT/DOWN	0.4900	0.5150
TWI	71.1	70.8	72.6	71.23	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 drifted last week. The main global trend in FX markets – USD depreciation – paused last week, and this saw most of the major currencies shift back into consolidation mode. The NZD/USD shuffled around a 0.6490-0.6640 range and NZD/AUD spent the week chopping around either side of 0.9100.

Outlook

The CBA/ASB foreign exchange forecasts were revised last week to enshrine a weaker USD view. This reflects CBA's expectation that the US current account deficit will widen, and the US Terms of Trade will decrease.

All else being equal a weaker USD outlook would lift NZD/USD forecasts. However, some NZD-specific factors are expected to limit NZD upside. Most notably, the RBNZ is about to embark on a much more aggressive monetary easing campaign than many of its offshore peers. This means interest rate differentials between NZ and the rest of the world are set to become more of a drag on the currency.

We've started to see this happen already. NZ-US 2-year swap differentials fell to -15bps last week, from -9bps the week prior. This has dragged our short-term valuation model's estimated NZD/USD "fair-value" range down to 0.6300-0.6700. Our highest conviction view is for further downside in the NZD against the AUD. We target a sub-9000 cross rate by year end.

The week ahead is relatively quiet, at least on the data front. The potential for another round of US fiscal stimulus, and US-China government tensions look set to remain front and centre for market sentiment. It is unclear if the US Congress will agree to a new fiscal package, including its size and composition. News of agreement on a sizeable package ($US2tn+) would likely spur a brief USD relief rally (NZD/USD lower).

US inflation figures on Friday are expected to increase thanks to the recovery in oil prices. There will also be attention on Fed Chair Powell's speech at the Jackson Hole symposium (starting Friday night).

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ASB foreign exchange forecasts (end of quarter)	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	<< actual	forecast >>					
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	0.27	0.30	0.30	1.19	UNCH/DOWN	UP
2-year swap	0.11	0.13	0.22	0.97	UNCH/DOWN	UP
5-year swap	0.16	0.23	0.33	1.00	UNCH/DOWN	UP
10-year swap	0.53	0.63	0.69	1.29	UNCH/DOWN	UP
10-year govt bond yield	0.64	0.69	0.83	1.13	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.42	0.50	0.47	0.32	UNCH	DOWN

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

Market Recap

NZ and global yields start the week lower and the curve flatter than a week ago, with more sizeable falls for local yields. The major local catalyst to lower NZ yields was the after-wash of the August MPS, which has seen major local banks (ASB included) formally shift OCR calls to a negative OCR from early 2021. Local data were scant, with markets fixated on COVID-19 developments. The recent community outbreak in NZ has seen the NZ General Election pushed out to October 17, with the Pre-Election Economic and Fiscal Update (PREFU) delayed until September 16.

Wavering global risk sentiment, concerns that the recent gains in equities may have run out of puff, and the dovish Fed Minutes helped push global yields lower. US 10-year Treasury yields (0.63%) fell to the lowest in a fortnight. The August Fed minutes stopped short of providing explicit guidance for markets and did not provide further details on ability of bond purchases, with the Federal funds rate to be held at 0% to 0.25% until the Fed is confident the US economy "has weathered recent events". The RBA Minutes warned the Australian recovery was likely to be slower than expected. Helped by $1,078m in RBNZ purchases (the highest in 2 months), NZ 10-year government bond yields (0.62%) ended the week close to record lows, around 25bps below Australian counterparts across the curve.

Near-term interest rate outlook

Market pricing has shifted a considerable distance, with the OCR expected to trough at about -0.20% by late 2021. Given our OCR view (see below) we see further scope for yields to move lower. In the interim we expect the RBNZ will use its beefed-up asset purchase programme and forward guidance to dampen yields. The RBNZ has announced $1.35bn in government bonds will be sought this week. Cumulative RBNZ purchases ($25.8bn) are well under the $100bn LSAP cap and comfortably below Crown indemnity thresholds, providing plenty of scope for the RBNZ to front-load asset purchases. This week the NZ Debt Management Office will be tapping the 2027 NZ Government bond via syndication, with solid demand expected. Syndicated issues have helped limit weekly tenders, with just $1bn to be offered this week.

Partials for Q2 Australian GDP are due, and we expect just a 6% Q2 contraction in Australian GDP (vs a 17% fall in NZ), maintaining our downward bias for NZ rates versus Australian counterparts. US underlying PCE inflation should remain soft, with the Republican National Convention and gyrations in equity markets expected to be larger determinants.

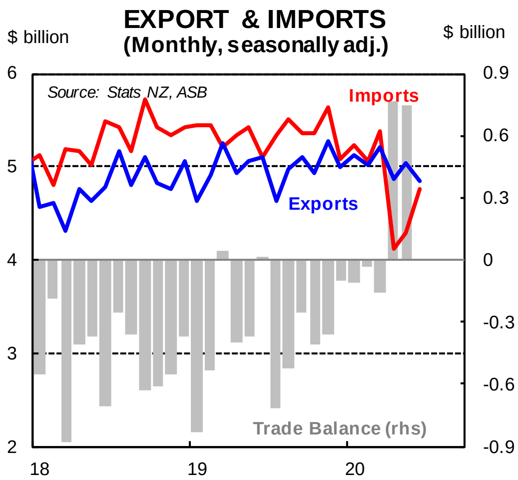
Medium-term outlook

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 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 flat despite high public debt issuance. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, July, $m	26/08	10:45am	-	281

Preliminary trade data, already released, point to a trade surplus of $281m in July. This surplus is in contrast to the trade deficit NZ typically records in July; the average size of the July trade deficit over the past 3 years is $300m. The COVID-19 pandemic has resulted in a sharp fall in import demand in NZ, but export activity has held up relatively well. While imports are tentatively recovering, they remain well down on year-ago levels. There remain some anecdotes of importers facing supply shortages of certain goods due to COVID-19 lockdowns impacting overseas production. Meanwhile, NZ's food exports have continued to perform well – especially kiwifruit.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CBA Card Spending, ending 21 Aug	25/08	-	-
Australia Construction Work Done, Q2, %qoq	26/08	-	-5.5
Australia Capex Volumes, Q2, %qoq	27/08	1:30 pm	-8.5
US PCE Deflator, July, %yoy	28/08	12:30 am	1.0

Originally published by CBA Global Markets Research on Friday 21 August at 1:25 pm

Our CBA colleagues will be watching internal data closely to see whether spending in Victoria and NSW continue the easing trend from the preceding week. In-store spending collapsed in Victoria for the week ending 14 August and is approaching lows reached during the first lockdown in March-April.

We expect another **weak quarter of construction work done in Australia** over Q2 2020. There was a fall of 1% in Q1 2020, but since then the housing outlook has deteriorated due to border closures and economic uncertainty driven by Covid-19. We expect further weakness for the remainder of 2020 and into H1 2021.

A very weak outcome is expected for **Australian capex volumes in Q2 2020**. We have pencilled in a fall of 8.5% in the quarter with large falls in plant & equipment and other buildings and structures. A preference for liquidity and an uncertain demand outlook has seen businesses wind back investment decisions and intentions. We also expect the third estimate of capex plans for 2020/21 to print at $A93bn which will be an implicit downgrade on estimate two. Non-mining investment is wearing the brunt of the downgrade, we expect estimate three to print at $A55bn while mining investment is expected to print at $A38bn.

We expect an uptick in the **US Personal Consumption and Expenditure (PCE) deflator**, following a sharp rise in the July headline CPI. Higher gasoline prices over the month helped boost prices. We expect a similar lift in the core PCE deflator to 1.3%yoy. However, some of the price rises in July (including motor vehicle insurance) are unlikely to be sustained. Excess capacity in the US labour market suggests inflation can ease in coming months.

Key Forecasts

ASB NZ economic forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	forecast >>						
GDP real - Q%	-14.5	12.9	1.2	0.4	0.4		
GDP real - A%	-14.8	-4.6	-3.9	-1.9	15.2	1.6	3.0
GDP real - AA%	-2.7	-4.5	-5.9	-6.3	0.6	4.9	2.5
CPI - Q%	-0.5	0.9	0.0	0.1	0.2		
CPI - A%	1.5	1.7	1.2	0.6	1.2	1.3	1.3
HLFS employment growth - Q%	-0.4	-2.3	-1.3	0.5	0.0		
HLFS employment growth - A%	1.1	-1.5	-2.9	-3.4	-2.9	1.7	1.8
Unemployment rate - %sa	4.0	6.2	7.1	6.9	7.1	6.7	6.6
Annual current account balance as % of GDP	-2.5	-2.3	-2.6	-3.1	-3.2	-2.8	-2.8

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	-0.50	-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	-0.10
NZ 5-year swap rate	0.35	0.15	0.10	0.00	-0.20	-0.20	0.10
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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(end of quarter)	<< actual	forecast >>					
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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
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