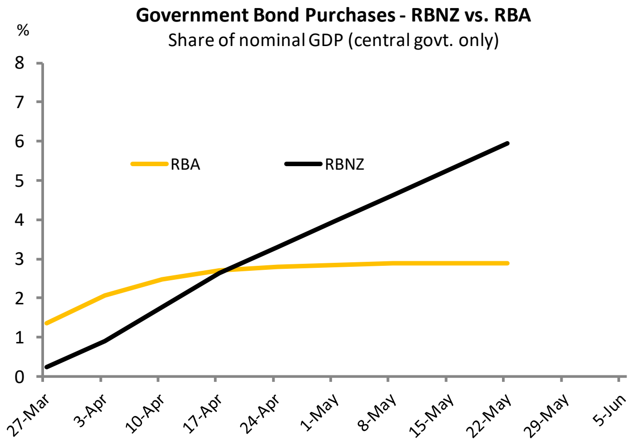
Economic Weekly

25 May 2020

Take two of these and call me in six months

Doctors would never prescribe a cure before knowing how sick the patient is. But we're in an environment where NZ's policy makers are having to rush out cures well in advance of knowing the full extent of our economic ills. Massive fiscal and monetary easing programmes are being pushed out the door to address a picture that economists admit could differ wildly from forecasts. Of course, this is always the case. Economic data, particularly in NZ, come with a long lag so policy is generally set by looking in the rear-view mirror. But the issue is that much more marked in the current environment. The uncertainty of the economic environment is unprecedented, and so is the size and cost of the support measures.



Source: RBNZ, RBA, ASB

Still, it's been hard to argue with the treatment plan to date. The government's cash splash – particularly the wage subsidy – has at least prevented an even worse prognosis. And the RBNZ's quantitative easing programme has been successful in keeping wholesale interest rates extraordinarily low. As we saw last week, we're now starting to see this flow through to retail and mortgage rates. The fact that the RBNZ on Friday announced plans to "taper" down its government bond purchases is perhaps another sign the battle is being won. The Bank's central banking counterparts in Australia and the US tapered some time ago (see chart). We think it's the right move.

No new policy measures are expected from this week's RBNZ Financial Stability Report, but the Bank will seek to reassure markets that it has plenty more medicine to keep the recovery in the economic and financial markets going.

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Recent COVID-19 publications	Where to find support
ASB Economic forecasts and monitoring: Sector impacts of COVID-19 An outlook for the labour market ASB COVID-19 Chart pack **Financial market trends:** COVID-19: Market stocktake and what we are watching ASB Podcast for investors **Policy response:** RBNZ confirms increase to QE at May Monetary Policy Statement Budget 2020 delivers huge support, huge debt	ASB financial support package Government support package COVID-19 alert system explainer For these publications and more COVID-19 research, see here

Sector Impacts of COVID-19 - Sharing the pain

- COVID-19 is expected to lower nominal value-added production GDP by around 7% over 2020, which cumulates to a loss of more than $30bn over 2020. The hit to production values (which measures intermediate inputs in addition to just the valued-add component) will be correspondingly greater.
- The hardest-hit sectors are those that have been directly impacted by tighter border requirements on tourism and the enhanced focus on physical distancing.
- Our sector analysis suggests that the direct impacts of COVID-19 are likely to be widespread, with production values for more than 60% of the economy expected to fall by more than the 7% fall for the NZ economy.
- The second-round impacts are expected to be significant, with proportionately more of the impacts to fall on the services sector. This will have implications for employment and consumer spending.

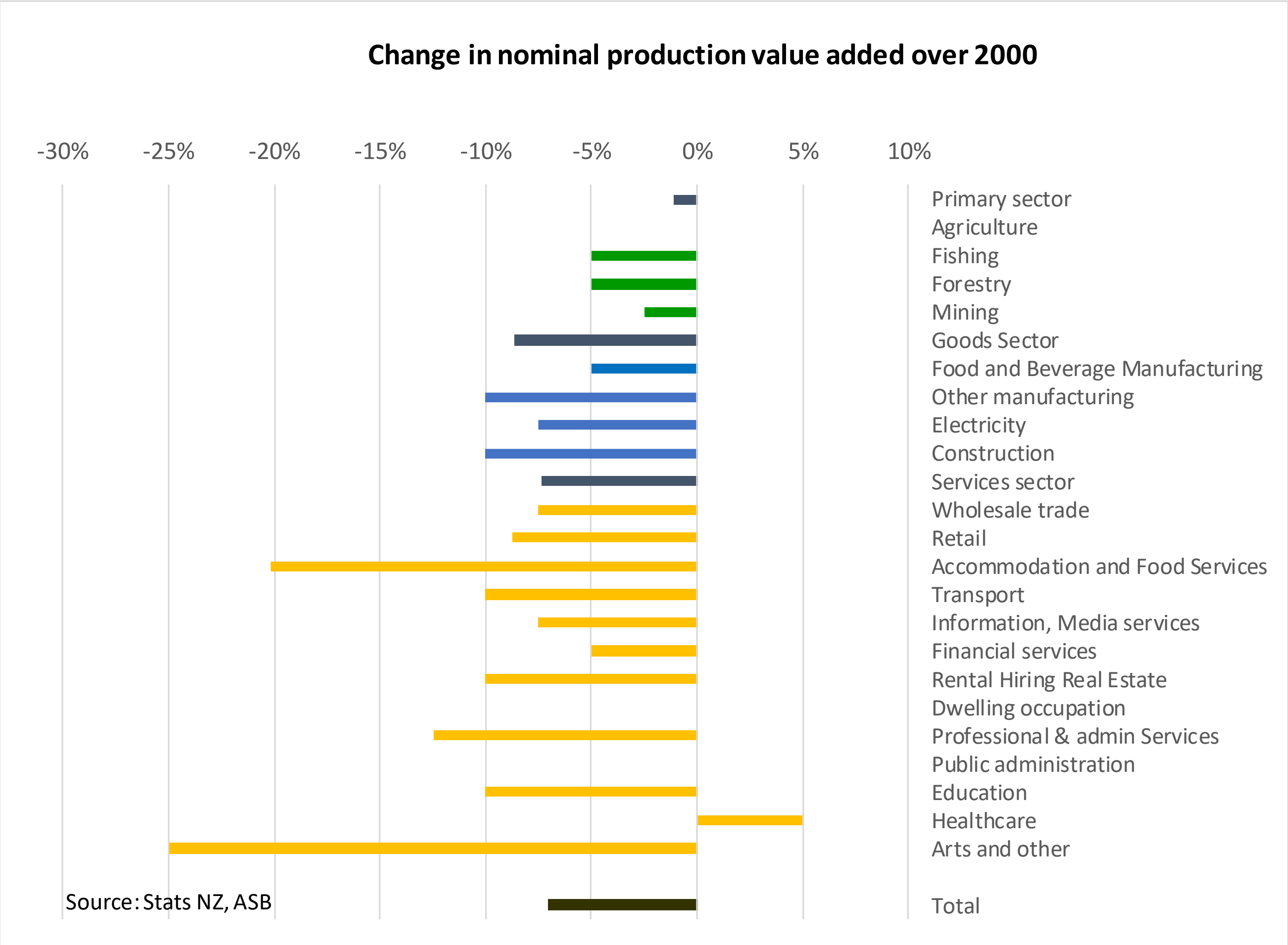
This is a condensed summary of research we released late last week.

Summary and key takeouts

COVID-19 represents a significant negative shock to the NZ and global economy, potentially the largest since the Great Depression almost a century ago. NZ's nominal GDP will shrink 7% and will be a cumulative $32.5bn lower over 2020 compared to pre-COVID-19 levels. Moreover, the actual cumulative fall in sales values (rather than value added/GDP) will be much larger - in the region of $70bn over 2020 according to our estimates.

Direct effects of COVID-19

The direct impacts of COVID-19 are likely to be widespread across sectors (see chart). Our sector analysis suggests that production values for more than 60% of the economy are expected to fall by more than the 7% fall for the NZ economy.



The hardest-hit sectors are those who have been directly impacted by the tighter border requirements and focus on physical distancing to try to contain the spread of the outbreak. Many of the sectors reliant on tourism – including accommodation services, transport, hospitality, retail trade - are likely to be the hardest hit in terms of percentage falls. Businesses with a large amount of interpersonal physical contact – including professional services, and arts and other services – will also be significant hit.

The non-primary manufacturing and construction sectors have been significantly impacted by the lockdowns and stricter distancing requirements and, although a pick-up in the second half of 2020 is envisaged, the next few years could prove challenging. The primary sector, food manufacturing, and the healthcare sector should be amongst the stronger performers. The rest of the economy is somewhere in the middle.

Beyond 2020

It gets murkier beyond 2020. The timing for when a new vaccine for COVID-19 will be available is highly uncertain, with the risk that the 2020 slump in activity persists well into 2021. Sectors that can adapt to the new environment and are not dependent on physical contact will tend to outperform. Rates of recovery will vary by sector and there will be marked differences within sectors. Our core macro-economic forecasts assume that the level of real GDP does not overtake pre-COVID-19 levels until 2023. For sectors bearing the brunt of the direct hit from COVID-19, the period at which the level of activity will remain below pre-COVD-19 levels is likely to be considerably longer.

Wider economic impacts

Even those sectors that are not directly impacted by COVID-19 will likely be impacted by a fall in demand from other sectors. Our estimates suggest the magnitude of indirect (i.e. spill-over) economic impacts for the NZ economy are about 80% of the direct impact. We estimate a direct $32.5bn hit to NZ production value-added GDP over the 2020 year as a result of COVID-19, but the total longer-run impact could be closer to $60bn after taking into account the weaker demand for firms supplying inputs to these sectors. More of the second-round impacts are expected to be borne by the employment-rich services sector. This, in turn, will have implications for employment and wider consumer spending throughout the economy. mark.smith4@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6095	0.5952	0.5988	0.6516	DOWN	0.5950	0.6250
NZD/AUD	0.9332	0.9241	0.9425	0.9460	FLAT/DOWN	0.9150	0.9500
NZD/JPY	65.60	63.76	64.44	71.40	DOWN	64.00	67.3
NZD/EUR	0.5593	0.5500	0.5559	0.5828	DOWN	0.5450	0.5730
NZD/GBP	0.5005	0.4919	0.4849	0.5147	FLAT /DOWN	0.4890	0.5140
TWI	69.2	67.6	68.2	71.96	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

Improving risk sentiment last week proved to be NZD supportive with the NZD making gains against most majors last week. The opening up of countries from lockdowns and hopes that a new vaccine to fight COVID19 would be found provided a boost to equity markets and commodity prices, supporting the NZD.

Signals from global policymakers that they will pull out all of the stops were also NZD supportive. Last week, the Bank of Japan announced an additional lending program to support bank lending to businesses. The Chinese National People's Congress did not provide an explicit target for GDP growth this year but unveiled huge fiscal stimulus (in the order of 9% of GDP) to support the economy.

Tempering the NZD upside have been mounting geopolitical tensions in the weekend between China and the US. The Chinese Government announced plans to impose national security law on Hong Kong. In response, US President Donald Trump warned China the US would "address that issue very strongly". Over the weekend, China Foreign Minister warned the US not to try and change China and said some Americans were risking a "new cold war."

Outlook

NZD direction will ultimately depend on how successful the global economy is in restarting after COVID-19 lockdowns. NZ looks to be better positioned than most, and we remain constructive on the medium-term NZD outlook.

The NZD, however, is still likely to face a bumpy ride until the fog caused by COVID-19 clears. Increasing geopolitical tensions between the US and China are expected to be USD and yen supportive and should likely weigh on CNH and commodity currencies like the NZD. Moreover, the European Commission is expected to present this week the full proposals of the Franco-German recovery fund and the seven-year European Union budget, which should support the euro. The lack of progress on Brexit talks should continue to undermine the GBP, particularly with MPC voter Ramsden signalling he was open minded about a negative policy interest rate and increasing BOE asset purchases.

The RBNZ is set to taper (slow the pace of) asset purchases this week, purchasing 'only' $1.175bn of NZ Government bonds. If this signals NZ monetary policy settings are moving into closer alignment with global peers it will be NZD supportive. This week's economic data will continue to be largely ignored. The focus for markets will be whether forward-looking data – including this week's domestic consumer and business sentiment measures – point to brighter signs ahead. mark.smith4@asb.co.nz

ASB foreign exchange forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.67	0.60	0.55	0.58	0.60	0.61	0.64	0.65
NZD/AUD	0.96	0.97	0.96	0.97	0.95	0.94	0.94	0.94
NZD/JPY	73	65	54	58	61	63	67	69
NZD/EUR	0.60	0.54	0.47	0.51	0.53	0.54	0.57	0.58
NZD/GBP	0.51	0.49	0.46	0.47	0.48	0.48	0.49	0.50
NZD/CNY	4.7	4.3	3.9	4.1	4.2	4.3	4.5	4.6
NZD TWI	73.8	68.8	63.7	66.6	68.1	68.8	71.5	72.4

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	0.25	0.25	0.31	1.70	UNCH	UP
2-year swap	0.16	0.11	0.29	1.49	UNCH	UP
5-year swap	0.24	0.20	0.46	1.60	UNCH	UP
10-year swap	0.60	0.59	0.86	1.97	UNCH	UP
10-year govt bond yield	0.63	0.65	0.83	1.74	UNCH	UP
Curve Slope (2s10s swaps)	0.44	0.48	0.57	0.49	UNCH	DOWN

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

Market Recap

NZ yields start the week firmer for most shorter-term maturities, with the curve flattening. Market participants have reassessed the risks of cuts to the OCR, with the terminal OCR endpoint around 10bps higher at 0.0%. The last week has seen RBNZ monetary policy committee members - most notably Governor Orr and Deputy Governor Bascand – water down the likelihood of OCR cuts and reaffirm that increasing Large-Scale Asset purchases (LSAP) would be the first option if more monetary stimulus was needed.

The combination of extremely weak data, the ratcheting up of US-China tensions and the cautious tone by central banks and other authorities have capped yields at low levels. RBNZ asset purchases continued at a solid NZD1,350m weekly pace, taking cumulative NZGB purchases to around $11.9bn. This, and the RBNZ not ruling out a lower OCR, have been factors that have kept NZ yields below US and Australian counterparts, as the Fed and RBA have been tapering asset purchases and have been less keen on negative rates. NZ 10-year bond and swap yields are currently lying about 25bps below Australian counterparts and are slightly below US yields.

Near-term interest rate outlook

The future direction of NZ yields will hinge upon how confident markets are that the easing in restrictions to combat COVID-19 will not trigger a new wave of infections and subsequent lockdowns. Equity markets will prove to be a good barometer. COVID-19 has resulted in the Chinese authorities abandoning their practice of setting numerical targets for GDP growth this year and unease over the situation in Hong Kong could keep markets on edge and dampen yields.

A tapering of monetary stimulus by the RBNZ looks to be in the wings. The RBNZ has signalled it will be purchasing $1.175bn in NZ bonds this week (and $50 in LGFA bonds), down from the $1.35bn of the last 5 weeks. If this results in little change in NZ yields, this tapering is likely to continue. If yields move higher, tapering could prove short-lived, or it could prompt the RBNZ to use more direct methods (such as adopting a yield curve control target) to hold down shorter-term interest rates that are key for bank and corporate borrowing. In the May Financial Stability Report (Wednesday), the RBNZ should reiterate the financial system has remained sound and that it has the necessary tools and firepower to avoid market dislocations. Risks to financial stability have clearly grown and become more widespread, but massive actions by central banks have prevented a sizeable blow-out in spreads and have keep credit markets functioning.

The hard activity and price data– NZ business and consumer confidence, Q1 Canadian GDP, US personal spending and PCE inflation, Eurozone CPI – should be soft, but should attract minimal attention. NZ and Australia look to have managed the health challenges posed by COVID-19. It is the looming economic challenges we are concerned about.

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 its $60bn asset purchase programme before cutting the OCR. Weak 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

Domestic events

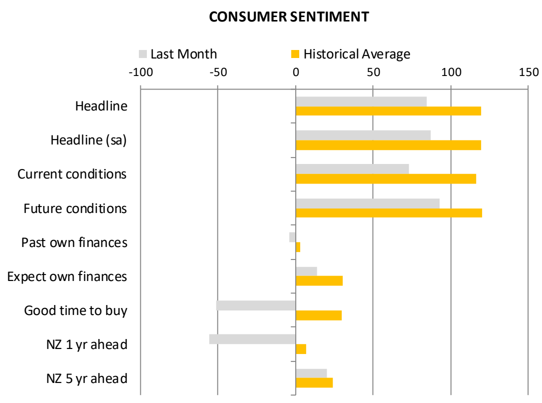
Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, April, $m	26/05	10:45 am	-	$500
RBNZ Financial Stability Report - May	27/05	9:00 am	-	-
ANZ Business Outlook, Own activity next 12 months, May	28/05	1:00 pm	-	-
ANZ Consumer Confidence, Headline, May	29/05	10:00 am	-	⬆

We expect a trade surplus of circa $500m in April. 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 and as well broader import volumes.

The **RBNZ's May Financial Stability Report (FSR)** is expected to acknowledge that, to date, the financial system has remained sound with banks well-capitalised and with sufficient liquidity. The RBNZ will seek to reassure markets that it has the necessary tools to keep the financial system ticking over. The RBNZ will, however, remain on the lookout for financial stability risks. There is likely to be greater focus on the financial resilience of households given pending job losses and house price falls. Businesses in sectors directly exposed to COVID-19 will come under closer scrutiny, and we suspect the commercial property sector will also be in the spotlight. There will likely be less focus than usual on the rural sector.

COVID-19 presents a stern challenge to the financial system and in reponse global central banks have pulled out the stops. In NZ we have seen the OCR cut to a record low 0.25%, a Quantitative Easing programme launched along with a huge range of initiatives including the **Term Auction Facility** to help banks to access term funding as well as a **Term Lending Facility** to support bank lending for low interest rates for up to 3 years under the **Business Finance Guarantee Scheme**. What's more, the RBNZ has pledged to delay to the start date for higher **bank capital requirements** by 12 months, **relaxed the core funding ratio** from 75% of 50% of eligible funding, **shelved the loan-to-value restrictions on housing lending** for the next 12 months and (along with banks) **granted a six-month principal and interest payment mortgage holiday for mortgage holders and SME businesses**.

ANZ will release the full May month business confidence reponses next week, after releasing the preliminary reponses earlier in the month. The preliminary results saw business confidence bounce off April's lows, but confidence remains at very low levels and consistent with a 7% contraction in the economy over 2020. The lift in May likely reflects some improved optimism as some firms were able to reopen in late April as the Alert Level 4 restrictions were eased to Alert Level 3. However, most firms will be operating at reduced capacity in order to meet social distancing requirements. The full May results will provide further insight into business activity fared following the shift from Alert Level 4 to Level 3 in late April.



Source: ANZ, ASB

April consumer sentiment plunged to 84.8 its level lowest since 2008, with record lows hit for respondent expectations of the short-term NZ economic outlook (-56) and whether it was a good time to purchase a major item (-51). COVID-19 looks to be directly impacting household finances, with the financial situation of consumers (-4) falling to a 7-year low. We expect modest improvement in the May figures, with the easing of COVID-19 restrictions in recent weeks to put consumers in a better frame of mind. The outlook for the household sector remains grim, nonetheless, with consumers expected to remain cautious for some time to come.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Construction Work Done, Q1, %qoq	27/05	1:30 pm	-1.5
US PCE Deflator, April, %yoy	28/05	3:30 pm	0.5
Australia Private Sector Credit, April, %mom	29/05	1:30 pm	0.9
Eurozone CPI, May, %yoy	29/09	12:00 pm	0.3

Originally published by CBA Global Markets Research on Friday 22nd May at 1:27 pm

We expect **Australian construction work** done to fall by 1.5% in Q1. We expect further weakness over 2020 as demand for housing will fall as net overseas migration is restricted due to COVID-19. In Q1, residential construction will continue to be soft and follows a 1.4% fall over Q4 2019.

We expect private sector credit in Australia to lift strongly again in April by 0.9% after rising 1.1% in March. In annual terms, this would see the annual rate of credit growth accelerate to 4.4% in April. Our view is driven by growth in business and household credit. The Reserve Bank of Australia's term funding facility, which has provisioned $A90bn for business lending at 0.25%, will continue to support business credit growth. For households, loan deferrals will see the stock of credit rise as interest payments are deferred and principal grows. We expect the acceleration in credit growth to be a near-term phenomenon. We see deleveraging beginning towards the end of 2020 in line with lower business investment, falling house prices and a rising household savings rate.

US CPI slowed sharply in April, reflecting tumbling gasoline prices, widespread stay-at-home orders and slumping demand. We expect the **US Personal Consumption and Expenditure** (PCE) deflator in April to also be very soft, at only 0.5%yoy. We estimate the core PCE will have slowed to just 1.0%yoy, the slowest rate since 2011.

Headline **CPI** inflation in the **Eurozone** eased in April to 0.4%yoy. Headline inflation is likely to decline considerably further over the coming months because of lower gasoline prices and the sharp downturn in economic activity.

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	-0.5	-17.3	11.6	1.9			
GDP real - A%	1.8	0.9	-16.6	-7.7	-6.5	-6.1	2.7	4.8
GDP real - AA%	2.3	1.8	-2.9	-5.4	-7.5	-9.2	4.9	4.6
CPI - Q%	0.5	0.8	-0.6	0.3	-0.1			
CPI - A%	1.9	2.5	1.3	1.0	0.4	-0.1	1.2	1.6
HLFS employment growth - Q%	0.1	0.7	-5.7	-1.5	0.6			
HLFS employment growth - A%	0.8	1.6	-4.8	-6.4	-6.0	-6.2	3.0	2.7
Unemployment rate - %sa	4.0	4.2	8.9	9.3	8.5	8.2	7.1	6.1
Annual current account balance as % of GDP	-3.0	-2.7	-2.9	-2.9	-3.3	-4.2	-2.8	-1.7

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
(end of quarter)		<< actual	forecast >>					
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	0.40	0.45	0.50	0.55	0.65	0.85
NZ 10-year swap rate	1.78	0.93	0.75	0.80	0.90	0.90	0.95	1.05
NZ 10-year Bond	1.65	1.03	0.80	0.90	1.00	1.00	1.05	1.15

ASB foreign exchange forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.67	0.60	0.55	0.58	0.60	0.61	0.64	0.65
NZD/AUD	0.96	0.97	0.96	0.97	0.95	0.94	0.94	0.94
NZD/JPY	73	65	54	58	61	63	67	69
NZD/EUR	0.60	0.54	0.47	0.51	0.53	0.54	0.57	0.58
NZD/GBP	0.51	0.49	0.46	0.47	0.48	0.48	0.49	0.50
NZD/CNY	4.7	4.3	3.9	4.1	4.2	4.3	4.5	4.6
NZD TWI	73.8	68.8	63.7	66.6	68.1	68.8	71.5	72.4

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