Economic Weekly

27 July 2020

Wary of the 'W'

The COVID-19 global downturn is so 'unprecedented' it requires many letters of the alphabet to describe it: we have talked about the various 'V', 'U' and 'L' shapes to the potential economic path. Increasingly a 'W' is being talked about. The acceleration in COVID-19 cases in a number of countries raises the chances that these economies have a second dip after their initial rebounds out of the first round of COVID-19 containment measures.

The US is one high-profile case. Thursday night will see its Q2 GDP outcome, for which we expect a 9.3% qoq fall (milder than the 17% fall we expect for NZ). The influential Institute for Supply Management's manufacturing survey has pointed to a decent Q3 rebound in US GDP (see chart), but the flare-up in COVID-19 cases flags the risk of a subsequent downturn beyond that. The US Fed will give its views on the economy prior to the GDP release.

There will also be a bit of focus on Australia's economic progress this week. CBA's weekly card spending data on Tuesday will give further insights into how Victoria's COVID-19 restrictions are affecting overall retail activity in Australia. Trade, building consents and inflation data are also out.

And we'll also get the final July read on ANZ's NZ business confidence, which showed a heartening bounce in the preliminary results earlier this month. The early read had businesses' views of future trading activity at a less pessimistic level than what was recorded during October 2008 to March 2009, the most challenging six months of the Global Financial Crisis. That's not to say that everything is suddenly peachy again – there are still many challenges ahead given NZ's borders are likely to be heavily restricted for some time and the rest of the world is having a tougher time than NZ in dealing with the pandemic. But, with confidence a critical factor impacting businesses' preparedness to employ and invest, the quick recovery from extreme depths of pessimism is a ray of light amid the doom and gloom and clear challenges that the NZ economy faces in rebuilding and reshaping itself.

nick.tuffley@asb.co.nz

Recent key economic 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 leaves QE target unchanged in June

For COVID-19 research, see here

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6635	0.6550	0.6443	0.6654	FLAT/UP	0.6580	0.6760
NZD/AUD	0.9355	0.9375	0.9347	0.9581	FLAT	0.9300	0.9460
NZD/JPY	70.49	70.26	68.98	72.27	FLAT	68.00	71.60
NZD/EUR	0.5693	0.5727	0.5739	0.5969	FLAT/DOWN	0.5650	0.5830
NZD/GBP	0.5183	0.5228	0.5181	0.5345	FLAT	0.5130	0.5260
TWI	72.7	72.1	71.4	73.05	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/USD rose to 6-month highs a shade below 0.6700 last week.

A weakening USD remains one of the driving forces of the currency's recent strength. Indicative of such, the NZD actually fell against most of the other major currencies last week, including the AUD, EUR, and GBP.

On a trade-weighed basis, the US dollar remains near its lowest level since September 2018. The recovering global economy is a negative for 'safe-haven' currencies like the USD and JPY. At the same time, the US's failure to control COVID-19 and the attendant risk this poses to its economy is further hampering the USD. The expiry of the US COVID unemployment benefit on Friday is not helpful for investors in this regard.

A stronger EUR is the other key factor weighing on the USD (the EUR comprises 58% of the trade-weighted USD). The agreement of the €750b EU recovery fund has not only bolstered the European growth outlook, but reduced longer-term fears of a European break-up.

Outlook

There's plenty of international news/events this week to help shape financial market sentiment, and hence direction for the NZD. Congressional negotiations around the size and shape of the next US fiscal stimulus package are likely to remain front and centre for markets, at least initially. Republican senators will table their draft bill today.

On Thursday, the Federal Reserve is expected to leave its key policies unchanged. But there will be plenty of attention on the Statement and press conference for hints more easing action is likely in future meetings, most obviously a move to "conditions-based" forward guidance. US GDP also on Thursday is expected by our CBA colleagues to show a 9.3% contraction for Q2, which will mark the trough for the US recession. European Q2 GDP is expected to contract 8%, following a 4% contraction in Q1. The official Chinese manufacturing PMIs will be released on Friday. Aussie CPI on Wednesday is expected to reveal the largest quarterly fall on record and the first negative read on inflation (of -0.5% yoy) since 1997.

Overall, we expect the NZD/USD to continue to trade with a positive bias now that resistance at 0.6600 has fallen and the EUR/USD is pushing higher. We wouldn't rule out a short-term test of the top end of our valuation model's estimated 0.6400-0.6800 'fair-value' range. But we also caution that volatility is likely to pick up given the weight of event risk described above. mike.jones@asb.co.nz

ASB foreign exchange forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	69	66	66	67	69	67
NZD/EUR	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	71.4	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	0.30	0.30	0.30	1.49	UNCH	UP
2-year swap	0.22	0.21	0.21	1.27	UNCH	UP
5-year swap	0.33	0.33	0.37	1.33	UNCH	UP
10-year swap	0.69	0.69	0.77	1.68	UNCH	UP
10-year govt bond yield	0.82	0.88	0.94	1.51	UNCH	UP
Curve Slope (2s10s swaps)	0.47	0.48	0.56	0.42	UNCH	DOWN

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

Market Recap

NZ swap yields start the week little changed on a week prior, with the curve marginally flatter. Yields are lower and curves flatter in the US and Australia. Catalysts include risks of growing economic disruptions caused by increasing global cases of COVID-19, weaker than expected US data (the first rise in initial jobless claims since March) and rising political tensions between the US and China that have stoked increased risk aversion.

Such influences have pushed North American and Australasian government bond yields lower. Last week, US10-year Treasury yields fell to their lowest in 3 months (0.58%). NZ Government bond yields also fell to their lowest in more than 1 month (10Y 0.81%), given solid demand at the weekly bond tender, easing global yields and $940m in RBNZ Asset Purchases (taking the cumulative total of purchases to roughly to $22bn since March). European bond yields are generally firmer than a week ago but remain very low in outright terms (UK 10Y 0.14%, German 10Y -0.45%).

Near-term interest rate outlook

This week looms as a critical one for markets and global yield direction. We expect yields to remain very, very low with few catalysts to push them markedly higher. Market pricing is expected to be biased towards policy interest rate cuts, both here and abroad. With markets considerably more settled than they were back in March/April, we don't expect substantive changes from the major central banks over the next few weeks, absent a sudden deterioration in economic prospects. We don't expect the RBNZ to seriously entertain the notion of a lower OCR in August and odds are increasing that the $60bn RBNZ asset purchasing programme will not be increased next month.

Yields have typically been less sensitive than usual to data, and this week's Q2 GDP for the US (mkt: -8.8% qoq) and Eurozone (mkt: -12% qoq) would likely have a mild bearing on yield direction. Our worry is that a flaring up of COVID-19 may derail the global economic recovery and forthcoming data such as this week's US Initial jobless claims will be watched for signs of slippage. We also expect a huge 1.9% fall in Australian Q2 CPI (mkt: -2% qoq, -0.5% yoy), with cooling core inflation highlighting potential deflation risks in Australasia, dampening yields.

Senate Republicans are expected to propose the next stimulus bill that will have a bearing on the H2 2020 profile in US economic activity. The US Federal Reserve decision looms, with the Federal Funds rate to be left on hold at the effective lower bound. With a highly uncertain economic outlook, the Fed is expected to avoid issuing conditions-based forward guidance. It will, however, seek to assure markets it will continue to use extraordinary programs to help the economy.

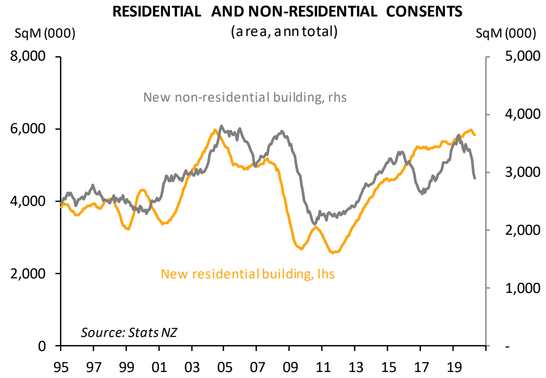
Issuing more bonds via syndication has helped to cap the NZ weekly bond tender, with $850m in conventional NZ Government bonds set to be tendered this week. With the RBNZ set to continue with $NZ940m of NZ Government bond purchases (and $30m of LGFA purchases), this should help keep the NZ yield curve flat.

Medium-term outlook

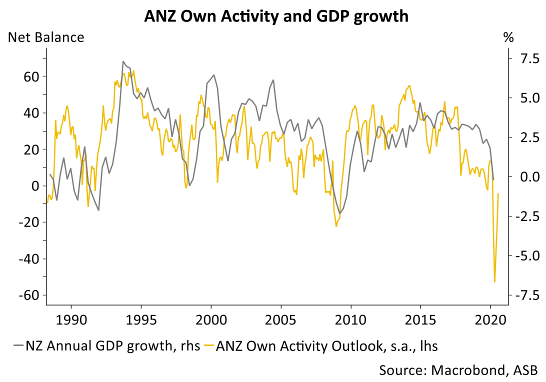
We don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. If more policy stimulus was needed the RBNZ will likely increase and broaden its $60bn asset purchase programme before cutting the OCR. It seems more likely that the RBNZ will not substantively change the size and scope of its asset purchase programme in August but will likely wait till November. Sub-par global activity and RBNZ asset purchases should help to cap longer-term NZ interest rates despite a flood of global public debt issuance. mark.smith4@asb.co.nz

Domestic events

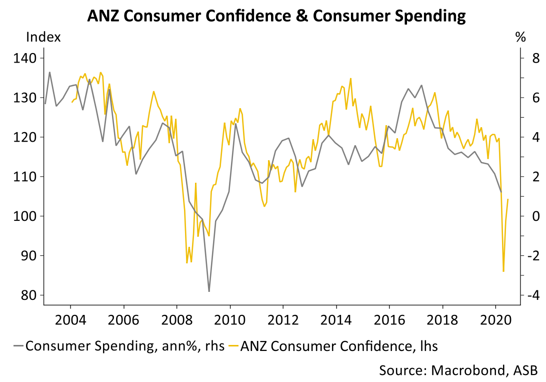
Data	Date	Time (NZT)	Market	ASB
NZ Building Consents, Residential, June, %mom	30/07	10:45 am	-	↑
ANZ Business Outlook, Own activity next 12 months, July	30/07	1:00 pm	-	↑
ANZ Consumer Confidence, Headline, July	31/07	10:00 am	-	↑



Residential and non-residential building consent numbers jumped in May after COVID-19 had weighed on consent processing in March and April. The move to Alert Level 1 in early June would likely have help speed up processing in regions that had been particularly impacted by social distancing and the lockdown of office premises during higher alert levels. **Over the next month or two there is potential for consent issuance to edge higher given the likely backlog of applications that need to be processed**. **Beyond that, we expect consent issuance (and subsequent construction activity) to weaken given lower construction demand**. There could be potentially longer-lasting impacts on construction activity if NZ's borders stay shut or the shift in work patterns observed during COVID-19 becomes more entrenched.



The preliminary results for July month business confidence showed a sizeable and broad-based improvement from the June survey, with double-digit jumps in firms' own activity expectations (-6.8), investment intentions (-4.5), employment intentions (-15) and profit expectations (-25.8). **We expect a much more gradual degree of improvement to be evident in the final July survey** and expect underling levels of sentiment to remain weak, consistent with the scale of economic challenges the NZ economy faces during a global pandemic and with the overseas tourism market on ice. We will be closely following employment intentions and profit expectations for guidance on how severe the current downturn is likely to be.



July Consumer sentiment is expected to edge up from June readings with easing COVID-19 restrictions and NZ's apparent success at containing the outbreak likely to place consumers in a more positive mindset. Despite this, we expect consumers to remain cautious on the short-term prospects for the NZ economy and to remain reluctant to commit to large purchases. Rising job losses may start to weigh on past and future consumer assessments of their own financial situation. Our expectation that consumers will remain cautious suggests that the recent buoyancy of retail spending is likely to prove short-lived.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
AU CBA Card Spending, week ended 24 July	28/07	-	-
Australia CPI, Q2, headline, %qoq	29/07	1:30 pm	-1.9
Australia Building Approvals, June, %mom	30/07	1:30 pm	0.0
Australia Export Prices, Q2, %qoq	30/07	1:30 pm	-2.5
US FOMC Interest Rate Announcement, %	31/07	6:00 am	0.00-0.25
US GDP, Q2, %qoq	31/07	12:30 am	-9.3
Eurozone GDP, Q2, %qoq	31/07	9:00 pm	-8.0
Eurozone CPI, July, %yoy	31/07	9:00 pm	0.2

**Originally published by CBA Global Markets Research on Friday 24th July at 2:02 pm*

Australia' CBA household card spending for the week ended 24th July will be released on Tuesday morning. Data for the week ended 17th July showed that spending growth rose over the week to be 11.4% higher than a year ago. The growth in spending masks the effects of rising coronavirus cases in Victoria. We expect Victoria's spending to continue to lag behind the other states while the stage 3 shutdowns are in place. There is the risk that spending momentum eases further in other states too as confidence takes a hit from the situation in Victoria.

We expect **Australia's headline and trimmed mean CPI inflation** to fall by 1.9% and 0.2% respectively in Q2 2020. This fall in headline CPI would be the biggest quarterly fall on ABS records which date back to 1948. It would also be the first time the annual headline inflation has been negative since 1997. Free childcare services from 6 April to 28 June, changes in the rental property market which have caused rents to fall and the plunge in petrol prices by ~20% are driving the historic outcome. Additionally, around 13% of the CPI basket will be missing as a result of unavailable goods and services due to COVID-19 restrictions. This means a decent chunk of the CPI will be imputed. Disinflationary pressure is likely to persist over the next year given the huge relative shock to the economy.

The outlook for **Australian building approvals** is weak. We expect dwelling approvals to be flat in June after plummeting 16.9% in May, and then continue to trend downwards over 2020. Border closures have caused a collapse in Net Overseas Migration and pose a major headwind for new housing construction which we expect to fall 25% in 2020. The HomeBuilder $A25,000 grant for eligible owner-occupiers will provide some support to the residential construction sector.

In Q2 we expect **Australian export and import prices** to fall by 2.5%qoq and 1.5%qoq respectively. A lower oil price has weighed on import prices but this has been partially offset by a stronger AUD towards the end of the quarter. A fall in commodity prices will weigh on export prices in the quarter.

We expect the US Federal Reserve to leave the Fed Funds rate on hold at the effective lower bound. We expect the US Fed will hold off adopting conditions-based forward guidance because the economic outlook remains unclear. The virus outbreak is not under control and continues to complicate the economic outlook.

We expect **US economic activity** contracted very sharply in Q2. We expect the 9.3%qoq fall (-37.2% seasonally adjusted annual rate) will mark the trough of the coronavirus recession in the US. We estimate all components of GDP, except for government spending, contracted in Q2. US retail sales fell 7.5% over the quarter and US personal spending remains well-below the pre-coronavirus peak. Consumption accounts for roughly 70% of US GDP.

After contracting by almost 4% in Q1 2020, we expect **Eurozone GDP** growth to contract by 8% in Q2 2020. Countries with the strictest lockdowns such as Italy will likely contract even more. But we expect a bounce back over Q3.

The coronavirus shock has cut demand more than supply. In particular, demand for consumer services. As a result, **we expect inflation to ease further this year in the Eurozone**.

Key Forecasts

ASB NZ economic forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-1.6	-16.8	14.7	1.1			
GDP real - A%	-0.2	-17.1	-5.7	-5.1	-3.8	2.7	4.9
GDP real - AA%	1.5	-3.3	-5.3	-7.0	-7.9	5.1	4.6
CPI - Q%	0.8	-0.5	0.5	0.0			
CPI - A%	2.5	1.5	1.3	0.8	0.4	1.4	1.6
HLFS employment growth - Q%	0.7	-2.8	-1.6	-1.1			
HLFS employment growth - A%	1.6	-1.8	-3.6	-4.8	-4.5	1.7	2.7
Unemployment rate - %sa	4.2	6.0	7.1	7.4	6.7	6.7	5.7
Annual current account balance as % of GDP	-2.7	-2.5	-1.9	-1.8	-2.1	-1.0	-0.5

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	Mar-20	Jun-20	Sep-20	Dec-20	Mar-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	0.51	0.30	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	0.53	0.21	0.30	0.35	0.40	0.40	0.60
NZ 5-year swap rate	0.63	0.35	0.40	0.50	0.55	0.65	0.85
NZ 10-year swap rate	0.93	0.74	0.75	0.85	0.90	0.95	1.05
NZ 10-year Bond	1.03	0.91	0.75	0.85	0.95	1.05	1.15

ASB foreign exchange forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.60	0.64	0.64	0.65	0.66	0.68	0.66
NZD/AUD	0.97	0.93	0.91	0.90	0.88	0.88	0.86
NZD/JPY	65	69	66	66	67	69	67
NZD/EUR	0.54	0.57	0.55	0.57	0.58	0.60	0.58
NZD/GBP	0.49	0.52	0.52	0.52	0.52	0.52	0.51
NZD/CNY	4.3	4.5	4.6	4.6	4.7	4.8	4.6
NZD TWI	68.8	71.4	71.1	71.7	72.1	73.6	71.4

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
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets