

Economic Weekly

27 October 2020

Housing market complicates RBNZ’s balancing act

The RBNZ’s job just got a lot trickier than usual. The RBNZ has multiple jobs to juggle – it has its Monetary Policy objectives - a dual target of inflation and maximum sustainable employment. But at the same time, it must also balance Financial Stability Risks. Most of the time, it can juggle both responsibilities, as the various risks move together through the economic cycle so relaxing Monetary Policy settings does not conflict with the RBNZ’s Financial Stability goals. However, there was no modern precedent for the COVID-19 pandemic, and during this highly unusual time we are all learning as we go.

In the early days of the COVID-19 pandemic, the RBNZ was quick to grasp the seriousness of the situation and was quick to deliver policy support via slashing the OCR, putting in place a range of monetary implementation measures and introducing Quantitative Easing in NZ. On the Financial Stability front, the RBNZ relaxed Loan to Value (LVR) lending restrictions across the board, in large part to support the housing market. Alas, economists (including ASB) got it wrong, and the surprisingly resilient economy, plus large falls in mortgage rates, plus relaxing LVR lending restrictions proved a very potent mix for the housing market (see [here](#)). Strong housing demand across the board (it’s not just investors that are buying), coupled with chronic housing shortages means the housing market is now very tight and house prices have lifted strongly to reflect that.

The RBNZ needs to recognise that the housing market risks have shifted dramatically – no longer are they facing the risk of falling house prices, but that of strongly increasing house prices. And by doing nothing, the RBNZ faces the risk of fuelling the fire of a housing market bubble, which, if underpinned by highly leveraged buyers, can increase financial stability risks down the line. The [subdued inflation](#) print last week will likely support the RBNZ’s conclusion that additional monetary support will still be needed for some time. Which means the RBNZ’s needs to consider reinstating the LVR lending restrictions at the November Financial Stability review – even if it means going back on its previous forward guidance. 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](#)

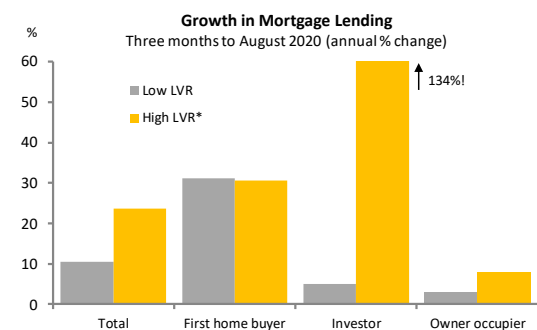
Policy response:

[RBNZ September MPR Review](#)

[Assessing the RBNZ’s bag ‘o’ tricks](#)

For COVID-19 research, see [here](#)

Chart of the week



"High" LVR = higher than most recent RBNZ threshold before it was dropped - 70% for investors, 80% for all other cohorts

Source: ASB, RBNZ

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6683	0.6582	0.6558	0.6369	FLAT	0.6530	0.6790
NZD/AUD	0.9375	0.9340	0.9278	0.9340	FLAT/UP	0.9170	0.9405
NZD/JPY	70.07	69.45	69.11	69.20	FLAT	69.00	72.00
NZD/EUR	0.5658	0.5589	0.5621	0.5735	FLAT	0.5600	0.5800
NZD/GBP	0.5132	0.5083	0.5142	0.4959	FLAT	0.5100	0.5270
TWI	71.9	70.8	71.1	70.49	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 kiwi dollar's been the strongest performing G10 currency over the past week, a week in which most currencies made gains against the USD. The NZD/USD briefly poked its head above 0.6700 for the first time in a month while NZD/USD flirted with 0.9400 – the highest level since July.

Notably, gains in both NZD/USD and NZD/AUD have occurred despite interest rate differentials between NZ and the rest of the world continuing to trend slowly lower. This reflects one of the more obvious trends in financial markets of the past few weeks – slowly rising offshore interest rates. US 10-year Treasury yields are above 0.8%, for example, having started August south of 0.6%. NZ rates haven't participated as much in this tentative uptrend as RBNZ officials have continued to signal a preference for negative rates in NZ.

Outlook

Financial market sentiment has started the week on the back foot as investors reassess the global growth outlook in light of a) an apparent third wave of COVID infections across the US and Europe, and b) the dwindling chances of a US fiscal support package being agreed upon before the US election.

The more circumspect mood has dragged NZD/USD 30-40 points below last week's highs and we suspect the topside will remain capped in the near-term. The currency has recently struggled to sustain gains above the top end of our short-term valuation model's estimated 0.6300-0.6700 "fair-value" range. Pre-election caution and COVID concerns will likely reinforce resistance around 0.6700.

There are two obvious catalysts for a break above this level: 1) a convincing US election result – for example a clean sweep for the Democrats – that reduces the chances of a drawn out period of legal challenges and uncertainty, and 2) any concessions from the RBNZ that negative interest rates are indeed becoming less likely. Neither scenario is likely to play out this week.

The near-term NZD/AUD outlook is slightly more exciting. Our CBA colleagues now look for the recent uptrend to continue in light of the change to the outlook for Australian monetary policy. The RBA is expected to cut rates to 0.10% next week and ramp up its quantitative easing programme. NZD/AUD is expected to push up towards 0.9450.

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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	0.93	0.89	0.88	0.86	0.86	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.56	0.54	0.54	0.53	0.53	0.53
NZD/GBP	0.52	0.51	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.5	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	71.6	69.9	69.4	68.0	67.6	67.6

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	0.27	0.30	1.06	UNCH/DOWN	UP
2-year swap	-0.01	0.02	0.04	0.93	UNCH/DOWN	UP
5-year swap	0.10	0.09	0.11	1.01	UNCH/DOWN	UP
10-year swap	0.51	0.46	0.49	1.33	UNCH/DOWN	UP
10-year govt bond yield	0.60	0.54	0.47	1.20	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.52	0.44	0.45	0.40	UNCH	DOWN

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

Market Recap

Global yields pushed higher last week, and the curve steepened, likely driven by expectations of a Democratic clean sweep in the upcoming US elections. US 10-year Treasury yields hit their highest point since June (0.87%) late last week, with the US yield curve (2s10s), its steepest since early 2018. This prompted a modest climb in Australian and NZ yields. The lack of a US fiscal stimulus deal, climbing cases of COVID-19 in the US and Europe, and the impending US election has subsequently imparted more caution, with US yields down since the start of this week (US10Y 0.80%) and Australian yields lower yesterday. Markets largely turned a blind eye to data, with short-term NZ yields modestly lower on weaker-than-expected Q3 NZ CPI inflation data.

Near-term interest rate outlook

We have kept our downward bias for local yields. We still feel the RBNZ are preparing to go down the negative OCR route next year and would rather deploy LVR restrictions on investor lending to slow the resurgent housing market than refrain from cutting the OCR. Local data – including business and consumer sentiment – is unlikely to move markets, but we will be looking for signs of stalling improvement that will prompt more RBNZ easing. Today sees the launch of the November 2018 NZ Government bond via syndication, and we expect solid demand. There will be no weekly tender, with the \$880m in NZ Government bond purchases by the RBNZ expecting to dampen yields.

Australia has a number of key events, including the RBA presenting to parliament's Senate Economics Committee and Q3 CPI, which is expected to be weak. We expect the RBA to cut their cash rate, the term funding facility rate and the 3-year bond target to 0.1% at their November 3 meeting, which should help dampen NZ yields at the margin.

We expect a more volatile week for global yields as we approach the US elections (November 3). Equity markets will prove to be a useful barometer and the surge in COVID-19 cases heading into the northern hemisphere winter concerns us. A US fiscal stimulus bill before the US elections is looking increasingly unlikely, which should dampen yields. This week's global data – including Q3 US GDP (mkt: 32% qoq annualised) and core PCE inflation for September (mkt: 1.5% yoy) – will mostly be lost in the wash. The ECB is expected to make no policy changes and maintain its easing bias, but subdued inflation suggest President Lagarde could lay the groundwork for additional stimulus.

Medium-term outlook

The RBNZ have signalled they will launch a Funding for Lending Programme by the end of the year, most likely shortly after the November MPS on November 11. This will only provide modest economic support in our view. We have pencilled in a 75bps OCR cut in April to take the OCR to -0.5%, but whether the RBNZ does cut to this extent will depend on the economic outlook and whether the Bank deems the OCR to be the preferable policy lever to pull. Prior to that, the RBNZ is expected to maintain asset purchases above the weekly NZ Government bond tender and will employ dovish forward guidance to dampen yields. Low global inflation and subdued prospects for global economic activity should keep NZ yields low. mark.smith4@asb.co.nz

ASB interest rate forecasts

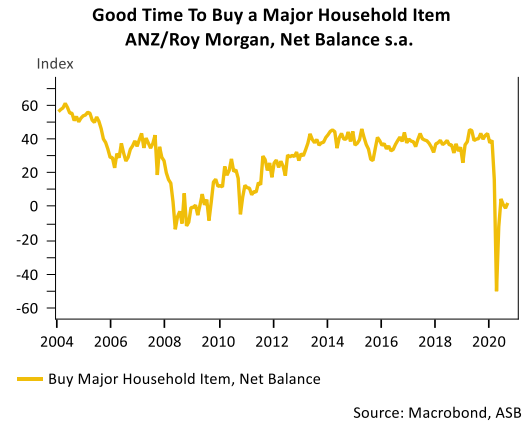
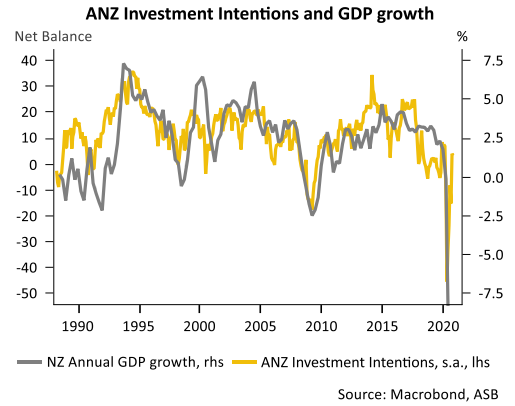
(end of quarter)	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<<actual	forecast>>				
NZ OCR	0.25	0.25	0.25	0.25	-0.50	-0.50	-0.25
NZ 90-day bank bill	0.30	0.31	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.06	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.13	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.51	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.46	0.45	0.25	0.00	0.20	0.55

Domestic events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own activity next 12 mths, Oct F	29/10	1:00pm	-	
ANZ Consumer Confidence, Headline, Oct	30/10	10:00am	-	-

ANZ will release the full month results of the October business outlook survey on Thursday, after releasing the preliminary results earlier this month. Business confidence lifted steadily from late August, with many survey components now close to year-ago levels in early October.

Despite the improvement in business confidence, **consumer sentiment has remained weak and sits around 2009 lows – considerably below historical averages.** The hesitancy of consumers to commit to major purchases is interesting, although not consistent with evidence of recent housing market strength.



Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CPI, Q3, %qoq	28/10	1:30 pm	1.4
Australia Terms of Trade, Q3, Export Prices, %qoq	29/10	1:30 pm	-3.5
Bank of Japan Interest Rate Announcement, %	29/10	-	No change
ECB Interest Rate Announcement, %	30/10	1:45 am	No change
US GDP, Q3, saar	30/10	1:30 am	31
Eurozone GDP, Q3, %qoq	30/10	11:00 pm	8.3
Eurozone CPI, Oct, %yoy	30/10	11:00 pm	-
US PCE Deflator, September, %yoy	30/10	1:30 am	1.6

*Originally published by CBA Global Markets Research on Friday 23 October at 11:20 am

We expect **Australia's headline CPI** to increase by 1.4% qoq in Q3 2020 following the 1.9% qoq fall in the previous quarter. An outcome in line with our forecast would put the annual inflation at 0.5% and well shy of the Reserve Bank of Australia's (RBA) 2-3% target. We forecast the trimmed mean, the RBA's preferred measure, to rise by 0.4% over Q3 20. Such an outcome would see the annual pace of core inflation sit at just 1.2%. The latest RBA communication has emphasised the importance of actual inflation outcomes in their decision making rather than projections. The latest inflation readings add to the case for more monetary policy easing in November.

Trade price indexes measure the prices of goods exports and imports and provide a good gauge of movements in the **Terms of Trade** over the quarter. We expect **Australia's** goods exports prices fell about 3.5% in Q3 as commodity prices eased. We are forecasting a flat outcome for import prices with the stronger AUD putting downward pressure on import prices but the oil price a lot higher in Q3 adding to fuel import costs. Outcomes in line with our expectations would see the Terms of Trade post a decent fall in the quarter.

We expect the Bank of Japan (BoJ) to maintain its policy status quo. Governor Kuroda mentioned the BoJ has no intention of following the US Fed in revamping its inflation target. We expect the BoJ to downgrade its GDP growth and inflation outlook for FY 2020. Virus infections remain a risk to the recovery in Japan.

We expect the European Central Bank (ECB) to make no monetary policy changes and continue to maintain its easing bias. ECB President Christine Lagarde's post-meeting press conference could lay the groundwork for additional easing because of growing concerns over Eurozone disinflationary pressures.

We estimate a historic surge in **US GDP** of 31% seasonally-adjusted annual rate (saar) in Q3 following historic slump over the second quarter of 2020. However, the percentage increase overstates the health of the US economy. Economic activity remains below pre-coronavirus levels. The jump in activity over Q3 was likely largely driven by consumption – which accounts for 70% of the US economy. Residential investment is also likely to have supported a rebound in GDP. However, the US economy is facing a number of headwinds and we expect the growth rate to moderate sharply from here.

The ECB projects **Eurozone GDP** to rise by 8.3% in Q3, implying a recovery of around half of the loss experienced in the first half of the year.

Headline **Eurozone CPI** fell at an annual pace of 0.3% in September. The ECB projects deflation to persist over the coming months.

We forecast the **US Personal Consumption and Expenditure (PCE) deflator** accelerated to 1.6%yoy in September, in line with a rise in the already-released US CPI. On the other hand, we estimate the core PCE deflator was unchanged at 1.6%yoy. The outlook for a prolonged period of labour force slack suggests inflation will remain muted for years.

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	11.0	0.7	0.3	0.1	0.4	0.8
GDP real - A%	-12.4	-3.4	-3.2	-1.5	12.3	0.7	3.3
GDP real - AA%	-2.1	-3.5	-4.8	-5.1	0.7	3.5	2.3
NZ House Prices (QV Index) - A%	6.8	6.9	9.1	9.0	11.3	7.0	4.9
CPI - Q%	-0.5	0.7	0.1	0.2	0.3	0.4	0.5
CPI - A%	1.5	1.4	1.0	0.5	1.3	1.5	1.3
HLFS employment growth - Q%	-0.3	-2.3	-1.1	0.1	0.5	0.5	0.5
HLFS employment growth - A%	1.5	-1.2	-2.6	-3.5	-2.7	2.2	1.8
Unemployment rate - %sa	4.0	5.6	6.5	6.7	6.7	5.9	5.8

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

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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	0.56	0.54	0.54	0.53	0.53	0.53
NZD/GBP	0.52	0.51	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.5	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	71.6	69.9	69.4	68.0	67.6	67.6

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