Economic Weekly

28 January 2020

Markets nervous on coronavirus outbreak spread

The Lunar New Year has kicked off to a shaky start with global financial markets rattled as reports confirm the spread of the coronavirus outbreak from China to several other countries. It remains early days in terms of understanding the new virus strain, let alone any potential economic impact, but financial markets are nervous and measures of volatility have spiked. The virus emerges as a global health threat just as the NZ tourism industry approaches its seasonal peak. We recap the impact on visitor arrivals during the 2003 SARs outbreak in the chart of the week below.

Economic data this week is likely to play second fiddle to virus headlines. NZ inflation measures are still clustered around the RBNZ's inflation target mid-point. Tomorrow provides an update for Australian inflation. The NZ economy remains well placed, but the virus outbreak is a reminder that the RBNZ should remain vigilant.

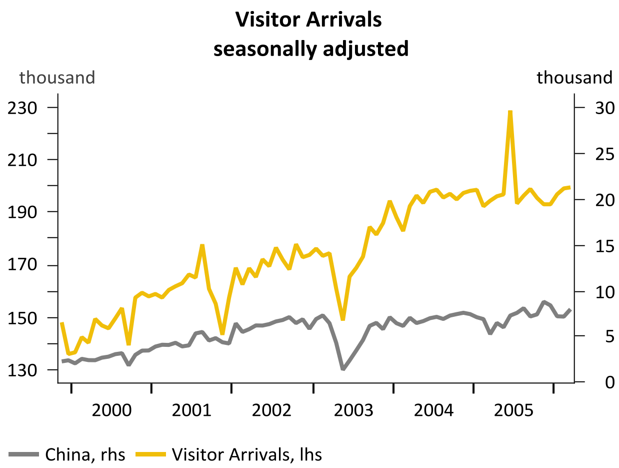
Key events and views

Foreign exchange	NZD to remain under pressure as global risk appetite dries up.
Interest rates	Local and global yields lower on coronavirus concerns.
Domestic events	Quiet week domestically with Dec Trade Balance and Jan consumer confidence data due.
International events	Australian CPI inflation, Federal Reserve policy announcement, US Q4 GDP estimate.

Chart of the Week: NZ tourism more exposed to China-led fall in arrivals

The new coronavirus outbreak sparks fear of a repeat of 2003's SARs outbreak, which saw a sharp, but temporary, drop in visitor arrival numbers to NZ. Total visitor arrivals fell 15% from March to May of 2003, but bounced back quickly in June and July and quickly reverted to trend growth (all on a seasonally-adjusted basis). Arrivals from China fell much more sharply over 2003, from 7,330 per month in February to just 1,389 arrivals in May (all ASB seasonally-adjusted estimates), with a more modest subsequent recovery in visitor numbers.

Given the greater importance of the Chinese tourism market to NZ at present (11% of total arrivals to NZ versus 4% in 2003), the direct impact of lower Chinese inbound tourism numbers will likely be more acutely felt this time around. The imposition of travel restrictions could also deliver a significant hit to the tourism sector, during its seasonal peak. Recent NZD falls will likely help partly cushion the economy.



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6545	0.6607	0.6679	0.6867	DOWN	0.6480	0.6720	FLAT/UP
NZD/AUD	0.9683	0.9624	0.9602	0.9535	FLAT	0.9400	0.9700	UP
NZD/JPY	71.27	72.65	73.10	75.10	DOWN	70.70	73.60	DOWN
NZD/EUR	0.5940	0.5953	0.6007	0.6011	DOWN	0.5810	0.6050	FLAT
NZD/GBP	0.5013	0.5077	0.5137	0.5202	DOWN	0.4915	0.5200	FLAT
TWI	72.3	72.5	73.3	74.07	DOWN	N/A	N/A	UP

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

NZD Recap

After spending most of last week becalmed, concerns about the rapidly spreading Chinese coronavirus took a significant toll on markets and the NZ dollar yesterday.

Risk assets everywhere were shunned. Global equities are 1% off their highs, most commodity prices posted steep declines, and the recent trend higher in bond yields was scuttled. In FX markets, the safe-haven currencies of JPY, CHF, and USD all outperformed.

The NZD, along with the AUD, tended to fall more than most. Investors likely punished the kiwi for its high commodity exposure and trade reliance on China (the epicentre of the disease). Chinese tourism arrivals into NZ were already falling and the Chinese government announced yesterday tour groups will be banned from visiting outside of China.

Near-term outlook

In the near-term, the coronavirus represents something of a game-changer for financial markets. Attention will likely shift away from signs of global economic recovery and strong corporate earnings, to how quickly the disease is spreading and the likely fallout on China and the global economy. Already, the economic impact on China looks like it will be severe and the virus is far from contained.

From this perspective, investors risk appetite – having already suffered a decent knock over the past few days – is likely to remain subdued, keeping the NZD under pressure in the short-term. How far the currency ultimately falls will depend on this week plays out in terms of the virus's severity. Support at 0.6520 looks set to be tested during the week with the next key support level down at 0.6430.

Economic data will take something of a back-seat this week. But there will be interest in Aussie CPI figures tomorrow (1.7% yoy expected). Last week's strong employment report reduced the chance of an RBA rate cut next week (CBA are no longer calling a cut). Relatively speaking, Thursday morning's FOMC meeting should be relatively unexciting with no one expecting any change in interest rates or policy stance. In contrast, the Bank of England meeting is finely poised (market pricing ≈60% chance of rate cut). There's only second tier data out in NZ.

Medium-term outlook

We expect the NZD to remain on a gradual uptrend through the first half of 2020, although our view of a still-strong USD is expected to cap the extent of NZD/USD strength.

We also expect the NZD/AUD to continue rising over 2020, as the NZ economy continues to outperform that of Australia. This is reflected in our central bank views and hence NZ/AU interest rate forecasts. In NZ we expect only one more OCR cut from the RBNZ while in Australia we expect two more RBA cuts.

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ASB foreign exchange forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

ASB

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH	UP
90-day bank bill	1.27	1.27	1.27	1.91	UNCH	UP
2-year swap	1.18	1.22	1.27	1.90	UNCH	UP
5-year swap	1.25	1.35	1.44	2.12	UNCH	UP
10-year swap	1.51	1.67	1.76	2.56	UNCH	UP
10-year govt bond yield	1.35	1.55	1.63	2.33	UNCH	UP
Curve Slope (2s10s swaps)	0.33	0.45	0.50	0.65	UNCH	DOWN

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

Market Recap

Local and global yields have fallen, with yields curves flattening. **The Novel coronavirus outbreak has worsened in China and is spreading to other countries (potentially including NZ), which has triggering a new wave of risk aversion.** NZ (1.34%) and global 10-year government bond yields yields are currently trading around their lows for the year, with US10-year Treasury yields (1.60%) at 3 month lows. Stronger than expected Australian employment data had earlier supported short-term Australasian yields, as did NZ Q4 CPI data which printed slightly higher than market expectations (+0.5% qoq, 1.9% yoy), with core CPI inflation measures still close to 2% yoy (1.8% yoy% for the RBNZ sectoral factor model). The increase in yields proved to be short-lived given global concerns about the potential impact of the coronavirus.

Near-term NZD interest rate outlook

Having gone off the idea of more OCR cuts over recent months, the market is now moving to price them back in, with a 25bp cut close to fully priced in over 2020. This has taken market pricing closer to our OCR forecasts (which include a 25bp OCR cut in May) and we have opted for a neutral bias. **We admit, however, that uncertainty over the local interest rate outlook has increased, given that the focal point for the disease outbreak is NZ's largest trading partner.** Local and global yields could ease and curves flatten if the outbreak proves to have more significant impacts than currently factored in by markets. Conversely, yields could move higher and the curve will likely steepen if the outbreak is contained and its impact is modest. Tomorrow's Q4 CPI is the last major piece of Australian economic data to be published before the 4 February RBA Board meeting. We expect the data will confirm that the underlying inflation pulse remains weak, but we do not expect an RBA interest rate cut until April. The Federal Open Market Committee is likely to hold the Federal Funds Rate at 1.50%-1.75% on Thursday, with current settings deemed to be appropriate and the US economy in a good place. Focus will be on whether the Fed changes its USD60bn in monthly Treasury bill purchases, which look to have calmed short-term money markets. For the Bank of England, we are siding with current UK market pricing (roughly 60% odds) and believe the Bank will deliver a 25bp cut this week (to 0.50%) in response to subdued UK GDP growth and inflation.

Medium-term outlook

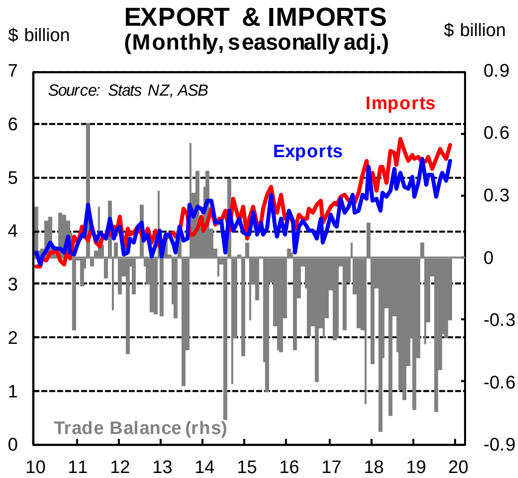
We expect a further 25bp RBNZ cut in May 2020, with the OCR on hold at 0.75% until a series of mild and gradual hikes from 2022 (OCR endpoint of 2.25%). The RBA is expected to cut the 0.75% cash rate by 50bps in 2020 (April, Aug), with the RBA cash rate at the 0.25% effective lower bound. The 1.50%-1.75% Federal Funds rate is expected to be cut by 50bps in 2020 (Jun 20, Sep 20). **Low inflation, moderate global growth and negative (but receding) risks should cap NZ and global long-term interest rates at low levels.** mark.smith4@asb.co.nz

ASB interest rate forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.00	1.00	1.00	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.2	1.3	1.2	1.0	1.0	1.3	1.8
NZ 2-year swap rate	0.9	1.3	1.1	1.0	1.0	1.3	1.7
NZ 5-year swap rate	0.9	1.4	1.2	1.1	1.2	1.5	1.9
NZ 10-year swap rate	1.2	1.8	1.4	1.3	1.4	1.6	2.0
NZ 10-year Bond	1.1	1.7	1.2	1.1	1.2	1.4	1.8

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, December, $m	30/1	10:45am	-	250

We expect a trade surplus of circa $250m in December. Looking over the month, record-high meat prices are likely to contribute buoyant export values. Meanwhile, dairy export values are likely to be strong over the month reflecting robust dairy export prices. On the import side, we expect import values growth to remain relatively modest in line with generally modest domestic demand. The annual trade deficit is likely to narrow towards $4.6 billion.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia CPI, Q4, %qoq	29/01	1:30 pm	0.6	0.6
Australia Import Price Index, Q4, Imports, %qoq	30/01	1:30 pm	0.4	0.2
US Federal Reserve Interest Rate Announcement, %	30/01	8:00 am	No chg	No chg
US GDP, Q4, %saar	31/01	2:30 am	2.1	1.5
Australia Private Sector Credit, December, %mom	31/01	1:30 pm	0.2	-
Japan Industrial Production, December, %mom	31/01	12:50 pm	0.7	0.7
Eurozone GDP, Q4, %qoq	31/01	11:00 pm	0.2	-
Eurozone CPI, January, %yoy	31/01	11:00 pm	1.2	-

**Originally published by CBA Global Markets Research on Friday 24th January at 2:25 pm*

Australia's Q4 2019 CPI figures will likely confirm the underlying weak inflation pulse. We are forecasting a 0.6% (1.7%yoy) lift in the headline rate of inflation and a 0.4% (1.5%yoy) rise in the trimmed mean or underlying inflation. We expect 16 quarters of below-target inflation to be confirmed when the Q4 19 CPI prints.

Softer commodity prices over Q4 mean that **Australia's** export prices are forecast to fall. Import prices look to have lifted a touch. The net result implies we expect to see the **terms of trade** decline over the December quarter. This will weigh on nominal GDP growth.

Overall credit growth in Australia is soft. Recent cuts to the Reserve Bank of Australia's cash rate have generated a lift in new housing-related lending and the acceleration in debt repayment. As at November 2019, housing credit growth had slowed to 2.9%yoy, business credit growth was 2.5%yoy and personal credit was 4.9%yoy. The overall stock of credit was running at just 2.3%yoy. We expect to see another soft outcome in December.

We estimate **Japanese industrial production** increased by 0.7% in December. Production should begin to rebound following the sharp slump in October and November following an increase in the consumption tax. The pick-up in the global economy should also help Japanese manufacturers.

We expect no change to US monetary policy. The US Federal Reserve has indicated it will keep monetary policy on hold unless they revise the US economic outlook lower.

The average of the New York and Atlanta Fed's estimates for **US Q4 2019 GDP** growth is weak at only 1.5% seasonally adjusted annual rate (saar). Consumer spending has expanded at a solid rate because of the strong labour market. And the trade deficit has narrowed modestly because of shrinking imports. But industrial production, inventories and business investment decreased over the quarter.

The European Central Bank projects **Eurozone real GDP** to increase at a quarterly pace of 0.3% in Q4 and 1.2% over 2019, underpinned by domestic demand activity. Going forward, the Eurozone expansion will continue to be supported in part by robust growth in wages, a mildly expansionary fiscal stance and a recovery in foreign demand.

Eurozone headline and core CPI inflation came in at 1.3%yoy in December. Inflation is expected to remain muted in January because there is still plenty of slack in the Eurozone economy. Eurozone real GDP growth has been below the ECB's potential output growth estimate of around 1.5% for the past year. The ECB projects Eurozone headline CPI inflation of just 1.1% in 2020.

Key Forecasts

ASB NZ economic forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	0.7	0.3	0.6	0.6			
GDP real - A%	2.3	1.5	1.7	2.2	2.8	2.5	2.7
GDP real - AA%	2.7	2.2	1.9	1.9	2.5	2.6	2.6
CPI - Q%	0.7	0.5	0.5	0.3			
CPI - A%	1.5	1.9	2.2	2.0	2.0	2.0	1.8
HLFS employment growth - Q%	0.2	0.3	0.3	0.4			
HLFS employment growth - A%	0.8	1.1	1.6	1.2	1.7	1.7	2.0
Unemployment rate - %sa	4.2	4.2	4.2	4.3	4.2	4.2	4.0
Annual current account balance as % of GDP	-3.3	-2.8	-2.4	-2.2	-2.3	-2.7	-2.5

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

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NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

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