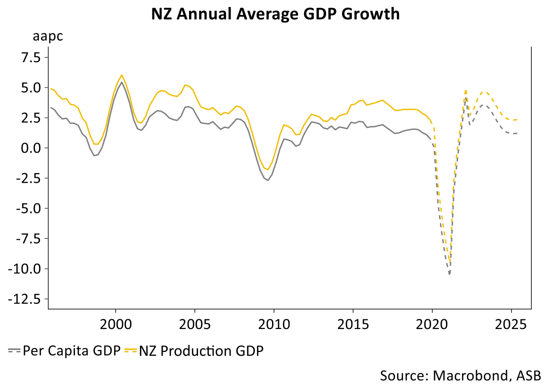
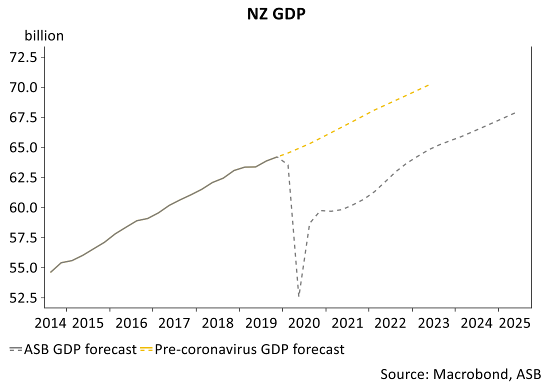
Economic Weekly

28 April 2020

We're out! (but not as we know it)





As New Zealand emerges, squinting, out of Level 4 lockdown, attention is inevitably shifting from the extent of economic damage wrought by the lockdown, to the shape of the recovery. There's all manner of letters being used to describe the recovery path: "V's", "U's", "L's", and even "W's".

Most commonly touted is the "V". And given economist estimates for GDP growth – see top chart – it's not hard to see why. Certainly, the economy will be generating some big growth numbers as we bounce out of lockdown. For example, we have +12%q/q on the board for third quarter GDP growth.

But we are quick to lean against the notion we've heard in some quarters about a "strong" recovery. The growth numbers are only big because the fall was so large. It certainly won't feel like a strong or V-shaped recovery.

We estimate economic activity will still only be around 80% of normal in Level 3. The economy will be battling through the headwinds of damaged household incomes and business balance sheets, weak confidence, and a much larger debt burden. The tourism sector will be MIA for some time. The second chart, of the *level* of GDP rather than the growth rate, provides the necessary perspective. We think it will take a full three years before the economy gets back to its pre-COVID starting point. The point here is not be overtly gloomy, but simply to urge caution around the post-lockdown business and investment climate.

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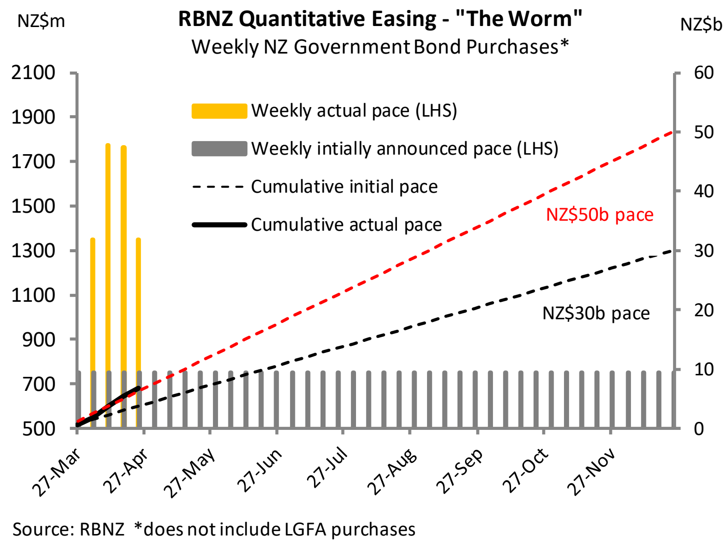
Recent COVID-19 publications	Where to find support
ASB Economic forecasts and monitoring:	ASB financial support package
Thinking about the new normal for housing	Government support package
ASB COVID-19 Chart pack	COVID-19 alert system explainer
COVID-19 and the economic path ahead (central forecasts)	
COVID-19 possible paths in an uncertain future (alternative scenarios)	
Financial market trends:	For these publications and more COVID-19 research, see here
COVID-19: Market stocktake and what we are watching	
ASB Podcast for investors	
Policy response:	
RBNZ QE upside likely in May	

RBNZ Quantitative Easing Update

- RBNZ already owns about 10% of nominal NZ government bonds on issue
- As purchases continue to be front-loaded ahead of a likely QE upsize in May
- The current pace of buying is closer to a $50b programme than the announced $30b

Last week, the RBNZ purchased a further $1.35b in NZ Government Bonds (NZGBs) under its quantitative easing (QE) programme. Cumulative NZGB purchases now stand at $6.7b. In other words, the RBNZ owns around 10% of the entire stock of government bonds. A further $1.35b will be sought this week.

It's only taken the Bank five weeks to get there. And you'd have to say the programme has been relatively effective so far in restoring order to wholesale interest rate markets and lowering government bond yields. Ignoring the mid-March spike, 10-year NZGBs have fallen 35-40bps since the programme was started and now stand at 0.95%.



Broader interest rates have continued to feel the downward pressure emanating from the Bank's QE, and associated cash injection. Two-year swap yields, for example, are basically bang on the OCR at 0.26%.

The Bank has continued to operationally front load the current $30b QE programme. Indeed, the pace of QE purchases to date is now $3b ahead of the initially communicated $750m/week run rate (dotted black line in the chart opposite).

We reckon the QE programme will be upsized to at least $45-50b in May.

We've illustrated in the chart via the red line what the required run rate would look like under a $50b QE programme (the red line), assuming the same end date.

It's interesting to note that the current run rate is very similar to that which would be required under a $50b programme. The implication is that if the RBNZ Monetary Policy Committee do upsize QE next month, there won't be any 'catch-up' purchases required.

Operationally, QE is already running at a $50b pace.

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ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6041	0.5984	0.5993	0.6678	FLAT/UP	0.5900	0.6200
NZD/AUD	0.9343	0.9495	0.9805	0.9462	FLAT/DOWN	0.9200	0.9550
NZD/JPY	64.80	64.33	64.99	74.53	FLAT/UP	63.30	66.60
NZD/EUR	0.5578	0.5524	0.5411	0.5984	FLAT	0.5450	0.5730
NZD/GBP	0.4861	0.4825	0.4881	0.5162	FLAT	0.4750	0.4900
TWI	68.6	68.2	68.5	72.81	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 has started the week slightly higher against most of the major crosses, but continued to underperform the AUD. The oil price collapse during the first half of the week resulted in some global jitters, but financial markets quickly shrugged off the volatility. Over the second half of the week, cautious optimism among global investors supported global equities and the antipodean currencies. Investors are encouraged by signs that COVID-19 infection rates are slowing and hopeful on the prospect of lock-down restrictions gradually easing.

The Reserve Bank of New Zealand (RBNZ) announced on Friday it will buy another NZ$1.35bn of NZ government bonds this week, bringing total purchases to NZ$8.1bn. This gives further evidence to the belief that the overall asset purchase program size will be revised higher at the upcoming May Monetary Policy Statement. The total size of the RBNZ's Large Scale Asset Purchase program is currently NZ$33bn over twelve months – and we expect this to be revised higher to $45-50b.

Short-term outlook

Looking to the week ahead, we expect more of the same from last week. We expect the NZD/USD to continue to trend sideways, and trade within recent ranges. The USD could retrace some of its recent gains as global sentiment improves. However, the NZD is also likely to remain weighed down, with weak business confidence figures released this week keeping focus on the weak domestic economic outlook. Meanwhile, we see scope for the AUD/USD to lift this week as the USD consolidates. The AUD has been pushed and pulled by stronger equity markets and weaker commodity prices. The NZD is likely to continue to underperform against the AUD this week, reflecting NZ's weaker economic outlook relative to Australia's.

Medium-term outlook

Currently, market participants appear to believe the worst will soon be over for the world economy and it will snap back rapidly because of the monetary, liquidity and fiscal assistance. We remain wary that recent financial market optimism may not be sustained. There remains a very high degree of uncertainty on the outlook over the next year or so. We are expecting a relatively slow global economic recovery, and there remains the risk of a second wave of infections in key trading partners. We continue to suggest focusing less on the (highly uncertain) outlook and more on stress-testing exposures, using lower hedge ratios or FX options to retain flexibility, and trying to use volatility to your advantage. jane.turner@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	1.75	UNCH	UP
90-day bank bill	0.33	0.35	0.49	1.80	UNCH	UP
2-year swap	0.29	0.34	0.55	1.67	UNCH	UP
5-year swap	0.46	0.49	0.66	1.80	UNCH	UP
10-year swap	0.86	0.89	0.99	2.21	UNCH	UP
10-year govt bond yield	1.01	0.91	1.10	1.90	UNCH/UP	UP
Curve Slope (2s10s swaps)	0.55	0.55	0.45	0.55	UNCH	DOWN

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

Market Recap

NZ yields start this week hovering around record lows, with compressing bank bill and swap spreads. Markets are starting to grasp the enormity of the economic challenge that lies ahead, with little reaction to NZ yields after the April 28 move to Alert Level 3 was announced. Global markets were jolted by the plunge in oil prices, which sent shockwaves into equity and bond markets. NZ bond yields fell on comments by RBNZ Governor Orr not ruling out direct purchases of NZ government bonds and on the belief the overall RBNZ asset purchase program will be larger. Last week, the RBNZ purchased $1.35bn in NZ government bonds (NZGB), taking cumulative NZGB purchases to $6.7b, around 10% of total (nominal) NZGBs on issue. Yesterday, the Bank of Japan expanded its purchases of commercial paper and corporate bonds and said it would buy unlimited amounts of Government bonds to keep the yield around 0%. After falling last week, US and Australian yields have started on a firmer footing, bolstered by further government support packages announced for the US (USD484bn) and Europe (EUR540bn).

Near-term NZD interest rate outlook

We expect NZ yields to start this week on a firmer footing, but beyond that the direction of yields and slope of the curve is likely to hinge upon the duration and magnitude of the economic hit delivered by COVID-19. Many countries (NZ included) are contemplating (or are) relaxing lockdown restrictions and the direction for yields will hinge on whether it triggers a new wave of infections. With the NZ and global economies in the early stages of a severe downturn, central bank policy rates are expected to remain close to (or at) operational lows for some time to come. Any pronounced lift in yields is expected to be fleeting until signs emerge that the worst has passed.

We expect global and NZ economic data over the next month or so – NZ business confidence, Australian/Eurozone CPI, Q1 US GDP, ISM, PCE, and US Non-farm Payrolls – to remain weak. With policy interest rates already at effective lower bounds, this week's Fed and ECB policy decisions will be watched for tweaks to monetary policy implementation measures or asset purchases to cap yields, ensure market functioning and keep wholesale and retail interest rates low. The RBNZ has already notified the market it will seek $1.35b in NZGBs and $130m of LGFA bonds this week. We expect the NZ Government to unveil further sizeable fiscal support measures at the 2020 Budget on 14 May. This, and the weak fiscal position will see a mountain of NZ Government debt issuance, with the RBNZ having to step up asset purchases (potentially around $60bn). This will still leave the market with a lot of bonds to absorb.

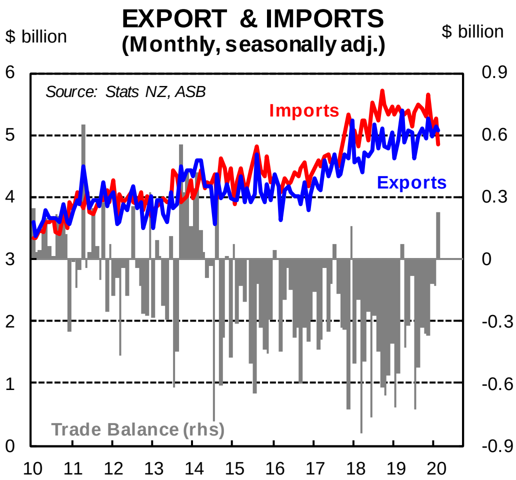
Medium-term outlook

Central bank policy rates are expected to maintain highly accommodative settings. Given the risks to the outlook we don't expect the OCR to move above its 0.25% operational lower bound until 2024 at the earliest. The OCR could move lower if the RBNZ deemed this to be operationally feasible. Weak global growth, negative risks and the prospect of central bank asset purchases should cap long-term NZ interest rates, although we are wary over the impacts of sizeable global and NZ public debt issuance on government bond yields. mark.smith4@asb.co.nz

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	0.50	0.50	0.50	0.50	0.50	0.50
NZ 2-year swap rate	1.26	0.53	0.50	0.50	0.50	0.50	0.50	0.60
NZ 5-year swap rate	1.45	0.63	0.65	0.65	0.65	0.65	0.65	1.05
NZ 10-year swap rate	1.78	0.93	1.00	1.00	1.50	1.50	1.10	1.50
NZ 10-year Bond	1.65	1.03	1.40	1.40	1.40	1.40	1.40	1.45

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, March, $m	29/04	10:45 am	-	500
ANZ Business Outlook, Own activity next 12m, April results	30/04	1:00 pm	-	-



We expect a trade surplus of circa $500m in March. 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.

ANZ Business Confidence plummeted to unprecedented lows in early April as businesses reeled from the implications of the 4-week Alert Level 4 lockdown. The survey's preliminary results were released earlier this month, using survey results from 5pm March 31 to April 6th. The full-month survey results will be released on April 30th. The preliminary results showed a net 61% of firms expected a contraction in business activity over the coming year, a massive 40 points more than the previous record of 21% during the 2008/09 Global Financial Crisis. We forecast the NZ economy will contract 7% over the year to Dec 2020, with the unemployment rate rising to around 9%.

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia CPI, Q1, %qoq	29/04	1:30 pm	0.2
US GDP, Q1, %qoq	29/04	12:30 am	-0.4
Australia Private Sector Credit, March, %mom	30/04	1:30 pm	0.4
Eurozone GDP, Q1, %qoq	30/04	9:00 pm	-
ECB Interest Rate Announcement, %	30/04	11:45 pm	-
US FOMC Interest Rate Announcement, %	30/04	6:00 am	-
Australia CoreLogic House Prices, April, %mom	01/05	-	0.3

Originally published by CBA Global Markets Research on Friday 24th April at 11:28 am

We expect **Australia's headline and trimmed mean CPI** to rise in Q1 20 by 0.2%qoq and 0.4%qoq, respectively. The drop in oil prices will weigh on the headline CPI in Q1 20. The coronavirus restrictions ramped up over the first quarter of this year and have seen private demand drop for many goods and services and job losses begin. We are unlikely to see much in the way of inflationary pressures in the quarter. And a disinflationary pulse will be evident over the rest of the year.

We expect the stock of **Australia's private sector credit** to grow by 0.4% in March. Private sector credit grew by 0.4% over February and is running at 2.8%yoy. Credit growth is likely to remain soft in the coming months as the housing market weakens and businesses pull back on investment due to the coronavirus restrictions and shutdowns.

The daily data are showing a modest rise in **Australian dwelling prices** in April. Most of the capital cities look to be on track for a small rise in the month. Looking ahead we expect a fall in dwelling prices of around 10% over the next six months. The restrictions and shutdowns to contain the coronavirus are negatively impacting the jobs market and pose a significant headwind for the housing market.

We estimate **US GDP** contracted by 0.4%qoq in Q1 2020. Various US states entered into lockdowns at the tail end of the quarter, strangling economic output. Non-farm Payrolls contracted by over 700,000 in March. At the same time, the manufacturing sector weakened over the quarter, reflecting supply chain disruptions in China.

The **Eurozone economy** grew by 1.2% in 2019. The first estimate of Q1 2020 GDP will not fully capture the negative shock from COVID-19. The IMF projects Eurozone real GDP to contract sharply by 7.5% in 2020 with most of the disruptions concentrated in Q2 2020.

The ECB is expected to make no monetary policy changes. But the ECB could widen the eligible universe of its asset purchase programmes (APP & PEPP) to include non-investment grade corporate bonds, asset-backed securities and non-financial commercial paper. The ECB has already changed its rule to accept as collateral from Eurozone banks "fallen angel" bonds (companies that lose investment grade status).

We expect the US Federal Reserve to keep monetary policy stable. Interest rates are at the effective lower bound and the central bank has said it will not cut interest rates further. But the Fed may introduce new or tweak existing lending programs as required to support financial market functioning.

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	-1.0	-17.3	11.6	1.8			
GDP real - A%	1.8	0.3	-17.0	-8.1	-6.9	-6.1	2.7	4.8
GDP real - AA%	2.3	1.6	-3.2	-5.8	-8.0	-9.5	4.9	4.6
CPI - Q%	0.5	0.8	0.0	0.3	0.1			
CPI - A%	1.9	2.5	2.0	1.6	1.2	1.0	1.2	1.4
HLFS employment growth - Q%	0.0	-0.3	-5.8	-1.5	0.6			
HLFS employment growth - A%	1.0	0.7	-5.8	-7.5	-6.9	-6.3	3.0	2.7
Unemployment rate - %sa	4.0	4.7	9.1	9.3	8.5	8.3	7.1	6.2
Annual current account balance as % of GDP	-3.1	-3.3	-3.7	-3.8	-4.3	-4.8	-3.4	-2.3

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	0.96	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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