Economic Weekly

28 September 2020

RBNZ readying to rock and roll on FLP

Last week, the RBNZ released its September monetary policy review. For those aficionados who recall the previous monetary policy statement, it was playing a very familiar song, with the OCR on hold at 0.25%, and the Large-Scale Asset Purchase Programme still pegged at $100 billion. The RBNZ kept singing the blues, highlighting the downbeat economic global outlook, and “unprecedented contraction” in Q2 GDP. The bank continued to highlight its three favourite options for additional monetary stimulus, with a ‘Funding for Lending Programme’ (FLP) – a cheap form of direct lending to banks, rounding out the trio with a negative OCR and foreign asset purchases.

Yet there was a notable departure. Previously, the Bank had suggested it would roll out alternative monetary policy as part of a joint package of measures. This time around, the RBNZ suggested they could be deployed independently, with the FLP being the first. The review stated that the FLP would be ready for deployment by the end of this calendar year (possibly as soon as November), rather than alongside a negative OCR in 2021. In other words, the RBNZ has kept the same band playing the same tunes, but given one of the members a solo, and with a slightly faster tempo.

The news that the FLP could be deployed sooner and separately, was music to our ears. An earlier FLP gives financial institutions a measure of certainty and speeds up the transmission of lower borrowing costs to businesses and consumers. We could envisage the FLP being launched as early as the November MPS. We still expect the RBNZ to cut the OCR in 2021, with April as the most likely date. You can read our full review here.

Still, the shape and speed of further stimulus is hard to predict amidst all the uncertainty. Even interpreting the data when it does come in can be a challenge – what sounds like a sweet melody can be masking more worrying noises. For example, last week’s August trade showed a solid year-on-year lift in exports, seemingly highlighting the resilience of the NZ export sector. While that was true to a certain extent, the headline figures were also inflated by a large shipment of aircraft overseas for long-term storage while the border stays shut – a resonant reminder of tough times ahead. On a similar theme, data on the household sector seems to be both encouraging and worrying. On page 2, economist Mark Smith helps you interpret the cacophony. nathaniel.keall@asb.co.nz.

Recent key economics

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Quarterly Economic Projections

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Corporate Hedging Toolbox

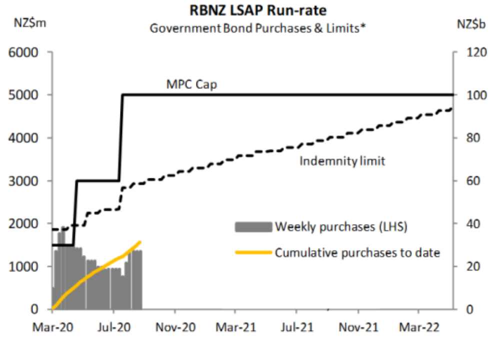
Policy response:

RBNZ September MPR Review

Assessing the RBNZ’s bag ‘o’ tricks

For COVID-19 research, see here

Chart of the week



Source: ASB, RBNZ *Excludes LGFA, indemnity based on current bond programme

Household sector outlook: The good, not so good and the ugly

- NZ's timely healthcare and economic policy responses have meant the impact of COVID-19 restrictions on the NZ household sector may not have been as damaging as it could have otherwise been.
- Nevertheless, the impact of the outbreak on the household sector has been highly uneven. The economic costs of the outbreak are sizeable and are likely to cumulate over time, with COVID-19 adding another layer of uncertainty to the household outlook.
- Our hope is that the household sector takes the COVID-19 hit on the chin and staggers on. The risk is that consumers retrench, deepening the downturn.

This article summarises an economic note we released late last week.

The impacts of COVID-19 have been highly uneven on households. On the positive side, NZ's border restrictions and a dose of good luck have helped contain COVID-19 and reduce the fallout to a sizeable chunk of the household sector and the economy in general. COVID-19 restrictions in NZ have not been as long-lasting as they have in other trading partners and lockdowns have been reasonably brief, reducing the damage to the circa 60%+ of retail deemed to be non-essential. **Economic policymakers have also stepped up to the plate, front-footing stimulus** to support incomes, reduce borrowing costs and generally buy some more time for impacted households.

Some households have adapted to the challenges posed by the COVID-19 outbreak reasonably well, have strengthened their balance sheets and may even have enjoyed the additional flexibility of changing working environments. Moreover, the front-loading of policy stimulus and a brief lull during the COVID-19 storm provided a honeymoon period for some households and retailers. Record low mortgage interest rates and more returning kiwis helped to boost the residential property market and other interest-rate sensitive pockets. **Local tills have also been supported by the substitution of spending that had been earmarked to head overseas**, government income support measures and by the time of year where overseas visitor numbers are typically at a lull.

Influences impacting the household sector

Good	Not so Good	Ugly
NZ's success at limiting the outbreak has minimised disruption posed by COVID-19. Households showing adaptability and flexibility. Still-solid population growth in the short term with kiwis returning home. Increased attractiveness of NZ as a safe-haven place to live, with technology increasing accessibility. Timely fiscal stimulus to support household incomes. More household spending on nest-building. Record low mortgage interest rates. Housing wealth expected to remain elevated. Households expecting COVID-19 hit to be short-lived. Elevated Terms of Trade supporting households.	Small household saving buffer. Risk of periodic flare-ups and economic disruption. Less resilient NZ households and firms. Job losses from heavily-exposed sectors. Cautious consumers reluctant to commit to major purchases and showing signs of cutting back on discretionary spending. Tightening in credit conditions. Less pent-up demand likely to be evident after subsequent restrictions. Lower interest income for savers.	NZ border to remain shut, with sharply lower spending from overseas tourists. Slowing population growth. Rolling-off of fiscal support measures. Widespread job losses and firm closures. Heightened uncertainty and hit to household incomes sees household sector retrench.

Source: ASB

There are some clear negatives, however. **The closure of the NZ border has delivered a circa 3-5% of GDP hit that can't easily be made up.** Border controls represent a sizeable economic headwind that will likely intensify as we hit the peak inbound tourism season in the summer months. Spending by overseas visitors has slowed to a trickle and is unlikely to recover its mojo until border restrictions are significantly relaxed. Firms and households exposed to the tourism and hospitality sector are bearing the brunt and have already suffered significant hardship. The impact of the closed border for tourism and educational students will be felt more acutely in the summer months. Firms and households look to be adapting to the physical distancing requirements posed by higher Alert Levels, but economic activity is still weaker, particularly with some fiscal support measures rolling off. **Some of the effects are cumulative,**

with households and firms in a weaker position and less able to sustain softer conditions.

What's more, Job losses are mounting and are set to escalate as support measures roll off. Households have largely kitted themselves out now and we are unlikely to see ongoing strength in durable consumption, despite low borrowing costs. The greater income uncertainty posed by COVID-19 has resulted in more bank caution with regards to lending and a reluctance by consumers to commit to large purchases. We do not expect this uncertainty to abate for a while yet. Our expectation of a 7%+ unemployment rate, reduced job security and stagnant wage growth, suggests households might knuckle down, redirecting expenditures towards the essentials. Discretionary expenditures would be particularly hard hit.

Our view is that we are unlikely to see consumer demand recover to the extent it did post the first lockdown. We also suspect economic divides will widen as government policy support measures subside and retail interest rates fall. However, the current climate is still highly uncertain, with COVID-19 yet another known unknown to contend with. The hope is that the household sector takes the COVID-19 hit on the chin and staggers on. The risk is that many households retrench and build up saving buffers, deepening the current downturn.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6549	0.6771	0.6663	0.6289	FLAT	0.6400	0.6650
NZD/AUD	0.9315	0.9247	0.9135	0.9306	UP	0.9200	0.9400
NZD/JPY	69.15	70.61	71.09	67.71	FLAT	67.50	70.50
NZD/EUR	0.5631	0.5705	0.5610	0.5758	FLAT	0.5500	0.5750
NZD/GBP	0.5138	0.5226	0.5026	0.5101	FLAT	0.5050	0.5200
TWI	71.3	72.4	71.7	70.27	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 fell against most of the major crosses over the past week, except for the AUD. Risk aversion was the theme of the week in financial markets, with equites continuing to gradually pull back from recent highs. Rising rates of COVID-19 infections across Europe ahead of the northern hemisphere winter have many investors worried. However, US investor sentiment stabilised somewhat heading into the weekend on signs that US lawmakers were making progress on a reported US$2.4 trillion stimulus package that could be voted on during the week ahead.

It's not unusual for the NZD to outperform the AUD during bouts of risk aversion as the AUD/USD is often more heavily impacted. In saying that, a couple of additional developments may have helped weigh on the AUD vs the NZD. Speculation is growing across the ditch that the RBA may cut the OCR further, with one major Australian bank officially changing its view, triggering a fall in Australian interest rates and the AUD. The RBA has previously been reluctant to cut its cash rate into negative territory but cuts to the cash rate and increased QE were highlighted in a speech from RBA Deputy Governor Debelle last week. The recent fall in iron ore commodity prices, a key Australian commodity export – whilst dairy prices remain broadly steady – may also be adding extra weight to the AUD vs the NZD.

Outlook

Market sentiment will remain the key driver for the NZD this week and we expect the weekend's stabilisation in sentiment to continue. There are no major economic data releases until US non-farm payrolls (employment) at the end of the week, so instead remain wary of COVID-19 developments or political headlines to trigger shifts in currency direction. Meanwhile, further NZD/AUD upside is likely as speculation around a cash rate cut speculation mounts ahead of next week's RBA meeting.

Our medium-term FX forecasts are underpinned by a weaker USD view, reflecting an expectation that the US current account deficit will widen, and the US Terms of Trade will decrease. However, NZD-specific factors are expected to limit NZD upside, particularly as the RBNZ is about to embark on a much more aggressive monetary easing campaign than many of its offshore peers. Meanwhile, the risks around our NZD/AUD view have shifted over the past week, as the RBA have opened the door to further cash rate cuts and the NZ-AU relative interest rates story is no longer clear cut. Further falls in the NZD/AUD are less likely given the Australian market participants are now speculating on further RBA policy easing. jane.turner@asb.co.nz

ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)	<< actual	forecast >>					
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.90	0.89	0.88	0.86	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.54	0.54	0.54	0.53	0.52	0.53
NZD/GBP	0.52	0.50	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.6	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	69.6	70.0	69.5	68.0	67.5	67.7

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	0.30	0.30	0.29	1.14	UNCH/DOWN	UP
2-year swap	0.04	0.05	0.09	0.95	UNCH/DOWN	UP
5-year swap	0.11	0.13	0.21	0.95	UNCH/DOWN	UP
10-year swap	0.49	0.52	0.63	1.21	UNCH/DOWN	UP
10-year govt bond yield	0.48	0.53	0.64	1.10	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.45	0.47	0.55	0.26	UNCH	DOWN

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

Market Recap

NZ yields ground lower last week, with yields down to record lows and the curve flattening. NZ Swap yields fell below 0.5% across the curve out to the 10-year tenor, with yields approaching zero for the belly of the curve. NZ 10-year government bond yields fell to 0.43%, with negative yields out to five years. As we expected, the RBNZ delivered a dovish assessment (see our take here), maintaining current settings, but signalling that a funding for lending programme is likely to be launched before year end. It also confirmed it was "on track to be operationally prepared for negative interest rates by year end", confirming the prospect of a negative OCR from April 2021. Australian yields were lower and the curve flatter. In his speech last week, RBA Deputy Governor Debelle stuck to the script in watering down the prospect of a negative cash rate. However, he flagged several other measures, including moving the 0.25% cash rate closer to zero, increasing the Term Funding Facility and more widespread asset purchases. There was little market reaction to last week's data. US yields were little changed, waxing and waning in line with equities.

Near-term interest rate outlook

We have retained our downward bias for local yields on the view that there remains considerable scope for current market pricing – which has a negative OCR by April and around 50bps of OCR cuts priced in till late 2021 – to move lower still given the RBNZ's willingness to push NZ yields lower.

We expect NZ yields to remain well below US and Australian peers. There may be scope for Australian yields to ease by more than NZ counterparts if the RBA cuts the cash rate next week. For now, however, our CBA colleagues expect the RBA to hold the cash rate and 3-year bond target at 0.25%. However, if the RBA were to increase asset purchases beyond the 3-year tenor this could help flatten the curve and narrow spreads with lower NZ yields. The RBNZ has signalled a slightly reduced $1.16bn weekly pace of NZ government bond purchases, but this still considerably outpaces the $600m in weekly tenders, helping to dampen yields and flatten the curve. The direction of risk appetite and global equities is likely to continue impacting local and global yields and the slope of the yield curve. US Treasury yields could push higher this week if a fiscal deal is struck between Democrats and the While House although with the NZ (October 17) and US elections (November 3) looming, political uncertainty could see yields press lower. This week's local and offshore data should elicit modest reaction in the rates market.

Medium-term outlook

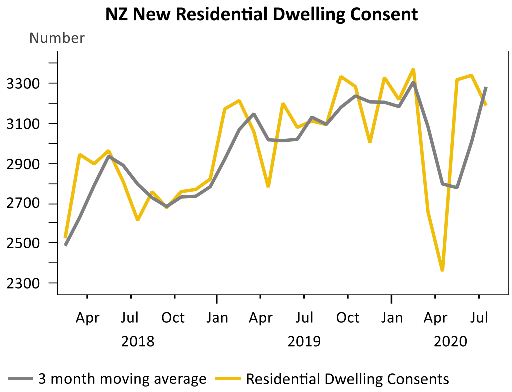
We expect the RBNZ to launch a funding for lending programme by the end of the year, most likely the November MPS on November 11. The earlier launch of the FLP reduces the risk of an earlier OCR cut, but we still expect a front-loaded 75bp cut in April, taking the OCR to -0.50%. The RBNZ are expected continue to front-loading asset purchases and employing forward guidance to dampen yields. Low global inflation and subdued global growth prospects should keep NZ yields low and the curve reasonably flat despite high public debt issuance. mark.smith4@asb.co.nz

ASB interest rate forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)	<< 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	0.25	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.10	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.15	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.50	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.55	0.45	0.25	0.00	0.20	0.55

Domestic events

Data	Date	Time (NZT)	Market	ASB
NZ Building Consents, Residential, Aug, %mom	30/9	10:45am	-	-
ANZ Business Outlook, Own activity next 12 mths, Sep F	30/9	1:00pm	-	-
ANZ Consumer Confidence, Headline, September	02/10	10:00am	-	-

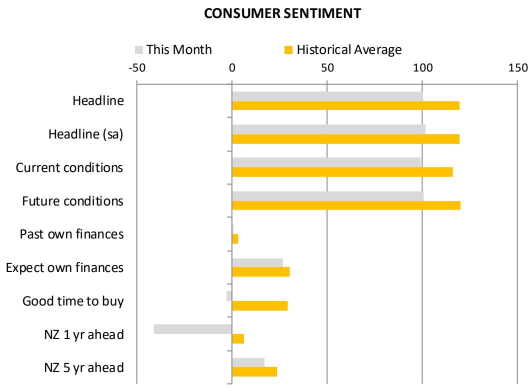
After staging a strong recovery in May, **residential building consent numbers tracked sideways over June and July but remained at relatively high levels**. Over May, June and July, the 3-month average number of residential building consents have recovered to its pre-COVID trend. The key question going forward is how long NZ's housing construction demand will hold up. We have been surprised by the resilience of the NZ economy, with economic and housing demand stronger than expected during the middle of the year as NZ largely returned to business as normal under Level 1 restrictions. The re-emergence of COVID may dent confidence somewhat, but we have revised our construction forecasts to reflect housing construction demand holding up over the second half of the year.



Source: Macrobond, ASB

ANZ release the full month results of the September business outlook survey, after releasing the preliminary results earlier this month. Business confidence lifted in early September, moving back towards July levels, with the business community taking the news of the August COVID-19 community outbreak in Auckland in its stride. Investment intentions made strong gains in early September and we will watch closely to see if this lift is sustained. Employment intentions, while improving, remain weak and we continue to expect the labour market will soften over the coming year and this will directly weigh on NZ's economic performance heading into summer.

September consumer sentiment is expected to remain at around 2009 lows as the household sector continues to navigate its way through the COVID-19 storm. The timing of this survey likely means that the September readings will only partly incorporate the announced shift down in alert levels from September 21. We expect consumers to remain cautious over the near-term economic outlook, with continued reluctance to purchase a major household item. There is also the risk that mounting job losses may start to weigh on past and future consumer assessments of their own financial situation. **Our expectation (see p2 and our full household sector note here) is that despite interest-rate sensitive pockets responding to record low mortgage interest rates, increasing caution on retail spending will become evident in the coming months.**



Source: ANZ, ASB

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Private Sector Credit, August, %mom	30/09	1:30 pm	-0.1
Australia Building Approvals, August, %mom	30/09	1:30 pm	-5.0
Eurozone CPI, September, %yoy	30/09	9:00 pm	-
Australia Job Vacancies, Quarterly, August, %qoq	01/10	1:30 pm	32.0
Australia Retail Trade, August, %mom	02/10	1:30 pm	-4.2
US ISM Manufacturing Index, September, points	02/10	1:45 am	56.5
US Non-farm Payrolls, Sep, Unemployment Rate, %	03/10	12:30 am	8.0
Australia 2020/21 Budget, Cash Balance AUD$bn	06/10	-	220

**Originally published by CBA Global Markets Research on Friday 24 September at 1:39 pm*

We expect the stock of **Australian private sector credit** to contract by 0.1% in August. This would see the annual growth rate fall from 2.4% in July to 1.2% in August. The stock of housing lending has continued to expand over recent months. But personal credit and business credit are contracting at a faster rate. This is driving the overall stock of credit lower. We expect this trend to continue in the near-term. But continued home loan deferrals may afford some support to the stock of credit over the remainder of 2020.

We expect the *number* of **Australian building approvals** to decline by 5% in August after a lift of 12% in July. This would see the annual rate move negative in August to -3.3% from 6.3% in July. The outlook for residential construction remains subdued as border closures and uncertainty over COVID-19 reduce demand for new housing.

We **expect job vacancies in Australia** to lift by 42k (or 32%) to 171k in the quarter to August. This lift would still see vacancies down around 25% from their pre-coronavirus levels. Our view is in line with the surprisingly strong recovery in the labour market over the 3 months to August with jobs growth of 457k. However, there is still a long way to go with 875k jobs lost between March and May this year. The ANZ Job Ads series also indicates that vacancies will recover solidly.

Our **Australian parent CBA's internal data pointed to a solid fall in August retail trade** (forecast: -4.0%), in line with ABS' preliminary estimate for August at -4.2%. We expect a similar result for the final August estimate with Victoria leading the falls given the stage 4 restrictions in Melbourne and stage 3 restrictions in Regional Victoria. By industry, household goods and retailing drove the decline but still up around 20% from year-ago levels. The preliminary data showed that the clothing & footwear and eating out categories were also weak in August.

Our CBA colleagues have forecast an underlying **cash deficit for Australia's Commonwealth Budget** of $A220bn in 2020/21. The deficit is projected to be $A110bn in 2021/22. Our full budget preview will be published on Tuesday 29 September.

Eurozone headline CPI fell at an annual pace of 0.2% in August, with market expectations aligned with a 0.2% annual fall in September. The European Central Bank projects headline inflation to remain negative over the coming months.

We forecast the **US ISM manufacturing index** rose to 56.5 points in September (mkt: 56.3, prior 56). Already-released regional manufacturing surveys were mixed, but on balance suggest a slight increase in activity over the month. However, we expect the employment indicator to remain below 50 points because of ongoing concern over the economic outlook.

We expect **US Non-farm Payrolls** lifted by 1m in September but note the very wide range of forecasts (mkt: 850k, range -100k to +1200k). So far, the US labour market has recovered at a quicker-than-expected pace. But we expect the recovery to begin to moderate shortly. Some job losses will have been permanent, rather than temporary. And ongoing weak aggregate demand suggests it will take time to regain those lost jobs. We forecast that the unemployment rate fell to 8% with a modest 0.2%mom lift in average hourly earnings.

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	10.1	0.8	0.3	0.1		
GDP real - A%	-12.4	-4.2	-3.9	-2.2	11.5	0.7	3.3
GDP real - AA%	-2.1	-3.7	-5.2	-5.7	-0.1	3.4	2.3
CPI - Q%	-0.5	1.0	0.0	0.1	0.2		
CPI - A%	1.5	1.8	1.3	0.7	1.3	1.3	1.3
HLFS employment growth - Q%	-0.4	-2.6	-1.2	0.1	0.5		
HLFS employment growth - A%	1.1	-1.9	-3.2	-4.1	-3.2	2.1	1.8
Unemployment rate - %sa	4.0	6.4	7.3	7.5	7.3	6.7	6.6
Annual current account balance as % of GDP	-1.9	-1.2	-1.1	-1.5	-2.1	-2.2	-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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(end of quarter)	<< 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	0.25	0.15	0.00	-0.50	-0.50	-0.20
NZ 2-year swap rate	0.21	0.10	0.00	-0.15	-0.30	-0.30	0.00
NZ 5-year swap rate	0.35	0.15	0.10	0.00	-0.15	-0.15	0.15
NZ 10-year swap rate	0.74	0.50	0.30	0.10	-0.10	0.10	0.50
NZ 10-year Bond	0.91	0.55	0.45	0.25	0.00	0.20	0.55

ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)	<< actual	forecast >>					
NZD/USD	0.64	0.66	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.93	0.90	0.89	0.88	0.86	0.85	0.86
NZD/JPY	69	70	71	70	69	69	69
NZD/EUR	0.57	0.54	0.54	0.54	0.53	0.52	0.53
NZD/GBP	0.52	0.50	0.50	0.49	0.49	0.49	0.49
NZD/CNY	4.5	4.6	4.6	4.6	4.5	4.4	4.4
NZD TWI	71.4	69.6	70.0	69.5	68.0	67.5	67.7

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