ASB

Economic Weekly

30 March 2020

I am a rock, I am an island

I have been working from home since Friday 20th. There are some distinct upsides: hearing tuis singing outside, reduced retina damage from less exposure to orange road cones. And a realisation that people should probably have been panic-buying coffee not toilet paper. We are amazingly adaptable when we need to be, and now is the hour!

The team has gone through and come up with a first cut of what the economy will look like as it goes through the lockdown and comes out the other side, covered on Page 2. There will be huge uncertainties still, so dry numbers will change and should not have too much weight put on them. The broad story is a short but extremely sharp downturn and rebound, followed by a gradual grind higher for an economy that will be smaller coming out the other side.

It is worth reflecting on what NZ is trying to achieve. Importantly, NZ's approach is a combined and coherent strategy. Our health is everything. And being healthy and safe will also make for a healthier (less disrupted) economy. We have made the decision to aggressively lock down the country to try and get on top of the virus early and – hopefully – swiftly. In the meantime, we are mothballing a large chunk of the economy during this period in a way that keeps it as ready as possible to resume. Wage subsidies are enabling many businesses to keep hold of their employees and preserve jobs. Government/bank capital support will help give businesses the funds to resume trading. NZ's strategy of keeping the economic disruption to a relatively short period should reduce the long-term economic harm. Huge fiscal policy actions can't be done indefinitely and would ultimately be ineffective without the decisive health actions.

NZ is lucky that we have had clear, crisp and pragmatic leadership. In contrast, the US has more infections than anywhere else. Over 3 million people in the US registered for unemployment claims in the week to March 20, a record high and tenfold increase over the prior week.

We are an island (islands) and our geographical isolation can be of benefit in times of such as this. However, as a trade dependent economy, our fortunes are tied to what happens globally. For now, we need to keep our physical distance from those outside of our bubble, but it is important that we continue to stay in touch and be each other's supportive rocks. Take care all – Nick (nick.tuffley@asb.co.nz)

Recent COVID-19 publications

COVID-19 and the economic path ahead – page 2 summarises the key take outs

RBNZ policy actions

Fiscal fights back
RBNZ OCR cut March 16
Housing immunity about to be tested
COVID-19: Market impacts, responses, and ideas
Thinking about coronavirus impacts on business: Be prepared – it doesn't hurt
Government support – quick guide to accessing it

Where to find support

ASB financial support package
Government support package
COVID-19 alert system explainer

COVID-19 and the economic path ahead – our key takeouts

The economy is going into a deep but short-lived contraction. It's going to be painful, but it is entirely necessary to avoid even worse health and economic outcomes further down the track. No one knows how deep the hole is or precisely how long it will take the economy to recover. But, the important point is that the economy WILL recover.

The response by NZ's policy makers has been timely, and appropriately aggressive. The fallout on NZ's labour market, housing market and economy more generally will be limited greatly by the decisive actions we've seen to date. We're confident they will work to support the economy as we endure the lockdown, and then stimulate the economy as we emerge.

It gives us the best chance of emerging from this crisis in reasonable shape compared to some. But how the rest of the world fares in this still matters a great deal for us, given NZ remains a trade-dependent economy. It's a well-worn cliché, but it's true that we're all in this together.

There will be sectoral, regional, and employment differences. Humans are incredibly adaptive and will find new ways of working, but this will be easier said than done for many. COVID-19 is a viral outbreak, and sectors that rely on person-to-person contact and the movement of people will face greater challenges. Providing that the Chinese economy manages to recover from its winter flu, prospects for NZ food exporters may not be as bad as they could be given the pending global downturn. Our Terms of Trade should hold up reasonably well, but we acknowledge the downside risks around this view.

NZ has more fiscal and monetary ammunition (than most). And policymakers have already shown boldly that they are not afraid to use it.

Don't pay too much attention to point forecasts. Forecasting is tough at the best of times, borderline impossible now. The relevance of forecasts is also reduced in an environment where some firms are simply trying to stay afloat rather than doing any sort of planning for the future. We outline our updated outlook below and encourage you to focus on the story and risk profile, rather than the numbers.

Businesses on the front line of this shock will have the clearest sense of the impacts, and are thus best placed to figure out the way forward. **Kiwis have proven themselves to be resilient and innovative**. These qualities stand us in good stead as we tackle this thing.

Carpe (28) diem. Essential industries and businesses that are able to function during the lockdown will learn a lot about new work techniques. Others have time to plan for the future. Make the most of this unusual opportunity.

There is plenty of help out there from government and banks. Seek it out and encourage others to make use of it. Help others get through if there are things you can do that will make a difference.

Co-operation and caring matters. If we all pull together, follow official advice and look out for each other, it will be easier to get through this. Kia Kaha New Zealand.

For much greater detail, read last Friday's Economic Note.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6030	0.5627	0.6253	0.6783	FLAT	0.5750	0.6100
NZD/AUD	0.9809	0.9772	0.9564	0.9571	FLAT	0.9700	1.000
NZD/JPY	64.93	62.04	68.26	75.10	FLAT	61.70	65.20
NZD/EUR	0.5420	0.5251	0.5690	0.6041	FLAT	0.5200	0.5450
NZD/GBP	0.4849	0.4830	0.4857	0.5192	FLAT	0.4770	0.5030
TWI	69.2	66.0	70.0	73.66	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 surged over 6% higher last week, a top five performance in terms of weekly gains since 1990. The kiwi's performance against the crosses was much more mixed (up against JPY & EUR, down against AUD & GBP) illustrating that broad USD moves remain the driving force in currency markets at present. NZD/USD (6-month) implied volatility, having jumped from 8 to 22% the week prior, fell back to around 15%.

US dollar demand dropped away sharply last week on signs of easing USD funding pressures as well as reduced 'safe-haven' demand as markets regathered some of their poise. Price action across a range of markets was bolstered by a tidal week of enormous fiscal packages (most notably the US Government's two USD2 trillion package on Friday), as well as early hopes that COVID-19 infection curves are showing some signs of flattening in some parts of the world. US equities posted their best week in over 10 years. Commodity prices and credit markets also rallied strongly.

Near-term outlook

Despite the magnitude of last week's NZD/USD surge, we wouldn't necessarily characterise the recent recovery as overdone. To us, it looks more like a case of modest 'normalisation' from the excessive, and borderline-disorderly NZD/USD falls through 0.5600 and 0.5500. These occurred at a time when equity markets were falling 5-10% per day, and NZ markets were fretting about the government's enormous debt issuance task and when the RBNZ would start quantitative easing. Markets are now trading on a much surer footing.

Supporting this story is the latest estimate of short-term NZD/USD 'fair-value'. Our valuation model suggests the current combination of NZ-US interest rate differentials, commodity prices, and risk appetite is consistent with a NZD/USD fair-value range of 0.6100-0.6500. Given the flighty nature of markets, this should be interpreted as indicative only, but it does support the idea that the NZD/USD got a little "oversold" down at 0.5500.

Near-term, and assuming the markets can maintain their new-found calm, we look for the NZD/USD to continue to stabilise in a relatively wide range. Higher than usual volatility and reduced liquidity will remain features of the market though, as well as wider than usual dealing spreads. All of these things make transacting more difficult. On a more positive note, we have seen vastly improved conditions in the NZD/USD forwards market thanks to the actions of the RBNZ and US Federal Reserve in recent weeks.

This week's key data – NZ business confidence for March and March global manufacturing PMIs – will undoubtedly be awful. But this shouldn't matter too much for currencies given everyone is expecting bad readings and investors are more focused on forward looking COVID-19 developments.

mike.jones@asb.co.nz

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	0.25	1.00	1.75	UNCH	UP
90-day bank bill	0.49	0.58	1.05	1.85	UNCH	UP
2-year swap	0.54	0.55	0.86	1.63	UNCH	UP
5-year swap	0.64	0.66	0.92	1.77	UNCH/UP	UP
10-year swap	0.99	1.00	1.20	2.16	UNCH/UP	UP
10-year govt bond yield	1.14	1.52	1.06	1.81	UNCH/UP	UP
Curve Slope (2s10s swaps)	0.45	0.45	0.34	0.53	UNCH/UP	DOWN

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

Market Recap

Concerns over the impact of COVID-19 on the global economy and effective actions by global policymakers combined **last week to push NZ and global yields lower, with yield curves also flattening.** Global longer-term yields fell last week (US Treasury 10Y 0.67%, Australian/NZ 10Y government bond 0.89%, 1.09% respectively), with investors on edge over the impact of COVID-19 on the global economy.

Global central banks have progressively upped the ante. Last Monday, the RBNZ announced a $30bn government bond purchase programme, which has contributed to the sizeable fall in government bond (and swap) yields over the past week. The US Federal Open Market Committee (FOMC) further stepped up its Quantitative Easing (QE), pledging to purchase an unlimited amount of US Treasuries and mortgage-backed securities. The Federal Reserve's balance sheet has soared to over USD5trillion for the first time on record. The European Central Bank, Bank of England and Reserve Bank of Australia have also moved to relax limits or increase their QE programmes.

Policymakers have also pulled out most of the stops to provide liquidity. This morning the RBNZ announced another tool to support liquidity in the corporate sector, and put in place other measures to support monetary policy implementation and to keep financial markets functioning. Swap, credit and corporate bond spreads have narrowed since central bank actions were unveiled. We suspect more measures will be unveiled soon, if strains in liquidity and credit markets resurface (see our recent note here).

Near-term NZD interest rate outlook

COVID-19 continues to dominate market attention. We believe that policy actions to provide additional stimulus to offset the hit from COVID-19 and weakness in the global outlook should continue to dampen yields. Our latest economic forecasts point to a sizeable contraction in NZ economic activity, necessitating extraordinary policy support over the year ahead. **However, we have flagged that there are also likely to be episodic bouts of volatility**.

The first of many litmus tests will come at this week's NZ Government bond tenders. The RBNZ announced last week that it will be purchasing $1.35bn of NZ government bonds, with purchases more concentrated in the mid-part of the curve. There could be further central bank steps unveiled in the coming weeks. We are wary that a flaring up of risk aversion could see spreads widen and push NZ government bond yields higher, steepening curves.

Data this week will largely be ignored but is likely to show in improving signs in China, weakness in OECD economies and sizeable falls in manufacturing/services PMIs. The March US non-farm payrolls print will not be too bad (a circa 200k drop is expected), but considerably weaker prints lie ahead.

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. Markets are expected to remain selective in pricing risks, with swap, credit and corporate bond spreads to remain elevated. 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 debt issuance on yields. mark.smith4@asb.co.nz

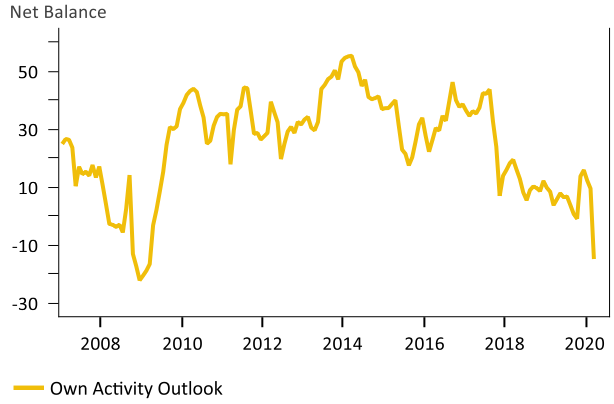
Domestic events

Data	Date	Time (NZT)	Market	ASB
Residential Building Consents, Feb, % mom	31/03	10:45 am	-	-
ANZ Business Outlook, own activity, March, net%	31/03	1:00 pm	-	-

February building consents were likely unaffected by the early stages of the coronavirus outbreak. Prior to the outbreak, house building demand was supported by lower interest rates and a supply shortage across NZ. March and April consents will be impacted by the Alert Level 4 shut down, with the risk of much longer-lasting impacts if the shutdown persists. Over 2020, house building activity will likely be negatively impacted by weaker demand from economic uncertainty and potentially supply shortages due supply-chain disruptions from lock downs in various countries.

ANZ has already released provisional results for the March survey on March 10th. Unsurprisingly, business confidence fell in March, to levels not seen since the 2008 Global Financial Crisis. This fall was led by a plunge in export intentions, to a record low. While the full results for March will be welcome, few of the responses are likely to have been received after it was announced on March 23 that NZ would go into lock down. As such, we would expect further deterioration in readings from this survey in the coming months

ANZ Business Outlook Survey (seasonally-adjusted)



Source: Macrobond, ASB

Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
Australia Private Sector Credit, February, %mom	31/03	1:30 pm	0.3
China Manufacturing PMI, March, points	31/03	1:00 pm	45
Eurozone CPI, March, %yoy	31/03	12:00 pm	-
RBA Meeting Minutes, March	01/04	1:30 pm	-
Australia Building Approvals, February, %mom	01/04	1:30 pm	10.0
Australia CoreLogic House Prices, March, %mom	01/04	12:00 pm	0.8
US ISM Manufacturing, March, points	01/04	5:00 pm	42
Australia Retail Trade, February, %mom	03/04	1:30 pm	0.4
US Non-farm Payrolls, March, 000s	03/04	3:30 pm	-200

**Originally published by CBA Global Markets Research on Friday 27th March at 14:51 pm*

Australia's private sector credit is set to grow by 0.3% in February. Owner-occupier and business credit have driven credit growth recently. Personal credit has been contracting. Measures to close auction houses and open homes is likely to see housing turnover and credit growth slow in the coming months.

Our daily trackers show **China's** business activity largely has returned to normal. We expect the official **manufacturing PMI** to rebound to 45 points. We expect the non-manufacturing PMIs to report a smaller rebound to 40 points because continued caution among consumers is delaying the recovery in services.

The **Reserve Bank of Australia is set to release its meeting minutes** later this week. These minutes relate to the emergency meeting held on 18 March when the RBA lowered the cash rate to 0.25% and announced the start of quantitative easing.

We expect **Australia's building approvals** to grow by 10% over February after a large fall last month. Building approvals were showing signs of stabilising on the back on interest rate cuts and rising dwelling prices. Looking ahead the coronavirus poses a threat to building activity.

We have pencilled in a 0.8% lift in **Australian dwelling prices** over March in line with the daily data. Sydney looks to have posted the biggest increase. Looking ahead the restrictions on open inspections and auctions will weigh heavily on housing turnover. Concerns about job security are also likely to weigh on prices and activity.

The preliminary estimate of **Australian retail trade** – first released on 16th March – showed a 0.4% rise in retail trade for February. CBA card spend data has indicated changes in household spending decisions as a result of coronavirus. Expenditure on goods has lifted materially but services spend has contracted. Spending on food, alcohol and health has lifted strongly in recent weeks.

Eurozone headline CPI inflation will likely slow below the ECB's 2020 projection of 1.1% on lower energy prices and a collapse in economic activity.

Most of the **US regional manufacturing surveys** fell significantly in March in the first disruption caused by the coronavirus. We estimate a large fall in the national manufacturing ISM from 50.1 points in February to 42 points in March.

We expect the March survey report to show a 200,000 decrease in **US Non-farm Payrolls**. But this is only the initial impact of the disruption caused by the coronavirus. The ten times jump in initial jobless claims in late March will show up a much larger decrease in the April Non-farm Payrolls report.

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 Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
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

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