Quarterly Economic Forecast

December 2020

A demonstration of resilience

- **The NZ economy has come through 2020 surprisingly well given the 'unprecedented' backdrop.**
- **Vaccines give some light at the end of the tunnel, though the border closure will remain a 2021 constraint.**
- **We no longer expect the RBNZ will cut the OCR below zero given how strongly households have responded**.

2020 is a year that many people will be quite keen to put behind them. It has been tumultuous and testing, yet also shown the surprising resilience of the NZ economy in the face of one of the biggest shocks in modern history. Our latest forecasts have the economy ending 2020 'only' 3% smaller than it finished 2019. Compared to forecasts made at the start of the March lockdown, that is around half the decline we anticipated back then. That outcome reflects the sheer degree of support the economy has received, the relatively quick exit from lockdown, and the alacrity with which people have reached for their wallets or tapped out transactions on their phones. Fear of losing jobs has quickly given way to fear of missing out on a bargain or some fun.

NZ's 2020 outcome looks like it will be similar to Australia's. Both countries are benefitting from China's rebound, which is helping support demand for our key commodity and food exports. However, Australia's 2021 recovery is likely to be stronger than NZ's given that NZ's economy will still be held back by border constraints.

There is good and bad around the rest of the world. The really encouraging news is the initial results of various vaccine trials. There is still much to learn about the long-term efficacy of these vaccines, but they do start shining a light at the end of the tunnel by suggesting that borders can progressively open up around 2022. Disquietingly, the pandemic's spread continues in Europe and the US as they head into winter: health and economic challenges will remain acute for the time being.

Locally, the debate has quickly turned to the strength of the housing market, which is helping to tow consumer spending along, and whether or not interest rates will or should go lower. Households don't need even lower interest rates to encourage them to spend more money and buy houses at present – they have jumped the starter's gun on that one. In contrast, business borrowing appetites are weak at present and businesses have stockpiled deposits in banks. On this front, the issue is not one of the supply of credit being too tight or costly. Getting businesses to the point at which they have the confidence to act is what will make the difference here. That is a combination of time to see some uncertainties reduce enough, clarity from government around its approach (particularly those sectors most affected by COVID-19), and in general businesses formulating clearer plans for the future.

We no longer see a negative Official Cash Rate as necessary, given the strong household response to date to low interest rates as well as the roll-out of the RBNZ's Funding for Lending Programme (FLP). The FLP will help to keep a lid on bank funding costs, though against a backdrop of recent rebounds in wholesale interest rates as the hot housing market and the increasingly level of government concern about housing get digested. The silver lining is: it's better to see the economy responding to low interest rates than not – that would be a much bigger problem to cope with.

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ASB COVID-19 related publications

ASB Economic forecasts and monitoring:
ASB COVID-19 Chart pack
A chart pack, updated weekly, monitors key economic and financial markets trends for NZ and its major trading partners, with a specific focus on the impact of the COVID-19 pandemic.

COVID-19 Economics Frequently Asked Questions

Financial market trends:
Markets Monthly
A monthly recap of key financial market developments

Corporate Hedging Toolbox
Our pragmatic guide for corporates managing foreign exchange and interest rate exposures. Using a variety of quantitative tools, we try and make sense of financial markets, and offer some hedging considerations to address the challenges facing corporate treasuries.

ASB Podcast for investors
Worried about Kiwisaver? Don't fret, listen to the latest podcast from the ASB Investment Team, discussing key COVID-19 and financial market developments and how the will impact investments, featuring Senior Economist Chris-Tennent Brown.

Policy response:
RBNZ November Financial Stability Report – High LVR lending restrictions to be formally reintroduced from 1 March

RBNZ November Monetary Policy Statement – Funding for Lending Programme confirmed, ASB believes further OCR cuts no longer required

Expected impact of the RBNZ's Funding for Lending Programme

Potential impacts of a negative OCR

Industry specific analysis and other:
Housing Boom – who is buying?

Home Loan Rate Report (November 2020) – Mortgage rates keep getting lower

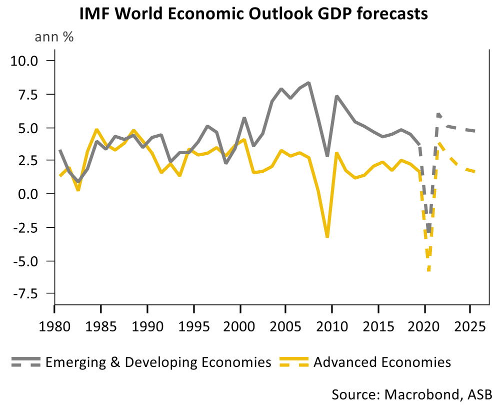
Household Sector Outlook

Farmshed Economics – Winners and losers
Now that the COVID-19 dust has settled somewhat (in NZ at least) what does it all mean for NZ agri sector?

Where to find support
ASB financial support package
Government support package
COVID-19 alert system explainer

International Outlook – so near, yet so far

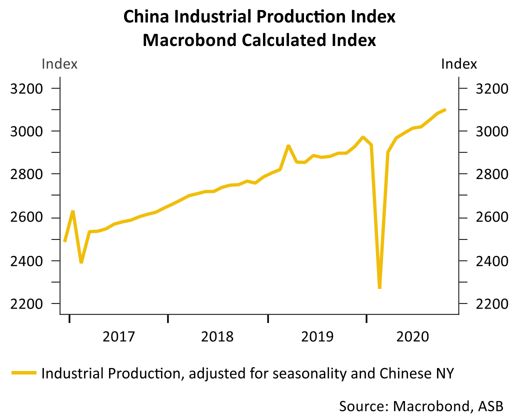
The COVID-19 pandemic continues to roil the global economy. Twelve months on from COVID's first emergence, 1.46m people have died and many countries are still struggling with outbreaks. After sharp falls in Q2, many countries saw decent rebounds in their GDP in Q3 as restrictions were lifted in many parts of the world. But the global economy is still heading for a sizable contraction over 2020, and output will remain below pre-COVID levels for some time.



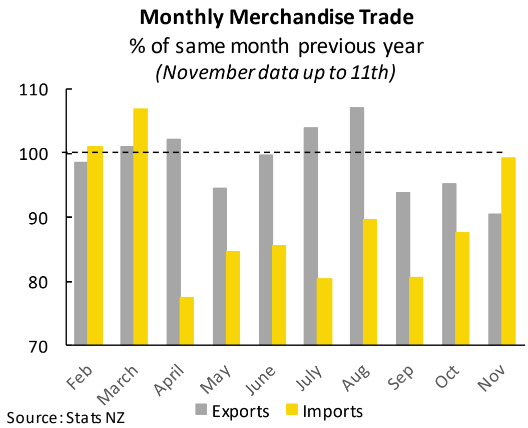
Despite recent vaccine news there are big headwinds remaining. There has been a lot of excitement recently with the news that several candidates have yielded positive results in trials. The US *Food and Drug Administration* is set to hold hearings approving the authorisation of Pfizer's vaccine on 10th December. Yet, in the near term, many countries are struggling with worsening outbreaks that will weigh down economic activity. The US is approaching 200,000 new cases a day and parts of Europe and South East Asia are also seeing record daily infections. Many countries have been forced to re-introduce restrictions, with much of Europe going back into lockdown. Some places have begun to lift measures, but others may extend restrictions deep into winter.

Since our last quarterly, growth forecasts have been revised up in some countries and down in others. The US economy has proven stronger than anticipated with most economists now forecasting a smaller contraction in 2020 and holding their 2021 forecasts steady. Economists also now expect a smaller 2020 decline in Australia and a larger lift in 2021. By contrast, worsening COVID outbreaks mean the outlook has continued to weaken in South East Asia, the UK and arguably Europe. All-up, NZ main trading partner GDP is forecast to contract 2.6% in 2020 and grow by 5.4% 2021.

China has weathered the storm well, and the latest data show the economic recovery maintaining momentum. Of the major economies, China remains the standout performer and is one of the few countries around the world that will end 2020 with positive GDP growth. With the virus broadly under control and policy settings providing considerable stimulus, recent data show industrial production rising and retail sales growth accelerating. Our CBA colleagues have revised up their Chinese GDP forecasts from 1.6 to 1.8% in 2020 and from 8.7% to 9.1% in 2021.



International trade has proven remarkably resilient and is proving a key support to the NZ economy. Earlier in the year, the *World Trade Organisation* forecast global merchandise trade could fall by between 13-32% in 2020, but now the decline looks likely to be just 9.2% – better than the most optimistic end of the forecast. New Zealand's own exports have held up particularly strongly. Over the seven months from March to September, NZ export values were down only 0.2% on the same period in 2019. Our export sector's exposure to China has helped, and solid demand for many commodities has supported prices (except for meat and wool). On the other hand, the outlook for service exports remains grim, with border restrictions likely to remain for some time, and heavily reliant on rollout of that vaccine.

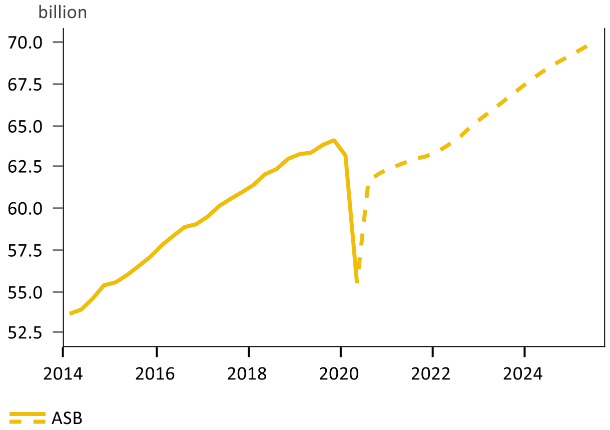


The New Zealand Economy – went harder, now better, faster, stronger

The NZ economy contracted 13.4% over the first half of 2020 as a result of the COVID-19 pandemic reaching NZ and the 4-week long strict lockdown NZ undertook to rid itself of community transmission. NZ economic activity bounced back remarkably quickly once alert level restrictions were gradually eased through May and June, and by July the NZ economy almost felt like businesses as usual. **By the end of the year, we expect the NZ economy to be down 3% on pre-COVID levels (i.e. the December 2019 quarter).**

Electronic card spending data and the Retail Trade Survey show that NZ retail spending was relatively quick to recover from the March-June lockdown. Spending remains sensitive to a tightening in Alert Level restrictions, particularly hospitality spending, as seen during the August resurgence. Nonetheless, by October, spending on most retail sectors was back to pre-COVID levels (including hospitality), with spending on consumer durable goods up 16% on pre-COVID levels. Fuel was the only sector in which spending remained pre-COVID levels.

GDP Forecasts



Source: Macrobond, ASB

The labour market has also fared better than expected – unemployment rose to 5.3% in the September quarter and we expect the unemployment rate to peak at 6.5% in mid-2021. Labour market indicators have proved stronger than expected: the monthly employment indicator suggests that the number of employed has almost recovered to pre-COVID levels, whilst the number of weekly jobless claims appears to have stabilised in October and November. Furthermore, employers have started to note difficulty in finding labour – with border closures and limited managed isolation capacity likely to be a constraint on skilled labour availability over the coming year.

The housing market fired up over winter and spring – with demand supported by low interest rates, a resilient NZ economy and pent-up demand from strong population growth in the 6 months prior to the pandemic. Meanwhile, supply remains tight due to chronic housing shortages across the country. We expect housing construction to remain at high levels over 2020, but for rates of construction to gradually ease over 2021 due to slower population growth.

Exports of services have taken the full brunt of the pandemic hit – down 43% over the first half of 2020 due to closed borders bringing international tourism to a near halt. In saying that, exports of services did not fall as far as initially feared in Q2, as a greater number of overseas visitors than expected remained in NZ. And for tourist operators in NZ, there has been some offset over winter due to a rise in domestic tourism. The impact of the border closure is likely to be most acutely felt over summer, which is the seasonal peak for overseas visitor arrivals.

NZ exports of goods have held up well, supported by strong demand for NZ food exports. For the 12 months ending September, exports of dairy, meat, fruit and wine were all well above levels from the previous year. Although export commodity prices initially fell in response to the pandemic, prices have since partially recovered (although are still down on 2019's relatively high levels). In contrast, imports of goods have struggled to recover from the sharp drop in March, with anecdotes suggesting the sluggish recovery in imports may be due to global supply chain issues and strong global competition for shipping and air freight capacity.

Although the NZ economy has proven to be more resilient than expected over 2020, **we remain relatively cautious about the pace of growth over 2021 and 2022.** We see growth prospects in NZ as being relatively muted over 2021, with the border likely to stay closed and weak global growth limiting NZ's export performance. Even though a number of vaccines have been successfully developed, it will take some time before they can be manufactured and distributed in quantities which will allow border restrictions to be materially relaxed. **In our view, it will be some time during 2022 before the NZ and global economies properly enter 'recovery mode' and allow for above-average rates of GDP growth.**

Interest Rates and Exchange Rates – on the up given brighter signs

OCR unlikely to go negative in 2021

We no longer expect the Reserve Bank of New Zealand (RBNZ) to take the OCR negative in 2021, with the change in view reflective of both domestic and global catalysts. The NZ economy has proved to be more resilient than previously expected, with interest-rate sensitive pockets responding. The housing market has strengthened and is in little need of further policy stimulus, with the loan-to-value restrictions set to be re-imposed in March 2021. The outlook for the global economy has improved on hopes that an effective vaccine for COVID-19 will be available over the next year or two. However, a difficult period lies ahead over the Northern Hemisphere winter, with double-dip recession risks and the likelihood that central banks in Europe will increase policy accommodation.

Although we don't expect the OCR to move lower, the RBNZ still wants to deliver additional stimulus to the economy. In December the RBNZ will launch its Funding for Lending Programme (FLP) – which offers 3-year funding at the current OCR to banks for up to 6% of bank credit – with the aim of lowering bank lending interest rates. We expect the FLP to push customer interest rates lower, with more sizeable falls likely for term deposit interest rates. We have pencilled in a 0.25% OCR until mid-2023, followed by a gradual path of policy tightening, but note that the OCR outlook remains highly uncertain. Viral outbreaks in the past have typically resulted in 'V'-shaped recoveries, and there is the risk the NZ and global economy repeats this pattern. Alternatively, COVID-19 remains a clear downside risk to the outlook until a workable vaccine is widely adopted. Inflation is likely to remain low and central banks will want to make sure that the rebound is entrenched before raising policy interest rates.

We expect that NZ longer-term yields will remain becalmed over the next few months, with the assumption that the recent climb in yields has run its course. This is a major unknown. Yields could continue to march higher, but there is also the risk of a pullback in the coming months given COVID-19 impacts in the Northern Hemisphere winter and central bank bond purchases. We subsequently expect longer-term yields to grind higher over the next few years and for the curve to modestly steepen until shorter-term rates start to firm. Once again, uncertainty is elevated. Entrenched low global inflation should cap global yields at historically-low levels.

Foreign Exchange

We have also revised up our NZD view, given the brightening global backdrop and our assessment of a stronger NZ economic and interest rate outlook. OCR cuts are now looking less likely. The vaccine news has considerably brightened global prospects, raising the likelihood of a 'V'-shaped recovery and bolstering risk currencies, whilst weakening safe-haven currencies, such as the Japanese yen and USD. Although the USD index is hovering around 2-year lows, there is scope for further weakness over 2021 given the climbing US Federal Budget deficit and the widening US current account deficit.

We expect the NZD to move above 70 US cents from early next year and to remain slightly above our 0.64-0.68 USD fair value range over the next year or so. We have significantly revised up our NZD/AUD view and expect the NZD to remain within a 90 to 95 Australian cent range zone. The RBNZ is less likely to cut the OCR a key NZD support but the stronger exposure of the Australian economy to the Chinese global growth engine capping NZD upside. The NZD is expected to continue to strengthen against the yen, ending 2012 at around 80 JPY. Brighter global signs have seen us revise up our outlook for the Chinese CNH, which is expected to strengthen to 6.30 USD. For the euro and Pound, the stronger starting point for NZD crosses is expected to slowly unwind, with the NZD easing to 0.53 euro and 0.49 sterling by late 2022.

The NZD outlook is contingent on the domestic and global economy holding together. There are risks aplenty, both to the upside and downside. A vigorous 'V'-shaped cyclical rebound could push the NZD higher, at least over the short-term, whereas the crystallisation of downside risks to the global economy could clip the kiwi's wings.

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Economic and Financial Forecasts

ASB economic forecasts		Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<< actual	forecast >>					
NZ GDP real	**AA%**	-2.1	-3.5	-4.7	-5.0	1.0	4.3	2.6
private consumption	AA%	-1.3	-2.8	-4.1	-4.8	0.9	4.9	3.0
dwelling construction	AA%	-6.5	-8.9	-11.5	-10.1	2.2	4.7	-4.3
other investment	AA%	-5.1	-7.2	-8.1	-7.5	2.7	5.5	5.4
exports	AA%	-5.6	-9.2	-12.8	-15.0	-10.0	2.8	8.8
imports	AA%	-6.0	-11.9	-17.6	-20.4	-11.9	5.5	8.7
NZ GDP real	A%	-12.4	-3.4	-3.1	-1.2	13.0	1.5	3.3
NZ GDP real	Q%	-12.2	11.1	0.7	0.5	0.4	0.4	0.8
NZ CPI	Q%	-0.5	0.7	0.0	0.5	0.1	0.4	0.5
NZ CPI	**A%**	1.5	1.4	1.0	0.7	1.3	1.3	1.5
NZ house prices (QV index)	A%	6.8	6.9	9.3	9.3	12.1	7.4	4.9
NZ unemployment (sa%)	Qtr	4.0	5.3	5.8	6.2	6.5	5.7	5.5
NZ private sector wages (LCI)	A%	2.1	1.8	1.5	1.4	1.7	1.7	1.9

ASB interest rate forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ cash rate target	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	0.30	0.31	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	-0.21	-0.06	-0.25	-0.25	-0.25	-0.25	-0.45
NZ 10-year govt bond	0.91	0.46	0.85	0.85	0.85	1.00	1.2
ASB foreign exchange forecasts							
(end of quarter)							
USD per NZD	0.64	0.66	0.69	0.70	0.70	0.71	0.71
GBP per NZD	0.52	0.51	0.52	0.52	0.51	0.52	0.52
AUD per NZD	0.93	0.93	0.93	0.93	0.92	0.91	0.92
JPY per NZD	69.2	69.9	71.1	73.5	74.2	77.4	80.2
EUR per NZD	0.57	0.56	0.58	0.57	0.56	0.55	0.53
CNY per NZD	4.5	4.5	4.5	4.6	4.6	4.5	4.5
TWI - 17 country	71.4	71.6	71.5	72.1	71.7	71.5	71.5

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