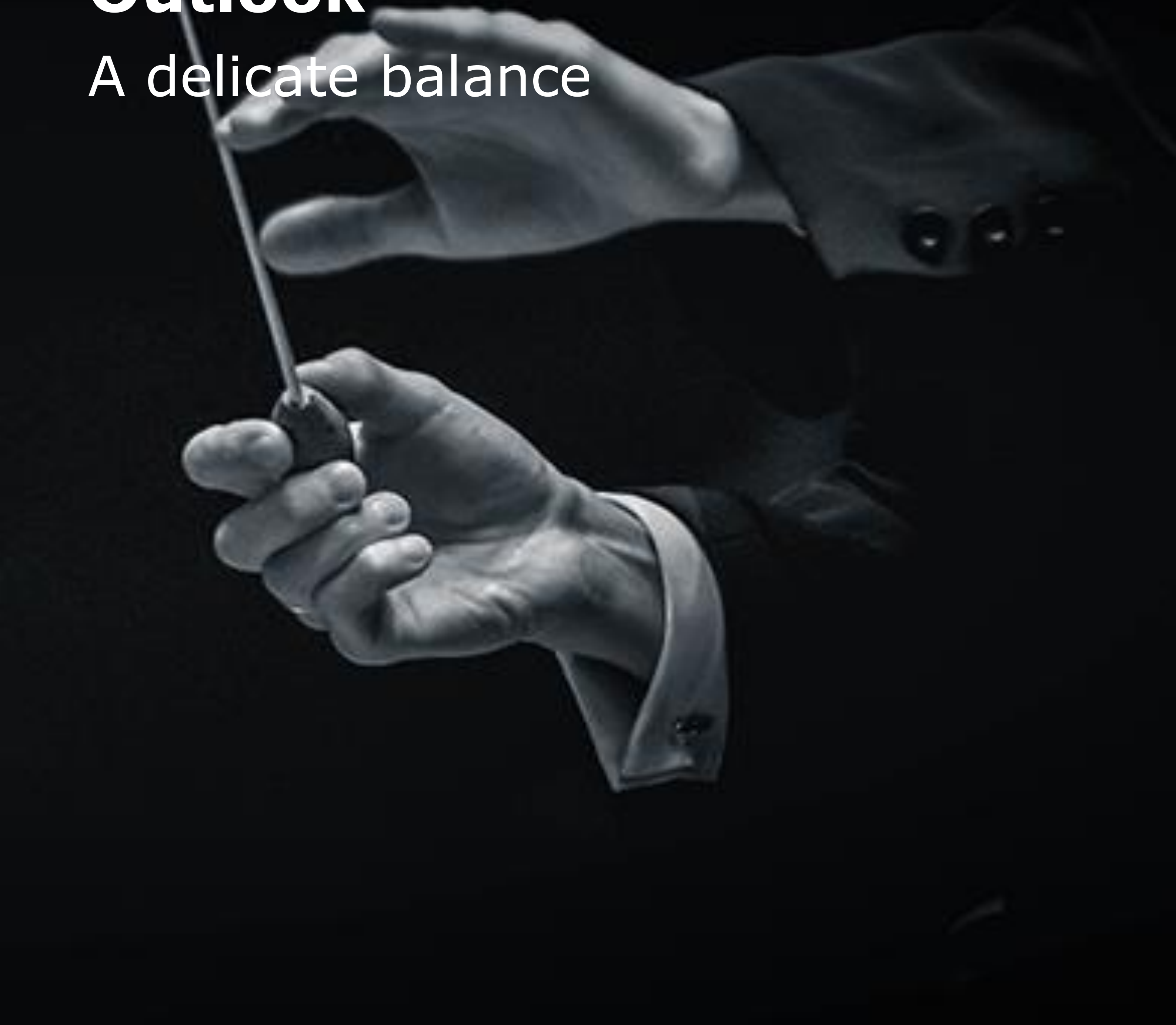
Quarterly Economic Outlook

A delicate balance



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Balancing the outlook

Although the New Zealand economy has been relatively resilient through the COVID-19 crisis so far, the outlook remains highly uncertain. The downturn is still getting underway, and there is noise in the data and much still to be learned about the true state of the economy. Weighing up the outlook in the face of this uncertainty is a challenge for policy makers, businesses and households alike. But although much is unknown, there are some key features that will shape the outlook. Click here for more.

Risks and policymaking

We present four alternative scenarios to demonstrate just how uncertain the outlook is. But here's the kicker: we're not going to know with certainty what state of the world we are in before the RBNZ introduces a Funding for Lending Programme (FLP) and implements a negative OCR. Acting swiftly with fiscal and monetary policy has absolutely been the right approach, but the response is now set to become more complex. Policymakers must still take into account a weak outlook and downside risks that are enormous, but stimulus *ad infinitum* is not feasible. Click here for more.

Finely balancing fiscal policy

An extraordinary amount of fiscal support has been unleashed that has effectively limited the impacts of lockdown. While needing to manage ongoing health risks, the Government should now also be preparing to facilitate the economic recovery. No matter how much the Government spends, there will be no recovery until momentum in the private sector changes direction. Policies to encourage households to spend and businesses to invest and hire are needed. But policy makers also need to keep an eye on the long term and the growing debt burden, aiming to ensure swift recovery and lift productive capacity. It's not easy; a delicate balance is required. Click here for more.

An evolution in monetary policy

The monetary policy toolkit is evolving, with a Funding for Lending Programme expected in November and the OCR set to go negative in April next year. Given the employment and inflation outlook compared with the RBNZ's targets, the case for more monetary stimulus remains clear, and exactly how this plays out is captivating markets. But the combo of tools will be a balance and over time policy is set to become more nuanced. Click here for more.

Calendar Years	2017	2018	2019	2020(f)	2021(f)	2022(f)
New Zealand Economy						
Real GDP (annual average % change)	3.1	3.2	2.3	-4.8	3.1	4.0
Real GDP (annual % change)	3.3	3.3	1.8	-2.4	0.8	4.6
Unemployment Rate (Dec quarter)	4.5	4.4	4.1	6.2	7.5	5.7
CPI Inflation (annual %)	1.6	1.9	1.9	1.2	1.1	1.5
Terms of Trade (OTI basis; annual %)	7.9	-4.8	7.1	-3.1	-3.6	3.1
Current Account Balance (% of GDP)	-3.0	-4.3	-3.4	-1.7	-3.2	-2.8
NZ Financial Markets (end of Dec quarter)						
TWI	74.4	73.4	73.7	69.7	70.4	
NZD/USD	0.71	0.67	0.67	0.65	0.65	
NZD/AUD	0.91	0.95	0.96	0.89	0.87	
Official Cash Rate	1.75	1.75	1.00	0.25	-0.25	
10-year Bond Rate	2.72	2.37	1.65	0.30	0.50	

Source: Statistics NZ, Bloomberg, ANZ Research

Balancing the outlook

Summary

Although the New Zealand economy has been relatively resilient through the COVID-19 crisis so far, the outlook remains highly uncertain. The downturn is still getting underway, and there is noise in the data and much still to be learned about the true state of the economy. Weighing up the outlook in the face of this uncertainty is a challenge for policy makers, businesses and households alike. But although much is unknown, there are some key features that will shape the outlook.

1. The global environment will be challenging, but New Zealand is relatively well placed.
2. More difficult times lie ahead as recessionary impacts are felt, especially with the border closed.
3. Households will be a bit more cautious about spending and debt, especially as job losses mount.
4. Business investment will be slow to improve, especially in the face of lingering uncertainty.
5. Fiscal and monetary policy will provide a cushion, but fully offsetting the economic impact isn't feasible.

Relatively resilient but path ahead uncertain

The New Zealand economy has weathered the COVID-19 crisis well to date. In part that reflects the elimination of the virus, and the temporary support provided by the likes of the wage subsidy. But separate from that, businesses and households have been getting on with it, with spending and activity bouncing sharply out of lockdown.

The current downturn will be characterised by a number of phases, though. Thus far, we have weathered the disruption well, but there's more to come that will test the resilience that we have seen to date. Underlying momentum in the economy is unclear and data will remain noisy for a while yet. Add to that a wide spectrum of risks that could buffet the outlook and the path ahead is highly uncertain.

Weighing up the outlook in the face of this uncertainty is a difficult but important challenge. But while much is unknown, a number of key themes are expected to shape the path ahead and these are explored further in this chapter. Our central projection balances a number of risks, but there are wide bounds of uncertainty around any set of forecasts at present. Chapter 2 weighs up how the outlook could play out differently.

ANZ Baseline Forecast – October 2020

- GDP enters 2021 3½% below pre-crisis levels.
- Recovery takes until mid-2022.
- Unemployment peaks at 7½%.
- Inflation weak through 2021.
- Negative OCR is on the way.

See **Forecast Tables** for more.

Global environment difficult, NZ well placed

The COVID-19 pandemic is an enormous global challenge. Policy has been supportive to the extent it can be, but while the wait for a vaccine continues, the outlook remains difficult, with social distancing and renewed lockdowns prevalent.

New Zealand has been fortunate to avoid the same persistent economic impacts seen in other countries, but the effects of the global slowdown and closed border are still very real. As a small open economy, we are affected significantly by global developments, especially via export demand.

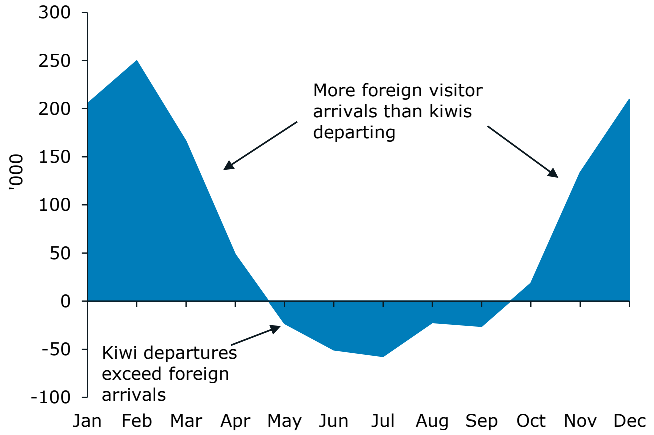
For goods exports, demand for what we produce has held up, but the outlook ahead will be more challenging and the elevated exchange rate has dampened returns for our primary producers. Nonetheless, we are relatively fortunate. Even in a global downturn, New Zealand remains well placed to feed the world. See our latest ANZ Agri Focus for more.

Challenges ahead, closed border will weigh

On the services exports side, conditions are significantly more challenging and expected to become more difficult. Education exports are already seeing a significant gap. For tourism, a captive domestic audience has been enough to cushion the blow during the winter months, but the test will come during summer, when international tourists would usually provide a significant impulse to accommodation, retail, hospitality and other services industries. Kiwis' ability to travel will remain crimped and that will support tourism-exposed industries, but the offset will not be enough (figure 1).

New Zealand is very exposed to international tourism, and with a closed border our economy is ultimately a smaller one – probably around 5% smaller – even if that has not become fully evident yet due to seasonality. As a consequence, we can expect to see less national income and spending for a time. We assume that the border does not open until early 2022, which will be a boon for the industry at that time, given pent-up demand, even if spending power of tourists may be weaker than otherwise. But for some in the industry, that will be too long to wait.

Figure 1. Seasonal tourism impacts



Source: Stats NZ, ANZ Research

A closed border also affects our ability to source skilled labour. For some who lose their jobs, this may mean fewer competitors in the job market. But for firms, this may make hiring even more difficult, especially since in some areas there will be more of a skills mismatch between labour required versus available. This could see pockets of wage pressure emerge, but also has the potential to weigh on economic activity. Inflation is expected to be weak, with demand lacking and firms not using all their production capacity. And yet, there will likely also be some pockets of cost pressure in an environment where price increases are difficult to pass through, impacting margins.

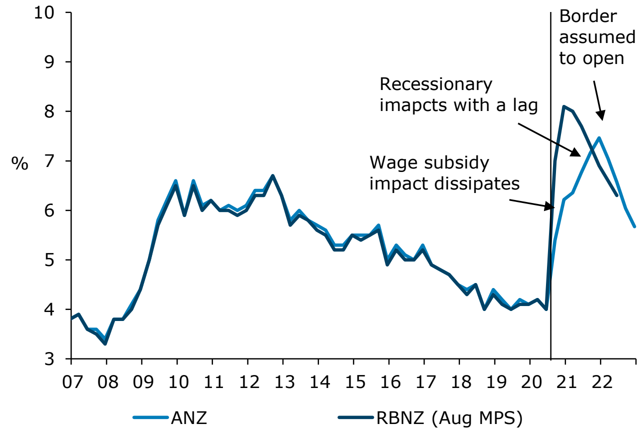
Fewer migrants also means weaker growth in household spending and demand for housing, though this may take time to flow through and the housing outlook will be affected by offsetting forces. For now, the housing market remains supported and building activity strong, supporting construction and related industries. But the housing market faces challenges ahead, especially as job losses mount, and the asset price cycle could turn. We expect some wobbles to emerge next year.

Households will be cautious as job losses rise

Job losses are expected to rise as closed border impacts start to bite and fiscal policy supports from the likes of the wage subsidy roll off. Firms' reluctance to hire will become more entrenched as weak demand becomes clearer. Wage costs will also be a relevant consideration, especially in tourism-exposed industries like retail and hospitality, with the minimum wage set to rise further.

For households, worsening job security is expected to weigh on spending, with households already a bit cautious about making major purchases. We expect a theme of household wariness to remain evident, if not intensify, with households looking to shore up their financial positions and save more, particularly if there is any weakening in the housing market.

Figure 2. ANZ unemployment forecast



Source: Stats NZ, RBNZ, ANZ Research.

Investment sluggish, uncertainty to linger

For businesses, there are significant reasons to be cautious, with the threat of renewed restrictions ever-present and the broader outlook highly uncertain. Although it has been encouraging to see business sentiment improve in this environment, we expect firms to be reluctant to expand and invest, and in some cases employ, for a while yet.

The RBNZ have taken significant steps to make financial conditions accommodative, but an eventual recovery in investment will require a confident business sector, a recovery in demand, and an outlook that is more assured. There are reasons to be positive about the outlook as we start on the journey towards recovery in advance of many other countries and with progress being made towards an eventual vaccine. But we remain of the view that although the path may be bumpy, on the whole the recovery will be slow.

Policy to provide an offset, but only partial

Policymakers have responded aggressively, globally and in New Zealand, to cushion the blow of the crisis – and stimulus is expected to continue, stemming the extent of the downturn.

But it is not possible to pump the economy indefinitely, target stimulus with precision, or offset all the impacts – and policymakers must consider the spectrum of risks. Chapter 2 discusses these risks and implications for policy. Chapter 3 considers the fiscal outlook and economic impacts. Chapter 4 considers the response of monetary policy and the outlook for markets.

Risks and policy making

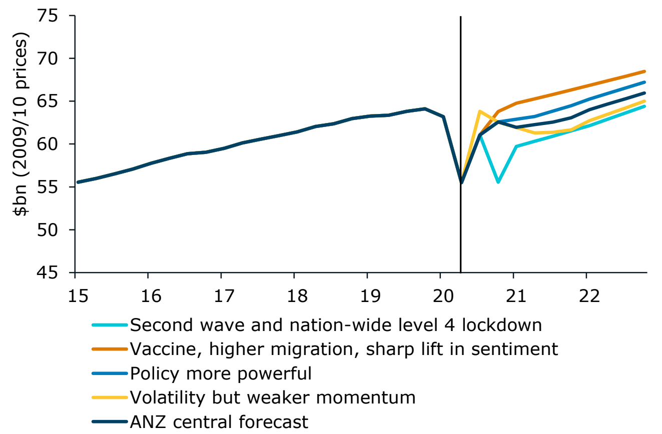
Summary

We present four alternative scenarios to demonstrate just how uncertain the outlook is. But here's the kicker: we're not going to know with certainty what state of the world we are in before the RBNZ introduces a Funding for Lending Programme (FLP) and implements a negative OCR. Acting swiftly with fiscal and monetary policy has absolutely been the right approach, but the response is now set to become more complex. Policymakers must still take into account a weak outlook and downside risks that are enormous, but stimulus *ad infinitum* is not feasible.

Many possible states of the world…

The outlook remains highly uncertain. Last quarter we presented four alternative scenarios to demonstrate the degree of uncertainty around our central outlook (figure 1). While only illustrative, these scenarios help us get a feel for the balance of risks. The common theme across them is that upside is limited and will remain that way until virus risks are contained.

Figure 1. Central GDP forecast and alternative scenarios



Source: Statistics NZ, ANZ Research

Broadly speaking we don't have a lot more certainty around the medium-term outlook than we did three months ago. And unfortunately, lockdown-induced volatility will be a key feature of the data for the remainder of 2020. Even though the Q2 contraction in GDP (-12% q/q) was smaller than our initial forecasts, the magnitude was still surreal to behold. Q3 GDP is the next cab off the rank – and is expected to show a very sharp (but partial) rebound. And yet this may not be representative of the state of economic momentum. Noise in the data is not going to settle down until 2021 (assuming we manage to avoid further lockdowns).

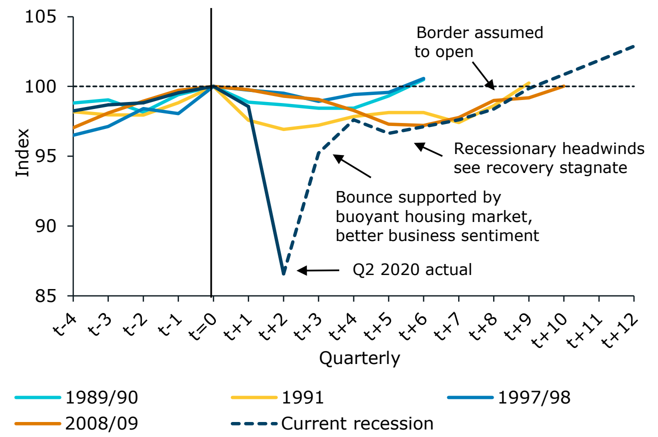
…but policy implications are binary, mostly

It is true that the outlook is now looking less dire than forecasters were assuming when the COVID shock was in its infancy. But we're still staring down the barrel of an economic shock that's likely to leave a hole in NZ GDP around twice that left by the Global Financial Crisis (Figure 2). Given this, it makes perfect sense that the Government and RBNZ have adopted accommodative polices towards the extreme end, at least initially.

But at some point that same uncertainty means that the RBNZ will need to make a judgement about when to stop and pause. We think the RBNZ will maintain their "least regrets" approach and take the OCR negative when they have a little more clarity that recessionary impacts are becoming evident. We think the hurdle to do more will be met in April next year. But the RBNZ will not put pedal to the medal *ad infinitum*, and we think they will pause after a drop in the OCR of 50bps to see how the economy tracks from there. See Chapter 4 for more.

For fiscal policy, those same "least regrets" considerations necessitated an aggressive stimulatory response through the likes of the wage subsidy. But the Government faces financial constraints, so must pivot to providing policy that is more targeted. Though clearly more is needed, it's not always about getting out the chequebook. See Chapter 3.

Figure 2. GDP index – current vs historical recessions



Source: Statistics NZ, ANZ Research

A question of timing

So when will we know if the RBNZ and Government have done enough? Unfortunately, we won't know with certainty what state of the world we are in until after the Reserve Bank has implemented the FLP and taken the OCR negative. We'll continue to keep a very close eye on the data and adjust our forecasts as signal changes. But the lost summer of international tourism, expiring temporary income relief, and cautious businesses and households is setting 2021 up to be a tough year. Macro-policy will need to remain highly accommodative for a while yet.

Finely balancing fiscal policy

Summary

An extraordinary amount of fiscal support has been unleashed that has effectively limited the impacts of lockdown. While needing to manage ongoing health risks, the Government should now also be preparing to facilitate the economic recovery. No matter how much the Government spends, there will be no recovery until momentum in the private sector changes direction. Policies to encourage households to spend and businesses to invest and hire are needed. But policy makers also need to keep an eye on the long term and the growing debt burden, aiming to ensure swift recovery and lift productive capacity. It's not easy; a delicate balance is required.

Damage control

The lion's share of Government spending in the COVID-19 crisis so far has been about limiting the damage brought about by lockdown measures. Top of the list here is the $14bn wage subsidy, which supported incomes while both production and expenditure declined sharply. From a nominal expenditure perspective, wage subsidy payments were worth around 9% of total GDP in the first half of the year – that's huge!

Indeed, it looks like this very significant cash injection from the Government (aka future tax payers and Government service recipients) to businesses and households made a material difference in terms of holding up economic momentum on the other side of lockdown (as reflected in the vigorous rebound in spending and broader activity). However, ongoing caution on the part of businesses and households suggests further job losses are in the pipeline. Clearly, had it not been for the wage subsidy, things could have been much worse.

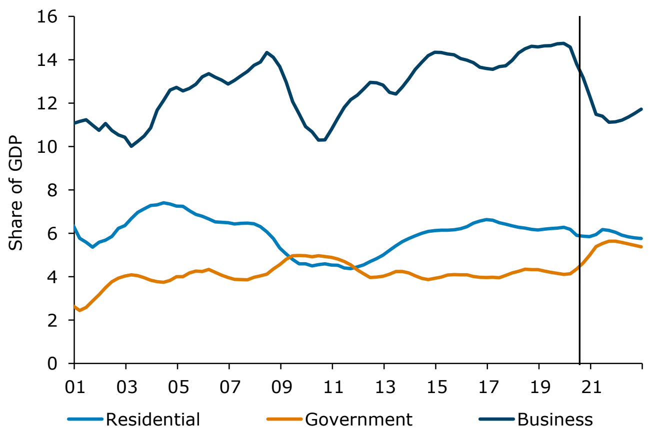
Unfortunately, we will never know with any precision how many jobs were actually saved by the wage subsidy compared with how many job losses it merely deferred. But it's certainly been effective at leaning against the initial impact of lockdown. Now, we are watching labour market indicators to see if the pace of deterioration accelerates as the economy is weaned off this fiscally unsustainable temporary support. We expect it will to some extent.

Overall, the near-term fiscal response to this crisis goes a long way towards explaining why many in the economy have weathered lockdown measures relatively well. But lockdowns are just the beginning of this crisis, and private sector momentum has clearly already turned south. Turning this around must be the next focus for fiscal policy.

Shifting to the next phase of fiscal stimulus

Now, with virus risks managed (touch wood), the focus needs to turn towards facilitating the eventual recovery. And it will need to go a lot further than the Government lifting its infrastructure spending game. Government investment spending as a share of GDP (figure 1) is important, but it isn't enough to turn the tide of the economic cycle on its own. It will help create a few thousand jobs in the near term, have broader "second round" effects, and support the productive capacity of the economy over the medium term. But it can't turn the tide on its own; it needs to be supplemented by policies that encourage private businesses to hire and invest. It's those decisions that are really going to determine how the economic recovery plays out.

Figure 1. Investment share of GDP



Source: Stats NZ, RBNZ, ANZ Research

What the recovery is really waiting on is for businesses to start investing and adding to headcount once again, and for households to start spending a little more freely – a difficult feat with virus risks still ever-present.

But that doesn't mean policy makers should just be waiting for the shake-out to run its course and for risks to disappear. Rather, they should be thinking very hard about the optimal suite of policies that will encourage spending, hiring and investment. And it needs to be done in a way that is effective and doesn't see Government debt explode. That's where the "timely, targeted, and temporary" fiscal policy mantra comes in.

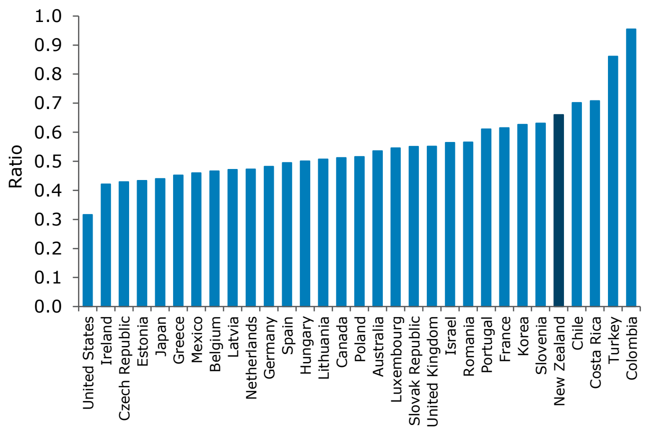
When it comes to keeping the fiscal response affordable, one should never underestimate the power of regulatory policies. Starting afresh with the Resource Management Act is a great start, and could help the construction sector get moving.

But worryingly, the Government's intention to lift the minimum wage further next year is going to deter some hiring in such an uncertain business environment. Sure, the flexi-wage subsidy will provide some offset and those who keep their job will be better off, but the net impact on activity (and therefore, ultimately, incomes) is expected to be negative. There is no question that this particular economic shock is unfortunately hitting lower-income earners disproportionately hard. This means that fiscal policy has a very important role to play to even things out. But we think a better policy mix to achieve important wellbeing aims would be to use tax and transfers to boost incomes at the lower end of the wage spectrum, while limiting wage costs to businesses in order to encourage firms to create the most possible jobs.

To put some numbers around this, MBIE estimates that the last increase in the minimum wage in April cost 6,500 jobs. But given how vulnerable and uncertain businesses are at present, the 2021 increase is likely to be even more costly. Some of the industries that have been hardest hit by this crisis (retail, and accommodation and food services) are also highly exposed to the minimum wage. And the minimum wage rise has the potential to hurt marginal would-be workers (eg younger new entrants into the labour market) in particular.

While it is intuitive to think of the minimum wage in absolute terms, ie what it is fair that an hour's work should buy, relativities matter a lot in practice. Data for 2019 (figure 2) show that out of OECD countries, New Zealand had the fifth-highest minimum wage relative to the median wage (after Colombia, Turkey, Costa Rica, and Chile).

Figure 2. Minimum relative to median wage



Source: OECD

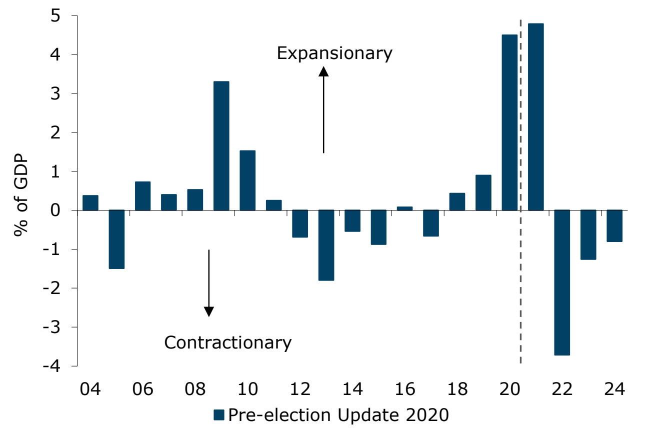
And it's been at the higher end of the spectrum for quite some time. If the answer to New Zealand's low-wage, low-productivity economy is a higher regulated minimum wage, one would have hoped to have seen some benefits by now. And that argument, that higher wages will drive productivity, relies on firms being prompted to choose productivity-enhancing capital over labour at the margin. That's fine and dandy in a strongly growing economy, but has nasty consequences for employment in a slowing one. That's why it's important that minimum wage raises take into account economic conditions at the time.

The more restrictive labour market settings are during times of crisis, the longer it will take for businesses to start hiring again, and the slower the economic recovery will be, which is bad news for workers in aggregate. Minimum wage rises at a time many firms can't afford them risk ending up with permanently higher unemployment and poorer social outcomes than otherwise. Policy naturally has a bias to protect incumbents (firms or workers), as jobs never created and firms never started aren't measured, and will always remain the subject of conjecture. But that doesn't mean the impacts aren't real.

Fiscal stimulus can't pick up the slack forever

Despite the fact that the policy mix could be tweaked to better facilitate the recovery, overall fiscal settings are unquestionably extremely stimulatory. But unless we're happy to accept widening deficits and exploding Government debt, the direct impetus to economic growth can't go on forever. In fact, the Treasury's pre-election estimates of the fiscal impulse show that from the year to June 2022 fiscal settings are going to flip into contractionary territory (figure 3).

Figure 3. Fiscal impulse



Source: The Treasury

Now that's not to say that the fiscal stance won't still be supporting the *level* of activity come 2022 – it most certainly will. But is does show that when it comes to the contribution to economic *growth*, the direct impact of discretionary fiscal policy is going to take a back seat – it has to. That said, as is typical with government spending, we expect delays to see this near-term stimulus pushed out a touch, suggesting a smaller but longer-lasting positive impulse.

Finely balancing fiscal policy

The Government (and the Treasury) are always quick to point out that the fiscal impulse doesn't account for second-round impacts (ie fiscal multipliers). But in times of crisis it does offer some useful insight when it comes to the following question: Will the private sector will be in a position to take the reins of growth before 2022? The answer to this question will depend heavily on virus developments, but based on our forecast assumption that New Zealand will be able to remove border restrictions from Q1 2022, the timing fits with our outlook. But this is just an assumption that could go either way.

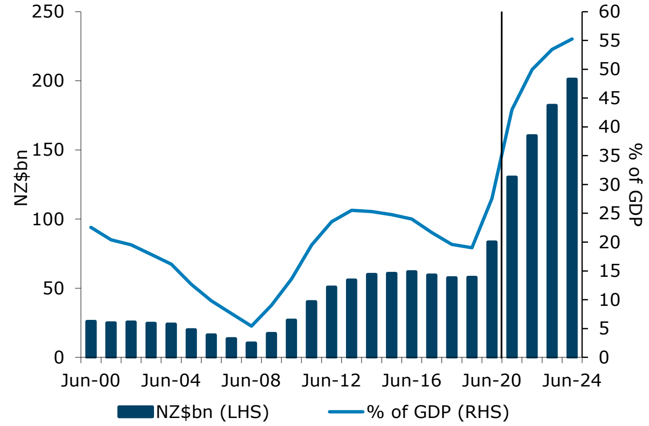
A growing burden yet to be carried

Taking a longer-run perspective, policy makers have a lot of work to do. Pushing the government spend up too far (towards low-value spending) could end up creating more problems for those younger people who will not only have to pay for all of this government borrowing (either though lower-than-otherwise government services or higher taxes), but also have to save for their own retirement, pay for the retirement of the generations ahead of them, pay hand over fist to buy a home, and deal with the fallout of climate change.

Intergenerational inequality is worsening right in front of our eyes, alongside the widening wealth divide. The best thing policy makers can do right now is pursue a suite of policies that support a swift economic recovery while boosting the productive capacity of the economy over the medium term.

Among other things, productivity is boosted by investment in infrastructure and education (particularly in early childhood education where the academic divide begins – the Free and Healthy School Lunch programme is an amazing start!), capital deepening within private industry, and a business landscape that encourages a little risk taking and R&D. Deploying more policy resource to NZ's dismal productivity performance could go a long way in boosting future economic activity, growing incomes sustainably, and growing our way out of the debt position (figure 4). And the sooner the debt ratio is brought back to "prudent levels" the better positioned New Zealand will be to respond to the next, inevitable crisis.

Figure 4. Net core Crown debt



Source: The Treasury

An evolution in monetary policy

Summary

The monetary policy toolkit is evolving, with a Funding for Lending Programme (FLP) expected in November and the OCR set to go negative in April next year. Given the employment and inflation outlook compared with the RBNZ's targets, the case for more monetary stimulus remains clear, and exactly how this plays out is captivating markets. But the combo of tools will be a balance and over time policy is set to become more nuanced.

Pedal-to-the-medal time

Since the onset of the COVID-19 crisis, the case for aggressive monetary stimulus has been clear. Over the medium term, the outlook is for inflation to be too low and unemployment too high. And given downside risks, the RBNZ has repeatedly said that too much stimulus is better than too little. In recent communication, there is nothing to suggest that this view has changed.

Stimulus cannot continue in perpetuity and at some point the RBNZ will need to take stock and pause, considering the case for stimulus and the optimal balance of tools a bit more carefully – especially as new tools take us deeper into uncharted territory. We are not yet there though. Given the challenging outlook ahead (Chapter 1) and downside risks (Chapter 2), the case for more stimulus in the near term remains clear, if the RBNZ is to have a realistic shot at hitting its inflation and employment targets. But eventually the RBNZ will need to pause and take stock.

Funding for Lending (FLP) on the way

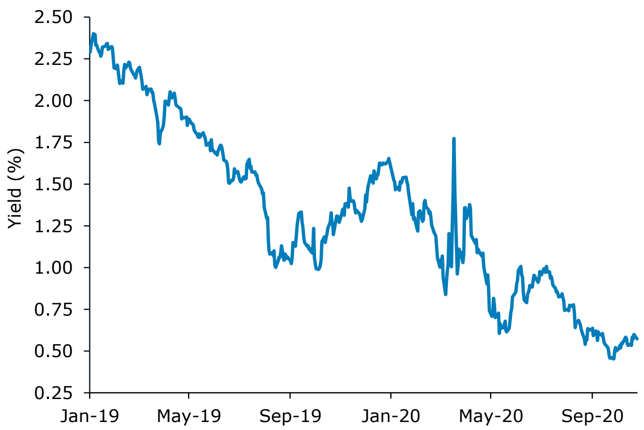
The RBNZ has signalled that a Funding for Lending Programme is the next cab off the rank for monetary stimulus. We expect that one will be announced (along with all relevant details) at the November Monetary Policy Statement (MPS), with implementation soon after.

Essentially, the FLP would provide cheap funding to the banks in order to provide the headroom for them to lower retail interest rates further. See our recent insight and previous FAQ on a negative OCR and FLP for more on how this would work.

This new addition to the toolkit represents a concerted effort by the RBNZ to have a more targeted impact on retail interest rates directly. The FLP would complement the continuing Large-Scale Asset Purchases (LSAP) programme that has seen a significant easing in wholesale long-term interest rates (figure 1) but which has had less of an impact on retail interest rates, the determinants of which are more complex.

The degree of traction the FLP achieves on retail rates will be its measure of success. To generate maximum impact, we expect the FLP will be quite large – perhaps in the order of $30-50bn.

Figure 1. NZ 10-year Government Bond Yield



Source: Bloomberg, ANZ Research

LSAP still a cornerstone for markets

The FLP and LSAP will be complementary, with the LSAP expected to remain part of the monetary policy landscape for a long time. While the FLP will provide additional stimulus, taking pressure off the LSAP somewhat, we do not expect that the RBNZ will back away from the LSAP in any meaningful way. Continued purchases under the LSAP will remain a cornerstone for wholesale markets (see our FAQs here and here).

Nonetheless, with an FLP of significant magnitude now expected and forecast bond supply reduced at the PREFU, the case to expand the LSAP limit no longer adds up. We now think that the LSAP limit will remain at $100bn, rather than be increased further. Given the outlook for bond issuance, LSAP purchases are still likely to exceed issuance going forward, keeping NZGB yields capped and seeing local wholesale rate curves remain low and flat more broadly.

It will be a challenge to see longer-term rates move meaningfully lower from here, but we think there is a little bit further to run with more stimulus on the way, including a negative OCR. We see 10-year yields bottoming out at about 0.3% by year end. That's not far from levels prevailing at the end of October. And importantly, with policy set to remain easy for a considerable period, equally we don't expect yields to rise for a long time either. Instead, we expect a prolonged period of low long-term interest rates.

An evolution in monetary policy

Finessing the combination of tools

With the FLP being added to the toolkit, the RBNZ will have to think more over time about how its tools are working in combination. The FLP and the LSAP are essentially retail and wholesale facets of the same strategy, but the effectiveness of the FLP is unknown – and will be largely bank-led. Uncertainty about the impacts of the FLP introduces more that the RBNZ must weigh up when considering the outlook for policy and the required combination of tools for the job.

All things considered, we expect that the RBNZ will deem it necessary to take the OCR negative in April next year, given the very challenging outlook for both the labour market and inflation. Our forecast is for the OCR to be dropped by 50bps to -0.25%, with the RBNZ pausing to consider its effects thereafter.

In terms of risks around this outlook, if the FLP is very effective, then that could reduce pressure on the RBNZ to take the OCR lower, at least in the short term, increasing the odds of a slightly later or more gradual implementation. On the other hand, with economic risks skewed firmly to the downside, there is the possibility that more stimulus is deployed, and quickly.

The outlook for the OCR to go lower will drive short-end rates, particularly on implementation. But ambiguity about whether the RBNZ might renege on its forward guidance following comments from Governor Orr that the RBNZ might move in February is seeing the short end struggle to find an anchor. Currently, we are seeing OIS markets price in more than even odds of a February OCR cut. And while we remain firmly of the view that the RBNZ will stick to its commitment not to cut the OCR before mid-March, there is scope for short-term rates to ebb and flow in the meantime.

NZD in the balance

For NZD the outlook for the OCR to go lower will provide downward pressure, but continued policy easing around the world is providing some offset. And although we think that a move to a negative OCR will have a meaningful (but not disorderly) impact on currency markets, that is being weighed squarely against the fact that New Zealand is well placed relative to others, reflecting containment of COVID-19, the openness of our economy, and elevated commodity prices.

These offsetting forces should see the NZD remain near current levels over the forecast horizon. That’s not to say that we think the exchange rate will literally be flat, but that it is more likely to ebb and flow near current levels than trend in a sustained way. But of course, like everything at the moment, the outlook is delicately balanced.

Table 1: Forecasts (end of quarter)

FX Rates	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
NZD/USD	0.65	0.65	0.65	0.65	0.65	0.65	0.65
NZD/AUD	0.89	0.87	0.87	0.87	0.87	0.87	0.87
NZD/EUR	0.54	0.54	0.55	0.55	0.57	0.57	0.57
NZD/JPY	69.6	69.6	69.6	69.6	69.6	69.6	69.6
NZD/GBP	0.51	0.52	0.53	0.53	0.52	0.52	0.52
NZD/CNY	4.45	4.43	4.41	4.37	4.37	4.37	4.37
NZ$ TWI	69.7	69.5	69.9	70.0	70.4	70.4	70.4
Interest Rates	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
NZ OCR	0.25	0.25	-0.25	-0.25	-0.25	-0.25	-0.25
NZ 90 day bill	0.25	-0.08	-0.25	-0.25	-0.25	-0.25	-0.25
NZ 2-yr swap	-0.04	-0.18	-0.19	-0.16	-0.13	-0.13	-0.13
NZ 10-yr bond	0.30	0.30	0.30	0.40	0.50	0.50	0.50

Source: Bloomberg, ANZ Research

Key economic forecasts

Calendar Years	2016	2017	2018	2019	2020(f)	2021(f)	2022(f)
NZ Economy (annual average % change)							
Real GDP (production)	3.9	3.1	3.2	2.3	-4.8	3.1	4.0
Private Consumption	5.8	5.3	3.3	2.9	-3.8	2.7	4.3
Public Consumption	2.1	2.9	3.7	4.3	6.5	4.0	-0.7
Residential investment	11.2	-0.8	0.1	4.3	-9.9	6.9	-1.4
Other investment	0.9	7.2	7.7	1.9	-11.2	0.1	5.6
Stockbuilding[1]	0.1	0.2	0.3	-0.7	-0.5	0.7	0.0
Gross National Expenditure	4.6	5.1	4.2	2.2	-4.1	3.9	3.3
Total Exports	2.4	2.5	2.8	2.3	-11.9	4.2	11.5
Total Imports	3.8	7.3	6.5	2.2	-15.2	6.3	10.0
Employment (annual %)	6.0	3.6	2.2	1.2	-0.3	-0.5	3.2
Unemployment Rate (sa; Dec qtr)	5.3	4.5	4.4	4.1	6.2	7.5	5.7
Labour Cost Index (annual %)	1.6	1.9	2.0	2.4	1.6	2.1	1.6
Terms of trade (OTI basis; annual %)	6.7	7.9	-4.8	7.1	-3.1	-3.6	3.1
Current Account Balance (sa, $bn)	-5.9	-8.4	-12.6	-10.5	-5.1	-10.1	-9.3
as % of GDP	-2.2	-3.0	-4.3	-3.4	-1.7	-3.2	-2.8
Prices (annual % change)							
CPI Inflation	1.3	1.6	1.9	1.9	1.2	1.1	1.5
Non-tradable Inflation	2.4	2.5	2.7	3.1	2.6	2.0	2.4
Tradable Inflation	-0.1	0.5	0.9	0.1	-0.6	-0.3	0.1
REINZ House Price Index	14.4	3.5	3.3	5.3	9.0	-0.6	4.1
NZ Financial Markets (end of December quarter)							
TWI	77.7	74.4	73.4	73.7	69.7	70.4	
NZD/USD	0.69	0.71	0.67	0.67	0.65	0.65	
NZD/AUD	0.96	0.91	0.95	0.96	0.89	0.87	
NZD/CNY	4.81	4.62	4.62	4.69	4.45	4.37	
NZD/EUR	0.66	0.59	0.59	0.60	0.54	0.57	
NZD/JPY	81.1	80.0	73.8	73.1	69.6	69.6	
NZD/GBP	0.56	0.53	0.53	0.51	0.51	0.52	
Official Cash Rate	1.75	1.75	1.75	1.00	0.25	-0.25	
90-day bank bill rate	2.00	1.88	1.97	1.29	0.25	-0.25	
2-year swap rate	2.46	2.21	1.97	1.26	-0.04	-0.13	
10-year government bond rate	3.33	2.72	2.37	1.65	0.30	0.50	

[1] Percentage point contribution to growth

Forecasts finalised 27 October 2020

Source: Statistics NZ, REINZ, Bloomberg, Treasury, ANZ Research

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