Watch this space

Bottom line

- As universally expected RBNZ left the OCR unchanged at 1.0% today, noting that “monetary policy has time to adjust if needed” to negative impacts of the devastating COVID-19 outbreak in China.

- The forecast OCR track was revised higher, with no cuts in the near term projections and a higher end point. The COVID-19 outbreak is considered “an emerging downside risk” but the RBNZ “assume the overall economic impact... in New Zealand will be of a short duration.” We’re assuming something a little larger, though also short-lived, but we are increasingly nervous.

- We are not currently forecasting any further OCR cuts, but all economic forecasts have a short shelf life at present. It’s a fast-moving situation and the RBNZ will respond as they see appropriate.

Key points

The RBNZ today left the OCR unchanged at 1.0%, while leaving the door open to further action if required. The market had not expected a move today, but the RBNZ did strike a more sanguine tone than expected, seeing the NZD and short-term yields spike higher. The tone at the Q&A at 3pm may well also engender a market response. The RBNZ will be taking questions via twitter.

As expected, the RBNZ revised down its near-term growth forecast on coronavirus disruptions but remains optimistic on the medium-term outlook, anticipating a pick-up in growth in the second half of the year. The OCR track was revised 10-18pts higher, with the current upward momentum in the economy taken to mean that monetary policy has the luxury of “time to adjust if needed as more information becomes available.”

The RBNZ’s take on the near-term impact of the COVID-19 outbreak is milder than our own, with Q1 growth a little lower than was forecast in the November MPS but Q2 growth a touch stronger, reflecting the assumption that the impacts will be very short-lived. We suspect the impact will last well into Q2 at least, but it’s fair to say that all estimates are highly uncertain and will be under constant review.

Beyond the estimated virus impact, our core macro view is similar to that of the RBNZ, though we see greater downside risks from emerging bank balance sheet pressures caused by declining deposit growth and soaring mortgage demand. This could squeeze credit availability, particularly to the productive sector. We remain less optimistic about the outlook for business investment, particularly now this new, significant uncertainty has presented itself.

Emerging drought conditions also present a medium-term growth risk. Normally, stock offloading in response to drought provides a near-term boost to GDP (at the cost of less output later), but with China port disruptions there are currently significant bottlenecks in the processing chain. The dynamics may therefore play out somewhat differently this time. We will be watching developments closely.
In terms of the data to watch from here, commodity prices are key, as are monthly trade statistics. We already know that tourist arrivals will be well down, with China accounting for 11% of arrivals, but we’ll be watching arrivals from other countries to gauge any broader impact on appetite for long-haul travel. And of course, we’ll be watching statistics about the outbreak itself as well as anecdotes of disruptions to New Zealand producers who have China as a part of their supply chains.

Details of the projections

The RBNZ expects 0.4% q/q GDP growth in Q4 (previously 0.6%), and have also trimmed their Q1 growth forecast to 0.4% (previously 0.7%). The latter reflects the initial impacts of COVID-19 (assuming there is no substantial outbreak in New Zealand and that the outbreak overseas is beginning to be contained by the end of the month). However, Q2 has been revised higher to 0.9% q/q (previously 0.7%) reflecting a rapid bounce back.

Annual growth is forecast to trough at 1.6% y/y in Q1 2020 and lift to 3.1% by Q4 2020. This forecast is more optimistic than our own (see charts page), due in part to differing views on the likely responsiveness of business investment to the current monetary stimulus. In our view, uncertainty and reduced availability of credit will curtail the investment response to lower rates. But COVID-19 threatens to swamp such forecast nuances.

The outlook for annual non-tradable inflation is a touch stronger over the latter forecast years, despite the RBNZ revising their estimate for potential GDP growth a little higher. Weaker tradable inflation provides a partial offset, meaning the headline inflation forecast is little changed from November. Headline inflation is expected lift to 2.2% in Q1 2020, but moderate to 1.7% by Q1 2021. Inflation is forecast to average 2% over the forecast horizon.

Risks

Naturally, COVID-19 was a key part of the risk discussion. It is expected to dampen Q1 GDP by 0.3% – a smaller and more short-lived impact than we are assuming (0.5%pts over H1) – with export prices expected to be 0.5% lower. The channels the RBNZ identifies are the same ones most forecasters are discussing: tourism and education exports, disrupted demand for exports (eg due to disruption at China’s ports), a hit to confidence impeding spending and investment, and financial market impacts. They did not mention implications if the supply of intermediate goods from China were to be significantly disrupted.

They note that a lower NZD would be an important offset to the economic impacts and that impacts would be broader if there were to be a substantial outbreak in New Zealand.

The RBNZ notes that estimating the economic impact of the outbreak is “extremely difficult” and that the impact will depend on how long the outbreak lasts, how widely it spreads, and how people respond. They said that the current implications for monetary policy are small because the impacts are assumed to be short-lived, and monetary policy acts over longer horizons. However, if the impacts looked likely to be more significant or persistent than assumed, then monetary policy implications could be larger.

They also noted some upside risks – greater government spending, a faster pace of wage growth and stronger consumption – along with both upside and downside risks to business investment. They also noted some of the challenges facing the rural sector: environmental policy, tighter credit conditions, and drought conditions. They did say that imports of services could be affected if fewer New Zealanders were to travel overseas, which would be a positive for GDP. They said the recent bank capital changes would dampen the outlook for the OCR, but that this was swamped by other positive developments since the
November MPS. They did not mention the emerging risks we see to credit availability in light of the slow pace of deposit growth, which could be an emerging headwind to growth.

Our take

After significant cuts to the OCR last year the Reserve Bank would have been feeling increasingly confident they had done enough, until the COVID-19 outbreak in China came along. Last year’s cuts have been working: business sentiment found a floor, wage pressure is lifting, the housing market is booming, and consumers think it’s a good time to spend. But there’s suddenly a big black cloud on the horizon, and no one can tell what economic weather it will bring.

The RBNZ has no more information than anyone else on how things will pan out from here. They could have chosen to cut the OCR today as an insurance move, similar to what they did in response to September 11, the SARS outbreak, and the Christchurch earthquake. The economic impacts were highly uncertain then too. But what’s different this time is that the RBNZ has very little conventional ammunition left. Every bullet must be used judiciously.

By 25 March, a very long six weeks away, we will all have a much better idea of both the near-term immediate impact, and the potential timeline and geographic spread of the epidemic. If it’s warranted, the RBNZ will cut the OCR. The OCR path they forecast today should not be seen as any kind of commitment in such a rapidly moving situation.

But it’s actually the exchange rate, rather than interest rates, that is the most important adjustment mechanism for this kind of global shock that hits exporters hardest. There’s no reason to think the NZD won’t do its job, and move broadly together with our commodity prices, wherever they may head. We tend to take the NZD for granted, and it can never please all the people all the time, but it’s an absolutely crucial adjustment mechanism, particularly when the OCR is nearing rock bottom.

Market reaction

The no-cut decision, removal of cuts from the OCR projections, higher end-point (the projection for Dec 2021 was lifted by +18bps) and stoic view of the potential impacts of COVID-19 have seen the NZD regain its composure, and will likely buoy sentiment near term. NZD rates have also moved higher and will remain under pressure over coming days. That said, while there is now a big gap between market expectations and the RBNZ’s new projections (around 15bps of cuts priced in by August vs the RBNZ’s no-change track), implying further upside risk, we doubt cuts will be fully priced out just yet given the developing nature of near-term virus-related risks.
Source: Statistics NZ, ANZ, RBNZ
The Monetary Policy Committee has decided to keep the Official Cash Rate (OCR) at 1.0 percent.

Employment is at or slightly above its maximum sustainable level while consumer price inflation is close to the 2 percent mid-point of our target range. Low interest rates remain necessary to keep employment and inflation around target.

Economic growth is expected to accelerate over the second half of 2020 driven by monetary and fiscal stimulus, and the high terms of trade. The outlook for government investment is stronger following the Government’s announcements in December. There are also indications household spending growth will increase.

However, soft momentum in economic growth has continued into early 2020. Slower global growth over 2019 acted as a headwind to domestic growth. In addition, competitive pressures and recent subdued business confidence have suppressed business investment.

The global economic environment has shown signs of stabilising and trade tensions have receded somewhat. However, the COVID-19 (coronavirus) outbreak is an emerging downside risk.

We assume the overall economic impact of the coronavirus outbreak in New Zealand will be of a short duration, with most of the impacts in the first half of 2020. Nevertheless, some sectors are being significantly affected. There is a risk that the impact will be larger and more persistent.

Monetary policy has time to adjust if needed as more information becomes available.
This document is intended for ANZ’s Institutional, Markets and Private Banking clients. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all Jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (ANZ); or its relevant subsidiary or branch (each, an Affiliate), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (recipients).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information. Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ’s policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (ANZ).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ’s Financial Services Guide please click here or request from your ANZ point of contact.

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

European Economic Area (EEA): United Kingdom. ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (PRA) and is subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of “eligible counterparty” or “professional client”. It is not intended for and must not be distributed to any person who would come within the FCA definition of “retail client”. Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (PRA) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.

Myanmar. This publication is intended to be general and part of ANZ’s customer service and marketing activities when implementing its functions as a licensed bank. This publication is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

New Zealand. This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008 (FAA).
Oman. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman’s Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the BOQ, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People’s Republic of China (PRC). This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Company Limited (ANZ China). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNV/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, nor be distributed within the PRC or constitutes circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

Qatar. This document has not been, and will not be:
• lodged with or registered, or reviewed or approved by, the Qatar Central Bank (QCB), the Qatar Financial Centre (QFC) Authority, QFC Regulatory Authority or any other governmental authority in the State of Qatar (Qatar); or
• authorised or licensed for distribution in Qatar, and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC Authority. The financial products or services described in this document have not been, and will not be:
• registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
• authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This document is distributed in Singapore by the Singapore branch of ANZ solely for the information of “accredited investors”, “expert investors” or (as the case may be) “institutional investors” (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser’s licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore.

United Arab Emirates (UAE). This document is distributed in the UAE or the Dubai International Financial Centre (DIFC) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCML) No. 12 of 2004; and (d) a financial product, as defined under the DIFCML No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (DFSA) and/or the Central Bank of the UAE. The financial products or services described in this document are only available to persons who qualify as “Professional Clients” or “Market Counterparty” in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office (ANZ Representative Office) in Abu Dhabi regulated by the Central Bank of the UAE. The ANZ Representative Office is not permitted by the Central Bank of the UAE to provide any banking services to clients other than the original recipient.

United States. Except where this is a FX- related document, this document is distributed in the United States by ANZ Securities, Inc. (ANZ SI) which is a member of the Financial Regulatory Authority (FINRA) (www.finra.org) and registered with the SEC. ANZSI’s address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only — not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as “US person” is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Where this is an FX-related document, it is distributed in the United States by ANZ’s New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163).

Vietnam. This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand, Ph 64-9-357 4094, e-mail nzecconomics@anz.com, http://www.anz.co.nz