ANZ Research

New Zealand Weekly Focus

2 March 2020

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Escalating rapidly

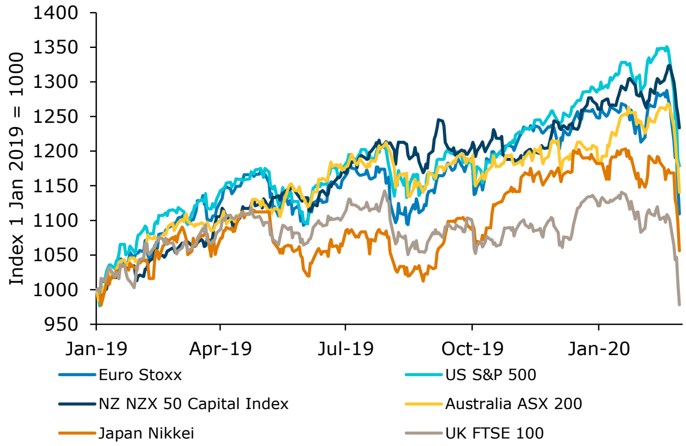
Economic overview

We now expect the RBNZ to cut the OCR 50bp in March and a further 25bp in May, taking the OCR to just 0.25%. The COVID-19 situation is evolving very rapidly, spreading fast outside China – including, now, in the US – and the virus is now present in New Zealand, although it appears to be isolated so far. A marked global slowdown is guaranteed, due to both demand and supply disruptions. Our forecasts assume New Zealand GDP stalls in the first half of the year, with a gradual recovery from there. But although New Zealand is better placed than many countries to weather this shock, we see clear risks of a larger slowdown or even recession. Fiscal policy will need to do the heavy lifting, but lowering the OCR will ease financial pressure, facilitate a lower NZD, aid confidence at the margin, and support the recovery.

Chart of the week

Financial markets have capitulated as the severity of the global shock has sunk in.

Global equity markets



Source: Bloomberg

The ANZ heatmap

Variable	View	Comment	Risks around our view
GDP	2.7% y/y for 2021 Q1	We expect a big COVID-19 dent to growth, with the persistence of the shock and outlook for the eventual recovery uncertain.	Neutral  Negative Positive
Unemployment rate	4.2% for 2021 Q1	The labour market is "tight" but a longer growth slowdown will have ramifications in time.	Neutral  Down (better) Up (worse)
OCR	0.25% in June 2020	We are now forecasting a 50bp cut in March and 25bp in May, taking the OCR to 0.25%.	Neutral  Down Up
CPI	1.9% y/y for 2021 Q1	Inflation is around where it needs to be, but the outlook is murkier as the economy navigates a complex combined demand and supply shock.	Neutral  Negative Positive

Economic overview

Summary

We now expect 75bp of OCR cuts. The impending global slowdown is becoming more concerning by the day.

We now expect the RBNZ to cut the OCR 50bp in March and a further 25bp in May, taking the OCR to just 0.25%. The COVID-19 situation is evolving very rapidly, spreading fast outside China – including, now, in the US – and the virus is now present in New Zealand, although it appears to be isolated so far. A marked global slowdown is guaranteed, due to both demand and supply disruptions. Our forecasts assume New Zealand GDP stalls in the first half of the year, with a gradual recovery from there. But although New Zealand is better placed than many countries to weather this shock, we see clear risks of a larger slowdown or even recession. Fiscal policy will need to do the heavy lifting, but lowering the OCR will ease financial pressure, facilitate a lower NZD, aid confidence at the margin, and support the recovery.

Forthcoming data

Terms of Trade – Q4 (Monday 2 March, 10:45am). The terms of trade are expected to lift slightly in Q4, but the outlook is for deterioration from there.

Provisional NZ trade with China – up to 23 February (Monday 2 March, 2pm). Statistics NZ will release provisional merchandise trade data today that will provide an initial snapshot of trade with China in the past four weeks, compared with the same period last year. While the data might not be perfect (it will be subject to revision), it will give us a useful steer on how goods exports and imports have been impacted by COVID-19 disruption. In the 12 months ended January, China took 28.3% of our goods exports and supplied 20.2% of our goods imports.

We will get some provisional trade data this week…

Building Consents – January (Wednesday 4 March, 10:45am). Construction is booming, but headwinds are in store. Expect elevated levels to remain, but there are downside risks, including from a potential shortage of building supplies.

GlobalDairyTrade auction (Wednesday 4 March, early am). Dairy demand is expected to be muted due to supply chain disruption within China and the large quantities of stock already in-market. Futures suggest a further fall.

…and dairy prices are expected to fall again.

ANZ Commodity Price Index – February (Wednesday 4 March, 1:00pm).

Work Put in Place – Q4 (Friday 6 March, 10:45am). We expect to see a modest lift in work overall (we're picking 0.4%), with a lift in residential activity, but a pull-back on the non-residential side.

Evolving rapidly

We now expect the RBNZ to cut the OCR 50bps in March and another 25bps in May, taking the OCR to 0.25%. The March OCR Review is only three weeks away, but things are not moving at anything like the normal macroeconomic pace. The COVID-19 situation is evolving rapidly, with the outbreak worsening significantly over the past week outside of China, in Asia, Europe and the US. People and businesses are being significantly affected globally, with the human toll rising and the spread now impacting more and more countries – including New Zealand, with the first case identified here on Friday. As the spread and disruption widens, the likely economic impacts increase, and the prospects for a rapid recovery diminish. The nature and channels of the economic shock are also shifting as the situation develops and we learn more. Financial markets have capitulated; downside risks are significant.

We are now calling cuts.

Although the outbreak is no longer spreading as it was in China, the economy will be reeling there for some time, and 'business as usual' remains a long way off. Our China Research team currently estimates that the economy as a whole is running at around 20% of its typical capacity utilisation. PMI data over the weekend slumped to its lowest-ever levels, leading ANZ to revise down its China Q1 GDP forecasts for 2020 further, to just 2% y/y, with a V-shaped recovery after that looking highly unlikely.

The Chinese economy will be reeling for some time.

Economic overview

Even if activity resumes, it will hardly be business as usual.

We are still hopeful that China's activity can continue to recover over coming weeks, but it has to be gradual, given the painful trade-off between restarting the economy and containing the virus. And even once China is back to something like normal production, it will take a significant amount of time for distribution backlogs and supply chains disruptions to resolve. Plus, even if industrial activity resumes in China, consumer and firm behaviour will take longer to truly normalise. It will take some time for fear to recede, spending to recover and normal activity (in the true sense of the word) to resume. And with some businesses likely to be significantly affected, the scars will take time to heal. Worryingly, there is a risk that there could be a breakdown in liquidity availability for the corporate sector; in this case, the outcome for bad loans, defaults, bankruptcy and employment could be severe.

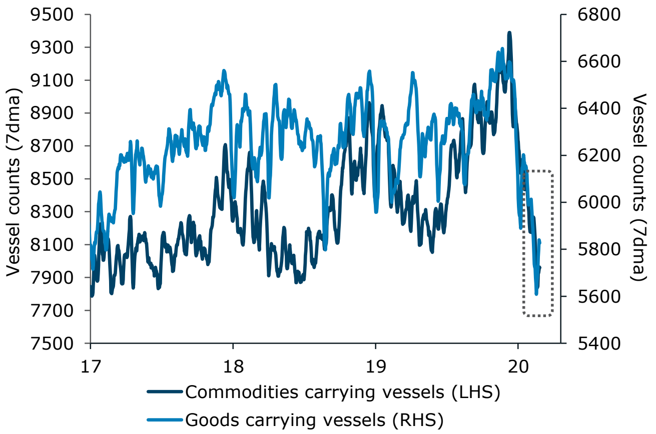
The focus has widened beyond China.

China is New Zealand's biggest trading partner by far, and the impacts of that were already looking pretty bad. But now the focus has widened well beyond China, with the prospect of disruption and social distancing in other countries presenting new and significant risks. While we do not know how long or significant the outbreaks in other countries will be, the scale and duration of global disruption has clearly increased, and the number of new cases is worryingly exponential. Trade is clearly being affected, with reduced movement of global shipping vessels (figure 1) – and with some vessels carrying cargo at well below full capacity, from what we understand.

We are starting to see market impacts.

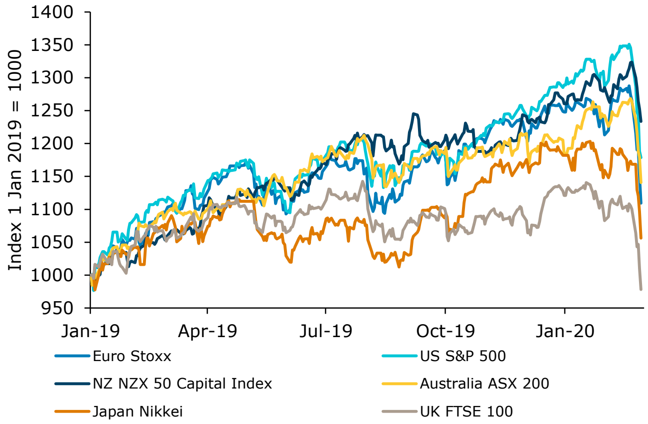
Globally, travel bans are now more widespread both by governments and firms (to/from South Korea, Japan and Italy as notable examples) and caution is being exercised regarding travel to a wide range of countries. Social distancing and disruption is becoming evident in affected areas. And we are starting to see impacts on global economic data and corporate earnings forecasts, alongside increased uncertainty. These possible impacts are weighing on financial markets, with equities falling heavily last week (figure 2). With the weekend bringing evidence of established community outbreaks in the US, this week could be pretty rough as well.

Figure 1: Movement of global shipping vessels



Source: Bloomberg, ANZ Research

Figure 2: Global equity markets



Source: Bloomberg

How has the view changed?

Risks of a more pronounced slowdown are rising. Recession is possible.

When the facts change, we change our minds. And the facts are changing fast. The economic impact of the COVID-19 outbreak is now looking impossible for RBNZ to look through, as it becomes clear it won't be brief.

We downgraded our forecasts just last week in light of the continued global spread, to assume more widespread economic impacts, including softer domestic demand for longer, alongside a more gradual recovery. But already, these forecasts are looking out of date, given the spread of the virus since then, the presence of the virus in New Zealand, established community outbreaks in the US, and the violent sell-off in global financial markets. A sharper global slowdown is on the cards.

Economic overview

Risks of a more pronounced slowdown are rising. Recession is possible.

The RBNZ will have to act quickly.

In light of this, we think the RBNZ will have to act very quickly, and that more fiscal levers will need to be pulled to directly support businesses affected. Just a few weeks ago the RBNZ sounded optimistic that they wouldn't need to respond, but the situation has changed significantly since then, and we expect they will change their assessment rapidly.

At this stage, a 50bp OCR cut in March is our pick, with a follow up 25 cut in May. That would take the OCR to 0.25%. If the situation continues to escalate, then unconventional policy can't be ruled out down the track.

When the outbreak looked likely to affect only specific sectors of the economy, fiscal policy looked both necessary and sufficient to provide support, not least because measures can be targeted to affected businesses. The Government has already announced packages to help tourism businesses and displaced forestry workers, with more announcements likely soon.

By contrast, monetary policy cannot be targeted in the same way. But now, a monetary policy response looks very justified, given the synchronised nature of the shock – both globally, and across domestic industries. In fact, global shocks don't really come more synchronised than this.

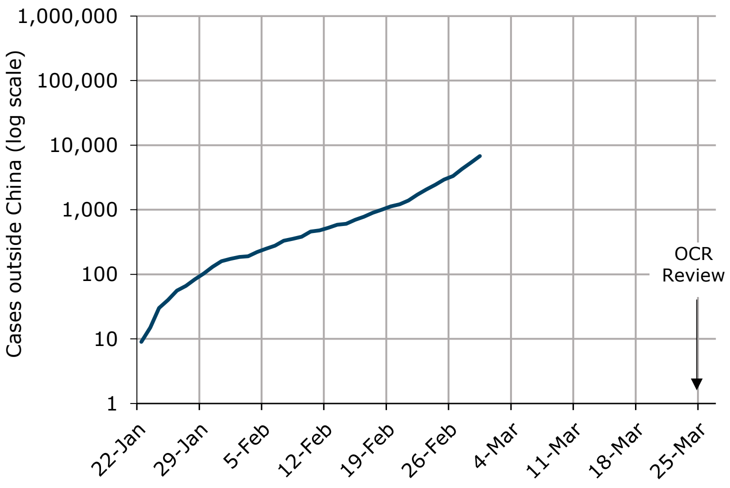
A monetary policy response is justified – it can't fix the problem, but it can help.

A lower OCR can't fix the fundamental problem, of course, but it can help by lowering the NZD, easing financial pressure on businesses (by easing debt-servicing costs, which could be very important), helping guide expectations, and helping facilitate the recovery. Regular readers will know we have been critical of the structural damage wrought by prolonged super-low interest rates in economies that are going along perfectly well, but this is something else entirely. Economies are anything but fine; excessive risk-taking in this environment is not going to be a problem. Monetary policy can help.

The next OCR review now seems a long time away.

The OCR should be lowered rapidly. The OCR Review is 23 days away, on 25 March. Typically in a three week period we'd get two or three interesting economic data points. But this situation is evolving much more quickly than a purely economic shock would. There has been a *24-fold* increase in confirmed COVID-19 cases outside China in the past 23 days. By 25 March we believe there will be clear evidence that a sharply lower OCR is appropriate. Either the current global infection trend (figure 3) will have continued (or accelerated), or it will have been successfully slowed by aggressive shutdowns of people's movements on a global scale. Neither possibility is 'good' from an economic activity perspective.

Figure 3. New COVID-19 cases outside of China – log scale



Source: worldometers, ANZ Research

Economic overview

Authorities are not overreacting and will not give up the fight.

Because we often get questions about it, it's worth taking the time to lay out exactly why authorities globally are reacting so aggressively to what is, for the vast majority of people, a mild illness. In short, it's a numbers game. Even though just a small proportion of those infected with COVID-19 become seriously ill, because no one is immune, health systems will be utterly overwhelmed if the epidemic is left to run its natural course. A significant number of lives will be saved if the infections can be spread out over a longer period, particularly if a vaccine is eventually in the offing. Therefore, even when it is clearly no longer possible to stamp out the disease, there is still a strong moral imperative for governments to slow it down as much as possible. That means restricting the movement of people. And that is what does the economic damage. To save a lot of lives.

Forecasts lower; risks to the downside

We've downgraded our forecasts again, with risks clearly tilted to the downside.

We've downgraded our forecasts, but they already seem out of date.

We now expect to see more of an impact on New Zealand GDP growth through the middle of the year, with the recovery in exports more gradual and domestic demand expected to be affected by flow-on effects, import disruption, and reduced confidence. Some of the downgrade also reflects drought impacts, though to a much lesser extent. The combination of drought conditions and seized up export logistics is highly unlucky.

There isn't a great deal of point in going through our forecasts in detail, as they'll keep changing. But we'll touch on the themes.

Sharp impact on exports, dry pasture conditions

We are assuming a sharp impact on exports in both Q1 and Q2 (as discussed in last week's ANZ Weekly Focus). And we expect it will take quite some time for normality to resume. This is significant for growth; exports comprise 30% of GDP.

We expect a sharp impact on exports, with a gradual recovery.

The slow pace of recovery in exports reflects caution and soft demand amongst households for longer than the physical disruptions last. We also think it will take some time for supply chains to normalise, especially with disruption now spreading to other trading partners.

Drought will weigh, but to a much lesser extent.

Drought in Northland and Waikato and dry conditions in other areas will also weigh on production and exports to some degree. Both COVID-19 and drought concerns are affecting agriculture sentiment and production decisions, meaning the two are difficult to disentangle – but COVID-19 is the more economic significant concern.

The timing of drought impacts on production will be complicated by capacity and supply chain constraints, restricting the scope for cows and ewes to be culled early. Hydro-electricity production may also be affected in the near term. Softer agriculture production (predominantly in Q2) will dampen exports through the middle of the year.

Conditions will be challenging for primary industries.

Fortunately, following an excellent spring, supplementary feed is more plentiful than has been seen in previous drought episodes, muting the impact of drought to some degree relative to historical experience. But nonetheless, conditions may be quite challenging for those in primary industries and related businesses in the next few quarters – reflecting a trifecta of COVID-19 effects, dry conditions, and a pre-existing challenging backdrop related to regulation, costs and credit availability. And with the COVID-19 outbreak and associated disruption worsening, there are risks that the recovery in exports is more muted and/or delayed.

Export prices to fall further, but impact on prices complicated

The COVID-19 outbreak is a complex shock, with lower global demand (negative for prices) seen alongside disruption to supply (positive for prices as shortages bite).

Import prices are expected to fall; oil has

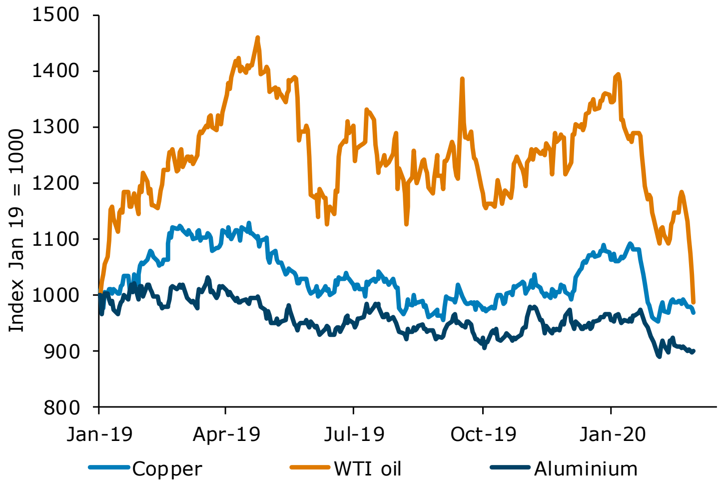
Overall, we expect that our terms of trade will be lower. There will likely be some pockets of upwards pressure on import prices in the near term (in world price terms), *plunged.*

but we expect weaker demand impacts will dominate, with import prices lower overall. Recent oil price moves support this view, with WTI having fallen from around USD64/bbl in early 2020 to under USD45 currently.

Export prices are expected to fall further.

On the export side, global dairy prices have already fallen around 7.5% over the past two GDT auctions and it looks like another dip is on the cards this week. Hard commodities are under pressure globally as the demand outlook worsens (figure 4) and soft commodities tend to follow. We see downward pressure on New Zealand's commodity prices for at least the next couple of months, as it will take time for Chinese consumption activity to resume to normal levels (particularly when it comes to eating out at restaurants). Beyond that, global food supply disruptions could have a say.

Figure 4: Global hard commodity prices



Source: Bloomberg, ANZ Research

NZD a shock absorber

The NZD would be expected to fall if conditions deteriorate.

The NZD is an important shock absorber in an adverse global economic event, helping to relieve some of the pressure on our exporters by keeping them competitive and encouraging domestic consumption (eg by making international travel more expensive and domestic travel more attractive – not that international holidays will be in vogue for a while).

A lower NZD would help soften the blow.

A lower NZD is not without costs; it lowers purchasing power for consumers and can have financial implications for exporters with open FX positions as a result of hedging arrangements, particularly if they are unable to get their product to market at the volumes and/or prices anticipated. Nonetheless, a lower NZD would be a net positive for the economy, helping to absorb some of the economic impact. OCR cuts will help encourage the NZD to move lower. That said, if China allows the yuan to decouple from the USD, we may struggle to get much of a depreciation against the currency of our largest trading partner. After all, China's economy is clearly in worse shape than ours at present.

The impact on CPI is complicated.

While world import prices are expected to fall on balance, the lower NZD will provide an offset when it comes to CPI inflation. Insofar as this shock puts upward pressure on prices via supply-side disruption and/or a lower NZD, CPI could remain elevated. Low growth and high inflation (stagflation) is an ugly prospect. Our current expectation is that any near-term price pressure will dissipate pretty quickly as dampening demand-side impacts dominate. But possible impacts on prices are highly uncertain.

Overall, we see the risks as tilted towards spare capacity opening up more than we expect, seeing inflation expectations slip, and underlying price pressures dissipate. A more prolonged period of sub-par growth could do this.

Domestic impact more widespread

Domestic demand will also be affected, dampening our expectations for GDP growth through the middle of the year. We expect to see weaker consumption and business investment and a softening in residential construction activity.

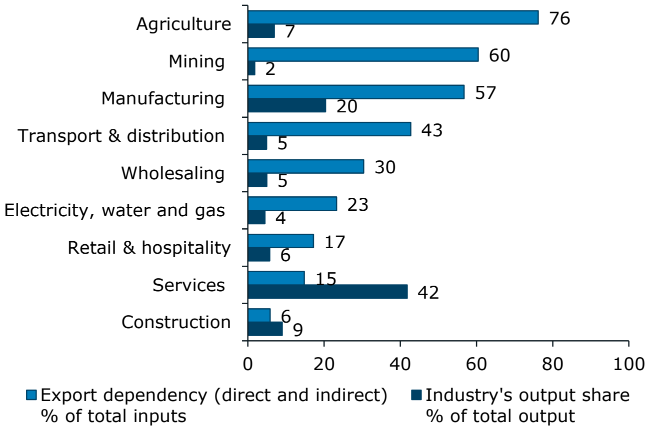
The magnitude of these impacts is highly uncertain:

Domestic impact more widespread.

Export impacts flow on to other industries.

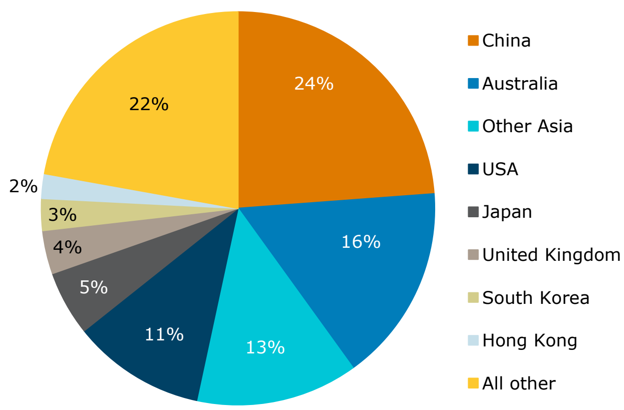
Flow-on effects: Impacts on our exports are expected to be sizable, and this will have flow-on effects to a range of industries in the domestic supply chain. Figure 5 shows the export reliance of various industries, taking into account both direct impacts and indirect exposure through the supply chain. Obviously, agriculture is highly dependent on exports (with 76% of output ultimately exported). But dependency on exports is widespread across industries, including manufacturing (57% of output is exported), wholesale (30%), distribution (43%) and services (15%). Approximately 10% of employment supports export-oriented production, with flow-on implications for income and spending. And as the spread of the outbreak increases, more export markets may be affected, which could amplify these effects (figure 6).

Figure 5: Export reliance of various industries



Source: Statistics NZ, ANZ Research

Figure 6: Destinations for our exports



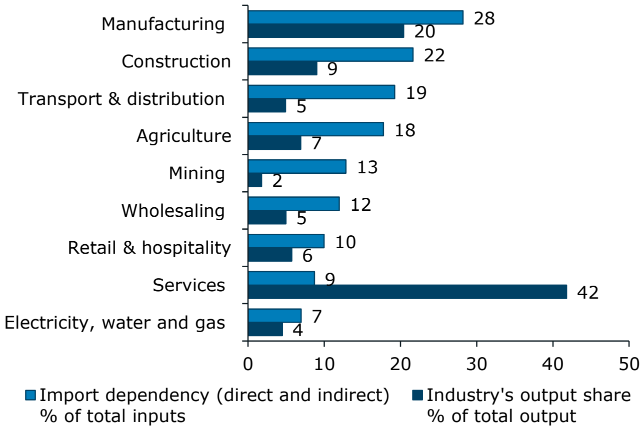
Source: Statistics NZ, ANZ Research

Import disruption will affect supply chains.

Import disruption: Disruption in global supply chains matters. New Zealand is a small, open economy that is very reliant on imports across most industries (figure 7). Any problems sourcing imports will impact production, consumption and investment. Manufacturing is most exposed (28% of inputs are ultimately sourced from imports). But really no industry is immune to global disruption if it persists, with the impact depending on reliance and inventory levels. For example, while construction is thought of as a very domestically oriented industry, 20-25% of construction inputs are ultimately imported. It will be impacted if global supply of building supplies and/or steel is disrupted for a significant period. 18% of agricultural inputs are also imported, so this sector could experience a pinch from both sides of the trade equation.

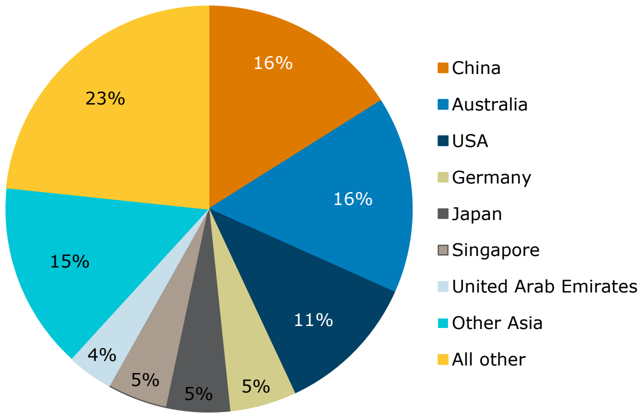
At present, it is hard to say how long disruption of imports might go on for, especially with the outbreak going global. Currently, disruption is emanating primarily from halts and delays in distribution logistics in China, a key source of our imports (figure 8). But the risk is that disruption becomes more widespread and that impacts become harder to track and quantify. It can only take one blockage or delay in the chain for an entire supply chain to be disrupted, given how intertwined global production has become.

Figure 7: Import reliance of industries



Source: Statistics NZ, ANZ Research

Figure 8: Sources of our imports



Source: Statistics NZ, ANZ Research

Confidence will likely take a hit.

Sentiment effects: With export and import-reliant industries directly affected and a sharp impact on growth already baked in, we expect business confidence (and to a lesser extent consumer confidence) will be affected. Last week's ANZ Business Outlook saw confidence slide 5 points (to a net 19% of businesses expecting conditions to worsen), but a more marked deterioration was evident from those firms responding over the latter part of February once COVID-19 had hit the headlines. A further slide in sentiment looks inevitable and could impact investment and employment decisions as firms take a "wait and see" approach. We expect a smaller dent in consumer sentiment, given we currently anticipate only a modest deterioration in the labour market, but the risk is that the blow is larger.

We are expecting softer GDP growth.

Our current forecasts are for softer GDP growth through the middle of the year, reflecting softer domestic demand, only a gradual recovery in exports and dry pasture conditions (table 1). Our current forecasts are now perilously close to a technical recession in the first half of the year. Growth then recovers, with a muted bounce back over the second half of the year, and moderate rates of growth over the medium term. But seriously, watch this space. Forecast updates have become a weekly exercise.

Table 1: GDP forecast update

	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Current assumption for COVID-19 impact (and small drought effect)	-0.6%pts	-0.4%pts	+0.3%pts	+0.3%pts
Updated GDP forecast	-0.1% q/q	0.2% q/q	0.9% q/q	0.9% q/q
	1.3% y/y	**1.4% y/y**	**1.6% y/y**	**1.9% y/y**

Risks and policy implications

Risks are building.

Risks are building that the slowdown in growth is sharper or more persistent than we are currently expecting. A recession could occur if global outbreaks continue to spread and intensify; if the virus establishes itself in New Zealand and cannot be promptly stamped out; if exports were more significantly impacted; or if domestic demand were to be more significantly impacted than currently assumed, for example due to a disproportionate rise in fear and associated reduced spending.

An outbreak in New Zealand would curb activity.

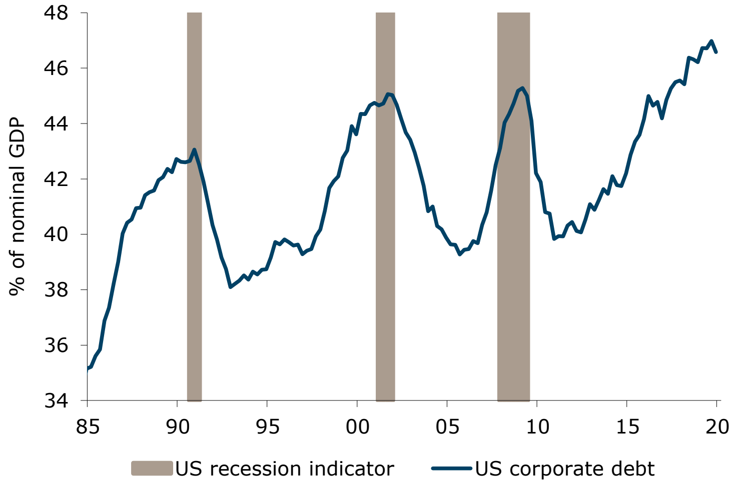
The growth outlook would be particularly under threat if we were to see an outbreak of COVID-19 in New Zealand establish itself in the community. In that case, New Zealand's pandemic response could bring about closures of schools and workplaces, cancellation of events and direct encouragement of social distancing. Social distancing can also happen by people's own choice to avoid public places as much as possible. The economic toll of such measures would quite rightly be a secondary consideration to the priority of preserving human life, but it would nonetheless be significant.

Economic overview

Market ructions are a risk.

In addition to all that, the global financial market response has already been ugly and could get uglier still, especially if the tail-risk of risk repricing in credit markets were to materialise. The world is awash with debt of all kinds, an unfortunate backdrop for a large earnings shock such as this. Over the weekend it became clear that authorities have lost the scent of the virus in the US, and cases are set to soar. This implies containment measures are on the cards. US corporate balance sheets are poorly placed to deal with a significant revenue shock (figure 9).

Figure 9: US corporate debt to GDP



Source: Bloomberg, ANZ Research

New Zealand is well placed in a lot of ways.

Whatever happens, it is clear that there will be an unavoidable negative economic impact from the current outbreak – the question is how large and how long it proves to be. But New Zealand is well placed in a lot of ways and the picture on the other side of this remains bright. We have a good amount of fiscal headroom, corporate balance sheets are in good stead, we have a freely floating exchange rate, and demand will always be there for the goods we produce. Maybe not at the price we prefer, but people need to eat, whatever happens. Indeed, while the knee-jerk reaction of major global food commodities has been downward, potential supply disruptions could see food security become an issue globally this year. It already is in Africa, with locust plagues causing havoc.

But conditions will be challenging.

Despite New Zealand's advantages, conditions, both economic and otherwise, will likely be challenging for a time for both people and businesses (which are, in the end, collections of people) and we are very cognisant of that. We will continue to watch developments closely and update our forecasts regularly.

The week ahead

We have construction data this week.

This week we will learn more about construction activity through the end of 2019 and into 2020. Work put in place data out on Friday will shed some light on construction activity in Q4, which is an important input into our estimate of where GDP landed in the quarter (which is currently sitting at 0.6% q/q; 1.8% y/y). We expect that building work put in place rose 0.4% q/q, from already very high levels. Digging into the details, we expect that non-residential construction (which is lumpy) fell 1.5% in Q4, following a 2.4% lift in Q3. On the residential side, we expect there was a 2.2% lift in activity, following a strong run up in consents into the second half of last year. Building consents data for January will also be out, with continued high rates of activity expected. However, while activity is at a high level, headwinds lay ahead for the construction industry in the first half of the year.

And expect to see a fall in dairy prices.

Dairy demand is expected to be muted at this week's GDT event due to supply chain disruption within China and the large quantities of stock already in-market reducing the urgency to replace stocks. The spread of COVID-19 into other nations which are also major importers of milk powders such as Algeria, Malaysia and the Philippines is expected to dent buyer confidence at this week's auction. The steady intensification of the drought in New Zealand is largely being drowned out by COVID-19 concerns. Fonterra has slightly revised down its milk production forecasts but has made no change to its GDT offerings of milk powders. We expect to see a decrease in the GDT Price Index of approximately 3.5% at this week's event, which would amount to a fall of around 11% over three auctions.

Local data

Overseas Merchandise Trade – January. A deficit of $340 million was better than expected. Exports fell seasonally, but not by as much as expected. The majority of the supply chain disruptions due to COVID-19 didn't occur until February.

ANZ Business Outlook – February. Headline business confidence fell 6 points to -19 in February. A net 12% of firms expect stronger activity for their own business (down 5). Survey responses received after the COVID-19 outbreak hit the headlines (about a third of all responses) were more negative.

ANZ Roy Morgan Consumer Confidence – February. Eased 1 point in February to 122. This is a solid start to the year, following gains made at the end of 2019. Consumers are feeling good for now, but emerging global risks could weigh in coming months.

RBNZ Sectoral lending data – January. The bank funding gap widened further in January as housing credit growth (up 0.6%), outpaced household deposits growth (0.2%). Higher interest rates and/or reduced credit availability are possible ways to close the funding gap. Both would represent a tightening in financial conditions. See our previous Weekly for further details.

What you may have missed

Please contact us if you would like to be added to the distribution list for any of these publications. Otherwise click on the links below to view reports.

- ANZ Business Outlook - Sound the alarm
- ANZ NZ Roy Morgan Consumer Confidence - Started solid
- NZ Insight - OCR cut odds rising rapidly

FX / rates overview

Summary

Interest rates and the Kiwi going lower, perhaps significantly.

With policy rate cuts coming here and elsewhere, we expect global interest rates to be under generalised downward pressure, reminiscent of 2008. The local market is already pricing in one cut by May and follow-on cuts, but are well behind our expectation of 75bps of cuts. The Kiwi is hovering around our March forecast, but the downside risks are clear given the changing interest rate environment. This week we also discuss what has happened in global financial markets so far and detail how we expect markets to evolve going forward.

Special report: financial market moves late last week

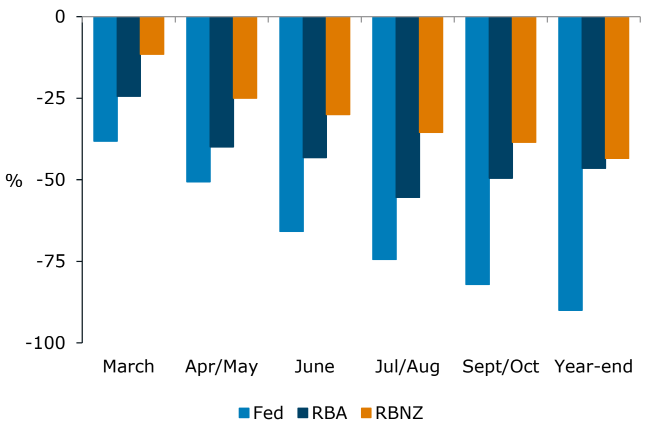
Equities and bond yields lower, with markets eyeing March cuts.

Global financial markets have reacted swiftly to the rapidly evolving situation, with the pace and magnitude of the reaction gathering a head of steam into the end of last week. The S&P 500 fell for seven straight days through Friday, down 13% from its 19 February high, wiping out four months of gains. US 10-year bond yields have fallen to all-time lows and the market is pricing in a 38bps of Fed cuts (ie some chance of a 50bp cut or an intra-meeting cut) by March and 90bps of cuts by year-end.

Figure 1. NZ and US 10year Bond Yields

Source: Bloomberg

Figure 2. Rate cut expectations for the Fed, RBA and RBNZ



Source: Bloomberg, ANZ (and subject to significant intra-day volatility)

The New Zealand market closed on Friday with a 25bp cut priced in by May, having “only” been expecting a cut by August on Thursday (and by September on Wednesday). However, New Zealand long-end bond yields and swap spreads were still above 2019 lows, largely due to the market not expecting cuts as deep as those expected in 2019. But that is set to change. Other measures of stress are also evident – for example, the VIX index of volatility is back at a 5-year high. Moves in NZD/USD have been tamer; in part reflecting the impact rapidly falling interest rates has had on the USD itself.

What’s next?

Kiwi will do what is required to absorb this significant economic shock.

We expect the NZD to go lower, fuelled by both growing expectations of cuts, and as a natural response to what is a global economic shock. The same can be said about other currencies too, suggestive of a bit of a “race to the bottom” across global exporter currencies. That implies crosses like NZD/AUD and NZD/EUR will be more stable than NZD/USD and NZD/Asia cross rates.

Interest rates going lower, led by the short end.

In the interest rate space, all rates will fall, albeit to varying degrees. Rapidly growing OCR cut expectations ought to see the yield curve start to re-steepen, led by the short end in a classic bull-steepening move. Until now, the curve has been flattening as the long end has followed global long-end rates lower, with the short end struggling to rally on the back of what has been upbeat and slightly hawkish RBNZ rhetoric. That will change now and the short end will start to play catch-up. 3-month BKBM has been falling rapidly but it remains above 1%, and obviously has a long way to go if our OCR expectations become reality.

New Zealand interest rates will likely continue to lag the rally in US rates, but that's only because the Fed Funds Rate is further from zero than the OCR is. NZ rates would, however, likely contract against Japanese and European interest rates, where yields are already negative. We do not expect offshore investor outflows. New Zealand rates are no longer the highest in the G10, but they are still positive and OCR cuts typically keep offshore participants engaged.

Bonds to lag swaps …

NZGB yields are set to continue falling, but the presumption of a forthright fiscal response will see them lag swap yields, possibly driving swap spreads back into negative territory. That said, near-term moves may be difficult to describe – short covering by fund managers – if seen – would, for example, possibly drive near-term bond outperformance given the supply/demand mismatch.

Credit markets remain open, and NZ banks have ample liquidity on hand. However, we would likely see a pause in capital raising offshore, placing downward pressure on basis swap spreads, which have been faltering on the back of the slow start to the year in the Kauri market.

Key events this week

The RBA meeting tomorrow (4.30pm NZT) is key. With a cut almost fully priced in, how the RBA responds will shape expectations here. No cut would obviously rattle markets.

NZD/USD: Is the natural shock absorber at a time like this, and we expect it to go lower, possibly into the high 0.50s.

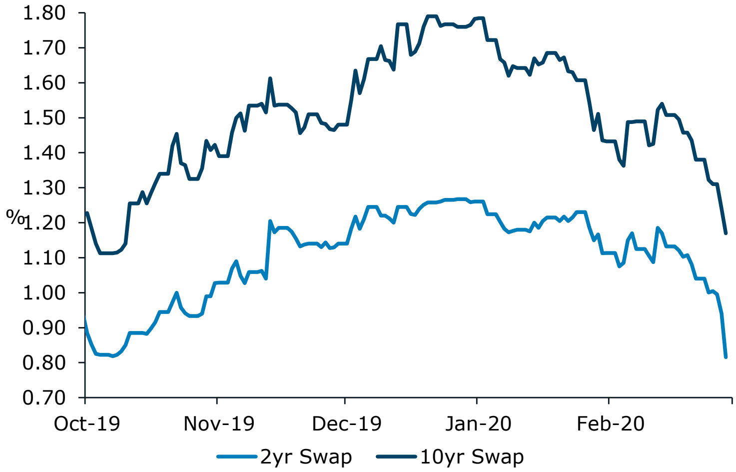
NZD/AUD: Price action will be all about timing, and the RBA has an earlier rate cut window than NZ. Broad-based stability will come from a commonality of drivers.

NZD/EUR: Stability for this cross also comes from a commonality of drivers, but the NZD has more downside risks from the NZ's lower rates profile.

NZD/GBP: The weaker NZD is likely to be the bigger driver of this cross. GBP has held in well in recent days, and we expect it to be structurally supported by post-Brexit expansionary fiscal policy.

NZD/JPY: NZD has scope to go well lower, but JPY has been firmly re-established as the Asian safe-haven currency. We see this cross as being biased lower.

Figure 3. NZ 2 and 10 year swap rates



Source: Bloomberg, ANZ Research

Data calendar

Date	Country	Data/event	Mkt.	Last	NZ time
2-Mar	AU	Ai Group Perf of Mfg Index - Feb	--	45.4	10:30
	NZ	Terms of Trade Index QoQ - Q4	0.8%	1.9%	10:45
	AU	CBA PMI Mfg - Feb F	--	49.8	11:00
	AU	CoreLogic House Px MoM - Feb	--	0.9%	12:00
	AU	Melbourne Institute Inflation MoM - Feb	--	0.3%	13:00
	AU	Melbourne Institute Inflation YoY - Feb	--	1.8%	13:00
	AU	Inventories SA QoQ - Q4	-0.1%	-0.4%	13:30
	AU	Company Operating Profit QoQ - Q4	-1.3%	-0.8%	13:30
	AU	ANZ Job Advertisements MoM - Feb	--	3.8%	13:30
	JN	Jibun Bank PMI Mfg - Feb F	--	47.6	13:30
	CH	Caixin PMI Mfg - Feb	46.0	51.1	14:45
	GE	Markit/BME Manufacturing PMI - Feb F	47.8	47.8	21:55
	EC	Markit Manufacturing PMI - Feb F	49.1	49.1	22:00
	UK	Markit PMI Manufacturing SA - Feb F	51.9	51.9	22:30
	UK	Net Consumer Credit - Jan	£1.0B	£1.2B	22:30
	UK	Consumer Credit YoY - Jan	--	6.1%	22:30
	UK	Net Lending Sec. on Dwellings - Jan	£4.6B	£4.6B	22:30
	UK	Mortgage Approvals - Jan	68.0k	67.2k	22:30
	UK	Money Supply M4 MoM - Jan	--	0.1%	22:30
	UK	M4 Money Supply YoY - Jan	--	3.8%	22:30
	UK	M4 Ex IOFCs 3M Annualised - Jan	--	3.9%	22:30
3-Mar	US	Markit Manufacturing PMI - Feb F	50.8	50.8	03:45
	US	Construction Spending MoM - Jan	0.6%	-0.2%	04:00
	US	ISM Manufacturing - Feb	50.5	50.9	04:00
	US	ISM New Orders - Feb	51.8	52.0	04:00
	US	ISM Prices Paid - Feb	50.5	53.3	04:00
	US	ISM Employment - Feb	47.5	46.6	04:00
	AU	ANZ-RM Consumer Confidence Index - 1-Mar	--	108.3	11:30
	AU	Building Approvals MoM - Jan	1.0%	-0.2%	13:30
	AU	Building Approvals YoY - Jan	1.9%	2.7%	13:30
	AU	BoP Current Account Balance - Q4	A$2.3B	A$7.9B	13:30
	AU	Net Exports of GDP - Q4	0.2	0.2	13:30
	AU	RBA Cash Rate Target - Mar	0.75%	0.75%	16:30
	UK	Markit/CIPS Construction PMI - Feb	49.0	48.4	22:30
	EC	PPI MoM - Jan	0.5%	0.0%	23:00
	EC	PPI YoY - Jan	-0.4%	-0.7%	23:00
	EC	CPI MoM - Feb P	0.2%	-1.0%	23:00
	EC	CPI Core YoY - Feb P	1.2%	1.1%	23:00
	EC	CPI Estimate YoY - Feb	1.2%	1.4%	23:00
	EC	Unemployment Rate - Jan	7.4%	7.4%	23:00
4-Mar	NZ	QV House Prices YoY - Feb	--	4.4%	05:00
	AU	Ai Group Perf of Construction Index - Feb	--	41.3	10:30
	NZ	Building Permits MoM - Jan	--	9.9%	10:45
	AU	CBA PMI Services - Feb F	--	48.4	11:00
	AU	CBA PMI Composite - Feb F	--	48.3	11:00
	NZ	ANZ Commodity Price - Feb	--	-0.9%	13:00
	AU	GDP SA QoQ - Q4	0.4%	0.4%	13:30
	AU	GDP YoY - Q4	2.0%	1.7%	13:30

Continued on following page

Data calendar

Date	Country	Data/event	Mkt.	Last	NZ time
	JN	Jibun Bank PMI Services - Feb F	--	46.7	13:30
	JN	Jibun Bank PMI Composite - Feb F	--	47.0	13:30
	CH	Caixin PMI Composite - Feb	--	51.9	14:45
	CH	Caixin PMI Services - Feb	48.0	51.8	14:45
	GE	Retail Sales MoM - Jan	1.0%	-2.0%	20:00
	GE	Retail Sales NSA YoY - Jan	1.5%	1.7%	20:00
	GE	Markit Services PMI - Feb F	53.3	53.3	21:55
	GE	Markit/BME Composite PMI - Feb F	51.1	51.1	21:55
	EC	Markit Services PMI - Feb F	52.8	52.8	22:00
	EC	Markit Composite PMI - Feb F	51.6	51.6	22:00
	UK	Official Reserves Changes - Feb	--	$2162M	22:30
	UK	Markit/CIPS Services PMI - Feb F	53.2	53.3	22:30
	UK	Markit/CIPS Composite PMI - Feb F	53.3	53.3	22:30
	EC	Retail Sales MoM - Jan	0.6%	-1.6%	23:00
	EC	Retail Sales YoY - Jan	1.1%	1.3%	23:00
5-Mar	US	MBA Mortgage Applications - 28-Feb	--	1.5%	01:00
	US	ADP Employment Change - Feb		170k	291k
	US	Markit Services PMI - Feb F	49.5	49.4	03:45
	US	Markit Composite PMI - Feb F	--	49.6	03:45
	US	ISM Non-Manufacturing Index - Feb	55.0	55.5	04:00
	US	Federal Reserve releases Beige Book	--	--	08:00
	AU	Trade Balance - Jan	A$4800M	A$5223M	13:30
	GE	Markit Construction PMI - Feb	--	54.9	21:30
6-Mar	US	Nonfarm Productivity - Q4 F	1.4%	1.4%	02:30
	US	Unit Labor Costs - Q4 F	1.4%	1.4%	02:30
	US	Initial Jobless Claims - 29-Feb	216k	219k	02:30
	US	Continuing Claims - 22-Feb	1725k	1724k	02:30
	US	Factory Orders - Jan	-0.2%	1.8%	04:00
	US	Factory Orders Ex Trans - Jan	--	0.6%	04:00
	US	Durable Goods Orders - Jan F	-0.2%	-0.2%	04:00
	US	Durables Ex Transportation - Jan F	--	0.9%	04:00
	AU	Ai Group Perf of Services Index - Feb	--	47.4	10:30
	NZ	Volume of All Buildings SA QoQ - Q4	0.6%	0.4%	10:45
	AU	Retail Sales MoM - Jan	0.0%	-0.5%	13:30
	AU	Foreign Reserves - Feb	--	A$73.3B	18:30
	GE	Factory Orders MoM - Jan	1.2%	-2.1%	20:00
	GE	Factory Orders WDA YoY - Jan	-5.4%	-8.7%	20:00
7-Mar	US	Trade Balance - Jan	-$47.0B	-$48.9B	02:30
	US	Change in Nonfarm Payrolls - Feb	175k	225k	02:30
	US	Unemployment Rate - Feb	3.6%	3.6%	02:30
	US	Average Hourly Earnings MoM - Feb	0.3%	0.2%	02:30
	US	Average Hourly Earnings YoY - Feb	3.0%	3.1%	02:30
	US	Average Weekly Hours All Employees - Feb	34.3	34.3	02:30
	US	Labor Force Participation Rate - Feb	63.4%	63.4%	02:30
	US	Wholesale Inventories MoM - Jan F	--	-0.2%	04:00
	US	Consumer Credit - Jan	$17.00B	$22.06B	09:00

Key: AU: Australia, EC: Eurozone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States, CH: China.
Source: Dow Jones, Reuters, Bloomberg, ANZ Bank New Zealand Limited. All $ values in local currency.
Note: All surveys are preliminary and subject to change

Local data watch

The concerning global slowdown is expected to dent domestic activity over H1, with a muted recovery expected in H2. Exports will be hit, but domestic demand is also expected to be softer. Risks of a sharper slowdown have increased. We think the OCR will need to be lowered.

Date	Data/event	Economic signal	Comment
Mon 2 March (10:45am)	Terms of Trade – Q4.	Lift	The terms of trade are expected to lift slightly in Q4, but the outlook is for deterioration from there.
Mon 2 March (2:00pm)	Provisional NZ trade with China – up to 23 February.	Snapshot	Provisional data that will provide an initial snapshot of trade with China in the past four weeks.
Wed 4 Mar (early am)	GlobalDairyTrade auction	Down	Reduced demand from major importers will not be enough to offset supply concerns due to the dry conditions.
Wed 4 Mar (10:45am)	Building Consents –January	Hi there	Consents have been holding at a high level. While downside risks remain, recent resurgence in the housing market is expected to provide continued support.
Wed 4 Mar (1:00pm)	ANZ Commodity Price Index – February	--	--
Fri 6 Mar (10:45am)	Work Put In Place – Q4	Build me up	Another nudge up is expected, with building consents having pushed higher.
Tue 10 Mar (10:00am)	ANZ Truckometer – February	--	--
Tue 10 Mar (10:45am)	Economic Survey of Manufacturing– Q4	Line ball	The PMI suggests manufacturing activity lifted in Q4, but with the December month coming in below 50 it's a line-ball call.
10 -17 Mar	REINZ housing data – February	Up	The market has tightened, and that is expected to translate to into lifting house price inflation.
Fri 13 Mar (10:45am)	Food Price Index – February	Dip	Food prices are expected to slip slightly. Supply disruption into China presents some downside.
Fri 13 Feb (10:45am	Rental Price Index – February	Small rise	Continued increases in rental prices should support a quarterly rise in CPI rents.
Mon 16 Feb (10:45am)	Net Migration – January	Easing	These data are noisy, but we'll be looking for confirmation that the cycle has been easing, albeit with a 3 quarter lag.
Mon 16 Mar (1:00pm)	ANZ Monthly Inflation Gauge – February	--	--
Wed 18 Mar (early am)	GlobalDairyTrade auction	Weaker	Concerns of a slow global economic growth is expected to weigh on dairy prices
Wed 18 Mar (10:45am)	Balance of Payments – Q4	Stable	We expect the annual current account deficit to remain stable as a share of GDP at 3.3%.
Thu 19 Mar (10:45am)	GDP – Q4	The last hurrah?	Quarterly growth of 0.6% is expected to see annual growth slow to 1.8%. COVID-19 impacts mean annual growth is likely to slow further in Q1 2020.
Wed 25 Mar (10:45am)	Overseas Merchandise Trade – February	Disruption	We'll be watching these data closely for a signal on how COVID-19 disruption has weighed on both sides of the trade balance.
Fri 27 Mar (10:00am)	ANZ Roy Morgan Consumer Confidence – March	--	--
Tue 31 Mar (3:00pm)	RBNZ sectoral lending – February	Watching	The funding gap has been widening recently. We'll be watching to see how that evolves, with credit an emerging headwind. Though emerging risks could see a move back into deposits.
Tue 31 Mar (10:45am)	Building Consents – February	High	Consents have been holding at a high level. While downside risks remain, recent resurgence in the housing market is expected to provide continued support.
Tue 31 Mar (1:00pm)	ANZ Business Outlook – March	--	--
Mon 6 Apr (1:00pm)	ANZ Commodity Price Index – March	--	--
Wed 8 Apr (early am)	GlobalDairyTrade auction	Weaker	Concerns of a slow global economic growth is expected to weigh on dairy prices
Thu 9 Apr (10:00am)	ANZ Truckometer – March	--	--
14-17 Apr	REINZ housing data – March	More muted?	We expect a slowing at some point soon.
On balance		**Data watch**	**Risks are clearly tilted to the downside, with global developments evolving rapidly.**

Key forecasts and rates

	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
GDP (% qoq)	0.7	**0.6**	**-0.1**	**0.2**	**0.9**	**0.9**	**0.7**	**0.7**	**0.7**
GDP (% yoy)	2.3	**1.8**	**1.3**	**1.4**	**1.6**	**1.9**	**2.7**	**3.2**	**3.0**
CPI (% qoq)	0.7	0.5	**0.4**	**0.2**	**0.8**	**0.3**	**0.6**	**0.3**	**0.7**
CPI (% yoy)	1.5	1.9	**2.1**	**1.7**	**1.8**	**1.7**	**1.9**	**2.1**	**2.0**
LCI Wages (% qoq)	0.6	0.6	**0.4**	**0.8**	**0.5**	**0.5**	**0.4**	**0.8**	**0.5**
LCI Wages (% yoy)	2.3	2.4	**2.5**	**2.5**	**2.4**	**2.3**	**2.3**	**2.3**	**2.3**
Employment (% qoq)	0.2	0.0	**0.3**	**0.2**	**0.1**	**0.2**	**0.6**	**0.7**	**0.4**
Employment (% yoy)	1.0	1.0	**1.3**	**0.8**	**0.6**	**0.8**	**1.1**	**1.6**	**1.9**
Unemployment Rate (% sa)	4.1	**4.0**	**4.2**	**4.3**	**4.4**	**4.3**	**4.2**	**4.1**	**4.1**
Current Account (% GDP)	-3.3	**-3.3**	**-3.5**	**-3.9**	**-4.3**	**-4.5**	**-4.6**	**-4.4**	**-4.2**
Terms of Trade (% qoq)	1.9	**0.9**	**1.0**	**-4.6**	**0.4**	**1.3**	**0.3**	**0.3**	**0.2**
Terms of Trade (% yoy)	1.0	**5.3**	**5.3**	**-0.9**	**-2.3**	**-2.0**	**-2.7**	**2.3**	**2.1**

	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20
Retail ECT (% mom)	-0.6	0.3	0.0	1.2	0.2	-0.5	3.0	-0.9	-0.1	--
Retail ECT (% yoy)	3.4	1.5	2.0	3.1	0.6	1.6	5.1	3.9	4.2	--
Car Registrations (% mom)	-2.1	-2.7	5.2	0.0	6.5	-6.6	-1.4	2.2	-4.7	--
Car Registrations (% yoy)	-12.6	-11.0	-5.4	-5.2	4.7	-6.6	3.0	5.6	-3.5	--
Building Consents (% mom)	16.1	-4.2	-1.2	0.7	7.0	-1.2	-8.4	9.9	--	--
Building Consents (% yoy)	8.2	9.5	18.7	12.4	23.5	18.5	8.0	15.8	--	--
REINZ House Price Index (% yoy)	1.7	1.8	1.6	2.7	3.2	3.8	5.5	6.5	6.9	--
Household Lending Growth (% mom)	0.5	0.5	0.5	0.6	0.5	0.5	0.6	0.6	0.6	--
Household Lending Growth (% yoy)	6.0	5.9	5.9	6.0	6.1	6.2	6.3	6.5	6.6	--
ANZ Roy Morgan Consumer Conf.	119.3	122.6	116.4	118.2	113.9	118.4	120.7	123.3	122.7	122.1
ANZ Business Confidence	-32.0	-38.1	-44.3	-52.3	-53.5	-42.4	-26.4	-13.2	..	-19.4
ANZ Own Activity Outlook	8.5	8.0	5.0	-0.5	-1.8	-3.5	12.9	17.2	..	12.0
Trade Balance ($m)	175	330	-732	-1642	-1310	-1038	-785	384	-340	--
Trade Bal ($m ann)	-5602	-4987	-5516	-5591	-5321	-5055	-4836	-4460	-3866	--
ANZ World Comm. Price Index (% mom)	0.0	-3.9	-1.4	0.3	0.0	1.2	4.3	-3.4	-0.9	--
ANZ World Comm. Price Index (% yoy)	0.7	-2.4	-0.5	0.9	3.4	7.2	12.4	8.7	5.7	--
Net Migration (sa)	3860	3370	4080	4270	3850	3770	2490	3930	--	--
Net Migration (ann)	47661	47273	47285	47344	46790	46751	44966	43765	--	--
ANZ Heavy Traffic Index (% mom)	0.9	-2.3	2.2	-3.5	3.4	2.8	-1.3	-2.5	4.8	--
ANZ Light Traffic Index (% mom)	0.8	-2.0	1.4	0.3	-0.3	0.2	1.3	-2.2	2.0	--
ANZ Monthly Inflation Gauge (% mom)	0.2	0.5	0.5	0.3	0.3	0.3	0.1	0.4	0.6	--

Figures in bold are forecasts. mom: Month-on-Month; qoq: Quarter-on-Quarter; yoy: Year-on-Year

Key forecasts and rates

	Actual			Forecast (end month)					
FX rates	Jan-20	Feb-20	Today	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
NZD/USD	0.646	0.625	0.621	0.62	0.63	0.64	0.64	0.64	0.64
NZD/AUD	0.966	0.959	0.960	0.95	0.95	0.96	0.96	0.96	0.96
NZD/EUR	0.583	0.566	0.563	0.59	0.61	0.61	0.59	0.57	0.56
NZD/JPY	70.04	67.39	66.62	68.8	70.6	71.7	71.7	71.7	71.7
NZD/GBP	0.489	0.487	0.486	0.48	0.48	0.47	0.47	0.46	0.46
NZ$ TWI	71.63	70.01	69.84	70.7	71.8	72.4	71.7	71.0	70.5
Interest rates	Jan-20	Feb-20	Today	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
NZ OCR	1.00	1.00	1.00	0.50	0.25	0.25	0.25	0.25	0.25
NZ 90 day bill	1.26	1.06	1.06	0.97	0.47	0.47	0.47	0.47	0.47
NZ 10-yr bond	1.30	1.06	1.06	1.25	1.20	1.35	1.50	1.40	1.40
US Fed funds	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
US 3-mth	1.75	1.46	1.46	1.90	1.90	1.90	1.90	1.90	1.90
AU Cash Rate	0.75	0.75	0.75	0.75	0.50	0.25	0.25	0.25	0.25
AU 3-mth	0.88	0.81	0.81	0.95	0.70	0.45	0.45	0.45	0.45

	28-Jan	24-Feb	25-Feb	26-Feb	27-Feb	28-Feb
Official Cash Rate	1.00	1.00	1.00	1.00	1.00	1.00
90 day bank bill	1.26	1.14	1.12	1.09	1.08	1.06
NZGB 05/21	1.01	0.91	0.90	0.88	0.87	0.80
NZGB 04/23	0.98	0.88	0.90	0.89	0.85	0.76
NZGB 04/27	1.23	1.12	1.12	1.11	1.05	0.98
NZGB 04/33	1.52	1.42	1.40	1.38	1.30	1.25
2 year swap	1.15	1.00	1.00	1.00	0.96	0.86
5 year swap	1.21	1.07	1.06	1.05	1.00	0.89
RBNZ TWI	72.31	71.01	71.18	70.82	70.69	70.65
NZD/USD	0.6527	0.6312	0.6324	0.6300	0.6319	0.6246
NZD/AUD	0.9677	0.9580	0.9581	0.9590	0.9612	0.9589
NZD/JPY	71.05	70.25	69.88	69.55	69.54	67.39
NZD/GBP	0.5015	0.4894	0.4876	0.4872	0.4909	0.4875
NZD/EUR	0.5923	0.5836	0.5835	0.5787	0.5776	0.5665
AUD/USD	0.6745	0.6588	0.6601	0.6569	0.6574	0.6515
EUR/USD	1.1019	1.0816	1.0838	1.0887	1.0940	1.1026
USD/JPY	108.86	111.29	110.49	110.39	110.06	107.89
GBP/USD	1.3015	1.2898	1.2971	1.2932	1.2870	1.2823
Oil (US$/bbl)	53.48	51.43	49.90	48.73	47.09	44.76
Gold (US$/oz)	1579.39	1686.94	1653.17	1649.37	1648.13	1585.69
NZX 50	11685	11857	11719	11534	11437	11261
Baltic Dry Freight Index	539	506	508	517	529	535
NZX WMP Futures (US$/t)	3240	2890	2845	2830	2825	2820

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