ANZ Research

New Zealand Weekly Focus

11 May 2020

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Contents

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Hang on to your hats

Economic overview

This week brings a whirlwind of key events: today we will find out if we can move to Alert Level 2, the RBNZ MPS is on Wednesday, and the Budget is on Thursday. At the MPS, we expect QE to be roughly doubled, and there seems to be broad consensus in markets on that. But the risk is that the RBNZ needs to do more, with inflation expectations taking a massive hit last week. The market is looking for direction on where to next – and in particular, the likelihood of negative policy rates. In our view, there are plenty of options that are less risky and more straightforward. We see QE as the tool of choice, with plenty of scope to up the ante effectively. For the Government, it will be a "sobering" Budget to deliver and difficult choices are on the horizon. Clearly stimulus is required to cushion the blow, but it needs to be targeted to where the economic pain is being felt the most. An obvious area is tourism. Opening up the border with Australia would be helpful on that front, but not a panacea. We remain comfortable with our forecasts, with a sluggish recovery ahead, but much will depend on our progression out of lockdown and what the RBNZ and Government do. Hang onto your hats!

FX/rates overview

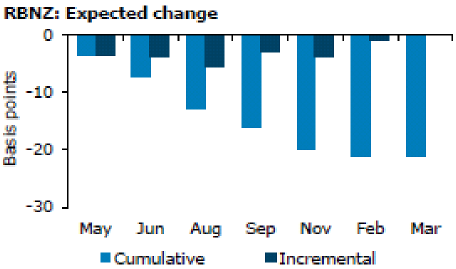
Global financial markets continue to be fuelled by liquidity, with equity indices well off earlier lows, bond yields still close to lows and high-grade credit spreads narrower. Although all of these are intended outcomes of QE, we remain cautious about the apparent gap between equity market sentiment and the economic outlook. This week's key events are the RBNZ MPS and the Budget. We expect NZGB issuance for 2020/21 to be lifted to a record $45bn pace, but the impact of this supply will be more than offset by a doubling of the QE programme to $60bn. QE has and will remain large enough to absorb all NZGB issuance through until the middle of next year, keeping the NZGB yield curve low and flat. Buoyant markets have also helped keep the NZD elevated, and it may snap higher if the RBNZ maintains its forward guidance ruling out OCR cuts this year. However, risks are tilted towards more easing in time and the NZD remains sensitive to global risk appetite. Those are its Achilles heels.

Chart of the week

Markets are looking for guidance on whether the OCR might go lower.

Market pricing for the Official Cash Rate

New Zealand	**Rate**	***Change from current***
Current Rate	*0.25*	
Wed 13 May 20	0.22	*-0.04*
Wed 24 Jun 20	0.18	*-0.08*
Wed 12 Aug 20	0.12	*-0.13*
Wed 23 Sep 20	0.09	*-0.16*
Wed 11 Nov 20	0.05	*-0.20*
Wed 10 Feb 21	0.04	*-0.21*
Wed 24 Mar 21	0.04	*-0.21*



Source: Bloomberg, ANZ Research

Economic overview

Summary

Hang on to your hats: it's a huge week ahead!

This week brings a whirlwind of key events: today we will find out if we can move to Alert Level 2, the RBNZ MPS is on Wednesday, and the Budget is on Thursday. At the MPS, we expect QE to be roughly doubled, and there seems to be broad consensus in markets on that. But the risk is that the RBNZ needs to do more, with inflation expectations taking a massive hit last week. The market is looking for direction on where to next – and in particular, the likelihood of negative policy rates. In our view, there are plenty of options that are less risky and more straightforward. We see QE as the tool of choice, with plenty of scope to up the ante effectively. For the Government, it will be a "sobering" Budget to deliver and difficult choices are on the horizon. Clearly stimulus is required to cushion the blow, but it needs to be targeted to where the economic pain is being felt the most. An obvious area is tourism. Opening up the border with Australia would be helpful on that front, but not a panacea. We remain comfortable with our forecasts, with a sluggish recovery ahead, but much will depend on our progression out of lockdown and what the RBNZ and Government do. Hang onto your hats!

Forthcoming data

ANZ Business Outlook Flash – May (Monday 11 May, 1:00pm).

ANZ Truckometer – April (Tuesday 12 May, 10:00am).

RBNZ Monetary Policy Statement – May (Wednesday 13 May, 2:00pm). We expect the RBNZ to leave the OCR unchanged at 0.25% but approximately double its QE programme. A dovish tweak to the Bank's foreword guidance wouldn't be a surprise. See our preview.

REINZ housing market data – April (Thursday 14 May, 9:00am). April is when the lockdown rubber met the road. Expect sales volumes to plummet.

Net migration – March (Thursday 14 May, 10:45am). Volatility in these data makes interpretation difficult, but some migrant workers would have left New Zealand pre-lockdown and some kiwis abroad will have come home. April data will flat-line.

New Zealand Budget Economic and Fiscal Update (Thursday 14 May, 2:00pm). The Government's new fiscal strategy as well as any new policies aimed at cushioning the blow and supporting the recovery will be the main focus. At this early stage of the crisis, uncertainty around the economic and fiscal forecasts is extreme. See our preview.

Performance of Manufacturing Index – April (Friday 15 May, 10:30am). The survey was not conducted in March due to COVID-19 disruption. Expect a sharp deterioration in the April release.

Performance Services Index – April (Monday 18 May, 10:30am). Same story as above. It's not going to be pretty.

What's the view?

It's a huge week.

It's a huge week. First up, today we will find out if we can move to Alert Level 2, and when. Cabinet is meeting this morning to make a decision, with an announcement expected at 4pm. Last week we were given an indication that any move to Level 2 would take place 48 hours after the decision, which means we could be moving there as soon as Wednesday evening. However, the Prime Minister also mentioned that we might not be able to ease restrictions all at once, with some phasing potentially on the cards. It is unclear what that might entail, but all should be revealed today.

We'll find out if we can move to Alert Level 2.

We have been supportive of a cautious approach when it comes to easing restrictions due to the enormous cost of getting it wrong, but the case for moving to Alert Level 2 has been clearly building over the past week or so. Thankfully, it now looks like we are ready to move there, if not later this week then certainly soon. We have had only a few cases popping up here and there over the past week (figure 1) and these have been easily linked to known

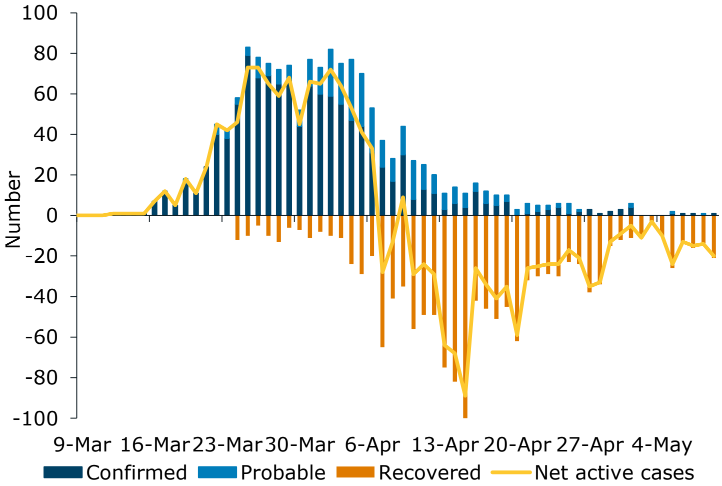
Economic overview

The case has built to do so. It would be a big relief to firms.

cases, and in some cases are old. There is no evidence of community transmission taking place, and the two weeks in Alert Level 3 has given enough time to confirm that new clusters have not been bubbling away unknown to officials. It's great news!

Clearly, if we can move to Alert Level 2 that will be a huge relief for many businesses, with firms in services (including hairdressers!), retail, domestic tourism and hospitality now able to open their doors, albeit in a still-restricted fashion. Schools will be open, domestic travel will be taking place, people can pop their bubbles, and some larger gatherings will be allowed, although distancing measures will still be in place. Cafes, restaurants and pubs must adhere to the three S's: Seated, Separated, and Single Server, as evidence shows that a combination of crowds and alcohol create high-risk situations for super-spreader events. This does mean that some hospitality businesses such as nightclubs and restaurants that are reliant on high volumes of customers will struggle to find a viable business model under these restrictions.

Figure 1. NZ COVID-19 cases



Source: Macrobond

The details of Alert Level 2 are broadly consistent with our forecast assumptions. There may be a little bit of upside risk to our Q2 forecast given the change in guidance around domestic travel, but not much given the much wider bounds of uncertainty around various assumptions.

The details of Alert Level 2 are broadly consistent with our expectations.

Relative to our forecasts, it appears we will be able to move to Alert Level 2 about ten days quicker than we previously assumed, but on the other hand, Alert Level 4 may have had slightly more of an impact than we have included in our central forecast. Those two factors probably broadly balance out at this stage. We've got our ANZ Truckometer out this week, along with PMI and PSI data, which will give us a sense for how bad things got in April. We also have the ANZ Business Outlook Flash for May out for today, which will give us a sense for how firms' sentiment and intentions are tracking.

The next question is how long we will be in Alert Level 3. Previously, we had assumed that we would be in Alert Level 2 until the end of June. This may be too pessimistic now, but it actually may not matter a whole lot: the difference in GDP effects between Alert Level 1 and 2 are not expected to be all that large in practice due to demand effects and the like (more on this later).

We are comfortable with our forecasts, though they are highly uncertain.

Beyond Q2, our forecasts still look about right, notwithstanding all of the inherent uncertainty at present. That said, the fact that we have made such progress in eliminating the virus means that a key source of downside risk has dissipated: the possibility of a prolonged or oscillating lockdown situation. A key emphasis of Level 2 will be to stay vigilant to avoid the risk that new clusters arise and take hold in the community. The prospects of a trans-Tasman safe-travel zone presents some upside relative to our forecasts, as does greater-than-expected fiscal and/or monetary stimulus. But financial risks and the possibility of more long-lasting demand effects present downside risks.

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It's not what can take place that matters from here, but what will.

In terms of specific GDP impacts of the different alert levels, we remain comfortable with our expectation that GDP will be 10-15% below pre-COVID levels in Alert Level 2. That's a sharper impact than the 8.8% impact included in estimates released by the RBNZ last week and those estimated by the Treasury (table 1).

There's a simple reason for that: the RBNZ and Treasury estimates are part of an intentionally narrow exercise. They look at what activity is permitted across different industries and then calculate what level of output might be achievable, taking into account what is allowed to take place and any hits to productivity from the restrictions. However, what can take place and what will take place are of course not the same thing. In forecasting actual activity, we need to include flow-on effects (from one industry to another) and demand effects of the current crisis, domestic and global – all of those things will be important. Those considerations will also feature in the RBNZ and Treasury forecasts released this week.

Table 1. GDP reduction under different alert levels

Alert Level	The Treasury	RBNZ	ANZ
1	5-10%	3.8%	5-15%
2	10-15%	8.8%	10-20%
3	25%	19%	15-25%
4	40%	37%	30-40%

Source: RBNZ, The Treasury, ANZ Research

Demand is severely impacted…

As we continue to move down the alert levels, the outlook will be driven less by the restrictions on activity and more by the state of demand. Extremely low household and business confidence and a severely weaker outlook for household incomes will likely dominate. The labour market is deteriorating rapidly, firms are very cautious about investing and employing, and some people will still be reluctant to venture out. Even if activities like hopping on a plane are allowed, it doesn't mean people will do it in the same numbers as previously. Quite apart from whether people feel physically safe or not, in these uncertain times they may not want to part with their cash. The shape and pace of the economic recovery is highly uncertain for that reason.

… and will be sluggish to recover.

By the time we hit Q3, it is our assumption that we will be in Alert Level 1. Current guidance is that most activity can take place under this alert level, with the exception of international travel and some mass gatherings. That's still pretty significant; the RBNZ puts the direct impact of that at 3.8% of GDP. But we see GDP as weaker than that: 10-11% lower in Q3 and 8-10% lower at the end of the year on the back of weak global and domestic demand. The growth recovery will be sluggish in these conditions.

More stimulus is needed.

In terms of the recovery from here, a lot will hinge on the response of the RBNZ and Government. More will need to be done to shore up demand, both in terms of Government initiatives and monetary stimulus. We will find out more on both of these fronts this week.

The Budget will be "sobering".

The Minister of Finance's pre-Budget speech last week gave away very little, and doesn't change our expectations for this week's Budget. The Minister of Finance said the Treasury's economic outlook will be "sobering", that the Government will run fiscal deficits for an extended time, net debt will rise, and that the crisis brings an opportunity to address the housing shortage. The financial statements for the nine months to March showed the beginning of the inevitable deterioration in the Government's books, with net core Crown debt reaching 21.3% (versus 20% forecast pre-crisis). But that's only the beginning; April numbers are set to be a shocker.

The Government will want to soften the blow.

The low starting point for Government debt creates some room for that to happen. But fiscal ammunition is finite and needs to be deployed carefully. Come Budget day, we think the Government will need to leave plenty in reserve (unallocated capital and operating allowances) to make well-informed, well-timed, and well-targeted decisions. The Government will want to do what it can to soften the economic blow, manage health resources and keep unemployment as low as possible.

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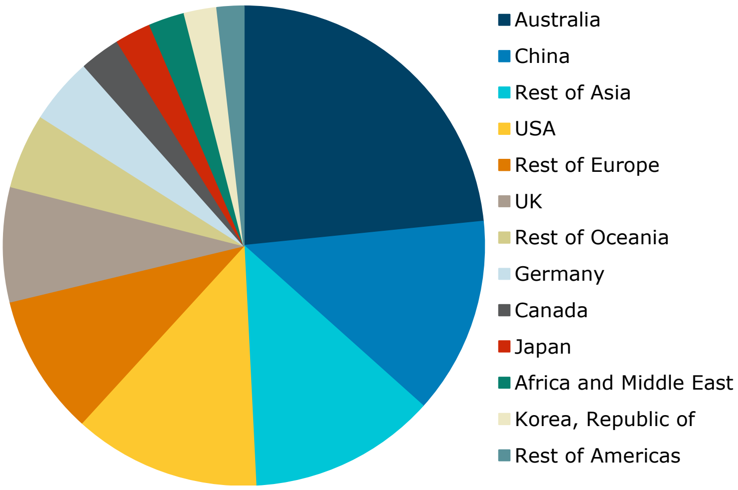
The tourism industry is struggling.

One industry that will need all the help it can get is tourism. Domestic tourism will soon be allowed, meaning some revenue will return. But it appears international travel with be off the table for the foreseeable future – potentially until a vaccine or treatment is available – leaving an enormous economic hole. There's no point in trying to hold the industry in stasis for a return to normal 'one day'. Resources need to shift; the economy needs to adapt to the new reality. Not every business can or should be saved. That's the brutal reality.

A trans-Tasman bubble would help.

But one way to ease the economic blow is by allowing the opening of our borders to Australia, given that they have also made excellent progress to date in beating back the virus (although they are notably still dealing with some active clusters). This idea of a "trans-Tasman bubble" has gained some traction of late. We have a lot more to say about this in a future ANZ Weekly Focus, but our overall view is that this would reduce the blow to tourism, but wouldn't be a panacea. International tourism comprises 40% of total tourism in New Zealand, with 24% of international visitor spend coming from Australians (figure 2), so it's only a portion. It should also be borne in mind that not all of those Aussie visitors are here for a holiday – and we have to be realistic about the fact that holidays are a 'nice to have' at a time when the Australian economy will also be a deep recession with rising unemployment.

Figure 2. International spend in New Zealand by country (NZDm)



Source: MBIE

But impacts on tourism will still be sizeable and long lasting.

That said, there are many who would want to hop across the ditch in both directions if borders were opened. International travel options for both Australians and New Zealanders will be limited, to say the least. And while a holiday in New Zealand isn't exactly a close substitute for, say, the south of France, we do have a lot of great attractions, including great skiing. Limited options and the fact that there are about five times as many Australians as New Zealanders mean there would definitely be a meaningful boost for the tourism sector. A lower NZD/AUD would also help.

Kiwis are also likely to substitute domestic holidays for international ones. But again, there will be many households looking to tighten their belts, weighing on visitor numbers and prices. Additionally, while domestic travel is set to be on the cards before trans-Tasman travel (and comprises a much larger share of tourism sector income), kiwis tend to spend less on their domestic trips than international visitors do. So overall, it's going to be a very tough time ahead for the industry, even if domestic travel looks set to resume and a trans-Tasman bubble may provide some relief. In any case, before we can transition into a trans-Tasman bubble, we will likely need to make it through to Alert Level 1, and it is still unclear what it would take to move there. But more days with no new cases and we could be well on the way.

Economic overview

QE is expected to be doubled at the MPS.

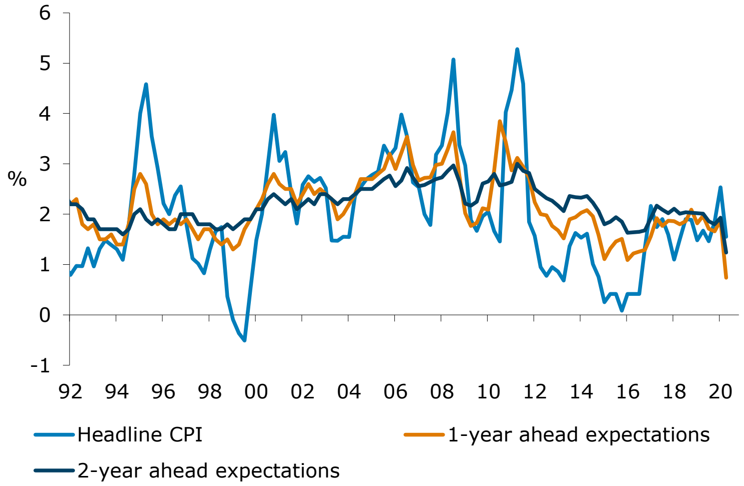
The other key event this week will be the RBNZ's MPS on Wednesday. We expect that the QE programme will be roughly doubled from $33bn to $60bn, with most of the new purchases oriented towards Government bonds (NZGBs), soaking up expected increases in bond issuance. However, this sort of ramp-up appears to be "in the bag" based on market expectations and anything less will likely disappoint.

A case could be made for the RBNZ to do more.

A case could be made for the RBNZ to do more than meet expectations and expand QE to $60bn – this shock is enormous and inflation expectations have fallen dramatically, reaching record lows (figure 3). While we expect that inflation expectations will rise from here as we move past the worst of the shock, current reads are well below the target midpoint, and there is a risk they might stay stubbornly low.

The RBNZ may want to push harder in order to make sure they put a floor under inflation expectations. If they did exceed expectations with stimulus next week, then this would pose some upside risk to our forecasts, which would be nice as they are rather bleak (including our expectations for inflation). From that perspective, more stimulus would be welcome. The question is how the RBNZ might choose to do it.

Figure 3: Inflation expectations



Source: RBNZ, Statistics NZ

Markets are pricing in a chance of cuts.

Markets are currently speculating about what more can be done and have moved to price in 4bps of OCR cuts this week (figure 4). That might not sound like much, but it is a nod to the possibility that the OCR could go lower than its current level of 0.25% (say to 0.1%), or even negative, despite the RBNZ's clear forward guidance in March that the OCR would not be moved in either direction for 12 months. The fact that 21bps of cuts is priced in by the start of next year suggests that negative rates are considered to be quite possible in time, at least as far as markets are concerned.

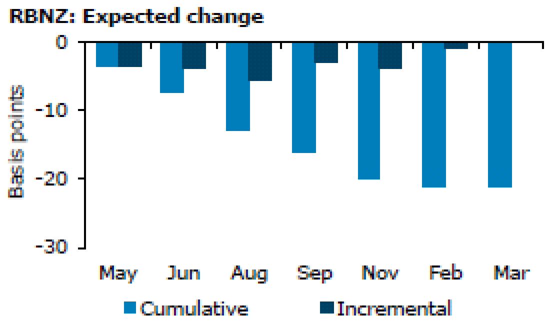
But we see QE as the tool of choice for a while.

Overall, we see risks skewed towards the RBNZ doing more. But while we wouldn't want to rule anything out, and negative interest rates may be with us in time, we don't see it happening any time soon. In our view, QE will remain the tool of choice for some time yet, and it's the right tool for the current job. (For more on how QE works, check out our recent FAQ.)

Economic overview

Figure 4: Market pricing for the Official Cash Rate

New Zealand	Rate	Change
Current Rate	*0.25*	***from current***
Wed 13 May 20	0.22	-0.04
Wed 24 Jun 20	0.18	-0.08
Wed 12 Aug 20	0.12	-0.13
Wed 23 Sep 20	0.09	-0.16
Wed 11 Nov 20	0.05	-0.20
Wed 10 Feb 21	0.04	-0.21
Wed 24 Mar 21	0.04	-0.21



Source: Bloomberg, ANZ Research

We've talked before about why we don't think negative rates are likely in the next wee while at least, and why we're dubious about the concept at all.

We don't think negative rates are a good choice.

In particular:

- Banks and financial infrastructure would need to be ready (and it currently isn't);
- Groundwork needs to be done to ready the public, especially given the impact that it would have on savers;
- Negative rates would need to be more acceptable internationally – it is still controversial as a policy tool, and although we don't think the RBNZ would shy away from challenging the status quo, evidence on its effectiveness in Europe is mixed at best;
- The economic outlook would need to be materially worse and QE would need to be perceived as having hit its limits, given that gains can still be made on that front.
- Credit markets would need to be resilient and financial risks would need to have dissipated. Negative policy rates can undermine the performance of the banking system and thereby credit supply, which is particularly concerning if markets are vulnerable to a repricing of risk and funding pressures emerging, as they are now.

So what can the RBNZ do?

So then the obvious question is – what else could the RBNZ do? We would emphasise that there are plenty of other more straightforward, less risky options available before negative rates would be the obvious next cab off the rank. There are various options that are an extension of the current QE programme and which could provide significant stimulus seem the more logical choices to us:

- **Expanding asset purchases** to more than $60bn (say $65-70bn in the first instance, and potentially more in time). This would likely involve buying LGFA or inflation-linked bonds, since there are limits to how many NZGBs the Government would want to hold.
- Providing **more forward guidance** about wanting to see the yield curve lower and flatter than it is now, perhaps saying that they expect rates to be low for a long time, and want long-term yields closer to short-end ones.
- Stating that they are willing to conduct "**unlimited" QE** in order to see the yield curve where they want it, as done by the Federal Reserve. This doesn't mean purchases would literally be unlimited, but would remove any sort of cap and emphasise a willingness to do what is required.

Lots!

- Providing explicit forward guidance about where they want the yield curve to go in response to QE – basically setting a price target. This is called "**yield curve control**" and it is used by the RBA.
- Expanding QE to **include other assets**, like residential mortgage backed securities or highly rated corporate bonds. This could be difficult and distort incentives and risk pricing, so is the least desirable, in our view.

These options are less risky and more straightforward.

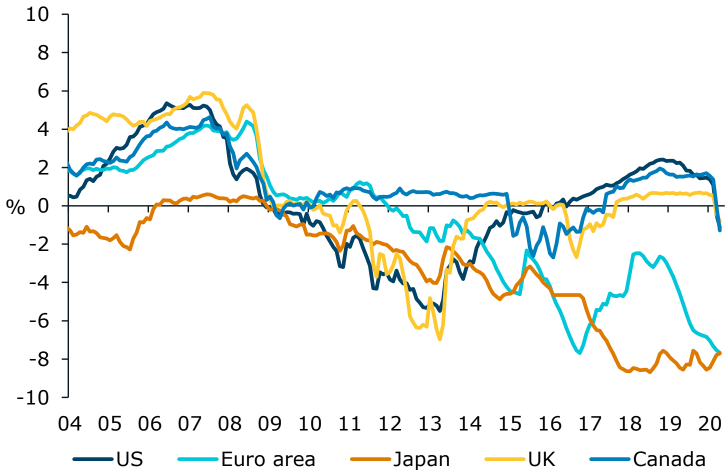
And they could be quite effective.

All of these policies could be implemented before taking the OCR negative. And although some would require changes to current arrangements (eg introducing more securities), they would be relatively straightforward and less risky than employing a negative OCR. We remain of the view that negative policy rates, if they were employed, would be a long way off.

It is also possible that the RBNZ could lower the OCR to something very low but still positive, say 0.1%. However, this was also ruled out in the RBNZ's forward guidance in March. In any case, an extra 15bps would be nothing compared to the sort of impact QE can achieve, and focusing attention on QE is likely to deliver the best results.

Estimates are very uncertain but at this stage, we are running with the rough rule of thumb that $10bn of QE is equivalent to a 50bp reduction in the OCR. That means that an increase of $27bn this week would provide an extra 135bps worth of stimulus, which would take estimates of the stance of policy – or "Shadow Short Rates" (SSRs) – from -2% to around -3.25%, or lower. And there is scope for much more. SSR estimates internationally have gone a lot lower and the same could occur here with more QE (figure 5).

Figure 5. Shadow short rates



Source: LJK Limited

This week's decision carries a lot of uncertainty, even if more QE is expected.

All of that said, there is an enormous amount of uncertainty about the path forward at present – and more than it might seem. There is some consensus on the quantity of QE that might be on the table, but not a lot of agreement on what will happen next. That is partly why markets are drifting towards pricing in negative rates – they are looking for direction. Views within the RBNZ are likely to be evolving quite quickly in response to a rapidly evolving situation, so one can't be too hung up on what the RBNZ have said before, nor can one easily predict what they might be thinking. So although the forward guidance in March was quite definitive, the MPS could nonetheless surprise us, and markets. See FX/Rates (page 10) for more details.

Reflecting this uncertainty, focus will be particularly on any tweaks to the RBNZ's forward guidance. Last time, they committed to leaving the OCR unchanged at 0.25% for "at least 12 months" – any change to this that left open the possibility of the OCR going lower sooner would be widely perceived to be opening up the door to negative rates, even if the RBNZ don't at this stage intend to pull the trigger. Markets even just pricing in the possibility would give 'free' stimulus in terms of holding down short rates, but could create volatility down the track. Beyond negative rates, the market will also be looking for an indication of what might be the next cab off the rank and what other tools the RBNZ might have up its sleeve. There are lots of options, and in our view they won't be afraid to use them if required.

Economic overview

Local data

Building Consents – March. The first hard-data impacts of the COVID-19 crisis and lockdown were seen in building consents data for March, which fell 21% – the largest monthly fall since October 2008. More weakness is set to come.

ANZ Commodity Price Index – April. The ANZ World Commodity Price Index fell a further 1.1% in April. The index has now fallen 9% in the past year.

GlobalDairyTrade auction. The auction delivered a stronger result than expected. The GDT Price Index fell just 0.8% against expectations of a fall closer to 5%. Whole milk powder and skim milk powder prices both lifting 0.1%.

Labour Market Statistics – Q1. The unemployment rate moved broadly sideways in Q1, with the current lockdown not evident in the data – yet. This reflects measurement issues and the fact that the data is now out of date.

RBNZ Inflation Expectations Survey – Q2. 2-year ahead inflation expectations declined to a record low of 1.24%. The dip is hardly a surprise – we've certainly downgraded our CPI outlook over the past few months. The 10-year ahead remained stable at 1.96%. The RBNZ will certainly have its work cut out if this slips meaningfully.

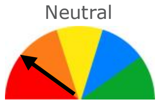
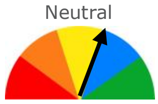
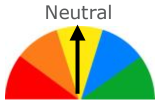
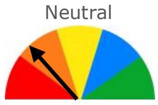
Treasury's Interim Financial Statements of the Government of New Zealand for the nine months ended 31 March 2020. March showed the beginning of the deterioration in the Government's books, largely as expenses lifted on wage subsidy payments.

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.

- RBNZ Quantitative Easing FAQ
- RBNZ MPS Preview – QE hui
- NZ Q1 Labour Market Review – Standing idle
- NZ Dairy Update - Defying gravity
- ANZ NZ Commodity Price Index - Slow motion
- NZ Budget 2020 Preview - The end of the beginning

The ANZ heatmap

Variable	View	Comment	Risks around our view
GDP	-5.5% y/y for 2021 Q1	Highly uncertain, but we know the coming domestic recession will be deep. We expect a bounce, even if some activity is never regained.	
Unemployment rate	8.1% for 2021 Q1	The labour market is set to deteriorate rapidly, with the unemployment rate set to rise significantly.	
Monetary policy	OCR at 0.25% in June 2020	A 0.25% OCR is here for at least 12 months. We expect QE to be roughly doubled to $60bn to keep bond curves low and flat.	
CPI	0.9% y/y for 2021 Q1	Inflation is currently around where it needs to be, but is set to slip and remain weak as the slowdown takes hold.	

FX / rates overview

Summary

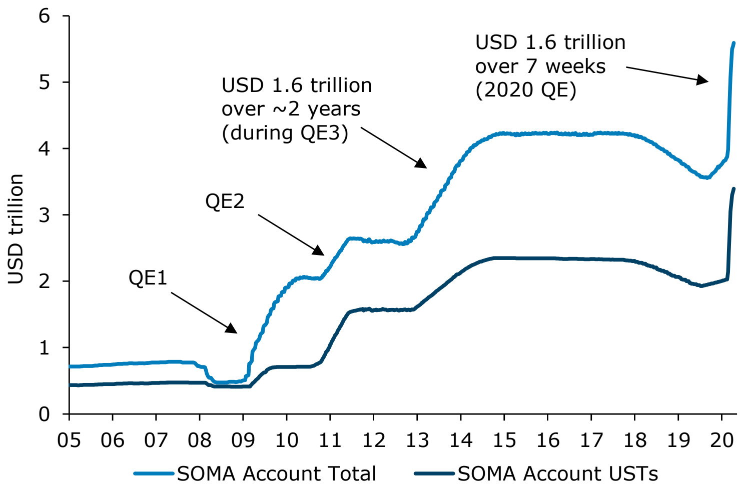
Global financial markets continue to be fuelled by liquidity, with equity indices well off earlier lows, bond yields still close to lows and high-grade credit spreads narrower. Although all of these are intended outcomes of QE, we remain cautious about the apparent gap between equity market sentiment and the economic outlook. This week's key events are the RBNZ MPS and the Budget. We expect NZGB issuance for 2020/21 to be lifted to a record $45bn pace, but the impact of this supply will be more than offset by a doubling of the QE programme to $60bn. QE has and will remain large enough to absorb all NZGB issuance through until the middle of next year, keeping the NZGB yield curve low and flat. Buoyant markets have also helped keep the NZD elevated, and it may snap higher if the RBNZ maintains its forward guidance ruling out OCR cuts this year. However, risks are tilted towards more easing in time and the NZD remains sensitive to global risk appetite. Those are its Achilles heels.

The Budget will show record bond issuance, but this will be matched by more QE.

Global financial markets remain buoyant despite record rapid rises in unemployment across the globe and many central banks forecasting the deepest recessions in over 100 years. Liquidity remains the main driver. While at a high level that's arguably to be expected given how quickly the latest round of QE has occurred in most countries, we remain guarded about how sustainable rises in prices of risky assets like equities are, given how dire the economic outlook is. To illustrate how quickly liquidity has hit markets, consider the following: the Fed's latest round of QE has seen it expand its balance sheet by USD 1.6trn, which is about the same as QE1 or QE3, but QE3 occurred over around two years, while this latest expansion has occurred over just seven weeks (figure 1).

The expansion of liquidity this year has been on a par with past periods of QE, only faster – a lot faster!

Figure 1: Size of the US Federal Reserve's SOMA (QE) Portfolio



Source: Bloomberg

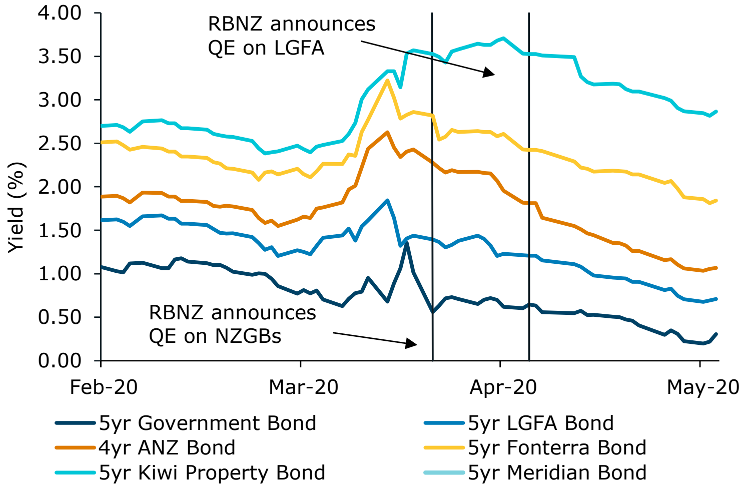
The rapid increase in liquidity has also been felt in New Zealand interest rate markets, with corporate bond yields falling at least as fast as government bond yields (figure 2 - overleaf). These are, of course, the intended outcomes of the RBNZ's QE programme, and we expect these broad trends to continue over coming weeks as the programme gets expanded to $60bn.

Ordinarily we'd be calling for a steeper curve about now …

That said, the picture is extremely complicated. Indeed, ordinarily, we'd expect bond yields to start rising about now, following the typical pattern of the yield curve steepening well before we hit the low point in growth (which is likely to be happening this quarter). Markets are forward-looking whereas economic data tends to lag the cycle, and markets tend to be quick to swing from "if they aren't cutting then their next move will be a hike" mentality. Most cycles are also very gradual, whereas this time around the slowdown was extraordinarily abrupt and the recovery is expected to be uncertain and protracted. That makes it an extremely atypical cycle. Just because we are likely at the growth lows doesn't mean it's time to price in the recovery – we are right at the very start of this.

Ordinarily, the low point in the cycle is often characterised by increased bond issuance as fiscal automatic stabilisers kick in (higher government spending and transfers and lower tax revenue), exacerbating the sell-off in bonds. But this time around, we have QE containing what would otherwise be rising bond yields.

Figure 2: Yields on selected New Zealand 4-5 year corporate bonds



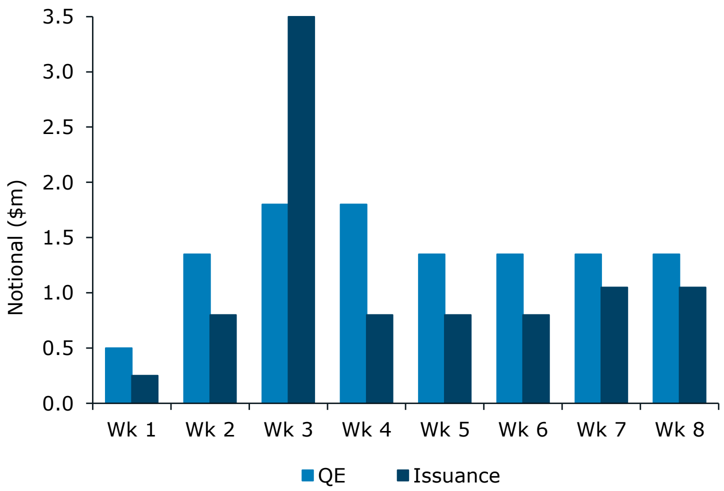
Source: Bloomberg, RBNZ

... but RBNZ QE is helping keep the curve low and flat.

Indeed, this downturn will see the most dramatic fiscal expansion ever seen, and while that would ordinarily give the bond market an enormous bellyache, QE is more than offsetting issuance and we expect it to continue to do so. Next year's likely $45bn bond programme will be easily absorbed by the remaining headroom on the RBNZ's already announced $33bn programme and the lift to $60bn we expect. Although it's true that the market is starting to ask the question of what happens down the track when QE can't absorb all issuance, that situation won't arise till mid 2021 at the earliest, and even then the RBNZ has options. In the short term, we expect weekly QE buying flows and issuance selling flows to be the main driver of bond yields. To date, QE demand has outpaced issuance supply (Figure 3) and we don't expect that to change any time, which should keep the NZGB curve low and flat.

Figure 3: QE versus issuance over the 8 weeks since inception (including this week)

QE has generally exceeded issuance.



Source: RBNZ, NZDM

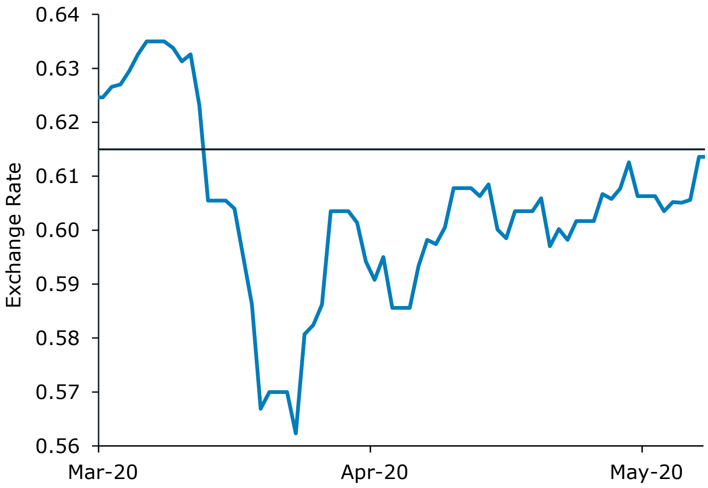
Markets are pricing in some chance of an OCR cut this week and talk of negative rates has been widespread. We don't expect a cut, but given what's priced in, if we are right, the short end is in for a correction, with the magnitude dependent on the RBNZ's forward guidance. If the RBNZ maintains its "at least 12 months" guidance for leaving the OCR unchanged, we are in for a decent amount of re-pricing. But if those words are

A break above 0.6150 could occur if the RBNZ maintains March's forward guidance…

absent, we wouldn't expect the market to give up on OCR cuts, even without a cut or an explicit suggestion that one might be forthcoming. This is especially true given the US market is now pricing in some probability of a negative Fed Funds rate, and given recent comments by RBNZ Governor Orr seemingly in favour of negative rates.

Currency markets remain especially sensitive to the prospect of negative rates, and the recent shift in Fed Funds expectations has weighed on the USD. Improving global liquidity conditions have also benefitted the NZD and other risk currencies, but even so, over the past few weeks, NZD/USD has struggled to sustain breaks above 0.6150 (figure 4).

Figure 4: NZD/USD since early March



Source: Bloomberg

We are just under that level now, and that's ahead of what is a consensus expectation of both a mega-expansionary Budget and a further expansion to QE, so barring any major surprises, we don't expect a sustained break higher this week either.

… but we expect the market to fade the move.

We do see some risk that the NZD will spike higher if the RBNZ maintains their earlier guidance that the OCR will remain at 0.25% for at least the next 12 months. However, we'd characterise that as a knee-jerk reaction that would likely prove short-lived. With inflation expectations tanking, the risks are skewed towards the RBNZ doing more rather than less easing over time (as discussed on page 6), even if that's not immediate OCR cuts. We are also mindful that NZD price action over the past few weeks has shown that it remains sensitive to risk sentiment, and given our caution with regard to the apparent disconnect between the economic outlook and asset prices, we still see NZD strength as being on borrowed time.

Data calendar

Date	Country	Data/event	Mkt.	Last	NZ time
11-May	CH	Money Supply M2 YoY - Apr	10.3%	10.1%	11-15 May
	CH	New Yuan Loans CNY - Apr	1300.0B	2850.0B	11-15 May
	NZ	Card Spending Retail MoM - Apr	-50.0%	-3.9%	10:45
	NZ	Card Spending Total MoM - Apr	--	-8.7%	10:45
	NZ	ANZ Business Confidence - May P	--	-66.6	13:00
	NZ	ANZ Activity Outlook - May P	--	-55.1	13:00
12-May	NZ	ANZ Truckometer Heavy MoM - Apr	--	-8.0%	10:00
	AU	ANZ-RM Consumer Confidence Index - 10-May	--	89.5	11:30
	AU	NAB Business Conditions - Apr	--	-21	13:30
	AU	NAB Business Confidence - Apr	--	-66	13:30
	CH	PPI YoY - Apr	-2.6%	-1.5%	13:30
	CH	CPI YoY - Apr	3.7%	4.3%	13:30
	US	NFIB Small Business Optimism - Apr	85.0	96.4	22:00
13-May	US	CPI MoM - Apr	-0.8%	-0.4%	00:30
	US	CPI YoY - Apr	0.4%	1.5%	00:30
	US	CPI Ex Food and Energy MoM - Apr	-0.2%	-0.1%	00:30
	US	CPI Ex Food and Energy YoY - Apr	1.7%	2.1%	00:30
	US	Monthly Budget Statement - Apr	-$737.2B	-$119.1B	06:00
	JN	BoP Current Account Balance - Mar	¥2043.0B	¥3168.8B	11:50
	JN	BoP Current Account Adjusted - Mar	¥1287.2B	¥2378.1B	11:50
	JN	Trade Balance BoP Basis - Mar	¥184.7B	¥1366.6B	11:50
	AU	Westpac Consumer Conf Index - May	--	75.6	12:30
	AU	Westpac Consumer Conf SA MoM - May	--	-17.7%	12:30
	AU	Wage Price Index QoQ - Q1	0.5%	0.5%	13:30
	AU	Wage Price Index YoY - Q1	2.1%	2.2%	13:30
	NZ	RBNZ Official Cash Rate - May	0.25%	0.25%	14:00
	UK	Industrial Production MoM - Mar	-5.5%	0.1%	18:00
	UK	Industrial Production YoY - Mar	-9.1%	-2.8%	18:00
	UK	Manufacturing Production MoM - Mar	-6.0%	0.5%	18:00
	UK	Manufacturing Production YoY - Mar	-10.5%	-3.9%	18:00
	UK	Index of Services 3M/3M - Mar	-2.5%	0.2%	18:00
	UK	Visible Trade Balance GBP/Mn - Mar	-£10000M	-£11487M	18:00
	UK	Trade Balance Non EU GBP/Mn - Mar	-£4000M	-£5573M	18:00
	UK	Trade Balance GBP/Mn - Mar	-£2500M	-£2793M	18:00
	UK	Monthly GDP (MoM) - Mar	-7.9%	-0.1%	18:00
	UK	GDP QoQ - Q1 P	-2.5%	0.0%	18:00
	UK	GDP YoY - Q1 P	-2.1%	1.1%	18:00
	EC	Industrial Production SA MoM - Mar	-12.0%	-0.1%	21:00
	EC	Industrial Production WDA YoY - Mar	-11.9%	-1.9%	21:00
	US	MBA Mortgage Applications - 8-May	--	0.1%	23:00
14-May	US	PPI Final Demand MoM - Apr	-0.5%	-0.2%	00:30
	US	PPI Final Demand YoY - Apr	-0.3%	0.7%	00:30
	US	PPI Ex Food and Energy MoM - Apr	0.0%	0.2%	00:30
	US	PPI Ex Food and Energy YoY - Apr	0.9%	1.4%	00:30
	NZ	REINZ House Sales YoY - Apr	--	-4.8%	09:00
	NZ	Net Migration SA - Mar	--	8250	10:45
	UK	RICS House Price Balance - Apr	-25%	11%	11:01
	AU	Consumer Inflation Expectation - May	--	4.6%	13:00

Continued on following page

Data calendar

Date	Country	Data/event	Mkt.	Last	NZ time
14-May	AU	Employment Change - Apr	-550.0k	5.9k	13:30
	AU	Unemployment Rate - Apr	8.3%	5.2%	13:30
	AU	Participation Rate - Apr	65.3%	66.0%	13:30
	NZ	Budget 2020	--	--	14:00
	GE	CPI EU Harmonized MoM - Apr F	0.4%	0.4%	18:00
	GE	CPI EU Harmonized YoY - Apr F	0.8%	0.8%	18:00
	GE	CPI MoM - Apr F	0.3%	0.3%	18:00
	GE	CPI YoY - Apr F	0.8%	0.8%	18:00
15-May	US	Import Price Index MoM - Apr	-3.4%	-2.3%	00:30
	US	Import Price Index YoY - Apr	-7.3%	-4.1%	00:30
	US	Export Price Index MoM - Apr	-2.3%	-1.6%	00:30
	US	Export Price Index YoY - Apr	--	-3.6%	00:30
	US	Initial Jobless Claims - 9-May	2500k	3169k	00:30
	US	Continuing Claims - 2-May	24800k	22647k	00:30
	NZ	BusinessNZ Manufacturing PMI - Apr	--	--	10:30
	JN	PPI MoM - Apr	-0.8%	-0.9%	11:50
	JN	PPI YoY - Apr	-1.4%	-0.4%	11:50
	CH	Industrial Production YoY - Apr	1.5%	-1.1%	14:00
	CH	Industrial Production YTD YoY - Apr	-5.4%	-8.4%	14:00
	CH	Retail Sales YoY - Apr	-5.9%	-15.8%	14:00
	CH	Retail Sales YTD YoY - Apr	-13.8%	-19.0%	14:00
	CH	Fixed Assets Ex Rural YTD YoY - Apr	-9.5%	-16.1%	14:00
	GE	PPI MoM - Apr	--	-0.8%	18:00
	GE	PPI YoY - Apr	--	-0.8%	18:00
	GE	GDP SA QoQ - Q1 P	-2.3%	0.0%	18:00
	GE	GDP NSA YoY - Q1 P	-1.6%	0.3%	18:00
	GE	GDP WDA YoY - Q1 P	-2.0%	0.4%	18:00
	EC	Trade Balance SA - Mar	€17.0B	€25.8B	21:00
	EC	Trade Balance NSA - Mar	--	€23.0B	21:00
	EC	Employment QoQ - Q1 P	--	0.3%	21:00
	EC	Employment YoY - Q1 P	--	1.1%	21:00
	EC	GDP SA QoQ - Q1 P	-3.8%	-3.8%	21:00
	EC	GDP SA YoY - Q1 P	-3.3%	-3.3%	21:00
16-May	US	Retail Sales Advance MoM - Apr	-11.7%	-8.4%	00:30
	US	Retail Sales Ex Auto and Gas - Apr	-6.0%	-2.8%	00:30
	US	Retail Sales Control Group - Apr	-4.2%	2.0%	00:30
	US	Retail Sales Ex Auto MoM - Apr	-8.4%	-4.2%	00:30
	US	Empire Manufacturing - May	-60.0	-78.2	00:30
	US	Industrial Production MoM - Apr	-12.0%	-5.4%	01:15
	US	Capacity Utilization - Apr	64.0%	72.7%	01:15
	US	Manufacturing (SIC) Production - Apr	-14.0%	-6.3%	01:15
	US	Business Inventories - Mar	-0.2%	-0.4%	02:00
	US	JOLTS Job Openings - Mar	--	6882	02:00
	US	U. of Mich. Sentiment - May P	68.0	71.8	02:00
	US	Net Long-term TIC Flows - Mar	--	$49.4B	08:00
	US	Total Net TIC Flows - Mar	--	-$13.4B	08:00

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

Date	Data/event	Economic signal	Comment
Mon 11 May (1:00pm)	ANZ Business Outlook – May Preliminary	--	--
Mon 11 May (10:45am)	Electronic Card Transactions – April	Noisy	Retail spend was down 3.9% in March, with strong growth in consumables offset by weak hospitality, apparel and services.
Tue 12 May (10:00am)	ANZ Truckometer – April	--	--
We 13 May (10:45am)	Rental Price Index – April	Wither	Fewer students and rent freezes. Is this historically significant driver of domestic inflation about to wither? Probably.
Wed 13 May (2:00pm)	RBNZ Monetary Policy Statement – May	Hold	With the OCR on hold "for at least the next 12 months" it's all about QE and the RBNZ's assessment of how the situation is likely to evolve. We see QE roughly doubling to $60bn.
Thu 14 May (09:00am)	REINZ housing data – April	Stopped	The housing market will have ground to a halt in April. Expect some volatility, with a trend deterioration forming overall.
Thu 14 May (2:00pm)	NZ Budget	Massive	A spike in debt, huge deficits, and a new fiscal strategy. The Government is taking on COVID-19 head on. It's still early days, but hopefully the Budget will mark the end of the beginning and the beginning of the recovery.
Wed 20 May (early am)	GlobalDairyTrade auction	Weaker	Prices are expected to fall further as the NZ dairy production season draws to a close. Returns are expected to continue to ease further into Q3 as the new production season commences.
Wed 20 May (10:45am)	Food Price Index – April	Uncertain	Higher demand for groceries and necessities; zero supply of restaurant meals. It's all pretty uncertain.
Wed 20 May (1:00pm)	ANZ Monthly Inflation Gauge – April	--	--
Fri 22 May (10:45am)	Retail Sales – Q1	On a cliff edge	Q1 sales volumes will likely show a few cracks around the edges, but nothing compared to what's coming in Q2.
Tue 26 May (10:45am)	Overseas Merchandise Trade – April	Holding up	Goods exports have been holding up well. Imports have tailed off owing to supply disruptions and a weak domestic demand pulse. We see this theme continuing.
Wed 27 May (09:00am)	RBNZ Financial Stability Report – May	Changed	The global economy is materially weaker, and that could expose financial market vulnerabilities. Weakness in the property market and associated risks may also be a theme. At least the NZD is down and dairy prices haven't fallen too much, yet.
Thu 28 May (1:00pm)	ANZ Business Outlook – May	--	--
Fri 29 May (10:00am)	ANZ Roy Morgan Consumer Confidence – May	--	--
Tue 2 Jun (10:45am)	Terms of Trade – Q1	Up a little	The terms of trade are expected to improve slightly in Q1, as export returns held relatively well, while import prices eased.
Tue 2 Jun (10:45am)	Building Consents – April	Drop	Building consents look set to drop considerably in April, but the recent pipeline of work should keep construction going for a while. The question is how many projects will be cancelled. Weak demand will weigh medium term.
Wed 3 Jun (early am)	GlobalDairyTrade auction	Weaker	Prices are expected to fall further as the NZ dairy production season draws to a close. Returns are expected to continue to ease further into Q3 as the new production season commences.
Thu 4 Jun (1:00pm)	ANZ Commodity Price Index – May	--	--
Mon 8 Jun (10:45am)	Work Put In Place – Q1	Tools down	Solid activity early in the quarter will be offset by the halt in activity as lockdown began.
Tue 9 Jun (10:00am)	ANZ Truckometer – May	--	--
On balance		**Data watch**	**Risks are clearly tilted to the downside, with global developments evolving rapidly.**

Key forecasts and rates

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
GDP (% qoq)	0.5	**-2.5**	**-20.6**	**15.5**	**2.0**	**1.0**	**1.0**	**1.0**	**1.0**
GDP (% yoy)	1.8	**-1.2**	**-21.6**	**-10.1**	**-8.8**	**-5.5**	**20.2**	**5.1**	**4.1**
CPI (% qoq)	0.5	0.8	**-0.4**	**0.1**	**-0.1**	**0.5**	**0.2**	**0.3**	**-0.2**
CPI (% yoy)	1.9	2.5	**1.6**	**1.0**	**0.4**	**0.1**	**0.7**	**0.9**	**0.8**
Employment (% qoq)	0.0	0.7	**-6.0**	**-2.5**	**2.5**	**2.0**	**0.7**	**0.9**	**1.0**
Employment (% yoy)	1.0	1.6	**-5.1**	**-7.7**	**-5.4**	**-4.2**	**2.6**	**6.2**	**4.7**
Unemployment Rate (% sa)	4.0	4.2	**7.6**	**10.5**	**9.4**	**8.1**	**8.0**	**7.7**	**7.1**

	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20
Retail ECT (% mom)	-0.1	1.2	0.4	-0.5	2.6	-0.5	-0.2	0.5	-3.9	--
Retail ECT (% yoy)	2.0	3.1	0.6	1.6	5.1	3.9	4.2	8.6	-1.8	--
Car Registrations (% mom)	5.6	-0.7	4.4	-6.6	0.3	1.2	-6.1	9.1	-30.6	-88.7
Car Registrations (% yoy)	-5.4	-5.2	4.7	-6.6	3.0	5.6	-3.5	-0.3	-31.1	-92.5
Building Consents (% mom)	-1.5	0.8	7.5	-1.7	-8.3	10.5	-3.3	5.7	-21.3	--
Building Consents (% yoy)	18.1	12.3	24.3	18.9	8.6	18.0	1.4	5.1	-13.4	--
REINZ House Price Index (% yoy)	1.6	2.7	3.2	3.8	5.5	6.5	6.9	8.6	9.3	--
Household Lending Growth (% mom)	0.5	0.6	0.5	0.5	0.6	0.6	0.6	0.6	0.2	--
Household Lending Growth (% yoy)	5.9	6.0	6.1	6.2	6.3	6.5	6.6	6.7	6.4	--
ANZ Roy Morgan Consumer Conf.	116.4	118.2	113.9	118.4	120.7	123.3	122.7	122.1	106.3	84.8
ANZ Business Confidence	-44.3	-52.3	-53.5	-42.4	-26.4	-13.2	..	-19.4	-63.5	-66.6
ANZ Own Activity Outlook	5.0	-0.5	-1.8	-3.5	12.9	17.2	..	12.0	-26.7	-55.1
Trade Balance ($m)	-732	-1642	-1310	-1038	-786	380	-396	531	672	--
Trade Bal ($m ann)	-5516	-5591	-5321	-5055	-4837	-4467	-3927	-3302	-3456	--
ANZ World Comm. Price Index (% mom)	-1.4	0.3	0.0	1.2	4.3	-3.4	-1.4	-2.1	-2.0	-1.1
ANZ World Comm. Price Index (% yoy)	-0.5	0.9	3.4	7.2	12.4	8.7	5.1	0.1	-5.8	-9.2
Net Migration (sa)	5030	5310	5150	5620	4920	6090	6860	8250	--	--
Net Migration (ann)	51765	52799	53424	55025	55543	57259	61053	65211	--	--
ANZ Heavy Traffic Index (% mom)	2.3	-3.5	3.4	2.7	-1.5	-2.6	4.7	-3.2	-8.0	--
ANZ Light Traffic Index (% mom)	1.4	0.3	-0.3	0.2	0.9	-2.2	2.9	-0.8	-29.3	--
ANZ Monthly Inflation Gauge (% mom)	0.5	0.3	0.3	0.3	0.1	0.4	0.6	0.2	0.1	--

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	Mar-20	Apr-20	Today	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
NZD/USD	0.594	0.613	0.614	0.57	0.53	0.55	0.57	0.59	0.60
NZD/AUD	0.976	0.936	0.941	0.95	0.98	0.98	0.95	0.97	0.97
NZD/EUR	0.543	0.563	0.567	0.55	0.53	0.56	0.58	0.59	0.58
NZD/JPY	64.55	65.30	65.45	63.8	59.4	61.6	63.8	66.1	67.2
NZD/GBP	0.481	0.489	0.495	0.47	0.45	0.47	0.48	0.48	0.48
NZ$ TWI	68.40	69.24	69.50	67.1	64.6	66.7	68.2	69.9	70.2
Interest rates/QE	Mar-20	Apr-20	Today	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
NZ OCR	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
LSAP ($bn)	30	33	33	60	60	60	60	60	60
NZ 90 day bill	0.49	0.27	0.26	0.32	0.32	0.32	0.32	0.32	0.32
NZ 10-yr bond	1.08	0.88	0.70	0.75	1.00	1.25	1.50	1.50	1.50
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
US 3-mth	1.45	0.69	0.43	0.40	0.40	0.40	0.40	0.40	0.40
AU Cash Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
AU 3-mth	0.37	0.10	0.10	0.20	0.20	0.20	0.25	0.28	0.28

	8-Apr	4-May	5-May	6-May	7-May	8-May
Official Cash Rate	0.25	0.25	0.25	0.25	0.25	0.25
90 day bank bill	0.45	0.26	0.27	0.26	0.26	0.26
NZGB 05/21	0.26	0.14	0.13	0.13	0.13	0.11
NZGB 04/23	0.40	0.07	0.11	0.18	0.15	0.10
NZGB 04/27	0.86	0.38	0.40	0.50	0.47	0.41
NZGB 04/33	1.41	0.78	0.81	0.91	0.88	0.81
2 year swap	0.49	0.18	0.20	0.21	0.20	0.17
5 year swap	0.67	0.30	0.33	0.37	0.36	0.31
RBNZ TWI	68.37	68.38	68.65	68.70	68.41	69.18
NZD/USD	0.5974	0.6035	0.6052	0.6051	0.6056	0.6136
NZD/AUD	0.9680	0.9429	0.9392	0.9400	0.9368	0.9396
NZD/JPY	65.02	64.47	64.61	64.30	64.51	65.45
NZD/GBP	0.4840	0.4864	0.4860	0.4890	0.4896	0.4953
NZD/EUR	0.5495	0.5520	0.5584	0.5601	0.5612	0.5664
AUD/USD	0.6173	0.6400	0.6444	0.6438	0.6464	0.6532
EUR/USD	1.0872	1.0932	1.0838	1.0803	1.0792	1.0839
USD/JPY	108.84	106.84	106.75	106.26	106.52	106.65
GBP/USD	1.2345	1.2407	1.2454	1.2375	1.2371	1.2410
Oil (US$/bbl)	25.09	20.39	24.56	23.99	23.55	24.74
Gold (US$/oz)	1648.55	1704.90	1698.53	1702.00	1693.64	1702.70
NZX 50	10032	10476	10491	10573	10649	10696
Baltic Dry Freight Index	607	598	575	534	514	514
NZX WMP Futures (US$/t)	2710	2560	2560	2580	2580	2580

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