

To taper or not to taper, that is the question

The NZ COVID-19 count continued to trickle lower, with another 13 community cases reported yesterday (all in Auckland). NZ might have been slow out of the blocks, but it is catching up and is towards the top of the OECD for new COVID vaccinations per capita, with roughly 500k doses administered over the last week and close to two-thirds of the eligible population having had at least 1 dose of the 2-dose Pfizer programme. With an extra 250k Pfizer doses due to arrive in NZ this morning from Spain, PM Ardern was confident the NZ vaccination programme could retain strong momentum until the bulk of the Pfizer doses arrive in October. The faster the vaccine rollout and the more we follow the rules (social distancing and contact tracing), hopefully the more options we have in future.

The euro firmed after the ECB kept its key policy interest rates unchanged, settings unchanged, and with an “unanimous decision on all respects” (according to ECB President Lagarde) opted to conduct asset purchases at a “moderately lower pace” than earlier this year. ECB officials stressed the moves shouldn't be seen as a policy taper and reiterated they would keep their €1.85 trillion emergency programme running till at least March 2022. The ECB also reiterated interest rates would be at current or *lower* levels until the ECB was confident inflation would stabilise at 2% over the medium term. To us, the moves are very much a taper, with the impact of QE dependent on the *pace* of asset purchases as well as their outright *level*.

Markets traded with a mild risk-off tone overnight on concerns of reduced policy support and the impact of the worsening delta variant outbreak on global growth. Comments from yesterday's Fed Beige book signalling a deceleration in US growth momentum in recent months didn't help, despite the better US initial jobless claim data overnight (310k versus mkt: 335k).

There were sizeable moves lower in government bond yields overnight, with curves generally flattening. US Treasury yields were lower across the curve (10Y 1.30%, -4bps). This was despite comments by FOMC hawk (and non-voter) Kaplan pushing for an October taper that followed earlier calls by FOMC Vice Chair Williams for tapering before the end of the year. NZ bonds followed Australian yields lower, with still a massive gap in yields. NZ swap yields were little changed yesterday, but this followed a steady grind higher since the August MPS. Current market pricing (OIS) is more than 100% priced in for a 25bp OCR hike in October with 50bps of hikes priced in by the end of the year. This is consistent with our core economic view.

Global equities have continued their drift lower this week, with the major US indices falling on late session trading to be slightly lower than their open. Stocks in Europe erased some of their earlier losses, taking the announced 'taper' by the ECB as a sign of confidence in the economic outlook. Fears of further regulatory crackdowns weighed on Chinese stocks, with Asian stocks generally lower (ASX200 -2%, NZSX 50 -0.7). **Growth concerns and the reported tapping of crude reserves by China pushed near-term contract prices for oil to 2-week lows.**

It might be the rear vision mirror but data to date have suggested the NZ economy had considerable momentum heading into the lockdowns. We have pencilled in a circa 1½% increase in Q2 NZ GDP after yesterday's Q2 services sector data showed strong growth in scientific, architectural and engineering activity, coming on top of the ripper 3.3% Q2 climb in retail volumes and strong Q2 gains to transport sector activity related to the (brief) opening of the trans-Tasman bubble. Reported manufacturing volumes rose just 0.1% in Q2. And, although Q2 wholesale trade sales rose 3% in Q2, rising prices mean wholesale volumes are likely to be flat in Q2.

Surging commodity prices saw Chinese August producer price inflation lift to 9.5% yoy, its highest since 2008. To date there is limited flow-through to consumer prices, with lower food and oil prices seeing a smaller than expected 0.8% yoy lift in August CPI. Our CBA colleagues expect further monetary policy easing from the PBoC in the coming months.

FX Update: Safe-haven currencies were generally in the ascendancy overnight, with the yen and Swiss Franc at the top of the G10 leader board. NZD resilience has remained evident despite the more guarded market tone, with the NZD making gains against the USD and AUD. The NZD pushed through 71 US cents last night and traded in a 0.7075 to 0.7135 USD range overnight, with the kiwi firming to 96.5 Australian cents. Wide NZ interest rate differentials and a solid commodity price backdrop remain key NZD supports.

Day ahead: A large lockdown-induced fall is expected for NZ August card spending (we expect a circa 20% mom fall), which we expect to be short-lived given the subsequent move down in Alert Levels for much of the country. Border restrictions will contribute to still-weak readings for July NZ net PLT immigration, with the (currently-halted) trans-Tasman bubble providing a fleeting boost to travel. UK July data should show reasonable momentum for construction, industrial production and services activity. US August producer prices are expected to lift on the core (mkt: +6.3% yoy) and overall

measures (8.2% yoy), with the FOMC hoping this uplift is temporary with a fleeting impact on consumer prices. Time will tell. Have a safe and enjoyable weekend. Author: mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.7114	0.2%	NZD/SEK	6.122	-0.1%	NZX WMP	3735.0	0.1%	Dow	34915	-0.3%
NZD/AUD	0.9649	0.1%	NZD/DKK	4.472	0.1%	Gold \$/o	1794.2	0.3%	S&P 500	4500	-0.3%
NZD/EUR	0.6014	0.1%	NZD/THB	23.3	0.0%	WTI Oil \$/b	68.3	-1.5%	NASDAQ	15282	0.0%
NZD/JPY	78.04	-0.3%	AUD/USD	0.7372	0.0%	Money Market (%)			FTSE	7024	-1.0%
NZD/GBP	0.5139	-0.3%	EUR/USD	1.183	0.1%	90 Day BB	0.53	0.02	CAC-40	6685	0.2%
NZD/CAD	0.8999	2.3%	USD/JPY	109.7	-0.5%	OCR	0.25	0.00	DAX	15623	0.1%
NZD/CHF	0.6522	-0.4%	10 Yr Bond Yields (%)			ASB Swap Rates (%)			H.Seng	25716	-2.3%
NZD/HKD	5.533	0.2%	NZ	1.98	-0.04	1yr	1.05	0.01	Nikkei	30008	-0.6%
NZD/SGD	0.9551	-0.1%	US	1.30	-0.04	2yr	1.38	0.02	ASX200	7370	-1.9%
NZD/CNH	4.589	0.1%	Aust	1.27	-0.03	5yr	1.78	0.00	NZX50	13096	0.0%

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