

Time to reflect as the BoE rate hike delivers another 2021 surprise

With 2022 rapidly approaching it would be remiss not to reflect on 2021. Despite the clear risks from COVID-19, once again the NZ and global economies have proved to be remarkably resilient. Markets have adjusted accordingly, albeit to varying degrees. US Treasury and Australian bond yields out to the 10-year tenor are roughly 50bps to 100bps higher than at the start of the year. This pales in comparison to the 135bp-185bp jump in NZ counterparts, with the NZ 2-year swap rate up a massive 200bps as markets have rushed to do the RBNZ's work for it. Equity market performance has been reasonable globally (MSCI global index up 18%, S&P500 up 27%, ASX +11, but with higher NZ interest rates likely weighing on the NZSX 50, down 2.4%). Throughout 2021 currency movements were less volatile than in 2020, with the NZD trading in a 0.6745 to 0.7436 USD range, between 0.9165-0.9700 on the AUD and 72.6 to 76.8 on the NZ TWI.

Following yesterday's hawkish tilt by the FOMC, the BoE went one better by surprising markets and voting 8-1 to hike the bank rate by 15bps to 0.25%, the first G7 central bank to hike post-COVID-19. The reasons for the hike were very familiar to those here – concerns over “more persistent” medium-term inflation and very tight labour markets according to BoE Governor Bailey – with markets now placing 80% odds on a 25bp follow-up hike in February and speculating that the BoE will imminently cease reinvesting its expired QE bond holdings. UK yields and sterling jumped following the decision but have subsequently pared gains.

While the BOE move should encourage other central banks to get a move on, **ECB President Lagarde reaffirmed 2022 ECB rate hikes were very unlikely despite possible upside risks to the inflation outlook.** To avert a ‘brutal transition’ from the expiration of the €1.85bn Pandemic Emergency Purchase Programme (PEPP) in March, the ECB has pledged to temporarily double its Asset Purchase Programme in Q2 of 2022 to €40bn per month.

Market action overnight was mixed. A sell-off in major technology stocks (including Apple and Tesla) weighed on the Nasdaq, with modest falls in the S&P500. The major European stock indices were around 1% higher overnight, with only a brief dip in the FTSE 100 following the BoE hike. Chinese stocks were weighed by the possibility of US sanctions as political tensions ratchet up. US Treasury yields were lower across the curve, underpinned by strong demand. UK bond yields were about 2bps higher across the curve following the BoE hike, with Eurozone yields higher. The possible imposition of sanctions on Russia provided a boost to energy commodity prices.

Data wrap: US initial jobless claims (206k) were in line with expectations, with continuing claims down to a fresh post-March 2020 low (1,845k). US manufacturing (57.8) and services PMIs (57.5) depicted solid momentum, as did those for the UK (57.6 and 53.2, respectively), the Eurozone (58 and 53.3), and Australia (57.4 and 55.1). Other US data – industrial production (+0.5% mom), housing starts (+11.8% mom), building permits (+3.6% mom) – were solid.

NZ yields ticked up after Q3 NZ GDP showed a milder contraction relative to market expectations (-3.7% qoq, -0.3% yoy). As we [commented](#) yesterday, the better-than-expected result likely reflected strong underlying momentum heading into the mid-August lockdown and general resilience of the NZ economy. We are constructive on the outlook for the NZ economy over 2022, although are cognisant of the challenges facing households given high inflation, rising interest rates and a less supportive housing market backdrop.

Australian yields jumped after easing COVID-19 restrictions unleashed a monster 366k jump in November employment. While the participation rate rose to a five-month high (66.1%), the unemployment rate fell to 4.6%. In a speech, RBA Governor Lowe watered down the prospect of RBA hikes for 2022 and set out three options for tapering quantitative easing in February (including exiting QE altogether). Our CBA colleagues expect the labour market to tighten considerably over 2022 and for the cash rate to move up in late 2022.

FX Update: The post-FOMC jump in the USD proved to be short-lived, with the USD remaining weak overnight, and sterling and topping the G10 currency stakes courtesy of the BOE hike. CAD and the Swiss franc did well, whereas the AUD and NZD were generally weaker against most currency pairs. The NZD traded in a 0.6760 to 0.6835 USD range over the past 24 hours and is currently 94.7 Australian cents. The higher NZ yields on offer over the holiday season relative to our trading partners are likely to be NZD supportive, coupled with the strong export commodity price backdrop (record NZD highs according to our latest ASB commodities [report](#)).

Day ahead: Locally, we have the December ANZ business outlook (1pm) which will be looked for signs of economic direction after November's Own Activity expectations (15) fell to a 2021 low. Pricing metrics from the survey should remain elevated. UK November retail sales (mkt: 0.8% mom, 4.2% yoy) and the German IFO survey highlight a quiet night for data, with a Q&A on the US economic outlook from Fed Governor Waller tomorrow morning. This is our last Daily

Alert for 2021. Tune in on the 17th January for our first full daily update for 2022. Until then, have a safe and enjoyable holiday break. Author: mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.6798	1.1%	NZD/SEK	6.148	-0.1%	NZX WMP	4225.0	0.0%	Dow	36017	0.2%
NZD/AUD	0.9464	0.1%	NZD/DKK	4.465	0.2%	Gold \$/o	1795.7	1.1%	S&P 500	4691	-0.4%
NZD/EUR	0.6005	0.4%	NZD/THB	22.7	0.7%	WTI Oil \$/b	72.7	2.6%	NASDAQ	15281	-1.8%
NZD/JPY	77.28	0.1%	AUD/USD	0.7182	0.9%	Money Market (%)			FTSE	7261	1.3%
NZD/GBP	0.5105	0.1%	EUR/USD	1.132	0.8%	90 Day BB	0.92	0.00	CAC-40	7005	1.1%
NZD/CAD	0.8688	-1.3%	USD/JPY	113.7	-0.4%	OCR	0.75	0.00	DAX	15636	1.0%
NZD/CHF	0.6257	0.1%	10 Yr Bond Yields (%)			ASB Swap Rates (%)			H.Seng	23476	0.2%
NZD/HKD	5.304	1.0%	NZ	2.33	-0.02	1yr	1.75	0.01	Nikkei	29066	2.1%
NZD/SGD	0.9271	0.6%	US	1.43	-0.03	2yr	2.28	0.02	ASX200	7296	-0.4%
NZD/CNH	4.336	0.2%	Aust	1.57	0.01	5yr	2.58	0.02	NZX50	12778	0.0%

ASB Economics & Research

			Phone	Fax
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659	(649) 302 0992
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657	
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661	
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853	
Senior Economist, Wealth Economist	Chris Tennent-Brown Nat Keall	chris.tennent-brown@asb.co.nz nathaniel.keall@asb.co.nz	(649) 301 5915 (649) 301 5720	



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ASB Economics
ASB North Wharf, 12 Jellicoe Street, Auckland

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