

Here we go again, with RBNZ now expected to hold OCR at 0.25% today

Yesterday afternoon it was announced that a community case of COVID-19 was discovered in Auckland, with no known links to the border or managed isolation facilities. Market reaction was swift, with NZ yields down 10-15bp and the NZD down half a cent against the USD and AUD following the announcement. While not confirmed, the case is likely to be the highly contagious delta variant. The NZ Government moved swiftly, announcing that from 11.59pm last night NZ would move to Alert Level 4 for at least the next 3 days, with Auckland and the Coromandel to be at Level 4 for at least 7 days.

So where to from here for the NZ economy and monetary policy settings? The NZ economy has demonstrated resilience and had built up considerable momentum heading into this lockdown. **Provided the lockdown is short and sharp, the economic impacts will be modest. However, the lockdown complicates what had appeared to be a more straightforward NZ monetary policy decision**, and we imagine heart rates at the RBNZ would have jumped on the news of the outbreak. The outbreak news saw market odds ease from fully pricing in a 25bp OCR hike today to just 75% odds, with just over 50bps of hikes priced in over 2021 (closer to 65bps before).

ASB had earlier expected that the 'least regrets' approach for the RBNZ would be to hike the OCR by 25bps today (to 0.50%) and by 75bps till the end of the year (to 1.0%) given NZ's economic overheating. **The lockdown has increased the option value of waiting and ASB now expects the RBNZ to hold the OCR at 0.25% today.** Providing the lockdown is short-lived and causes minimal disruption, we still expect at least 50bps of OCR hikes by the end of this year and a 1.50% OCR endpoint from late 2022. More initial thoughts are in an [Economic Note](#).

Last night saw markets trade with a risk-off tone as weaker US retail sales data and concerns over the disruption caused by the rapidly spreading delta variant weighed on sentiment. The major US equity indices were roughly 1% lower, with more modest falls in European bourses. Stocks were lower in the Asia/Pacific, with tightening competition rules triggering sharp falls in Chinese technology stocks. US 10-year Treasury yields were a touch lower for longer-dated tenors (10Y 1.26%), with little change in European yields. NZ yields were sharply lower across the curve, with modest falls in Australian yields.

Concerns over weaker global demand and the stronger USD generally pushed commodity prices lower. **Prices from the GDT auction rose 0.3%, but whole milk powder prices fell 1.5% to USD3,552 per metric tonne. We have retained our \$7.90 kgMS Fonterra milk price forecast for the 2022 season.**

In overnight comments Fed Chair Powell noted that the ultimate impact of the delta variant was still unknown, that while the Fed's tools were "powerful" they had limitations, and that it was too soon to declare victory on fighting the pandemic. The US economy had changed to more flexible working practices relative to pre-pandemic times and the FOMC continues to "watch carefully" to understand these changes and their implications for policy. **Yesterday's release of the RBA Meeting Minutes** highlighted the conditionality of the pending taper of the RBA bond purchase programme. Our CBA colleagues believe the RBA has been too optimistic in its assessment and see the clear risk that the RBA reverses the taper decision as COVID-19 case numbers rise and the economic toll mounts.

Data wrap: US advance retail sales fell 1.1% in July (mkt: -0.2% mom), with core sales down 0.4%. Lower e-commerce and auto sales weighed with concerns higher consumer prices are denting discretionary spending. US industrial production rebounded a stronger than expected 0.9% in July. UK labour market data showed a strong rebound from earlier lulls, with employment (+95k in 3 months to June) and weekly earnings growth (+8.8% yoy) accelerating. July data showed a small fall in claimant count unemployment (still 5.7% of the labour force).

FX Update: The NZD fell sharply yesterday afternoon after the community case was announced and was the weakest G10 currency overnight. Generalised USD strengthening was also observed overnight, with the greenback at the top of the G10 table. This has pushed the NZD down to around 69 US cents at present, with the kiwi trading in a 0.6900 to 0.6960 USD range overnight. NZD losses have not been as marked against the AUD, with the NZD making modest gains overnight to currently sit at around 95.3 Australian cents. Short-term NZD direction will hinge on the RBNZ and the course of the virus on NZ, although we remain upbeat on NZD direction beyond then.

Day ahead: NZ Q2 producer prices at 10:45am (further solid increases expected), ahead of the August Monetary Policy Statement release at 2pm (no change to the 0.25% OCR expected). At 1.30pm are Q2 Australian wage data (mkt: 0.6% qoq, 1.9% yoy). The UK CPI tonight is expected to show a moderation in annual headline and core inflation (to 2.3% yoy and 2.0% yoy, respectively). Eurozone July CPI is also out (mkt: headline 2.2% yoy, core 0.7% yoy). US housing starts and building permits are released, with the focal point on tomorrow's Fed Minutes (6am) that might provide clues on forthcoming QE tapering. **Author:** mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.6907	-1.6%	NZD/SEK	6.049	-0.4%	NZX WMP	3515.0	0.9%	Dow	35303	-1.0%
NZD/AUD	0.9524	-0.5%	NZD/DKK	4.386	-1.1%	Gold \$/o	1783.0	-0.2%	S&P 500	4441	-0.9%
NZD/EUR	0.5897	-1.1%	NZD/THB	23.0	-1.7%	WTI Oil \$/b	66.6	-1.0%	NASDAQ	14647	-1.0%
NZD/JPY	75.69	-0.9%	AUD/USD	0.7252	-1.2%	Money Market (%)			FTSE	7181	0.4%
NZD/GBP	0.5028	-0.9%	EUR/USD	1.171	-0.6%	90 Day BB	0.61	-0.06	CAC-40	6820	-0.3%
NZD/CAD	0.8719	-1.2%	USD/JPY	109.6	0.3%	OCR	0.25	0.00	DAX	15922	0.0%
NZD/CHF	0.6319	-1.4%	10 Yr Bond Yields (%)			ASB Swap Rates (%)			H.Seng	25746	-1.7%
NZD/HKD	5.382	-1.5%	NZ	1.73	-0.09	1yr	0.98	-0.15	Nikkei	27424	-0.4%
NZD/SGD	0.9410	-1.1%	US	1.26	-0.01	2yr	1.24	-0.14	ASX200	7511	-0.9%
NZD/CNH	4.484	-1.1%	Aust	1.14	-0.02	5yr	1.59	-0.12	NZX50	12635	0.0%

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