Economic Weekly

01 March 2021

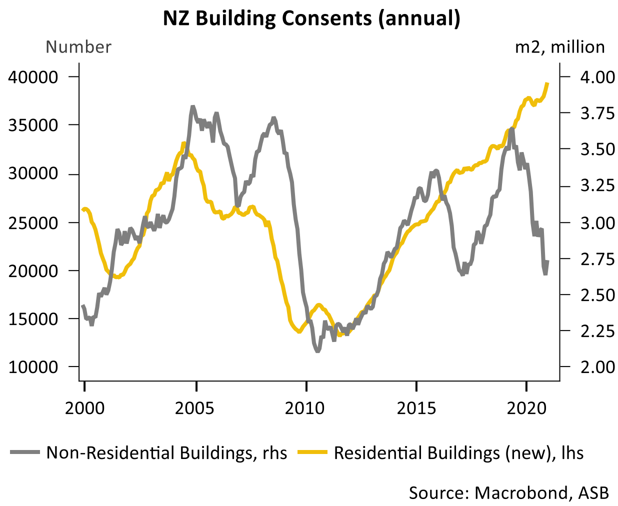
Bringing out the f-word

What seem like inconsequential decisions at the time can ripple through to have major consequences. A decision Saturday to defer a zoo visit until Sunday triggered an awkward explanation in the morning to a houseful of expectant kids, with some frustration about "coronavirus" manifesting at times during a more housebound day. That scene played out in a much more serious scale for the country over the weekend as events were abruptly cancelled in response to the continued growth in the current community cluster, with "frustrating" being the official word from the top to describe what has led NZ back into this week's lockdown restrictions.

Our back-of-the envelope mechanical calculations suggest L3 Auckland/L2 elsewhere lockdowns carry a weekly cost of around $240 million – though note this estimate does not account for any catch-up activity after lockdown conditions get loosened. This lockdown (Lockdown 3.1 or 4.0?) is likely to be proportionately larger in its impact than the mid-February one, as it includes parts of 2 weekends. It is the services sector – particularly hospitality and events – that bears the brunt of the impact, even if contactless sales do enable some venues to open during people's leisure time.

That sum could be well off the mark. Nevertheless, it serves to highlight the value in spending money to do what we can to minimise the 'human factors' part of the whole process, to ensure that the right people isolate appropriately and they are supported while they make a sacrifice for the wider community. Life in a time of pandemic is a constant learning opportunity – let's hope we can collectively refine how we manage our way through. It's a long time to hold on until the next season of *Bridgerton* is out.

The data calendar has a few updates this week for how some of NZ's more robust sectors travelled through the closing stages of last year and early parts of this year. Our goods Terms of Trade (export prices relative to import prices) should show a Q4 lift of around 1.7%. That would put NZ's international purchasing power back only 3% below the record high set just last year. That's a pretty impressive performance in the midst of a global pandemic and it's helping to offset the hit to export sectors bearing the brunt of the continued border closure. Building activity is another area of the economy that has held up. Friday's building work put in place release will show whether the sector continued to grow after rebounding sharply post-lockdown, with non-residential work still having scope for more catch-up. Wednesday's building consent figures will provide an update on the pipeline of work that will get underway this year. Unsurprisingly, residential consents have been on a tear of late given the heat in the housing market. nick.tuffley@asb.co.nz



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7234	0.7308	0.7151	0.6253	FLAT	0.7100	0.7400
NZD/AUD	0.9380	0.9274	0.9362	0.9564	FLAT	0.9300	0.9500
NZD/JPY	77.09	77.19	74.73	68.26	FLAT	75.50	78.50
NZD/EUR	0.5993	0.6029	0.5911	0.5690	FLAT	0.5900	0.6100
NZD/GBP	0.5190	0.5213	0.5220	0.4857	FLAT	0.5100	0.5300
TWI	75.6	75.4	74.3	70.02	FLAT	N/A	N/A

*^ Weekly support and resistance levels * Current as at 9.30am today; week ago as at Monday 5pm*

NZD Recap and Outlook

The NZD outperformed the AUD over the past week, but it was mixed against the rest of the key crosses. The NZD started the week out on strong note, with positive global market sentiment driving lifts in equities, interest rates, commodity prices and the commodity currencies (including the NZD). However, this momentum stalled on Friday, prompted by a sizable reversal in demand for technology shares. The sharp drop in sentiment took the NZD lower against most of the major crosses (except the AUD).

From a domestic perspective, the key event last week was the RBNZ OCR announcement and Monetary Policy Statement on Wednesday. Despite the RBNZ trying to remain “dovish” in its commentary, the upgraded economic forecasts confirmed that further rate cuts are now very unlikely (barring another unforeseen severe event). This sent the NZD higher against all its key crosses. The upward momentum got a further kick on Thursday following news that the Government now formally requires the RBNZ to take account of Government housing policies when assessing monetary and financial stability policy settings. This move was interpreted by market participants as further lifting the bar for the RBNZ to cut the Official Cash Rate, as lower interest rates tend to stimulate housing demand and house prices.

Global financial market sentiment will be the key driver of currency direction this week. It is relatively quiet from a domestic perspective for the next week or two, with the next significant data release being Q4 GDP on the 18th of March.

Global financial markets could continue to take a breather this week, and we may see a touch of profit taking in rates and equities following recent gains. Nonetheless, NZ’s relative economic fortunes compared to our key trading partners will continue to support the NZD (even with this week’s return to Level 3 in Auckland).

The main market focus over the week-ahead is likely to be the US $1.9 trillion stimulus package championed by President Biden. The bill was passed by the House of Representatives over the weekend, and is now with the Senate to approve. The package includes USD$1,400 direct payments to many Americans, and, along with falling rates of COVID-19 transmission in the US, is likely to provide a substantial near-term boost to US retail sales.
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ASB foreign exchange forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)	<< actual	forecast >>					
NZD/USD	0.72	0.70	0.70	0.71	0.71	0.71	0.71
NZD/AUD	0.94	0.93	0.92	0.92	0.91	0.91	0.92
NZD/JPY	75	74	74	76	77	77	80
NZD/EUR	0.59	0.57	0.56	0.56	0.55	0.55	0.53
NZD/GBP	0.53	0.52	0.51	0.52	0.52	0.52	0.52
NZD/CNY	4.7	4.6	4.6	4.6	4.5	4.5	4.5
NZD TWI	75.1	73.4	73.0	73.7	73.2	73.0	72.9

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	0.25	0.25	1.00	UNCH	UP
90-day bank bill	0.31	0.28	0.29	1.05	UNCH	UP
2-year swap	0.48	0.39	0.32	0.86	UNCH	UP
5-year swap	1.20	0.99	0.66	0.92	UNCH	UP
10-year swap	1.99	1.74	1.19	1.20	UNCH	UP
10-year govt bond yield	1.91	1.64	1.13	1.06	UNCH	UP
Curve Slope (2s10s swaps)	1.51	1.35	0.87	0.34	UNCH	DOWN

** Current as at 9.30am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market Recap

NZ and local yields have been extremely volatile, generally trading in thin volumes, with local and global yields hitting post-COVID-19 highs last week. The NZ 10-year swap yield peaked at 2.19%, and the swap yield curve (2s10s) was its steepest in a decade. Markets largely discounted the RBNZ's dovish message in the MPS, with local yields up after the release of the statement and then firming the following day after it was announced the RBNZ's new monetary policy remit will take into account supporting more sustainable house prices. Yields then eased on Friday after Governor Orr reiterated this would not substantively change how the RBNZ set policy. NZ 10-year Government bond yields topped 2% last week even though the RBNZ maintained the $100 LSAP cap and the flexibility to adjust purchases in order to support 'market functioning'.

The resilient tone of offshore data, speedy pace of COVID-19 vaccine rollouts, rising commodity prices (particularly oil) and expectations of further US fiscal stimulus have seen global yields push higher on the reflation trade. US 10-year Treasury yields briefly hit post-COVID-19 highs (1.61%). The lift in yields has triggered more bond buying from global central banks (including the RBA) and central bank signalling that further stimulus could be added if needed. Falls in global equities and low readings for consumer price inflation pushed global yields lower at the end of the week.

Near-term interest rate outlook

Markets are now pricing in around 10bps of OCR hikes by the end of the year, and a 0.50% OCR by August 2022, which is consistent with our OCR view. However, the near-term interest rate outlook should remain extremely volatile, with the raising in Alert Levels in Auckland (Level 3) and the Rest of NZ (Level 2) in the weekend a reminder of the risks. We could see local yields ease and curves flatten, given they have risen a long way in a short period of time. Forward interest rates (the 5Y peaked at 3.13% last week and is now a shade under 2.90%) are running well ahead of where we think long-term yields will eventually end up. The $570m in NZ government bond purchases by the RBNZ this week will slightly outstrip the $500m tender and could help to dampen yields at the margin.

There is a lot going on globally. The US House has just passed the USD1.9tr fiscal stimulus package and this is likely to (narrowly) pass the Senate this week, which should be positive for sentiment and yields. Data is unlikely to see much reaction, although a positive reading from the manufacturing ISM, global PMIs, US payrolls, solid Q4 Australian GDP data (CBA: + 2.8% qoq, mkt: +2.3% qoq), Australian housing lending and house price data could pressure yields higher. The RBA are expected to deliver a dovish statement, including signalling no hikes till 2024 as well as the likely continuance of sizeable bond purchases at the 3 year part of the curve to maintain the 0.1% target (our CBA colleagues believe that the RBA will remove its yield curve control policy towards the end of this year). The risk is that the market reaction to the RBA is similar to the sell-off that followed the RBNZ.

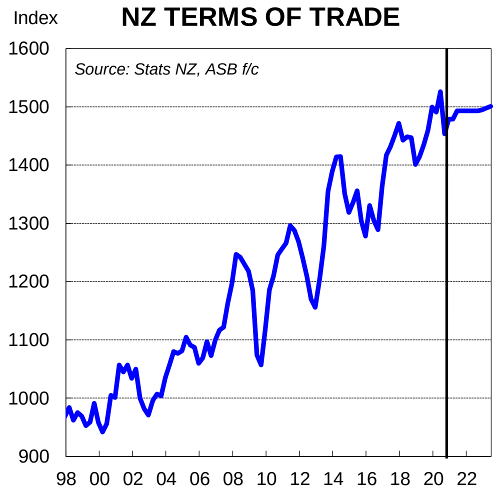
Medium-term outlook

We expect the OCR to start moving up from mid next year (August 22), followed by a gradual pace of OCR hikes, with the OCR at 1.25% in March 2024, slightly below neutral levels. Our bias is for shorter-term yields to edge up over the next few years and for the yield curve to flatten, with longer-term NZ yields to peak at historically low levels (around 2%). mark.smith4@asb.co.nz.

Domestic Events

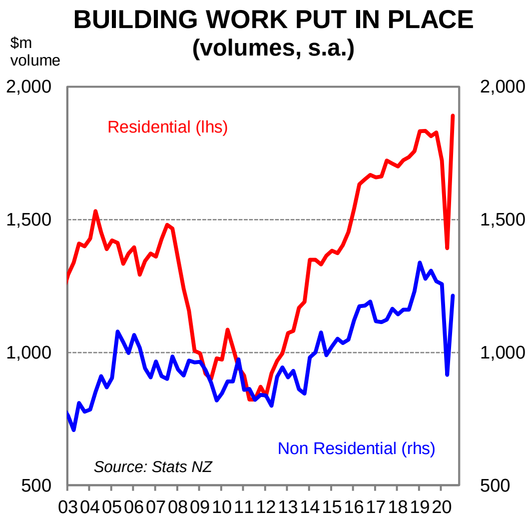
Data	Date	Time (NZT)	Market	ASB
Terms of Trade, % qoq, Q4	02/03	10:45am	-	+1.7%
Building Consents, Jan, % mom	03/03	10:45 am	-	-
Building Work Put in Place, volumes, Q4, % qoq	05/03	10:45 am	-	1.6%

We expect data to show NZ's goods Terms of Trade (ToT) lifted 1.7% in the December quarter, recovering some of the previous quarters 4.7% decline. We expect small gains in export prices and a small decline in import prices. The ToT remain at historically high levels, and the strength of international demand for NZ goods exports remains a key cushion for the NZ economy through the COVID-19 pandemic.



Residential building consents have continued to lift strongly over the final months of 2020. Home building demand remains supported by strong housing market activity, record low mortgage interest rates and chronic housing shortages across New Zealand. We expect home building demand to remain at record high levels through early 2021.

We expect Q4 building activity (building work put in place) to lift 1.6%, extending the 34.6% recovery post lockdown. Housing construction demand has soared over the second half of the year, as low interest rates and chronic housing shortages have underpinned housing demand. The construction sector is booming as a result. We expect a further lift in in activity over Q4 – largely from non-residential building activity as the level of activity remained below pre-pandemic levels in Q3. There is some risk of a pullback in residential activity as, anecdotally, there was a lot of overtime in Q3 to try to catch up from lockdown delays.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia Company Profits, Q4, %qoq	01/03	1:30 pm	-10
RBA Interest Rate Announcement, %	02/03	4:30 pm	0.1
Australia Building Approvals, January, %yoy	02/03	1:30 pm	-2.0
Eurozone CPI, Feb, %mom	02/03	11:00 pm	
US ISM Manufacturing Index, Feb, points	02/03	4:00 am	59
Australia GDP, Q4, %qoq	03/03	1:30 pm	2.8
Australia Retail Trade, January, %mom	04/03	1:30 pm	0.6
Australia Trade Balance, January, $bn	04/03	1:30 pm	9.0
US Non-farm Payrolls, February, 000s	06/03	2:30 am	160

** Forecasts and commentary originally published by CBA Global Markets Research Friday 26 February at 2:40 pm*

We expect a 10% fall in **Australian company profits** in Q4 20. This sounds like a large fall, but it comes off the back of very strong growth over the first two quarters of the year as profits were boosted by government stimulus. We expect some underlying profit growth in Q4 as the economy was well into recovery mode, but this will be offset by the tapering of government stimulus.

We expect the Reserve Bank of Australia's (RBA) Board to leave monetary policy settings where they are at the March meeting. The RBA has made it clear that the cash rate will stay where it is until inflation is sustainably within the 2-3% target. This is likely to take number of years.

Approvals for detached houses in Australia have been rising very strongly with demand boosted by the Government's HomeBuilder grant scheme. We expect a small fall in approvals this month as the Homebuilder grant is tapered to $A15k in January from $A20k last year.

The preliminary estimate showed a 0.6% lift in **Australian retail trade** for January. New South Wales led the gain, rising by 1.0%, assisted by an easing of restrictions in Greater Sydney post the Northern Beaches lockdown. Working the other way, Queensland fell by 1.5% in January due to a three-day lockdown in Greater Brisbane.

We expect to see **Australia's trade surplus** increase to $A9.0bn in January from $A6.8bn in December. Strong commodity prices, particularly for iron ore, should see exports rise solidly in the month.

We have a solid 2.8% lift in **Australia's Q4 GDP** in our forecasts as the economy continues to recover from the coronavirus pandemic. We expect all the major components to contribute to growth in the quarter with the exception of net exports, which look set to make a small subtraction. We will firm up our forecast and issue a full GDP preview on Tuesday once all the partial data has been released.

Headline **Eurozone CPI** turned positive year-on-year in January for the first time in six months. Headline inflation will likely increase in the coming months, in part supported by the end of the temporary VAT reduction in Germany. Still, ample spare capacity suggests inflation will remain subdued over 2021.

Already-released regional manufacturing surveys point to a modest lift in **US manufacturing activity** in February. We expect the ISM manufacturing index to lift 59.0 points. The strength in the ISM manufacturing index reflects less restrictive social distancing requirements in the manufacturing sector compared to the services sector.

We forecast **US employment** rose by 180,000 in February. US government stimulus propped up the economy in January and this is likely to have flowed into hiring decisions. Further, initial jobless claims have fallen back towards November's lows in recent weeks. We forecast the unemployment rate remained unchanged at 6.3%. Ongoing labour market slack likely kept wages growth muted at just 0.1%mom.

Key Forecasts

ASB NZ economic forecasts	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	14.0	0.5	0.3	0.2	0.3	0.3	0.8
GDP real - A%	0.4	0.7	2.2	15.1	1.3	0.9	3.2
GDP real - AA%	-2.3	-2.6	-2.0	4.3	4.5	4.2	2.2
NZ House Prices (QV Index) - A%	9.5	11.7	15.5	20.3	18.1	9.5	4.9
CPI - Q%	0.7	0.5	0.6	0.4	0.8	0.3	0.5
CPI - A%	1.4	1.4	1.3	2.1	2.3	2.0	2.0
HLFS employment growth - Q%	-0.7	0.6	0.3	0.4	0.4	0.4	0.5
HLFS employment growth - A%	0.4	0.7	-0.1	0.6	1.7	1.4	1.8
Unemployment rate - %sa	5.3	4.9	5.1	5.0	5.1	5.1	4.8

Q% = percentage change on previous quarter
A% = percentage change since same quarter the previous year
AA% = percentage change for year ending quarter since the previous year

ASB interest rate forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)	<< actual	forecast >>					
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.75
NZ 90-day bank bill	0.27	0.30	0.30	0.30	0.30	0.35	0.90
NZ 2-year swap rate	0.28	0.40	0.50	0.60	0.70	0.80	1.20
NZ 5-year swap rate	0.54	0.90	1.00	1.10	1.20	1.30	1.70
NZ 10-year swap rate	0.98	1.65	1.70	1.75	1.80	1.85	2.05
NZ 10-year Bond	0.99	1.50	1.55	1.60	1.65	1.70	1.90

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NZD/EUR	0.59	0.57	0.56	0.56	0.55	0.55	0.53
NZD/GBP	0.53	0.52	0.51	0.52	0.52	0.52	0.52
NZD/CNY	4.7	4.6	4.6	4.6	4.5	4.5	4.5
NZD TWI	75.1	73.4	73.0	73.7	73.2	73.0	72.9

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