



Economic Weekly

03 May 2021

Knockin' on housing's door

After a period of gazing at overseas events, the focus for this week is more firmly back onshore with Wednesday bringing another dairy auction, the RBNZ's Financial Stability Report (FSR), and labour market data.

Dairy prices should prove resilient enough to support \$7.50+ farmgate milk prices for this season and next. Local production is faring well heading into autumn, and in time it will be interesting enough to see how this late flush counterbalances the continued strong buying interest from China.

The FSR is going to bring the attention back onto NZ's housepocalypsearmageddon. The November FSR was released when the housing market was evidently heating up over and above a post-lockdown rebound and the Finance Minister had just written to the RBNZ Governor suggesting that monetary policy decisions take into account house prices.

Since then, the action has only heated up in the market and in the Government's responses. The Government has tweaked the RBNZ's Monetary Policy Remit so the Monetary Policy Committee needs to assess the impacts of monetary policy decisions on the Government's housing policies (namely discourage investors from buying pre-existing homes). The RBNZ also needs to have regard to house price sustainability with its financial stability decisions. Finance Minister Robertson has also announced that he will establish a new framework for deciding what type of lending the RBNZ is permitted to restrict. Until now, there has been no formal oversight of what tools the RBNZ can use other than the RBNZ Governor and Finance Minister signing a Memorandum of Understanding over what lending restrictions the RBNZ would employ. The devil will be in the details of how prescriptive this process will be and whether there are any tensions between what types of lending the Government would like to see restricted (and what not) relative to the RBNZ's assessment of where it sees the financial stability risks as being greatest.

And of course, when it comes to assessing the risks, the housing outlook is up in the air in the wake of the Government's tax changes to discourage residential property investors. Accountant: put my tax deduction in the ground, I can't use it anymore. We'd expect the RBNZ to still be unsure about the impacts on house prices and financial stability. The changes are likely to sound the death knell for continued unbridled capital gains and further stretch in house prices relative to incomes and rents. But there is also the risk that the tax changes are a little too effective, so the RBNZ want to take the time to see what happens – and has no new tools to use yet anyway.

To round out a busy Wednesday morning, the labour data for the March quarter will be out. The influences on employment and wages are a curious mix of flat activity, slow population growth, emerging skill shortages yet regional pockets suffering from the lack of international tourists. We expect flat employment over the quarter yet a marginally lower unemployment rate, with annual wage growth likely to start building over the course of the year.

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Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7167	0.7180	0.6966	0.6087	UP	0.7135	0.7290
NZD/AUD	0.9284	0.9281	0.9200	0.9415	FLAT	0.9160	0.9460
NZD/JPY	78.33	77.47	77.06	65.18	UP	75.60	79.20
NZD/EUR	0.5958	0.5968	0.5941	0.5559	FLAT/DOWN	0.5880	0.6130
NZD/GBP	0.5189	0.5179	0.5054	0.4843	FLAT	0.5050	0.5380
TWI	74.9	74.9	73.5	68.69	FLAT/UP	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/USD spent most of last week on the front foot, before an abrupt change in investor risk appetite on Friday saw the NZD/USD give back all of the week's gains. It thus opens the new week pretty close to where it was a week ago, around 0.7180. Even NZD/AUD, which enjoyed a mid-week burst higher on the back of weaker Australian CPI figures, is largely back to where it was.

We don't expect the NZD sell-off to extend. First, risk sentiment has (unsurprisingly) proven itself to be choppy and fragile through the COVID period. But the global recovery remains largely on track which should keep financial market sentiment on the straight and narrow, on a trend basis.

Second, broader NZD/USD fundamentals actually strengthened last week. Despite the negatives from souring risk sentiment, this is being more than offset by the continued trend higher in NZ commodity export prices. Over the past month the souring in risk appetite has knocked around 20 points off the 'fair-value' range implied by our short-term valuation model, while the increase in commodity prices has added just over ½ cent (60 points). The implied 'fair-valued' range is currently 0.7150-0.7550.

Still, whether or not the NZD/USD uptrend resumes this week will depend on the absolute swathe of event risk due. Offshore, booming results are expected from both the two top-tier US data releases – ISM manufacturing (tonight) and Non-farm Payrolls (Friday) – which may bolster USD sentiment. The RBA is meeting on Tuesday and, while we expect no changes in policy, the Statement may hint at some forecast upgrades (higher inflation, lower unemployment) for Friday's Statement of Monetary Policy.

Closer to home, Wednesday's quarterly NZ labour market data bring with them – as always – heightened potential for financial market volatility. The risk to us is that a lower-than-expected reported unemployment rate (market: 4.9%, ASB 4.8%) gets the market excited about earlier RBNZ rate hikes again as it would confirm the Bank is close to hitting its policy objectives. Wednesday's RBNZ Financial Stability Report will be housing-heavy, and market relevant to the extent there are hints about future policy. mike.jones@asb.co.nz

ASB foreign exchange forecasts

(end of quarter)

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
		<<actual	forecast >>				
NZD/USD	0.72	0.70	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.92	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	77	80	83	84	85	88
NZD/EUR	0.59	0.60	0.59	0.59	0.58	0.57	0.54
NZD/GBP	0.53	0.51	0.51	0.51	0.51	0.50	0.48
NZD/CNY	4.7	4.6	4.7	4.7	4.7	4.7	4.5
NZD TWI	75.1	73.9	75.2	75.4	75.5	75.5	74.6

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	0.25	UNCH	UP
90-day bank bill	0.36	0.35	0.34	0.26	UNCH	UP
2-year swap	0.47	0.47	0.45	0.19	UNCH	UP
5-year swap	1.07	1.04	1.11	0.33	UNCH	UP
10-year swap	1.84	1.79	1.95	0.72	UNCH	UP
10-year govt bond yield	1.66	1.60	1.82	0.62	UNCH	UP
Curve Slope (2s10s swaps)	1.37	1.32	1.49	0.53	UNCH	DOWN

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

Market Recap

Local and US longer-term yields nudged higher late last week, with yield curves steepening. There were modest moves for short-term local yields. The key NZ 2-year swap yield maintained tight trading ranges (just 0.46% to 0.48%) last week, with little reaction to local data.

Rates in the belly of the curve and for longer-dated maturities edged higher late last week, unwinding some of their previous weekly fall. US Treasury yields (1.63%) rose just over 5bps last week, with similar gains to NZ counterparts. Likely supports were the solid US data pulse, rising commodity prices (oil prices hit 6-week highs last week), and a new proposal by President Biden for USD1.8 trillion in US social spending.

Yields were earlier weighed by a dovish FOMC assessment in which the key policy interest rates and US\$120bn monthly pace of asset purchases were maintained. Chair Powell also emphasised that the recovery was "...uneven and far from complete" and "a long way from our goals" despite positive signs of late. Australian yields were also dampened by weaker-than-expected headline and core Australian Q1 CPI prints.

Near-term interest rate outlook

We expect short-term local yields to remain little changed this week, with few catalysts to push them out of their current narrow trading ranges. Market expectations have an OCR hike fully priced in by early 2023, which looks reasonable in light of the risk profile.

Market implications from Wednesday's RBNZ Financial Stability Report (FSR) are likely to be limited as the RBNZ have delayed the announcement on debt-to-income limits and restrictions to interest-only mortgages till the end of this month. Expectations for OCR hikes could be bought forward if this week's labour market data shows tightening labour market conditions and/or surveyed inflation expectations jump. The RBA will also be in focus this week with the Board meeting on Tuesday, a speech from the Deputy Governor on Thursday and the Statement on Monetary Policy (SMP) scheduled for release on Friday. We don't expect any marked changes in Australian rates to result. The Bank of England are expected to hold current settings, but the tone of their policy assessment and the May Inflation Report could be more upbeat.

We have shifted to a more neutral bias for longer-term bias for longer-term NZ rates and the belly of the curve. The improving global outlook and increasing pricing pressures could push yields higher and steepen NZ yield curves. US data this week (including the manufacturing ISM and non-farm payrolls) is expected to remain strong and could push yields higher. However, implied local rates from the back end of the curve look too high relative to our neutral OCR view. Weekly RBNZ government bond purchases have been maintained at \$350m, above the weekly \$300m NZ bond issuance profile by NZDM and should weigh on bond yields at the margin.

Medium-term outlook

We expect the RBNZ to continue to trim its LSAP programme and to halt purchases from 2022, prior to raising the OCR from August 2022 - with risks of a slightly later start to RBNZ tightening. The OCR is expected to reach 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. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
GDT	29/04	-	-	-
RBNZ Financial Stability Report	29/04	9:00 am	-	-
HLFS Unemployment Rate, %, Q1	05/05	10:45 am	-	4.8
ANZ Business Outlook, Own Activity, May prelim, net %	06/05	10:45 am	-	-
RBNZ Survey of Expectations, CPI inflation 2-year ahead- Q2	07/05	3:00pm	-	-

The RBNZ's May Financial Stability Report will have a lot more focus on housing, which was already becoming a hot potato at the time of last November's FSR. Since then, the housing market has heated up considerably more, the loan to value ratio (LVR) restrictions on mortgage lending are back in place, and the Government has announced policy measures intended to discourage property investment purchases.

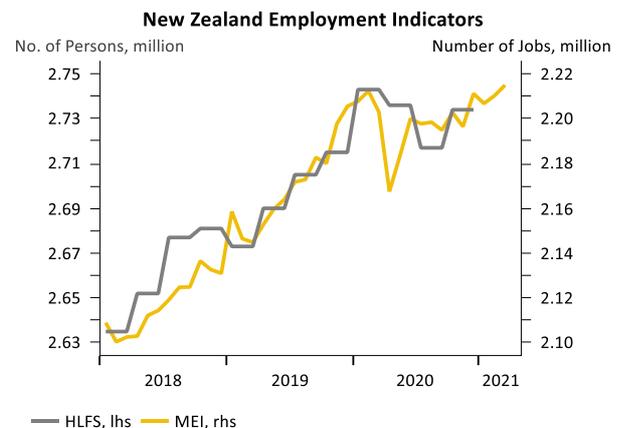
The RBNZ has been working on developing alternative macro-prudential tools so it has more than just the LVRs on mortgage lending to target housing-related financial stability risks. The RBNZ has long expressed a desire for using a debt-to-income (DTI) tool to limit mortgage lending and is also investigating restrictions on interest-only mortgages for property investment. **However, the FSR will be too soon to announce any concrete progress on these measures, let alone any implementation.** Along related lines, Finance Minister Robertson has also announced that he is establishing a new framework for deciding what type of lending the RBNZ is permitted to restrict.

The RBNZ will also update its assessment of current financial stability risks. Housing is likely to be seen as a higher risk given the strong house price growth recorded over the past 6 months. The Government's recent policy announcements are likely to cool further house price gains. The relative resilience of the economy and high dairy prices suggest risks in other areas of focus – commercial property, the rural sector – remain contained. However, the RBNZ will remain watchful.

We expect the unemployment rate to edge down to 4.8% over the March quarter (from 4.9% in Q4) on the back of flat employment growth. Monthly employment indicators point to the level employment remaining fairly steady over the first quarter of the year. We expect LCI private sector wage growth to lift 0.5% qoq and 1.6% yoy in Q1 – with wage inflation pressures set to step up further in the June quarter.

The preliminary results for May business confidence are released on Thursday 6th of May. The full April month ANZ Business Outlook Survey showed a continued firming in business confidence and activity expectations. Investment and employment Intentions are both comfortably above average levels from the past 10-years. Meanwhile, elevated surveyed pricing and cost pressures continue to point to price increases over the coming year.

We expect shorter-term inflation expectations from the RBNZ survey to continue to edge up given increasing capacity constraints, firming headline inflation and the uptick in cost and price expectations in various business surveys. Lifts in the one- and two-year-ahead readings for CPI inflation are expected (1.73% and 1.89%, respectively, in Q1) with longer-term inflation expectations to be slightly above 2%. Inflation expectations around the midpoint of the inflation target are consistent with the OCR remaining on hold for a while yet. However, if expectations continue to move higher and are at odds with the inflation target the prospect of OCR hikes increasingly comes into play.



Source: Macrobond, ASB

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia CoreLogic Dwelling Prices, April, %mom	03/05	1:30 pm	1.7
Australia Trade Balance, March, \$bn	04/05	1:30 pm	10.5
RBA Interest Rate Announcement, %	04/05	4:30 pm	0.1
US ISM Manufacturing Index, April	04/05	2:00 am	65.5
RBA Deputy Governor Debelle speech	06/05	9:00 pm	-
Bank of England Interest Rate Announcement, %	06/05	11:00 pm	-
RBA Statement of Monetary Policy	07/05	1:30 pm	-
US Non-farm Payrolls, April, Unemployment Rate, %	08/05	12:30 am	5.8

* Forecasts and commentary originally published by CBA Global Markets Research Friday 30 April at 10:27 am

The daily data in **Australia** is pointing to another solid rise in **dwelling prices** in the month. There look to be strong dwelling price rises for all the capital cities but with Sydney once again leading the charge.

Very strong commodity prices are boosting exports in **Australia**. We expect a **trade surplus** of \$10.5bn in March which would be the largest on record.

We don't expect any changes to monetary policy at the Reserve Bank of Australia (RBA) May meeting. The next decision for the RBA is whether to stick to targeting the April 24 bond or whether to move the target to the November 24. This choice will provide a strong signal as to when the RBA expects the cash rate needing to be lifted. Given the strength of the economy we expect that the RBA will stick with the April 24 bond, although we don't expect a decision to be announced until July or August this year.

RBA Deputy Governor Guy Debelle will speak on "Monetary Policy during COVID". Based on the title it sounds like the speech will be backward looking rather than forward looking.

We expect the RBA to downwardly revise their profile for the unemployment rate and upwardly revise their profile for inflation, but overall their forecasts are anticipated to remain conservative. Our expectation is that the upgraded forecasts will sit in the 'sweet spot' that enables the RBA to persist with the "2024 at the earliest" forward guidance on the cash rate whilst also signalling that the April 2024 bond will remain the target bond for yield curve control (i.e. the forecasts will signal that the RBA does not intend to shift to the November 2024 bond later in the year).

Already-released regional **US Fed** manufacturing surveys point to another solid increase in the **US ISM manufacturing** index in April. The fall in inventories over Q1 bodes well for strong demand for new orders in early Q2. A lift to 65.5pts would see the US ISM manufacturing index at its highest level since 1983.

The Bank of England (BoE) is widely expected to make no policy changes and continue to suggest additional stimulus is unlikely. The BoE's near-term GDP growth projection will likely be revised higher. The BoE projects to complete its £150bn UK government bond-buying program by early November 2021.

The fall in initial and continuing jobless claims in April suggests the **US labour market** recovery is ongoing. We forecast 925,000 jobs were added in April, dropping the unemployment rate to 5.8%. Nevertheless, considerable slack remains in the economy and the US Fed estimates the true unemployment rate is closer to 10%. Excess labour market slack will also be evident in muted wage growth. We expect average hourly earnings lifted just 0.1%mom.

Key Forecasts

ASB NZ economic forecasts

	Dec-20 << actual	Mar-21 forecast >>	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
GDP real - Q%	-1.0	-0.2	1.2	1.0	-0.6	-1.0	0.5
GDP real - A%	-0.9	0.1	14.0	1.1	1.5	0.7	4.5
GDP real - AA%	-3.0	-3.0	3.0	3.3	3.9	4.0	2.5
NZ House Prices (QV Index) - A%	15.4	17.4	17.9	12.5	7.4	3.2	5.1
CPI - Q%	0.5	0.8	0.5	0.5	0.4	0.5	0.5
CPI - A%	1.4	1.5	2.5	2.3	2.3	1.9	2.2
HLFS employment growth - Q%	0.6	0.0	0.3	0.4	0.4	0.3	0.5
HLFS employment growth - A%	0.7	-0.3	0.2	1.2	1.0	1.3	2.2
Unemployment rate - %sa	4.9	4.8	4.7	4.7	4.7	4.7	4.0

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 << actual	Jun-21 forecast >>	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)							
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.75
NZ 90-day bank bill	0.27	0.35	0.35	0.35	0.35	0.35	0.90
NZ 2-year swap rate	0.28	0.47	0.50	0.55	0.65	0.75	1.15
NZ 5-year swap rate	0.54	1.12	1.10	1.20	1.30	1.40	1.80
NZ 10-year swap rate	0.98	1.96	1.90	2.00	2.10	2.15	2.35
NZ 10-year Bond	0.99	1.78	1.70	1.85	1.95	2.00	2.20

ASB foreign exchange forecasts

	Dec-20	Mar-21 << actual	Jun-21 forecast >>	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)							
NZD/USD	0.72	0.70	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.92	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	77	80	83	84	85	88
NZD/EUR	0.59	0.60	0.59	0.59	0.58	0.57	0.54
NZD/GBP	0.53	0.51	0.51	0.51	0.51	0.50	0.48
NZD/CNY	4.7	4.6	4.7	4.7	4.7	4.7	4.5
NZD TWI	75.1	73.9	75.2	75.4	75.5	75.5	74.6

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