Economic Weekly

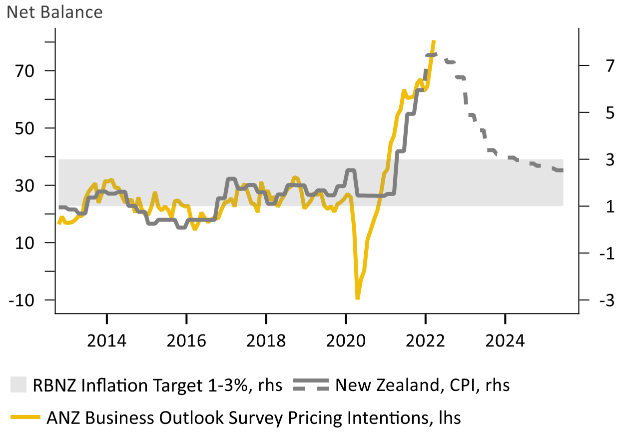
04 April 2022

50/50 on a 50?

Results in last week's ANZ Business Outlook confirmed that input costs are continuing to rise apace. Affirming the plethora of anecdotal evidence we've already heard over the beginning of 2022, a net 95.9% of responding businesses in the March survey expected higher costs, up from an already lofty +92% in February.

Surging cost pressures have obviously been making headlines for some time, as have their usual hellspawn, stronger pricing intentions (+80.5% versus +74.1% in February). Still, the recent clip of data is notable for showing no obvious end in sight to the dynamic. If anything, inflation pressures are accelerating, even as businesses report some challenging operating conditions, with activity and profit expectations well below long-run levels. Indeed, we now see annual CPI inflation peaking at 7.5% mark in the middle of the year.

Pricing Intentions and Inflation Forecast



Source: Macrobond, ASB

Policymakers are in a tight spot in the current environment. Typically, we expect the labour market to tighten when activity runs hot, pushing up wages and boosting inflation. In that scenario, tightening monetary policy tout suite is uncontroversial. But in the current environment, it's not strong economic activity that's holding the smoking inflation gun: rising energy costs and logistics disruption are playing havoc with non-labour costs for many businesses, while population growth is the bigger driver pushing unemployment to multi-decade lows. Thus, the RBNZ is faced with the task of continuing to hike while the growth outlook has darkened both here and overseas. There's even been the odd instance of Treasury yield curve inversion recently – a closely-watched indicator of a recession in the US.

Despite that dynamic, the odds of the Bank needing to hike the OCR by 50bps at both or either of the next two meetings continues to edge up in our view. There's no perfect environment in which to make monetary policy in – uncertainty and the risk of unintended consequences are staples of the job. All policymakers can do is make a call on which target they are at greater risk of missing. On that front, it's still clearly that 1-3% CPI inflation band that the RBNZ is most clearly at risk of missing for a prolonged period. And bear in mind it's employment rather than growth that the RBNZ targets as the other part of its dual mandate. While growth and employment are obviously heavily correlated, the starting point for the labour market is so tight that slower growth and higher interest rates won't necessarily be a big sucker punch. Indeed, eroding real incomes is probably the bigger risk for those on lower pay or in insecure work if inflation pressures don't start to come down.

For now, we are sticking with our forecast of two 25bp hikes at the next two RBNZ meetings, but the odds probably aren't much better than a coinflip at this point in proceedings. nathaniel.keall@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6912	0.6948	0.6804	0.6966	FLAT	0.6870	0.6990
NZD/AUD	0.9230	0.9232	0.9272	0.9200	FLAT	0.9180	0.9420
NZD/JPY	84.76	85.51	78.48	77.06	FLAT	84.00	87.00
NZD/EUR	0.6261	0.6341	0.6170	0.5941	FLAT	0.6130	0.6400
NZD/GBP	0.5275	0.5282	0.5101	0.5054	FLAT	0.5160	0.5320
TWI	74.4	74.2	72.3	73.5	FLAT	N/A	N/A

*^ Weekly support and resistance levels * Current as at 12.30pm today; week ago as at Monday 5pm*

NZD Recap and Outlook

The key theme in markets last week was a partial pricing out of Russian-invasion impacts. Apparent signs of progress in peace talks between Ukrainian and Russian negotiators looked questionable, and were later largely debunked. But markets nevertheless have taken an optimistic view for now.

Global equity markets notched up a decent bounce as risk sentiment recovered. Some of the war premium in oil futures was priced out (Brent crude down 10% over the week). In FX markets, the key post-invasion trends were walked back slightly – European currencies outperformed and the previously outperforming 'commodity currencies' mostly lost ground.

The NZD/USD ended the week down 0.5% around 0.6920, and the barnstorming run in NZD/JPY was also brought to a halt. Having hit a mid-week 7-year high around 86.50, NZD/JPY finished up closer to 85.00.

Stepping back, we retain a constructive view on the NZD overall. This is mostly thanks to the powerful uptrend occurring in NZ's commodity export prices. There's a secondary layer of support in some cases from a widening interest rate differential (NZD/JPY, NZD/EUR, NZD/GBP) but not for NZD/AUD and NZD/USD, where offshore rates have tended to rise even faster than those in NZ. These differences in relative interest rates help explain the mixed performance of the NZD cross rates of late.

Also worth noting is the fact that NZ government bonds have been added to the FTSE-Russell world government bond index (WGBI), effective November 2022 (weight 0.19%). Global investors required to track the WGBI will have to start adding NZ bonds to their portfolios as a result. The currency purchases on the back of this could support the NZD.

There's a dearth of big event risk for the NZD/USD this week (next week has the key RBNZ meeting). This, and the lack of any clear bias from the technical picture, means we suspect a week of sideways range trading is in prospect. Resistance up around 0.6980/90 is proving a tough nut to crack, while initial support is eyed around 0.6870.

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Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	0.25	UNCH	UP
90-day bank bill	1.67	1.60	1.34	0.34	UNCH	UP
2-year swap	3.40	3.25	2.81	0.45	UNCH	UNCH
5-year swap	3.52	3.46	3.04	1.11	UNCH	UNCH
10-year swap	3.45	3.52	3.03	1.95	UNCH	UNCH
10-year govt bond yield	3.31	3.34	2.77	1.82	UNCH	UNCH
Curve Slope (2s10s swaps)	0.05	0.27	0.22	1.49	UNCH	UNCH

** Current as at 12.30pm today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market recap

Another reasonably volatile week for NZ yields, with the 2-year swap yield hitting fresh 7-year highs (3.38%) and the yield curve under flattening pressure. Short-term NZ yields and market pricing briefly jumped after the ANZ Business Outlook flagged an intensification of inflation pressures. Liquidity in local markets was thin. Longer-term local yields declined over the latter part of the week in line with global counterparts. This left the NZ yield curve (2s10s) its flattest since the GFC and with 5-year swap and bond yields higher than those for the 10-year tenor. Swap spreads with bonds and bill-OIS spreads slightly widened.

Global yield curves have also flattened, and the US Treasury yield curve (2s10s) briefly inverted last week. Inverted yield curves typically flag a pending slowdown, although outright levels for yields are still low. Short-term yields were underpinned by solid US data and expectations of substantial FOMC tightening, with FOMC speakers flagging 50bp hikes in May and more concerted tightening thereafter. US 10-year bond yields were down roughly 10bps on a week ago (10Y 2.38%), weighed by diminished risk appetite. The Ukraine conflict has dragged on, equities have flat-lined and oil prices are down, with the BoJ signalling it would be purchasing JGBs helping to dampen yields. Australian yields have cooled over the week in tandem with global yields despite the Australian Budget offering more fiscal support.

Near-term interest rate outlook

Near-term OCR expectations currently have 86bps of RBNZ hikes priced in over the next 2 meetings, little changed on a week ago. This looks plausible given our elevated CPI inflation view, with sizeable risks of a 50bp hike on April 13 (+42bps priced in) and/or May 25 (+44bps). Tomorrow's Q1 NZIER Quarterly Survey of Business Opinion will likely show stretched capacity and elevated cost and pricing pressures, this could embolden markets to push higher. We still view the extent of hikes priced in (around 210bps by the end of the year) as being excessive and even if the OCR does move above 3%, we don't expect yields to settle at those levels given our circa 2% neutral OCR view. Markets seem to be coming around to this view, with forward interest rates from swaps showing a peak of just under 4% for the 1Y1Y, but then receding. Omicron cases in NZ look to be on the way down but this should have a modest impact.

We have dropped our upward bias for global yields. Global short-term yields and market pricing (215bp of FOMC and 170bp of RBA hikes over 2022) has moved a long way in a short period of time and could potentially retrace. Our CBA colleagues expect the RBA to hold the cash rate at 0.1% tomorrow, with the risk the RBA removes its 'patient' stance. Thursday's Fed minutes and Fed speakers might shed more light on the pace of Fed hikes, and the former may offer details on quantitative tightening that could impact longer-term yields. The tone of US dataflow is likely to remain robust, but the continuing Ukrainian conflict and periodic COVID-19 flare-ups could add another layer of volatility and cap longer-term yields. Commodity prices, equities and the cost of funds remain key barometers.

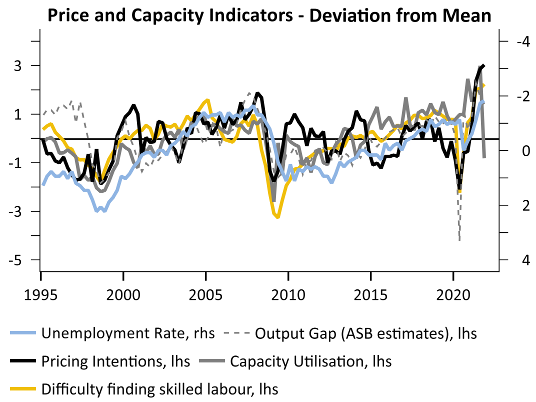
Medium-term outlook

We expect a steady sequence of 25bp hikes at each decision, with the OCR peaking at 2.75% in early 2023. Risks to our OCR outlook are to the upside with the risk of a faster pace of hikes. The RBNZ will also start quantitative tightening from July and this could provide upward pressure to longer-term yields. Our CBA colleagues expect RBA rate hikes from June (1.25% endpoint). The US FOMC is expected to hike rates by a total of 175bp over 2022 and a further 100bps over 2023 (2.75-3% peak by 2023 Q3), running down its balance sheet in June. Longer-term local and global yields are expected to drift up, keeping the yield curve flat. mark.smith4@asb.co.nz

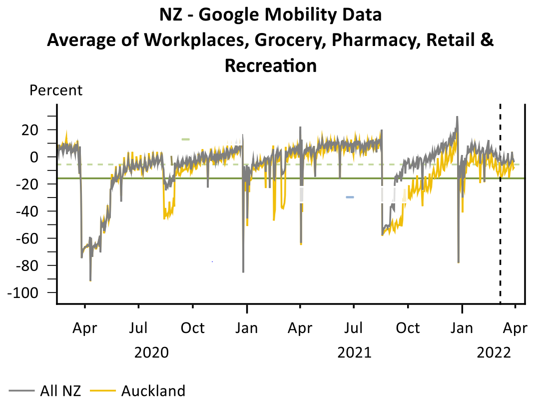
Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market Expects	ASB Expects
NZIER QSBO, Q1	5/4	10:00 am	-	-	Weal activity High inflation
Electronic Card Transactions, retail, % mom, March	11/4	10:45am	-7.8	-	-1

Activity metrics from the Q1 NZIER QSBO – including actual and expected domestic trading activity, employment and investment intentions – are expected to cool given the deterioration in other business and consumer sentiment surveys of late. However, capacity metrics – skilled and unskilled labour shortages and labour and capacity as limiting factors – should remain intense, with surveyed capacity utilisation set to largely reverse its Q4 21 dip. There is also the likelihood that pricing and cost measures from the survey ratchet higher still and become more widespread across sectors. That the QSBO should continue to show extremely tight capacity and heightened pricing pressures is consistent with our long held view (see our July 2021 note). **The economic outlook remains extremely awkward and the RBNZ faces difficult choices ahead.**



Source: Macrobond, ASB



Source: Macrobond, ASB

We expect a broadly flat outturn for March card spending that followed the large Omicron-induced February dip. Retail sectors likely to be under the pump include hospitality and accommodation. While there were sizeable cuts to retail fuel prices in the middle of the month mobility data suggests increased vehicle use has partly compensated for this. MBIE card spending for the 4 weeks to the end of March was slightly down, with non-retail sector spending (notably travel and transport) lifting given easing travel restrictions. A short-term post-Omicron lift is to be expected over the next month or two, but the boost to retail activity should be short-lived given higher retail prices and debt servicing costs, a cooling housing market outlook and ongoing COVID-19 caution for many consumers.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU RBA Board Meeting, April	5/4	4.30 pm	0.1%
CA Bank of Canada Business Outlook Survey, Q1	5/4	2.30 am	-
AU Trade Balance, February	7/4	1.30 pm	$A11bn
US FOMC Minutes	7/4	6.00 am	-
EC Retail Sales, February	7/4	9.00 pm	0.3%/mth
AU RBA Financial Stability Review	8/4	1.30 pm	-
JP Current Account, February	8/4	11.50 am	-¥100bn
CA Net Employment Change, March	9/4	12.30 am	50,000
CA Unemployment Rate, March	9/4	12:30 am	5.5%

** Forecasts and commentary originally published by CBA Global Markets Research Friday 1st April*

Our view is that the RBA will commence a tightening cycle from June 2022 with a 15bp increase in the cash rate target. While we expect the cash rate to remain at 0.1% at the April Board meeting next week, we will be looking for any change in language from the RBA Governor. Specifically, we see clear risk that the RBA Governor removes the line that “the Board is prepared to be patient” from his post-meeting Statement.

Elevated cost pressures, labour shortages and supply chain disruptions will likely remain the dominant themes in the Bank of Canada’s Q1 Business Outlook. We expect businesses’ inflation expectations will lift even higher given the continued increase in inflation and the Ukraine war. In our view, strong results increase the risk of a April 50bp rate hike by the BoC.

We expect the Australian trade surplus reduced to $A11bn in February due to exports softening slightly on lower non-rural commodity prices after a bumper increase the month prior. We expect imports increased in the month.

Minutes of the March FOMC meeting will highlight the considerations behind the 25bp hike in March and the roughly 10 further hikes priced flagged till the end of next year in the dot plots. FOMC chair Powell has signalled that the minutes will provide details on options to shrink the Fed’s large balance sheet.

Eurozone retail data for February precedes the sharp spike in energy prices that took place in early March. Over the coming months the ECB will be watching for signs that high energy prices, and high inflation more generally, is cutting into discretionary spending.

The Financial Stability Review provides the RBA’s semi-annual assessment of the current condition of the financial system and potential risks to financial stability. The RBA is likely to cast an eye over the financial stability risks of elevated household borrowing and housing prices. The Council of Financial Regulators (of which the RBA is one of four members) has recently expressed some concern about the increased share of loans with a high debt-to-income ratio.

The already released customs trade balance suggests Japan’s current account contracted into a surplus in February. The spike in energy and agricultural prices caused by the Ukraine war suggests the current account deficit will expand in March.

Following a blowout February labour market report, the Canadian economy is at, or very close to, full employment. As a result, we expect a more modest employment gain of 50,000 in March. But the risks are skewed to a larger gain. We estimate the Canadian unemployment rate will remain low at 5.5%.

Key Forecasts

ASB NZ economic forecasts	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	3.0	0.1	0.3	0.4	1.3	0.8	0.8	0.6
GDP real - A%	3.1	1.9	-0.2	3.9	2.2	2.9	2.9	2.5
GDP real - AA%	5.6	5.3	1.1	2.2	1.9	2.2	2.2	3.0
NZ House Prices (QV Index) - A%	24.7	11.3	4.7	-0.1	-6.0	-2.2	-2.2	6.8
CPI - Q%	1.4	2.3	1.4	1.9	0.8	0.7	0.7	0.6
CPI - A%	5.9	7.4	7.5	7.1	6.5	4.9	4.9	3.1
HLFS employment growth - Q%	0.1	0.0	-0.3	0.8	0.4	0.3	0.3	0.3
HLFS employment growth - A%	3.7	3.0	1.6	0.5	0.8	1.2	1.2	1.2
Unemployment rate - %sa	3.2	3.0	2.9	2.8	3.0	3.1	3.1	3.4

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	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Mar-23	Mar-24
(end of quarter)	<< actual	forecast >>						
NZ OCR	1.00	1.50	2.00	2.50	2.75	2.75	2.75	2.75
NZ 90-day bank bill	1.61	1.80	2.30	2.80	3.00	3.05	3.00	3.05
NZ 2-year swap rate	3.28	3.33	3.38	3.43	3.48	3.53	3.48	3.58
NZ 5-year swap rate	3.40	3.45	3.50	3.55	3.60	3.65	3.60	3.65
NZ 10-year swap rate	3.38	3.43	3.48	3.53	3.58	3.63	3.58	3.68
NZ 10-year Bond	3.27	3.26	3.28	3.31	3.33	3.38	3.33	3.43

ASB foreign exchange forecasts	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Mar-23	Mar-24
(end of quarter)	<< actual	forecast >>						
NZD/USD	0.70	0.73	0.74	0.75	0.73	0.73	0.73	0.73
NZD/AUD	0.93	0.96	0.95	0.94	0.94	0.94	0.94	0.94
NZD/JPY	85	86	88	90	88	88	88	88
NZD/EUR	0.62	0.63	0.63	0.63	0.60	0.59	0.60	0.56
NZD/GBP	0.53	0.54	0.54	0.54	0.51	0.50	0.51	0.50
NZD/CNY	4.4	4.6	4.6	4.7	4.5	4.5	4.5	4.5
NZD TWI	74.8	77.0	77.2	77.6	75.6	75.4	75.6	75.0

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