Economic Weekly

06 September 2021

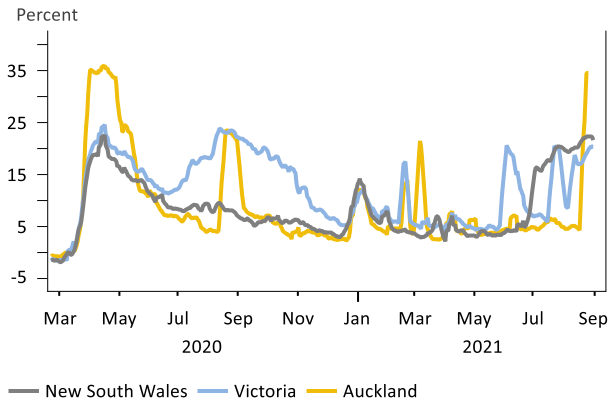
Don’t give up Auckland, we are on the right track

Over the weekend, it was very encouraging to see the number of new COVID-19 cases continue to trend down. This demonstrates NZ’s Alert Level 4 lockdown is working – and not just slowing the virus spread but stopping the spread. For now, elimination remains NZ’s best strategy for both the economy and health outcomes. Elimination means back to “normal” faster and enables the economy to quickly bounce back. We currently expect Q3 GDP to contract around 6-7% due to the NZ community outbreak and the subsequent lockdown. And assuming elimination is successful, we expect GDP to bounce back over Q4 – with an 8% rebound pencilled in.

Some may have been disheartened last week to see Australian states New South Wales and Victoria give up on the elimination strategy, after failing to stop the spread of the Delta variant in these communities (RIP trans-Tasman Bubble). But NZ should not take this is a sign of inevitable defeat. Google uses its popular maps app to measure changes in people movement, and it’s provided a great insight into the effectiveness of lockdown restrictions. Comparing Auckland with New South Wales (NSW) and Victoria (see charts below), **NZ’s Alert Level 4 has been more effective at keeping more people at home and reducing the number of people needing to physically be at retail locations**. This comparison clearly shows that restrictions in NSW and Victoria were on par with NZ’s Alert Level 3 in limiting the movement of people, not Alert Level 4. Alert Level 4 restrictions are hard and stressful, but a month here will be better than staying at Alert Level 3 for a number of months as has been the case for NSW. Furthermore, disappointing US employment figures over the weekend show that living with the virus before most people are vaccinated does slow and inhibits economies’ ability to recover. jane.turner@asb.co.nz

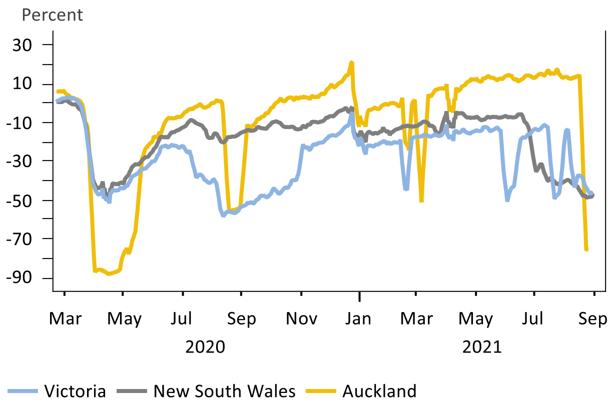
Need help or information? Find ASB and Government support information **here**.

Google Maps Mobility - Residential Compared to Baseline



Source: Macrobond, ASB

Google Maps Mobility - Retail & Recreation Compared to Baseline



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7157	0.6997	0.7048	0.6704	UP	0.7060	0.7300
NZD/AUD	0.9594	0.9578	0.9539	0.9218	FLAT/DOWN	0.9420	0.9660
NZD/JPY	78.49	76.79	77.39	71.14	FLAT/UP	77.00	80.20
NZD/EUR	0.6024	0.5928	0.5959	0.5655	FLAT	0.5800	0.6050
NZD/GBP	0.5159	0.5081	0.5062	0.5047	FLAT	0.5070	0.5200
TWI	75.6	74.1	74.5	72.13	FLAT/DOWN	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 beat a one-way track higher last week. Most of this reflected a weaker US dollar over the week, with Friday night's disappointing US employment report rubbing salt into the greenback's wounds. But there were elements of antipodean outperformance in the mix too, with the NZD and AUD sitting atop the week's FX performance rankings.

The NZD/USD trades at two-month highs around 0.7150 and the NZD/AUD at 0.9600 – a little below the 18-month high struck in the early part of last week around 0.9640.

A further lift in RBNZ rate hike expectations supported the kiwi's rally last week. Interest rate markets are pricing a near 90% chance the OCR is lifted 25bps in each of the next three meetings, taking it to 1% by February. This underpinned a steady trend higher in wholesale rates last week: the 2-year swap yield is back to where it was pre-lockdown (1.38%). At the same time, US interest rates have gone the other way, as markets have pushed back the timing of Fed tapering (our friends at CBA are now calling November). NZ-US 3-year swap spreads widened out to a 5-year high of 110bps.

We've been flagging the risk for a while that any setbacks for the USD (the likes of which we're seeing now from the tapering push-back) would see NZD/USD outperform given its strong fundamentals. This now seems be occurring. It's not just widening interest rate differentials. Last week's trade data showed the NZ terms of trade rising back to around record highs with further gains expected.

Our valuation model shows that there's room for additional NZD gains, should the USD remain on the backfoot. Our model (based on rate differentials, commodity prices, and risk appetite) puts short-term 'fair-value' for NZD/USD at around 0.7600. This of course relies on all things COVID continuing to go in the right direction. A worsening in the current outbreak remains the key downside risk for the currency.

There's a little less immediate event risk on the slate for the NZD this week. It's basically central bank watch with the RBA, ECB, and BoC (Bank of Canada) all meeting. The RBA is expected to reverse its decision to taper (albeit it's a close call) and the BoC and ECB are expected to hold the line, but with the latter possibly signalling timing for their own QE taper. There's still something for Fed watchers in the form of a speech from NY Fed president Williams.

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ASB foreign exchange forecasts (end of quarter)	Mar-21	Jun-21 << actual	Sep-21 forecast >>	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
NZD/USD	0.70	0.70	0.69	0.67	0.68	0.69	0.72	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.94	0.92	0.92	0.92
NZD/JPY	77	77	78	76	79	81	85	85
NZD/EUR	0.60	0.59	0.59	0.59	0.61	0.61	0.60	0.55
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.51	0.51	0.51
NZD/CNY	4.6	4.5	4.5	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.9	73.7	73.2	71.3	72.8	73.0	74.4	73.8

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	0.48	0.46	0.65	0.30	UNCH	UP
2-year swap	1.36	1.29	1.23	0.06	UNCH	UP
5-year swap	1.74	1.64	1.56	0.14	UNCH	UP
10-year swap	2.04	1.96	1.87	0.54	UNCH	UP
10-year govt bond yield	1.85	1.73	1.62	0.60	UNCH	UP
Curve Slope (2s10s swaps)	0.68	0.67	0.64	0.49	UNCH	DOWN

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

Market recap

Local yields have continued to grind higher with more pronounced increases in the belly of the curve. Last week's COVID-19 news had a modest impact, with the trend decline in new community cases and relaxation of Alert Level restrictions outside of Auckland likely supporting market expectations of RBNZ hikes. RBNZ headlines have quietened post the August MPS flurry although last week's proposed tightening of the LVR restrictions for owner-occupiers clearly signalled the intent to slow housing market buoyancy.

Global yields showed generally more modest changes, with spreads between NZ yields and global equivalents widening. There was little market reaction to the stronger than expected 'historical' Q2 Australian GDP outturn. The delta variant outbreak is starting to disrupt offshore economic activity. The Chinese manufacturing PMI fell to an early 2020 lows. Market expectations of pending FOMC tapering were pared back after August US Payrolls significantly undershot expectations (235k versus mkt: 733k) and our CBA colleagues expect a delay in the tapering announcement till November. Delayed FOMC tapering and firmer US wage growth likely steepened the US Treasury yield curve post the Payrolls release, with 10-year yields (10Y 1.32%) up close to 5bps over the week.

Near-term interest rate outlook

Market pricing is heavily biased towards OCR hikes with the RBNZ expected to 'look through' the short-term lockdown impacts and back up earlier hawkish rhetoric. Currently, a 25bp hike in October is about 95% priced in, with just under 50bps by November and with a terminal OCR or around 1.60%. Given our OCR view we expect short-term rates and those in the belly of the curve to be supported, but sensitive to the course and persistence of the delta variant outbreak in NZ. The local dataflow should attract limited market reaction and is likely to increasingly reflect an August lockdown hit (Friday's card spending should show a sharp fall), but resilience prior to this (e.g. Q2 GDP).

With the delta variant established in Australia we expect Australian interest rates to soften relative to NZ equivalents as the repercussions to the Australian economy hit home. Our CBA colleagues expect a large Q3 GDP hit (-4½% qoq) to Australia and falls in employment (circa 500k in August/September). It seems likely the RBA will hold the cash rate at 0.1% tomorrow and announce a delay in tapering its AUD5bn in weekly bond purchases till November. No changes to settings are expected by the ECB and Bank of Canada this week.

Our bias is for longer-term global yields to eventually move higher as markets 'look through' COVID-19 impacts and increasingly focus on improving prospects. However, the delta variant is likely to contribute to additional volatility, and global yields could move down before they move up.

Medium-term outlook

We have pencilled in 25bp hikes in each of the next three OCR decisions (October, November and February), with the OCR ending 2022 at 1.50%. Uncertainty is pronounced, and the economy (and OCR settings) could follow a number of different paths. Our CBA colleagues expect RBA cash rate hikes from May 2023, with a 1.25% endpoint. The US FOMC is expected to announce the tapering of monthly asset purchases in November, with the Fed Funds rate to move up from March 2023 (1.50% in 2024). Longer-term yields are expected to remain capped at low levels, with the yield curve flatter given larger rises in shorter-term yields. mark.smith4@asb.co.nz

Domestic Events

Data	Date	Time (NZT)	Market	ASB
Building Work Put in Place, Q2, %qoq	06/09	10:45 am	-	1.7
Electronic Card Transactions, Retail, August, % mom	10/09	10:45 am	-	-25
NZ Food Prices, August, %mom	13/09	10:45 am	-	0.7

We expect Q1 building activity (building work put in place) to lift 1.7% - adding to the previous quarter's lift of 3.7%. Construction demand remains very strong, but capacity constraints in the construction sector could limit the ability of the sector to grow to meet this demand. We expect at 3% lift in residential building activity and a 0.5% fall in non-residential building activity.

We expect a sharp fall in card spending in August as NZ entered lockdown in the 2nd half of the month. MBIE card spending for August was down 22% on the previous month, despite an approximate 10% monthly climb in food & liquor sales. The course of card spending will heavily depend on the trajectory of the delta variant outbreak in NZ. **We are hoping that the period of higher restrictions proves to be short-lived (weeks rather than months), which should facilitate a decent rebound**. The move down in Alert Levels outside of Auckland is a clear positive for non-essential retail outside our largest city. The longer the period of lockdown, the harder conditions will get for non-essential retail, particularly hospitality.

August food prices are expected to advance at a strong 0.7% monthly clip, with broad-based gains amongst the subgroups. Food prices are on track to rise 2½% in Q3 (+0.4 contribution to Q3 CPI). High global food commodity prices point to a subsequent uplift in retail food prices.

Dwelling rents for the August month are expected to continue to move up despite the lockdown. Data for 2020 showed rents (stock measure) climbed every month despite the early/mid 2020 lockdown. Strong demand for rental properties by tenants, the resilient housing market and policy changes should continue to push rents higher. **Our latest forecast points to annual CPI inflation approaching 4½% by the end of this year**

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
RBA Board Meeting, Cash rate, Yield target	07/09	4:30 pm	0.1%, 0.1%
China trade balance, August	07/09	-	$US51bn
Bank of Canada Meeting, Overnight rate	09/09	2:00 am	0.25%
AU weekly payrolls and wages, Aug	09/09	1:30 pm	-
China CPI, PPI, August/yr	09/09	1:30 pm	1%, 9%
ECB Meeting	09/09	11:45 pm	-
UK GDP, July	10/09	6:00 pm	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 27 August*

Since the **RBA Board** last met in August lockdowns have been introduced or extended in NSW, Vic and the ACT. There is no doubt that the economy is the midst of a large negative shock (we estimate a -4.5%/qtr contraction in Q3). As such, we do not expect the RBA Board to go ahead with the announced taper at the September Board meeting. To be clear, reversing the planned tapering and sticking to the $A5bn per week bond buying rate is not likely to have a significant impact on the economy. But the optics of a perceived pullback in support in a time when the national economy is likely to record the second largest quarterly shock since at least 1975 is not good. The path of least regret should be to keep the pace of bond buying steady.

We forecast growth in **Chinese exports and imports** to ease to 17%/yr and 27%/yr in August, respectively. Fading base effects led to slower growth in both exports and imports. However, the continued virus spread in emerging economies and recovering demand in advanced economies supports Chinese exports. We forecast the trade surplus eased to US$ 51bn.

The **Bank of Canada** (BoC) is expected to make no policy changes and emphasise again it expects to keep the overnight rate at 0.25% until 'sometime in the second half of 2022'. Our base case scenario is for the BoC to trim the pace of weekly bond purchases to $C1bn (from the current clip of $C2bn/week) at the next policy meeting (27 October).

Australian payroll jobs and wages estimates cover the fortnight ending 14 August. The data will capture the effects of the lockdowns in Qld (29 Jul-11 Aug), Vic (5 Aug onwards), ACT (12 Aug onwards) as well as the broadening of the lockdown from Greater Sydney to the rest of NSW. As such, we expect employment losses to worsen as the impacts of extended lockdowns accumulate. We estimate that 550k workers have been stood down because of the NSW and Vic lockdowns.

We predict **Chinese CPI inflation** will remain steady at 1%/yr as rising fresh vegetable prices offset falling pork prices. PPI inflation may remain high at 9%/yr because of elevated commodity prices.

The **ECB** is widely expected to make no policy or forward guidance changes. The risk is that the ECB signals a reduction in the pace of bond purchases under its €1,850bn Pandemic Emergency Purchase Programme (PEPP). Eurozone financing conditions are favourable, inflation dynamics have improved and the economic recovery is intact.

The composite Markit PMI points to another solid **UK GDP growth** print in July. UK economic slack is diminishing at a decent pace with the level of GDP just 2.2% below the levels seen in February 2020.

Key Forecasts

ASB NZ economic forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	1.6	1.1	-6.5	7.8	0.4	1.3	0.6	0.6
GDP real - A%	2.4	16.1	-4.9	3.6	2.3	2.5	3.4	2.5
GDP real - AA%	-2.3	4.2	2.8	3.9	3.9	0.9	4.9	2.5
NZ House Prices (QV Index) - A%	22.0	28.2	27.8	22.1	14.9	8.8	2.6	6.8
CPI - Q%	0.8	1.3	1.4	0.4	0.7	0.6	0.5	0.5
CPI - A%	1.5	3.3	4.1	4.1	3.9	3.2	2.4	2.3
HLFS employment growth - Q%	0.6	1.1	-0.2	-0.2	0.4	0.5	0.3	0.3
HLFS employment growth - A%	0.3	1.7	2.1	1.2	1.0	0.4	1.4	1.4
Unemployment rate - %sa	4.6	4.0	4.1	4.5	4.3	4.0	3.9	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 (end of quarter)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.25	0.75	1.00	1.25	1.50	1.50
NZ 90-day bank bill	0.35	0.35	0.50	1.00	1.25	1.50	1.75	1.75
NZ 2-year swap rate	0.47	0.78	1.35	1.50	1.60	1.70	1.95	2.15
NZ 5-year swap rate	1.12	1.36	1.75	1.85	1.95	2.05	2.20	2.40
NZ 10-year swap rate	1.96	1.88	2.00	2.05	2.10	2.15	2.30	2.50
NZ 10-year Bond	1.78	1.77	1.90	1.95	2.00	2.05	2.20	2.40

ASB foreign exchange forecasts (end of quarter)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZD/USD	0.70	0.70	0.69	0.67	0.68	0.69	0.72	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.94	0.92	0.92	0.92
NZD/JPY	77	77	78	76	79	81	85	85
NZD/EUR	0.60	0.59	0.59	0.59	0.61	0.61	0.60	0.55
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.51	0.51	0.51
NZD/CNY	4.6	4.5	4.5	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.9	73.7	73.2	71.3	72.8	73.0	74.4	73.8

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