Economic Weekly

06 December 2021

Cautiously optimistic, still

The emergence of the Omicron variant is the latest (unwelcome) risk to stir into the 2022 economic maelstrom. But we still don't know enough about it to be able to say anything sensible about the potential economic damage. It could be some weeks before we do. For now, we maintain a cautiously optimistic view of the NZ economy next year. And we saw plenty of snippets of positive economic news out last week to support this view.

- Retail spending is humming. We expect this to be confirmed in Friday's 'official' card spending data, for which we're picking a 15% monthly surge. Looking ahead, the further easing in COVID restrictions this month should lift hospitality, fuel and services spending numbers.
- Rural cash flows will receive a leg-up from Fonterra's upgrade to its payout forecast announced last week. This will confer an extra $2-2.5bn to rural communities, and we still reckon the balance of risks are to the upside. High dairy prices are a key support behind our positive medium-term prognosis for NZ's export prices and terms of trade, with the latter hitting a fresh record high last week.
- NZ COVID case numbers have flattened. Clearly this could change in a heartbeat, particularly now that parts of the North Island are operating with fewer restrictions. But, for now, it will be boosting hopes that NZ's high vaccination rate is working, which might help economic confidence at the margin.

These factors are consistent with our macro forecasts for a decent rebound in GDP growth over Q4 and the first half of next year, following a 7% lockdown-driven decline in Q3. The unemployment rate is expected to rise only a little over the next couple of quarters, while retaining a "3" handle for the foreseeable future. Of course, 2022 won't be all plain sailing by any means. There are plenty of headaches for businesses, and plenty of risks that could upset the economic apple cart, even outside of the now de rigueur COVID mentions. For example, last week:

- We flagged that lofty house prices are at risk from the confluence of three big macro forces next year. We now expect small falls in house prices over the second half of 2022. This promises to temper retail sales growth and economic momentum more generally. Although, if our own Housing Confidence survey is anything to go by, the public aren't buying it, or not yet anyway.
- Business confidence remained on a cooling trajectory in November, despite the relaxation of COVID restrictions. There's plenty of uncertainty about how businesses will respond to the opening up of the country over summer. Upcoming releases should be watched for any further wobbles.

This heightened uncertainty and risk profile is partly why we think financial markets are overdoing RBNZ cash rate expectations. A 25bps OCR hike at each of next year's seven meetings is close to fully priced. We think the odds favour a pause somewhere along the line. For this week, focus will once again be on news pertaining to the Omicron variant. Economic data will be secondary. In NZ, the final building blocks for estimating next week's Q3 GDP outcome will be released. Offshore highlights include tomorrow's RBA meeting, US CPI, and Chinese trade & inflation data.

mike.jones@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6762	0.6833	0.7095	0.7055	DOWN	0.6600	0.6900
NZD/AUD	0.9655	0.9562	0.9588	0.9498	FLAT	0.9500	0.9800
NZD/JPY	76.34	77.67	80.63	73.27	DOWN	74.00	79.00
NZD/EUR	0.5978	0.6056	0.6143	0.5808	DOWN	0.5800	0.6100
NZD/GBP	0.5112	0.5124	0.5254	0.5246	DOWN	0.5000	0.5300
TWI	73.0	73.3	75.3	73.9	FLAT/DOWN	N/A	N/A

*^ Weekly support and resistance levels * Current as at 10.00am today; week ago as at Monday 5pm*

NZD Recap and Outlook

Last week, currency markets largely stuck to their recent, anxious mood. A cloud of Omicron-related uncertainty looms large over proceedings as global public health experts scramble to glean more information about the variant. The most obvious symbol of frazzled investor nerves has been the moves in the VIX index (a measure of market volatility), which hit its highest level since last week. Beyond that, global equity markets have shed about 5% over the past fortnight and bond yields have similarly dropped as markets recalibrate their rate hike expectations (the benchmark US 10-year Treasury yield is down circa 35 bps, for example).

On the currency front, the more circumspect mood has helped support the traditional safe-haven currencies like NZD and JPY, though as we noted last week, it's been difficult to distinguish Omicron hitting the headlines from the broader USD rally that was already underway. The DXY index largely tracked sideways last week but is still hovering not far off eighteen-month highs. USD strength last week was helped not just by Omicron anxieties, but by surprisingly hawkish comments by newly-reappointed FOMC chair Jerome Powell.

On that theme, last week saw NZD/USD and NZD/JPY continuing to trundle along recent lows, with the former in a 0.6710-0.6870 and the latter in a 0.76-0.78 range. By contrast, the kiwi fared better against its fellow commodity currencies, with NZD/AUD gaining over a cent to finish the week around the 0.9650 mark.

This week, Omicron headlines are likely to remain in the driver's seat, with second-tier local data unlikely to feature. That could mean a little more downside pressure on NZD/USD in the near term, but will help support NZD/AUD, given our CBA friends expect the Aussie is more vulnerable to negative COVID headlines. Tuesday's RBA meeting isn't expected to result in any policy or outlook change.

As we noted last week, it's difficult to say much constructive on the medium-term outlook until we have better information on the nature of the Omicron variant, and therefore its likely implications for the economic outlook or the RBNZ's calculus. For what it's worth though, the news would have to be very negative to shift the RBNZ's balance of risks materially towards delaying OCR hikes – it's the present hot, increasingly persistent inflationary pressures that are still the bigger threat to its mandate. Add to that the strong commodity price outlook – we'll get another reminder of that with the latest GlobalDairyTrade auction on Tuesday night – and it is clear NZD fundamentals still look fairly robust.

nathaniel.keall@asb.co.nz

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	MT Bias
Cash rate	0.75	0.75	0.50	0.25	UP
90-day bank bill	0.87	0.80	0.80	0.25	UP
2-year swap	2.22	2.15	2.21	0.26	UP
5-year swap	2.53	2.63	2.60	0.46	UP
10-year swap	2.53	2.72	2.67	0.92	UP
10-year govt bond yield	2.34	2.45	2.52	0.91	UP
Curve Slope (2s10s swaps)	0.31	0.58	0.46	0.66	DOWN

** Current as at 10.00am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market recap

Local short-term yields have retraced the previous week's falls, with the 2-year swap yield briefly topping 2.30%. Local longer-term yields were weighed by weaker global counterparts with the 12bp fall in NZ 10-year Government bond yields (2.37%) over the week broadly matching falls in Australian and US counterparts. Catalysts for NZ yield direction were mostly global with few local events to stir markets. FOMC market pricing and US short-term yields shot up after FOMC Chair Powell deemed currently high US inflation no longer to be 'transitory' at his Senate testimony, flagging an earlier start to US QE tapering and FOMC rate hikes. US 10-year Treasury yields fell 10bps (1.35%) after the disappointing November jobs report dampened risk sentiment, with 30-year yields (1.67%) down to January lows. US 2-year yields eased 2bps (0.59%) after Payrolls to end 10bp higher over the week. Australian short-term yields nudged higher after Q3 GDP wasn't as weak as expected, but moves were modest.

Near-term interest rate outlook

We have retained a modest downward bias to short-term NZ yields. There are now roughly 33bps of RBNZ hikes priced in by February 2022, with the OCR approaching 2.25% by late 2022 and 2.9% by August 2023. Our core view is that the RBNZ will continue to move in 'slow and steady steps' (in 25bp rather than 50bp increments) and not overcook the degree of OCR hikes given the degree of tightening already delivered, the erosion of incomes from high inflation, still-present COVID-19 risks and the economic adjustment needed to live with COVID-19. This will eventually mean a scaling back in market pricing and NZ short-term yields. We are still wary of the possibility of NZ yields shooting higher and the curve steepening if the NZ economy overheats, a wage/price spiral unfolds, and longer-term inflation expectations jump. We don't envisage much interest rate reaction from this week's local data, but more upside is likely if the data reveal a more resilient than expected economy.

There is more upside than downside risk to global yields. No substantive changes in tone or policy direction are expected from the RBA tomorrow and we also don't expect much market reaction from this week's speech by RBA Governor Lowe. Thursday's Bank of Canada decision should also be mostly uneventful. Uncertainty over the potency of the Omicron variant is likely to remain over the coming weeks, and this could serve to cap upside on global yields. Still, sub 1.50% US 10-year Treasury yields are looking increasingly at odds with the post COVID-19 global recovery we see unfolding. Longer-term global yields could receive a leg up if this week's US inflation data show a strong print and broadening price pressures.

Medium-term outlook

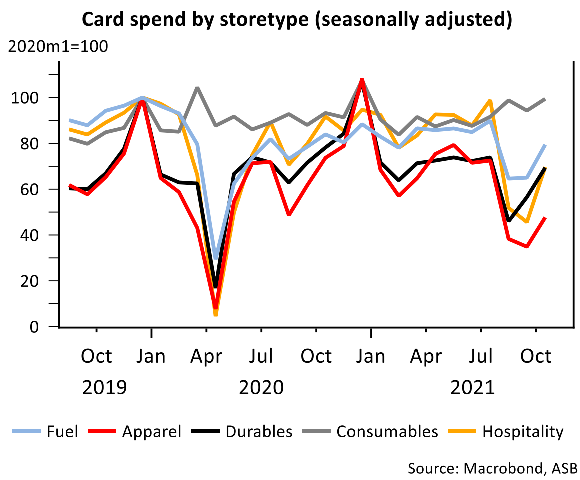
We have pencilled in a steady sequence of 25bp hikes, with the OCR peaking at 2% by late 2022. The RBNZ will start to pare back its LSAP holdings from early 2022. Our CBA colleagues expect QE tapering from February 2022 (ending May 2022) and RBA rate hikes from November 2022 (1.25% endpoint). The US FOMC is now expected to have finished its QE tapering by April 2022, with rate hikes from June 2022 (2.5% by early 2024). Longer-term yields are expected to drift up and for the yield curve to remain flat, with risks of a more pronounced lift in yields. mark.smith4@asb.co.nz

Domestic Events for the week ahead

Data	Date	Time (NZT)	Market	ASB
Manufacturing Activity, Q3, % qoq	9/12	10:45am	-	-
Electronic Card Transactions, Retail, October, % mom	10/12	10:45 am	-	15

StatsNZ releases a range of business survey data on Thursday 9th of December, which are key inputs to the Q3 GDP estimates. This includes wholesale trade sales volumes, manufacturing sales volumes, the selected services survey data and business financial data. Once we have transformed and analysed the data, we will update our final Q3 GDP estimate. We currently believe that Q3 GDP contracted 7% qoq, although to date the data have come in stronger than this - a very encouraging sign of the NZ's economy's resilience.

We expect a circa 15% monthly lift in November card spending that followed a 10% climb from weak September and August levels. MBIE card spending for the 4 weeks to the end of October showed a 12% climb, although ASB card spending data point to a stronger lift (particularly over the Black Friday sales weekend). Spending in Auckland, the Waikato and Northland soared after the easing of Alert Level restrictions. The Black Friday sales also helped drive strong growth in apparel and durables retail. The shift to the Traffic Light framework and the relaxation of the Auckland boundary (December 15) is expected to boost hospitality, fuel and services spending. Strong household balance sheets, pent-up demand, high producer incomes and the tight labour market are key supports. However, higher retail prices, the cooling housing market, retail stock shortages, and still-present restrictions should temper retail trade growth over 2022.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU House Price Index, Q3, % qoq	7/12	1:30 pm	5.2
RBA Board Meeting, Cash Rate	7/12	4:40pm	0.1
China Trade Balance, Nov, Exports % yoy, Imports % yoy	7/12	-	20, 19
Bank of Canada rate decision, Cash Rate	9/12	4:00 am	0.25
RBA Governor speech at Payments Summit	9/12	11:00 am	-
China CPI, Nov, % yoy	9/12	2:30 pm	2.2
UK GDP, October	10/12	8:00 pm	-
US CPI, Nov, Headline % mom, Core % mom	11/12	2:30 am	0.7, 0.5

** Forecasts and commentary originally published by CBA Global Markets Research Friday 3rd December*

The ABS will release the **Australian House Price Index for Q3.** Monthly CoreLogic dwelling price data show that while the pace of dwelling price growth remains robust, it has slowed recently.

We don't expect any policy changes at the **Reserve Bank of Australia (RBA) Board's last meeting of the year**. Although the Q3 GDP print indicated that the economy had been more resilient than expected over the lockdown period, we don't see that as having moved the dial on the RBA's thinking around inflation and wages growth. The RBA's current pace of bond purchases will continue until at least February 2022.

The **RBA Governor** will speak at the annual Payments Summit. Given the forum the speech will likely touch on the payments system and will not be relevant for monetary policy.

Chinese manufacturing production and exports recovered amid easing power shortages. We estimate **Chinese exports and imports** to rise 20%/yr and 19%/yr in November, respectively. We estimate the monthly trade surplus will lift to a record high of $US92bn. The large trade surplus will expand China's current account surplus too.

We expect **Chinese consumer inflation** to quicken to 2.2%/yr in November because of rising food inflation, easing pork deflation and rising electricity prices. By contrast, PPI inflation may decelerate to 11.5%/yr in November because of falling coal, iron ore and other upstream material prices.

At its October policy meeting, the **Bank of Canada** (BoC) ended its bond buying program and brought forward its guidance for the rate lift-off to 'the middle quarters of 2022'. Spare capacity is diminishing rapidly. At the same time, inflation continued to lift higher above the BoC's inflation target. Nevertheless, the discovery of the Omicron variant casts a shadow over the Canadian economy. We expect the BoC will keep its policy interest rates on hold at 0.25%.

In September, the level of **UK real GDP** stood just 0.6% below the levels seen in February 2020. The composite Markit PMI points to solid GDP growth in October driven by output from the services sector. Over Q4, the BoE projects GDP to expand by 1%.

We expect a further increase in **US CPI inflation in November.** Gasoline prices rose for the 12th consecutive month and will continue to underpin headline inflation. At the same time, strong demand, rapidly-rising employment costs, ongoing supply constraints and rising inflation expectations all point to another rise in the core CPI. We also anticipate the monthly annualised lift in the trimmed CPI will stay firm and reinforce that inflation in the US is broadening and high. In our view, the trimmed CPI is a more accurate measure of underlying inflation pressures.

Key Forecasts

ASB NZ economic forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	2.8	-6.7	4.9	1.3	1.7	1.5	0.6	0.6
GDP real - A%	17.4	-3.9	1.9	1.9	0.8	9.7	4.4	2.6
GDP real - AA%	5.1	3.7	4.2	3.9	0.2	3.5	4.9	2.7
NZ House Prices (QV Index) - A%	28.3	26.1	24.5	17.2	8.1	2.9	-2.9	6.8
CPI - Q%	1.3	2.2	1.4	0.8	0.8	1.2	0.5	0.5
CPI - A%	3.3	4.9	5.9	5.8	5.2	4.2	2.9	2.5
HLFS employment growth - Q%	1.0	2.0	-0.5	0.3	0.3	0.5	0.2	0.3
HLFS employment growth - A%	1.6	4.3	3.1	2.8	2.1	0.7	1.4	1.0
Unemployment rate - %sa	4.0	3.4	3.7	3.6	3.6	3.4	3.4	3.6

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	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.75	1.00	1.50	1.75	2.00	2.00
NZ 90-day bank bill	0.35	0.65	1.00	1.25	1.75	2.00	2.25	2.25
NZ 2-year swap rate	0.78	1.42	2.40	2.45	2.50	2.55	2.65	2.80
NZ 5-year swap rate	1.36	1.87	2.70	2.75	2.80	2.85	2.95	3.05
NZ 10-year swap rate	1.88	2.24	2.80	2.85	2.90	2.95	3.05	3.15
NZ 10-year Bond	1.77	1.97	2.65	2.70	2.75	2.80	2.90	3.00

ASB foreign exchange forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.70	0.69	0.70	0.71	0.73	0.74	0.73	0.73
NZD/AUD	0.93	0.96	0.97	0.96	0.96	0.95	0.94	0.94
NZD/JPY	77	77	80	82	86	88	88	88
NZD/EUR	0.59	0.59	0.62	0.62	0.63	0.63	0.60	0.56
NZD/GBP	0.51	0.51	0.52	0.53	0.54	0.54	0.51	0.50
NZD/CNY	4.5	4.4	4.5	4.5	4.6	4.6	4.5	4.5
NZD TWI	73.7	73.7	75.1	75.5	76.9	77.2	75.5	74.9

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720

www.asb.co.nz/economics

@ASBMarkets