Economic Weekly

07 March 2022

David vs. Goliath

Russia's invasion of the Ukraine continues, though this has appeared to lose momentum in recent days. In contrast, the economic ripples – particularly the blowback onto the Russian economy – have started to come through swiftly.

Economic and financial sanctions on Russia from the West are crippling Russia's ability to trade and undertake financial transactions, including limiting the ability of Russia's central bank to access foreign reserves to prop up the plunging ruble. Russia may default on its sovereign debt, reflected in its credit rating being cut to 'junk' status. On top of government actions, many multi-national corporations are severing ties with Russia. Russia's sharemarket remains shut, interest rates have soared, and people are queuing at ATMs to withdraw cash.

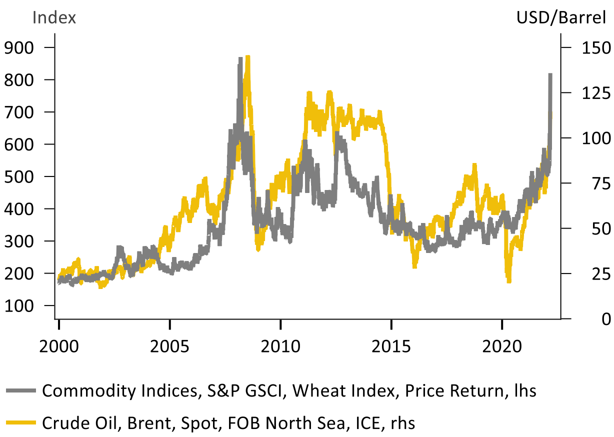
The full global impacts of imposing various sanctions on the world's largest natural gas and second-largest oil exporter, and 20th largest overall trading nation, will take time to flow through. Much will depend on how severely energy and food supplies are impacted. The EU remains the most directly exposed given its dependence on Russian energy. Even so, Russia only accounted for 4% of the EU's exports.

For much of the rest of the world, the economic impacts are most likely to be evident on the pricing side of the ledger. Rising fuel prices are already being felt around the world and are adding to transport costs and already pressuring stretched global supply chains. Traded wheat prices are nearing the levels seen around early 2008, when oil prices soared and some food crops were used to make biofuels. Russia and the Ukraine account for around 30% of global wheat exports, with much of this shipped via ports in the Black Sea, close to the Ukraine conflict. Retail prices of grains, other foodstuffs that make use of them, and substitutes for them are likely to rise over time. Added spending on necessities reduces more discretionary spending, impacting wider demand.

For NZ, it is the direct impacts of oil and affected food prices that will be most noticeable, with annual consumer price inflation likely to exceed 7% in the first half of this year. The wider demand for our exports will depend on the extent to which global growth slows. There are few signs of this yet, with dairy export prices continuing to ratchet higher.

This week – aside from Ukrainian developments – we get data that will help us size up the 2021 Q4 rebound in GDP as the Delta-induced COVID restrictions were eased. Electronic cards transactions for February will show that spending has dipped, but likely fared better than during August's Level 4 lockdown. Nick.Tuffley@asb.co.nz

Oil and Wheat prices, USD



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6848	0.6678	0.6674	0.7169	FLAT/UP	0.6680	0.6900
NZD/AUD	0.9295	0.9303	0.9341	0.9298	FLAT	0.9250	0.9400
NZD/JPY	78.62	77.14	76.68	77.44	FLAT/UP	76.50	79.50
NZD/EUR	0.6261	0.5987	0.5823	0.5994	UP	0.6100	0.6450
NZD/GBP	0.5178	0.5003	0.4904	0.5159	UP	0.5090	0.5230
TWI	73.5	71.2	71.0	74.7	FLAT/DOWN	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 NZD/USD rose steadily throughout last week, ending the week 1½ cents higher. The kiwi made gains against all the cross rates with the exception of the AUD, which just pipped it for the title of strongest performing currency over the week.

Gains were most marked against the underperforming European currencies. NZD/GBP hit a four-month high near 0.5180 and NZD/EUR soared to a 4½ year high around 0.6280. Even though the NZD/USD remains relatively low, the trade-weighted NZD is up around three-month highs as a result.

The kiwi's key drivers are working in opposite directions. Global risk sentiment is a clear drag. Russia's invasion of Ukraine has markets in a heightened state of nervousness with the VIX proxy for risk aversion up around one-year highs and equity markets (as a global growth barometer) roughly 10% below where they started the year. According to our NZD/USD 'fair-value' model this sapping of global risk appetite is worth about 2 cents off the value of the NZD/USD, all else being equal.

Surging global commodity prices have more than offset the weight from higher risk aversion. The Russian invasion has most obviously sent natural gas and oil prices soaring. But there's also been strong gains in grains prices with both Ukraine and Russia important players in global wheat and corn supply. Short-dated wheat futures are up 50% since mid-February with the corn equivalents up around 15%, from already elevated levels. We may have already seen some follow-through to dairy prices with the last four GDT dairy auctions producing circa-5% lifts in whole-milk powder prices. There's only two occasions in history in which global dairy prices have traded up around these levels and the commodity-sensitive NZD/USD was at, or above, 0.8000 on both occasions.

Like others, we have no way of knowing how the tragedy in Ukraine will play out. But we suspect the two NZD drivers noted above will continue on their opposing paths, at least in the short-term. This may see NZD/USD test 0.6900 at some stage this week. And with European currencies continuing to underperform given proximity and trade exposures to Russia, our bias is for further NZD outperformance against EUR and GBP.

Economic data will retain a bit-part in driving currencies this week. In NZ, the final building blocks for Q4 GDP forecasts will be released. Offshore the big highlight is Friday morning's US CPI which is expected to hit almost 8% y/y.

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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	0.75	0.25	UP	UP
90-day bank bill	1.34	1.26	1.16	0.32	UP	UP
2-year swap	2.81	2.75	2.44	0.56	FLAT	UP
5-year swap	3.04	2.99	2.76	1.27	FLAT	UP
10-year swap	3.03	3.03	2.81	2.07	FLAT	UP
10-year govt bond yield	2.81	2.74	2.58	1.93	FLAT	UP
Curve Slope (2s10s swaps)	0.22	0.27	0.37	1.51	FLAT	FLAT

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

Market recap

Local yields are little changed on a week ago, although there has been some volatility and the curve has flattened. The 2-year swap (2.81%) is still around 6-year highs with the 10-year yield earlier touching 3-year highs (3.1%) before subsequently retracing. NZ government bond yields have been weighed on falls for most global counterparts. There were minimal moves on local market pricing despite NZ business and consumer confidence pointing to slumping economic activity but highlighting substantial pricing pressures. The week has seen a widening in NZ bank-bill OIS spreads, with swap spreads to bonds fractionally wider.

Markets have been highly volatile, swinging between periodic bouts of risk aversion over the Ukraine and concerns over inflation. US Treasury 10-year yields traded in a 30bp range and ended the week about 10bp lower (1.73%) with flatter curves despite rocketing oil prices and the strong Non-farm Payrolls print. FOMC market pricing has pared back with Chair Powell signalling the Fed did not want to add to market uncertainty or volatility, with just 23bp of March Fed rate hikes priced in. Our CBA colleagues have trimmed March hike expectations to 25bp (from 50bp), but still expect 150bp of hikes for 2022. Oil prices and US inflation break-evens have ratcheted higher as markets contend to the prospect of more inflation. Australian yields were weighed by lower global yields, with the RBA also sticking to its "patient" script and signalling no pressing need to raise the 0.1% cash rate.

Near-term interest rate outlook

Market pricing - 68bp of hikes over next 2 meetings, close to 170bp of 2022 hikes – looks appropriate in our view, with predominantly upside risk to our published forecasts of a sequence of consecutive 25bp OCR hikes and a 2.75% OCR endpoint. Nonetheless, there is still the possibility that the OCR peaks at a lower level and/or subsequently retraces towards circa 2% neutral levels. Headwinds facing the consumer are intensifying. Soaring Omicron cases in NZ will create significant disruption but have a more modest impact on the local rates market.

Global yields are expected to eventually trend higher, but a ramping up of the Ukraine conflict should push Government bond yields lower, flatten curves and widen bank Bill-OIS spreads. Conversely, inflation developments have been largely upward, and we could see further escalation in inflation indicators (including oil prices). The ECB are expected to stick to their dovish script, with a risk that they delay a faster withdrawal of policy stimulus given Ukraine upheavals. Data will largely be ignored, but upward surprises for US inflation data (headline CPI: 7.9%, core CPI: 6.4% yoy) could nudge yields higher, bolstering views of policymakers being behind the curve. With the March FOMC decision looming, there are no scheduled speeches this week, with markets looking to settle on a 25bp hike.

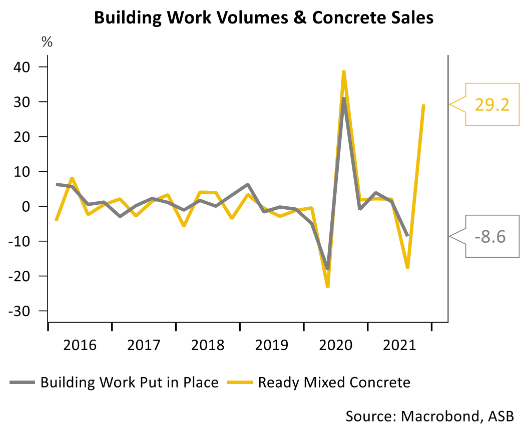
Medium-term outlook

We expect a steady sequence of 25bp hikes at each decision, with the OCR peaking at 2.75% in early 2023. Risks to the OCR outlook are mostly to the upside with the risk of a faster pace of hikes and a higher OCR endpoint. 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 have finished its QE tapering and to hike rates by 25bps in March 2022 (2.25-2.5% by early 2024), 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

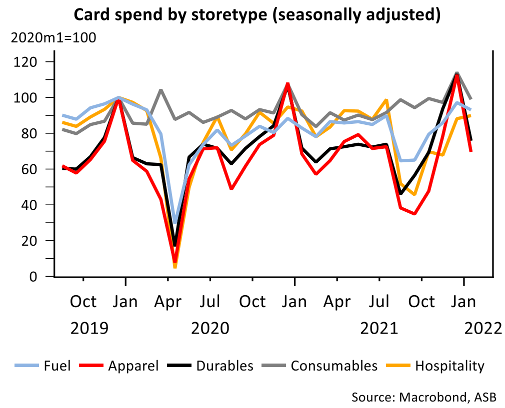
Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market Expects	ASB Expects
Building Work Put in Place, Q4, % qoq	8/3	10.45 am	-8.6	-	-
Economic Survey of Manufacturing, Q4, % qoq	9/3	10.45 am	-2.2	-	-
Electronic Card Transactions, Retail, February, % mom	10/3	10.45 am	3.0	-	-7.0
Food Prices, December, % mom	11/3	10.45 am	2.7	-	-1.0

Data on building work put in place over Q4 is likely to show a decent surge in the aftermath of the gradual easing in Alert Level restrictions over the quarter. Concrete sales, our preferred indicator, point to a sizable upswing in activity, despite widespread reports of shortages in labour and raw materials. Underlying construction demand remained strong throughout 2021 and consents issuance remains healthy, though we expect a cooling housing market, worsening supply constraints and rising interest rates will begin to dampen activity over 2022.



Stats NZ will release a plethora of business survey data next week, which will be the final inputs into our Q4 GDP estimate. This includes wholesale trade sales volumes, manufacturing sales volumes, the selected services survey data and business financial data. We currently expect the NZ economy grew 3.3% over Q4, largely – but not entirely – clawing back its contraction over Q3.



We expect a circa 7% seasonally adjusted fall in February card spending, as the community Omicron outbreak weighs. Retail sectors likely to be hardest hit include hospitality, apparel, accommodation, and services. MBIE card spending for the 4 weeks to the end of February was down by a similar margin with more modest falls for Auckland spending. Further volatility lies ahead, and the year ahead could prove challenging for much of the retail sector. Retail headwinds include sharply higher retail prices and debt servicing costs, still-present retail stock shortages, tight credit conditions, a cooling housing market outlook and ongoing COVID-19 caution.

Falls in fruit and vegetable prices and a modest retracement in meat and non-alcoholic drinks should drive a small February fall in overall food prices. **Annual food price inflation should remain close to 6% and looks to remain elevated over 2022 given high global food commodity prices (the Ukraine crisis has provided a leg-up to commodity prices), rising input costs (fuel and labour costs), and issues with logistics and freight. Rents are expected to continue to firm** given high headline CPI inflation, solid demand for rental properties, and housing policy changes. **Annual NZ CPI inflation is on track to move above 7% by early 2021, with the risk of high inflation outcomes proving to be more persistent.**

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
CN Exports (YTD), February	7/3	-	18%/yr
Imports (YTD)			15%/yr
Trade Balance (YTD)			US$132bn
AU CommBank Household Spending Intentions, February	8/3	11:00	-
AU NAB Business Survey, February	8/3	1.30 pm	-
JP Current Account Balance, January	8/3	12:50 pm	¥ 500bn
AU WBC/MI Consumer Sentiment, March	9/3	12.30 pm	-
AU Governor Lowe Speech	9/3	3.00 pm	-
CN CPI Inflation, February	9/3	2.30 pm	0.9%/yr
PPI Inflation			8.8%/yr
EZ ECB Meeting	11/3	1.45 am	-
Refinance Rate			0.00%
Marginal Lending			0.25%
Deposit Facility			-0.5%
US CPI, February	11/3	2.30 am	-
Headline			8.0%/yr
Core			6.6%/yr
Trimmed			8.0% saar
CA Net Unemployment Change, February	12/3	-	90,000
Unemployment Rate (%)			6.2%

** Forecasts and commentary originally published by CBA Global Markets Research Friday 4th March*

We expect **Chinese exports** remained strong at the start of 2022 with two consecutive rises in the new export order PMI. We forecast exports grew by 18%/yr. Imports may rise by 15%/yr. The trade surplus may rise to US$132bn over January and February.

The **CommBank Household Spending Intentions** (HSI) index for February will be released. The monthly HSI index combines CBA internally generated transaction and lending data with publically available Google search terms to provide a view not only on what Australians were spending money on, but also what they intend to spend money on.

Changes in **Aussie business conditions and confidence** were mixed in January as the Omicron wave affected the readings. However, the survey pointed to a clear continued acceleration in prices. Purchase costs (input prices) lifted strongly and final prices also accelerated. The survey shows inflationary pressures continue to build for businesses and consumer.

We expect **Japan's current account** surplus eased to ¥ 500bn in January, driven by a weaker trade deficit.

Aussie consumer sentiment fell again in February, though optimists continue to outweigh pessimists. Expectations of higher mortgage rates are increasing and rising inflationary pressures are looking to be affecting consumer sentiment. However, sentiment around job security was a bright spot. The war in Ukraine and resultant financial market volatility may impact the March reading on sentiment.

The **RBA Governor Philip Lowe will deliver a speech** at the AFR Business Summit. While the title of the speech has yet to be released, we may see Governor Lowe provide more colour around the RBA Board's deliberations at the March meeting and give some insight into how the RBA views the latest wages growth data.

We forecast **Chinese consumer inflation** to remain unchanged at 0.9%/yr in February. The impact of easing pork prices might be offset by higher energy prices. We expect PPI inflation to ease again to 8.8%/yr in February. However, geopolitical tensions lifted commodity prices sharply. We expect high PPI inflation ahead.

Before the war, Europe was experiencing high inflation and tight labour markets. The **ECB** was preparing to exit its extreme policy support. But now, the ECB will need to balance the upside to inflation and inflation expectations, and the downside to economic growth from the spike in energy prices.

It is too soon for the impact of the Ukraine war on energy prices to impact recorded **US consumer prices**. The impact will show up in March. However, we expect the various core measures of inflation to continue to accelerate. Strong demand and high labour costs are the fundamentals underlining high inflation.

The renewed lockdowns following an Omicron outbreak in some **Canadian** provinces saw **employment** fall by 200,000 in January. But we expect the job losses to be quickly unwound. Lockdown restrictions were gradually relaxed in February. At the same time, businesses' hiring intentions are at record highs. The Canadian labour market has generally recovered very swiftly throughout the pandemic. We estimate a 90,000 gain in employment over February. We also expect the unemployment rate to fall to 6.2%.

Key Forecasts

ASB NZ economic forecasts	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	-3.7	3.3	0.7	0.3	0.4	1.3	0.8	0.6
GDP real - A%	-0.3	3.4	2.6	0.5	4.7	2.7	2.8	2.5
GDP real - AA%	5.0	5.7	5.5	1.6	2.8	2.6	2.6	2.9
NZ House Prices (QV Index) - A%	25.5	24.7	11.3	4.7	-0.1	-6.0	-2.2	6.8
CPI - Q%	2.2	1.4	2.0	1.4	1.3	0.8	0.8	0.3
CPI - A%	4.9	5.9	7.1	7.2	6.2	5.5	4.3	2.7
HLFS employment growth - Q%	1.9	0.1	0.0	-0.3	0.8	0.4	0.3	0.3
HLFS employment growth - A%	4.2	3.7	3.0	1.6	0.5	0.8	1.2	1.2
Unemployment rate - %sa	3.3	3.2	3.0	2.9	2.8	3.0	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 (end of quarter)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZ OCR	0.25	0.75	1.00	1.50	2.00	2.50	2.75	2.75
NZ 90-day bank bill	0.65	0.97	1.35	1.80	2.30	2.80	3.00	3.00
NZ 2-year swap rate	1.42	2.17	2.80	2.85	2.90	2.95	3.00	3.15
NZ 5-year swap rate	1.87	2.55	3.05	3.10	3.15	3.20	3.25	3.30
NZ 10-year swap rate	2.24	2.64	3.10	3.15	3.20	3.25	3.30	3.40
NZ 10-year Bond	1.97	2.37	2.85	2.90	2.95	3.00	3.05	3.15

ASB foreign exchange forecasts (end of quarter)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZD/USD	0.69	0.68	0.71	0.73	0.74	0.75	0.73	0.73
NZD/AUD	0.96	0.94	0.96	0.96	0.95	0.94	0.94	0.94
NZD/JPY	77	79	82	86	88	90	88	88
NZD/EUR	0.59	0.60	0.62	0.63	0.63	0.63	0.60	0.56
NZD/GBP	0.51	0.51	0.53	0.54	0.54	0.54	0.51	0.50
NZD/CNY	4.4	4.4	4.5	4.6	4.6	4.7	4.5	4.5
NZD TWI	73.7	73.2	75.6	77.0	77.2	77.6	75.6	75.0

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