Economic Weekly

07 December 2020

Construction lifts as housing shortage grew in 2019

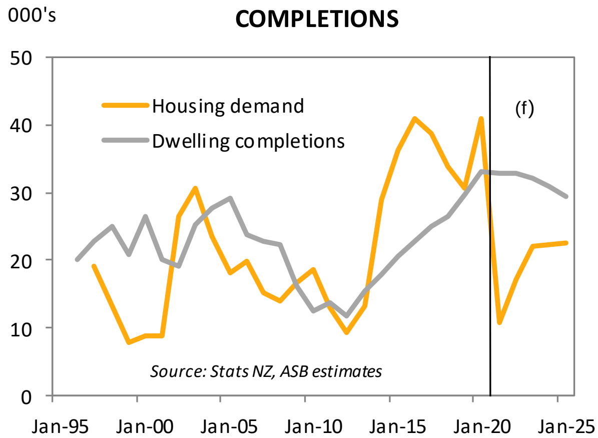
Building Activity figures released by StatsNZ last week confirmed that construction activity continued its post-lockdown recovery without skipping a beat. Building work completed over the September quarter lifted a whopping 35% - with residential building activity leading the charge and activity surging to above pre-COVID levels. Strong demand from an on-going need for additional housing continues to support residential construction activity. Earlier this year, when expectations for the economy were grim, we had expected that pending construction plans would be ditched amid heightened economic uncertainty and rising unemployment. However, NZ's stoic ability to keep calm and carry on proved economists wrong – the NZ economy quickly pulled itself together after lockdown and NZ housing demand is possibly the strongest since the 2006/07 housing boom.

Prior to the COVID-19 outbreak, net migration into NZ surged over the second half of 2019 – likely in response to the increasingly tight NZ labour market and demand for skilled labour. Given the change in methodology for calculating NZ population growth by StatsNZ, the sheer strength of this population surge wasn't immediately clear. Now it is. NZ's housing stock was already stretched due to chronic housing shortages which have emerged right across NZ. Despite NZ housing construction rising to record levels, it has not been able to keep pace with population growth. Recent updates to NZ's population count by StatsNZ (a very delayed input of the woeful 2018 Census) revealed the NZ housing shortage is worse than ever.

An outcome of the devastating COVID-19 pandemic is the opportunity for NZ to finally deal with its housing shortage. Population growth over this year is set to be very soft by historical standards, due to limited MIQ capacity capping NZ net migration (indeed over winter, NZ has recorded net outflows with departures outstripping arrivals). But with construction holding up at record levels, NZ can finally make a good progress in reducing the extent of the housing shortage. NZ can probably overbuild for a good couple of years before housing stock is at risk of being 'over supplied'.

But this approach, if not carefully managed, comes with some risk. Price signals are the catalyst for private investors to build – higher prices for existing housing stock increase the incentive to build new houses. This risk is, come 2022 and 2023, if population growth does not recover fast enough, will NZ be set for a rather uncomfortable correction in house prices and housing construction? jane.turner@asb.co.nz

NZ HOUSING DEMAND AND DWELLING COMPLETIONS



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7049	0.7024	0.6779	0.6556	FLAT/UP	0.6800	0.7100
NZD/AUD	0.9486	0.9510	0.9341	0.9582	FLAT/DOWN	0.9440	0.9600
NZD/JPY	73.38	72.99	70.08	71.25	FLAT/UP	72.00	74.00
NZD/EUR	0.5815	0.5868	0.5732	0.5902	FLAT	0.5750	0.5900
NZD/GBP	0.5274	0.5267	0.5163	0.4981	FLAT	0.5170	0.5300
TWI	74.0	74.0	72.1	72.42	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

The NZD consolidated last week. The NZD/USD briefly pierced 0.7100 mid-week, for the first time since mid-2018. It finished the week back down around 0.7050.

A weaker USD remains the dominant force in currency markets. Emboldened by the recent spate of encouraging vaccine news, investors are pricing in a better 2021 for the global economy. Global risk appetite has recovered accordingly, sapping demand for safe-haven currencies like the USD and JPY and boosting global-growth sensitive currencies like the NZD, AUD and CAD.

Firmer global risk appetite, along with rising NZ commodity prices and NZ-US interest rate differentials moving back into positive territory, are all positive fundamental drivers of the NZD/USD. We've been noting in recent weeks that the NZD/USD spot rate has run ahead of fundamental 'fair-value' but that the latter will eventually catch-up. We'd note on this front that fair-value moved higher again last week. Our short-term valuation model now puts it in a 0.6600-0.7000 range, the highest since February.

Outlook

For this week, the USD is likely to remain under pressure. It's looking increasingly likely US Congress will be able to agree on a watered-down stimulus bill before year-end, and this is likely to keep investor sentiment positive. Even if some economic data released this week are soft, we expect market participants to discount it given the improving medium-term economic outlook (witness the reaction to Friday's disappointing Payrolls figures).

Additional near-term gains in NZD/USD will be harder won though, given how far and fast it has come. As we noted last week, short-term technical and momentum indicators indicate the currency needs to pause for a breath for a bit, and this remains the case. Of note, last week's pullback in the NZD/AUD could extend towards further 0.9400. Aussie commodity prices, notably iron ore, are surging on the back of Chinese demand, notwithstanding the recent trade tensions. Recent data are also pointing to 2021 being a decent year for the Australian economy too.

We don't see anything in this week's economic data to upset the market's optimistic apple-cart. The ECB is expected to increase its bond buying programme, and US fiscal stimulus talks are inching closer to a resolution. In NZ, this week's second-tier data are expected to continue the theme of strong NZ economic performance.
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ASB foreign exchange forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
(end of quarter)		<<actual	forecast >>				
NZD/USD	0.64	0.66	0.69	0.70	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.93	0.93	0.92	0.91	0.92
NZD/JPY	69	70	71	74	74	77	80
NZD/EUR	0.57	0.56	0.58	0.57	0.56	0.55	0.53
NZD/GBP	0.52	0.51	0.52	0.52	0.51	0.52	0.52
NZD/CNY	4.5	4.5	4.5	4.6	4.6	4.5	4.5
NZD TWI	71.4	71.6	71.5	72.1	71.7	71.5	71.5

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	1.00	UNCH	UP
90-day bank bill	0.25	0.25	0.29	1.20	UNCH	UP
2-year swap	0.26	0.24	0.04	1.24	UNCH	UP
5-year swap	0.46	0.44	0.15	1.35	UNCH	UP
10-year swap	0.92	0.88	0.55	1.66	UNCH	UP
10-year govt bond yield	0.99	0.85	0.57	1.49	UNCH	UP
Curve Slope (2s10s swaps)	0.66	0.64	0.51	0.42	UNCH	DOWN

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

Market Recap

Local swap yields start the week a touch firmer, but this was modest in relation to lifts in global yields and steepening curves as markets focused on generally positive vaccine news. US 10-year Treasury yields (0.97%) hit their highest levels since March as US equities touched record highs. Softer headline US data (including ISM manufacturing, non-farm payrolls) and surging cases of COVID-19 in the US were largely ignored. Australian yields firmed after Q3 Australian GDP (+3.3% qoq versus mkt: 2.5% qoq) was stronger than expected. There was minimal market reaction after the RBA held its policy rates at 0.1%, with entrenched low inflation and spare capacity in the labour market seeing the pledge not to raise the cash rate for 3 years. RBA Governor Lowe noted that the Australian economy had turned the corner, but that the recovery will be uneven, bumpy and drawn out. RBNZ Governor Orr reiterated that the RBNZ was focused on being operationally ready to implement a negative OCR, which remained an option rather than a commitment and would depend on the circumstances at the time.

Near-term interest rate outlook

We expect little change in NZ short-term yields over the next few weeks as markets consolidate after a frenetic November. Current market pricing has less than 10bps of cuts priced in, but we expect short-term yields to remain close to the current OCR as rate cut expectations are trimmed further.

Today sees the launch of the circa $30bn Funding for Lending Programme (FLP) that will offer 3-year funding to NZ registered banks at the 0.25% OCR. The intent of the FLP is to lower borrowing costs for NZ households and businesses. The more we see customer interest rates fall, the less likely the OCR is likely to be cut. Local data – including partials for Q3 GDP, card spending for NZ – are likely to be largely ignored.

This year has been a rollercoaster for global markets, but we believe that the recent climb in longer-term yields is likely to stick, with global economic activity set to pick up in 2022 (if not before that). This is provided the US Congress agrees to additional fiscal stimulus (a vote on the USD908bn interim fiscal stimulus package is reportedly due this week) and other risk events (e.g. trade tensions between Australiana and China, Brexit) do not flare up. Chinese trade data, the ZEW survey for the Eurozone, NAB business confidence for Australia will be perused for signs of improving momentum/solidity. Price data (US and Chinese PPI and CPI inflation) should remain weak. We expect the ECB to leave policy interest rates on hold, but to provide additional accommodation by recalibrating the size/scope of its Pandemic Emergency Purchase Program (PEPP) and targeted long-term refinancing operations (TLTROs). The RBNZ has signalled $800m in NZ government bond purchases this week, outstripping the weekly $650m NZ Government tender and helping to dampen yields at the margin and keep the NZ yield curve flatter than Australian and US curves.

Medium-term outlook

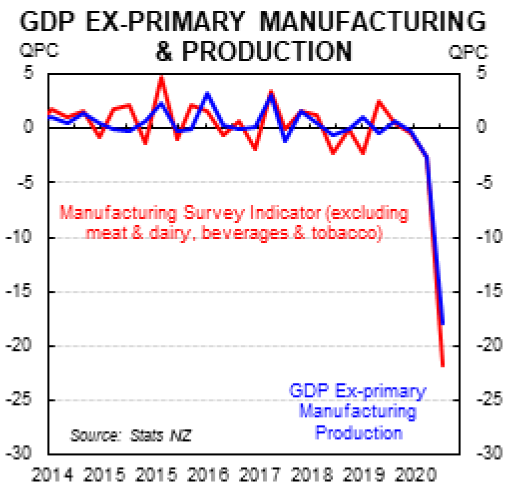
We no longer expect the RBNZ to take the OCR below zero in 2021 and have pencilled in a 0.25% OCR until mid-2023, given the resilience being displayed by the NZ economy and the expectation that the RBNZ's Funding for Lending Programme will help lower interest rates for borrowers within the economy. The outlook is highly uncertain with scope for heightened volatility over the next few months. We expect local and global longer-term yields to subsequently grind higher, but to remain at historically-low levels over the next few years. mark.smith4@asb.co.nz

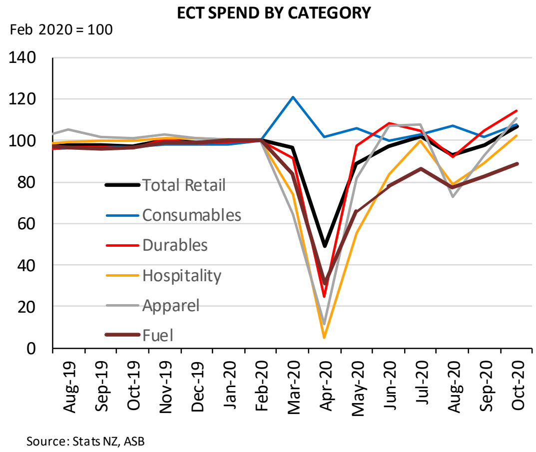
Domestic events

Data	Date	Time (NZT)	Market	ASB
Economic Survey of Manufacturing, ex meat and dairy, Q3, % qoq	09/12	10:45am	-	-
Electronic Card Transactions, Retail, November, % mom	10/12	10:45am	-	+1.0

We use sales and inventory from the **Economic Survey of Manufacturing** as an indicator for Q3 GDP ex-meat and dairy manufacturing production. We expect a 17.7% lift in Q3 GDP ex-meat and dairy manufacturing production, a rebound from the previous quarter's lockdown-induced 17.9% fall. The previous quarter's manufacturing survey reported a 12% fall in sales volumes of manufactured goods, and a 17% fall in sales volumes, excluding meat and dairy.

Our expectation is for another positive month for **November card spending**, which follows sizeable jumps in September and October and should remain healthily above pre-COVID-19 levels. The Black Friday, Singles Day and Cyber Monday sales should provide a November boost, with our proprietary internal card data showing a jump in spending towards the end of the month. We expect performance to differ by sector, with durable retail the standout as kiwis continue to nest-build. The Christmas retail period is shaping up to be much better than envisaged 6-months ago, but there will still be pockets of weakness rising unemployment and the lack of inbound tourists as we approach the peak summer months. Supply chain difficulties, freight delays and risks of another outbreak of COVID-19 are other challenges for the retail sector to contend with.





Major International Events for the week ahead*

Data	Date	Time (NZT)	ASB
RBA Gov Lowe speech	07/12	11:05 am	-
China Trade Balance, November, US$bn	07/12	-	53
Japan Current Account Surplus, October, ¥bn	08/12	1:50 pm	1,200
China CPI, November, %yoy	09/12	2:30 pm	0.2
Bank of Canada Interest Rate Announcement, %	09/12	4:00 pm	-
ECB Interest Rate Announcement, %	10/12	1:45 am	-
UK GDP, October, %yoy	10/12	8:00 pm	-
US CPI, November, %mom	11/12	2:30 am	0.0

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Reserve Bank of Australia's Governor Lowe will speak to the Australian Payments Network later today. The topic of the speech is "Innovation and Regulation in the Australian Payments System". The speech is unlikely to touch on anything relevant to the settings of monetary policy.

Strong new exports orders PMI readings suggest **China's** export growth may accelerate to 12%yoy in November. We expect imports to lift 6%yoy because of solid domestic growth momentum. As a result, we predict a US$53bn **trade surplus.**

We expect **Japan's current account surplus** to dip to ¥1,200bn in October, driven by easing goods trade surplus.

We forecast **China's CPI inflation** to ease to 0.2%yoy in November because of falling food prices, particularly pork prices. PPI deflation may have fallen to 1.8%yoy because of recovering industrial activity.

We expect the Bank of Canada (BoC) to make no monetary policy changes. At its October meeting, the bank announced a reduction is the pace of increase of its large scale asset purchases from at least C$5bn/week to at least C$4bn/week and indicated the policy rate is expected to remain at the effective lower bound of 0.25% until 2023

We expect the European Central Bank (ECB) to leave policy interest rates on hold. However, we anticipate the ECB will provide additional accommodation by recalibrating the size/scope of its Pandemic Emergency Purchase Program (PEPP) and targeted long-term refinancing operations (TLTROs).

The composite PMI points to a modest expansion in **UK GDP** over October.

We forecast **US headline inflation** remained weak in November. A 1.2% fall in gasoline prices will have been an extra drag on headline inflation. At the same time, excess capacity in the US economy will have kept a tight lid on core inflation. We expect core inflation lifted just 0.1%mom in November, taking the annual rate down to 1.5%.

Key Forecasts

ASB NZ economic forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-12.2	12.4	0.7	0.5	0.4	0.4	0.8
GDP real - A%	-12.4	-2.2	-2.0	0.0	14.3	1.5	3.4
GDP real - AA%	-2.1	-3.2	-4.2	-4.2	2.1	4.6	2.6
NZ House Prices (QV Index) - A%	6.8	6.9	9.3	9.3	12.1	7.4	4.9
CPI - Q%	-0.5	0.7	0.0	0.5	0.1	0.4	0.5
CPI - A%	1.5	1.4	1.0	0.7	1.3	1.1	1.6
HLFS employment growth - Q%	-0.3	-0.8	-0.3	0.1	0.4	0.6	0.5
HLFS employment growth - A%	1.5	0.2	-0.4	-1.4	-0.6	2.1	1.9
Unemployment rate - %sa	4.0	5.3	5.8	6.2	6.5	5.7	5.5

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

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(end of quarter)		<< actual	forecast >>				
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	0.30	0.31	0.30	0.30	0.30	0.30	0.30
NZ 2-year swap rate	0.21	0.06	0.25	0.25	0.25	0.25	0.45
NZ 5-year swap rate	0.35	0.13	0.35	0.35	0.35	0.35	0.65
NZ 10-year swap rate	0.74	0.51	0.80	0.80	0.80	0.95	1.15
NZ 10-year Bond	0.91	0.46	0.85	0.85	0.85	1.00	1.20

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NZD/JPY	69	70	71	74	74	77	80
NZD/EUR	0.57	0.56	0.58	0.57	0.56	0.55	0.53
NZD/GBP	0.52	0.51	0.52	0.52	0.51	0.52	0.52
NZD/CNY	4.5	4.5	4.5	4.6	4.6	4.5	4.5
NZD TWI	71.4	71.6	71.5	72.1	71.7	71.5	71.5

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