

Economic Weekly

08 June 2021

A rising tide

Commodity prices have surged over the first half of 2021. As of this week, the ASB Commodity Index (a weighted index of major commodities based on their share of NZ exports) has reached an eighteen-month high in NZD terms. Price gains have been sustained for quite some time. In fact, our NZD index reached its highest monthly average ever during March and May.

Gains are proving impressively broad-based. While COVID-19 impacted different commodities unevenly, the bulk of NZ's major exported commodities are being buoyed by the rising tide. Dairy prices have surged to eight-year highs, forestry prices are at a record high and fruit prices hit record levels at the end of last season. Meat prices aren't quite as frothy given their pandemic tumble, but our meat index has risen 15% since the beginning of March.

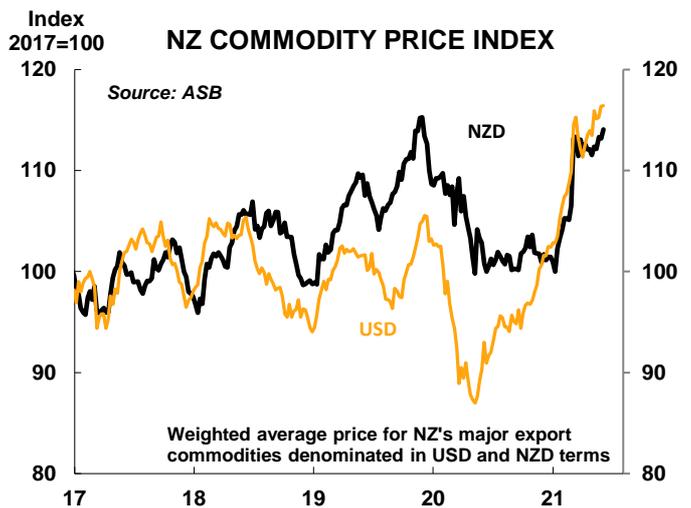
A range of demand and supply side factors are underpinning the gains. Most obviously, consumption is picking up around the world as economies tentatively lift pandemic restrictions. Forecasts for global growth over 2021 and 2022 have been revised up, which usually accompanies strengthening demand for key commodities. New Zealand's exposure to China has proven a particular boon on that front. Ongoing shipping disruption and global logistics woes are adding to the mix, prompting a sizable premium to be paid secure supply.

Analysts overseas are heralding the dawn of a new commodity price 'supercycle' – a decades long period of above-trend price growth. Past supercycles followed the industrialisation of the US in the 19th century, the post-WW2 economic recovery in Europe, and China's integration into the global economy during the early 2000s.

We're a bit sceptical the post-pandemic era will herald a similar boom. At least some of the factors underpinning recent gains are likely to prove temporary. The timing for a return to normality is highly uncertain, but shipping woes should be resolved in time. Similarly, supply responses will take some of the heat out of higher prices for some commodities, notably dairy. We suspect the next supercycle won't begin until the Indian economy further liberalises.

Nevertheless, we expect commodity prices to remain elevated over 2021, and there's a good chance our index exceeds its record high in the coming weeks. It's all supportive of our bullish Term of Trade view, our favourable NZD outlook and our belief inflationary pressures could prove a bit more sustained than the RBNZ expects. To stay up to date with all the latest developments, make sure to subscribe to our Commodities Weekly [here](#).

nathaniel.keall@asb.co.nz



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7237	0.7277	0.7231	0.6514	FLAT	0.7130	0.7315
NZD/AUD	0.9327	0.9395	0.9298	0.9347	FLAT/DOWN	0.9160	0.9460
NZD/JPY	79.06	79.68	78.88	71.30	FLAT/UP	75.60	80.00
NZD/EUR	0.5935	0.5953	0.5992	0.5770	FLAT	0.5880	0.6130
NZD/GBP	0.5102	0.5112	0.5200	0.5125	FLAT	0.5050	0.5380
TWI	75.1	75.1	75.1	72.03	FLAT	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/USD remains confined to a 0.7130-0.7315 range, as it has for about two months now.

Last week once again proved that underlying demand for the NZD/USD remains strong on dips. On Friday morning the NZD/USD suddenly plunged almost ¾ cent, seemingly on thin air. But all of these losses, and then some, were reversed on Friday evening such that the NZD is back trading firmly mid-range around 0.7230 USD.

A weakening in the USD following Friday's lukewarm US employment report was the key driver of the higher NZD. The turbo-charged US economic recovery is starting to see the USD behave more like a 'normal' currency – with strong US economic data leading to USD appreciation, and vice versa (as opposed to the risk on/risk off trading that has driven the USD in the past few years).

This is the beginnings of the 'US dollar smile' theory, that some readers may be familiar with. It's something to watch, as, in our view, USD strength is the only candidate capable of throwing the NZD/USD off the appreciation trend we see playing out over the rest of the year.

Highlighting the NZD/USD's upside potential, our short-term valuation model is currently estimating the highest fundamental 'fair-value' range in five years at 0.7200-0.7600. Global-reflation and the burst higher in commodity prices are the key stories here. Over the past year, the lift in NZ's commodity export prices has pushed fair-value up by almost 7 US cents alone. We think this trend has further to run.

For this week, we can't see the NZD/USD breaking out of its sideways range. Support around 0.7130 is looking very solid. We'd mark the chances of a topside break as higher than one to the downside.

Data-wise, locally we have the last few partials for Q1 GDP (our current forecast is 0.4% qoq), and ANZ business confidence. Offshore, the biggest data release for currencies will probably be US CPI on Thursday. A lift in annual US inflation to 4.7% yoy is expected, with core (ex-food & energy) expected to increase from 3.0% to 3.5% yoy. Markets have shown themselves to be sensitive to inflation surprises recently given the finely balanced outlook for global monetary policy. A positive surprise would likely see the USD strengthen and the NZD/USD pushed back towards the low 0.7100s support window. mike.jones@asb.co.nz

ASB foreign exchange forecasts

(end of quarter)

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.72	0.70	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.92	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	77	80	83	84	85	88
NZD/EUR	0.59	0.60	0.59	0.59	0.58	0.57	0.54
NZD/GBP	0.53	0.51	0.51	0.51	0.51	0.50	0.48
NZD/CNY	4.7	4.6	4.7	4.7	4.7	4.7	4.5
NZD TWI	75.1	73.9	75.2	75.4	75.5	75.5	74.6

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	0.32	0.32	0.37	0.26	UNCH	UP
2-year swap	0.58	0.57	0.52	0.26	UP	UP
5-year swap	1.30	1.28	1.16	0.45	UP	UP
10-year swap	2.00	1.97	1.88	0.91	UP	UP
10-year govt bond yield	1.85	1.74	1.74	1.01	UP	UP
Curve Slope (2s10s swaps)	1.42	1.40	1.36	0.65	UNCH	DOWN

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

Market Recap

Local swap yields start this week slightly lower with marginally larger falls in the belly of the curve. NZ yields eased after RBNZ officials Ha and Hawkesby emphasised the conditionality of the 150bps of OCR hikes priced into the May MPS interest rate track. However, global yields initially pushed higher, helped by the strong tone of global data (US services ISM, stronger than expected Q1 Australian GDP, surging Australian housing lending). Messages from global central bankers were generally cautious but yields responded to the more positive tone. The RBA maintained policy settings and signalled it won't be raising the 0.1% cash rate until 2024, although it hinted that the next round of asset purchases will be tapered. Our CBA colleagues have long expected the RBA to announce in July that they will trim their next round of QE programme from AUD100bn to AUD50bn. NZ Government bond yields were pressured higher as the RBNZ signalled that it will taper the LSAP, with the \$250m in purchases next week the lowest since March 2020. Softer US employment data over the weekend triggered a pullback in global yields, with US 10-year Treasury yields currently towards the bottom of their 1.55%-1.64% weekly range.

Near-term interest rate outlook

Markets now have a 25bp OCR hike close to fully priced in by mid-2021 and around 50bps of hikes priced in by early 2023. With a quieter week ahead, our short-term bias is for local yields to initially rally and then grind higher as the eventual normalisation of interest rate settings and the start date/continuation of policy tapering by global central banks is factored in (our focus is on the FOMC and RBA). The Bank of Canada this week is expected to keep the overnight rate at 0.25% until "sometime in the second half of 2022", but the risk is that the BOC further trims the weekly pace of bond purchases from the current clip of CA3bn. The ECB are not expected to make policy or forward guidance changes, but yields will be sensitive to the tone of the policy assessment. Biasing longer-term yields higher will be the \$250m in LSAP purchases by the RBNZ that falls below the \$350m weekly NZ Government bond tender.

With markets wary on inflation, a stronger than expected US core CPI print (mkt: 3.5% yoy, prior: 3.0% yoy) could squeeze global yields higher and steepen curves as could a sustained uplift in cost and pricing metrics from the ANZ NZ Business Outlook. Local Q1 GDP inputs (Economic Survey of Manufacturing, Wholesale Trade) which should continue to highlight upside risk to the RBNZ's -0.6% Q1 pick for GDP. The event calendar is light across the Tasman, with NAB business confidence and speech by RBA Assistant Governor Kent out this week.

Medium-term outlook

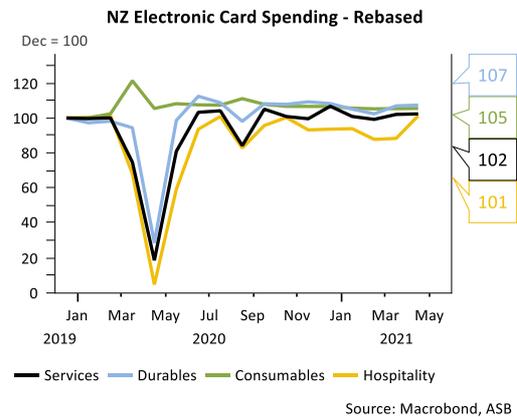
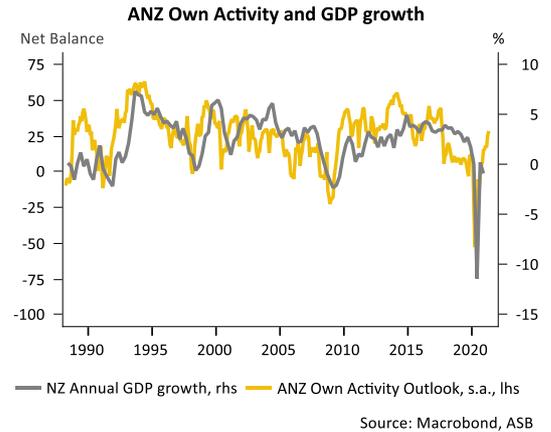
We expect the RBNZ to continue to trim its LSAP programme and to halt purchases from 2022, prior to raising the OCR from May 2022. NZ yields are biased higher. The OCR is expected to peak at a historically low 1.25% in March 2024, and our bias is for yields to remain capped at historically low levels with a flatter yield curve. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own Activity, June Preliminary	09/06	1:00 pm	-	-
Electronic Card Transactions, Retail, May, % mom	10/06	10:45 am	-	-2

Business sentiment has continued to lift throughout April and May, with ANZ own activity expectations climbing in May to be at above average levels (10-year historical average). We focus on own activity expectations over headline business confidence, as the former is the better indicator of GDP growth. Business sentiment points to strong economic growth over the Q2 2021. We currently have a 1.4% qoq lift pencilled in for Q2 GDP but will likely fine tune this estimate after we get the Q1 GDP figures in June.

We expect a modest pullback from the strong April spend that was boosted by the school holiday's, still resurgent housing market and the boost provided by the reopening of the trans-Tasman travel bubble on April 19. MBIE card spending was down about 3% up on the previous month, despite a solid climb in May Overseas card spending (although the latter remained around 50% below May 2019 levels). Domestic spending largely flatlined over May but was still 5% above 2019 levels. Despite the May decline, we have an optimistic outlook for consumer spending over 2021, given tight labour markets, the elevated terms of trade, the Budget-related surge in income support payments from July and increased saving by households (household deposits are \$20bn above pre-COVID levels). Increased consumer demand will help support the NZ economy over the remainder of 2021.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Japan Balance of Payments, April, ¥bn	08/06	11:50 am	1,400
UK GDP, April,	08/06	6:00 pm	-
RBA Asst. Gov. Kent speech	09/06	4:00 pm	-
China CPI, May, %yoy	09/06	1:30 pm	1.5
US CPI, May, %yoy	10/06	12:30 am	4.5
ECB Interest Rate Announcement, %	10/06	11:45 pm	-

* Forecasts and commentary originally published by CBA Global Markets Research Friday 4 June at 11:12 am

We expect **Japan's current account surplus** to ease to ¥1,400bn in April 2021 because of a fall in the goods trade surplus.

Reserve Bank of Australia (RBA) Assistant Governor (Financial Markets) Chris Kent will give a speech and be on a panel at the KangaNews Debt Capital Markets Summit. The title of the speech has not been published although given the audience it's likely to have a bond market focus.

We forecast **China's CPI inflation** to accelerate to 1.5%yoy in May because of a comparison with the weakness in 2020 and recovering domestic demand. PPI inflation may lift to 8.5%yoy because of the strength in commodity prices.

The composite Markit PMI points to solid **UK GDP** growth in April.

We estimate annual headline **US CPI** continued to accelerate in May. The comparison with the weak May 2020 figure will boost annual inflation. Sharp price rises in some areas reflects the economy reopening. Higher gasoline prices in May will likely have provided an additional boost. Base and re-opening effects will also underpin another jump higher in core CPI to 3.4%yoy. In our view, the trimmed CPI is currently a better indicator of underlying inflation in the US as it removes big price swings associated with re-opening effects. In April, the trimmed CPI rose more modestly to just 2.4%yoy.

The European Central Bank (ECB) is widely expected to make no policy or forward guidance changes. Improving Eurozone economic and inflation dynamics suggest the ECB will announce a scaled down pace of asset purchases under the pandemic emergency purchase programme (PEPP) over Q3.

Key Forecasts

ASB NZ economic forecasts

	Dec-20 << actual	Mar-21 forecast >>	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
GDP real - Q%	-1.0	0.4	1.1	0.8	-0.6	-0.8	0.5
GDP real - A%	-0.9	0.7	14.4	1.3	1.7	0.5	4.4
GDP real - AA%	-3.0	-2.8	3.3	3.6	4.2	4.2	2.5
NZ House Prices (QV Index) - A%	15.4	17.4	19.3	14.9	9.7	5.4	5.1
CPI - Q%	0.5	0.8	0.7	0.8	0.6	0.6	0.5
CPI - A%	1.4	1.5	2.7	2.9	3.0	2.8	2.2
HLFS employment growth - Q%	0.6	0.5	0.4	0.3	0.3	0.2	0.5
HLFS employment growth - A%	0.8	0.3	0.9	1.9	1.6	1.3	2.2
Unemployment rate - %sa	4.9	4.7	4.7	4.7	4.7	4.7	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

	Dec-20	Mar-21 << actual	Jun-21 forecast >>	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)							
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.75
NZ 90-day bank bill	0.27	0.35	0.35	0.35	0.35	0.55	1.10
NZ 2-year swap rate	0.28	0.47	0.60	0.65	0.70	0.80	1.20
NZ 5-year swap rate	0.54	1.12	1.35	1.40	1.50	1.60	1.95
NZ 10-year swap rate	0.98	1.96	2.00	2.05	2.10	2.15	2.35
NZ 10-year Bond	0.99	1.78	1.85	1.90	1.95	2.00	2.20

ASB foreign exchange forecasts

	Dec-20	Mar-21 << actual	Jun-21 forecast >>	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)							
NZD/USD	0.72	0.70	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.92	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	77	80	83	84	85	88
NZD/EUR	0.59	0.60	0.59	0.59	0.58	0.57	0.54
NZD/GBP	0.53	0.51	0.51	0.51	0.51	0.50	0.48
NZD/CNY	4.7	4.6	4.7	4.7	4.7	4.7	4.5
NZD TWI	75.1	73.9	75.2	75.4	75.5	75.5	74.6

ASB Economics & Research

Chief Economist
Senior Economist
Senior Economist
Senior Economist
Senior Economist, Wealth
Economist
Publication & Data Manager

Nick Tuffley
Mark Smith
Jane Turner
Mike Jones
Chris Tennent-Brown
Nat Keall
Judith Pinto

nick.tuffley@asb.co.nz
mark.smith4@asb.co.nz
jane.turner@asb.co.nz
mike.jones@asb.co.nz
chris.tennent-brown@asb.co.nz
nathaniel.keall@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 301 5657
(649) 301 5853
(649) 301 5661
(649) 301 5915
(649) 301 5720
(649) 301 5660

www.asb.co.nz/economics

[@ASBMarkets](https://twitter.com/ASBMarkets)

Disclaimer

This document is published solely for informational purposes. It has been prepared without taking account of your objectives, financial situation, or needs. Before acting on the information in this document, you should consider the appropriateness and suitability of the information, having regard to your objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice. We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this document. Any opinions, conclusions or recommendations set forth in this document are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by ASB Bank Limited. We are under no obligation to, and do not, update or keep current the information contained in this document. Neither ASB nor any person involved in the preparation of this document accepts any liability for any loss or damage arising out of the use of all or any part of this document. Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. ASB does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met.