ASB

Economic Weekly

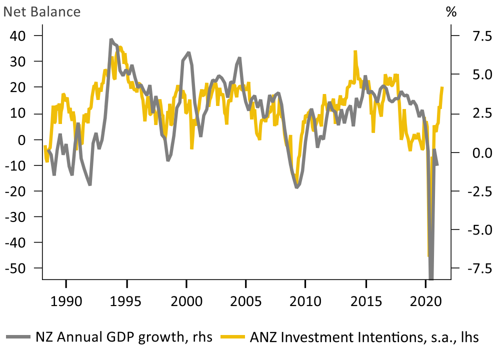
10 May 2021

Upside risks building

Economists are well versed in espousing downside risks. To be sure, these remain plentiful. We're in a global pandemic after all. But it's also important to acknowledge the positives. And it's actually these upside risks that are looking more pertinent as the economic data has rolled in over the past few weeks.

The global backdrop, while patchy, is looking better by the day. COVID hotspots remain, with the tragedy in India particularly troubling. But global growth as a whole is now expected to expand a strong 6.3% this year. China and Asia are out in front. But the impressive turnaround in the fortunes of the US and UK is certainly bearing out the 'who vaccinates wins' thematic. Three quarters of the population in those countries have now had at least one vaccine dose, enabling a more rapid economic reopening. Forecasters in the UK, for example, now expect GDP growth to exceed 5% both this year and next.

ANZ Investment Intentions and GDP growth



Source: Macrobond, ASB

The steadying in the global economy is bolstering demand for commodities generally, including our own export commodities. In fact, there's something of an export price boom underway – it's just that the housing boom tends to attract all the column inches. Global prices are holding around the highest level in seven years. And thanks to a restrained currency, prices in NZ dollar terms are not far from the highest level ever. We think prices will hold up or even push a little higher this year. The income windfall for NZ's agriculturally-exposed regions is providing the foundation upon which NZ's economic recovery is being built.

Against this backdrop, confidence in the economic upturn is growing. Last week's ANZ business confidence survey saw investment and employment intentions continue to ratchet higher. The former are now at 4-year highs, and suggestive of GDP growth miles ahead of our forecasts (chart 'o' the week).

Stretched capacity, shortages of labour, and spiralling costs are flies in the ointment we've discussed before. Business surveys are pointing to these things worsening. Cost and pricing intentions are at the highest levels on record. We're still of the view the impacts on inflation will mostly be temporary, but we're keeping an eye on it. By contrast, the turn higher in wage inflation we expect this year will proffer more of a sustained, albeit modest, inflationary impulse. Last week's labour market figures provided support for this view. Unemployment printed below market/RBNZ expectations at 4.7%. It will continue to track lower from here, in our view. Should this pan out, the RBNZ could be brushing up against its Maximum Sustainable Employment objective in a few quarters time. The upshot from all this from an interest rate perspective is that we're a little more confident in our view that the RBNZ will be able to start reducing stimulus next year. We continue to expect an August 2022 OCR hike, something we note the market is now close to fully pricing. There's also room for RBNZ bond purchases to be tapered further. mike.jones@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7283	0.7158	0.7045	0.6119	UP	0.7200	0.7400
NZD/AUD	0.9281	0.9271	0.9230	0.9368	FLAT	0.9200	0.9350
NZD/JPY	79.11	78.49	77.04	65.12	UP	78.00	80.50
NZD/EUR	0.5988	0.5948	0.5917	0.5643	FLAT	0.5900	0.6100
NZD/GBP	0.5206	0.5169	0.5130	0.4939	FLAT	0.5150	0.5280
TWI	75.6	74.6	74.0	69.00	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 and Outlook

The NZD outperformed the USD over the past week, as an improvement in risk sentiment supported equities and weighed on the USD and JPY. The NZD/USD is sitting just under 0.7300 this morning. The NZD remained broadly steady against other major crosses such as the AUD, GBP and EUR. Strong corporate earnings and easing COVID-19 restrictions abroad (particularly in the US and Europe) appear to be supporting global growth expectations and equities demand. Meanwhile, US Federal Reserve officials managed to keep a lid on US interest rate expectations, consistently playing down inflation concerns.

There was no market reaction to the RBNZ's May Financial Stability Report – no new macro-prudential measures were forthcoming and the RBNZ adopted a wait and see approach to the housing market. The Q1 labour market data were stronger than expected, prompting a small lift in the NZD and NZ interest rates. NZ 2-year-ahead inflation expectations lifted to a 3-year high in the latest survey.

There was no market reaction to the RBA announcement last week. The RBA made no policy changes and reaffirmed its long-term commitment for ultra-loose monetary policy settings. The RBA did note that Australia's faster than expected economic recovery is forecast to continue and upgraded its economic projections.

Geopolitical tensions with China simmered in the background, after G7 foreign ministers criticised China for human rights abuses and urged China to "participate constructively" in a ruled-based international system. The AUD dipped and Australian government bond yields eased after China announced that it had indefinitely suspended its regular economic dialogue with Australia.

Looking at the week ahead, FX direction will continue to take its cue from offshore investor sentiment. Conditions remain supportive for the NZD/USD to continue to grind higher over the coming months. Improving global sentiment should continue to weigh on the USD. Meanwhile, the NZD will also find support from NZ's relatively robust economic performance and evidence of growing inflation pressures. In terms of economic data, April card spending figures are out on Tuesday, while we are also expecting the latest REINZ house sales figures for April later this week or early next week. The REINZ figures will be of high interest, as they will be the first clear read on the housing market following the announcement by Government to changes the tax treatment for investment properties. Anecdotes suggest housing demand may have cooled, but just to a gentle simmer from a rapid out-of-control boil. The Australian 2021 Budget is out this week, ahead of the NZ Budget next week. jane.turner@asb.co.nz

ASB foreign exchange forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)		<<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	0.37	0.36	0.32	0.26	UNCH	UP
2-year swap	0.52	0.47	0.45	0.17	UNCH	UP
5-year swap	1.15	1.08	1.05	0.32	UNCH	UP
10-year swap	1.87	1.85	1.82	0.72	UNCH	UP
10-year govt bond yield	1.75	1.68	1.71	0.57	UNCH	UP
Curve Slope (2s10s swaps)	1.35	1.39	1.37	0.55	UNCH	DOWN

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

Market Recap

Local yields edged higher across the curve last week, with modest falls in US and Australian yields. Short-term NZ yields broke out of recent ranges, with the 90-day bank bill (0.37%) and 2-year swap (0.52%) hitting post-COVID-19 highs. Stronger-than-expected NZ Q1 labour market data and the robust tone of other recent data highlighted the risks of the RBNZ tightening sooner rather than later, with business sentiment strengthening and rising cost and pricing pressures being reported. There was little market reaction following the RBNZ Financial Stability Report and after the RBA maintained its pledge not to raise the cash rate until 2024, deferring till July a decision on the target 3-year bond for their yield curve control programme. Last week, 10-year US Treasury yields (currently 1.58%) traded in a 1.46% to 1.65% range, with a brief dip following weaker-than-expected non-farm payrolls data. Despite elevated equity values and signs that economic momentum in OECD economies is strengthening, longer-term Australasian and US yields remain fractionally lower than a month ago. Messages by central banks in downplaying the risks of economic overheating and reaffirming the need for ongoing monetary policy support look to have been effective.

Near-term interest rate outlook

Market expectations for OCR hikes have been modestly brought forward, with a full OCR hike now fully priced in by late 2022. This is moving closer to our core view (+25bps August 22). It's a light week for domestic data, although signs of resilience from April REINZ data (too soon to gauge the impact of government measures to slow housing investor demand) and April card spending could push short-term yields higher still.

We have retained our neutral bias for longer-term NZ rates and expect local and global yields to maintain their recent flattish trend. Activity data is expected to be mixed (a contraction in Q1 UK GDP, upbeat Australian business sentiment, moderation in US retail sales growth). Base effects are expected to push annual US headline inflation to 3.6% (core inflation +2.3% yoy) and this could flow through into longer-term interest rates if there are concerns higher inflation could be persistent. Tomorrow's Australian Federal Budget is expected to show the Government unveil more policy stimulus, but also trim borrowing. Weekly RBNZ government bond purchases have been maintained at $350m, above the weekly $300m NZ bond issuance profile by NZDM and should weigh on bond yields at the margin. Looking ahead to next week's NZ Budget, we envisage that a scaled back profile of NZ Government bond issuance should be supportive of NZ bonds (i.e. yields lower).

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 August 2022. The OCR is expected to reach 1.25% in March 2024, slightly below neutral levels. Our bias is for shorter-term yields to edge up over the next few years and for the yield curve to flatten, with longer-term NZ yields to peak at historically-low levels. mark.smith4@asb.co.nz

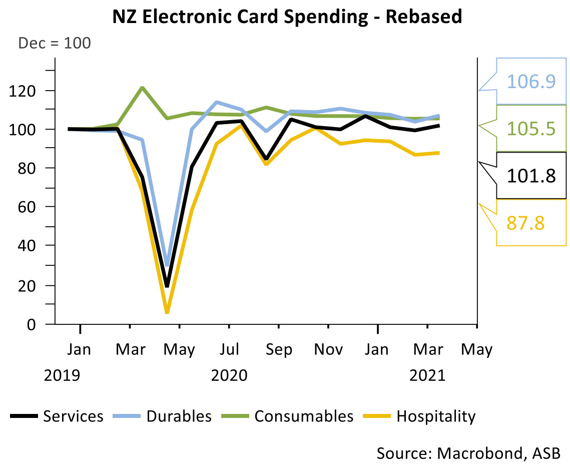
Domestic events

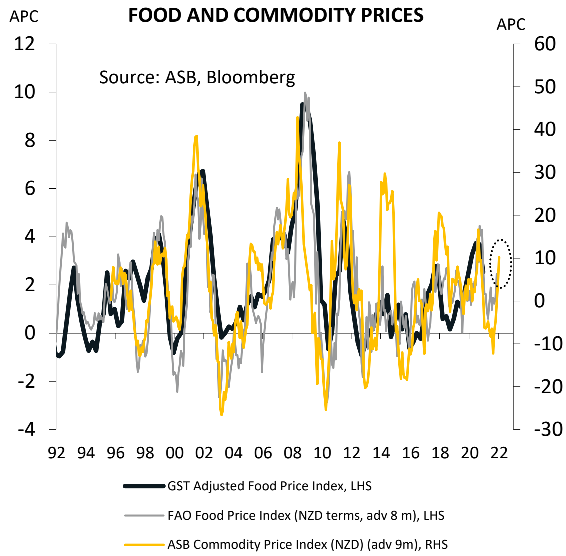
Data	Date	Time (NZT)	Market	ASB
Electronic Card Transactions, Retail, Apr, % mom	11/05	10:45 am	-	1.5
Food Price Index, Apr, % mom	13/05	10:45 am	-	1.0

We expect a solid increase in monthly total and retail card spending in April. A school holiday boost and the reopening of the trans-Tasman travel bubble on April 19 are likely to have boosted spending, with overseas card spending data from MBIE showing an April showing a lift. Consumable retail is expected to post its first monthly increase of 2021, with services and hospitality ECT spending also expected to rise, with strong housing construction activity expected to underpin durable retail.

With the April 2020 figures significantly dampened by the COVID-19 lockdowns, core and retail spending will be about double that of a year ago, with more sizeable increases for hospitality and apparel retail. After spending much of the March quarter on the side lines, we expect increased consumer demand to help prop up the NZ economy over the remainder of 2021.

A seasonal increase in April food prices is expected, with overall food prices little changed on a year ago. We expect monthly increases across most of the food subgroups, with higher prices for fruit & vegetables, meat and grocery foods. **Rising prices for global food commodity prices point to a firming outlook for retail food prices over 2021. This is part of the 'perfect storm' of price increases from a selection of cost, capacity and demand sources that will push inflation higher over 2021.**





Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia Retail Trade, March, %mom	10/05	1:30 pm	1.4
Australia Federal Budget 2021/22, deficit, AUD$bn	11/05	9:30 pm	78
China CPI, April, %yoy	11/05	1:30 pm	1.0
UK GDP, Q1, %qoq	12/05	6:00 pm	-
Japan Current Account Balance, March, ¥bn	13/05	11:50 am	1,900
US CPI, April, %yoy	13/05	12:30 am	3.6
US Retail Sales, April, %mom	15/05	12:30 am	1.0
US Industrial Production, April, %mom	15/05	1:15 am	1.2

** Forecasts and commentary originally published by CBA Global Markets Research Friday 7 May at 1:23 pm*

Already-released preliminary **Australian retail trade** figures for March showed a lift of 1.4%. We expect the same lift for the final figure. We expect a fall of 0.6% for Q1 21 volumes, with nominal sales roughly flat, price rises should see volumes lower. The outlook for consumer spending remains upbeat with consumer confidence at an 11-year high, a strong labour market and positive wealth effects.

We expect a much-improved bottom line for the 2021/22 **Australian Federal Budget**. We expect the deficit to print at $A78bn compared to the estimate of $A108bn. The Budget bottom line will be greatly improved because of the much better performing economy and significantly higher commodity prices.

We estimate previous lifts in commodity prices, producer prices, a recovery in consumer spending and some supply constraints may add some upward pressure on inflation. But **Chinese inflation** still remains soft at only 1.0%yoy.

Already-released customs data suggest **Japan's trade balance** moved back into surplus. Therefore, we estimate the current account balance increased further to ¥1,900bn (around 4% of GDP).

The Bank of England (BoE) projects real **UK GDP** to fall by 1.6% over Q1 because significant Covid restrictions were in place during this period. The BoE still projects GDP to recover strongly to pre-Covid levels over the rest of 2021

We forecast annual headline **US CPI** jumped to 3.6% in April, largely because of Covid-related weakness a year ago. In comparison, we expect headline inflation rose just 0.2%mom as the pace of gasoline price increases moderated. We also forecast a 0.2%mom rise in core CPI, lifting annual core inflation to 2.3%.

We expect a moderation in the pace of **US retail sales growth** in April. Nevertheless, the ongoing impact from the $US1,400 stimulus cheques suggest retail sales activity remained strong. We forecast a 1%mom lift in retail sales in April, off the back of a 9.7%mom rise in March. We forecast a 0.8%mom lift in 'control group' retail sales

The very high US ISM manufacturing index suggests **US industrial production** lifted again in April. The rebound in US economic activity and low inventory levels is supportive for factory production in particular. However, ongoing supply shortages and shipping constraints are a headwind to production. We expect total industrial production rose 1.2%mom.

Key Forecasts

ASB NZ economic forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-1.0	-0.2	1.2	1.0	-0.6	-1.0	0.5
GDP real - A%	-0.9	0.1	14.0	1.1	1.5	0.7	4.5
GDP real - AA%	-3.0	-3.0	3.0	3.3	3.9	4.0	2.5
NZ House Prices (QV Index) - A%	15.4	17.4	18.5	13.6	8.4	4.1	5.1
CPI - Q%	0.5	0.8	0.6	0.5	0.4	0.5	0.5
CPI - A%	1.4	1.5	2.6	2.4	2.3	1.9	2.2
HLFS employment growth - Q%	0.6	0.5	0.3	0.4	0.4	0.3	0.5
HLFS employment growth - A%	0.8	0.3	0.8	1.8	1.5	1.3	2.2
Unemployment rate - %sa	4.9	4.7	4.6	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

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(end of quarter)		<< actual	forecast >>				
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	0.35	0.90
NZ 2-year swap rate	0.28	0.47	0.50	0.55	0.65	0.75	1.15
NZ 5-year swap rate	0.54	1.12	1.10	1.20	1.30	1.40	1.80
NZ 10-year swap rate	0.98	1.96	1.90	2.00	2.10	2.15	2.35
NZ 10-year Bond	0.99	1.78	1.70	1.85	1.95	2.00	2.20

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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

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