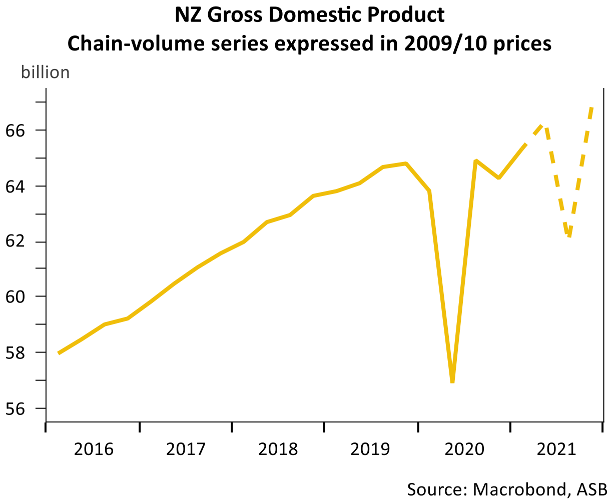
Economic Weekly

13 September 2021

Economy charged into lockdown

It may feel a bit like looking through the rear-vision mirror but indications are the economy was on a charge up until lockdown hit. Q2 GDP figures out on Thursday will give the full picture. We expect a 1.5% quarterly increase will be reported. Retail spending, accommodation (helped by the trans-Tasman bubble), manufacturing, logistics and various services all played a role in supporting huge momentum over the first half of the year. And watch for ANZ's preliminary business confidence survey results this afternoon for a gauge on how businesses view the impact of this lockdown.



Housing has been one driver of the economy this year, and the latest ASB Housing Confidence Survey showed people's expectations of house prices have been dampened only slightly by factors such as tax changes, tighter RBNZ lending restrictions, and anticipated mortgage rate increases.

Retail spending had been steadily growing until August, when it took the expected hit from lockdown. Retail transactions on electronic cards plunged 20% in August. Consumables sales rose 9.3%, officially confirming what the bare supermarket shelves told us. But with two toilet paper suppliers apparently set to pull out of NZ, perhaps we can rationalise to ourselves our toilet paper purchases.

Tomorrow marks four weeks of lockdown conditions of various strictness for this outbreak. The 4pm media conference today will bring a decision on any easing of Alert Levels for Auckland or the rest of the country. Judging from the epidemiologist pundits, there is every chance that the current strict conditions get extended further, given the continued run of mystery cases that are turning up. If Level 4 conditions get extended, that will take Auckland towards uncharted territory. Last year's main lockdown had 33 days at Level 4 and 49 in total at Levels 3 and 4. A further week of Level 4 would take Auckland to 35 days before then presumably some period at Level 3.

We all need to hang in there in our bunkers to stamp out transmission, even if it does mean reaching for the sourdough recipes to get a break from scones. The alternative would be overwhelming the health system. But the longer strict conditions remain, the greater the prospect of scarring to the economy through damage to businesses. The Government has announced additional business resurgence payments to help cushion the blow, but should remain alert to how it can further help out where the blowtorch of lockdown is felt most acutely. And no-one should be shy about taking up any form of support that will help get them through. Hang in there. nick.tuffley@asb.co.nz

Need help or information? Find ASB and Government support information **here**.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7117	0.7139	0.7004	0.6662	FLAT/UP	0.7060	0.7300
NZD/AUD	0.9671	0.9597	0.9542	0.9154	UP	0.9420	0.9690
NZD/JPY	78.21	78.39	77.32	70.72	FLAT	77.00	79.00
NZD/EUR	0.6025	0.6013	0.5965	0.5629	FLAT	0.5800	0.6100
NZD/GBP	0.5141	0.5155	0.5070	0.5195	FLAT	0.5070	0.5200
TWI	75.5	75.2	74.3	71.78	FLAT/DOWN	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

It was a week of consolidation in local interest rate and FX markets last week. Local swap rates and the NZD/USD shuffled sideways in tight ranges as they consolidated the prior week's sharp increases.

Sentiment towards the USD remains a dominant driver of the kiwi, as offshore markets obsess about the timing of the Fed's asset purchase tapering (CBA has it pegged for November). But local factors are still exerting some important influence, particularly on the crosses. RBNZ cash rate expectations have returned to recent highs, and this has lifted NZ-US 2-year swap differentials to the highest level in five years – a key fundamental support for the currency.

We still think the balance of risks favour further appreciation in the NZD/USD. But this is more a commodity price story than one of additional support from interest rates. OIS markets are already fully pricing our view of three consecutive RBNZ OCR increases.

We'll likely see more consolidation for the NZD/USD this week, although we wouldn't be surprised to see another test of the 0.7165 resistance level at some point. Local event risk is light. Markets will likely look through a strong NZ Q2 GDP result on Thursday given it's old news and pre-dates lockdown (ASB f/c: 1.5% vs. 1.2% market). There's the Chinese monthly data dump on Wednesday to keep an eye on, US CPI Wednesday night, Aussie employment Thursday, and a potentially market-moving RBA speech tomorrow.

NZD/AUD is worth a mention. We think NZD/AUD risks remain skewed towards further upside. Australian lockdowns look likely to remain in place for some time and, unlike in NZ, RBA interest rate increases remains years away. This policy divergence is reflected in widening NZ-AU interest rate spreads. We would not be surprised to see a NZD/AUD push above 0.9700 in coming sessions.

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ASB foreign exchange forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
(end of quarter)		<<actual	forecast >>					
NZD/USD	0.70	0.70	0.69	0.67	0.68	0.69	0.72	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.94	0.92	0.92	0.92
NZD/JPY	77	77	78	76	79	81	85	85
NZD/EUR	0.60	0.59	0.59	0.59	0.61	0.61	0.60	0.55
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.51	0.51	0.51
NZD/CNY	4.6	4.5	4.5	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.9	73.7	73.2	71.3	72.8	73.0	74.4	73.8

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	0.53	0.50	0.67	0.30	UNCH	UP
2-year swap	1.37	1.37	1.33	0.05	UNCH	UP
5-year swap	1.75	1.78	1.66	0.13	UNCH	UP
10-year swap	2.04	2.08	1.97	0.53	UNCH	UP
10-year govt bond yield	1.87	1.90	1.73	0.61	UNCH	UP
Curve Slope (2s10s swaps)	0.67	0.71	0.64	0.48	UNCH	DOWN

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

Market recap

Near-term market pricing for OCR hikes has firmed, but the previous grind higher in local rates in the belly of the curve looks to have petered out, with long-term yields lower and the yield curve flatter. Yields in the 2-year swap (1.37%) earlier ticked up to 1.38% (the highest since prior to the latest outbreak), after the rest of the country moved to Alert Level 2. However, the subsequent decline in NZ yields coincided with a pick-up in delta variant cases in Auckland. Local data had minimal impact on the rates market. NZ 10-year swap yields and yields on NZ 10-year bonds ended the week about 10bps lower since the middle of last week.

Moves in global yields were more modest, with spreads between NZ yields and global counterparts narrowing. Firming US producer prices pushed US 10-year Treasury yields higher at the end of last week (10Y 1.34%) despite falls in global equities. Earlier comments by various FOMC officials (including FOMC Vice Chair Williams) advocating QE tapering before the end of the year were largely overshadowed by concerns the worsening delta-variant outbreak will hit growth, with the Fed Beige book signalling a deceleration in US growth momentum.

Central bank announcements had a fleeting impact on yields. The RBA held the cash rate at 0.1%, opted not to reverse the September taper to AUD4bn per week (from AUD5bn), but decided to extend QE to "at least" February 2022 (November 2021 prior). The ECB signalled it would 'moderately' reduce the pace of asset purchases, but rate hikes would not occur until inflation was settled around 2%. The Bank of Canada held rates and its current CAD2bn weekly pace of asset purchases but released guidance signalling it will hike rates before reducing bond holdings.

Near-term interest rate outlook

Market pricing is heavily biased towards OCR hikes with the RBNZ expected to 'look through' the short-term lockdown impacts. Currently 26 bps of hikes are priced in by October, 51bps by November, and 72bps by next February. This is close to our OCR view, but short-term rates and those in the belly of the curve will be sensitive to the course and persistence of Auckland's delta variant outbreak. We view it highly unlikely the Government will signal a shift lower in alert levels for Auckland today. This week's local data – Q2 GDP, September business confidence and August PMIs – will largely take a back seat to COVID-19 news.

Our bias is for longer-term global yields to eventually move higher as markets 'look through' COVID-19 impacts and increasingly focus on improving prospects. The delta variant is likely to contribute to additional volatility, and NZ and global yields could move lower (and spreads between NZ yields and global counterparts narrow) if disruptions persist. Global activity data over coming weeks (Chinese retail sales, industrial production, US retail sales/housing activity, Australian employment) is expected to show a delta variant hit. We are also wary that markets will become more attuned to the risk that high inflation proves to be persistent, potentially steepening curves. This week's inflation readings for the UK (mkt:2.9% yoy), Eurozone (3.0% yoy) and the US (core CPI steady at 4.3% yoy) could provide a reminder. With the FOMC monetary policy decision next week, this week's FOMC chatter will be light.

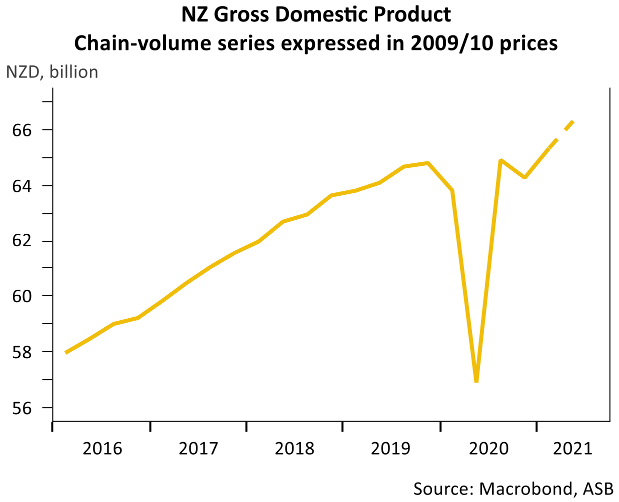
Medium-term outlook

We have pencilled in 25bp hikes in each of the next three OCR decisions (October, November and February), with the OCR ending 2022 at 1.50%. Uncertainty is pronounced, and the economy (and OCR settings) could follow a number of different paths. Our CBA colleagues expect RBA cash rate hikes from May 2023, with a 1.25% endpoint. The US FOMC is expected to announce the tapering of monthly asset purchases in November, with the Fed Funds rate to move up from March 2023 (1.50% in 2024). Longer-term yields are expected to remain capped at low levels, with the yield curve flatter given larger rises in shorter-term yields. mark.smith4@asb.co.nz

Domestic Events

Data	Date	Time (NZT)	Market	ASB
GDP, Q2, %qoq	16/09	10:45 am	-	1.5

We forecast the NZ economy grew 1.5% over Q2 2021, following on from a 1.6% lift in growth the previous quarter. If our forecast is correct, this will be an impressive performance over the first half of the year and a testament to the effectiveness of the elimination strategy. In saying that, post-COVID-19 quarterly GDP growth has become more volatile and difficult to predict, with quarterly forecast errors higher than usual. If a strong lift in Q2 is confirmed, then the NZ economy had considerable momentum prior to the current community COVID-19 outbreak.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
RBA Governor speech	14/09	2:45 pm	-
UK Unemployment, July	14/09	6:00 pm	-
US CPI, August, %mom	15/09	12:30 am	0.4%
China, Industrial Production, % yr	15/09	2:00 pm	6%
UK CPI, August,	15/09	6:00 pm	-
Australian Employment, August, 000's	16/09	1:30 pm	-300
US Retail Sales, August, %mom	17/09	12.30 am	-0.6%
UK Retail Sales, August	17/09	6:00 pm	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 10 September*

RBA Governor Lowe will deliver an address to the Anika Foundation. **The speech is titled 'Delta, the Economy and Monetary Policy**'. As such, the speech is likely to provide additional colour to the most recent monetary policy decision. The RBA in its September meeting maintained the planned taper but extended its commitment to buy bonds at $A4bn/week until February 2022. There may also be a preview of the RBA's new forecasts.

The **UK unemployment rate** dipped to 4.7% in the three months to June 2021. This follows a steady decline from the peak of 5.2% in the three months to December 2020. Rising job vacancies suggest labour market slack will continue to diminish at an encouraging pace.

We estimate the pace of **US price increases** eased again in August. The Manheim used car price index fell for the third consecutive month in August. At the same time, gasoline price rises moderated. We forecast headline CPI rose 0.4%/mth and core CPI lifted 0.3%/mth. We expect the temporary price spikes associated with the pandemic will continue to moderate in coming months

Chinese August data will likely be disappointing because social distancing restrictions will add to downward pressure on the already slowing growth momentum. We expect industrial production growth might have slowed to 6.0%/yr. Growth in fixed asset investment will likely ease to 9.5%/yr. Growth in retail sales, heavily disrupted by social distancing restrictions, might decelerate to 7%/yr.

UK headline CPI inflation eased to an annual pace of 2% in July from 2.5% in June. The Bank of England projects inflation to quicken over the rest of the year, reaching 4% in Q4, before returning to 2% in late 2023, as energy and core goods inflation strengthens further and then falls back.

The **August Australian Labour Force Survey** will give the first 'proper' reading into how the extended lockdown in NSW and Vic has affected labour market outcomes. The timing of July's survey (the first two weeks of the month) meant that many employees who were stood down were still counted as being employed (though hours worked did fall). We expect a massive 300k decline in employment, driven almost entirely by NSW. The rise in the unemployment rate will be softened by a drop in the participation rate. Hours worked will collapse as over most of the survey reference week NSW, Vic and Qld were in lockdown. As the Vic lockdown started later, we expect the majority of the hit to employment to show up in the September survey instead. That said, we would caution that there is a much higher than usual degree of uncertainty over the August outcomes.

We expect another fall in **US retail sales in August**. The combination of fading fiscal stimulus, an increase in restrictions and low consumer confidence likely weighed on retail sales.

UK retail sales volumes fell by 2.5% in July but were 5.8% higher than in February 2020, before the impact of coronavirus. High-frequency indicators of mobility and card spending point to a levelling off in retail sales activity.

Key Forecasts

ASB NZ economic forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	1.6	1.5	-6.5	7.8	0.6	1.4	0.6	0.6
GDP real - A%	2.4	16.5	-4.5	4.0	2.9	2.7	3.4	2.5
GDP real - AA%	-2.3	4.3	3.0	4.2	4.3	1.3	5.1	2.4
NZ House Prices (QV Index) - A%	22.0	28.2	27.8	22.1	14.9	8.8	2.6	6.8
CPI - Q%	0.8	1.3	1.5	0.7	0.7	0.6	0.5	0.5
CPI - A%	1.5	3.3	4.2	4.5	4.3	3.5	2.3	2.3
HLFS employment growth - Q%	0.6	1.1	-0.2	-0.2	0.4	0.5	0.3	0.3
HLFS employment growth - A%	0.3	1.7	2.1	1.2	1.0	0.4	1.4	1.4
Unemployment rate - %sa	4.6	4.0	4.1	4.5	4.3	4.0	3.9	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	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.25	0.75	1.00	1.25	1.50	1.50
NZ 90-day bank bill	0.35	0.35	0.50	1.00	1.25	1.50	1.75	1.75
NZ 2-year swap rate	0.47	0.78	1.35	1.50	1.60	1.70	1.95	2.15
NZ 5-year swap rate	1.12	1.36	1.75	1.85	1.95	2.05	2.20	2.40
NZ 10-year swap rate	1.96	1.88	2.00	2.05	2.10	2.15	2.30	2.50
NZ 10-year Bond	1.78	1.77	1.90	1.95	2.00	2.05	2.20	2.40

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(end of quarter)		<< actual	forecast >>					
NZD/USD	0.70	0.70	0.69	0.67	0.68	0.69	0.72	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.94	0.92	0.92	0.92
NZD/JPY	77	77	78	76	79	81	85	85
NZD/EUR	0.60	0.59	0.59	0.59	0.61	0.61	0.60	0.55
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.51	0.51	0.51
NZD/CNY	4.6	4.5	4.5	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.9	73.7	73.2	71.3	72.8	73.0	74.4	73.8

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