Economic Weekly

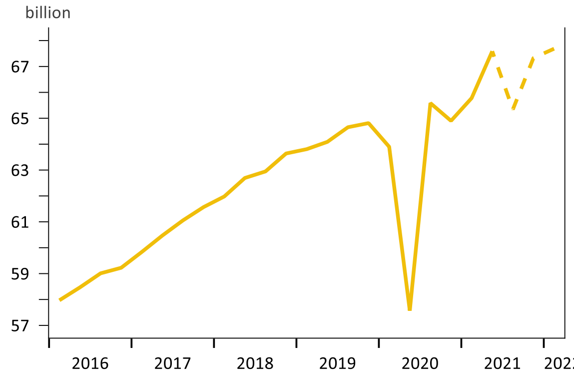
13 December 2021

Delta derailed 2021, here's hoping for a better 2022

2021 was not the year anyone expected and was largely shaped by the COVID-19 pandemic. Vaccines – using technology that has been developed over the past few decades – were rolled out, but misinformation and distrust undermined vaccination efforts globally. The emergence of the more contagious Delta variant changed the COVID-19 landscape. Many countries which had successfully maintained an elimination strategy while waiting for vaccine production to ramp up, including NZ, were forced to change tack once the virus eventually evaded tightly-controlled international borders. Supply chain shortages became even worse over the past year as international shipping struggled to cope with demand. As a result, inflation reared its ugly head, adding another twist for policy makers to contend with. But in NZ – despite the Delta outbreak and the awful 100+ day lockdown Auckland endured – we are ending the year on a somewhat positive note. Like Australia, NZ saw pleasingly-strong vaccine take-up. As a result of high vaccination rates, COVID-19 case numbers are falling in Auckland despite an easing in restrictions. Vaccination remains the way for our economy to move to a 'new' normal and avoid lockdowns. Many New Zealanders socialise outdoors through summer, and this should also keep the virus somewhat manageable for the next few months.

This week's release of the September quarter GDP figures are likely to show the NZ economy performing remarkably well through the Alert Level 4 lockdown (see our preview here), a testament to the resilience of all NZers. We expect that NZ economic output will return to pre-Delta levels over the first half of 2022. With our strong labour market and highly-vaccinated population, our economy will remain the envy of many of our trading partners next year.

NZ Gross Domestic Product
Chain-volume series expressed in 2009/10 prices



Source: Macrobond, ASB

The Treasury will be providing updated fiscal and economic forecasts on Wednesday this week – and a lot has changed since the May 2021 Budget.   With the economy booming prior to the start of the Delta-induced lockdown in mid-August, the Crown accounts for 2020/21 were considerably stronger than forecast. However, Government spending is also set to be running ahead of forecast, with the prolonged lockdown requiring ongoing fiscal support.

This is our last Economic Weekly of the year, and our team will be taking a break over the Christmas and New Year period. While we are fortunate to be taking a break, we know that many of our readers and customers will be still working hard – with many just getting back on their feet after a devastating and tough year. Our team will remain dedicated to doing our bit to support NZ businesses and hospitality safely and responsibly over the coming weeks 😉. We wish everyone a safe and prosperous New Year and we will be back in 2022 (Weekly from 17/1) to see what new economic challenges the world and COVID-19 will throw at us.   jane.turner@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6800	0.6754	0.7000	0.7107	FLAT/DOWN	0.6600	0.6900
NZD/AUD	0.9497	0.9618	0.9610	0.9391	FLAT/UP	0.9400	0.9700
NZD/JPY	77.03	76.31	79.97	73.93	DOWN	74.00	79.00
NZD/EUR	0.6012	0.5980	0.6119	0.5845	DOWN	0.5800	0.6100
NZD/GBP	0.5137	0.5102	0.5240	0.5334	DOWN	0.5000	0.5300
TWI	73.1	72.6	74.6	74.2	FLAT/DOWN	N/A	N/A

*^ Weekly support and resistance levels * Current as at 10.20am today; week ago as at Monday 5pm*

NZD Recap and Outlook

Anxious global risk sentiment remained clearly the key driver of NZD direction last week, even as some measures of market risk aversion (like the VIX index) improved a little. The week saw a gradual dribble of preliminary data suggesting the Omicron variant may be less severe than feared. But, for now, the variant's emergence seems to be primarily functioning as a reminder to currency markets that the post-COVID world remains an uncertain place and there is plenty of scope for things to go wrong (let's face it, we are at risk of running out of letters in the Greek alphabet).

The upshot saw NZD/USD continuing to trundle along recent lows after its tumble the week prior, trading in a circa 0.6730-0.6830 range. NZD's flatness meant it diverged from its trans-Tasman peer, with the AUD gaining nearly a cent-and-a-half against the USD off the back of the RBA meeting as the Bank removed '2023' from its forward guidance on raising the cash rate.

That unspectacular NZD performance came even as the RBNZ came across the wires with a not-particularly-forceful attempt to talk up the kiwi, saying "a higher currency in the short term will actually help us achieve our objectives more quickly". That's notable given the low-inflation post-GFC landscape of the past decade, developed-world central banks have usually been keener to talk *down* their currencies in order to avert an undershoot of their inflation target and boost sluggish growth rates via a helping hand to the export sector. As if we needed any more reminding, overshooting inflation targets and overheating the economy are now the big risks, and the RBNZ would like to get an assist via lower import prices. Still, the RBNZ's comments seemed to boost NZD only marginally if it at all. Future pontifications will need to be quite a bit more forceful to move the dial.

This week, there's scope for a bit of event risk. Thursday morning NZT sees both the Federal Reserve hold its last meeting of the year *and* StatsNZ release NZ's GDP print for Q3. Unhelpfully for anyone trying to guess week-to-week movements in currency markets, those two events are pointing in opposite ways when it comes to interest rate differentials, and therefore NZD direction. On the one hand, there's a risk the Fed significantly quickens its pace of tapering, accompanied by the much-ballyhooed 'dot plot' showing members expect two rate hikes in 2022 (NZD negative). On the other hand, we expect the GDP result to show the NZ economy contracted much less than the current consensus view (NZD positive). In short, expect volatility, though we are inclined to think the Fed will have a bigger impact – the NZ rates market is already pretty richly priced, while there's more scope for the US rates market to adjust higher.

Beyond that week-to-week churn, we end our last FX update of the year otherwise repeating familiar themes on our currency view. NZD/USD remains vulnerable to periodic bouts of risk aversion in the near term, at least as long the Omicron picture is still taking shape. But the fundamentals remain in rude health (think high meat and dairy prices, those still-favourable interest rate differentials), and we expect NZD/USD to move higher over the next year. For NZD/AUD, both the shorter- and medium-term headwinds are skewed to the upside given the AUD's own sensitivity to negative COVID headlines and the risk a dovish RBA fails to meet present market expectations.

Enjoy the break everyone, stay safe out there and try to rest up. Who knows what 2022 will bring.

nathaniel.keall@asb.co.nz

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	MT Bias
Cash rate	0.75	0.75	0.50	0.25	UP
90-day bank bill	0.89	0.88	0.85	0.26	UP
2-year swap	2.22	2.23	2.31	0.26	UP
5-year swap	2.52	2.52	2.68	0.45	UP
10-year swap	2.56	2.53	2.72	0.91	UP
10-year govt bond yield	2.41	2.29	2.61	0.88	UP
Curve Slope (2s10s swaps)	0.34	0.31	0.42	0.65	FLAT

** Current as at 10.20am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market recap

Local yields have generally spent the last week trading in narrow ranges with modest changes relative to a week ago, with the curve a fraction steeper. NZ market pricing has barely budged, with little immediate reaction to stronger-than-expected indicators for Q3 NZ GDP or to resilient NZ November card spending data. No substantive changes in tone or policy direction were delivered from the RBA, with a shift to a state-contingent (rather than date-contingent) timeframe for starting rate hikes. Receding concerns that the Omicron outbreak would derail the global recovery helped push Treasury yields higher than a week ago, with a curve-steepening bias. Shifting expectations of Fed rate hikes have contributed to swings in short-term yields, with roughly 80bps of FOMC hikes priced in for 2022. US Treasury yields and breakeven inflation rates fell at the end of last week after US CPI came out in line with expectations inflation (headline 6.8% yoy, core 4.9% yoy); markets had been braced for higher numbers.

Near-term interest rate outlook

There are now roughly 32bps of RBNZ hikes priced in by February 2022, with the OCR approaching 2.25% by late 2022 and 2.85% by August 2023. This looks a tad high given our OCR view, but NZ yields should be well supported this week. The NZ economy appears to have weathered the Q3 lockdown much better than earlier thought, with ASB's Q3 GDP pick (-3.3% qoq) above the market consensus (-4.5% qoq) and RBNZ forecast (-7.0% qoq). REINZ data this morning showed NZ house prices continuing to forge ahead, but conditions are in place that should cool the housing market and household spending growth over 2022. Wednesday's December Half Year Economic and Fiscal Update (HYEFU) should show the NZ economy holding up well, and a scaled back pace of bond issuance that should dampen NZ bond yields. The Australian Mid-Year Economic and Fiscal Outlook (MYEFO) should also similar fiscal improvement, with a pared-back bond programme. There is likely to be little interest rate impact from local COVID-19 developments or announcements this week.

We still view more upside than downside risk to global yields given the unfolding post COVID-19 recovery and the risk of consumer price increases being more enduring. Major central bank meetings – the FOMC, BoE, ECB and the BoJ – could trigger more volatility despite no changes expected to policy interest rates. We expect the FOMC to signal it is edging closer to market expectations, including a faster taper of USD25bn per month from January and for the median dot plots to show the majority of members now expecting two rate hikes in 2022. Australian yields could nudge higher as our CBA colleagues expect a massive 250k gain in November employment, with the unemployment rate falling to 4.7%. This will be preceded by a speech by RBA Governor Lowe.

Medium-term outlook

We have pencilled in a steady sequence of 25bp hikes, with the OCR peaking at 2% by late 2022. The RBNZ will start to pare back its LSAP holdings from early 2022. Our CBA colleagues expect QE tapering from February 2022 (ending May 2022) and RBA rate hikes from November 2022 (1.25% endpoint). The US FOMC is now expected to have finished its QE tapering by April 2022, with rate hikes from June 2022 (2.5% by early 2024). Longer-term yields are expected to drift up and for the yield curve to remain flat, with risks of a more pronounced lift in yields. mark.smith4@asb.co.nz

Domestic Events for the week ahead

Data	Date	Time (NZT)	Market	ASB
Half-year Economic & Fiscal Update	15/12	1:00pm	-	-
NZ GDP, Q3, % qoq	16/12	10:45am	-4.5	-3.3
ANZ Business Outlook, Own Activity, net %	17/12	1:00 pm	-	-

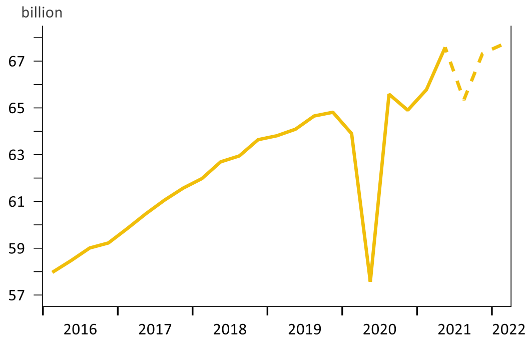
FISCAL PROJECTIONS - ASB HYEFU 2021 Estimates					
June years	**2021**	**2022**	**2023**	**2024**	**2025**
Total Crown OBEGAL (% GDP)					
ASB HYEFU 2021 Estimate	**-1.3**	**-5.0**	**-1.8**	**-0.7**	**0.0**
Budget 2021	*-4.5*	*-5.3*	*-2.6*	*-1.4*	*-0.6*
Net core Crown debt (%GDP)					
ASB HYEFU 2021 Estimate	**30.1**	**37.1**	**40.6**	**39.6**	**36.8**
Budget 2021	*39.7*	*49.1*	*52.6*	*50.7*	*46.9*
Bond Tender Programme ($bn)					
ASB HYEFU 2021 Estimate	**45.0**	**27.5**	**25.0**	**25.0**	**20.0**
Budget 2021	*45.0*	*30.0*	*30.0*	*30.0*	*25.0*

A lot has happened since the May 2021 Budget. The Crown accounts for 20220/21 were considerably stronger than forecast, with the economy booming prior to the start of the Delta-induced lockdown in mid-August. COVID-19 now has a foothold in NZ, with more fiscal support resulting in higher than forecast government spending, but Crown revenues to October still comfortably outstripped Budget forecasts.

Updated fiscal forecasts by the Treasury on Wednesday's Half Year Update are expected to show a narrowing profile of fiscal deficits beyond 2021/22 and the potential return to surplus. We envisage net core Crown Debt will fall well below 40% of GDP by 2024/25, with a modest scaling back in gross bond issuance relative to the Budget forecasts. Also supporting a stronger profile for residual cash and net public debt will be that the RBNZ has ceased its LSAP programme, with the Funding for Lending Programme not utilised as much as had been expected (currently around $6.2bn versus up to roughly $30bn). A key message from the HYEFU will be the need for ongoing fiscal policy support given the uncertain outlook, with only a mildly restrictive fiscal stance signalled beyond 2021/22. This should help keep the economy afloat.

We forecast that **Q3 GDP** contracted 3.3% due to the Delta community outbreak, as data released over recent weeks have been consistently stronger than expected and point to a much smaller contraction than experienced in the previous Alert Level 4 lockdown. Our forecast 3.3% decline compares with the previous Alert Level 4 lockdown which drove an 11.2% decline in GDP over the first half of 2020. Our earlier forecast for Q3 GDP was for a decline of 7-8% over the quarter, in line with the RBNZ's November MPS expectation of a 7% contraction. Ultimately, it is not the size of the fall, but how quickly the NZ economy recovers to pre-Delta levels that will matter to policymakers and that information won't be known until early next year. Uncertainty remains elevated around quarterly GDP releases, and this quarter is further muddied by historical revisions which StatsNZ incorporates annually, which have at times materially changed the starting point estimate of the level of GDP.

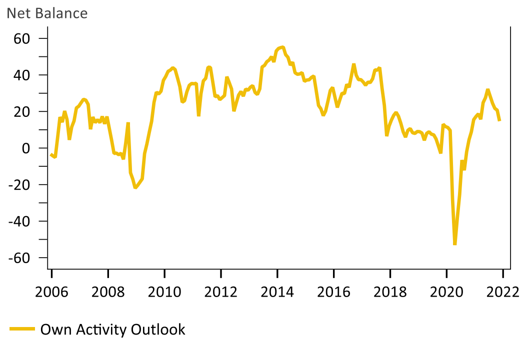
NZ Gross Domestic Product
Chain-volume series expressed in 2009/10 prices



Source: Macrobond, ASB

The ANZ Business Outlook Survey's full results for December are released on Friday 17th December: there was no preliminary release this month. The full November month results of the ANZ monthly business confidence survey showed business confidence was starting to slip, although remained at high levels. Inflation indicators remain at extremely high levels.

ANZ Business Outlook Survey
(seasonally-adjusted)



Source: Macrobond, ASB

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU NAB Business Confidence, Nov	14/12	1:30 pm	-
UK Unemployment Rate, Oct	14/12	8:00 pm	-
AU Westpac Consumer Confidence, Dec	15/12	12:3 0pm	-
CH, Nov, Industrial Prod., Retail Sales, Fixed asset growth ex Rural, %/yr	15/12	3:00 pm	4.0, 4.5, 5.6
UK CPI Inflation, Nov	15/12	8:00 pm	-
Canada CPI Inflation, Nov, headline, core, % yoy	16/12	2:30 am	4.9, 2.7
US Retail Sales, Nov, % mom	16/12	2:30 am	0.8%
Federal Reserve Fed Funds Rate,	16/12	8:00 am	unchanged
RBA Governor Lowe speaks	16/12	12:30 pm	-
AU Labour Market Data, Nov, Job Growth, Unemployment, Participation	16/12	1:30 pm	250k, 4.7%, 65.5%
AU Mid-Year Economic & Fiscal Outlook, Underlying Cash Deficit 21/22	16/12	-	$76bn
Bank of England, Policy Rate, %	17/12	1:00 am	unchanged
European Central Bank Meeting, policy rate	17/12	1:45 am	unchanged
US Industrial Production, Nov, % mom	17/12	3:15 am	0.8
UK Retail Sales, Nov	17/12	8:00 pm	-

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

Aussie business conditions and confidence rose in October as lockdowns ended in NSW and Victoria. The re-opening momentum gathered pace in November, with our high-frequency CBA card spending data indicating a sharp bounce-back in spending to around the pre-lockdown pace. The survey also asks businesses about pricing pressures they are facing, which will be important in gauging the current inflationary pulse ahead of the Q4 CPI print to be released in late January next year.

Aussie consumer sentiment lifted in November as the survey picked up the positive effects of the NSW and Victoria re-opening. Consumers have increased spending rapidly since restrictions were lifted and indicators of labour demand are strong, which will be supportive for consumer sentiment. But sentiment may be weighed down by news and uncertainty around the new Omicron strain of the coronavirus.

The **RBA Governor will deliver a keynote speech** to the CPA Australia Riverina Business Conference in Wagga Wagga. Although the speech title has not been released yet, we expect the speech to touch on monetary policy and possibly provide an update on where the RBA sees the economy heading into next year.

The reference period of the November **Aussie labour force survey** spans 31 October to 13 November. With NSW, Victoria and the ACT all having reopened by that point, we expect a massive lift in employment to have occurred. We estimate that employment rose by 250k, the unemployment rate fell by 4.7% and the labour force participation rate rose to 65.5%. Indicators of labour demand have been strong, with job ads at very high levels. Job vacancies are also elevated and we expect the labour market to tighten from here.

Since the 2021/22 Budget was handed down on 11 May the **Australian** economy has gone through another large negative shock from the Delta-induced lockdowns. But we expect the **Mid-Year Economic and Fiscal Outlook (MYEFO)** to show an improvement in the fiscal position relative to what was forecast in the Budget. Much stronger revenue, particularly on the corporate tax front, underpins the improvement.

We expect **Chinese growth momentum** to rebound in November. Industrial production growth may lift to 4.0%/yr following notable improvement in the production PMI sub-index. Retail sales growth might ease to 4.5%/yr in November. COVID restrictions and falling car sales weighed on consumption. We expect falling real estate investment to drag year-to-date growth in fixed asset investment down to 5.6%/yr.

A rapid rebound in energy and shelter costs has pushed **Canadian inflation** well above the Bank of Canada's (BoC)

2%/yr target in the past few months. Ongoing supply disruptions and intense labour shortages suggest inflation can lift further. Indeed, the BoC no longer describes these factors pushing up prices as temporary. We expect headline CPI inflation to print at 4.9%/yr in November. We also expect the average of the three measures of core inflation preferred by the BoC to remain elevated at 2.7%/yr.

The UK unemployment rate dipped to 4.3% in September. The decline in the unemployment rate is tracking better than the BoE's projection of 4.4% over Q3 but remains above where it was in Q4 2019 (3.8%). Record high job vacancies suggests labour market slack will continue to diminish at an encouraging pace. The BoE projects the unemployment rate to print closer to 4.5% over Q4.

UK headline CPI quickened to annual pace of 4.2% in October, the most since November 2011. The BoE projects inflation to reach 4.5% in November (primarily reflecting higher energy and other goods prices) and peak at around 5% in April 2022.

The money market has slashed the probability of a 15bps **Bank of England (BoE) December policy rate hike** because of the potential for a negative growth shock from Omicron. Our base case remains for the BoE to begin normalising the policy rate in February 2022. Following the November BoE meeting, a majority of MPC members said they prefer waiting for additional information on near-term developments in the labour market, before deciding when a tightening in monetary policy might be warranted.

UK retail sales volumes were 5.8% higher in October than their pre pandemic February 2020 levels. High-frequency card spending data and consumer confidence point to a further pick-up in retail sales activity.

The **European Central Bank (ECB) is widely expected to keep key policy interest rates steady**. Attention will be on the outlook for the ECB's Asset Purchase Programme (APP) once the pandemic emergency purchase programme (PEPP) is scheduled to stop end March 2022. We expect the ECB to continue with APP well into 2023 and a higher monthly pace of purchase (currently €20bn/month) cannot be ruled out.

We expect another robust lift in **US retail sales in November**. Pent-up demand, easing COVID-19 infections and high consumer savings are all strong tailwinds for retail spending. At the same time, high consumer inflation is also propping up retail volumes. So far, there has been little sign of a pull-back in consumption in the face of high inflation. However, there is a risk that high inflation could cool consumption in 2022.

We expect the **Federal Reserve to leave the Fed Funds rate unchanged**. However, following Fed Chair Powell's hawkish pivot we expect the Fed will announce a faster taper of $US25bn/mth from January. That would be consistent with the Fed's tapering ending in April 2022. The risk is an even faster taper of $30/bn given high and widespread underlying inflation. We also expect the median 'dot plot' will show the majority of members now expect two rates hikes in 2022. In September, roughly half of the FOMC members expected one rate hike in 2022. As a result, we also expect the median dot plot will show a higher Fed Funds rate by the end of 2024 of at least 2% (up from 1.8% in September).

We expect **US industrial production** rose by 0.8%/mth in November. Reports of easing chip shortages likely underpinned another lift in motor vehicle and parts production. At the same time, the already-released ISM Manufacturing index showed robust demand was supporting factory production.

Key Forecasts

ASB NZ economic forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	2.8	-3.3	3.0	0.5	1.6	1.5	0.6	0.6
GDP real - A%	17.4	-0.4	3.7	2.9	1.8	6.9	4.3	2.6
GDP real - AA%	5.1	4.7	5.6	5.6	2.0	3.8	4.3	2.7
NZ House Prices (QV Index) - A%	28.3	26.1	24.5	17.2	8.1	2.9	-2.9	6.8
CPI - Q%	1.3	2.2	1.5	0.8	0.8	1.2	0.6	0.5
CPI - A%	3.3	4.9	6.0	5.9	5.4	4.3	2.9	2.5
HLFS employment growth - Q%	1.0	2.0	-0.4	0.1	0.2	0.3	0.3	0.3
HLFS employment growth - A%	1.6	4.3	3.2	2.7	1.8	0.2	1.1	1.2
Unemployment rate - %sa	4.0	3.4	3.5	3.4	3.4	3.4	3.5	3.6

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	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.75	1.00	1.50	1.75	2.00	2.00
NZ 90-day bank bill	0.35	0.65	1.00	1.25	1.75	2.00	2.25	2.25
NZ 2-year swap rate	0.78	1.42	2.40	2.45	2.50	2.55	2.65	2.80
NZ 5-year swap rate	1.36	1.87	2.70	2.75	2.80	2.85	2.95	3.05
NZ 10-year swap rate	1.88	2.24	2.80	2.85	2.90	2.95	3.05	3.15
NZ 10-year Bond	1.77	1.97	2.65	2.70	2.75	2.80	2.90	3.00

ASB foreign exchange forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.70	0.69	0.70	0.71	0.73	0.74	0.73	0.73
NZD/AUD	0.93	0.96	0.97	0.96	0.96	0.95	0.94	0.94
NZD/JPY	77	77	80	82	86	88	88	88
NZD/EUR	0.59	0.59	0.62	0.62	0.63	0.63	0.60	0.56
NZD/GBP	0.51	0.51	0.52	0.53	0.54	0.54	0.51	0.50
NZD/CNY	4.5	4.4	4.5	4.5	4.6	4.6	4.5	4.5
NZD TWI	73.7	73.7	75.1	75.5	76.9	77.2	75.5	74.9

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720

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