

Economic Weekly

14 March 2022

It's all up in the Costpocalypse (unless it's down)

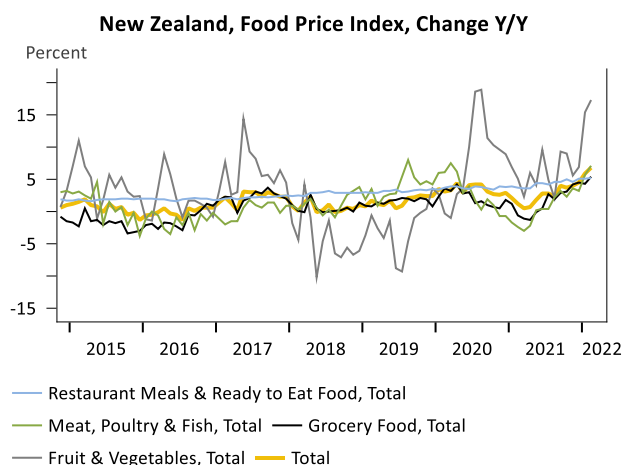
There is a lot of focus on what is going up at the moment, particularly prices. It isn't all one-way traffic, though, with some economic indicators heading in the other direction.

Let's start with some good news: an anticipated 3.6% rebound in Q4 GDP. Like Lazarus with a triple bypass, the NZ economy has once again recovered from a stringent lockdown, clawing back over Q4 most of its lost output. The NZ economy's resilience over the past eighteen months has been impressive, but headwinds are mounting, with capacity pressures, rising interest rates and a more cautious household sector set to bite. Growth over 2022 will be slower and patchier, with a booming construction industry and a cash-splashing household sector set to play less of a role. Even Rocky found it tougher to haul himself up off the canvas after a few falls. Read more in Nat Keall's GDP Preview.

Call it a crisis, challenge, or a mere Costpocalypse, but the cost of living keeps soaring. Oil prices bounced around last week on Russian-Ukrainian developments. But the fuel pump price is higher still with 91 Octane touching on \$3.30/litre in central Auckland, as this author observed as he pushed his car past a service station. At the peak (in the June quarter), we estimate the CPI will show around a 45% annual lift in petrol prices, with fuel prices accounting for nearly 2 percentage points of an estimated 7.4% headline inflation rate. In February, food prices rose 6.8% from a year earlier, the fastest pace of food price inflation in over a decade. Within that, fresh produce prices jumped 17%. Retail grain and dairy prices are likely to come under further upward pressure this year.

As to be expected, the value of electronic cards transactions fell over February, as the spread of Omicron triggered a wave of isolating and prompted others to be more cautious about getting out and about. As Mark Smith [noted](#), the 7.8% fall in retail transactions was considerably less than the 20% fall during the Level 4 Delta lockdown. We are likely to see another (more modest) fall in March before the disruption eases.

One thing that is going down is people's views that it is a good time to buy a house. As Mike Jones reports from ASB's latest [Housing Confidence Survey](#), buyer sentiment is the lowest it's been in the survey's 26-year history. House price expectations edged down further, though remain very elevated compared to our forecast of a 6% price decline over 2022. Unequivocally up in the survey was the view that mortgage rates would rise over the next year: the net balance expecting higher interest rates was the highest in history. That result suggests the general public is well aware of the Costpocalypse's influence on the RBNZ's decision-making. nick.tuffley@asb.co.nz



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6804	0.6887	0.6651	0.7217	FLAT	0.6680	0.6900
NZD/AUD	0.9331	0.9293	0.9313	0.9269	FLAT	0.9250	0.9400
NZD/JPY	79.85	79.13	77.24	78.43	UP	77.50	81.00
NZD/EUR	0.6232	0.6336	0.5837	0.6030	UP	0.6100	0.6450
NZD/GBP	0.5218	0.5213	0.4912	0.5161	UP	0.5100	0.5300
TWI	73.4	73.3	70.8	75.1	FLAT	N/A	N/A

^ Weekly support and resistance levels * Current as at 12.30pm today; week ago as at Monday 5pm

NZD Recap and Outlook

NZD/USD pared back some of its post-invasion gains last week, shedding about a cent over the course of the week to wind up around the 0.6800 mark. NZD/AUD gained roughly half a cent to wind up around 0.9330, shedding some of its earlier gains after the RBA took a very tentative step in a more hawkish direction (confirming the Bank doesn't necessarily need to see two further CPI prints before hiking, as previously signalled).

The two currencies most impacted by tensions in Ukraine – GBP and EUR – followed divergent paths. GBP/USD fell further to hit a new 18-month low. On the other hand, EUR/USD recovered a little ground (but remains well below pre-invasion levels), largely thanks to a more hawkish turn by the ECB, which accelerated its timeframe for tapering asset purchases. Given the Bank has been one of the more dovish institutions, there was plenty of scope for market pricing to strengthen, boosting interest rate differentials in EUR's favour. NZD/GBP and NZD/EUR are currently trading at 0.6230 and 0.5220, respectively, the former a little higher and the latter a little lower over the week.

Last week, we again highlighted the key drivers pulling NZD in two different directions: heightened global risk aversion (a NZD negative), and strong commodity prices (a NZD positive). There was a little bit of reversion in both trends last week: European equities actually climbed, while major energy commodities fell (including a circa US\$20 fall in oil prices). Still, those moves are a bit much-of-a-muchness in context. The MSCI global share index shows equities are down about 8% versus the beginning of February (with European equities about 12% lower), while Bloomberg's Commodities Index is up 18%. Notably for NZ, we reckon WMP prices are due another lift at this week's dairy auction.

We don't see any reason why this tug-of-war will come to a close any time soon, barring a surprise armistice in Ukraine (which most analysts think unlikely). We suspect that this will keep the NZD oscillating within recent support and resistance levels.

Among other central bank meetings this week, the Fed will be out on Thursday morning NZT with its latest statement. This would normally be a considerable source of event risk, but Chair Jerome Powell has been speaking extensively in testimony to Congress over recent weeks and has more or less confirmed a 25bps hike is in the offing. The focus will be how hawkish or otherwise the 'dot plots' (officials' views on the interest rate outlook) accompanying the statement are when it comes to currency direction. USD typically falls during periods where the Fed Funds rate is on the rise (given hikes are associated with improving global growth). But global risk appetite is soggy of late and it is cost-push rather than demand-pull inflation that's putting the pressure on global central banks. That means a sharp USD drop is an unlikely scenario.

NZ GDP for Q4 is also released on Thursday, but we suspect the implications for currency markets are relatively limited here too. We expect the NZ economy lifted 3.6% over the quarter as it clawed back much of its lockdown-driven retraction. But the quarter is very much in the rear-view mirror now, crowded out by the ongoing Omicron outbreak and the invasion of Ukraine – it's only a starting point for examining the 2022 outlook, and little else.

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Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	0.75	0.25	UP	UP
90-day bank bill	1.50	1.34	1.21	0.32	UP	UP
2-year swap	2.98	2.78	2.55	0.52	FLAT	UP
5-year swap	3.18	3.00	2.91	1.18	FLAT	UP
10-year swap	3.22	2.99	2.99	1.90	FLAT	UP
10-year govt bond yield	3.00	2.73	2.79	1.73	FLAT	UP
Curve Slope (2s10s swaps)	0.24	0.21	0.43	1.37	FLAT	FLAT

* Current as at 12.30pm today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged

Market recap

Local and global yields ground higher last week, with uniform lifts across the curve and with increases in US yields outpacing Australasian counterparts. Market pricing for OCR hikes has stepped up safer ANZ Bank called for two 50bp RBNZ hikes in April and May and a 3.50% OCR peak in 2023. Yield on the NZ 2-year swap and 10-year government bond briefly hit 3%, albeit on thin trading volumes, with little reaction to local data. Swap spreads to bonds have widened. Global yields have bounced high given hawkish overtures from the ECB and RBA and concerns over inflation. US Treasury yields have risen 20-25bps higher on a week ago, with 10-year yields briefly breaking through 2%. RBA Governor Lowe flagged upside risk to the inflation outlook and viewed 2022 hikes as being plausible, with markets adding about 15bp to RBA rate pricing over 2022. The ECB announced an accelerated tapering of its QE programme, paving the way for rate hikes from as early as the second half of this year. US inflation hit 7.9%, a 40-year high, with those for the 10-year tenor approaching 3%, a 40bp rise since the start of the year.

Near-term interest rate outlook

Market pricing - 85bp of hikes over next 2 meetings, 185bp of 2022 hikes and a circa 3.65% OCR endpoint – is above our published forecasts of a sequence of consecutive 25bp OCR hikes and a 2.75% OCR peak. Forward interest rates are pointing to yields converging to a 3.25%-3.5% range as opposed to a 2.50%-2.75% range at the start of the year.

Current market pricing is still plausible given our elevated CPI inflation view, but it is also possible that the OCR peaks at a lower level and/or subsequently retraces towards circa 2% neutral levels. Headwinds facing the domestic expansion have intensified and while the RBNZ could opt for 50bp moves and a high OCR peak, there is the possibility of an eventual RBNZ backtrack. This week's local data – the highlight being Q4 GDP – will largely be overlooked by the rates markets. Soaring Omicron cases in NZ will create significant disruption but should have a modest market impact.

Global yields are expected to continue to move up, with the laser-like focus on global central banks and their responses to escalating inflation. The RBA Minutes and the February employment data could impact RBA market pricing (5 rate hikes are fully priced in for 2022). Our CBA colleagues expect the FOMC to raise the Fed Funds rate by 25bps this week, but the focus will be whether the FOMC tweak up to its 'dot plots' of Committee members' Fed Funds expectations (the December plots signalled 75bp hikes in 2022 and 2023) to meet market pricing of more than 7 Fed hikes in the next 12 months. A 25bp hike is more than fully priced in for this week's Bank of England decision, with six hikes priced in over 2022. The continuing Ukrainian conflict could add to volatility and periodic bouts of risk aversion which could still push Government bond yields lower.

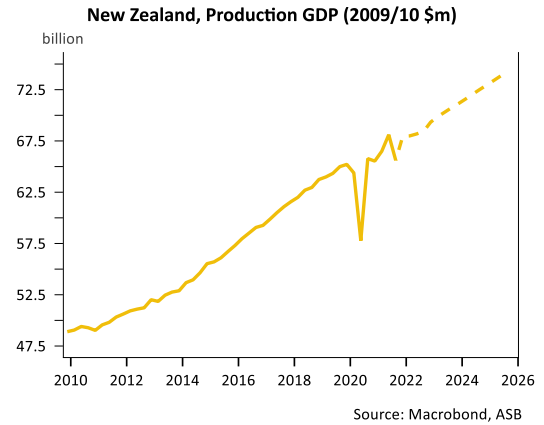
Medium-term outlook

We expect a steady sequence of 25bp hikes at each decision, with the OCR peaking at 2.75% in early 2023. Risks to our OCR outlook are mostly to the upside with the risk of a faster pace of hikes and a higher OCR endpoint. The RBNZ will also start quantitative tightening from July and this could provide upward pressure to longer-term yields. Our CBA colleagues expect RBA rate hikes from June (1.25% endpoint). The US FOMC is expected to have finished its QE tapering and to hike rates by 25bps in March 2022 (2.25-2.5% by early 2024), running down its balance sheet in June. Longer-term local and global yields are expected to drift up, keeping the yield curve flat. mark.smith4@asb.co.nz

Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market Expects	ASB Expects
Gross Domestic Product, Q4, % qoq	17/3	10.45 am	-3.7	-	+3.6

We anticipate the NZ economy grew by 3.6% over Q4 last year, following on from a 3.7% fall over Q3 when the country's third lockdown ground a chunk of activity to a halt. Rebounding activity in the goods sector (manufacturing and construction) and parts of the services sector (retail, wholesale trade and healthcare) should provide much of the Q4 lift. However, the manufacturing and construction sectors look to be facing capacity constraints, while the bounce back in services and its adjacent sectors appears to have been softer than it was after previous lockdowns. Ongoing supply chain woes, serious pricing pressures and the tight starting point for the labour market suggest that capacity constraints will stymie growth over 2022, while rising interest rates, a softer housing market and residual caution about the outlook will keep households from acting as the engine of growth as they have done over the past eighteen months.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU RBA Board Meeting Minutes, March	15/3	11.30 am	-
CN Industrial Production YTD	15/3	3.00 pm	4.0%/yr
Retail Sales YTD			3.5%/yr
Fixed Assets Ex Rural YTD			5.5%/yr
US Retail Sales, February	17/3	1.30 am	0.3%/mth
Core			0.6%/mth
US FOMC	17/3	7.00 am	
Funds Rate Target Range			0.50%-0.75%
CA Headline CPI, February	17/3	1.30 pm	5.3%/yr
Core		-	3.3%/yr
AU Labour Force, February	17/3	1.30pm	-
Employment			+40k
Unemployment Rate			4.0
Participation Rate			66.2
UK Bank of England, Bank Rate	18/3	1.00 am	0.75%
JP National CPI	18/3	12:30pm	1%/yr
Core CPI			-1%/yr
CA Retail Sales, January	19/3	1.30 am	2.4%/mth

* Forecasts and commentary originally published by CBA Global Markets Research Friday 4th March

The March Board Meeting detailed the RBA's current thinking on the impact of the war in the Ukraine, the floods and also a shift in language around wages growth to labour costs. The Minutes should reflect Governor Lowe's speech to the AFR summit this week and continue to highlight the increased flexibility the RBA is giving themselves over coming months. We continue to expect the first rate rise in June.

We estimate Chinese industrial production growth to ease slightly to 4%/yr in January and February. Part of production capacity near Beijing was restricted to reduce pollution over winter and the Olympics. We estimate Chinese retail sales to grow 3.5%/yr over the first two months. Intermittent virus outbreaks remain a key headwind to consumption. We forecast Chinese fixed asset investment growth to pick up to 5.5%/yr. Accelerating public investment and solid manufacturing investment may offset falling property investment.

The increase in petrol prices and the decrease in consumer confidence suggests a modest increase in US core retail sales in February following the 3.8%/mth surge in January.

Chair Powell has already more or less announced a 25bp increase in the Funds rate target range. Financial markets will be focused on (i) Powell's comments on the impact of the war on US inflation and economic activity, (ii) the 'dot plot' of projected interest rate increases in coming years, and (iii) plans for shrinking the balance sheet (QT). We think the FOMC are more concerned about inflation than economic activity and expect more tightening by the FOMC than is currently priced.

After a strong 5.1%/yr gain in January, Canadian headline CPI inflation will likely continue to ratchet higher to 5.3%/yr in February. Oil and other commodity prices rose sharply following Russia's invasion of Ukraine. Omicron related supply chain disruptions and the economic reopening also likely added to price pressures. We expect the average of the three measures of core inflation preferred by the BoC to remain elevated at 3.3%/yr.

We expect another strong Australian employment number in February. Forward looking indicators of labour demand continue to point to a lift in employment. A gain in employment of 40k is expected and the unemployment rate to fall to 4.0% with an unchanged participation rate of 66.2%.

We expect the BoE to continue to increase its policy interest rate. Inflation is high, inflation expectations have picked up, wage growth is strong, and the labour market is tight. Financial markets will be interested in the BoE's views on the impact of high energy prices on UK economic activity.

Japanese headline inflation will pick up to 1%/yr because of rising energy prices. Headline inflation will likely rise further once the impact of the recent surge in energy prices hit consumers' pockets. By contrast, we forecast core inflation remained weak at -1%/yr.

We estimate Canadian retail sales rebounded by 2.4%/mth in January following a 1.8%/mth decline the previous month. Easing public health restrictions will have led to pent up demand and increased spending on goods

Key Forecasts

ASB NZ economic forecasts

	Sep-21 << actual	Dec-21 forecast >>	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Mar-24
GDP real - Q%	-3.7	3.6	0.1	0.3	0.4	1.3	0.8	0.6
GDP real - A%	-0.3	3.7	2.3	0.1	4.3	2.0	2.7	2.5
GDP real - AA%	5.0	5.8	5.5	1.4	2.6	2.2	2.3	2.9
NZ House Prices (QV Index) - A%	25.5	24.7	11.3	4.7	-0.1	-6.0	-2.2	6.8
CPI - Q%	2.2	1.4	2.0	1.5	1.3	0.8	0.8	0.3
CPI - A%	4.9	5.9	7.2	7.4	6.4	5.7	4.4	2.7
HLFS employment growth - Q%	1.9	0.1	0.0	-0.3	0.8	0.4	0.3	0.3
HLFS employment growth - A%	4.2	3.7	3.0	1.6	0.5	0.8	1.2	1.2
Unemployment rate - %sa	3.3	3.2	3.0	2.9	2.8	3.0	3.1	3.4

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

(end of quarter)	Sep-21	Dec-21 << actual	Mar-22 forecast >>	Jun-22	Sep-22	Dec-22	Mar-23	Mar-24
NZ OCR	0.25	0.75	1.00	1.50	2.00	2.50	2.75	2.75
NZ 90-day bank bill	0.65	0.97	1.35	1.80	2.30	2.80	3.00	3.00
NZ 2-year swap rate	1.42	2.17	2.80	2.85	2.90	2.95	3.00	3.15
NZ 5-year swap rate	1.87	2.55	3.05	3.10	3.15	3.20	3.25	3.30
NZ 10-year swap rate	2.24	2.64	3.10	3.15	3.20	3.25	3.30	3.40
NZ 10-year Bond	1.97	2.37	2.85	2.90	2.95	3.00	3.05	3.15

ASB foreign exchange forecasts

(end of quarter)	Sep-21	Dec-21 << actual	Mar-22 forecast >>	Jun-22	Sep-22	Dec-22	Mar-23	Mar-24
NZD/USD	0.69	0.68	0.71	0.73	0.74	0.75	0.73	0.73
NZD/AUD	0.96	0.94	0.96	0.96	0.95	0.94	0.94	0.94
NZD/JPY	77	79	82	86	88	90	88	88
NZD/EUR	0.59	0.60	0.62	0.63	0.63	0.63	0.60	0.56
NZD/GBP	0.51	0.51	0.53	0.54	0.54	0.54	0.51	0.50
NZD/CNY	4.4	4.4	4.5	4.6	4.6	4.7	4.5	4.5
NZD TWI	73.7	73.2	75.6	77.0	77.2	77.6	75.6	75.0

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