Economic Weekly

15 March 2021

A big week looms

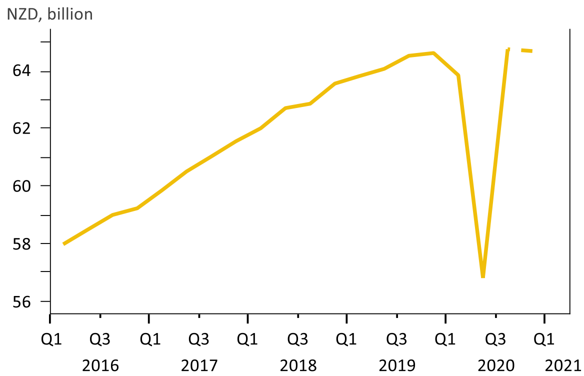
It's a packed calendar for events this week, with a number of key developments we'll be watching out for.

First up, it's a big week for dairy markets, with Tuesday night's Global Dairy Trade auction set to be one of the most closely watched such events in a long time. At the last auction, prices lifted through the roof with whole milk powder up an astonishing 21% on the previous auction. A bit of moderation might be on the cards at this auction, with Fonterra lifting the volumes on offer, but we expect dairy prices to remain supported, with growing Chinese demand continuing to outstrip supply. Keep an eye out for an update on our milk price outlook for the season post-auction.

Offshore, it's a packed week in the world of Central Banking, with the Federal Reserve Open Markets Committee meeting on Thursday morning NZT. There is unlikely to be any changes to any of the Fed's key policy settings but will still be an interesting watch given market developments over recent weeks. With the global economic outlook steadily improving, a further spending spree on the way in the US and commodity prices on the move, markets no longer view higher inflation as such a distant prospect and speculation has begun mounting around when policy makers will begin unwinding all that stimulus. To that end, wholesale interest rates have moved up sharply over the first quarter.

Policy makers are wary of the risks that premature tightening has for the recovery. In public comments by officials, the typical central bank line of late has been some variation of "*yes, the economic outlook has improved of late*," but with a heavy caveat along the lines of "*we are still a long way from our maximum employment target*" and/or "*there's an awful lot of uncertainty out there and we are committed to a least regrets approach.*" That's usually accompanied by a judicious bit of finger wagging at financial markets for pricing in rate hikes earlier than policymakers think is desirable.

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



Source: Macrobond, ASB

Conscious of the need to balance acknowledging reality with stemming the move up in yields, we expect the Fed to keep singing from that song sheet. Still, markets will be carefully watching for whether any committee members project a higher Federal Funds rate in the next two years.

But of course, the week's marquee event will be NZ's Q4 GDP release on Thursday at 10.45am. After Q3's monster comeback, we expect the NZ economy took a pause for breath, declining by 0.1% qoq. The expected decline in some sectors appears to be due to production returning to business as usual after a glut of post-lockdown overtime. Still, NZ GDP is likely to remain above pre-pandemic levels – a creditable performance. You can read our full GDP preview [here](), and stay tuned for our review on Thursday. nathaniel.keall@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7173	0.7155	0.7214	0.6129	FLAT/UP	0.7100	0.7440
NZD/AUD	0.9248	0.9299	0.9318	0.9741	FLAT	0.9225	0.9460
NZD/JPY	78.17	77.56	75.61	64.32	FLAT/UP	77.00	79.20
NZD/EUR	0.6001	0.6011	0.5952	0.5465	FLAT	0.5930	0.6130
NZD/GBP	0.5153	0.5177	0.5231	0.4880	FLAT	0.5140	0.5380
TWI	75.2	74.8	74.7	69.10	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 ground a little higher last week. We suggested dips would be limited to 0.7100 and, despite two further tests of this key support level, it ultimately held and the currency finished the week just under 0.7200.

Still, this was one of the weaker FX performances of the week with the NZD outperformed by all of the CAD, AUD, GBP, and EUR. NZD/AUD fell to around 0.9250 over the week, a 6-month low, despite some retrenchment in iron ore prices. Our short-term valuation model suggests the cross is 'cheap' down here with estimated 'fair-value' in a 0.9350-0.9750 range.

For NZD/USD and NZD/JPY, we continue to favour another push to the topside. Our CBA colleagues remain bearish on the USD, and believe the downtrend will resume this week. NZD fundamentals, meanwhile, remain constructive. Most notably, NZ commodity prices (particularly dairy) are on a tear, and the normalisation of global financial market conditions is emboldening investors' risk appetite.

The combination of these factors is equivalent to a 0.7150-0.7550 'fair value' range according to our NZD/USD short-term valuation model. This range lifted over two cents last week on the back of higher commodity prices and reduced risk aversion and is now at the highest level since late 2016. This tends to support the idea that NZD/USD dips back towards 0.7100 will be short-lived, with the bigger risk being another strop higher.

For this week, event risk picks up a bit. Locally, Q4 GDP growth will garner some attention (ASB -0.1% qoq, market +0.1%), but it's backward looking and subject to massive uncertainty still, so we suspect investors will move on quickly after the dust settles on the initial reaction. Our friends at CBA are expecting another upbeat read on Aussie employment Thursday (+30k jobs, unemployment down to 6.2%).

Thursday morning's US Federal Open Market Committee (FOMC) policy decision will be about the Fed striking a balance between acknowledging the strengthening US recovery, while not wanting to squeeze up bond yields any further for fear of snuffing that recovery out. Markets are expecting the Fed to lean against yield curve steepening so the risk is for further uplift in yields/steepening if they don't. mike.jones@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	0.72	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.95	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	78	80	83	84	85	88
NZD/EUR	0.59	0.59	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	75.2	75.3	75.6	75.6	75.7	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	1.00	UNCH	UP
90-day bank bill	0.32	0.32	0.29	0.90	UNCH	UP
2-year swap	0.53	0.55	0.36	0.79	UNCH	UP
5-year swap	1.18	1.25	0.80	0.89	UNCH	UP
10-year swap	1.90	2.03	1.42	1.17	UNCH	UP
10-year govt bond yield	1.74	1.89	1.31	1.20	UNCH	UP
Curve Slope (2s10s swaps)	1.37	1.48	1.06	0.38	UNCH	DOWN

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

Market Recap

NZ and global yields have remained volatile but are lower than they were a week ago, with a curve-flattening bias. Falls in longer-term NZ yields were larger than for global counterparts, helped by $630m of RBNZ asset purchases. Last week's NZ bond tender was well supported with strong demand. Local data were mixed (strong housing data versus weak card spending) but was largely ignored by the rates market. Australasian yields eased after RBA Governor Lowe pushed back on the recent ramping up in market pricing, reiterated that the Australian labour market would have to significantly tighten before interest rates would start to move up. Moreover, the RBA pledged to maintain the 0.1% 3-year target and buy more bonds if needed to push down yields.

Global yields are lower than this time last week but gained towards the end of the week. Supports included the passage of the USD1.9tr fiscal stimulus package into law, gains to global equity markets (the S&P500 hit record highs last week), the rapid pace of Covid-19 vaccine rollouts in the US and UK and with 10-year US breakeven inflation last week hitting its highest level since 2014 (2.26%). Global yields had earlier dipped after the softer than expected US core CPI print. European yields were lower after the ECB indicated it will boost the pace of asset purchases under the pandemic emergency purchase programme (PEPP).

Near-term interest rate outlook

Markets are now pricing in a 0.50% OCR by the RBNZ by mid-2022 and a 0.75% OCR by early 2023, which is in line with our OCR view. The near-term interest rate outlook should remain extremely volatile and picking week-to-week shifts is proving to be a bit of a lottery. There is the likelihood that yields start the week on a firmer footing following offshore moves, but this subsequently fades as markets absorb the sizeable increases in yields since the start of the year. Equity market direction will be a key barometer for yields and the slope of the curve. Outright yields for longer-dated tenors are approaching our medium-term view and forward rates (e.g. 5-year forward-starting 5-year swap rate at around 2.7%) are lower, but still well above where we think long-term yields will eventually end up.

There is expected to be minimal market reaction to data. We forecast a small contraction for NZ Q4 GDP and the potential for a mild technical recession by early 2021. Australian labour force data should continue the strong jobs growth seen in recent months. The monthly data dump for China should show very strong annual rates of growth are expected in retail sales, industrial production and fixed asset investment given favourable base effects.

No substantive changes to policy settings are expected from this week's Bank of England, the US FOMC and the Bank of Japan decisions. The underlying message is expected to acknowledge the improving outlook but strike a dovish tone and reiterate that an extended period of support is required to keep yields low. The RBA Minutes are also out tomorrow. The RBNZ has maintained a stepped-up pace of asset purchases for its weekly LSAP ($630m vs $450m in the weekly tender) and could help to dampen yields at the margin.

Medium-term outlook

We expect the OCR to start moving up from mid next year (August 22), followed by a gradual pace of OCR hikes, with the OCR at 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 (around 2%). mark.smith4@asb.co.nz

Domestic Events

Data	Date	Time (NZT)	Market	ASB
NZ Current Account Balance, Q4, % of GDP	17/03	10:45am	-	-
NZ GDP, Q4, % qoq	18/03	10:45am	-	-0.1

New Zealand's annual current account deficit narrowed to 0.8% of GDP over Q3. NZ's goods balance as improved as exports have generally proven more resilient than its imports through the pandemic, while the income balance has benefitted from softer domestic corporate profitability and lower interest rates offshore. We expect the annual current account deficit will remain low in Q4.

We expect Q4 GDP contracted by 0.1%, with the quarter's GDP just 0.1% above year-ago and pre-pandemic levels. That would mean annual growth slowed from 0.4% in Q3 to 0.1% in Q4. Our forecast is only slightly softer than the RBNZ's February MPS forecast of zero Q4 growth. NZ GDP will still be above pre-pandemic levels in Q4 and one of the strongest economic performers among NZ's key trading partners.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
China Retail Sales, February, % yoy	15/03	3:00 pm	30
RBA Governor Lowe speech	15/03	-	-
RBA Meeting Minutes	16/03	1:30 pm	-
US Retail Sales, February, %mom	17/03	1:30 am	-0.4
RBA Assistant Gov Kent speech	17/03	12:30 pm	-
Bank of Japan Interest Rate Announcement, %	18/03	-	0.0
Australia Unemployment, February %	18/03	1:30 pm	6.2
US Fed Interest Rate Announcement, %	18/03	7:00 am	0.00-0.25
Bank of England Interest Rate Announcement, %	19/03	1:00 am	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 12 March at 1:56 pm*

A low base in Q1 2020 will distort upcoming Q1 2021 **data releases in China**. Furthermore, the Chinese Government encouraged citizens to stay where they were during the 2021 Lunar New Year (LNY) holiday. As a result, manufacturing and construction activity continued through the holiday period with limited disruption. Furthermore, retail sales continued to grow because people shifted spending from travel to other areas.

Reserve Bank of Australia (RBA) Governor Philip Lowe is due to make opening remarks in Melbourne to the Business Analytics conference. There is no title to the speech and in the dovish speech last week Lowe has already pushed back on premature tightening expectations. We do not expect to learn anything new on the monetary policy front.

The focus for the **RBA Minutes** will be on further commentary on bond yields and the 3-year bond yield target. The speech by Governor Lowe on 10th March noted “We are not considering removing the target or changing the target from 10 basis points”. Instead, the option of keeping the target on the April 2024 or switching to Nov 2024 bond will have to be made at some point. We have favoured the target being lifted due to improvements in the economy.

RBA Assistant Governor (Financial Markets), Christopher Kent is delivering a speech titled *Small Business Finance in a Pandemic* at the Australian Finance Association. This speech is likely to follow on from comments Governor Lowe made in his speech last week about the importance of a lift in business investment for Australia’s longer-term productivity and potential growth.

We expect the **Bank of Japan (BoJ)** to remain firmly committed to a 2% inflation target, the current policy framework of a 0% target for the 10-year JGB yield and a -0.1% policy rate. BoJ Governor Kuroda hinted strongly there is no need to widen the trading range of the 10-year JGB yield.

The leading indicators of **Australia’s labour** demand all remain strong. As a result, we expect another solid increase in employment of 30k in February. We expect an unchanged participation rate of 66.1% and this would see the unemployment rate fall to 6.2% from 6.4%.

We expect **US retail sales** to steady in February after the burst of activity in January. Daily card spending data suggests spending consolidated in February. However, with $1,400 stimulus cheques to begin being sent out in a matter of days, retail spending in March and April is likely to step up sharply.

The **Bank of England (BoE)** is expected to make no policy changes and continue to suggest additional stimulus is unlikely. The BoE projects UK GDP to recover rapidly towards pre-COVID levels over 2021 and CPI inflation to rise quite sharply towards the 2% target in the spring.

We expect the **US Federal Reserve** will reaffirm that interest rates will remain low for a long time. Nevertheless, the central bank is likely to acknowledge that the economic outlook has improved, and we expect to see an upward revision to its GDP projections.

ASB

Key Forecasts

ASB NZ economic forecasts	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	14.0	-0.1	0.1	0.3	0.2	0.2	0.7
GDP real - A%	0.4	0.1	1.4	14.3	0.5	0.9	2.8
GDP real - AA%	-2.3	-2.7	-2.4	3.7	3.7	3.8	1.9
NZ House Prices (QV Index) - A%	9.5	14.9	16.8	21.7	19.8	10.5	5.6
CPI - Q%	0.7	0.5	1.0	0.5	0.7	0.5	0.6
CPI - A%	1.4	1.4	1.6	2.6	2.7	2.1	2.3
HLFS employment growth - Q%	-0.7	0.6	0.3	0.4	0.4	0.4	0.5
HLFS employment growth - A%	0.4	0.7	-0.1	0.6	1.7	1.4	1.8
Unemployment rate - %sa	5.3	4.9	5.1	5.0	5.1	5.1	4.8

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)	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
	<< 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	0.30	0.30	0.30	0.30	0.35	0.90
NZ 2-year swap rate	0.28	0.40	0.50	0.60	0.70	0.80	1.20
NZ 5-year swap rate	0.54	0.90	1.00	1.10	1.20	1.30	1.70
NZ 10-year swap rate	0.98	1.65	1.70	1.75	1.80	1.85	2.05
NZ 10-year Bond	0.99	1.50	1.55	1.60	1.65	1.70	1.90

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	0.72	0.73	0.74	0.74	0.74	0.73
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NZD/JPY	75	78	80	83	84	85	88
NZD/EUR	0.59	0.59	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	75.2	75.3	75.6	75.6	75.7	74.6

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