ASB

Economic Weekly

18 January 2021

Hello 2021, please be kind!

Over the holiday period, no doubt many of us gave some sort of appropriate salute to 2020 and looked ahead to the prospect of a better 2021. The start of the year is always a time for reflection, and there are a number of things worth thinking about as we look ahead to a year in which the economy should be in better shape than last year's rollercoaster ride.

The most astonishing thing about 2020 was that – for all the upheaval globally – NZ's economy rebounded sufficiently strongly in the September quarter (+14%!) that GDP is now higher than it was at the end of 2019. That is a milestone we hadn't expected for some time. The bounce also puts us firmly ahead of many of our key trading partners. We expected sharp rebounds in areas of the economy that were most affected by the March-June lockdown restrictions, but even so, the extent of the bounce in sectors such as construction and retail was more than anticipated. You can read our review here. Adaptability, huge financial support, and keeping COVID-free have all helped.

For 2021, we expect muted growth, somewhere around 1-2% in annual terms. In part, that outlook reflects how quickly some sectors have already got back on their feet, and how swiftly households have responded to super low interest rates. But NZ's largely closed border and the ongoing global economic impacts of the pandemic will continue to constrain NZ's full economic potential for a little while longer. Even as the first vaccines are being swiftly rolled out, the UK and a number of European countries have tightened up their COVID restrictions, which will drag on overall global growth.

Vaccination will still take a while to roll out in NZ and globally, leaving vulnerabilities in place and ongoing restrictions at our border. The new strains of COVID-19 – particularly the virulent UK one – create added threats to both when our border can be safely opened up and to the idyllic COVID-free way of life we have returned to. Vulnerabilities remain, and in 2021, vigilance will remain the price of liberty from COVID-19. Mark Smith's Watch List for 2021 gives more thoughts.

This week the NZ data flow starts off with an update on the extent of the Christmas spend-up (via Electronic Cards Transactions), net migration flows (still very subdued), and Q4 inflation figures. We expect inflation to be low for late 2020 and much of 2021, with an annual rate of 1.1% anticipated for Friday's December 2020 quarter release.

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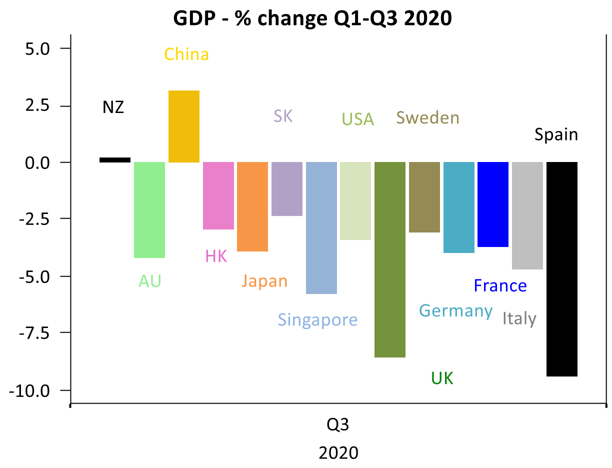


Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7140	0.7188	0.7130	0.6641	FLAT	0.7020	0.7310
NZD/AUD	0.9263	0.9330	0.9378	0.9633	FLAT/UP	0.9180	0.9400
NZD/JPY	74.06	74.88	73.74	73.18	FLAT	72.90	75.50
NZD/EUR	0.5907	0.5905	0.5821	0.5966	FLAT/UP	0.5750	0.5950
NZD/GBP	0.5251	0.5323	0.5269	0.5079	FLAT/DOWN	0.5200	0.5400
TWI	74.4	74.6	74.2	72.66	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

The NZD declined last week, as the US dollar finally found some legs. The kiwi's one cent fall to 0.7150 was one of the weaker performances over the week. Earlier in January the NZD/USD reached a 2½ year high a little above 0.7300.

For those turning their minds to financial markets for the first time in 2021, the broad themes remain similar to where 2020 left off. Optimism around the global vaccine rollout and large US fiscal stimulus (President-elect Biden floated an extra US$1.9t on Friday) is largely offsetting signs of weakening economic performance, worrying COVID news and new lockdown restrictions in Europe.

The USD has tended to find support from the noticeably higher and steeper US yield curve – itself a product of investors' heftier stimulus expectations. However, we're not sure the firmer USD can be sustained given US *real* yields are still negative and fact the trend improvement in global economic conditions remains intact (a negative for the USD's *safe-haven* appeal).

Outlook

The prospect of a re-weakening in the USD is a positive for the NZD/USD outlook. But it's worth noting that NZ-specific currency fundamentals are also supportive.

All of the key short-term fundamentals we monitor – relative interest rates, commodity prices, and risk appetite – have been slowly but steadily moving in favour of the NZD/USD over the past few months. Admittedly, 'fair-value', which is a model estimate based on these fundamentals, is a little lower than spot at around 0.7000. In contrast, our new NZD/AUD valuation model puts 'fair-value' in the cross above the spot rate in a 0.9350-0.9750 range.

Offshore factors will continue to drive the kiwi this week, with the domestic data schedule light until Friday's CPI (with some passing, likely positive, influence from the mid-week GDT dairy auction). Offshore highlights include Chinese GDP (6.5% yoy expected), European PMIs & the ECB meeting, Biden's inauguration on Thursday morning, and Aussie employment (+30k jobs) Thursday.

Overall, we look for NZD/USD dips to be limited to support around 0.7090 this week, with a lift back towards 0.7200 the bigger risk. NZD/AUD is starting to look oversold, thus we think additional losses will be limited to around 0.9220 this week. mike.jones@asb.co.nz

ASB foreign exchange forecasts (end of quarter)	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.72	0.70	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.94	0.93	0.92	0.91	0.92
NZD/JPY	69	70	75	74	74	77	80
NZD/EUR	0.57	0.56	0.59	0.57	0.56	0.55	0.53
NZD/GBP	0.52	0.51	0.53	0.52	0.51	0.52	0.52
NZD/CNY	4.5	4.5	4.7	4.6	4.6	4.5	4.5
NZD TWI	71.4	71.6	75.1	73.4	73.0	73.0	72.9

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	0.28	0.27	0.25	1.29	UNCH	UP
2-year swap	0.28	0.28	0.32	1.22	UNCH	UP
5-year swap	0.58	0.57	0.54	1.35	UNCH	UP
10-year swap	1.10	1.10	1.00	1.69	UNCH	UP
10-year govt bond yield	1.04	1.07	0.96	1.54	UNCH	UP
Curve Slope (2s10s swaps)	0.82	0.83	0.68	0.47	UNCH	DOWN

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

Market Recap

The NZ yields curve starts the week steeper than at the time of our last update about a month ago. Global sentiment has improved given COVID-19 vaccine developments and rollouts, the likelihood of further fiscal stimulus (a circa USD1.9 trillion fiscal package is set to be introduced by the incoming Biden administration) and the commitment by global central banks to maintain ultra-loose settings ("now is not the time to discuss rate hikes" according to FOMC Chair Powell). Last week, however, equities and global yields eased (and curves flattened) given the escalation in COVID-19 cases (and their dampening impact on economic activity) and political unrest in the US (riots in Washington, 2nd impeachment of President Trump). This has pushed US10-year Treasury yields about 6bps lower (1.08%), with Australasian long-term yields down by about half that amount. Last week's $450m tender of the NZ 2024, 2027 and 2041 Government bonds saw strong demand, with yields 3-4bps below mid-market levels.

Short-term NZ yields have remained close to the 0.25% OCR. NZ data has remained resilient, with NZ Q3 GDP (+14qoq), consumer and business confidence suggested the NZ economy was tracking better than expected. Housing market data has remained robust. The fiscal position and debt issuance profile is also looking better than expected.

Near-term interest rate outlook

We expect little change in NZ short-term yields given our on-hold-at-0.25% OCR view for 2021. Current market pricing has less than 5bps of OCR cuts priced in and we expect short-term yields to remain close to the current OCR. We don't expect much market reaction from this week's domestic data, including improving Q4 prints for the Quarterly Survey of Business Opinion and the NZ CPI (+0.2% qoq, 1.1% yoy). Risks are increasing that short-term yields edge higher as the NZ economy continues to outperform market expectations as the buoyancy in the housing market permeates throughout the economy and inflationary pressures stir.

The main focus offshore will be the inauguration of President Elect Biden (January 20 US time). A less than smooth transition could push longer-term yields and equities lower. The looming Senate Impeachment trial of President Trump will be a distraction for markets. Central bank announcements – on hold decisions from the ECB, the Bank of Canada and the BOJ – are unlikely to impact market direction. We envisage that data for China and Australia confirms both economies strengthened at the end of last year. Offshore data – global PMIs – will be perused for signs of COVID-19's impact on global growth over 2021 and we envisage a cooling period for US/European growth could push global yields lower. Lower issuance ($500m of NZ Government bond tenders are scheduled this week) should dampen NZ bond yields as should the (trimmed down) $650m of RBNZ bond purchases signalled for this week.

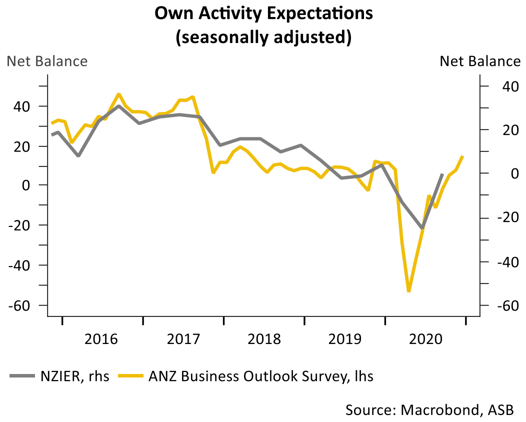
Medium-term outlook

We no longer expect the RBNZ to take the OCR below zero in 2021 and have pencilled in a 0.25% OCR until mid-2023, given the resilience being displayed by the NZ economy and the expectation that the RBNZ's Funding for Lending Programme will help lower interest rates for borrowers within the economy. The outlook is highly uncertain with scope for heightened volatility over the next few months. We expect local and global longer-term yields to continue to grind higher, but to remain at historically low levels over the next few years. mark.smith4@asb.co.nz

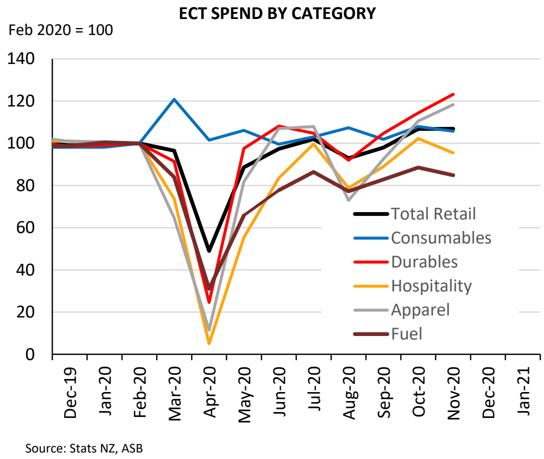
Domestic events

Data	Date	Time (NZT)	Market	ASB
NZIER QSBO, Own Activity, s.a., Q4	19/01	10:00am	-	Up
Electronic Card Transactions, Retail, December, % mom	19/01	10:45am	-	-2.0
Consumers Price Index, 2020Q4, % qoq	22/01	10:45am	-	+0.2

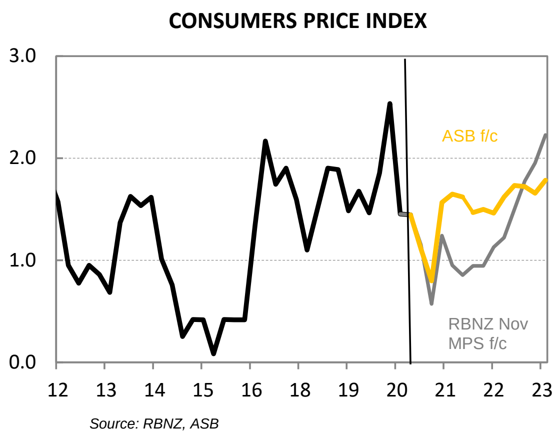
The **NZIER Quarterly Survey of Business Opinion** is likely to confirm the continued recovery in business confidence already seen in the ANZ monthly business outlook survey (see chart opposite). We typically place more emphasis on the Quarterly Survey by NZIER as it has a more reliable performance in predicting GDP growth. However, given the highly unusual circumstance of the COVID-19 pandemic, the relationship between QSBO responses and economic variables has broken down. Also, with the COVID back drop ever-changing, the monthly ANZ survey is timelier and more useful. Nonetheless, the QSBO survey is very detailed and we will pay close attention to questions relating to costs and prices, as pricing power is likely to have some bearing on how quickly inflation recovers over 2021.



Our expectation is for modest pullback in December **retail card spending**, which follows sizeable jumps in September and October. Larger falls are expected for durable and apparel spending. This should still leave retail card spending about 5% higher than 12 months ago and by a similar margin above pre-COVID-19 levels, consistent with the earlier reported Paymark figures. Card spending in the December quarter is expected to climb 8% qoq (core +9% qoq), as the consumer continues to prop up the economy. The retail sector has surprised with its resilience, but the year ahead will be testing given rising unemployment, the likelihood that households have already have their fill of consumer durables and the lack of inbound tourists/slowing population growth caused by the border restrictions. Supply chain difficulties, freight delays and risks of another outbreak of COVID-19 in NZ are other challenges facing the retail sector.



We expect **consumer prices** to climb 0.2% in Q4, pushing headline inflation down to 1.1%. This forecast is in line with the November Monetary Policy Statement (MPS) pick. Price rises in the housing and transport groups and anecdotes of price increases due to supply chain disruptions should offset falls for food prices. There is still a greater degree of uncertainty than usual around our CPI, pick given the impact of COVID-19 and the issue of whether the surprise weakness in the Q3 out-turn will be enduring or a one-off. Looking ahead, we expect annual headline inflation to dip below 1% at the start of this year but to gradually firm thereafter, with more upside risk now accumulating to the inflation outlook. The diminished risk of deflation suggests that the OCR is unlikely to move lower from its current 0.25% record low. However, the RBNZ is expected to maintain highly stimulatory settings until it is confident that economic activity and the labour market have both turned the corner.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
China GDP, Q4, %yoy	18/01	3:00 pm	6.3
Australia Unemployment, December, %	21/01	1:30 pm	6.7
Bank of Japan Interest Rate Announcement, %	21/01	-	0.0
Australia Retail Trade, December, %yoy	22/01	1:30 pm	-7.0
UK CPI, December, %yoy	20/01	8:00 pm	0.6
Bank of Canada Interest Rate Announcement, %	21/01	4:00 am	0.25
ECB Interest Rate Announcement, %	22/01	1:45 am	0.0
UK Retail Sales, December, %yoy	22/01	8:00 pm	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 15 January at 1:49 pm*

We expect China's Q4 20 GDP growth to accelerate to 6.3%yoy on robust industrial output, the recovery in services and strong exports. Both manufacturing and non-manufacturing PMI readings were robust in December despite easing slightly. We predict retail sales growth to accelerate to 5.5%yoy. Industrial production growth may stay strong at 7%yoy amid recovering global demand. Year-to-date fixed asset investment growth may accelerate to 3.2%yoy.

The **Australian** economy was gathering momentum at the end of 2020 prior to the outbreak in coronavirus cases on Sydney's Northern Beaches in the second half of December. Given the **labour market** survey was taken in early December we are expecting another strong result. We are forecasting a 30k lift in the number of jobs in the month. Alongside a tick up in the participation rate this would see the unemployment rate come down to 6.7%.

We expect the Bank of Japan (BoJ) to maintain the status quo at the January meeting. Japan PM Suga has expanded the State of Emergency from Tokyo to several other prefectures until early February. The total affected areas cover about 60% of Japanese GDP. We expect the BoJ to downgrade the growth forecast for FY2020 slightly to take into account the negative impact of lockdown measures.

November saw a huge 7.0% lift in **Australia's retail trade** as spending in Victoria surged on the winding back of restrictions. Spending posted a solid increase in most other states too. Our internal data is showing that spending pulled back in December and we are forecasting a 7.0% fall in the month. This sounds like a large fall, but it would still leave retail trade up 6.2% compared to a year ago.

The Bank of England projects headline CPI inflation to remain muted at 0.6% over Q4 reflecting some downward pressure from spare capacity.

We expect the Bank of Canada (BoC) to leave monetary policy unchanged and reiterate that it plans to keep the policy interest rate at the effective lower bound of 0.25% until into 2023. Canada's economic and inflation dynamics are unfolding in line the BoC's October Monetary Policy Report. Meanwhile, Canada's Business Outlook Survey indicator turned slightly positive in Q4 2020.

The European Central Bank (ECB) is widely expected to sit pat. Indeed, ECB President Christine Lagarde pointed out last week that the macroeconomic projections published in December 2020 "are still very clearly plausible."

UK retail sales volumes are 2.6% above the February 2020 pre-pandemic levels. Low consumer confidence points to a modest contraction in retail spending over December 2020.

Key Forecasts

ASB NZ economic forecasts	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-11.0	14.0	0.7	0.4	0.2	0.4	0.9
GDP real - A%	-11.3	0.4	0.9	2.5	15.5	1.0	3.6
GDP real - AA%	-1.8	-2.3	-2.5	-1.9	4.5	4.4	2.5
NZ House Prices (QV Index) - A%	6.8	6.9	9.6	10.0	13.1	7.6	4.9
CPI - Q%	-0.5	0.7	0.0	0.5	0.1	0.4	0.5
CPI - A%	1.5	1.4	0.9	0.7	1.2	1.2	1.6
HLFS employment growth - Q%	-0.3	-0.8	-0.3	0.1	0.4	0.6	0.5
HLFS employment growth - A%	1.5	0.2	-0.4	-1.4	-0.6	2.1	1.9
Unemployment rate - %sa	4.0	5.3	5.8	6.2	6.5	5.7	5.5

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)	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90-day bank bill	0.30	0.31	0.27	0.30	0.30	0.30	0.30
NZ 2-year swap rate	0.21	0.05	0.28	0.25	0.25	0.25	0.45
NZ 5-year swap rate	0.35	0.13	0.54	0.35	0.35	0.35	0.65
NZ 10-year swap rate	0.73	0.50	0.98	0.80	0.80	0.95	1.15
NZ 10-year Bond	0.91	0.46	0.99	0.85	0.85	1.00	1.20

ASB foreign exchange forecasts (end of quarter)	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.64	0.66	0.72	0.70	0.70	0.71	0.71
NZD/AUD	0.93	0.93	0.94	0.93	0.92	0.91	0.92
NZD/JPY	69	70	75	74	74	77	80
NZD/EUR	0.57	0.56	0.59	0.57	0.56	0.55	0.53
NZD/GBP	0.52	0.51	0.53	0.52	0.51	0.52	0.52
NZD/CNY	4.5	4.5	4.7	4.6	4.6	4.5	4.5
NZD TWI	71.4	71.6	75.1	73.4	73.0	73.0	72.9

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