# Economic Weekly

19 April 2021

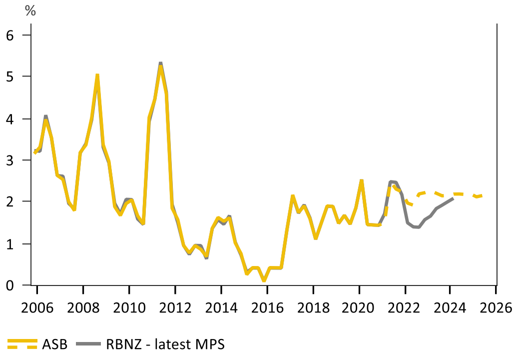
## The evolution of the rolling maul

COVID's rolling maul of unexpected economic challenges rumbles on.

The unusual nature of the post-COVID cycle has given rise to a series of issues no one could have foreseen. From an out-of-control housing boom, to fretting about how to restrain it, port logjams and broader supply chain difficulties…the latest issue to pop out of the maul is capacity constraints. Shortages, in other words. Not just of building materials and other (mostly imported) goods but, increasingly, labour.

These constraints are quickly becoming the number one issue for many of the firms we talk to, and they're also becoming more obvious in the data. Take last week's NZIER Quarterly Survey of Business Opinion (QSBO). Reported difficulties of finding skilled labour reached a 2-year high. Firms' cost expectations over the coming quarter hit a high not seen since 2008. And the percentage of firms reporting sales/demand as the main factor limiting turnover fell to the lowest level since 1974.

NZ Annual CPI Inflation Forecasts




Source: Macrobond, ASB

Higher prices (inflation) and a squeeze on profitability are two of the more obvious macro implications. Both of these were on display in the QSBO. Labour shortages also support our growing sense that: a) unemployment will remain in the "4's" this year rather than head back up through 5%, and b) wage inflation is set to accelerate from here. We've recently moved to explicitly factor higher wage inflation and lower unemployment into our published forecasts (see table).

Offering higher wages to attract staff will only work up to a point though, if the requisite workers simply aren't available. Such is the reality of the closed borders and the recruitment issues parts of the agricultural sector in particular are having. This speaks to another consequence of a capacity constrained economy – lower output than otherwise. Some industries – notably construction and horticulture – are constrained to the extent that activity will have to be scaled back. This adds to the growth challenges we see for the economy this year. Still, whispers of 'stagflation' are premature. Next year is still shaping up to be a strong one given strengthening global tailwinds.

Overall, we're left more confident in our view that inflation is set to lift this year, starting with Wednesday's Q1 print. The key question everyone is asking though is how long-lasting the uptick in inflation will be. Temporary as the world's central banks expect? Or less so, as market pricing for earlier stimulus withdrawal would imply. Uncertainty abounds, but we expect inflation to hold at higher levels than RBNZ forecasts (chart above), supporting our view the RBNZ will begin the stimulus withdrawal process in the back half of next year. mike.jones@asb.co.nz

## Foreign Exchange Market

| FX Rates | Current* | Week ago | Month ago | Year ago | ST Bias | Support^ | Resistance^ |
|---|---|---|---|---|---|---|---|
| NZD/USD | 0.7134 | 0.7024 | 0.7163 | 0.6018 | UP | 0.7000 | 0.7250 |
| NZD/AUD | 0.9228 | 0.9241 | 0.9247 | 0.9455 | FLAT | 0.9100 | 0.9300 |
| NZD/JPY | 77.60 | 76.94 | 77.98 | 64.83 | UP | 76.00 | 79.00 |
| NZD/EUR | 0.5957 | 0.5908 | 0.6012 | 0.5536 | FLAT/UP | 0.5850 | 0.6050 |
| NZD/GBP | 0.5157 | 0.5135 | 0.5147 | 0.4816 | FLAT/UP | 0.5050 | 0.5300 |
| TWI | 74.8 | 73.9 | 74.8 | 68.36 | 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 lifted over the past week, largely underpinned by perky global investor sentiment (particularly over Tuesday night and all day Wednesday) driving a rise in equities, commodity prices and the commodity currencies. The lift in the NZD/USD lift brings it more in line with fundamentals, and back into the bottom of our estimate 'fair value' range of 0.7100-0.7500.

The NZD is up over the week against most of the major crosses, except the AUD. The strong Australian job data released on Thursday boosted the AUD and saw last week's earlier lift in the NZD/AUD unwind.

The RBNZ Monetary Policy Review on Wednesday afternoon saw little market reaction, with the global investor mood mentioned above dominating FX direction over the day. The RBNZ maintained its dovish tone in its statement, noting ongoing uncertainty and re-iterating it remains ready to act with more stimulus if need be.

Strong US economic data released over the week continued to reinforce financial market optimism, and is likely to dictate the tone of financial markets for the time being. The Biden stimulus cheques have boosted March retail sales, manufacturing sentiment is very strong, and US jobless claims point to a strong recovery in US labour market conditions.

We are biased for the NZD to continue to firm against the USD this week. The NZD is sitting at the bottom of our estimated range for 'fair value', with strong global sentiment and global commodity prices likely to continue to support the NZD and weigh on the USD. Meanwhile, an upside surprise on NZ CPI inflation this week could also contribute to a higher NZD bias. Economist expectations are centred on annual inflation remaining steady at 1.4%, although we see some upside to this figure with a forecast of 1.5%. While inflation pressures are starting to pick up in Q1, we expect stronger inflation pressures to clearly emerge in the Q2 data.

The NZD is likely to continue to trend sideways against the AUD this week, absent a large data surprise from either side of the Tasman. The global factors supporting the NZD/USD are also lifting the AUD/USD. In addition, the Australian labour market is recovering, and Australian wage and CPI inflation are set to pick up. As a result, our colleagues at CBA expect the Reserve Bank of Australia will eventually have to back away from its on-hold-until-2024 cash rate guidance, and they predict a lift in the cash rate later this year or early next. jane.turner@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 | 0.70 | 0.73 | 0.74 | 0.74 | 0.74 | 0.73 |
| NZD/AUD | 0.94 | 0.92 | 0.91 | 0.89 | 0.91 | 0.94 | 0.95 |
| NZD/JPY | 75 | 77 | 80 | 83 | 84 | 85 | 88 |
| NZD/EUR | 0.59 | 0.60 | 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 | 73.9 | 75.2 | 75.4 | 75.5 | 75.5 | 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 | 0.25 | UNCH | UP |
| 90-day bank bill | 0.34 | 0.32 | 0.34 | 0.39 | UNCH | UP |
| 2-year swap | 0.45 | 0.46 | 0.52 | 0.35 | UNCH | UP |
| 5-year swap | 1.06 | 1.07 | 1.20 | 0.51 | UNCH | UP |
| 10-year swap | 1.83 | 1.85 | 1.99 | 0.91 | UNCH | UP |
| 10-year govt bond yield | 1.65 | 1.74 | 1.82 | 0.95 | UNCH | UP |
| Curve Slope (2s10s swaps) | 1.38 | 1.40 | 1.48 | 0.56 | UNCH | DOWN |

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

### Market Recap

Local swap yields start the week little changed, continuing a period of relative stability in the local rates market after the February/early March surge in local and global yields. The key NZ 2-year swap yield has continued to trade in tight ranges (just 0.44% to 0.47% last week), and eased after the RBNZ maintained current policy settings, downplayed near-term upside risks to inflation and emphasised the need for continued extensive policy support (see our take here). NZ Government bond yields have followed global counterparts lower. Positioning-related flows and stronger overseas demand saw 10-year US Treasury yields fall 9bps down for the week (1.58%) to be 6bps lower compared to a month ago. NZ 10-year Government bond yields (1.61%) fell 10bps last week (-13bps for the month), helped by $420m of RBNZ asset purchases. The tone of data confirmed that the global economy is mending, with strong NZ manufacturing PMI and REINZ housing market data. However, interest rate reaction was generally modest, with markets heeding the 'patient' mantra from global central bankers.

### Near-term interest rate outlook

Our core view is that we are in a period of consolidation after a frenetic period earlier this year in which local yields snapped higher and the curve has steepened. Market pricing has a full 25bp OCR hike priced in by early 2023, which is a shade later than our OCR view (August 2022), but consistent with our view of the risk profile. The opening of the Trans-Tasman bubble today is a reminder that local yields will eventually start to 'normalise' (i.e. move higher), but a lot can still happen with COVID-19 a clear risk. We expect local short-term yields to trade in tight ranges, with Wednesday's NZ Q1 CPI expected to attract little market reaction if it comes in below the RBNZ's 1.0% qoq (1.7% yoy) pick (ASB/mkt: 0.8% qoq, 1.5% yoy). An upward surprise to the RBNZ's pick would be harder to shake off.

There is still scope for longer-term local and global yields to move lower as some of the early 2021 jump is unwound. The market will likely look through likely higher inflation outturns from the UK and Canada. Signals on improving global growth (manufacturing/services PMIs are out this week) will largely be ignored. The RBA Minutes may shed more light on the RBA's view on whether to maintain the April 24 bond as the target bond for yield curve control or whether to shift to the November 2024 bond. Given the improved economic outlook we expect the RBA to stick with the April 24 bond. The focus for this week's central bank decisions by the Bank of Canada and ECB will be whether the improving global outlook will see a scaling back in central bank asset purchases. Weekly RBNZ government bond purchases have been scaled back further this week ($400m) but are still well above the $300m NZ bond issuance profile by NZDM ($300m this week) and should weigh on bond yields at the margin.

### Medium-term outlook

We expect the RBNZ to continue to trim its LSAP programme and to halt purchases altogether from 2022, prior to raising the OCR from August 2022 - with risks of a slightly later start to RBNZ tightening. The OCR is expected to reach 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.

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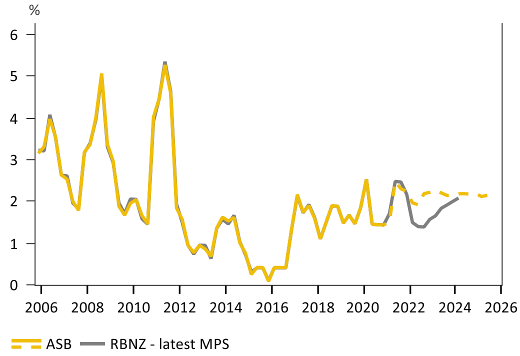
# Domestic events

| Data | Date | Time (NZT) | Market | ASB |
|---|---|---|---|---|
| Consumers price Index, 201Q1, % qoq | 21/04 | 10:45 am | - | 0.8 |

Our 0.8% qoq Q1 pick for the NZ CPI (+1.5% yoy) is slightly below RBNZ expectations (+1.1% qoq, 1.7% yoy), with positive contributions from petrol, housing and with some well-publicised issues with the movement of global freight and supply chain disruptions likely to provide some upward impetus. Looking ahead, we expect annual headline inflation to move above 2% for the rest of this year and next as a perfect storm of stretched capacity, supply bottlenecks, and higher costs flow through in consumer prices. For now, we expect the RBNZ to remain patient and defer from raising the OCR until it is confident the expansion is secure, the economy is close to full employment and medium-term inflation drivers are pointing well above 2%. This still some way away and we have pencilled in August 2022, with risks of a later start to OCR hikes.

NZ Annual CPI Inflation Forecasts




Source: Macrobond, ASB

## Major International Events for the week ahead

| Data | Date | Time (NZT) | ASB |
|---|---|---|---|
| RBA Board Meeting Minutes | 20/04 | 1:30 pm | - |
| UK Unemployment, February, %mom | 20/04 | 6:00 pm | 5.0 |
| Australia Retail Trade, March, %mom | 21/04 | 1:30 pm | 0.8 |
| UK CPI, February, %yoy | 21/04 | 6:00 pm | - |
| ECB Interest Rate Announcement, % | 22/04 | 11:45 pm | - |
| Japan CPI, March, %yoy | 23/04 | 10:50 pm | 0.0 |
| UK Retail Sales, March, %mom | 23/04 | 6:00 pm | - |

** Forecasts and commentary originally published by CBA Global Markets Research Friday 16 April at 2:27 pm*

**The Reserve Bank of Australia's April Board meeting** was a low-key affair. The Statement accompanying the decision repeated that the Board does not expect the conditions that would require lifting the cash rate target to be met until "2024 at the earliest". In the near term, the key decision for the RBA will be whether to maintain the April 24 bond as the target bond for yield curve control or whether to shift to the November 2024 bond. Given the strength of the economy this year we expect the RBA to stick with the April 24 bond.

Our internal data is pointing to a solid lift in **Australian retail spending** in March. We are likely to see the annual rate of growth drop sharply this month on base effects. This time last year saw a surge in retail trade as grocery stockpiling began.

We estimate **inflation remained very weak in Japan** in March. Already released Tokyo CPI indicates the national CPI was unchanged while the core CPI accelerated modestly to 0.4%/yr. Both inflation measures are a long way from the Bank of Japan's 2%yoy inflation target.

The **UK unemployment rate** dipped 1 percentage point to 5% in the three months to January and is printing better than the Bank of England's projection of 5.5% over Q1.

**UK headline CPI inflation** slowed at an annual pace of 0.4% in February. The Bank of England projects headline CPI inflation to pick-up in March and average 0.8% yoy over Q1 as a result of ending the reduction in VAT for certain services and developments in energy prices.

**The European Central Bank (ECB) is widely expected to make no policy or forward guidance changes**. The ECB's decision to scale up the pace of asset purchases under the pandemic emergency purchase programme (PEPP) over Q2 has so far been successful considering that European bond yields have been range-bound since the March meeting. The next ECB review to determine the pace of purchases needed over Q3 will take place at the 10 June meeting.

The recovery in consumer confidence points to a continued recovery in **UK retail spending** over March.

## Key Forecasts

| ASB NZ economic forecasts | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Mar-23 |
|---|---|---|---|---|---|---|---|
| | << actual | forecast >> | | | | | |
| GDP real - Q% | -1.0 | -0.2 | 1.1 | 1.0 | -0.8 | -0.6 | 0.5 |
| GDP real - A% | -0.9 | 0.2 | 13.8 | 0.9 | 1.2 | 0.7 | 4.5 |
| GDP real - AA% | -3.0 | -3.0 | 3.0 | 3.2 | 3.7 | 3.9 | 2.7 |
| NZ House Prices (QV Index) - A% | 15.1 | 19.7 | 20.0 | 15.4 | 9.1 | 2.4 | 5.1 |
| CPI - Q% | 0.5 | 0.8 | 0.5 | 0.5 | 0.4 | 0.6 | 0.6 |
| CPI - A% | 1.4 | 1.5 | 2.5 | 2.3 | 2.2 | 2.0 | 2.3 |
| HLFS employment growth - Q% | 0.6 | 0.0 | 0.2 | 0.3 | 0.3 | 0.4 | 0.6 |
| HLFS employment growth - A% | 0.7 | -0.3 | 0.1 | 1.2 | 0.8 | 1.2 | 2.3 |
| Unemployment rate - %sa | 4.9 | 4.8 | 4.8 | 4.8 | 4.9 | 4.8 | 4.1 |

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 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Mar-23 |
|---|---|---|---|---|---|---|---|
| (end of quarter) | | << 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 | 0.35 | 0.30 | 0.30 | 0.30 | 0.35 | 0.90 |
| NZ 2-year swap rate | 0.28 | 0.47 | 0.57 | 0.67 | 0.77 | 0.87 | 1.27 |
| NZ 5-year swap rate | 0.54 | 1.12 | 1.22 | 1.32 | 1.42 | 1.52 | 1.92 |
| NZ 10-year swap rate | 0.98 | 1.96 | 2.01 | 2.06 | 2.11 | 2.16 | 2.36 |
| NZ 10-year Bond | 0.99 | 1.78 | 1.86 | 1.91 | 1.96 | 2.01 | 2.21 |

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| NZD/EUR | 0.59 | 0.60 | 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 | 73.9 | 75.2 | 75.4 | 75.5 | 75.5 | 74.6 |


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