

Economic Weekly

21 June 2021

Playing off the front foot

It sounds bizarre. After all, we're still in a global pandemic with the borders shut and our formerly top export earning sector on the ropes. But the NZ economy is increasingly at risk of overheating.

The supply side of the economy is clearly restrained by the closed border and disruptions to global supply chains and inventory levels. At the same time, the strength of demand continues to outstrip even the most optimistic of forecasters. The associated lift in cost and inflation pressures is increasingly proving too worrisome for central banks to keep waving away as entirely temporary.

Illustrative of this solidarity in demand, we got more evidence last week that housing market heat is being released only gradually. It was enough for us to act on the risk we flagged last month and nudge up our [house price expectations](#) for calendar 2021 (2022 expectations were lowered). But the show-stopper was of course first quarter [GDP figures](#). The 1.6% quarterly surge in activity blew everyone's forecasts out of the water, as kiwis continue to front-foot pandemic uncertainty and build and spend like crazy. No one was more surprised than the RBNZ who, admittedly, didn't have the benefit of the most recent GDP indicators. Overall economic output was revealed to be 2.7% stronger than the RBNZ forecast less than a month ago. That's a surprise equivalent to a year's worth of growth! All the while, labour market data and anecdote points to a market that is getting tighter by the day.

We've previously written about the markets vs. central bank interest rate '[battle royale](#)'. We've tended to side more with financial markets' view that central banks would ultimately need to bring forward their stimulus withdrawal plans. This now appears to be (slowly) playing out. The highly influential US Federal Reserve was the latest to shuffle forward its plans last week. It tentatively pegged two rate hikes for 2023, where it previously had none. Hardly imminent sure, but it was the sniff markets were waiting for and wholesale rates around the world pushed higher still.

In NZ, our forecast for a May 2022 lift in the RBNZ's Official Cash Rate has become the consensus in the wake of last Thursday's GDP/FOMC double act. But, in light of the above, we're now weighing the risk that the RBNZ opts to get off the mark even earlier than May. The fact the US Fed is shuffling forward and the NZ dollar remains remarkably restrained may leave the Bank more comfortable in doing so.

Whatever the exact meeting date, the message for borrowers is that record low rates are on borrowed time. Two of our recent publications explore the issue in more detail. We flagged the risk of higher wholesale rates in our latest [Corporate Hedging Toolbox](#) and outlined some hedging considerations for corporates. Meanwhile, our latest [Home Loan Report](#) examines the moving parts for mortgage borrowers and nudges up our mortgage rate forecasts.

Finally, the local economics news slows right down this week. But of course the sporting excitement reaches fever pitch, with our beloved BlackCaps chasing cricket's biggest prize in England. Here's hoping the weather holds off and the team can stay on the front foot. mike.jones@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6940	0.7142	0.7185	0.6418	FLAT/DOWN	0.6850	0.7100
NZD/AUD	0.9275	0.9261	0.9261	0.9358	FLAT	0.9200	0.9350
NZD/JPY	76.52	78.38	78.15	68.58	FLAT/DOWN	75.00	78.00
NZD/EUR	0.5852	0.5901	0.5872	0.5723	FLAT	0.5750	0.5950
NZD/GBP	0.5028	0.5061	0.5065	0.5162	FLAT	0.4950	0.5100
TWI	73.2	74.1	74.5	71.24	FLAT/DOWN	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 fell below 0.70 cents against the USD on Friday night (the lowest level in three months) as the USD strengthened following the Federal Reserve announcement Thursday Morning NZT. The stronger-than-expected NZ GDP result, also released Thursday morning, saw a temporary pause in the fall of the NZD, but ultimately this pause was short-lived. The AUD saw similar falls against the USD, leaving the NZD/AUD relatively steady over the week. The NZD temporarily spiked higher against the AUD following the stronger NZ Q1 GDP result, but this lift was unwound once Australian jobs data were released Thursday afternoon (which revealed a sharp drop in the Australian unemployment).

Strong economic data, both in NZ and abroad, indicates that central banks will be looking to normalise interest rates sooner than previously expected. In terms of currency implications over the past week, it appears that changes on the US front dominated and overshadowed developments domestically.

USD demand (and weaker NZD demand) were supported by a slip in global investor sentiment since Thursday. US sharemarkets have retreated after the Federal Reserve updated its forecasts to indicate it will lift interest rates sooner than previously expected. Federal Reserve officials noted that it had begun discussions around tapering bond purchases as the “economy has clearly made progress”. Our colleagues at CBA now expect the Federal Reserve to start tapering asset purchases in October (previously December) and to start lifting the Fed Funds rates in early 2023.

After last week’s action-packed super Thursday, the data calendar for the week ahead is light with less event risk. The NZD outlook for the week is likely to remain dominated by USD direction. The USD is likely to remain supported after last week’s reaction to the Federal Reserve. There remains some near-term risk of further correction in US equities which would weigh further on the NZD. However, once the dust settles, we still think there is some potential for NZD recovery. We expect the RBNZ will likely be the first mover with lifting interest rates and commodity prices remain supportive for the NZD. jane.turner@asb.co.nz

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	0.70	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	0.33	0.32	0.32	0.29	UNCH	UP
2-year swap	0.70	0.52	0.53	0.23	UP	UP
5-year swap	1.33	1.18	1.19	0.37	UP	UP
10-year swap	1.87	1.80	1.93	0.74	UP	UP
10-year govt bond yield	1.76	1.66	1.83	0.90	UP	UP
Curve Slope (2s10s swaps)	1.17	1.27	1.40	0.51	UNCH	DOWN

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

Market Recap

Local yields pushed higher last week, unwinding earlier falls. As we had flagged, catalysts were local and global, with most of the action occurring last Thursday. US Treasury yields jumped, with more sizeable increases in the 5-to-7-year part of the curve after the US Federal Open Market Committee held policy settings but signalled 50bps of hikes within the 2023 'dot plots'. NZ yields followed suit and received a further boost following much stronger than expected NZ Q1 GDP figures, which firmed market pricing for OCR hikes. Stronger than expected Australian labour market data later that day added to the positive tone. RBA Governor Lowe's speech stuck to the script from the RBA Minutes, but with little market reaction. There was also little market reaction after the Fed's Bullard (2022 voter) viewed rate hikes from late 2022 due to high inflation. Local and global yields consolidated at the end of the week, with US 10-year Treasury yields 5bp lower, but NZ and Australian 10-year yields were about 10bp higher.

Near-term interest rate outlook

We have retained our upward bias for local yields. Market pricing has been bought forward in line with our core economic view, with a full hike priced in by May 2022 and an OCR of just over 1% by mid-2023. However, our view of the risk profile is that the RBNZ could hike earlier than May 2022 and move more quickly, with scope for market pricing to firm further, pushing up short-term local yields.

This week we expect yields to consolidate in what will be a quiet event week for markets. However, we believe the FOMC actions last week were a watershed moment, and this will eventually trigger climbs in US (and NZ) yields. This week's data (US PCE deflator) and the Bank of England decision could provide upward impetus to yields if they affirm the improving economic narrative.

The RBNZ has continued to taper asset purchases, with the \$200m earmarked this week the lowest since March 2020 and under the \$300m weekly tender for the 2nd consecutive week. We expect NZDM to increase the weekly pace of tenders in the coming months to meet its \$30bn gross issuance target for 2021/22, but we don't expect the RBNZ to increase weekly LSAP purchases. Moreover, the RBA is expected to taper its next six-monthly round of QE from September (to AUD50bn from AUD100bn). Yields will be pressured higher at the margin.

Medium-term outlook

We expect the RBNZ to raise the OCR from May 2022. The OCR is expected to peak at just 1.25% in late 2023, with yields to remain capped at historically low levels. Risks are tilted towards OCR hikes occurring sooner and for yields to be higher. Our CBA colleagues expect the FOMC will start increasing the Fed Funds rate in March 2023 and that it will reach 1.50% in 2024. mark.smith4@asb.co.nz

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia Retail Trade, May, %mom	21/06	1:30 pm	1.5
Eurozone Composite PMI,	23/06	8:00 pm	-
UK Composite PMI	23/06	8:30 pm	-
Bank of England Interest Rate Announcement, %	24/06	11:00 pm	-
US PCE Deflator, May, %mom	25/06	12:30 am	0.5

* Forecasts and commentary originally published by CBA Global Markets Research Friday 18 June at 11:43 am

Our internal data are pointing to another solid lift in **Australian retail trade**. We expect consumer spending to continue to lift this year with a very large pool of savings, a strong recovery in the labour market, a booming housing market all supportive. This data are before the recent lockdown in Vic which will impact the data in June.

The **Eurozone and UK composite PMIs** will show if the expansion in economic activity is moderating or accelerating.

The **Bank of England** is widely expected to make no policy changes. It will be chief economist Andrew Haldane's last policy-setting meeting and he will likely vote again to reduce the scale of bond purchases.

We expect the **US Personal Consumption and Expenditure (PCE) deflator** surged over the year to May 2021, in line with the sharp rise in the already-released CPI data. Over the month, we expect further solid gains in both the PCE deflator and the core PCE deflator of 0.5%mom amid strong demand and re-opening frictions. However, we expect a slight moderation in the pace of price rises, in line with the trend in the CPI data. We will also be monitoring the trimmed PCE deflator.

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	1.6	0.5	1.1	-0.2	-0.7	0.4
GDP real - A%	-0.8	2.4	15.4	2.3	3.1	0.7	4.0
GDP real - AA%	-2.9	-2.3	4.0	4.5	5.5	5.0	2.6
NZ House Prices (QV Index) - A%	15.4	17.4	21.6	18.8	14.6	10.1	2.3
CPI - Q%	0.5	0.8	0.8	0.9	0.6	0.6	0.5
CPI - A%	1.4	1.5	2.8	3.1	3.2	3.0	2.3
HLFS employment growth - Q%	0.6	0.5	0.4	0.4	0.3	0.3	0.4
HLFS employment growth - A%	0.8	0.3	1.0	2.0	1.7	1.4	2.0
Unemployment rate - %sa	4.9	4.7	4.6	4.6	4.5	4.5	4.0

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	0.35	0.35	0.35	0.35	0.55	1.10
NZ 2-year swap rate	0.28	0.47	0.60	0.65	0.70	0.80	1.20
NZ 5-year swap rate	0.54	1.12	1.35	1.40	1.50	1.60	1.95
NZ 10-year swap rate	0.98	1.96	2.00	2.05	2.10	2.15	2.35
NZ 10-year Bond	0.99	1.78	1.85	1.90	1.95	2.00	2.20

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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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