

Economic Weekly

22 February 2021

Are we going the right way?

Financial markets are nervously awaiting the Reserve Bank's policy decision on Wednesday afternoon. 'Nervously' because it's been a long time between drinks. The last such decision was on November 11. More importantly, a lot has happened in that time. The global vaccine roll-out has begun in earnest, global inflation is 'a thing' again, NZ economic activity has clearly exceeded RBNZ expectations and...NZ house prices have risen another 8%.

All of this has led to some big changes in market pricing. Negative rates that has been shelved and yield curves have risen and steepened everywhere as markets around the world have looked ahead to a COVID-less world. Local wholesale interest rates are between 10 and 90bps higher than November. The currency is about 4% stronger.

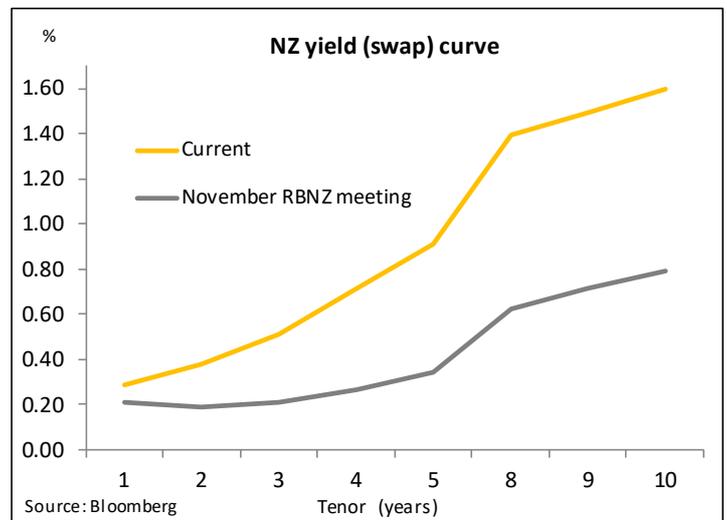
But investors are now wondering whether the RBNZ will entirely share this upbeat assessment. After all, financial markets and the central bank have not always seen eye-to-eye in the past when it comes to assessing the run of the economic green. It's about validation – akin to my toddler racing up a side street on her bike, before checking herself and throwing back a look of "Am I going the right way?"

An inclination from the RBNZ to play conservatively – more Kane Williamson than Brendon McCullum – risks some reversal of the recent big lift in wholesale interest rates and NZD/USD. Our view, outlined in our [preview](#), is that the Bank's emphasis will be more on the downside than the up. COVID is a marathon, not a sprint.

But the Bank will have to acknowledge and upgrade its economic forecasts to reflect the stronger run of data since November. And, whatever the wash-up on the day, our view is that the *trend* has indeed turned. We now expect the [first OCR hike](#) next year. Our updated interest rate forecasts have the recent uptrend (slowly) continuing. The risk profile facing the currency is similar – see the Special Topic of our latest [Corporate Hedging Toolbox](#). The point for Wednesday is that there is more potential for volatility than usual, something for risk managers to bear in mind.

Finally, all of the above seems a little inconsequential given today we mark ten years since the devastating 2011 Canterbury earthquake. Our thoughts are firmly with the people of Christchurch and all those affected.

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Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7294	0.7244	0.7192	0.6308	FLAT/UP	0.7080	0.7400
NZD/AUD	0.9263	0.9303	0.9286	0.9552	FLAT	0.9100	0.9500
NZD/JPY	76.91	76.09	74.47	70.66	FLAT	73.90	77.70
NZD/EUR	0.6020	0.5967	0.5906	0.5846	FLAT	0.5810	0.6110
NZD/GBP	0.5206	0.5211	0.5242	0.4892	FLAT	0.5080	0.5340
TWI	75.6	74.8	74.4	70.70	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

Auckland shifted down to COVID alert level 2 and the rest of the country down to alert level 1 on Wednesday night, but given markets had taken the initial move back up alert levels in their stride, reaction to the change was relatively muted.

The NZD traded comfortably within its recent band against the USD for much of the week, before posting gains towards the end of the week that saw it lift above a shade above the 0.73 mark for the second time this year. With iron ore prices nearing a 10-year high, the NZD fell against the AUD over the course of the week. The NZD was similarly mixed against the other major crosses, higher against the JPY, but lower against the EUR and GBP.

There was relatively little in the way of major data out and no major central bank meetings last week, so risk sentiment remained in the driver's seat for FX. With global vaccine efforts ramping up and further stimulus from the US on the cards, markets are increasingly looking ahead to an upswing in economic activity over 2021 and 2022. That view has seen commodity prices move up sharply. With data pointing to a pick-up in pricing pressures in many parts of the world, speculation is now mounting about when central banks will begin to tighten policy settings, and who will be the first to move. In the aggregate, the bullish tone has seen weakness in the safe-haven USD continue to remain the persistent theme in currency markets.

Looking to the week ahead, things are once again quiet on the data front internationally, but it should be a bit livelier domestically.

The RBNZ's latest Monetary Policy Statement on Wednesday afternoon will be the big focus for the NZD. The OCR remains on hold and the RBNZ is unlikely to lift its LSAP cap, but we will be watching the bank's tone and indications of its forward outlook. With recent NZ economic data outperforming expectations, we revised our OCR outlook last week and now expect the RBNZ to begin lifting the OCR in the second half of 2022.

The bank will be keen to emphasise the uncertainty still out there, particularly in light of last week's events, but the bank will also acknowledge the NZ economy's better-than-expected position. That carries some upside for the NZD as markets pick up the cue that the RBNZ is better placed to begin tightening ahead of many of its global peers, taking interest rate differentials in a favourable direction. nathaniel.keall@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	0.70	0.71	0.71	0.71	0.71
NZD/AUD	0.94	0.93	0.92	0.92	0.91	0.91	0.92
NZD/JPY	75	74	74	76	77	77	80
NZD/EUR	0.59	0.57	0.56	0.56	0.55	0.55	0.53
NZD/GBP	0.53	0.52	0.51	0.52	0.52	0.52	0.52
NZD/CNY	4.7	4.6	4.6	4.6	4.5	4.5	4.5
NZD TWI	75.1	73.4	73.0	73.7	73.2	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	0.30	0.29	1.14	UNCH	UP
2-year swap	0.40	0.37	0.31	1.05	UNCH	UP
5-year swap	0.94	0.85	0.64	1.11	UNCH	UP
10-year swap	1.67	1.52	1.16	1.38	UNCH	UP
10-year govt bond yield	1.52	1.38	1.08	1.26	UNCH	UP
Curve Slope (2s10s swaps)	1.27	1.15	0.85	0.34	UNCH	DOWN

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

Market Recap

Domestic market pricing has continued to firm as the market moved away from expecting OCR cuts and pivoted towards eventual OCR hikes. Local yields start this week at close to post-COVID-19 highs, with the yield curve (2s10s) its steepest in almost four years. 10-year NZ Government bond yields edged above 1.50%, gaining almost 20 basis point on last week. The \$450m tender of 2024, 2029 and 2041 NZ Government bonds did not attract as much demand as last week, with yields 25-50bps higher than the comparable auction roughly a month ago. This was despite the \$590m in Reserve Bank of New Zealand (RBNZ) Large Scale Asset Purchase (LSAP) being maintained.

Global yields rose and curves steepened, with 10-year Treasury yields hitting post-COVID-19 highs (1.34%). Rising global equities and oil prices, expectations of further US fiscal stimulus and slowing rates of new COVID-19 cases following vaccine rollouts lifted yields. This was despite minutes from the RBA (Tuesday) and Fed (Thursday) showed little urgency for settings to be tightened. There was little market reaction to the mixed run of global data.

Near-term interest rate outlook

Given our new OCR view (see below), the recent firming in local yields and curve steepening could have a little more to run and our medium-term bias is for higher yields. However, the near-term outlook will remain volatile and there is the risk that local yields could briefly move lower this week. The local dataflow is expected to be mixed (a small fall is expected for Q4 NZ retail sales versus generally improving signs from sentiment measures), and we expect the RBNZ to remain dovish at this Wednesday's Monetary Policy Statement (MPS). The RBNZ is likely to emphasise the continued risks, challenges and uncertainties to the outlook and reiterate that they will be prepared to maintain considerable policy support with the express purpose of keeping NZ yields low and dampening the NZD. The RBNZ could push out the \$100bn June 2022 cap on the LSAP, even though we expect the RBNZ to eventually taper purchases and then cease them ahead of OCR hikes next year. Meanwhile, a generally improving tone of US and Australasian data could be supportive for global yields.

Medium-term outlook

ASB formally changed its OCR call, bringing forward the timing of OCR hikes to August 2022. We have also revised up out forecasts for other local rates, believing most of recent increases will stick. We now expect that the RBNZ will hike the OCR by 25bps in August 2022, followed by a slow pace of OCR hikes, with the OCR hitting 1.25% by early 2024. Our bias is for NZ 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.

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

Domestic Events

Data	Date	Time (NZT)	Market	ASB
Retail Trade Survey, Seasonally-adjusted volumes, Q4, %qoq	23/02	10:45am	-0.5	-1
RBNZ OCR Review and February MPS, Official Cash Rate %	24/02	2:00 pm	0.25	0.25
ANZ Business Outlook, Feb full results, own activity	25/02	1:00 pm	-	-
ANZ Consumer Confidence, February	26/02	10:00am	-	-
Merchandise trade balance, February, \$m	26/02	10:45am	-	-626

Retail trade volumes are expected to modestly decline over Q4, a strong result considering the massive catch-up in spending that occurred over Q3. Nominal card spending data showed Q4 increases ranging from 0.5% (retail) to 1% (total) across the broad categories. Apparel retail was particularly strong, with further gains in services spending. However, durables, consumables and fuel card spending saw falls in Q4, with the 10% fall in vehicle registrations and rising consumer prices also pointing to a small negative quarter for Q4 retail volumes.

We expect no change in monetary policy settings from the RBNZ at its February OCR review and Monetary Policy Statement. We expect the RBNZ to leave the OCR unchanged over 2021 and leave its Large Scale Asset Purchase programme cap unchanged at \$100 billion, although expect that at some point the RBNZ will extend the end date of asset purchases from mid-2022. The starting point for the RBNZ's economic outlook is much better than was assumed late last year. Consequently, the RBNZ's medium-term economic objectives look to be much closer to being met and we expect the OCR to move up from the second half of 2022. Nevertheless, we expect the RBNZ will keep the emphasis on the continued risks, challenges and uncertainties.

Business confidence remained broadly steady in early February, holding onto strong gains made in December. Depending on when respondents filled in the survey, some of the February full month results may be weighed by the increase in COVID Alert Levels from February 15th. In saying that, business confidence remained resilient throughout late August and early September when the August resurgence outbreak hit. A key feature of the February preliminary results was the spike in cost pressures (presumably due to higher international shipping costs), which could result in strong price increases over early 2021.

Consumer sentiment lifted to post-pandemic highs last month and we expect outright levels to hold up and potentially post further gains despite the increase in COVID Alert Levels. Expectations over the economic outlook, the financial position of households and house price expectations (to another record high) are expected to lift. Resilient consumer sentiment should provide key support to consumer spending over 2021.

We expect the February merchandise trade release will show a deficit of \$626m. Both exports and imports are likely to be lower when compared with the same period last year, but we anticipate exports will be proportionately more impacted this month, in a reversal of the usual pandemic trend. We expect imports to be down 5% yoy to \$4.8b, and exports to be 10% below year ago levels. The result means that New Zealand's annual trade balance will narrow for a second month to \$2.7b but remain not too far off historic highs.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia Wage Price Index, Q4, %qoq	25/02	1:30 pm	0.3
Australia Construction Work Done, Q4, %qoq	25/02	1:30 pm	2.5
Australia Capex, Q4, %qoq	25/02	1:30 pm	4.5
RBA Credit Aggregates, January, %mom	26/02	1:30 pm	0.3
US PCE Deflator, January, %yoy	26/02	2:30 am	1.3

* Forecasts and commentary originally published by CBA Global Markets Research Friday 19 February at 2:40 pm

Spare capacity in **Australia's** labour market means that **wages growth** will no doubt be subdued in Q4 20. We are forecasting a 0.3% lift in wages in the quarter which would see the annual rate of wages growth fall to just 1.1%.

We are expecting a 2.5% lift in **Australian construction work** done over Q4 20. A strong lift in residential building approvals points to solid residential construction in the quarter. We are also expecting a small lift in engineering work done because of strong public capex but a flat outcome from non-residential construction.

We expect the fifth estimate of **Australia's 2020/21 capex plans** to print at \$A121bn. This would be an upgrade to plans from the fourth estimate, driven by non-mining investment intentions. We also receive a first estimate of 2021/22 spending plans. We expect the actual volume of capex to lift by 4.5% over Q4 20. Interpreting the results of the survey this time around is a little more complicated than usual as there are also a number of planned changes to the ABS private capital expenditure survey. After conducting experimental estimates of capex spending on Education & Training as well as Health Care & Social Assistance, both will now be included in the main capex survey.

We are forecasting a 0.3% lift in **Australian credit aggregates** in January. Housing credit growth is starting to accelerate as new lending surges. Both personal and business credit growth remain weak.

We expect headline **US PCE deflator** rose 0.2%mom in January, largely because of a lift in gasoline prices over the month. This should hold the annual rate steady at 1.3%yoy. We expect the core PCE deflator was flat over the month, and forecast the annual rate eased to 1.3%yoy. Already-released core CPI data highlighted that the US output gap is continuing to weigh on core inflation pressures.

Key Forecasts

ASB NZ economic forecasts

	Sep-20 << actual	Dec-20 forecast >>	Mar-21	Jun-21	Sep-21	Mar-22	Mar-23
GDP real - Q%	14.0	0.5	0.3	0.2	0.3	0.3	0.8
GDP real - A%	0.4	0.7	2.2	15.1	1.3	0.9	3.2
GDP real - AA%	-2.3	-2.6	-2.0	4.3	4.5	4.2	2.2
NZ House Prices (QV Index) - A%	9.5	11.7	15.5	20.3	18.1	9.5	4.9
CPI - Q%	0.7	0.5	0.6	0.4	0.8	0.3	0.5
CPI - A%	1.4	1.4	1.3	2.1	2.3	2.0	2.0
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 << actual	Mar-21 forecast >>	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
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

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NZD/USD	0.72	0.70	0.70	0.71	0.71	0.71	0.71
NZD/AUD	0.94	0.93	0.92	0.92	0.91	0.91	0.92
NZD/JPY	75	74	74	76	77	77	80
NZD/EUR	0.59	0.57	0.56	0.56	0.55	0.55	0.53
NZD/GBP	0.53	0.52	0.51	0.52	0.52	0.52	0.52
NZD/CNY	4.7	4.6	4.6	4.6	4.5	4.5	4.5
NZD TWI	75.1	73.4	73.0	73.7	73.2	73.0	72.9

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