Economic Weekly

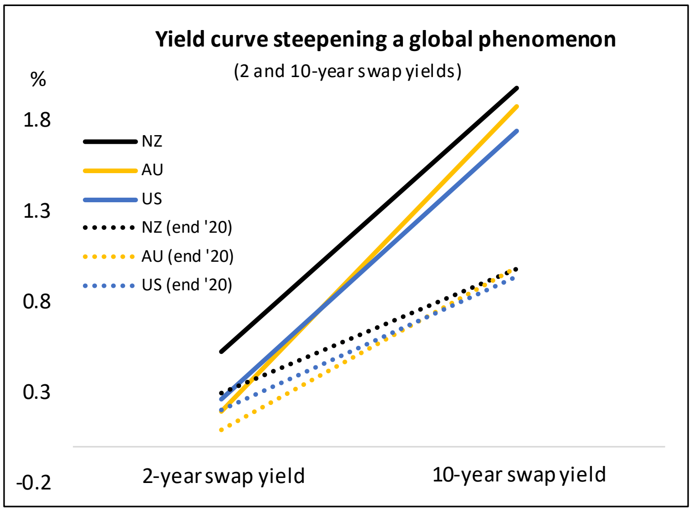
22 March 2021

GDP sidelined as global rates battle royale rages

Last week's GDP figures came and went with little fanfare. Barely a zephyr rippled through financial markets as Stats NZ reported the NZ economy went backwards to the tune of 1% in the fourth quarter of 2020. The currency held all of its recent gains and interest rate markets went on pricing a >50% chance of an RBNZ rate hike in February. Admittedly, there were probably a few on a Thursday go-slow in the wake of Te Rehutai's Wednesday exploits. But still.

It's a sign of the times that such a weak set of data, indeed much weaker than expected, were largely ignored. And yet, it was the correct reaction in our view. There was always going to be some chop as the economy re-set itself following the 14% post-lockdown surge of Q3. And there's every chance we see another negative quarter in Q1 as the closed borders continue to weigh heavily on some sectors. While this would mark another 'technical recession' (awful language we know, particularly for those feeling its effects most acutely), our broader economic and interest rate view hasn't changed. 2021 still looks like a year of flattish consolidation for the economy, with 2022 being "our year".

The more influential news last week was actually offshore. The arm wrestle between markets keen to price higher and steeper yield curves, and central bankers trying to hold them back, stepped up a notch. The global reflation story has been *the* big theme of 2021 and, as the chart shows, is a key driver of the uplift we've seen in NZ wholesale interest rates. Indicative of such, 10-year swap yields closed last week around 10bps *higher*, despite the weaker NZ economic data.



We saw central banks in Australia, the US, and the UK all trot out similar iterations of the tightly clung-to line that interest rates are going nowhere until they are totally convinced inflation and/or employment targets are being met, not just on a forecast basis, but in real-time. This is occurring even as central banks continue to put through chunky economic forecast upgrades, as both the BoE and Fed did last week. Only one side can ultimately win the arm wrestle of course, and our sense is that markets probably have the upper hand. This underpins our forecasts for NZ wholesale yields continuing to rise, on a trend basis.

It's more famine than feast on the economic data front this week. However, we'll be keeping our eyes peeled for government announcements on whether an April Trans-Tasman travel bubble will go ahead, as well as a package of measures designed to address rampant house price inflation. mike.jones@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7147	0.7199	0.7211	0.5752	FLAT/UP	0.7100	0.7440
NZD/AUD	0.9267	0.9288	0.9290	0.9804	FLAT	0.9225	0.9460
NZD/JPY	77.64	78.56	76.22	63.39	FLAT/UP	77.00	79.20
NZD/EUR	0.6016	0.6021	0.5967	0.5357	FLAT	0.5930	0.6130
NZD/GBP	0.5162	0.5169	0.5167	0.4948	FLAT	0.5140	0.5380
TWI	75.0	75.1	74.7	66.97	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 ended last week a shade lower. It was a packed week of data prints and central bank meetings, and we had highlighted the risk that a bit of event-driven churn could be on the cards. Things kicked off with Wednesday morning's GlobalDairyTrade auction, which was closely watched by analysts after a whopping price gain a fortnight ago. Despite that fact, there was relatively little impact on the NZD from the result, with dairy prices softening a bit more than expectations but remaining well north of long-run averages.

Things a got a bit livelier on Thursday morning, with the Federal Reserve meeting being the marquee event for global currency markets. As expected, the Fed held to a dovish line, despite the improving global outlook and rising inflation expectations, with a weaker USD being the result. The NZD/USD was up close to 0.7270 following the news, but the impact gradually unwound over the remainder of the week as the USD regained its ground against most of its peers.

Later on Thursday, NZ's Q4 GDP print showed a larger-than-expected fall, down 1.0% qoq (ASB: -0.1%, mkt: +0.2%). The result means the NZD economy shrunk 0.9% over 2020 – one of the largest dips on record. Whilst the NZ economy has still weathered the pandemic much better than most developed economies, the signs point to a relatively muted growth outlook for 2021 and a double dip recession can't be ruled out. There was virtually no currency impact despite the surprise result, but we'd previously highlighted the likelihood markets would treat the reading with a grain of salt given its backward-looking nature and the level of uncertainty around the data. Still, the NZD generally underperformed its peers as the week drew to a close.

Whilst last week's GDP reading may have been a bit disappointing, broader fundamentals continue to support the NZD, with our trade balance, lofty commodity prices and broader financial market normalisation all playing a role. Indeed, improving NZD fundamentals have lifted the 'fair-value' range implied by our short-term NZD/USD valuation model to 0.7150-0.7550, its highest level since late 2016. This supports our view that NZD/USD dips are likely to hold above 0.7100. Our CBA colleagues expect broader USD weakness to remain in vogue too, though the path is uneven.

Event risk is slightly less of a theme this week. The only local data of note is the latest NZ trade balance, which will have limited market impact given we know the result in advance. US PCE deflator data on Friday night NZT is the most notable international data of note (CBA: +1.6 yoy). nathaniel.keall@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	75.2	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	0.28	0.69	UNCH	UP
2-year swap	0.52	0.55	0.36	0.68	UNCH	UP
5-year swap	1.19	1.25	0.89	0.92	UNCH	UP
10-year swap	1.97	2.01	1.60	1.37	UNCH	UP
10-year govt bond yield	1.82	1.84	1.51	1.47	UNCH	UP
Curve Slope (2s10s swaps)	1.45	1.47	1.24	0.69	UNCH	DOWN

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

Market Recap

NZ swap yields start the week slightly lower for most tenors compared to a week ago. NZ yields generally ground lower last week and fell after the release of the much weaker than expected Q4 NZ GDP report (-1.0% qoq, -0.9% yoy), but this dip proved to be short-lived as it was followed by strong Australian labour market data later that day. Longer-term local yields are about back to week-ago levels after climbing in concert with US counterparts later last week. The $630m of RBNZ asset purchases helped to dampen NZ government bond yields.

Global yields are higher than a week ago with steeper curves. Messages and actions from central banks were dovish, with the RBA Minutes and Bank of England reiterating rate hikes were a long way off and with the Fed 'dot plots' showing no rate hikes till 2024. This had only a fleeting impact on yields, with US 10-year Treasury yields subsequently hitting their highest level since January 2020 (1.75%) after the US Federal Reserve announced it would restore capital requirements for large US banks next month. US Treasury yields eased at the end of last week (10Y 1.72%). The loosening by the BOJ around its 10-year yield target to 25bps from 20bps likely added to upward pressure.

Near-term interest rate outlook

Markets are now pricing in a 0.50% OCR by mid-2022 and a 0.75% OCR by early 2023, which is in line with our OCR view. There are few local events this week that will impact local yields. The path of least resistance is for yields to go up and for yield curves to steepen, given expectations of a post COVID-19 rebound in growth and firming pricing pressures. We don't expect this to be a smooth journey, with scope for volatility. Increasing geopolitical tensions between the US and China could pressure yields lower at the margin. Longer-term yields have moved a long way in a short period of time, with a close to 80bp increase in 10-year US, Australian and NZ yields this year.

We expect the market to have an asymmetric reaction to data surprises, in favour of larger moves for stronger than expected data. UK and US inflation data this week will be closely watched but are likely to remain benign and only modestly dent reflation-based lifts in longer-term yields. The RBNZ has maintained a high pace of asset purchases for its weekly LSAP ($630m vs $450m in the weekly tender) and could help to dampen yields.

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
Merchandise trade balance, February, $m	24/03	10:45am	-	181

We expect the February merchandise trade data will show a monthly surplus of $181m. With logistics disruption continuing to weigh, we expect exports and imports are likely to fall when compared with February 2020. Export activity looks to have been more impacted this month, with imports down 1% yoy to $4.5bn, and exports down 8.5% yoy to $4.3bn. The result means that New Zealand's annual trade balance will continue narrowing from record highs, to $2.4bn.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
UK Employment, January, %mom	23/03	8:00 pm	-
UK CPI, February, %mom	24/03	8:00 pm	-
UK PMI, February, points	24/03	10:30 pm	-
EZ PMIs, March, points	24/03	10:00 pm	-
UK Retail Sales, February, %mom	26/03	8:00 pm	-
US PCE Deflator, February, %mom	27/03	1:30 am	0.2

** Forecasts and commentary originally published by CBA Global Markets Research Friday 19 March at 1:19 pm*

UK labour market conditions remain weak but are in line with the Bank of England's (BoE) projections. The BoE anticipates the UK unemployment rate (5.1% in December) to average 5.5% over Q1 and peak at around 7¾% in the middle of 2021.

The Bank of England projects headline **UK CPI inflation** to remain around 0.6%yoy in January and February, before picking up quite sharply starting in March. That pick-up is mainly the result of the end of the reduction in VAT for certain services and developments in energy prices.

The **composite PMI in the UK** improved to 49.6 in February. The March PMIs will show if the UK economy is showing more signs of steadying.

The **composite Eurozone PMI** showed business activity fell for a fourth successive month in February, driven by the continued slump in the services sector. The March composite PMI will show if the contraction in economic activity is moderating or worsening.

UK retail sales volumes plunged by 8.2%mom in January because of tighter nationwide coronavirus restrictions. The recovery in consumer confidence points to a rebound in retail spending over February.

We expect the **US Personal Consumption and Expenditure (PCE) deflator rose** 0.2%mom and 1.6%yoy. Higher gasoline prices will have supported the headline index, similar to the already-released February CPI data. We forecast the core PCE Deflator was flat over February. Excess capacity in the labour market is a constraint on core inflation. Nevertheless, the combination of base effects and the disbursement of $US1,400 cheques to many Americans suggests that PCE inflation can jump around the middle of the year.

ASB

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	0.0	0.4	0.4	0.2	0.3	0.8
GDP real - A%	-0.9	0.3	13.2	-0.1	1.0	1.3	3.2
GDP real - AA%	-3.0	-2.9	2.9	2.8	3.3	3.6	2.3
NZ House Prices (QV Index) - A%	14.9	16.8	21.7	19.8	14.4	10.5	5.6
CPI - Q%	0.5	1.0	0.5	0.7	0.3	0.5	0.6
CPI - A%	1.4	1.6	2.6	2.7	2.5	2.1	2.3
HLFS employment growth - Q%	0.6	0.3	0.4	0.4	0.2	0.4	0.5
HLFS employment growth - A%	0.7	-0.1	0.6	1.7	1.3	1.4	1.8
Unemployment rate - %sa	4.9	5.1	5.0	5.1	5.3	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	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	0.30	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	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	75.2	75.4	75.5	75.5	74.6

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets