Economic Weekly

23 August 2021

Delta game changer

About a week after the Government's indication of how it plans to ease open the border, and on the eve of the RBNZ's pivotal monetary policy announcement, the game abruptly changed. COVID is no respecter of the best-laid plans of mice and humans. So here we are, back into the strictest lockdown settings that we have not needed since the initial outbreak. It will be tough for many, but we have learnt crucial lessons from Australia about the pitfalls of dallying. NSW's chances of eliminating its outbreak are vanishing quickly and it is in a drag race to get people vaccinated to contain growing pressure on its health system. Our L4 looks likely to be extended at today's announcement.

The economic impact of this lockdown depends heavily on how long the stricter L4 and L3 conditions remain in place. Our estimates are that during a nationwide L4 lockdown we forego activity worth around 0.5-0.6% of annual GDP ($1.9 billion) per week. Each week of Auckland at L4 and the rest of the country at L3 would be around 0.3% per week. And Auckland at L3 and the rest of the country at L2 quickly drops the loss to 0.1% per week. But a chunk of that foregone activity does get made up for afterwards. What we have learnt from the Auckland-centric lockdowns in August/September last year and February/March this year is that relatively short lockdowns only have modest long-term effects. There is a lot of pent-up activity that gets made up for afterwards, though the longer the strict conditions are in place, the less catch-up there will be of some activities.

At this stage, higher interest rates look *temporarily* on hold. The RBNZ last week seemed very gung-ho about still seeing a clear need to lift interest rates and is increasingly worried about the heights that house prices have scaled. The Governor himself has said that central banks need to start taking a long-term view of assuming that COVID will be endemic globally and some form of people restrictions and bouts of 'severe disruption' will happen from time to time.

With that in mind, **our drawn-in-the-sand assumption is that the RBNZ will lift the OCR in October, November and February to 1%, then more slowly lift it to 1.5% by end-2022**. Our warning is that lines in the sand get washed away daily by the tide. If L4 lockdown conditions go on longer than a couple of weeks the chances of the RBNZ starting a bit slower will increase. Borrowers and depositors alike should, for the time being at least, consider that interest rates are still likely to rise over time. But in reality, until the lockdown is over the timing and eventual magnitude of overall OCR increases will be up in the air.

Meanwhile, we have let one get past the goalie again and still seem to have room for improving border processes. And if L4 will be the delta go-to option even with high levels of vaccination, we should be constantly learning and evolving its processes and execution. Minimising the likelihood of L4 and impacts of L4 has huge benefits to all.

For those of you uncertain of what support you can get from ASB and the Government please read our resources here. Beyond that, it is important to know that sourdough bread is out, scones are apparently in – which sounds a lot less troublesome. Just don't be 'that guy' at the supermarket with a trolley filled with flour bags. Take care everyone.
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Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6819	0.7028	0.6972	0.6540	DOWN	0.6805	0.7070
NZD/AUD	0.9576	0.9570	0.9456	0.9080	FLAT	0.9420	0.9600
NZD/JPY	74.86	76.91	76.87	69.07	FLAT/DOWN	74.00	78.00
NZD/EUR	0.5830	0.5958	0.5923	0.5506	FLAT/DOWN	0.5800	0.6000
NZD/GBP	0.5004	0.5071	0.5066	0.4939	FLAT/DOWN	0.4985	0.5090
TWI	73.2	74.5	73.9	70.67	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/USD fell about 3% last week, to 9-month lows just above 0.6800.

Clearly, the COVID outbreak discovered early in the week and consequent lockdown and postponement of the RBNZ's OCR increase were the main reason for the kiwi's weakness. But a generalised firming in the USD added weight, with all the major FX pairs losing ground last week. Interestingly, the AUD actually underperformed the NZD over the week, with investors evidently deducing the still-worsening Australian COVID outbreak bodes even worse for the Aussie economic outlook than in NZ.

The RBNZ's 'hawkish hold' will be supporting NZD/AUD, and slowing the NZD/USD's descent. The RBNZ's forecasts and commentary were hawkish. And, in various post MPS communications, RBNZ Governor Orr has made it clear OCR increases are still being planned for later in the year, and at this stage could go ahead "even with Delta".

Clearly, the Bank wants to keep some traction over the interest rate curve, and remind markets COVID is not the only game in town when it comes to OCR expectations. Markets are not entirely convinced, and have reduced OCR pricing to just 33bps by year end (c.f 50bps forecast by ASB Economics).

This arm wrestle between the RBNZ's hawkish line and markets more focused on short-term COVID dynamics will go a long way toward setting NZD sentiment this week. We suspect current pricing already incorporates an expectation the current Level 4 lockdown will be extended, but we still see short-term downside for NZD/USD. This is particularly so given our CBA colleagues' expectation USD strength will continue as the spreading delta variant re-awakens global growth fears. Initial NZD/USD support at 0.6805 looks set to be tested.

Event risk wise, this week's local economic data will be ignored as markets continue to key off COVID headlines, with today's 4pm announcement the next in line. Offshore, the key event is Fed Chair Powell's address to the Jackson Hole symposium on Friday night. Everyone wants to know when the Fed will taper. Our expectation is October/November.

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ASB foreign exchange forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.70	0.70	0.69	0.67	0.68	0.69	0.72	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.94	0.92	0.92	0.92
NZD/JPY	77	77	78	76	79	81	85	85
NZD/EUR	0.60	0.59	0.59	0.59	0.61	0.61	0.60	0.55
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.51	0.51	0.51
NZD/CNY	4.6	4.5	4.5	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.9	73.7	73.2	71.3	72.8	73.0	74.4	73.8

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	0.39	0.67	0.46	0.27	UNCH	UP
2-year swap	1.17	1.37	1.05	0.09	UNCH	UP
5-year swap	1.56	1.70	1.44	0.14	UNCH	UP
10-year swap	1.86	2.00	1.79	0.51	UNCH	UP
10-year govt bond yield	1.60	1.72	1.52	0.62	UNCH	UP
Curve Slope (2s10s swaps)	0.69	0.63	0.74	0.42	UNCH	DOWN

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

Market recap

NZ yields slumped after a community case of COVID-19 was reported on Tuesday August 17, which saw NZ move to Alert Level 4 that night. Largely as a result of the NZ lockdown, the RBNZ held the OCR at 0.25% (a 25bp hike had been fully priced in by markets prior to the delta variant news), but the statement was hawkish, with the published OCR track flagging at least a 25bp hike for 2021 and a 2.14% endpoint. Post-MPS comments from Governor Orr were also hawkish (every meeting was "live" even if the outbreak persists), but NZ yields have subsequently ground lower on concerns over the worsening NZ delta variant outbreak. These fears were verified with the outbreak spreading geographically and with the NZ Government announcing on Friday that NZ will remain at Alert Level 4 till at least midnight tomorrow, with Auckland highly likely to remain in lockdown for a longer period.

US Treasury yields were little changed last week. The Minutes of the July FOMC Meeting signalled a pending taper of the USD120bn in monthly asset purchases this year, but yields have been dampened by concerns over the growth outlook. Climbing cases of the delta variant across the Tasman further weighed Australian yields with 10-year government bond yields (currently 1.08%) approaching 2021 lows.

Near-term interest rate outlook

Market pricing has been pared back significantly in light of the delta variant outbreak with 12bps of hikes for October, 35bps by November and with a terminal OCR of roughly 1.60%. Despite every OCR decision being 'live', the course of the delta variant outbreak will have a bearing on the course of NZ short-term yields, with scope for considerable volatility. News on the delta variant outbreak rather than (more lagging) NZ data will be of more relevance over the next few weeks.

Our bias is for longer-term global yields to move higher as markets 'look through' COVID-19 impacts and increasingly focus on improving prospects, although uncertainty is pronounced given the delta variant. It could well be that the dampening impact of the pandemic on global yields could have further to run. US Federal Reserve Chair Powell will speak at Jackson Hole this week and may provide more hints on when the FOMC will announce a taper of its asset purchase programme. Our CBA colleagues expect the FOMC to announce a taper in September, for implementation in October/November. US Private Consumption Expenditure inflation is expected to show monthly moderation, capping yields. Australian data should show reasonable momentum for Q2 (we have pencilled in a 0.7% qoq increase for Q2 GDP), but markets are likely to largely look through this. There is a clear risk that the RBA reverses its decision to taper bond purchases in September and stay the course at AUD5bn per week.

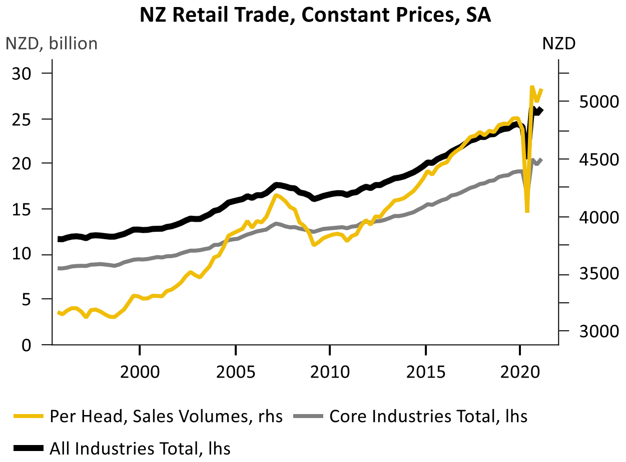
Medium-term outlook

We have pencilled in 25bp hikes in each of the next three OCR decisions (October, November and February) taking the OCR back to pre-pandemic levels, with the OCR ending 2022 at 1.50%. Uncertainty is pronounced, and the economy (and OCR settings) could follow a number of different paths. Our CBA colleagues expect RBA cash rate hikes from May 2023, with a 1.25% endpoint. The US FOMC is expected to taper monthly asset purchases from October/November, with the Fed Funds rate to move up from March 2023 (1.50% in 2024). Longer-term yields are expected to remain capped at low levels, with the yield curve flatter given larger rises in shorter-term yields. mark.smith4@asb.co.nz

Domestic Events

Data	Date	Time (NZT)	Market	ASB
Retail Trade Survey, Volumes, Q2, % qoq	24/08	10:45 am	2.0	2.0

Another strong quarter is expected for retail sales, with the consumer firmly in the driving seat of the domestic expansion. Core, retail and total electronic card spending expanded by 4.5%-5.5% in Q2, with the surge in tourism arrivals following the opening of the trans-Tasman bubble clearly supportive. Vehicle registrations have continued to advance at a strong quarterly clip. However, rising consumer prices (the Q2 CPI surged 1.3% qoq, 3.3% yoy), and further frictions with global supply chains could weigh on the contribution of the retail sector to GDP. The move to Alert Level 4 from August 18 will dent Q3 retail sales, but providing the lockdown is short-lived we anticipate a strong bounce-back in consumer spending towards the end of the year given pent-up demand, fiscal policy support, the tight labour market, solid household income growth and strong household balance sheets.



Source: Macrobond, ASB

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU Construction Work Done, Q2, %qoq	25/08	1:30 pm	2.5
AU CAPEX, Q2, %qoq	26/08	1:30 pm	2.5
AU Retail Trade, July, %mom	27/08	1:30 pm	-2.0
US PCE Deflator, July, %mom	28/08	12:30 am	0.4
Fed Chair Powell's speech at Jackson Hole Policy Retreat	28/08	-	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 20 August at 2:15pm*

We expect a small rise in Australian construction work done in Q2 2021 of 2.5%. We expect a rise in all components - residential building, non-residential building and engineering construction. Residential construction is being supported by the HomeBuilder program and strong renovation activity. Infrastructure investment will add to engineering work done.

We expect the Australian volume of capex in Q2 2021 to lift by 2.5%, driven by both gains in other buildings & structures and machinery, plant & equipment. The other key figure to watch is the third estimate of 2021/22. We expect this to print at $A128bn. This would lower the implied lift in investment in 2021/22 to ~10% on 2020/21 levels, down from 15% currently. We expect non-mining investment to wear the downgrade.

We expect Australian retail trade to fall 2.0% in July. This captures the extended lockdown in Greater Sydney and rolling lockdowns in Vic, QLD and SA. We will see further falls in coming months and we expect services spend to be hit more heavily than goods. This is a trend we have seen in the CBA weekly credit & debit card spend. This is the first month in which no preliminary retail sales data will be released. Instead, the ABS has made changes in delivery of this data. In this release we will receive national, state and industry retail trade. A further breakdown will be received on 3 September.

We expect the monthly pace of US price growth moderated in July, in line with the already-released CPI data. We are seeing signs that price pressures are peaking in some of the industries impacted by strong re-opening demand (e.g., used cars and airfares). Nevertheless, high gasoline prices will have contributed to the rise in the headline Private Consumption Expenditure deflator.

Federal Reserve Chair Powell's Jackson Hole speech (day and time tbc) is the major risk event this week. Chair Powell may provide more hints on when the FOMC will announce a taper of its asset purchase programme. We suspect Powell will provide more clarity than the FOMC Minutes because his speech will be shaped by recent (strong) labour market data. Our base case is that the FOMC will announce a taper in September, for implementation in October or November.

Key Forecasts

ASB NZ economic forecasts	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	1.6	0.8	-0.9	1.7	-0.6	1.4	0.6	0.6
GDP real - A%	2.4	15.8	0.5	3.2	0.9	1.5	3.5	2.7
GDP real - AA%	-2.3	4.1	4.1	5.2	4.8	1.5	2.7	2.6
NZ House Prices (QV Index) - A%	22.0	28.2	26.9	20.9	12.3	6.3	2.6	6.8
CPI - Q%	0.8	1.3	1.4	0.4	0.7	0.6	0.5	0.5
CPI - A%	1.5	3.3	4.1	4.1	3.9	3.2	2.4	2.3
HLFS employment growth - Q%	0.6	1.1	0.0	0.3	0.3	0.4	0.3	0.3
HLFS employment growth - A%	0.3	1.7	2.4	2.0	1.8	1.1	1.1	1.2
Unemployment rate - %sa	4.6	4.0	4.0	4.0	3.8	3.7	3.8	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)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.25	0.75	1.00	1.25	1.50	1.50
NZ 90-day bank bill	0.35	0.35	0.50	1.00	1.25	1.50	1.75	1.75
NZ 2-year swap rate	0.47	0.78	1.35	1.50	1.60	1.70	1.95	2.15
NZ 5-year swap rate	1.12	1.36	1.75	1.85	1.95	2.05	2.20	2.40
NZ 10-year swap rate	1.96	1.88	2.00	2.05	2.10	2.15	2.30	2.50
NZ 10-year Bond	1.78	1.77	1.90	1.95	2.00	2.05	2.20	2.40

ASB foreign exchange forecasts (end of quarter)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZD/USD	0.70	0.70	0.69	0.67	0.68	0.69	0.72	0.72
NZD/AUD	0.92	0.93	0.93	0.92	0.94	0.92	0.92	0.92
NZD/JPY	77	77	78	76	79	81	85	85
NZD/EUR	0.60	0.59	0.59	0.59	0.61	0.61	0.60	0.55
NZD/GBP	0.51	0.51	0.51	0.50	0.50	0.51	0.51	0.51
NZD/CNY	4.6	4.5	4.5	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.9	73.7	73.2	71.3	72.8	73.0	74.4	73.8

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