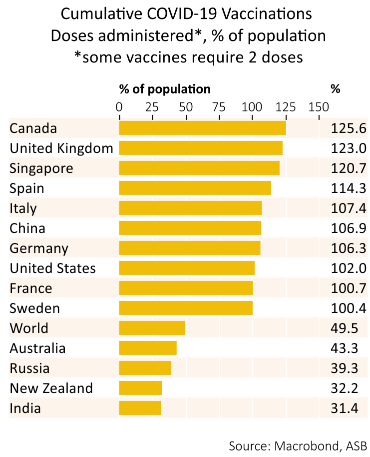
Economic Weekly

26 July 2021

Watching the tallies



This week the NZ data calendar is a little light, with less likelihood of the recent string of market-jolting events that have made an imminent Official Cash Rate increase look almost certain. Much of the week will be spent watching the Olympic medal tally – and the COVID case tally across the Tasman for signs the current Delta strain outbreak is coming under control.

That outbreak has put the trans-Tasman bubble on hold for at least 8 weeks. NSW is grappling to get on top of its outbreak and is still experiencing large numbers of community cases. The situation is more encouraging in other states that have recent experienced COVID cases, such as Victoria and Queensland, with the former set to ease some restrictions.

It is all a warning to NZ of the changed risk dynamics of the more infectious Delta variant. With still-small percentages of the population fully vaccinated, both Australia and NZ are very vulnerable to outbreaks and need to rely on swift lockdowns to contain outbreaks.

Domestic events are relatively light this week, with just the ANZ business and consumer confidence surveys on Thursday and Friday, respectively. The business confidence survey is the final read for July. It will still get an eye cast over it, given the preliminary ANZ read and the NZIER survey showed added inflation pressures are coming through dramatically. Still, any market implications will be dampened by the fact that expectations for future OCR increases have already been brought forward very sharply.

In Australia, their CPI will be dissected for signs of rising inflation pressures. There are many similarities between Australia and NZ, with supply-chain cost pressures and growing labour shortages. The immediate monetary policy implications aren't so strong as in NZ, however, as the Reserve Bank of Australia will be a lot more cautious about the state of the Australian economy once the current outbreak is finally contained.

The US Federal Reserve is meeting later this week. We don't expect any shifts in interest rates or asset purchases at this point. But it'll be worth a watch in case there are some tweaks to the guidance around how long future asset purchases will continue: we think the Fed will start reducing the pace of asset purchases before the end of the year.

After last week's soft dairy auction, we have tweaked our 2021/22 farmgate milk price forecast down a touch to $7.90/kg milk solids. Of late GDT auction prices have pulled back slightly faster than we had anticipated. Still, something near $8/kg would be a great outcome. And meat prices have been surging as COVID restrictions have eased in the UK and EU. Let's hope that encouraging trend can continue. nick.tuffley@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6979	0.6993	0.7069	0.6623	FLAT	0.6915	0.7100
NZD/AUD	0.9474	0.9467	0.9312	0.9347	FLAT	0.9390	0.9500
NZD/JPY	77.16	76.87	78.37	70.48	FLAT	76.00	78.00
NZD/EUR	0.5929	0.5923	0.5921	0.5709	FLAT	0.5750	0.6000
NZD/GBP	0.5073	0.5083	0.5077	0.5202	FLAT	0.4950	0.5150
TWI	74.3	74.0	74.1	72.55	FLAT	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

'Twas a week of two halves for the NZ dollar. Through the early part of last week, a sapping in investors' risk appetite, ostensibly driven by concerns about the global spread of the Delta variant, saw the NZD/USD pushed down to an 8-month low a shade below 0.6900.

But it wasn't long before investors once again 'bought the dip'. Despite the ongoing risks from COVID, economic data released last week, particularly Friday's PMIs, provided a timely reminder that the global economy remains in a boom phase. Indeed, our view is that the unwelcome spread of the Delta variant is more likely to temper the global recovery than upend it. NZD/USD subsequently rallied back to around 0.7000 and NZD/AUD made a 7-month high around 0.9475.

The kiwi dollar continues to track an awkward middle ground between domestic fundamentals that suggest the currency should be significantly higher, and the more immediate headwinds from the strong USD/weak AUD double-act. In the short term we suspect the latter will continue to win out, meaning the NZD/USD will continue to face resistance on rallies into the 0.7000-0.7050 window.

By contrast, with the Australian COVID situation worsening, the way is clear for further NZD/AUD upside. According to our short-term valuation model, the cross can sustain a push into the 0.9500s without becoming "expensive" on the basis of fundamentals such as widening NZ-AU interest rate differentials.

There's big event risk for NZD/USD this week in the form of the US Federal Open Market Committee policy announcement on Thursday morning. It's all about the Fed's posturing about tapering. Our friends at CBA expect the Fed to alter its language to allow a taper in September/October of this year (while keeping all policy measures unchanged for now). Such an outcome would likely further embolden the USD. Other global event risk of import to FX markets will be the first estimate of Q2 US GDP (Friday morning), and Aussie CPI on Wednesday. In NZ, the final reading of July ANZ business confidence will be of passing interest only. mike.jones@asb.co.nz

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	0.46	0.47	0.33	0.30	UNCH	UP
2-year swap	1.05	1.06	0.77	0.22	UNCH	UP
5-year swap	1.44	1.46	1.38	0.33	UNCH	UP
10-year swap	1.79	1.81	1.92	0.69	UNCH	UP
10-year govt bond yield	1.67	1.62	1.81	0.83	UNCH	UP
Curve Slope (2s10s swaps)	0.74	0.75	1.15	0.47	UNCH	DOWN

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

Market recap

With few domestic catalysts, last week saw less frenetic movements in local yields, which initially dipped but then firmed in line with global yields to currently sit around 5bps lower than their post Q2 NZ CPI spike. Early last week, US 10-year Treasury yields touched 5-month lows (1.13%) on increased investor caution over the Delta variant and worries over the growth outlook, but ended the week higher at 1.28% on improving risk sentiment. The worsening Delta variant COVID-19 outbreak in Australia and attendant tightening in restrictions has dampened Australian yields, with our CBA colleagues now seeing the risk that the RBA Board holds off with QE tapering from September. The dataflow has tended to be more nuanced, with markets becoming more wary of signs of slowing growth momentum. European yields dipped after the European Central Bank (ECB) revamped its monetary policy framework to reflect its new symmetric 2% inflation target, pledging not to tighten policy prematurely. Last week marked the winding up of the RBNZ Large Scale Asset Purchase programme, with total RBNZ purchases of central government and LGFA bonds topping out at just under NZ55bn, well short and much earlier than the NZ100bn mid-2022 cap earlier signalled.

Near-term interest rate outlook

Market pricing has an August hike about 70% priced in, with slightly more than 45bps of hikes by November and around 75bps priced in by mid-2022. This looks a tad light given our OCR view, but reasonable given global risks. Next Wednesday's Q2 NZ labour market report and the RBNZ survey of expectations (August 12) are key local data prints prior to the August 18th MPS decision, with both likely to see NZ yields edge further above global counterparts. Before then, NZ yields will likely continue to take direction from offshore. Stronger than expected CPI prints from Australia (CBA/mkt: 0.7% qoq, 3.7% yoy), Canada (mkt: 1.9% yoy), the Eurozone (mkt: 0.7% yoy) and an elevated reading for US core PCE inflation (mkt: 3.7% yoy) could rekindle reflation trade embers. However, with 60% of Australia's population in some form of COVID-19 lockdown and with the Delta variant proving tricky to contain globally, we don't expect yields to jump higher and curves to steepen. Thursday's US Federal Open Market Committee decision looms and our CBA colleagues expect the Fed Funds rate and asset purchases to be left unchanged. We suspect preparations behind the scenes for policy tapering in the coming months, but for the Fed to remain cautious, reiterating that rate hikes remain a long way off.

Medium-term outlook

We now expect the RBNZ to raise the OCR by 25bps in August 2021 (to 0.50%), which will be followed by 25bp hikes in November (0.75%) and February 2022 (1.00%). We then expect a further 50bps of hikes, with the OCR peaking at 1.50% by mid-2023. The risk is the RBNZ hikes more quickly and by more. Our CBA colleagues expect that the RBA will hike the cash rate in November 2022 (peaking at 1.25% in late 2023) but acknowledge the risks of a later start. The US FOMC is expected to start increasing the Fed Funds rate in March 2023 (1.50% in 2024). Longer-term yields are expected to remain capped at historically-low levels. mark.smith4@asb.co.nz

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia CPI, Q2, %qoq	28/07	1:30 pm	0.7
Australia Terms of Trade, Q2, Import Prices, %qoq	29/07	1:30 pm	2.5
Australia Private Sector Credit, June, %mom	30/07	1:30 pm	0.3
US Fed Interest Rate Announcement, %	29/07	6:00 am	unch
US GDP, Q2, saar	29/07	12:30 am	8.0
Eurozone CPI, July, %yoy	30/07	9:00 pm	-
Eurozone GDP, Q2, %qoq	30/07	9:00 pm	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 23 July at 12:16pm*

The focus in **Australia** is now firmly on the unfolding COVID-19 situation. Nonetheless the **Q2 CPI** figures will be worth watching as they will give us an idea of what inflationary pressures may have been brewing in the lead up to the latest lockdowns. This is important when assessing the outlook for inflation in 2022. Our forecast is for the headline CPI to increase by 0.7% in Q2 21 which would see the annual rate spike to 3.8% (recall that the Q2 20 CPI fell by 1.9% in large part because of free childcare). The trimmed mean will rise by 0.5% which will push the annual rate up a touch to 1.6%.

Changes in the prices of goods exports and imports give a good indication of how the **Terms of Trade** have tracked in the quarter. **Australian** commodity prices have lifted strongly in Q2 21, boosting export prices. We expect a 9.5% lift in goods export prices in the quarter and are forecasting a 2.5% rise in import prices. Strong demand for goods and some supply disruptions are adding to tradeables prices.

We expect a 0.3% lift in **Australian credit** in June. The May figures showed that overall credit growth remained soft. But looking beneath the surface housing credit growth is accelerating for both owner-occupiers and investors. Business credit has barely moved over the past year as healthy balance sheets meant that businesses were able to fund investment internally. Ongoing lockdowns, in particular the currently lengthy lockdown in Greater Sydney, will dampen business investment and consumer spending in the near term. As a result, we expect business and personal growth to remain soft in the coming months.

We expect the US Federal Reserve to leave the Fed Funds rate and asset purchases unchanged. However, we expect the central bank will change its guidance on the outlook for asset purchases. We expect the Fed to drop the word “substantial” and instead note that asset purchases will continue until “further progress” has been made towards the committee’s goals. Removing “substantial” would provide a clear signal that the bank believes it will soon be appropriate to taper asset purchases. We expect the Fed will announce a taper in September with effect in October. However, the pick-up in COVID infections in the US raises the risk that the central bank is more cautious.

We estimate **US** economic momentum accelerated in Q2 21 with a strong 8.0% seasonally-adjusted annual rate (saar) expansion. Once again, consumption will have been a major driver of **GDP growth** in Q2. Nevertheless, we expect production capacity constraints were a headwind to GDP growth over the quarter.

Headline **Eurozone CPI** printed at 1.9%yoy in June. The European Central Bank (ECB) projects inflation to average 1.9% in 2021 and peak at 2.6% in the fourth quarter of the year. According to the ECB, the hump in headline inflation in 2021 reflects upward effects on inflation from temporary factors such as the reversal of the German VAT rate cut, the rebound in the energy inflation rate, and an increase in input costs related to supply disruptions.

Real **Eurozone GDP** declined by 0.3% over Q1 to be 5.1% below its level in Q4 2019. Real GDP is expected to rebound in Q2 driven by private consumption. The ECB projects real GDP growth of 1.4% over Q2 and 4.6% for 2021 as a whole.

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	0.6	0.3	0.1	-0.7	1.7	0.4	0.6
GDP real - A%	2.4	15.5	1.6	2.7	0.3	1.3	3.8	2.5
GDP real - AA%	-2.3	4.0	4.3	5.2	4.7	1.5	2.5	2.5
NZ House Prices (QV Index) - A%	17.4	21.6	18.8	14.6	10.1	7.0	2.3	5.3
CPI - Q%	0.8	1.3	1.3	0.5	0.6	0.5	0.4	0.5
CPI - A%	1.5	3.3	4.0	4.0	3.8	3.0	2.1	2.3
HLFS employment growth - Q%	0.5	0.6	0.3	0.3	0.3	0.5	0.4	0.4
HLFS employment growth - A%	0.3	1.1	2.1	1.8	1.6	1.5	1.8	1.5
Unemployment rate - %sa	4.7	4.5	4.4	4.3	4.1	3.9	3.9	3.9

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	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.50	0.75	1.00	1.00	1.25	1.50
NZ 90-day bank bill	0.35	0.35	0.65	0.90	1.00	1.15	1.50	1.75
NZ 2-year swap rate	0.47	0.78	1.10	1.20	1.30	1.40	1.65	1.85
NZ 5-year swap rate	1.12	1.36	1.55	1.65	1.75	1.85	2.00	2.20
NZ 10-year swap rate	1.96	1.88	1.90	1.95	2.00	2.05	2.20	2.40
NZ 10-year Bond	1.78	1.77	1.80	1.85	1.90	1.95	2.10	2.30

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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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