Economic Weekly

26 October 2021

I see Red, I see Red, I see Red…in early December?

The much-awaited roadmap out of the current Alert Levels arrived on Friday with the traffic light system to regulate future restrictions. In the interim, the path to more freedom means 90% of 12+ year-olds being fully vaccinated before there will be a shift to the new system.

The paths differ for within Auckland and beyond. Auckland, with its hard border in place for now, can move to 'Red Alert' once all three of the region's DHBs have reached 90% full vaccination rates. Currently, the most lagging DHB had a first and second jab rate of 88% and 73%, respectively. Our rough estimate suggests the second dose target could be hit in the first week of December – bringing more freedom, assuming hospitals aren't overloaded at that point.

The rest of the country will get to move to 'Orange Alert' once all other DHBs have hit the 90% target, with the potential for the South Island to move earlier – if all its DHBs hit the 90% target before the North Island and it remains free of community transmission. Outside of Auckland, some DHB regions in both Islands have second jab rates in the low 60% mark. That suggests the transition – and full easing of regional borders – could be later than early December. It also leaves the question of what to do if some regions don't hit the target in some reasonable timeframe. Cabinet will review progress on November 29.

The system brought a clearer stance on vaccination: no jab no fun i.e. no access to many venues or services. It sounds like the Government is working on enabling employers to impose vaccine requirements on staff, which would make sense to do so. There is little point limiting entry access to vaccinated customers only for them to be served by unvaccinated staff. As it is, employers face thorny challenges around Health and Safety requirements for their staff and privacy issues. Having the Government sort that out through clear laws will save a lot of time and money for employers, particularly SMEs that don't have the deep pockets for Health & Safety consultants and lawyers.

What does this mean for the economy? Unfortunately for Auckland businesses (and those in other areas affected by restrictions), it means roughly another 5 weeks of some form of Level 3 restrictions: over 15 weeks in total of heavy restrictions. That's a long time to keep dragging a picnic blanket around like Linus to seek some comfort. The Government has doubled the Resurgence Support Payments for businesses. But the Government should keep plugged into on-the-ground business associations and be prepared to bolster that support. Most of us are making some form of sacrifice at the moment. But it is the owners of many Auckland SMEs, hospitality and entertain venues that are facing huge financial and mental strain. And soberingly, lockdown conditions could be running up close to Christmas, delivering a significant dent in what is typically a seasonal highpoint in revenues. The country owes it to these businesses to be compensated for the sacrifice they are making – through no fault of their own – to buy time for the last few to get vaccinated. nick.tuffley@asb.co.nz

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Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7162	0.7124	0.7069	0.6660	FLAT/UP	0.6855	0.7300
NZD/AUD	0.9563	0.9559	0.9682	0.9366	FLAT	0.9420	0.9700
NZD/JPY	81.45	81.29	78.07	69.74	UP	79.00	82.00
NZD/EUR	0.6168	0.6116	0.6022	0.5645	FLAT/DOWN	0.6000	0.6200
NZD/GBP	0.5203	0.5175	0.5150	0.5097	FLAT	0.5000	0.5300
TWI	76.0	75.4	75.0	71.44	FLAT/UP	N/A	N/A

*^ Weekly support and resistance levels * Current as at 11.30am today; week ago as at Monday 5pm*

NZD Recap and Outlook

The NZD topped the currency performance rankings last week, for the second week running. The NZD/USD rose to a 4-month high of 0.7200, NZD/GBP hit a 5-month high of 0.5200, while NZD/EUR and NZD/JPY both hit 4-year highs of 0.6190 and 82.20, respectively.

The global backdrop has flipped back to being much more favourable for commodity currencies like the NZD. Stagflation fears have been (rightly) put aside, as solid global activity data and surging inflation expectations have reflated the reflation trade. US equity indices have climbed back to all-time highs, and commodity prices have resumed their uptrend. The VIX index, a risk aversion indicator which historically has a close (inverse) correlation to the NZD/USD, hit a fresh post-COVID low last week.

While this firming in sentiment has seen the USD lose ground against all the major FX pairs, the NZD has risen by more than most thanks to supportive domestic fundamentals. Interest rate differentials widened out to the highest level since 2016 last week as RBNZ cash rate expectations ramped up even further. And NZ commodity export prices continue to creep higher in the background, with this morning's Fonterra Milk Price forecast upgrade (to a record high $8.40/kg at the midpoint) the latest evidence of such and following our forecast revision to $8.75/kg.

We can't forecast the week-to-week swings in global risk sentiment. But solid domestic fundamentals – record high commodity prices and higher interest rates – are expected to stick around, or strengthen further. This solidifies our constructive NZD view. We suspect NZD/USD dips below 0.7000 will be short-lived in the near term. Technical indicators point to the need for a period of consolidation after this month's rapid gains. But the broader risk is still that the uptrend extends further.

mike.jones@asb.co.nz

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.50	0.50	0.25	0.25	UNCH	UP
90-day bank bill	0.74	0.76	0.62	0.27	UNCH	UP
2-year swap	1.99	1.96	1.46	0.01	UNCH	UP
5-year swap	2.38	2.30	1.85	0.13	UNCH	UP
10-year swap	2.56	2.50	2.20	0.54	UNCH	UP
10-year govt bond yield	2.49	2.33	1.93	0.61	UNCH	UP
Curve Slope (2s10s swaps)	0.60	0.55	0.74	0.53	UNCH	DOWN

** Current as at 11.30am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market recap

The sizeable upward lift to NZ yields following the stronger than expected CPI data have largely stuck, notwithstanding a modest post CPI dip in short-term yields. Friday's announcement of the new COVID-19 roadmap spurred an end of week increase in NZ yields, despite record number of new NZ community cases NZ t**wo-year swap yields ended last week (1.99%) after peaking as high as 2.00% on Tuesday.** Swap yields further across the curve ended the week close to post-pandemic highs, with NZ 10-year Government bond yields (around 2.50%) about 10bps higher over the week.

Global yields pushed higher for much of last week, supported by improved risk sentiment and heightened concerns over inflation, but eased at the start of this week. US 2-year Treasury yields peaked at 0.46% last week (currently 0.43%), a fresh post-pandemic high, with US10-year Treasury yields (currently 1.63%) briefly topping 1.70%**.** Helped by the red-hot housing market, Australian yields have continued to head upwards, with the RBA forced to buy AUD1bn of 2024 securities to defend its 0.1% target. Ten-year Australian government bond yields rose to 1.79%. Canadian and UK yields posted gains on expectations of looming central bank tightening.

Near-term interest rate outlook

Market pricing has 30bps of hikes in November (0.81%), with roughly 60bps of hikes till February (1.1%) and 170bps of hikes till late 2022 (2.20%). This is a shade higher than our new OCR call of a further 150bps of hikes and a late 2022 OCR endpoint of 2.0%. Local markets are expected to remain selective to local data, with little reaction to local data this week (including NZ October business and consumer sentiment).

We **are wary that global inflation could turn out to be persistently higher than earlier assumed, pushing global yields higher and bringing central bank rate hike pricing forward.** US core PCE (mkt: 3.7% yoy) and Australian CPI (mkt/CBA: +0.8% qoq, 3.1% yoy) data releases could be triggers.

Our bias is for global yields to move higher as markets increasingly focus on improving prospects, narrowing spreads with (higher) NZ yields. Q3 GDP figures for the US, Eurozone and Canada should show solid enough growth. Interest rate hikes are not expected from the BOJ, BOC and ECB this week, the likely taper by the BOC should continue to pressure yields higher. There are also downside risks on the horizon – US fiscal policy gridlock, wobbly equities, and risks of financial contagion – that could drive a period of increased volatility and risk aversion.

Medium-term outlook

We have pencilled in a steady sequence of 25bp hikes, with the OCR hitting 1.50% by May 2022. We then expect 25bp hikes in August and November 2022 and a 2.0% OCR peak. Uncertainty is high and the OCR 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 implement tapering asset purchases from December 2021 (ending by July 2022), with rate hikes from late 2022 (1.50% by late 2023). Longer-term yields are expected to drift up and for the yield curve to remain flat, although risks are tilting to a more pronounced lift. mark.smith4@asb.co.nz

Major Domestic Events for the week ahead

Data	Date	Time (NZT)	ASB
ANZ Business Outlook Survey, October	27/10	1:00 pm	-
ANZ Consumer Confidence Survey, October	29/10	1:00 pm	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 22nd October*

ANZ released the preliminary **Business Outlook** survey results earlier this month, which showed a large and unexpected increase in own activity expectations – the most reliable indicator in the survey. Some of this increase can be explained by usual seasonal patterns, nonetheless a modest seasonally-adjusted lift is surprising given Auckland businesses remain stuck in an indefinite Alert Level 3 lockdown. Even more surprising, was that the level of optimism is actually higher in Auckland than outside of Auckland, according to ANZ.

Another subpar reading is expected for **Consumer Confidence** in October as the high alert level restrictions drag on in Auckland. There could be a nudge up in headline sentiment as more of the ANZ survey captures the subsequent easing in restrictions from early September. However, with alert level restrictions still above pre-delta norms and with supply chain disruptions hampering the availability of retail goods, consumer assessments of it being a good time to purchase a major item should remain weak. Households' actual financial position might have taken a hit from the prolonged Auckland lockdowns and confidence in our largest city will likely be below other regions. The longer that higher alert level restrictions remain in place, the larger the hit will be to households, with confidence readings providing a useful gauge. House price expectations should remain positive, notwithstanding recent increases in mortgage interest rates. More worrying will be consumer inflation expectations, indicating less resistance on the part of consumers to paying higher prices.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Australia CPI, Q3, % annual	27/10	1:30 pm	3.0 headline, 1.8 trimmed mean
Bank of Japan Meeting, %	28/10	-	-0.1 policy rate, 0.0 10-yr yield target
Bank of Canada Meeting	28/10	3:00 am	0.25% policy rate, C$1bn
Australia Trade Prices, Q3, % qoq	28/10	1:30 pm	3.5 imports, 6.5 exports
European Central Bank Policy Meeting, %	29/10	0:45 am	0 refi rate, 0.25 lending rate, -0.5 dep. rate
US GDP, Q3, %/saar	29/10	1:30 am	4.0
US PCE, September, %/mth	29/10	1:30 am	0.2 headline, 0.1 core
Australia Retail Trade, Q3, qoq	29/10	1:30 pm	0.5 nominal, -4.0 real
Australia Private Sector Credit, % mom	29/10	1:30 pm	0.5
Eurozone GDP, Q3, /%qtr	29/10	10:00 pm	1.7
Eurozone CPI, September, %/mth	29/10	10:00 pm	0.4 headline, 0.2 core
Canada GDP, Q3, %/qtr	30/10	1:30 am	1.7

** Forecasts and commentary originally published by CBA Global Markets Research Friday 11th October*

The pandemic hit the Australian economy hard over Q3 21 and that will have implications for the **Australian CPI** over the period. Sydney and Melbourne were essentially in lockdown for the entire quarter and that will weigh on some parts of the CPI basket. Notwithstanding, we think the Q3 21 CPI will show a modest acceleration in underlying inflation on a six-month annualised basis. It will set the scene for a firmer inflationary pulse next year.

Our forecast is for the headline CPI to increase by 0.8% in Q3 21 which would see the annual rate dip to 3.0% (recall that the Q2 21 headline CPI leapt to 3.8%/yr on a base effect). Tradeables inflation is forecast to be stronger than non-tradeables, while goods inflation should outpace services inflation.

On our figuring the trimmed mean will rise by 0.5% which will push the annual rate up a little to 1.8%. The six-month annualised rate, which better captures the inflationary pulse, is forecast to step up to 1.9%. The risk lies with a stronger print, particularly in light of the Q3 21 NZ CPI.

We expect no policy change from the **Bank of Japan**. The Bank of Japan will likely revise down its economic growth and CPI forecasts (as usual). We expect inflation to remain very low for the foreseeable future.

We expect the **Bank of Canada** will keep its policy interest rates on hold. We also expect the BoC will further taper its weekly asset purchases by $C1bn. The BoC's Business Outlook Survey showed capacity pressures, labour shortages and business expectations of faster wage growth lifted to record highs in Q3. In our view, the BoC will acknowledge the risk that supply disruptions could take longer to ease and revise higher its inflation forecasts. There is a risk the BoC will adjust its 'second half of 2022' forward guidance on interest rates.

The **Australian trade prices** measure changes in goods export and import prices and provide a reliable indication of how the terms of trade have moved in the quarter. We expect export prices have lifted by 6.5% in Q3 21 thanks to a strong lift in commodity prices. For import prices we also expect to see a solid lift as the Australian dollar depreciated in the quarter. A lift in the oil price will also boost fuel import prices.

We expect the **European Central Bank** to keep its policy settings unchanged. The ECB will likely reiterate that it expects the current spike in inflation will fade. Indeed, there is little evidence to suggest underlying inflation is building. However, policymakers may discuss the outlook for asset purchases once the Pandemic Emergency Purchases Program (PEPP) ends early next year. We expect the ECB will temporarily lift the pace of asset purchases under the Asset Purchase Program to offset some of the impact of the PEPP ending.

We estimate **US GDP** grew by a robust 4.0% saar in Q3 2021. Despite supply shortages, industrial production expanded strongly by 1.1%/qtr. Production and sales of cars was particularly weak in Q3 because of parts shortages. Consumer spending stalled in Q3, possibly in response to higher consumer prices and the stalling in jobs creation. Business investment continues to expand at a solid rate.

We expect a very slight moderation in both the headline and core **US Private Consumption Expenditure** deflator in September. Nevertheless, we expect annual rates to remain high at 4.3%/yr and 3.6%/yr, respectively. We believe the trimmed PCE deflator is a better measure of underlying inflation pressures as the economy re-opens. The risk is the monthly annualised trimmed PCE accelerated in September, further highlighting that underlying inflation pressures in the US are building.

CBA's internal data indicate a small lift in **Australian retail trade** in September after large falls in recent months. We are likely to see a lift in retail trade in the coming months as NSW and Victoria exit lockdowns. This release will also include real retail trade for Q3 21. We expect a chunky 4% fall in retail trade thanks to extended lockdowns in NSW, the ACT and Vic.

We expect a 0.5% lift in **Australian private sector** credit in September. Housing credit has been growing at a solid pace and business credit has lifted with businesses increasing their borrowing to support cash flows through the lockdowns.

We expect Eurozone economic momentum eased slightly in Q3 2021. We estimate **Eurozone GDP** growth of 1.7%/qtr. Easing restrictions and summer travel will have positively contributed to GDP growth in our view. However, supply chain disruptions have hampered production, particularly in Germany.

We expect another strong lift in headline **Eurozone CPI** inflation in October. Elevated gas prices have pushed headline inflation sharply higher in recent months. We expect core inflation increased by a more modest 0.2%/mth. Global supply chain disruptions are also impacting prices in the Eurozone.

We estimate **Canadian GDP** rose by 0.7%/mth in August following a surprising 0.1%/mth contraction in July. Service industries will have continued to contribute to economic growth amid a rapid vaccine roll-out and an easing of restrictions.

Key Forecasts

ASB NZ economic forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
	<< actual	forecast >>						
GDP real - Q%	2.8	-8.4	5.2	1.8	1.4	1.2	0.4	0.7
GDP real - A%	17.4	-5.6	0.3	0.8	-0.5	10.0	3.5	2.5
GDP real - AA%	5.1	3.3	3.3	2.8	-1.3	2.5	4.4	2.2
NZ House Prices (QV Index) - A%	28.2	27.8	22.1	14.9	8.8	4.3	2.6	6.8
CPI - Q%	1.3	2.2	1.3	0.8	0.7	1.1	0.5	0.5
CPI - A%	3.3	4.9	5.8	5.7	5.1	3.9	2.8	2.5
HLFS employment growth - Q%	1.1	0.0	-0.6	0.3	0.6	0.5	0.2	0.4
HLFS employment growth - A%	1.7	2.3	1.0	0.7	0.3	0.9	1.7	1.3
Unemployment rate - %sa	4.0	4.1	4.4	4.4	4.2	4.0	4.0	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)	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZ OCR	0.25	0.25	0.75	1.00	1.50	1.75	2.00	2.00
NZ 90-day bank bill	0.35	0.65	1.00	1.25	1.75	2.00	2.25	2.25
NZ 2-year swap rate	0.78	1.42	1.95	2.00	2.05	2.10	2.20	2.40
NZ 5-year swap rate	1.36	1.87	2.30	2.35	2.40	2.45	2.55	2.75
NZ 10-year swap rate	1.88	2.24	2.55	2.60	2.65	2.70	2.80	3.00
NZ 10-year Bond	1.77	1.97	2.45	2.50	2.55	2.60	2.70	2.85

ASB foreign exchange forecasts (end of quarter)	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
		<< actual	forecast >>					
NZD/USD	0.70	0.69	0.67	0.68	0.69	0.70	0.72	0.72
NZD/AUD	0.93	0.96	0.92	0.94	0.92	0.91	0.92	0.92
NZD/JPY	77	77	76	79	81	83	85	85
NZD/EUR	0.59	0.59	0.59	0.61	0.61	0.60	0.60	0.55
NZD/GBP	0.51	0.51	0.50	0.50	0.51	0.51	0.51	0.51
NZD/CNY	4.5	4.4	4.4	4.4	4.4	4.4	4.5	4.5
NZD TWI	73.7	73.7	71.6	73.1	73.3	73.5	74.6	73.9

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

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