Economic Weekly

27 April 2021

Unwinding

It may be an obvious truth, but it's worth repeating: the scale of fiscal and monetary stimulus the global economy has received over the past year or so dwarves the levels of support rolled out in any previous crisis. Central banks have sent policy rates to record lows and expanded asset purchases to record highs, before getting creative with new tools.

National governments have run roughshod over balanced budget commitments as they've piled on debt to stop ailing businesses from failing, expand social safety nets and inject funding into strained health systems. More than USD$5 trillion has been spent by the US Federal Government vs the circa USD$1.6 trillion earmarked in 2008-9 (and there is more on the way with a big infrastructure package signalled). The European Commission is dishing out €672.5 billion to member states – a decade ago, the body lacked the power to issue common debt. There have been some bold pledges from policymakers too. Just over twelve months ago, French President Emmanuel Macron and the German Economy Minister each pledged that not a single business would face bankruptcy because of the crisis.

There is still considerable uncertainty facing the global economy, but as 2021 wears on, speculation continues to mount about the likely timeframe for unwinding all this support. Inflation metrics around the world continue to tick upwards, and growth forecasts have been revised steadily upward. On the fiscal side of things, the level of support has already dropped off over recent months as programmes have expired. Anxieties about public debt will further come to the fore from here. Less new spending isn't so much of a worry in the US (where the recovery has bested expectations and the amount spent is already massive), but is more of a concern in Europe, where forecasts have been revised down, the pace of existing stimulus is already proceeding too slowly and there are risks of a wave of corporate bankruptcies as support rolls off.

For monetary policy, most central banks still see more risk in tightening too quickly than too slowly – particularly given we don't know how sustained the recovery or the uptick in inflation will be. To that end, monetary policymakers have been keen to keep their public comments as dovish as possible to stem the move up in yields over recent months.

Still, there are signs of some shift in the dovish consensus. Last week, the Bank of Canada became the first major central bank to signal a change in tone. The BoC added the usual caveats about uncertainty and 'pockets of weakness' in the economy, but the emphasis was all on the stronger-than-expected outlook. Notably, the bank announced it would scale back its asset purchases and brought forward its timetable for hiking rates.

This week it's all about the US Federal Reserve, with its Federal Open Market Committee (FOMC) meeting at 6am NZT on Thursday morning. Almost everyone (including us) expects the FOMC to stick to a more dovish line than its cousin to the north. Fed Chair Jerome Powell has studiously avoided putting an exact timeframe on tightening policy settings, and the bank was burnt by the 'taper tantrum' back in 2013 when it markets reacted negatively to the news the Fed was putting the brakes on its QE programme. Still, in times like these, markets will be closely reading every word for signs of a shift in tone. nathaniel.keall@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7234	0.7213	0.6968	0.5988	FLAT	0.7100	0.7350
NZD/AUD	0.9276	0.9250	0.9152	0.9425	FLAT	0.9100	0.9500
NZD/JPY	78.22	78.02	76.12	64.44	FLAT	76.20	80.20
NZD/EUR	0.5986	0.5979	0.5915	0.5559	FLAT	0.5840	0.6140
NZD/GBP	0.5205	0.5150	0.5063	0.4849	FLAT	0.5080	0.5340
TWI	75.4	75.0	73.3	68.20	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

The NZD trended sideways over last week, then popped higher over Monday against all the major crosses except the AUD. Global investor sentiment largely treaded water over the past week, with equities sideways and US yields also holding steady following recent declines. The surge in COVID-19 cases in developing countries, particularly in India and Brazil, may have given investors cause for pause.

NZ Q1 CPI was bang on our own expectations, and also that of the market median (as polled by Bloomberg). As a result, there was little market reaction. The Q2 inflation read is shaping up to be a pivotal release, with stronger annual inflation pressures poised to come to the forefront of financial market's attention.

The Bank of Canada (BoC) became the first major central bank to signal a move away from a dovish tone. The BoC left its benchmark at 0.25% (as expected) but scaled back its bond-buying programme by a quarter, substantially lifted its economic forecasts and brought forward its timetable for rate hikes. The move is a significant development, as most central banks (including the Federal Reserve, Reserve Bank of Australia and Reserve Bank of New Zealand) have been keen to hold the dovish line and emphasise the risks still facing the recovery.

Offshore market sentiment and USD direction is likely to remain the driver of FX moves this week. We expect the NZD may continue its period of consolidation this week, as global investor sentiment takes a slightly more circumspect approach. Nonetheless, we still have a medium-term bias for the NZD/USD to lift further.

The domestic release calendar is fairly quiet in NZ, so focus will be on Australia's CPI release (Wednesday). In the US, there are several event risks to watch out for later this week, including the Federal Reserve policy announcement (Thursday morning NZT) and US GDP and the Private Consumption Expenditure deflator (a key consumer inflation measure in the US). The market may be looking for the Federal Reserve to sound a touch more upbeat, following last week's BoC announcement which acknowledged the need to start unwinding stimulus at some point in the future.

In an update to our Corporate Hedging Toolbox subscribers, we note that the improving economic backdrop and growing confidence in the pending global economic recovery as led to a fall in financial market volatility. FX volatility is at 6-month lows and Mike Jones discusses the implications of this fall in volatility for hedging considerations: see the full report here. jane.turner@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	0.70	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.92	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	77	80	83	84	85	88
NZD/EUR	0.59	0.60	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	73.9	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	0.35	0.34	0.34	0.31	UNCH	UP
2-year swap	0.47	0.46	0.42	0.29	UNCH	UP
5-year swap	1.04	1.06	0.98	0.46	UNCH	UP
10-year swap	1.79	1.83	1.77	0.86	UNCH	UP
10-year govt bond yield	1.61	1.65	1.64	0.83	UNCH	UP
Curve Slope (2s10s swaps)	1.32	1.37	1.35	0.57	UNCH	DOWN

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

Market Recap

Local short-term swap yields start the week little changed, continuing a period of relative stability in the local rates market. The key NZ 2-year swap yield has continued to trade in tight ranges (just 0.44% to 0.47% last week), with little reaction from the in-line with market consensus NZ CPI pick. However, local and global yields in the belly of the curve and for longer-dated maturities continued to unwind early 2021 increases. After peaking just shy of 160bps in late February, the slope of the NZ swaps curve (2s-10s) fell back to around 132bps. Positioning-related flows and solid demand saw US Treasury yields retrace early 2021 climbs, with 10-year yields (1.56%) well below late-March 2021 peaks (1.77%). The dovish tone of RBA Minutes also helped lower Australian yields.

Near-term interest rate outlook

Our core view is that we are in a period of consolidation after a frenetic period earlier this year in which local yields snapped higher and the curve steepened. Market pricing has a full 25bp OCR hike priced in by early 2023, which is a shade later than our OCR view (August 2022), but consistent with our view of the risk profile. We expect local short-term yields to continue to trade in tight ranges and believe it would take a massive surprise from Wednesday's Q1 Australian CPI data (CBA 1.1% qoq, 1.6% yoy, mkt: 0.9% qoq, 1.4% yoy) to markedly shift them.
The US Fed is expected to leave its policy settings unchanged, with Chair Powell to reiterate that even early steps to a policy exit are not being considered given extensive spare capacity within the labour market. Uneven readings for Q1 US GDP (US mkt: 1.7% qoq) and Eurozone Q1 GDP (mkt: -0.8% qoq) are unlikely to significantly impact yields. The Bank of Japan meets but no changes are expected after tweaks were made at the previous meeting.

We have retained our downward bias for medium to longer-term local yields as we believe the early 2021 run-up appears to have been premature. Forward rates based on the back end of the curve (5-year ahead forward-starting 5-year rate = 2.61%) have eased of late, but we believe they have more scope to fall given our low neutral OCR view (circa 1½%). Signalled weekly RBNZ government bond purchases have been trimmed further, but at $350m are still well above the $300m NZ bond issuance profile by NZDM and should weigh on bond yields at the margin.

Medium-term outlook

We expect the RBNZ to continue to trim its LSAP programme and to halt purchases from 2022, prior to raising the OCR from August 2022 - with risks of a slightly later start to RBNZ tightening. The OCR is expected to reach 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. mark.smith4@asb.co.nz

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, March, $m	29/04	10:45 am	-	-304
ANZ business outlook survey, April, own activity	29/04	1:00 pm	-	-
ANZ consumer confidence, April, headline	30/04	10:00 am	-	-

We expect NZ recorded a $304m monthly trade deficit in March. The result means NZ's annual trade surplus will continue narrowing to $1.3bn after reaching record highs late last year. This time last year the country was in the depths of lockdown with international trade constrained and, as a consequence, we expect annual changes to be skewed. We expect an enormous annual lift in import values (+17% to $6.0bn) and a small annual decline in export values (-3% to $5.7bn).

Business confidence is expected to be little changed from preliminary April readings. These showed broadly unchanged own activity expectations (albeit slightly below historical averages), still-improving investment and employment intentions. Profit expectations were much improved on this time last year but remained anaemic (-4). Our focus will be on whether cost and pricing metrics continue to firm, potentially derailing the economic recovery we see unfolding later in 2021.

Consumer confidence dipped in March, with respondents revising down their assessments of the short-term NZ economic outlook and views on it being a good time to purchase a major item. **We expect sentiment levels for both current (108.2 in March) and future conditions (112.6) to lie below historical averages in April.** With the April survey taken after the announced changes on housing policy by the Government (23 March), but not fully incorporating the announcement of the trans-Tasman bubble (6 April), policy developments are likely to be a net negative for sentiment, which will likely weigh on the expected near-term economic outlook. House price expectations and views on it being a good time to purchase a major item are also expected to be scaled back.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Bank of Japan Interest Rate Announcement, %	27/04	-	-0.1
Australia CPI, Q1, %qoq	28/04	1:30 pm	1.1
US Fed Interest Rate Announcement, %	28/04	6:00 am	0.00-0.25
Australia Export Price Index, Q1, %	29/04	1:30 pm	7.2
US GDP, Q1, %saar	29/04	12:30 pm	5.5
Australia Private Sector Credit, March, %mom	30/04	1:30 pm	0.3
US PCE Deflator, March, %yoy	30/04	12:30 am	2.2
Eurozone CPI, April, %yoy	30/04	9:00 pm	-
Eurozone GDP, Q1, %qoq	30/04	9:00 pm	-

** Forecasts and commentary originally published by CBA Global Markets Research Friday 23 April at 11:15 am*

We expect no policy change after the **Bank of Japan** made tweaks to its policy tools at its previous meeting. The biggest risk to Japan's economic recovery is virus mutations that cause further lockdowns.

In Q1 21 we expect **Australian headline inflation** to rise by 1.1% and the Reserve Bank of Australia's (RBA) preferred trimmed mean measure to rise by a more muted 0.6%. We anticipate a strong lift in rents will lead to the large rise in quarterly headline CPI. We also expect a lift in food prices, transport prices due to petrol, and seasonal lifts in education and pharmaceuticals. We do expect seasonal falls in consumer durables and clothing. Our central forecast is inflation to rise over to over 3% mid-year due to base effects before falling again. We do expect the inflation debate to heat up in 2021 as the labour market tightens and wages growth is forecast to lift.

In Q1 21 we expect **Australian** export prices to lift by 7.2% and for import prices to rise by 1.0%. Export prices should lift strongly due to gains in commodity prices, particularly iron ore. Import prices should be driven higher by petrol prices. An outcome in line with our forecasts would see a strong lift in the **terms of trade** in Q1 21. A lift in the terms of trade adds to national income.

We forecast **Australian private sector credit** to lift by 0.3% in Mar 21; this would take the annual rate down to just 0.8%. Housing credit growth is slowly picking up, as is investor lending. In CBA's internal data we have also seen a lift in personal lending for cars and household goods.

We expect the US Federal Reserve to leave its policy settings unchanged. The US economy is improving but there is a lot of slack in the labour market. We expect Chair Powell to reiterate that even early steps to a policy exit are not being considered.

We estimate the **US economy** expanded by at least 5.5%saar in Q1 21. The US Government's fiscal stimulus package from December and March encouraged a boom in consumer spending. Business investment is also picking up.

The already-released CPI data indicate the **US headline personal consumption deflator (PCE)** accelerated significantly in March to 2.2%yoy. We also estimate the core PCE deflator accelerated to 1.6%yoy. However, much of the acceleration reflects weakness one year ago.

Headline **Eurozone CPI inflation** quickened in March at an annual pace of 1.3%, the highest rate since January 2020. Inflation will likely increase in the coming months supported by the end of the temporary VAT reduction in Germany and higher energy prices. The European Central Bank (ECB) projects inflation to average 1.5% over 2021.

In Q4 2020, **Eurozone real GDP** declined by 0.7% and the level of real GDP was 4.9% below its Q4 2019 level. The ECB projects real GDP to decline by 0.4% in Q1 2021 because of containment measures, followed by a recovery the following quarter.

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	-0.2	1.1	1.0	-0.8	-0.6	0.5
GDP real - A%	-0.9	0.1	13.7	0.9	1.1	0.7	4.5
GDP real - AA%	-3.0	-3.0	3.0	3.1	3.7	3.8	2.7
NZ House Prices (QV Index) - A%	15.1	19.7	20.0	15.4	9.1	2.4	5.1
CPI - Q%	0.5	0.8	0.5	0.5	0.4	0.5	0.5
CPI - A%	1.4	1.5	2.5	2.3	2.3	1.9	2.2
HLFS employment growth - Q%	0.6	0.0	0.2	0.3	0.3	0.4	0.6
HLFS employment growth - A%	0.7	-0.4	0.1	1.1	0.8	1.2	2.3
Unemployment rate - %sa	4.9	4.8	4.8	4.9	4.9	4.8	4.1

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

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(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	0.35	0.30	0.30	0.30	0.35	0.90
NZ 2-year swap rate	0.28	0.47	0.57	0.67	0.77	0.87	1.27
NZ 5-year swap rate	0.54	1.12	1.22	1.32	1.42	1.52	1.92
NZ 10-year swap rate	0.98	1.96	2.01	2.06	2.11	2.16	2.36
NZ 10-year Bond	0.99	1.78	1.86	1.91	1.96	2.01	2.21

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	0.70	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.92	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	77	80	83	84	85	88
NZD/EUR	0.59	0.60	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	73.9	75.2	75.4	75.5	75.5	74.6

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