

Economic Weekly

28 June 2021

A celebration and a warning

In our last [Economic Weekly](#), we noted the peculiar truth that the New Zealand economy is hotting up, despite the multibillion-dollar hole left by the absence of most of the tourism sector. In part, that's because while it's been a grim eighteen months for our service exports, NZ's goods exports are enjoying a golden run.

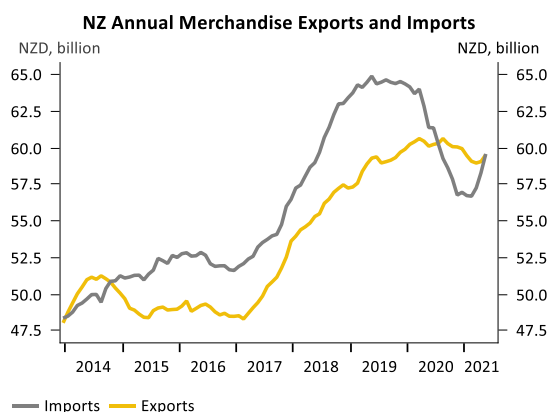
We were given a reminder of this last Friday, with Stats NZ's release of the monthly merchandise trade for May. The big headline was the circa 31% year-on-year recovery in imports (a function of their massive crash during lockdown this time last year) hidden in the trend was the news monthly goods exports hit their highest level ever at a cool \$5.9 billion.

The achievement caps a remarkable eighteen months for the sector, with export values surprising forecasters with their resilience through the pandemic. It's a microcosm of the broader strength of international goods trade through the pandemic, which wrongfooted expectations for a collapse in activity amid COVID's unprecedented demand and supply shocks (see [The Economist's](#) piece last year likening this to the scene in *Kill Bill* where Uma Thurman's character punches her way out of a coffin).

Now, as the global economy emerges from the worst of the pandemic, the outlook for the export continues to improve. [Surging commodity prices](#) are the big driver – as consumption has recovered overseas, global supply has struggled to keep up with demand, boosting prices for dairy, meat and forestry products by between 10 and 30% each since the beginning of the year (to continue the Tarantino metaphor, the impact on export revenue is akin to the adrenaline shot administered by John Travolta in *Pulp Fiction*). Despite all the headlines about shipping bottlenecks and widespread logistics disruption, NZ export volumes are also holding up well, as we [noted](#) a couple of weeks ago.

Having survived the challenges of COVID thus far, battling protectionism and global geopolitics are the next big challenges for the export sector. Last week saw mixed signals on that front. On the one hand, the US and EU moved to [resolve](#) the world's longest running trade dispute. On the other hand – closer to home – Aussie-China trade tensions have escalated further, with a new anti-dumping complaint [raised](#) before the WTO.

We are hopeful that global policymakers will remain mindful of the win-win gains to be had from trade, and the world can avoid a protracted surge in protectionism. Still, the export sector may need to continue employing some of that same resilience it's shown through the pandemic – leveraging strong relationships offshore and diversifying into new markets as much as possible. nathaniel.keall@asb.co.nz



Foreign Exchange Market

| FX Rates | Current* | Week ago | Month ago | Year ago | ST Bias | Support^ | Resistance^ |
|----------|----------|----------|-----------|----------|---------|----------|-------------|
| NZD/USD | 0.7072 | 0.6953 | 0.7266 | 0.6443 | UP | 0.6985 | 0.7135 |
| NZD/AUD | 0.9331 | 0.9279 | 0.9384 | 0.9347 | FLAT | 0.9160 | 0.9460 |
| NZD/JPY | 78.36 | 76.33 | 79.81 | 68.98 | FLAT/UP | 75.60 | 80.00 |
| NZD/EUR | 0.5925 | 0.5859 | 0.5962 | 0.5739 | FLAT | 0.5880 | 0.6130 |
| NZD/GBP | 0.5091 | 0.5038 | 0.5118 | 0.5181 | FLAT | 0.5050 | 0.5380 |
| TWI | 74.4 | 73.1 | 75.1 | 71.37 | 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

Market sentiment spent last week in recovery mode. The shock to investor positioning following the Fed's hawkish surprise of a few weeks ago appears to have run its course. A continued run of solid global data, particularly out of Europe, reminded investors that the global economy is still on the come-back. The S&P500 closed the week close to a fresh record high, and the VIX index (a common proxy for risk aversion) fell back to 15-month lows.

The NZD/USD mirrored the recovery in global sentiment, pushing higher through the week to end at 0.7070, just over a cent higher than at the start of last week. Assisting the kiwi's rally, the USD backed off its recent highs, allowing most of the major currencies to drift higher over the week.

We've now had two NZD/USD corrections back into the 0.6000s this year. On both occasions, the dip has proven to be extremely short-lived, a risk we've tended to highlight in our commentary. We continue to hold a medium-term constructive NZD view, reflecting not only the global commodity price upswing, but also the growing odds that the RBNZ is one of the first central banks in the world to lift interest rates.

On this front, we note from last week that OIS-implied market pricing is now consistent with a better-than-even chance of a 25bps RBNZ rate hike *this year*. This has helped lift NZ-US 2-year swap differentials to a 3½ year high, a clear NZD positive for yield hungry investors. If we plug the latest reading on the NZ-US swap yield differential, commodity prices, and VIX into our short-term NZD/USD valuation model it yields a "fair-value" range of 0.7300-0.7700. In other words, even as the NZD/USD spot has undergone a correction in the past few weeks, fair-value has pushed *higher*.

For this week, we suspect the NZD/USD recovery will continue, but with more mixed performances amongst the crosses (that is, we expect a weaker USD). Initial resistance for NZD/USD is eyed around the old support level at 0.7135. In terms of event risk, the most obvious piece is US non-farm payrolls on Friday. We expect a strong 700k increase in jobs and a fall in the unemployment rate to 5.7%. Such a result could reflate demand for the USD. In NZ, both June business and consumer confidence readings will remain commensurate with a robust economic recovery.

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| ASB foreign exchange forecasts (end of quarter) | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Mar-23 |
|--|--------|----------|-------------|--------|--------|--------|--------|
| | | <<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 | 75.5 | 75.6 | 75.7 | 75.7 | 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 | 0.33 | 0.33 | 0.33 | 0.30 | UNCH | UP |
| 2-year swap | 0.78 | 0.73 | 0.60 | 0.21 | UP | UP |
| 5-year swap | 1.39 | 1.34 | 1.35 | 0.37 | UP | UP |
| 10-year swap | 1.92 | 1.84 | 2.02 | 0.77 | UP | UP |
| 10-year govt bond yield | 1.81 | 1.74 | 1.86 | 0.94 | UP | UP |
| Curve Slope (2s10s swaps) | 1.14 | 1.11 | 1.42 | 0.56 | UNCH | DOWN |

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

Market Recap

Market pricing for OCR hikes has continued to firm and local yields have pushed higher with a curve-flattening bias as markets bring forward the adjudged timing of monetary policy tightening. This was despite Wellington moving to Alert Level two last Wednesday after an Australian visitor subsequently tested positive for COVID-19. Australian short-term yields have not kept pace, likely weighed by the announced COVID-19 lockdown in NSW and the increase in cases in other Australian states.

US Treasury yields have ground higher. Yields initially eased after Fed Chair Powell sought to downplay the risk of imminent Fed hikes. Yields subsequently rose given improved market sentiment, the resilient tone of US data, the announced bipartisan Senate USD1.2tr infrastructure deal. Some FOMC members (Bullard, Kaplan, Rosengren) noted that policy settings needed to be tightened (QE tapering followed by rate hikes) given inflation risks and the strengthening US economy.

Near-term interest rate outlook

We have retained our upward bias for local yields, notwithstanding the recent shift up in yields and our published OCR view. A 25bp hike is now close to fully priced in by February 2022, but the risk is that the RBNZ could hike sooner. NZ COVID-19 announcements this week could impact local market pricing, which is biased higher leading up to the RBNZ OCR Review (July 14) and Q2 CPI report (July 16).

Global yields are also biased higher. Our NZ interest rate and core economic view is closely aligned to the Australian view of our CBA colleagues, who have tweaked their published forecasts and expect the 0.1% RBA cash rate to be raised in November 2022 (to 0.25%), with the cash rate to peak at 1.25% in late 2023.

Global data (including global manufacturing/services PMIs, the US ISM, non-farm payrolls and Eurozone CPI) will be watched for signs of solidity/increasing price pressures. Central bank speeches from the FOMC, ECB and BOE will be scrutinised for hints that policymakers are now acknowledging policy normalisation may occur sooner than previously signalled.

This week is the last NZDM tender for 2020/21 with \$300m on offer. Tender issuance steps up in July with \$500-550m offered each week, consistent with the \$30bn gross issuance target for 2021/22. This week, the RBNZ has chosen to maintain a scaled down pace of weekly LSAP purchases (\$200m) and we don't expect the RBNZ to increase LSAP purchases in July. This will pressure yields higher at the margin.

Medium-term outlook

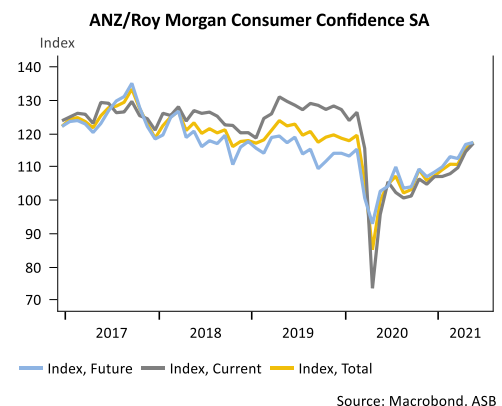
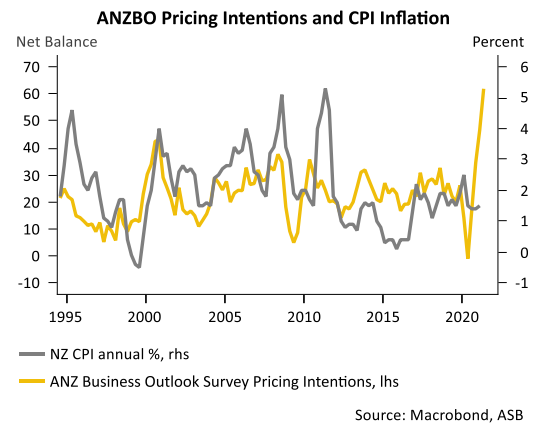
We expect the RBNZ to raise the OCR from May 2022. The OCR is expected to peak at just 1.25% in late 2023, with yields to remain capped at historically low levels. Risks are tilted towards OCR hikes occurring sooner and for yields to push higher, particularly for short to medium-term tenors. Our CBA colleagues expect that the RBA will hike the cash rate in November 2022 (peaking at 1.25% in late 2023), with the FOMC to start increasing the Fed Funds rate in March 2023 (1.50% in 2024). mark.smith4@asb.co.nz

Domestic events

| Data | Date | Time (NZT) | Market | ASB |
|---|-------|------------|--------|-----|
| ANZ Business confidence, June, own activity | 30/06 | 1:00pm | - | - |
| ANZ consumer confidence, June, headline | 02/07 | 10:00am | - | - |

Business sentiment measures point to firming demand and strong GDP growth continuing over Q2 2021, with **ANZ business own activity expectations slightly above decade-averages in May and the first week of June**. ANZ release the full month survey results on Wednesday 30th, with preliminary results released earlier in the month showed own activity climbing to 29.1. Focus is shifting to inflation measures with ANZ survey respondents reporting increasing cost and inflation pressures which indicate a strong lift in CPI inflation over 2021.

Consumer confidence is expected to modestly firm towards historical averages (119). Consumers' assessments of their current and future financial position are biased higher, a remarkable achievement considering we are in a global pandemic. The tight labour market has been a key support to consumer spending and has likely supported households' willingness to spend despite apparent caution in surveyed assessments of it being a good time to purchase a major item. **Despite middling consumer sentiment, we expect strong household balance sheets, the tight labour market and the July boost in income support to bolster retail spending over the second half of this year.**



Major International Events for the week ahead

| Data | Date | Time (NZT) | ASB |
|--|-------|------------|-----|
| Australia Credit Aggregates, May, %yoy | 30/06 | 1:30 pm | 0.3 |
| Eurozone CPI, June, %yoy | 30/06 | 9:00 pm | - |
| Australia Trade Surplus, May, \$Abn | 01/07 | 1:30 pm | 9.8 |
| US ISM Manufacturing Index, June, points | 02/07 | 2:00 am | 61 |
| US Non-farm Payrolls, June, 000s | 02/07 | 12:30 am | 700 |

* Forecasts and commentary originally published by CBA Global Markets Research Friday 25 June at 11:41 am

We expect a 0.3% lift in **Australian credit aggregates** in May. April data showed that housing credit is accelerating with both owner-occupiers and investors contributing. However, growth in both business and other personal credit remains soft.

We expect to see **Australia's trade surplus** increase to \$A9.8bn in May from \$A8.0bn in April. Commodity prices rose by a strong 6% in the month which should see export values lift.

Eurozone headline CPI inflation printed at 2.0%yoy in May, the highest since October 2018. 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.

Already-released **US regional manufacturing indices** point to a stabilisation in the national ISM. The ISM manufacturing index will remain elevated, boosted by a surge in demand as the economy re-opens. Focus will be on whether or not there is any easing in bottlenecks which are causing delivery delays and pushing prices higher. The employment index will also be closely monitored given the disappointment in non-farm payrolls in recent months.

We expect a strong 700,000 lift in **US jobs** in June. The US economy is improving rapidly which supports jobs creation. We also forecast the unemployment rate will dip to 5.7%. However, there is some concern that supplementary unemployment benefits are holding back employment gains. Half of all US states have, or will, end the federal unemployment assistance early. As a result, there is a risk of a set-back in employment in July/August if the transition to paid employment is not smooth.

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 | 1.6 | 0.5 | 1.1 | -0.2 | -0.7 | 0.4 |
| GDP real - A% | -0.8 | 2.4 | 15.4 | 2.3 | 3.1 | 0.7 | 4.0 |
| GDP real - AA% | -2.9 | -2.3 | 4.0 | 4.5 | 5.5 | 5.0 | 2.6 |
| NZ House Prices (QV Index) - A% | 15.4 | 17.4 | 21.6 | 18.8 | 14.6 | 10.1 | 2.3 |
| CPI - Q% | 0.5 | 0.8 | 0.8 | 0.9 | 0.6 | 0.6 | 0.5 |
| CPI - A% | 1.4 | 1.5 | 2.8 | 3.1 | 3.2 | 3.0 | 2.3 |
| HLFS employment growth - Q% | 0.6 | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.4 |
| HLFS employment growth - A% | 0.8 | 0.3 | 1.0 | 2.0 | 1.7 | 1.4 | 2.0 |
| Unemployment rate - %sa | 4.9 | 4.7 | 4.6 | 4.6 | 4.5 | 4.5 | 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

| | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Mar-23 |
|----------------------|-----------|--------|-------------|--------|--------|--------|--------|
| | << 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 | 0.35 | 0.35 | 0.35 | 0.55 | 1.10 |
| NZ 2-year swap rate | 0.28 | 0.47 | 0.60 | 0.65 | 0.70 | 0.80 | 1.20 |
| NZ 5-year swap rate | 0.54 | 1.12 | 1.35 | 1.40 | 1.50 | 1.60 | 1.95 |
| NZ 10-year swap rate | 0.98 | 1.96 | 2.00 | 2.05 | 2.10 | 2.15 | 2.35 |
| NZ 10-year Bond | 0.99 | 1.78 | 1.85 | 1.90 | 1.95 | 2.00 | 2.20 |

ASB foreign exchange forecasts

| | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Mar-23 |
|---------|-----------|--------|-------------|--------|--------|--------|--------|
| | << 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 | 75.5 | 75.6 | 75.7 | 75.7 | 74.6 |

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