ASB

Economic Weekly

29 November 2021

Omicron reminds us the pandemic is not over yet

Over the weekend the World Health Organisation named Omicron a COVID-19 variant of concern, while governments around the world scrambled to restrict international travel from high-risk countries. It remains too soon to know the degree of threat the new variant will pose to the management of the pandemic, but it is a timely reminder that the pandemic is far from over and many uncertainties and risks remain. Global financial markets reacted negatively to the news. The new variant comes as many European nations are struggling with rising COVID case numbers heading into the Northern Hemisphere winter and are looking to introduce new restrictions, particularly aimed at limiting movement and interactions of the unvaccinated.

Meanwhile, the speed with which travel restrictions and border closures were put in place over the weekend is also a timely reminder that international travel in 2022 won't be in anyway 'normal'. With NZ set to allow home isolation for fully-vaccinated citizens and residents from early next year, many are likely to be eying up an international trip. However, the lessons from Omicron (and the bursting of the TransTasman Bubble) are that international borders and quarantine requirements can be altered with little to no notice. People looking to travel overseas need to be prepared with a contingency plan and ready to fly home at a moment's notice (or risk becoming stuck for a prolonged and unknown period as is the case for those who remained in Australia). This also highlights the challenges and risks of opening up for international tourism over 2022.

The development of the Omicron variant also reinforces the RBNZ's decision to lift the OCR in "considered steps", opting for a 25 basis point lift in the OCR last week, rather than a 50 basis point lift. The RBNZ's message to financial markets was that, yes – interest rates do need to go up, but how high remains uncertain so don't get too far ahead of yourselves. Indeed, a new vaccine resistant COVID-19 variant really would materially hamper the recovery for the NZ and global economy next year. On domestic considerations, the RBNZ is wary of how much mortgage rates have already lifted, and – as strong as the economy has been over 2021 – is mindful of the number of headwinds facing households over 2022. Higher interest rates and the rising cost of living outstripping wage increases could have quite the cooling effect on spending. This could be potentially compounded by wealthier NZ households redirecting money away from domestic tourism and retail spending to international travel instead. Furthermore, credit conditions are tightening beyond just the lift in mortgage rates – tighter Loan to Value Ratio restrictions are just kicking in, along with some banks beginning to impose debt-to-income lending limits.

On some positive news (for Aucklanders at least) Freedom Day is close approaching for the vaccinated, and no doubt many NZers will be tuned in at 4pm to see what regions will be Red and what regions will be Orange under the new traffic light system. Like it or loathe it, the traffic light system is a positive step forward for the NZ economy, and with highly-transmissible COVID variants it looks like systems which restrict the movements of the unvaccinated are about to become the international norm. jane.turner@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	0.6824	0.6989	0.7187	0.7024	FLAT	0.6800	0.6990
NZD/AUD	0.9589	0.9648	0.9519	0.9510	FLAT	0.9420	0.9700
NZD/JPY	77.42	79.75	81.64	72.99	DOWN	76.50	80.00
NZD/EUR	0.6033	0.6200	0.6155	0.5868	DOWN	0.5850	0.6200
NZD/GBP	0.5117	0.5201	0.5209	0.5267	DOWN	0.5000	0.5300
TWI	75.1	74.7	75.7	74.0	FLAT/DOWN	N/A	N/A

*^ Weekly support and resistance levels * Current as at 11.20am today; week ago as at Monday 5pm*

NZD Recap and Outlook

The NZD was hit with a good old fashioned one-two punch last week, as both domestic and global factors combined to shave just over 1½ cents off the NZD/USD, and a cent off NZD/AUD. The currency thus had the dubious honour of being the worst performing G10 currency last week.

Globally, and as covered in depth elsewhere, the emergence of the Omicron variant has rocked global markets. It appears to have had the biggest impact on those financial markets seemingly 'priced for perfection', like equities and fixed interest markets. These markets have suffered a decent risk-off shakedown, which makes sense given a lot of good news was priced and uncertainty has now increased materially. It's pretty hard to now say anything sensible about the outlook as we all await more news on the severity of the Omicron variant, and in particular it's resistance or otherwise to the current crop of vaccines.

By contrast, currencies have been relatively less impacted. The USD was already trading up around 16-month highs prior to Omicron's arrival and so the standard 'risk-off' currency response to buy the USD, CHF, and JPY, and sell growth sensitive currencies hasn't been particularly severe. The NZD/USD lost a further 40pips or so on Friday night, to touch a one-year low around 0.6820.

The bigger driver of the recent NZD/USD decline has been the reduction in cash rate expectations following last week's RBNZ meeting. The Bank successfully cooled the market's jets on cash rate expectations, playing up (as we expected) the tightening work that rising mortgage rates are doing and the uncertainty from the spreading Delta variant. The market removed one full 25bps hike from its implied tightening profile but is still pricing a terminal OCR of 2.9%, which looks too high to us.

Whether or not the NZ dollar continues to slide will be determined, we suspect, by how local interest rate markets react to incoming news on the Omicron variant. Omicron's arrival should put paid to any lingering speculation the Bank could move in larger 50bps increments but outside of that is anyone's guess at this early stage. Still, it's worth remembering the NZD still wields a large interest rate differential over the USD and AUD and this, along with record-high NZ commodity prices, should limit the extent of near-term declines. 0.6800 is a key NZD/USD support level to watch.

Economic data/news will of course take a backseat this week, with markets likely to stay volatile and jumpy as incoming news is parsed for relevant information on the new COVID variant. Perhaps the most notable will be Fed Chair Powell's testimony (Tuesday) given the risks have been piling up on the 'speed up the taper' side of the fence. There's also US employment figures on Friday and European inflation data. In NZ, the only potentially market-moving release is Tuesday's ANZ business survey.

mike.jones@asb.co.nz

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	MT Bias
Cash rate	0.75	0.50	0.50	0.25	UP
90-day bank bill	0.80	0.91	0.80	0.25	UP
2-year swap	2.10	2.43	2.26	0.24	UP
5-year swap	2.58	2.81	2.63	0.44	UP
10-year swap	2.68	2.86	2.74	0.88	UP
10-year govt bond yield	2.46	2.55	2.58	0.85	UP
Curve Slope (2s10s swaps)	0.58	0.43	0.48	0.64	DOWN

** Current as at 11.20am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market recap

NZ yields and local market pricing significantly backtracked as the RBNZ hiked by the OCR 25bps (34bp of hikes was priced in shortly before the decision), with the published OCR track showing a moderate pace of hikes and a historically-low OCR peak (circa 2.60, still close to 50bps higher than in August). Moves were amplified by thin liquidity, with market pricing retracing 15-20bps across the curve, with swap yields down 10-20bp across the curve with larger falls for shorter tenors and the yield curve steepening. News of a new more contagious variant of COVID-19 (Omicron) pushed NZ and global yields down at the end of the week, taking weekly fall in swap yields to 20-35bps over the week, with bond yields down by a smaller margin.

The Omicron news stopped earlier climbs in global yields, particularly for short- to medium-term yields. US 10-year Treasury yields ended the week at 1.47% after earlier being as high as 1.69% mid-week, with 2-year Treasuries (0.50%) about 15bps lower and the paring back of FOMC rate hikes priced in. Australian yields have also retraced earlier climbs with more sizeable falls for longer-term tenors, with about 5bps taken out of RBA market pricing (+65bps by late 2022). The confirmation of Powell's for a second term as Fed chair, comments in the FOMC's November minutes and strong inflation data (headline and core annual PCE inflation at roughly 30-year highs) led to earlier climbs.

Near-term interest rate outlook

We have retained our downward near-term bias for yields. There are now roughly 30bps of RBNZ hikes priced in by February, with the OCR hitting around 1.6% in May 2022, 2.25% by late 2022 and 2.9% by August 2023. Our view is that the RBNZ will continue to move in 'slow and steady steps' (in 25bps rather than 50bps) and not overcook the degree of OCR hikes given the degree of tightening already delivered, still-present COVID-19 risks and the economic adjustment needed to live with COVID-19. The boost to NZ economic activity from the shift to the new traffic light system on December 3 looks to have been fully priced in by markets, but signs of a cooling in forward-looking indicators and continued inroads by the Omicron variant could push yields lower still.

With markets spooked over the Omicron variant, global yields are biased lower until more is known about its severity and resistance to vaccines. Equity market direction will prove to be a useful barometer. Congressional Testimony by FOMC Chair Powell and Treasury Secretary will be closely watched, with global yields sensitive to a move up if high inflation is deemed to be less transitory than earlier expected. Weak Q3 Australian GDP (mkt: -2.6% qoq , CBA: -3.5% qoq) will largely be ignored, with more timely data expected to show a post lockdown boost. Likewise, the strong tone of US November data - the US ISM manufacturing index, Non-farm Payrolls- will partly be discounted.

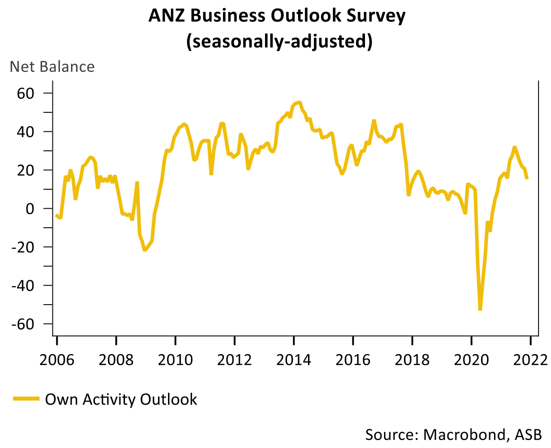
Medium-term outlook

We have pencilled in a steady sequence of 25bp hikes, with the OCR peaking at 2% by late 2022. The RBNZ will start to pare back its LSAP holdings from early 2022. Our CBA colleagues expect QE tapering from February 2022 (ending May 2022) and RBA rate hikes from November 2022 (1.25% endpoint). The US FOMC is expected to start tapering asset purchases from mid-November 2021 (ending by June 2022), with rate hikes from September 2022 (2.0% by early 2024). Longer-term yields are expected to drift up and for the yield curve to remain flat, with risks tilting to a more pronounced lift in yields. mark.smith4@asb.co.nz

Domestic Events for the week ahead

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own Activity, November	30/11	1:00 pm	-	-
Terms of Trade, November, % qoq	26/11	10:00am	2.0	2.5

ANZ releases the full November month **business outlook survey** results on Tuesday 30 November at 1pm. ANZ released the preliminary results earlier this month, which showed a small decline in own activity expectations – the most reliable indicator in the survey. This suggests that businesses are becoming more mindful of growth prospects as NZ transitions to living with COVID-19 over the coming year. Nonetheless, the overall level of business confidence remains solid. Inflation indicators remain extremely elevated.



We expect New Zealand's **terms of trade** lifted 2.5% over the September quarter, reaching a new all-time high. After last quarter's lift, we expect export prices advanced another 3.9% qoq as strong gains in agricultural commodity prices over the first half of the year continue filtering through into the trade figures. We expect import prices to lift more modest 1.4%.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU Company Profits, Q3, % qoq	29/11	1:30 pm	3
AU Balance of Payments, Q3, Current Account Surplus, AU$bn	30/11	1:30 pm	28.5
AU Building Approvals, Oct, % mom	30/11	1:30 pm	-5
AU Private Sector Credit, Oct, % mom	30/11	1:30 pm	0.6
EU CPI, Nov, % mom	30/11	11:00 pm	-
RBA Deputy Governor Debelle speaks	30/11	-	-
CA GDP, Sep, % mom	01/12	2:30 am	0.2
AU CoreLogic Dwelling Prices, Nov, % mom	01/12	12:00 pm	1.2
AU GDP, Q3, % mom	01/12	1:30 pm	-3.5
US ISM Manufacturing Index, Nov	02/12	4:00 am	61
AU Housing Lending, Oct, % mom	02/12	1:30 pm	-3
CA Employment Change, Unemployment Rate, Nov	04/12	2:30 am	+40k, 6.6%
US Non-Farm Payrolls, Unemployment Rate, Nov	04/12	2:30 am	+500k, 4.5%

** Forecasts and commentary originally published by CBA Global Markets Research Friday 26th November*

We expect a 3% increase in **Australian company profits** in Q3 due to strong commodity prices and government support. We have inventories subtracting around 0.7ppts from Q3 GDP.

We expect the **Australian current account surplus** to widen to $A28.5bn (~5.4% of GDP) in Q3 thanks to a massive trade surplus in the quarter. Taking into account price changes for exports and imports, we forecast net exports to contribute 1.0ppt to Q3 GDP.

We expect **Australian residential building approvals** continued their downward trend in October with a 5% fall. We expect a fall in approvals for detached houses as numbers pull back from the highs seen while the HomeBuilder grant scheme was in place. Multi-unit approvals are likely to pull back after a big lift last month.

Headline European CPI quickened at an annual pace of 4.1% in October (matching the July 2008 high) and core CPI inflation accelerated to 2.0% (matching the March 2008 high). Inflation is projected to rise further in November reflecting temporary factors such as the reversal of the German VAT rate cut, surging energy prices, and an increase in input costs related to supply disruptions. The ECB expects these temporary factors to fade from the beginning of 2022 but also warned that the phase of higher inflation may last longer. In the meantime, headline CPI inflation is tracking the ECB's 2021 average projection of 2.2%.

The **RBA Deputy Governor will make two appearances** on Tuesday. The first is on a panel at the 2021 Symposium on Indigenous Economies, the second at the ACI Australian conference. This conference has a focus on FX with crypto currencies, data and automation all likely to be discussed.

Canadian GDP grew at 0.4%/mth in August, missing expectations for a 0.7%/mth growth. We expect GDP growth moderated further to 0.2%/mth in September. Covid-19 infections picked up once again over the month, likely dampening spending and production. Ongoing supply chain disruptions and severe labour market shortages will also have weighed on growth.

The daily data indicate a rise in **Australian dwelling prices** of around 1.2% in November. Brisbane and Adelaide have posted very strong gains in the month while Sydney and Melbourne have seen smaller increases. We expect dwelling price growth to slow through 2022 and for prices to fall in 2023 as interest rates lift

We forecast a very large 3.5% contraction in **Australian real GDP** with NSW, Victoria and the ACT in lockdown in Q3. Consumer spending will post a very large contraction, while business investment, public spending and inventories will also be drags on growth in the quarter. Net exports will make a solid contribution to GDP.

We expect another solid reading for the November **US ISM manufacturing index**. Supply chain constraints have lasted much longer than expected and are holding sub-components like prices paid and supplier delivery times up at high levels. At the same time, demand is showing few signs of fading and is underpinning new orders. We expect the ISM manufacturing index will remain at elevated levels for some time.

Our internal data showed a fall in **Australian housing lending** in October. Some fixed mortgage rates have lifted and the minimum serviceability buffer for assessing a home loan has also increased.

High business employment intentions and job vacancies support a continued **labour market** recovery in **Canada**. At the same time, the end of pandemic-related income support programs on 23 October might have encouraged more Canadians to re-enter the labour force. We estimate a 40,000 rise in employment in November. We also expect the unemployment rate eased further to 6.6%.

We expect the **US labour market** recovered further in November. We forecast a solid 500,000 increase in employment which should help the unemployment rate dip further to 4.5%. Initial jobless claims are continuing to trend lower and high vacancy rates support an ongoing recovery in employment. Elevated vacancy and quit rates also suggest another solid 0.4%/mth increase in wages, taking the annual growth rate to 5%/yr.

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	-7.0	5.0	1.4	1.7	1.4	0.4	0.7
GDP real - A%	17.4	-4.1	1.8	1.8	0.7	9.8	3.9	2.4
GDP real - AA%	5.1	3.7	4.1	3.8	0.0	3.4	4.8	2.2
NZ House Prices (QV Index) - A%	28.2	28.2	24.5	17.1	10.9	6.0	2.6	6.8
CPI - Q%	1.3	2.2	1.4	0.8	0.7	1.1	0.5	0.5
CPI - A%	3.3	4.9	5.9	5.8	5.2	4.1	2.9	2.5
HLFS employment growth - Q%	1.0	2.0	-0.5	0.3	0.3	0.5	0.2	0.3
HLFS employment growth - A%	1.6	4.3	3.1	2.8	2.1	0.7	1.4	1.0
Unemployment rate - %sa	4.0	3.4	3.7	3.6	3.6	3.4	3.4	3.6

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	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
(end of quarter)		<< 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	2.40	2.45	2.50	2.55	2.65	2.80
NZ 5-year swap rate	1.36	1.87	2.70	2.75	2.80	2.85	2.95	3.05
NZ 10-year swap rate	1.88	2.24	2.80	2.85	2.90	2.95	3.05	3.15
NZ 10-year Bond	1.77	1.97	2.65	2.70	2.75	2.80	2.90	3.00

ASB foreign exchange forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Mar-23	Mar-24
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.70	0.69	0.70	0.71	0.73	0.74	0.73	0.73
NZD/AUD	0.93	0.96	0.97	0.96	0.96	0.95	0.94	0.94
NZD/JPY	77	77	80	82	86	88	88	88
NZD/EUR	0.59	0.59	0.62	0.62	0.63	0.63	0.60	0.56
NZD/GBP	0.51	0.51	0.52	0.53	0.54	0.54	0.51	0.50
NZD/CNY	4.5	4.4	4.5	4.5	4.6	4.6	4.5	4.5
NZD TWI	73.7	73.7	75.1	75.5	76.9	77.2	75.5	74.9

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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