ASB

Economic Weekly

30 August 2021

Four more weeks?

The past week has given us more information about the likely duration of this lockdown. After a week of seeing the number of contacts explode, we have also started to see the number of new cases level off. This latter development means the exponential rise of unfettered transmission has been knocked in its head. As has occurred in Australia, many new cases are within households of infected people, highlighting how infectious the delta variant is. However, the 'curve' has yet to bend down, meaning a need for caution remains. And we will need to be wary of whether another Australian pattern – essential workers getting infected at work and bringing infections home – becomes an issue here, too.

From Tuesday midnight, Auckland and Northland are set to stay in Level 4, probably for a further 2 weeks (although Northland could get released earlier if the perceived risks abate). A guess would be a further 2 weeks at Level 3, meaning at least 4 more weeks of being confined to the house – though with a good Thai takeaway achievable from the halfway mark. For the rest of the country, it could be 4 more weeks until – fingers crossed – a return to the normality of some form of Level 1.

Based off our rough and ready estimates, for the next fortnight the weekly foregone activity will be around 0.3% of GDP, nearly halving the disruption of the nationwide L4 lockdown. We continue to expect that there will be a decent degree of catch-up activity, though the longer the strict lockdown the less that foregone activity may be made up for.

Much of this week will be about watching COVID developments, including this afternoon's 4pm announcement to confirm the Level 4 extension for the upper North Island. There will be some data to look at too. The ANZ business confidence survey for August is out tomorrow afternoon. A fair proportion of the results were likely in before this latest lockdown was announced, but there may be some initial insights into how businesses are responding to the outbreak. Australia's Q2 GDP result is out on Wednesday. At this stage we expect a quarterly increase of 0.4% as the early parts of lockdown bite, though the last remnants of partial data out early this week could yet change forecasts. The reality is though, that the impact of continued lockdowns in Australia is of more consequence. At the end of the week, the US non-farm payrolls release will get the usual attention. At the weekend's speech, Fed Chairman Powell indicated that labour conditions had not yet met the test for reducing the pace of the Fed's ongoing asset purchases. But if jobs growth in the US remains strong, then that condition will be closer to being met. We expect the Fed will ease back on asset purchases from October, assuming a decent payrolls figure this week.

Days of the week do get a little blurry after a while, so a big thank you to Hilary Barry for reminding us when it's Friday. Asking for a friend: does a onesie count? And for 'that guy' shopping for avocadoes in the supermarket: we all like to find the perfectly ripened one, but Level 4 is not the time and place to be checking the ripeness of every one on the shelf... nick.tuffley@asb.co.nz

Need help or information? Find ASB and Government support information **here**.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6998	0.6819	0.7001	0.6663	DOWN	0.6750	0.7070
NZD/AUD	0.9579	0.9576	0.9475	0.9135	FLAT	0.9480	0.9640
NZD/JPY	76.88	74.86	76.67	71.09	FLAT/DOWN	74.00	78.00
NZD/EUR	0.5933	0.5830	0.5893	0.5610	FLAT/DOWN	0.5800	0.6000
NZD/GBP	0.5086	0.5004	0.5020	0.5026	FLAT/DOWN	0.5000	0.5100
TWI	74.4	73.2	73.9	71.71	FLAT/DOWN	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

Last week saw the NZD gain ground against most of its peers, with most major NZD crosses now at, or above, the ranges they were trading in prior to the step-up in Alert Levels a fortnight ago. Notably, NZD/USD is back around that all too familiar comfort zone, near the 0.7000 mark.

In our last update, we highlighted that near-term NZD direction would hinge largely on the arm wrestle between the near-term NZ COVID headlines and the broader fundamentals, which continue to suggest the RBNZ will tighten up monetary policy earlier than its global peers. For now, the fundamentals look to be winning the tug of war (if you'll forgive us for mixing sporting metaphors). Having shed the OCR hikes that were priced in the aftermath of the move to COVID Alert Level 4 and the RBNZ's decision to leave things unchanged at the last MPS, markets have continued to add some of those hikes back. As at the time of writing, the OIS curve has about ~47 bps of hikes prices by the end of the year (compared with circa 33bps at the start of last week) –in line with our own view that the RBNZ is likely to want to start the tightening cycle soon. Such a view was supported by public comments last week, with Assistant Gov Christian Hawkesby confirming the Bank was considering a 50bps hike prior to the news of an NZ COVID-19 outbreak.

The other dynamic visible last week was a generalised USD weakness in the aftermath of Jerome Powell's Jackson Hole speech, where the Fed Chair stuck to a cautious tone and suggested that while a taper could be announced at the next Fed meeting, any reduction in asset purchases won't be a signal on the timing of future rate hikes given the Bank had a 'substantially more stringent' criteria for lifting those.

For much of this week, there's relatively little on the cards to trigger obvious event risk, so it's likely that the aforementioned tug of war will be the main driver of NZD sentiment. The biggest event actually comes after the close of the Kiwi market on Friday night, with the release of non-farm payrolls (i.e. employment data) in the US. The release will have major implications for the next Fed meeting, and therefore for USD direction. We expect the US economy to have added around 800k jobs (on the strong side of expectations), which would be sufficient for the Fed to announce tapering at its 22nd September meeting. That suggests a bit of risk NZD/USD could shed some of this week's gains.

As we stated last week, near-term local data will have limited currency implications given it generally precedes the shift up alert levels. Q2 terms of trade data should also be viewed with caution – we expect a slight fall, but largely because the massive lift in commodity prices in the first half of the year isn't likely to be reflected in the data until Q3 – so don't be fooled into thinking NZD has lost a key support. nathaniel.keall@asb.co.nz

ASB foreign exchange forecasts (end of quarter)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Mar-23	Mar-24
		<< 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	0.39	0.47	0.29	UNCH	UP
2-year swap	1.29	1.17	1.06	0.09	UNCH	UP
5-year swap	1.64	1.56	1.46	0.21	UNCH	UP
10-year swap	1.95	1.86	1.82	0.63	UNCH	UP
10-year govt bond yield	1.72	1.59	1.53	0.64	UNCH	UP
Curve Slope (2s10s swaps)	0.66	0.69	0.76	0.55	UNCH	DOWN

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

Market recap

Local yields start this week around 5-10bps higher than a week ago. The catalyst were comments early last week by RBNZ Assistant Governor Hawkesby suggesting the timing of the delta variant outbreak prevented the OCR moving up in August and that 50bp hikes over 2021 were "definitely on the table" and "actively considered". Short-term yields and market pricing for October hike were up around 10bps. Last week's COVID-19 news had a modest impact, with the Government announcing the potential move for much of the country down to Alert Level 3 late tomorrow (August 31), but also highlighting the risk of more lengthy Alert Level 4 restrictions in Auckland.

NZ yields were also pressured higher by rising global yields as did Australian counterparts, where bond yields were roughly 10bps higher for medium to long-term tenors. Treasury 10-year yields hit 2-week highs (1.37%) on light trading leading up to the Federal Reserve Jackson Hole meetings. However, US Treasury yields were lower (10Y 1.31%) with more pronounced falls in the belly of the curve following the dovish Jackson Hole speech by Fed Chair Powell. Powell said the 'substantial further progress' test has been met for inflation, but that US labour market has not yet met that test despite 'clear progress'. Powell envisaged the start of Fed tapering by the end of the year, but warned that rate hikes were not imminent, with still "much ground to cover" before the US economy hits full employment.

Near-term interest rate outlook

Market pricing is heavily biased towards OCR hikes with the RBNZ expected to 'look through' the short-term lockdown impacts and back up earlier hawkish rhetoric. Currently, a 25bp hike in October is about 90% priced in, with just under 50bps by November and with a terminal OCR or around 1.60%. Every OCR decision is 'live', and while our core view is that the RBNZ hikes by 25bp in October, market pricing is likely to be sensitive to the course of the delta variant outbreak in NZ. Published data for Australia (and soon NZ) will increasingly reflect lockdown hits and dampen Australian yields. Our CBA colleagues expect Q2 Australian GDP growth to slow to just 0.4% qoq (mkt: +0.5% qoq) and have pencilled in a 4½% Q3 slump. Australian employment is also expected to be hit and it will take time for the labour market to heal, with the RBA likely to announce next week a delay in tapering its AUD5bn in weekly bond purchases till November.

Our bias is for longer-term global yields to move higher as markets 'look through' COVID-19 impacts and increasingly focus on improving prospects, notwithstanding clear delta variant risks that could drive additional volatility. With Federal Reserve tapering conditional on the labour market strengthening, this weekend's August non-farm payrolls print will be pivotal. The 800k increase in employment we expect (mkt: +750k) should be sufficient to prompt the Fed to announce tapering of asset purchases at its 22 September meeting.

Medium-term outlook

We have pencilled in 25bp hikes in each of the next three OCR decisions (October, November and February) taking the OCR back to pre-pandemic levels, with the OCR ending 2022 at 1.50%. Uncertainty is pronounced, and the economy (and OCR settings) 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 taper monthly asset purchases from October/November, with the Fed Funds rate to move up from March 2023 (1.50% in 2024). Longer-term yields are expected to remain capped at low levels, with the yield curve flatter given larger rises in shorter-term yields. mark.smith4@asb.co.nz

Domestic Events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own Activity, August	31/08	1:00 pm	-	-
Terms of Trade, Q2, % qoq	02/09	10:45am	-	-1.3

ANZ releases the full August month business outlook survey results on Tuesday 31st August at 1pm. NZ discovered the Delta strain of COVID in its community on Tuesday 17th of August, and NZ was immediately plunged into a very strict Alert Level 4 lockdown. NZ has not used Alert Level 4 since the initial outbreak back in March 2020. ANZ may have already received the majority of its responses to its August survey prior to August 17th, so insights into the business confidence reaction may be limited. In addition, businesses may be less panicked heading into this lockdown, with more confidence that activity will rebound quickly once the Alert Level restrictions are eased. ANZ has recently moved to releasing the business confidence survey results monthly, but it may decide to release preliminary results in early September - this has not been confirmed. Prior to the NZ COVID outbreak, business confidence was high and the key concern for businesses was strong cost and inflation pressures.

We expect New Zealand's Terms of Trade eased 1.3% over Q2. Despite surging agricultural commodity prices over the first half of 2021, the monthly trade data from Stats NZ suggests those gains aren't yet filtering through to the export sector. Consequently, we expect export prices remained relatively flat over the month (+0.2%). On the other hand, we expect import prices to have made more substantial gains (+1.5%), driven by higher freight costs and rising energy prices.

Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
AU Building approvals, July	31/08	1:30 pm	-7%
AU Current account, Q2 2021	31/08	1:30 pm	A$21.4b
AU GDP, Q2 2021	01/09	1:30 pm	0.4% qoq
US ISM manufacturing, August	02/09	2:00 am	58
US non-farm payrolls, August. Unemployment rate.	04/09	12:30am	800k, 5.2%

** Forecasts and commentary originally published by CBA Global Markets Research Friday 27 August*

Australian **residential building approvals** are on a downward trend. Approvals for detached homes are falling back to more normal levels now applications for the HomeBuilder grant have closed.

Strong export prices have seen the trade surplus increase in the June quarter. We expect an Australian **current account surplus** of $A21.4bn in the quarter or around 4% of GDP. While commodity prices have risen we calculate that export volumes are down in Q2. A smaller fall in import volumes would see net exports subtract 0.3ppts from Q2 GDP.

Our preliminary assessment is that **Australian real GDP** rose by 0.4% over Q2 21. That figure may appear a little soft compared with other economic data over the period. But lockdowns over the quarter will have had an impact on production. Consumer spending, which is the key source of uncertainty, is forecast to increase by 0.5%. Business investment will post a decent rise courtesy of a solid lift in plant and equipment spend. Public demand should be strong due to higher consumption and investment. Dwelling investment and net exports, however, will be a drag on growth.

We expect to see another moderation in the **US ISM manufacturing survey** in August. Already-released regional surveys moderated across the board in August. Once again, sub-components including prices and order backlogs will be closely watched. Nevertheless, at 58pts the ISM manufacturing index remains elevated and is consistent with an ongoing expansion in the manufacturing sector.

We expect another robust **US non-farm payrolls report** in August. We expect 800,000 new jobs were added which should lower the unemployment rate to 5.2%. High demand for workers likely underpinned another lift in wages over the month. However, there is a risk that high covid infections may have capped new hires if people are worried about returning to work and catching the virus. The sectors with the highest jobs openings tend to be where social distancing is difficult, such as leisure and hospitality.

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	1.1	-2.1	2.9	-0.5	1.4	0.6	0.6
GDP real - A%	2.4	16.1	-0.4	3.6	1.5	1.8	3.6	2.6
GDP real - AA%	-2.3	4.2	4.0	5.1	4.8	1.6	3.2	2.5
NZ House Prices (QV Index) - A%	22.0	28.2	27.8	22.1	14.9	8.8	2.6	6.8
CPI - Q%	0.8	1.3	1.4	0.4	0.7	0.6	0.5	0.5
CPI - A%	1.5	3.3	4.1	4.1	3.9	3.2	2.4	2.3
HLFS employment growth - Q%	0.6	1.1	0.0	0.3	0.3	0.5	0.3	0.3
HLFS employment growth - A%	0.3	1.7	2.3	1.9	1.7	1.1	1.3	1.2
Unemployment rate - %sa	4.6	4.0	4.1	4.1	3.9	3.7	3.7	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	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	0.25	0.75	1.00	1.25	1.50	1.50
NZ 90-day bank bill	0.35	0.35	0.50	1.00	1.25	1.50	1.75	1.75
NZ 2-year swap rate	0.47	0.78	1.35	1.50	1.60	1.70	1.95	2.15
NZ 5-year swap rate	1.12	1.36	1.75	1.85	1.95	2.05	2.20	2.40
NZ 10-year swap rate	1.96	1.88	2.00	2.05	2.10	2.15	2.30	2.50
NZ 10-year Bond	1.78	1.77	1.90	1.95	2.00	2.05	2.20	2.40

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

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