Economic Weekly

29 May 2023

RBNZ signals mission accomplished

Market participants and economists will be spending a lot of time with chiropractors after another case of whiplash. When lifting the OCR by 25bp to 5.5% last week, the RBNZ confounded most people by signalling that it has now done enough to control inflation. In contrast, forecasts ahead of the announcement were that the OCR would peak at 5.75% or 6%, and market pricing implied a 5.9% peak and some chance of a 50bp move last week alone. We had shifted to expecting a final 50bp increase to 5.75%. Yet, just a few weeks ago, widespread views were a 25bp increase in May would be the final lift of this tightening cycle. Oh for a DeLorean and some ethically-sourced Plutonium…

Doing a post-mortem, four things stood out as explaining the RBNZ's stance compared to widespread expectations: a rethink that the early 2023 weather events will now be less inflationary than signalled back in April; downplaying of the inflationary impacts of the recent Budget; taking a wait-and-see view on the inflationary impacts of migration, and; putting more weight than it did in April on the lower than expected level of GDP over 2022. You can read more here.

A key takeout is that NZ interest rates are around the peak, aside from the usual reactions to events and noise (though wholesale interest rates are still up over May). That 'RBNZ is done' message largely takes away a key uncertainty that has been hanging over home and business borrowers alike.

In the US, the world's biggest game of financial chicken may be close to having a disaster-saving swerve. The White House and Republicans have agreed in principle to a deal to raise the limit on how much debt the US Treasury can issue. However, the agreement still needs to be successfully voted on by Congress this week. June 5 is the day the US Secretary of the Treasury estimates the Federal Government will run out of options to avoid a default on its debts, so there is little leeway in the two-house voting process. Watch this space: although we expect the US Government will avert a wilful default, accidents can happen when you leave it to the last minute to avoid an avoidable collision.

The chart shows the stories of NZ and the US over the past few weeks. NZ yields lifted as the role of migration came into the spotlight and the Budget added more stimulus and debt than had been anticipated. A degree of pullback occurred after the RBNZ's one-and-done announcement. US interest rates have steadily crept up as the debt ceiling limit has drawn closer. The US 2-year bond is tracking around 50bp higher than what it averaged over April, and the 10-year bond roughly 35bp higher. Those higher rates will be impacting on wider borrowing costs in the US, meaning there are real consequences of playing debt ceiling chicken – even if a crash is avoided.

A lot of the attention this week will go on the US. Aside from the game of chicken, US Non-farm Payrolls are out overnight Friday, a key piece of data for the US Fed to mull ahead of its June 14 meeting. In NZ this week we have second-tier data of business confidence, building consents and the Terms of Trade. In Australia the key event will be the CPI on Wednesday.

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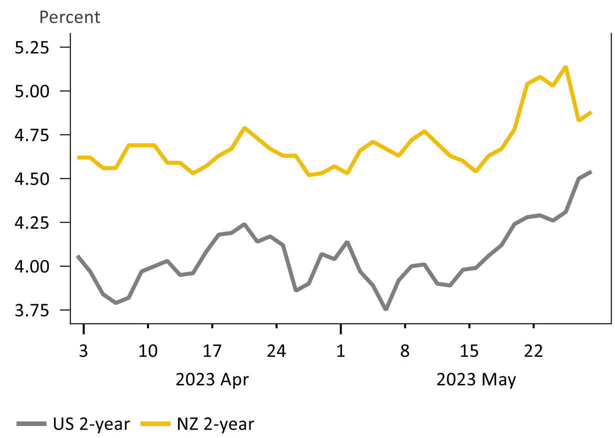
Government Bonds, 2-Year Yields



Source: Macrobond, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6059	0.6288	0.6143	0.6516	FLAT/DOWN	0.6000	0.6300
NZD/AUD	0.9280	0.9454	0.9285	0.9123	FLAT/DOWN	0.9230	0.9450
NZD/JPY	85.22	86.64	82.79	82.62	FLAT	84.00	87.00
NZD/EUR	0.5652	0.5811	0.5577	0.6057	FLAT	0.5600	0.5820
NZD/GBP	0.4908	0.5047	0.4921	0.5151	FLAT/DOWN	0.4790	0.5050
TWI	70.31	71.6	69.5	71.9	FLAT/DOWN	N/A	N/A

*^ Weekly support and resistance levels * Current as at 9.30 am today; week ago as at Monday 5.00 pm*

NZD Recap

NZD shed over 2 cents last week and was comfortably the weakest of the G-10 currencies. The major catalyst for the decline in NZD was the far more dovish than expected RBNZ May Monetary Policy Statement. The RBNZ raised the OCR by 25bps (as was widely expected) but then signalled that it was hanging up its hiking hat (which was not expected). Interest rate markets have carved almost 30bps off their expectations for the peak in the OCR (from around 5.9% to 5.6%) and are now pricing nearly 90bps of cuts over the October and November 2023 meetings.

NZD then extended its losses over the remainder of the week as strong US economic data and promising signs that the US government will avoid default bolstered the USD. Jobs data (initial and continuing claims), inflation data (PCE Deflator) and Q1 GDP all beat expectations. But it’s the persistence of inflation that really caught the attention of market participants. On balance, markets are now expecting another 25bp rate hike by the FOMC. It wasn’t all that long ago that market pricing was suggesting the FOMC had also finished its tightening cycle – after FOMC Chair Jay Powell had indicated his preference was to pause. At the same time, market pricing for the start of the rate cutting cycle has been pushed back from mid-2023 to the start of 2024.

NZD/AUD also tumbled over the week largely because of the dovish RBNZ meeting. However, NZD/AUD is only back to early May levels. Prior to the RBNZ signalling it thought it had done enough, NZD/AUD had lifted 1.3% over the month. The RBA’s dovishness and weak Chinese economic activity have been key tailwinds to NZD/AUD. NZD/GBP fell 3% last week and is at its lowest level since February 2022. Market pricing for additional BoE hikes doubled last week (from 50bp to 100bp) after UK CPI printed stronger than expected.

Near-term Outlook

Where NZ interest rate markets settle will likely have some influence on NZD this week. In our view, 90bs of RBNZ cuts over the final two meetings of 2023 is too much, too soon. We still think that the RBNZ will want to be certain inflation is heading back to its 1-3% target before even thinking about cuts. And upside risks remain – notably that net migration holds up for longer and proves more inflationary than the RBNZ currently expects. But in saying that, there is little in the way of NZ economic data to directly influence market expectations this week.

Offshore, US debt ceiling negotiations can continue to have a bearing on USD and NZD/USD by extension. The signs are promising but both sides still need to vote on the deal to raise the debt ceiling and avoid a US government default. If Congress passes the deal this week, NZD/USD can weaken further. In addition, signs of resilience in the US labour market during Saturday morning’s Non-farm Payrolls report could further weigh on NZD/USD.

Meanwhile, NZD/AUD will remain driven by relative interest rate expectations this week. A quickening in the pace of monthly Australian CPI could test the resolve of Australian interest rate markets (of a near-term RBA pause) and weigh on NZD/AUD.

Medium-term outlook

We expect NZD/USD to ease over the medium term, trending to a trough of 0.5800 by Q3, before gradually recovering (to 0.6500 by the end of 2024). Subdued dairy prices, NZ’s wide current account deficit and weakening local and global growth (a negative for the pro-cyclical NZD) are all weights on the Kiwi.

Slowing global growth is likely to trigger broader-based USD strength too, but NZD tends to underperform in a soft global economic environment relative to the less risk sensitive non-commodity currencies like JPY, EUR & GBP. Our full forecasts are on Page 6.

On the other hand, NZD/AUD is projected to follow the opposite path: trending higher to a 0.9300-0.9500 range over the coming months before easing thereafter. With China’s economic recovery likely to be consumption-led rather than infrastructure-driven, CBA expects Aussie commodity prices to fall 15-20% this year – a larger drop than we expect for the commodities the NZD is most exposed to, namely dairy and meat.

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Interest Rate Market

Wholesale interest rates	Current*	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	5.50	5.25	5.25	1.50	UNCH	DOWN
90-day bank bill	5.69	5.83	5.56	2.42	UNCH	DOWN
2-year swap	5.26	5.44	5.05	3.80	UNCH	DOWN
5-year swap	4.58	4.58	4.30	3.74	UNCH	DOWN
10-year swap	4.47	4.43	4.20	3.75	UNCH	DOWN
10-year govt bond yield	4.44	4.39	4.07	3.49	UNCH	DOWN
Curve Slope (2s10s swaps)	-0.79	-1.01	-0.86	-0.05	UP	UP

* *Current as at 9.30 am today; week ago as at Monday 5.00 pm. Key UNCH = Broadly unchanged*

Market recap

NZ yields start this week 10-20bps lower than a week ago for short-term tenors, with longer-term yields broadly unchanged, helping to flatten (inverted) yield curves. Volatility has been pronounced, with position-related flows pushing yields higher leading up to the May MPS, with 1-year swap yields above 6% for the first time since 2008 and with peak OCR market pricing just shy of 6.00%. NZ yields swiftly retreated after the RBNZ hiked by 'just' 25bps and signalled 5.50% was likely the peak in the OCR – little change from its February MPS view and considerably below expectations of a circa 5.75% peak. Market pricing was "reset" with peak OCR expectations about 35bps lower. NZ short-term swap yields fell 30-40bps and have plateaued at post OCR-announcement levels, whereas falls to longer-term yields were milder and were subsequently unwound.

Global yields have ground higher, amid periodic bouts of volatility, led by shorter-term tenors. There is market unease that the US politicians will fail to agree to raise the debt ceiling despite a tentative deal being outlined. There was also the risk the FOMC may have to still hike policy rates (the Fed Minutes highlighted divides on whether a pause was warranted), with US core PCE inflation (4.7% yoy) surprising to the upside. UK yields were sharply higher given stronger than expected UK inflation data, concerns by the BoE over persistent high inflation and speculation that the BoE was going to halve its £815bn QE portfolio over the next few years. About 100bps of BoE hikes are now priced in. Australian yields have drifted higher, with market pricing for 2023 erring on the side of RBA rate hikes.

Near-term interest rate outlook

Current market pricing has a circa 5.65% August 2023 OCR peak, followed by roughly 160bps of cuts through till the end of 2024 (4.10% OCR). We expect the hurdle to OCR moves to be high this side of the October 14 election, but if the RBNZ were to move it would likely hike than cut. The Q1 activity data for NZ in the coming weeks should help confirm whether NZ is heading for recession despite booming net immigration. Pricing metrics from sentiment measures have proved to be a useful directional signal for inflation, and the combination of soft business sentiment and cooling pricing intentions from the ANZBO should help keep the risk of OCR hikes on ice.

With June 5 named as the date from which the US Government could default on its obligations, there is not much time for the tentative debt deal to be approved by the US Congress. Global and local yields will be sensitive to news on the US debt ceiling, with headline-driven volatility expected until a deal is approved. Our base case is that a deal is struck, after which yields should settle. The global central bank rate hiking cycle is well into the mature phase, but it still looks premature to rule out further hikes, let alone factor in an aggressive sequence of rate cuts. Forthcoming data (manufacturing/services ISM, US non-farm payrolls) will be pivotal. The shift up in global yields over the past few months could have further to run. We envisage, however, that outright yields are still likely to peak at low levels. Our CBA colleagues would not rule out a June hike by the FOMC but still see a high hurdle to the RBA hiking in June, with close to 15bps of hikes priced in by September.

Medium-term outlook

We expect the OCR to remain on hold at 5.5% until Q2 2024, at which stage the OCR is gradually trimmed to 3% in the second half of 2025. Our CBA colleagues expect the RBA cash rate has peaked at 3.85%, followed by 50bps of cuts in Q4 2023 and a further 50bps of cuts in H1 2024 (2.85%). The FOMC is expected to leave the Fed Funds rate on hold, with rate cuts from early 2024 and the Fed Funds rate down towards 2.0% by early 2025. Yield curve inversion in NZ is expected to ease as shorter-term yields move lower, with the curve eventually normalising. We expect longer-term yields to remain at historically-low levels, both domestically and globally.

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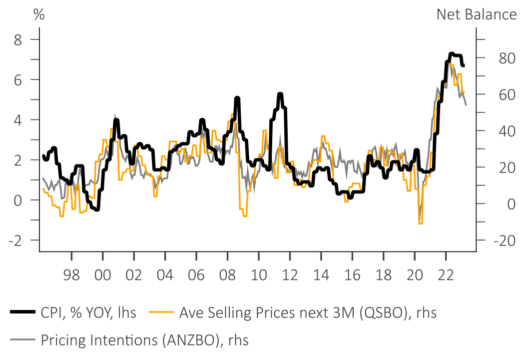
Domestic events for the week ahead

Data	Date	Time (NZT)	Previous	Market Expects	ASB Expects
ANZ Business Outlook, May, Own activity outlook	31/5	1:00pm	-7.6		Weak
NZ Terms of Trade, %qoq, Q1	2/6	10:45am	1.8		-0.5

Outright levels of sentiment for businesses' outlook for their own activity and for the wider economy are expected to remain soft, consistent with a soft pace of expansion at best, or more likely continued recessionary conditions. Firms are likely to signal continued retrenchment in future activity and subdued hiring and investment. Pessimism is likely to remain widespread across economic sectors. **The recent cooling in surveyed pricing intentions has led the decline in CPI inflation and will be closely followed as a directional signal on inflation. We expect household and business sector activity to be subdued over 2023 as the NZ economy flirts with mild recession.** Nevertheless, the RBNZ is likely to maintain restrictive policy settings and keep the OCR at 5.50% until it is confident CPI inflation will settle in the 1-3% target range**. It is unlikely to be until 2024 that conditions in the labour market and the inflation outlook warrant OCR cuts.**

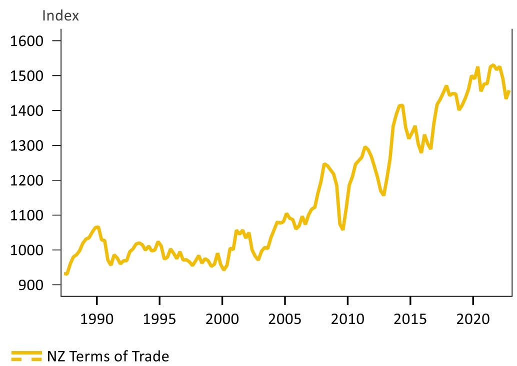
We expect NZ's terms of trade fell 0.5% in the December quarter. Both export and import prices look to have eased through the quarter, with export prices projected to have eased by 3% and import prices projected to have fallen a more modest 2.5%. **We also anticipate that import volumes have held up better than their export counterparts over the quarter.** In particular, NZ fuel imports have been strong in the aftermath of the Marsden Point refinery's closure. Monthly merchandise trade data suggest that the combination of a weaker terms of trade and resilient import volumes have helped push NZ's annual trade deficit to record highs.

CPI Inflation and Pricing Intentions



Source: Macrobond

NZ Merchandise Terms of Trade



Source: Macrobond, ASB

Major International Events for the week ahead

Data		Date	Time (NZT)	ASB
AU	Building Approvals, Apr	30/05	1.30pm	-1.0%
AU	Construction Work Done, Q1 23	31/05	1.30pm	Flat
AU	Private Sector Credit, Apr	31/05	1.30pm	0.4%
AU	CPI Indicator, Apr	31/05	1.30pm	6.4%/yr
CA	GDP, Mar	1/06	12.30am	-
AU	CoreLogic Dwelling Prices, May	1/06	2.01am	+1.4
AU	Capex	1/06	1.30pm	-
	Q1 2023 (qoq growth)	-	-	1.4%
	6th est 2022/23	-	-	$A158bn
	2nd est 2023/24	-	-	$A133bn
EZ	CPI, May	1/06	9.00pm	6.5%/yr
US	ISM Manufacturing, May	2/06	1.45am	47.5pts
AU	Home Lending, Apr	2/06	1.30pm	-1.0%
US	Payrolls, May	3/06	12.30am	220,000
	Unemployment rate	-	-	3.4%
	Average Earnings	-	-	0.4%/mth

** Forecasts and commentary originally published by CBA Global Markets Research Friday 26th of May.*

US political developments regarding the debt ceiling will be important to markets this week as the projected deadline for a default approaches.

On the data front, it's a busy week in Australia, with the highlights being Q1 construction work done and the monthly CPI indicator (Wednesday), and the Capex survey on Thursday.

Our CBA colleagues expect construction work done to record a flat outcome in Q1 23 after a fall of 0.4% in Q4 22. Challenges plague the industry, particularly in the residential space due to labour shortages and delays in both approvals and construction. Offsetting this is expected to be engineering work with the public capex pipeline remaining high.

CBA expect a slight acceleration in the annual pace of the monthly CPI in April. It printed at 6.3%/yr in March, and we expect it to lift by 6.4%/yr to April. The slight uptick in the annual rate is driven by petrol prices. CBA also expect some weakness in goods prices (e.g. clothing), a softer seasonal bounce in travel prices, and continued lift in rents.

There are three numbers to watch in the Q1 2023 Australian capex release. Firstly CBA expect the volume of capex to lift by 1.4%/qtr, following a gain of 2.2% in Q4 22. There is a large pipeline of work being done now. CBA expect small downgrades in the intentions data due to a slowing Australian economy. For the sixth estimate CBA expect it to print at $A158bn, which would imply a lift in investment of 12% in 2022/23, a small fall from the 13% expected in the fifth estimate. We expect a small shift lower in the second estimate of 2023/24. A print of $A133bn would imply a lift of 6% next financial year.

The Eurozone CPI on Thursday will be closely watched. Eurozone headline inflation is on a clear downward trend because of lower energy and some goods prices. We expect a further deceleration to 6.5%/yr in May. Core inflation can ease to 5.5%/yr. The ECB will be watching the outcome for services inflation closely, with services inflation often sticky.

The week is bookended by US Non-farm Payrolls, which is due Saturday morning NZT. The low level of jobless claims in the US suggests the monthly increase in payrolls remains strong, i.e., above 200,000. The unemployment rate is likely to remain near its historical low around 3.4%. Average earnings are therefore likely to have kept expanding solidly, circa 0.4% month on month.

Key Forecasts

ASB NZ economic forecasts	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Mar-25	Mar-26
	<< actual	forecast >>						
GDP real - Q%	-0.6	-0.6	0.0	-0.4	-0.3	-0.1	0.8	0.8
GDP real - A%	2.2	2.1	0.5	-1.6	-1.3	-0.9	2.5	3.3
GDP real - AA%	2.4	2.7	2.7	0.8	-0.1	-0.8	1.0	3.2
NZ House Prices (QV Index) - A%	-10.9	-12.1	-12.3	-10.3	-7.1	-3.0	11.1	13.9
CPI - Q%	1.4	1.2	1.1	1.7	0.8	0.7	0.5	0.6
CPI - A%	7.2	6.7	6.0	5.6	4.9	4.3	2.8	2.7
HLFS employment growth - Q%	0.5	0.8	0.3	0.1	0.1	0.1	0.4	0.4
HLFS employment growth - A%	1.6	2.4	2.8	1.7	1.4	0.6	1.3	1.6
Unemployment rate - %sa	3.4	3.4	3.6	4.0	4.4	4.8	5.1	4.8

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-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Mar-25	Mar-26
(end of quarter)	<< actual	forecast >>						
NZ OCR	4.75	5.50	5.50	5.50	5.50	5.25	4.00	3.00
NZ 90-day bank bill	5.23	5.70	5.70	5.70	5.50	5.25	4.00	3.20
NZ 2-year swap rate	5.02	5.30	5.25	5.10	4.95	4.80	4.35	3.90
NZ 5-year swap rate	4.41	4.60	4.55	4.45	4.35	4.30	4.15	4.05
NZ 10-year swap rate	4.29	4.50	4.50	4.50	4.45	4.40	4.25	4.20
NZ 10-year Bond	4.20	4.50	4.45	4.45	4.35	4.25	4.00	3.95

ASB foreign exchange forecasts	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Mar-25	Mar-26
(end of quarter)	<< actual	forecast >>						
NZD/USD	0.63	0.61	0.58	0.61	0.62	0.63	0.66	0.66
NZD/AUD	0.93	0.95	0.94	0.94	0.94	0.93	0.87	0.85
NZD/JPY	84	82	77	79	79	80	83	83
NZD/EUR	0.57	0.57	0.55	0.56	0.55	0.55	0.54	0.54
NZD/GBP	0.51	0.50	0.50	0.52	0.52	0.52	0.53	0.53
NZD/CNY	4.3	4.2	4.1	4.2	4.2	4.3	4.4	4.4
NZD TWI	71.3	70.8	67.9	70.0	70.3	70.5	71.5	71.2

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