ANZ Research

February 2021

Quarterly Economic Outlook

The journey back

This is not personal advice. It does not consider your objectives or circumstances. Please refer to the Important Notice.

Contact us

See page 12.

Contents

ISSN 2624-1439

Publication date: 26 February 2021

Uneven and uncharted

Compared to 2019, the economy is running a different vehicle on a different fuel, on a different road, leading to a different destination. This is not a textbook demand shock, nor a textbook supply shock. Getting a handle on the state of the economy is challenging, and it's not going to get any easier in 2021! The elevator pitch: 2021 will be a bit of a sideways year (with noise in the data); monetary policy has done enough (barring downside risks); and central government has its work cut out to address inequality and the housing crisis. Click here for more.

Turning around

From early 2022 the outlook is expected to change dramatically, with global economies seeing sustained recovery and the border expected to reopen. From this point, we expect to see a more rapid improvement in incomes and the labour market, evening out across the economy, an easing in supply constraints, a lift in inflation, greater focus on fiscal consolidation and longer-term issues, and higher interest rates in time. The economy won't look exactly the same on the other side of this and some scars will take time to heal, but the journey back to normality is in our sights. Click here for more.

Returning to normal

Monetary policy and fiscal policy settings are expected to be supportive of activity for a while yet, but further stimulus no longer appears necessary. With the recovery looking more assured from 2022, a return to more "normal" policy settings is on the cards in time. Eventually, the RBNZ will embark on a process of policy normalisation, which will ultimately lead to higher interest rates – though this is expected to be a gradual, multi-year process. Fiscal stimulus has helped the economy bounce back and settings will remain supportive in the short term, but meaningful consolidation will soon be necessary. Click here for more.

The road ahead for markets

Financial market conditions have changed dramatically since the end of Q4 as the reflation thematic has taken hold locally and globally. With the recovery now more assured and central banks keeping policy easy, we expect these trends to continue over the next two years, and that's reflected in our forecasts for higher and steeper yield curves and a stronger NZD. There will be volatility and pull-backs along the way, but we expect them to be shallow. Click here for more.

Calendar Years	2017	2018	2019	2020(e)	2021(f)	2022(f)
New Zealand Economy						
Real GDP (annual average % change)	3.5	3.4	2.4	-2.8	3.5	3.7
Real GDP (annual % change)	3.9	3.3	1.7	-0.3	1.3	4.0
Unemployment Rate (Dec quarter)	4.5	4.3	4.1	4.9	5.3	4.2
CPI Inflation (annual %)	1.6	1.9	1.9	1.4	1.7	1.7
Terms of Trade (OTI basis; annual %)	7.9	-4.8	7.1	-1.5	1.4	1.9
Current Account Balance (% of GDP)	-2.9	-4.2	-3.3	-0.8	-3.3	-2.6
NZ Financial Markets (end of Dec quarter)						
TWI	74.4	73.4	73.7	75.2	77.0	76.5
NZD/USD	0.71	0.67	0.67	0.72	0.77	0.77
NZD/AUD	0.91	0.95	0.96	0.94	0.94	0.94
Official Cash Rate	1.75	1.75	1.00	0.25	0.25	0.25
10-year Bond Rate	2.72	2.37	1.65	0.99	2.20	2.50

Source: Statistics NZ, Bloomberg, ANZ Research

Uneven and uncharted

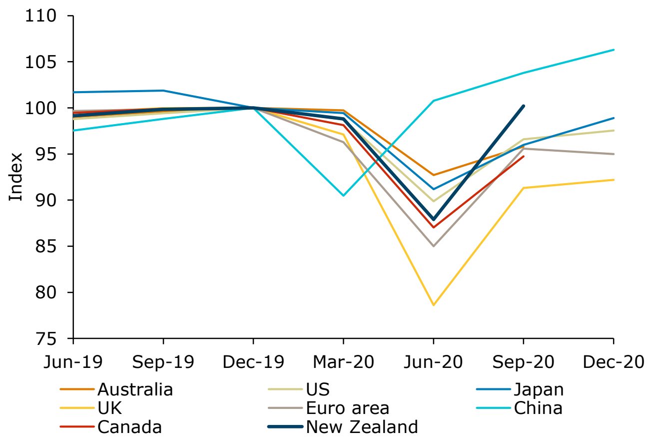
Summary

Compared to the 'good old days' of 2019, the economy is now running a different vehicle on a different fuel, on a different road, leading to a different destination, which, if we're being honest, economists still don't know a lot about, let alone how long it might take to get there. But we're doing our best to figure it out. This is not a textbook demand shock, nor a textbook supply shock. Getting a handle on the fundamental state of the economy is challenging in this environment, and it's not going to get any easier in 2021! The elevator pitch: 2021 will be a bit of a sideways year (with a fair amount of noise in the data); monetary policy has done enough (barring downside risks eventuating); and central government has its work cut out to address inequality and the housing crisis.

Uneven and uncharted

New Zealand's successful virus containment has created the necessary conditions for most kiwis to go about their daily lives with little disruption (notwithstanding short stints under higher alert levels). That, alongside the significant policy response, has made New Zealand one of the best-performing economies amongst its key trading partners (figure 1). And this outperformance looks set to persist for a while yet.

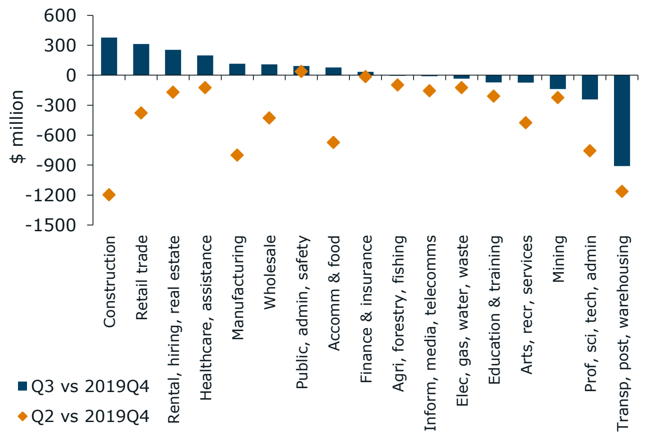
Figure 1. GDP levels (Q4 2019 = 100



Source: Macrobond, ANZ Research

But under the hood, the situation is rather complex. Talk to a builder or a plumber and they'll probably tell you that their pipeline of work is lengthy, and that their biggest concern is no longer the sustainability of demand but difficulty meeting it (whether it be landing materials in New Zealand, or just having enough people or hours in the day to do the mahi). Talk to a tourism operator or hotelier and they may be sounding pretty nervous, with New Zealanders having gone back to work and school, exposing the void typically occupied by international tourists.

Figure 2. GDP by industry vs pre-crisis (Q4 2019)

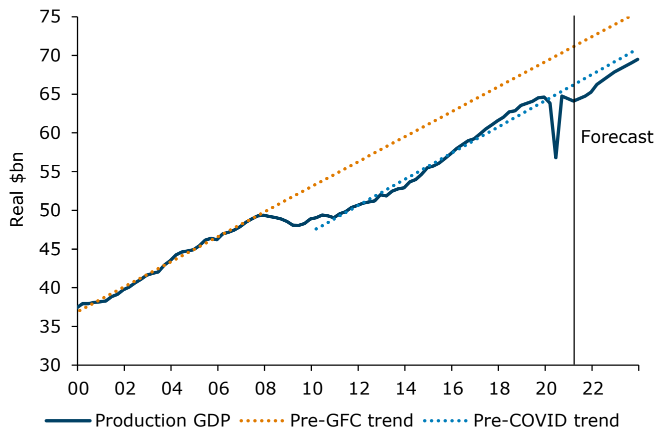


Source: Stats NZ, ANZ Research

This divergence has been stark in the data to date (figure 2). By weight, we estimate that around 75% of GDP industries more than recovered from lockdown by the end of 2020. And broadly speaking, strong growth in these industries has been enough to fill the hole left by the remaining 25%. But until borders reopen, growth is going to be harder to achieve from here, as the industries that have done most of the heavy lifting to date bump into capacity constraints.

There's no denying that the recovery thus far has been impressive. But while the economy has now officially recovered to its pre-crisis level (at the headline level) there remains a tourism-sized hole compared to where the economy would have been had COVID-19 never happened (figure 3). Relative to this counterfactual, we think a lot of this GDP is gone for good.

Figure 3. GDP level and pre-crisis trend



Source: Stats NZ, ANZ Research

The economy isn't just running at two speeds at an industry level. Regional divergence has also opened up, with the lack of visitors in key tourist hotspots having broader flow-on impacts, while closer to our CBDs, some regions are experiencing strong weekend demand as city folk venture out for a day trip or an overnight stay somewhere a little more accessible.

Globally, the pandemic has altered the composition of private consumption, the level of which has been bolstered by an unprecedented amount of temporary fiscal support. With many economies locking down, people have naturally traded restaurant/experience spending for online purchases of more stuff. This compositional shift towards manufactured goods is a lumpy one, and it's creating significant headaches for global supply chains, with the imbalance seeing shipping costs lift – significantly. This is challenging the world's "just in time" approach that has been a dominant feature of global trade these past few decades. Meanwhile, reduced air cargo means there's more for ships to carry. How long these disruptions persist is anyone's guess, but with vaccine light at the end of the COVID tunnel, it looks like global inventories will eventually rebuild (and possibly be kept permanently higher) as supply chain kinks are ironed out. That could happen as soon as the latter half of this year. An unwinding of these cost pressures could dampen inflation around the globe, which is why policy-makers are looking through this now.

Socially, the gap between the haves and have-nots is widening at an accelerated pace. Go talk to a boat or luxury car salesman (in the right location) and they're likely to say they're run off their feet, with deferred international holiday money being spent on new toys to enjoy the kiwi summer. Meanwhile, queues at food banks are getting longer, with many people still out of work or not getting the hours they would like. Break-neck house price inflation means the dream of home ownership has now all but evaporated for some, while others are finding equity in their house that they thought would take years to achieve. Every crisis breeds its share of winners and losers, but this one is doing so at an alarming pace. Looking beyond the headline economic data, wealth and intergenerational inequality is getting away on us, and some bold policy action on housing could go a long way to fix it.

More broadly, with so many forces pushing and pulling on the economy, policy-makers face a significant trade-off between keeping momentum going and not further exacerbating inequalities. But there are some cold hard realities, including the facts that you can't decouple the NZ economy from the housing market, and not every business can be saved (there's a point where subsidies that prop up unviable businesses are not a fair or efficient use of taxpayer dollars). Hard decisions need to be made, and 2021 could bring a lot of them.

But the glass-half-full view of the world is that the economy is genuinely in the most optimistic scenario we could have imagined when we started working through the implications of this crisis a year ago. Much of the stronger-than-previously-anticipated economy can be contributed to a handful of key factors, which have been very complementary:

- Successful containment of COVID-19 (with a few lockdowns along the way), which has provided kiwis the freedom and confidence to go out – and spend. We are very lucky.
- Fiscal policy stepping up to the plate, essentially putting a healthy chunk of Q2's lost production on its balance sheet (largely via the wage subsidy). That's meant incomes did not deteriorate anywhere near as much as production GDP did.
- Low interest rates doing their thing – admittedly largely via housing as opposed to business investment, but doing their thing nonetheless.

Put it all together, and the lucky ones (those not exposed to international tourism and who can muster a deposit) have jumped on the gravy train that is New Zealand housing, which in turn has become the key engine of domestic momentum. You have to ask, though, can housing-induced economic momentum carry the economy through to when borders reopen? Affordability constraints and credit headwinds (including renewed and higher LVR restrictions) suggest the impulse will slow – and that's our central expectation.

Looking through the noise – and there will be a fair amount of it – we think the economy is going to move broadly sideways through 2021, with the recent two-speed theme persisting under the hood. We do have a pretty soft start pencilled in, with Q1 being the quarter that MIA international tourists will be felt the most, and as the fiscal impulse turns to boot. But that's expected to go up against still-solid (but moderating) housing.

COVID and vaccine developments will be a key deciding factor for the year ahead (and beyond). While optimism has ebbed and flowed in recent months, we haven't seen the need to update our forecast assumption that the border will begin reopening to the wider world from early 2022.

For monetary policy this all speaks to an on-hold OCR and a lot of patience from the RBNZ as the data evolve (see Chapter 3: Returning to normal for more on the path to policy normalisation). Nobody can fully understand the size, composition, and persistence of the shocks to supply and demand in real time. But we think this will prove to be a net-demand shock over the medium term, justifying continued central bank caution.

Turning around

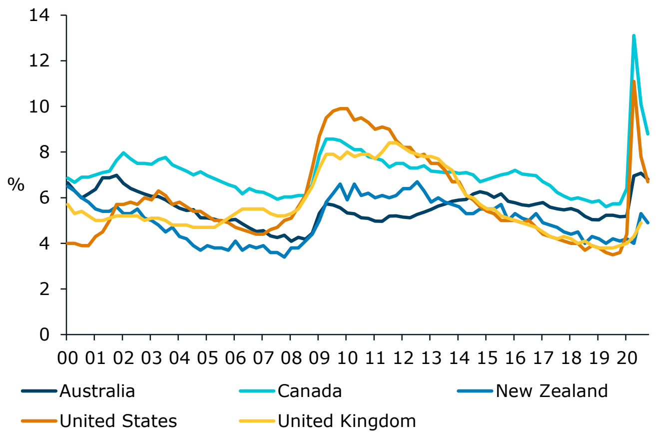
Summary

From early 2022 the New Zealand economic outlook is expected to change dramatically, with global economies seeing sustained recovery and the border expected to reopen. The road won't necessarily be smooth and risks mean that the map could well change. But we are assuming that the economic direction will change dramatically as life returns to normal. From this point, we expect to see a more rapid improvement in incomes and the labour market, evening out across the economy, an easing in supply constraints, a lift in inflation, greater focus on fiscal consolidation and longer-term issues, and higher interest rates in time. The economy won't look exactly the same on the other side of this and some scars will take time to heal, but the journey back to normality is in our sights.

Turning around

It's going to be an uneven and potentially bumpy ride this year (see Chapter 1: Uneven and uncharted), but in 2022 we expect the journey back to normality to begin. At that time, conditions globally are expected to be improving as COVID-19 containment is gradually achieved from the latter part of this year. For global economies that have been impacted by oscillating or prolonged lockdowns, this will mark an enormous shift that will see life return to normal, firms turn a corner, sustained growth, and a meaningful improvement in labour market outcomes (figure 1).

Figure 1. Selected unemployment rates



Source: ABS, StatCan, Statistics NZ, BLS, ONS, Bloomberg, Macrobond, ANZ Research

Note: The UK unemployment rate is artificially low because the 5.3m people on furlough are not technically defined as unemployed, masking the true impact of COVID-19 on jobs.

We are also assuming that COVID-19 inoculation occurs in New Zealand over the latter part of this year and the border can gradually reopen from early 2022. Although we have less lost ground to make up than other economies, this will be a game changer for the outlook domestically. As life normalises, so too will the way the economy operates.

Reopening the border from early 2022 appears achievable, but key milestones need to be reached before then: herd immunity needs to be sufficiently achieved here in New Zealand. Even if inoculation sees COVID-19 contained globally, opening the border implies letting COVID-19 in and living with it (assuming we continue to successfully keep it out until then).

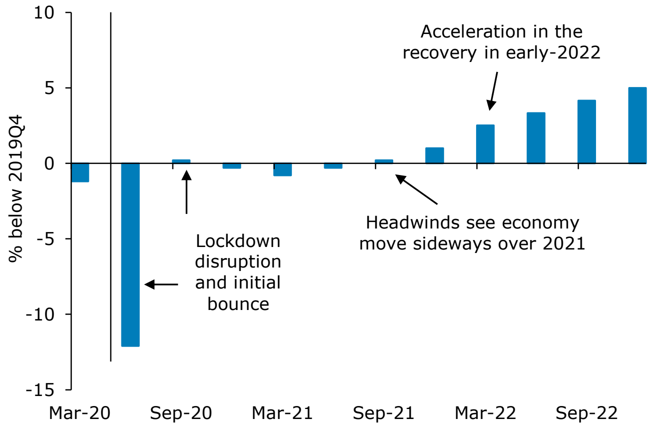
The path won't always be smooth and the road map could change between now and then due to unforeseen risks. But normalisation of global economic activity along with border reopening is assumed to bring the New Zealand economy to a crossroads in early 2022.

We expect:

- International tourism and education will resume. There may be caution regarding travel initially, but there will be a lot of pent-up demand too.
- Household spending patterns will shift. It may take some time to gear up if the labour market has deteriorated, but households will be willing to spend more as incomes grow, and travel again.
- More travel by Kiwis means more spending overseas and less here. Fortunately, the return of international tourists should more than offset this, but timing matters. There will likely be an influx of international visitors from pent-up demand, but if border opening does not occur early in the year (or isn't well signalled in advance), firms will miss another period of peak demand.
- Overall, border opening does not guarantee an immediate return to normal for tourism firms, and it may take some time for air capacity to return and scars to heal. But incomes will be able to normalise and grow again.
- The global economy will be able to progress on the path to economic recovery. New Zealand's goods exports have weathered the slowdown well. But for services exports, improvement in global incomes will support recovery and eventual growth.
- International shipping and trade will normalise, lifting a constraint on activity. Disruptions are expected to start to ease within the next six months, but there could be pockets of pressure until spending and supply volatility subside.
- Residual business caution will dissipate. In aggregate, business sentiment is pretty buoyant, but there are divergences. For firms impacted by the recent crisis, expectations and intentions around investment and employment will improve.
- The economic recovery will be able to move forward at a faster pace (figure 2), though there

may be some volatility as this plays out. Incomes will improve and even out.

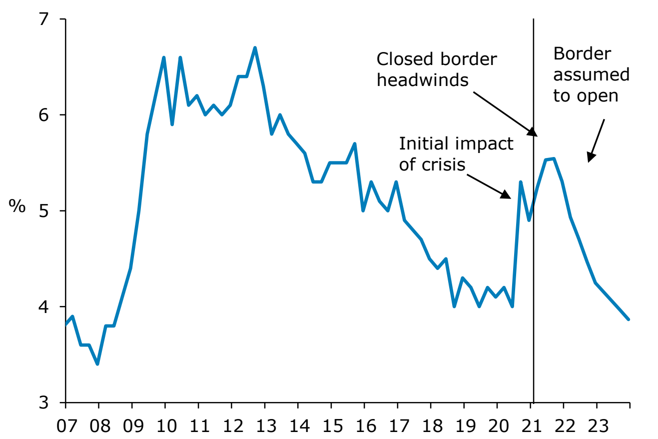
Figure 2. GDP forecast



Source: Statistics NZ, ANZ Research

- Areas of the economy that have been underperforming will likely experience a period of catch-up, potentially drawing resources back from more domestically focused industries that have been less affected by the recent period of economic disruption. Relative price and wage adjustments, along with eventual interest rate increases, will help to facilitate this reallocation.
- Immigration can resume. The outlook here is very uncertain, but population flows would boost both demand in the economy and its supply potential.
- Labour shortages will ease and supply mismatches will dissipate, making conditions easier for businesses and supporting a more rapid reduction in unemployment (figure 3).

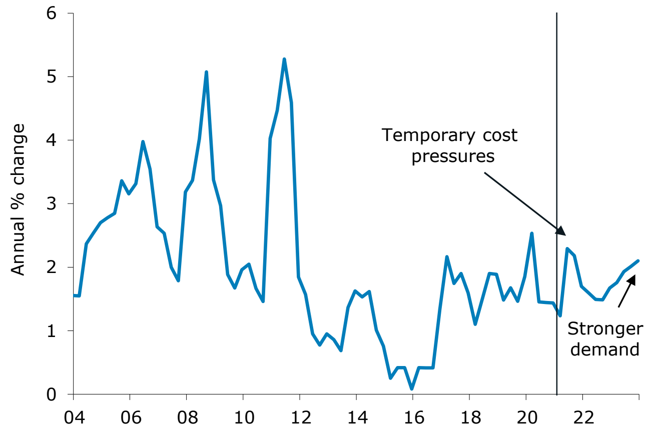
Figure 3. Unemployment forecast



Source: Statistics NZ, ANZ Research

- Demand will increase but so too will supply, alleviating pressure on resources to some extent. Nonetheless, with income gains more assured, spending is expected to lift and we assume that any residual spare capacity in the economy will be absorbed.
- Cost pressures on the back of supply disruption are expected to dissipate, eventually giving way to a demand-driven lift in inflation (figure 4) on the back of an improving labour market and tightening resource pressures.

Figure 4. Inflation forecast



Source: Statistics NZ, ANZ Research

- Downside risks will abate considerably. Other risks will remain, as always, quite separate from the pandemic. But the imminent threat of COVID-19 disruption will no longer weigh on firms, households and policymakers.
- Fiscal policy will be able to actively pivot towards consolidation. Although we are in a better position than most, the response to COVID-19 has been expensive. Ultimately, the money needs to be paid back and the Government will need to pave a clear path back to sustainable debt levels. Income growth will help, but a combination of reduced spending and/or higher taxes will be needed too.
- Longer-term policy challenges will become even more prominent, including poverty, housing affordability, climate change, population ageing and intergenerational equality.
- Monetary policy normalisation will be able to resume, meaning higher interest rates in time (see Chapter 3: Returning to normal).

The economy will not look the same on the other side of this: some firms will no longer exist, vocations will have changed, debt levels will be higher, and we may live, work and spend differently. Scars of the crisis may take time to heal, especially in economies where the human and economic toll has been enormous. But the journey back to normality is in our sights.

Returning to normal

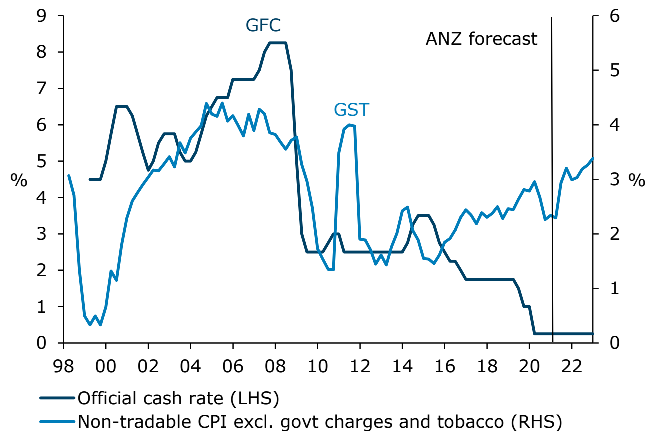
Summary

Monetary policy and fiscal stimulus have provided significant support to the economic recovery to date. Policy settings are expected to be supportive of activity for a while yet, but further additional stimulus no longer appears necessary. With the recovery looking more assured from 2022, a return to more "normal" policy settings is on the cards in time. Eventually, the RBNZ will embark on a process of policy normalisation, which will ultimately lead to higher interest rates – though this is expected to be a gradual, multi-year process. Fiscal stimulus has helped the economy bounce back and settings will remain supportive of activity in the short term, but meaningful consolidation will soon be necessary.

Returning to normal

The combination of monetary policy support and fiscal stimulus has provided a significant cushion to the economy, which has helped facilitate the vigorous bounce-back seen to date. On the monetary side, the RBNZ lowered the OCR to a record low of 0.25% (figure 1), introduced the Large-Scale Asset Purchase Programme (LSAP, or "QE"), implemented a bank Funding for Lending Programme (FLP), and readied the banking system for negative interest rates if required.

Figure 1. OCR and non-tradable CPI excluding government charges and tobacco



Source: Statistics NZ, RBNZ, ANZ Research

On the fiscal side, stimulus has been most potent from the wage subsidy, which protected jobs and incomes and provided a degree of certainty during disruption. A range of other temporary policy supports accompanied it. Now that the wage subsidy has rolled off, fiscal policy is pivoting towards the likes of infrastructure spending, which will support the level of economic activity, but will not be an impetus to growth (that would require ever-increasing rates of spending).

Overall, monetary and fiscal policy settings are expected to be "expansionary" for a while yet. And provided that downside risks do not eventuate, there is no need to add further stimulus to the pile – given the stronger-than-expected economic bounce seen to date. That means the focus can now turn to when – and how – policy might return to more normal settings. This will be a key focus for markets, shaping the outlook (see Chapter 4: The road ahead for markets).

For the RBNZ, the monetary policy outlook will depend on a range of macroeconomic demand and supply factors (see Chapter 1: Uneven and uncharted and Chapter 2: Turning around) and it is too soon to know exactly what normalisation will look like – and when. Our recent ANZ NZ Insight: The path to normal gives a framework for how the RBNZ might think about this.

We expect that the RBNZ will maintain a cautious approach to removing stimulus in line with their "least regrets" approach. Policy normalisation will be a gradual, multi-year process where they feel their way as they go. We think four criteria will need to be met before the RBNZ are ready to normalise:

1. The labour market will need to be at or above full employment.
2. Inflation needs to be at the target mid-point and expected to stay there.
3. Inflation expectations need to be at or above the target mid-point.
4. Risks to the economic outlook need to be balanced. This is clearly subjective. Currently, the RBNZ considers risks to be balanced, though this may change over time. There may also be residual caution until COVID-19 herd immunity is reached.

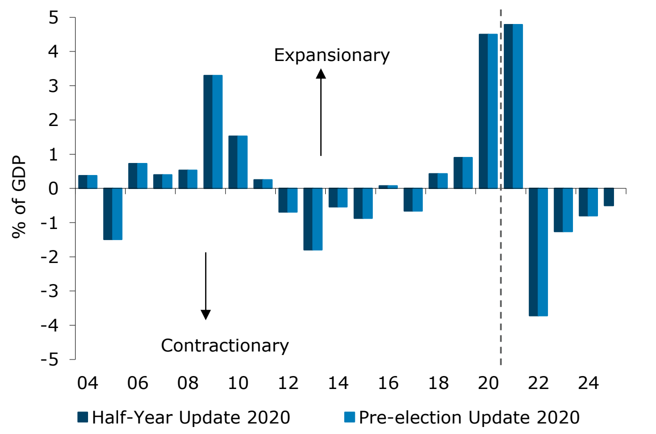
The RBNZ has indicated that meeting its targets will take time, but has so far kept its options open regarding the path forward, with no indication of what normalisation might look like, and not much information regarding when. The unconstrained OCR, which summarises the gamut of conventional and unconventional monetary stimulus into an OCR equivalent, is roughly flat this year but does lift around 70bp in 2022 once the border is open. In our view, this will be achieved via LSAP tapering first. 'Tapering' means reducing the pace of bond purchases, then eventually stopping, seeing support provided to markets lessen over time. This tapering would be a conscious policy decision, rather than a strategic adjustment by staff based on changes to bond supply, as is occurring already. OCR hikes will most likely occur after purchases have ended.

Based on our forecasts, we expect tapering might occur in 2022, with the RBNZ on track to meet the criteria above. Then the OCR might be gradually lifted from mid-2023, when we expect the RBNZ's targets will be comfortably achieved. Risks are skewed to this happening earlier.

Eventually, the RBNZ will look to reduce the size of its balance sheet by letting bond mature and not fully (or partially) re-investing the proceeds. This is likely to be very gradual, once the OCR has been lifted. We expect the RBNZ will let the FLP reach its planned end from the middle of 2022. This is expected to largely operate in the background and then naturally come to an end, rather than being a key part of normalisation.

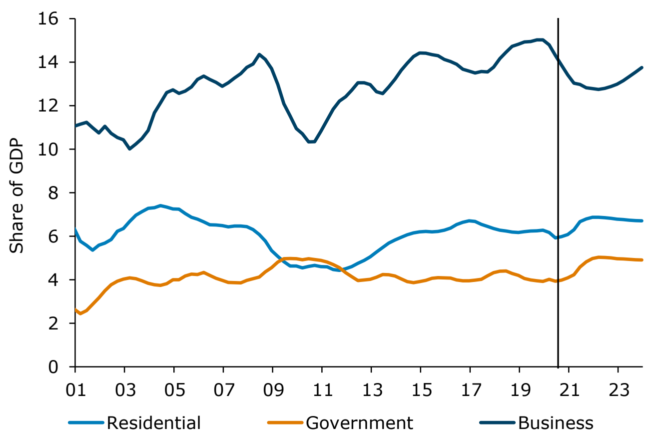
On the fiscal side, spending is expected to be pared back – then eventually paid back – seeing policy settings move from expansionary into contractionary territory quite soon (figure 2). At this point, the private sector will need to be ready to fill the gap (figure 3).

Figure 2. Fiscal impulse



Source: The Treasury

Figure 3. Investment share of GDP



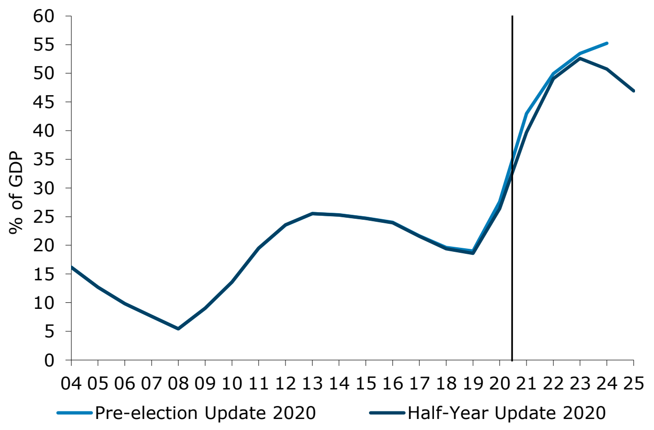
Source: Statistics NZ, RBNZ, ANZ Research

New Zealand was in a fortunate position at the advent of the COVID-19 crisis, with government debt levels low by international standards. And our successful health response has meant the price tag of the recent response has been relatively contained. But the fact is: there is no such thing as a free lunch. The wage subsidy was effective, but very expensive.

The bill will eventually need to be paid and the Government will be required to forge a path towards more prudent debt levels (figure 4). That will require significant surpluses, which will exert a meaningful drag on growth.

Previous communications from the Treasury suggest the appropriate "upper limit" for net core Crown debt is around 50-60% of GDP when responding to a significant crisis (and around 30% of GDP during good times). Based on latest forecasts, net core Crown debt is expected to peak at 52.6% of GDP in the 2023 fiscal year, then decline to 46.9% in 2025.

Figure 4. Core Crown net debt



Source: The Treasury

How exactly "prudent" levels of debt will be achieved thereafter is unclear. Growing the economy out of debt is an appealing strategy, and the more the Government does to boost productive capacity today, the easier that will be. Deploying more policy resource to our dismal productivity performance could go a long way in boosting future incomes and curbing the debt burden.

But this won't be enough to see debt return to prudent levels over a reasonable time (ie before the next big economic shock comes along). Some combination of higher taxes and less spending (fewer government services) will be required at some point.

The debate over how this should be achieved – and who should cover the cost – is poised to intensify. And the further the can is kicked down the road, the more the burden will fall on future generations. A number of longer-term challenges look set to put pressure on the fiscal position too, including the ageing population and climate change. The sooner the debt ratio is brought back to prudent levels the better positioned New Zealand will be to respond to these challenges, and the next (inevitable) crisis.

The road ahead for markets

Summary

Financial market conditions have changed dramatically since the end of Q4 as the reflation thematic has taken hold locally and globally. With the recovery now more assured and central banks keeping policy easy, we expect these trends to continue over the course of the next two years, and that's reflected in our forecasts for higher and steeper yield curves and a stronger NZD. There will be volatility and pull-backs along the way, but we expect them to be shallow.

More assured outlook

Global financial market sentiment improved markedly as Q4 drew to a close, fuelled by vaccine optimism, generally better-than-expected activity data (pointing to a more rapid recovery) and early signs of inflation. This improvement has not been uniform across the globe, and there have been exceptions. But there have also been outliers, and New Zealand has been one of them, having been less impacted by COVID-19 while still benefiting from unprecedented stimulus. As this more assured outlook has become clearer, markets have priced out expectations of further monetary easing, and have instead started to contemplate the timing of policy normalisation, as discussed in Chapter 3: Returning to normal.

If cuts aren't needed, hikes must be next

Markets wait for no one, and having taken the view that further easing isn't required, they have quickly latched onto the view that hikes come next, leaving only a discussion as to when that might occur on the table. Our expectation is that we will see OCR hikes in 2023, but the risks look skewed towards sooner rather than later.

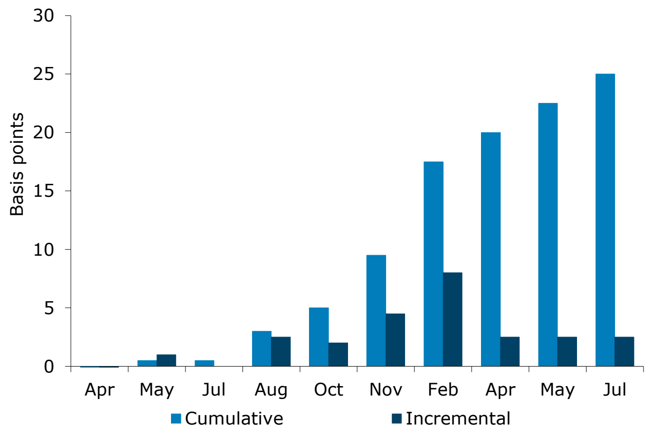
The RBNZ has made it clear that it will exercise "patience", expecting policy to remain easy for a "considerable" time, and won't tighten until its mandated targets (of sustained CPI inflation at 2% and maximum sustainable employment) are met.

But with the housing market booming, vaccine rollouts proceeding locally and abroad, and central banks generally erring on the side of caution and committing to keep policy stimulatory for longer, that has made the inflation outlook more assured. This in turn represents a challenge for bond markets. In the past, central banks have tended to pre-empt rises in inflation, and that has reduced bond yield volatility and kept interest rates in check. However, at the moment, central banks are looking to shore up inflation expectations (and in the case of the Fed, are prepared to tolerate a period of above-target inflation to make up for many years below target) and that speaks to yields going higher.

Incidentally, this shift away from being pre-emptive and towards looking for a more assured outlook for inflation and inflation expectations is reminiscent of the days before inflation targeting, when central banks were often criticised for being "behind the curve", as we discuss later.

There is a normalisation process to go through before the OCR can go higher, which will have more of an impact on the longer end of the yield curve as the RBNZ slows down the pace of its bond purchases. But markets are also fearful that when the OCR does go higher, it will do so quickly. Fears that the RBNZ might have "over-cooked" stimulus and might have to back-pedal rapidly have been at play at the short end, which is no longer pricing in cuts and is instead pricing in a hike by mid-2022 (figure 1).

Figure 1. Market expectations for changes in the OCR from its current level (February 26th)



Source, ANZ Research, Bloomberg

We don't expect hikes to occur as soon as the market does, but given the skew of risks and the upbeat tone of recent data, it's difficult to see market expectations being pared back too far, and past cycles tell us that markets tend to overestimate how quickly rates will rise. As such, pull-backs are likely to be shallow, even though what's priced into the market will, at times, look overdone.

NZD trading away from fair value

The same logic applies to currency markets. While one might call the NZD too high from a purely analytical perspective (it sits almost 10 cents above our long-run estimate of fair value), currency markets often spend months or even years trading away from measures of fair value (or where you'd expect them to be given macroeconomic fundamentals, interest rate differentials and the like).

The road ahead for markets

We are in an episode like that at the moment, and while the NZD remains a "market darling" and reflation remains the thematic, we expect it to continue trading at the rich end of valuations, especially with commodity prices also buoyant.

Given these considerations, the degree of momentum in markets, and the more assured domestic outlook (which is built on a foundation of successfully containing COVID), we have upgraded our NZD forecast and now see it gradually appreciating towards USD0.77 by the end of 2021 (table 1).

More upside yet for long-end interest rates

The RBNZ left the size and duration of its LSAP QE programme unchanged at $100bn in February. Reduced bond issuance means that is unlikely that the RBNZ will ever get to $100bn, but leaving the programme at that level buys the RBNZ optionality. With markets now functioning well, the LSAP is suppressing yields, but it is less of an influence than it was, and is set to become even less so as issuance slows over the next 18 months.

What matters more for the long end is what's happening offshore. Yields are rising rapidly across developed bond markets. With the Fed remaining deliberately "behind the curve", we expect global bond yields to continue rising as the COVID-19 crisis draws to a close and markets contemplate the more assured outlook for inflation. New Zealand long-term rates are expected to follow in turn.

This move higher in local bond yields is already well underway, and while the timing of it has come a little earlier than we had been anticipating, the overall trend is as we would have expected given the degree of stimulus that has been applied. For example, we did not expect the 10-year New Zealand government bond yield to reach the 2% level until nearer 2022, but it briefly touched that level during the last week of February, as this publication was going to print.

This move has been driven partly by a mild degree of market dysfunction and a lack of liquidity, and thus some pull-back is warranted, and is in our forecasts. However, the primary driver has been the rapid rise in global bond yields, and given the fast-evolving economic outlook, improving data-flow, and market optimism, the trend from here remains for yield curves to go higher and steeper, albeit at a slower pace, punctuated by shallow pull-backs (table 1).

Figure 2. NZ, Australian and US 10-year yields

Source, ANZ Research, Bloomberg

Increases in New Zealand long-end rates to date this year have been dramatic (figure 2) and that has seen NZ/US and NZ/AU 10-year spreads widen. These spreads have moved from negative to positive, as expectations of a negative OCR have been priced out, contributing to the faster pace of yield rises seen here. Now that the market has adjusted, we don't expect further significant NZGB underperformance.

Table 1: Forecasts (end of quarter)

FX Rates	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
NZD/USD	0.75	0.75	0.76	0.77	0.77	0.77	0.77
NZD/AUD	0.97	0.95	0.95	0.94	0.94	0.94	0.94
NZD/EUR	0.61	0.60	0.60	0.60	0.60	0.59	0.59
NZD/JPY	78.0	77.3	77.5	78.5	78.5	78.5	78.5
NZD/GBP	0.52	0.52	0.52	0.53	0.52	0.51	0.51
NZD/CNY	4.84	4.80	4.83	4.89	4.89	4.89	4.89
NZ$ TWI	77.4	76.4	76.8	77.0	77.0	76.5	76.5
Interest Rates	**Mar-21**	**Jun-21**	**Sep-21**	**Dec-21**	**Mar-22**	**Jun-22**	**Sep-22**
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.25
NZ 90 day bill	0.30	0.32	0.33	0.34	0.34	0.34	0.34
NZ 2-yr swap	0.52	0.59	0.61	0.65	0.67	0.67	0.71
NZ 10-yr bond	1.80	2.00	2.10	2.20	2.30	2.30	2.50

Source: Bloomberg, ANZ Research

Key economic forecasts

Calendar Years	2016	2017	2018	2019	2020(e)	2021(f)	2022(f)
NZ Economy (annual average % change)							
Real GDP (production)	3.9	3.5	3.4	2.4	-2.8	3.5	3.7
Private Consumption	5.9	5.6	4.4	3.6	-2.3	3.1	3.8
Public Consumption	2.0	3.4	3.4	5.4	5.9	2.6	-0.7
Residential investment	11.4	-1.5	1.3	4.8	-4.8	12.0	2.0
Other investment	0.4	7.3	9.7	2.6	-8.2	3.2	5.0
Stockbuilding[1]	0.1	0.2	0.4	-0.7	-0.6	0.6	0.0
Gross National Expenditure	4.6	5.3	5.3	2.9	-2.5	4.5	3.2
Total Exports	2.3	2.5	2.8	2.3	-11.4	3.9	12.0
Total Imports	3.8	7.3	6.5	2.2	-16.9	16.9	9.5
Employment (annual %)	6.0	3.7	2.2	1.3	0.7	0.5	2.9
Unemployment Rate (sa; Dec qtr)	5.3	4.5	4.3	4.1	4.9	5.3	4.2
Labour Cost Index (annual %)	1.6	1.9	2.0	2.4	1.5	1.8	2.1
Terms of trade (OTI basis; annual %)	6.7	7.9	-4.8	7.1	-1.5	1.4	1.9
Current Account Balance (sa, $bn)	-5.9	-8.4	-12.6	-10.5	-2.6	-10.8	-9.0
as % of GDP	-2.2	-2.9	-4.2	-3.3	-0.8	-3.3	-2.6
Prices (annual % change)							
CPI Inflation	1.3	1.6	1.9	1.9	1.4	1.7	1.7
Non-tradable Inflation	2.4	2.5	2.7	3.1	2.8	2.6	3.0
Tradable Inflation	-0.1	0.5	0.9	0.1	-0.3	0.3	-0.1
REINZ House Price Index	14.4	3.4	3.2	5.2	15.1	7.7	4.1
NZ Financial Markets (end of December quarter)							
TWI	77.7	74.4	73.4	73.7	75.2	77.0	76.5
NZD/USD	0.69	0.71	0.67	0.67	0.72	0.77	0.77
NZD/AUD	0.96	0.91	0.95	0.96	0.94	0.94	0.94
NZD/CNY	4.81	4.62	4.62	4.69	4.74	4.89	4.89
NZD/EUR	0.66	0.59	0.59	0.60	0.59	0.60	0.59
NZD/JPY	81.1	80.0	73.8	73.1	74.6	78.5	78.5
NZD/GBP	0.56	0.53	0.53	0.51	0.53	0.53	0.51
Official Cash Rate	1.75	1.75	1.75	1.00	0.25	0.25	0.25
90-day bank bill rate	2.00	1.88	1.97	1.29	0.27	0.34	0.34
2-year swap rate	2.46	2.21	1.97	1.26	0.28	0.65	0.71
10-year government bond rate	3.33	2.72	2.37	1.65	0.99	2.20	2.50

[1] Percentage point contribution to growth

Forecasts finalised 26 February 2021

Source: Statistics NZ, REINZ, Bloomberg, Treasury, ANZ Research

Contact us

Meet the team

We welcome your questions and feedback. Click here for more information about our team.

Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 27 664 3554
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Liz Kendall
Senior Economist

Research co-ordinator, publication strategy, property market analysis, monetary and prudential policy.

Telephone: +64 27 240 9969
Email: elizabeth.kendall@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Finn Robinson
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: finn.robinson@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

Important notice

[1 February 2021]

This document is intended for ANZ's Institutional, Markets and Private Banking clients. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (**ANZ**); or its relevant subsidiary or branch (each, an **Affiliate**), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (**recipients**).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ's policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (**ANZ**).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ's Financial Services Guide please or request from your ANZ point of contact.

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. The information contained in this document is confidential and is provided solely for your use upon your request. This does not constitute or form part of an offer or solicitation of any offer to engage services, nor should it or any part of it form the basis of, or be relied in any connection with, any contract or commitment whatsoever. ANZ does not have a licence to undertake banking operations or securities business or similar business, in Cambodia. By requesting financial services from ANZ, you agree, represent and warrant that you are engaging our services wholly outside of Cambodia and subject to the laws of the contract governing the terms of our engagement.

European Economic Area (EEA): ***United Kingdom.*** ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (**PRA**) and is subject to regulation by the Financial Conduct Authority (**FCA**) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (**PRA**) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.

Important notice

Myanmar. This publication is intended to be general and part of ANZ's customer service and marketing activities when implementing its functions as a licensed bank. This publication is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

New Zealand. This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008 (**FAA**).

Oman. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China (PRC). This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Company Limited (**ANZ China**). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

Qatar. This document has not been, and will not be:

- lodged or registered with, or reviewed or approved by, the Qatar Central Bank (**QCB**), the Qatar Financial Centre (**QFC**) Authority, QFC Regulatory Authority or any other authority in the State of Qatar (**Qatar**); or
- authorised or licensed for distribution in Qatar,

and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this document have not been, and will not be:

- registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
- authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This document is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore.

United Arab Emirates (UAE). This document is distributed in the UAE or the Dubai International Financial Centre (**DIFC**) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCML) No. 12 of 2004; and (d) a financial promotion, as defined under the DIFCML No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**) ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**). The financial products or services described in this document are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules.

United States. Except where this is a FX- related document, this document is distributed in the United States by ANZ Securities, Inc. (**ANZ SI**) which is a member of the Financial Regulatory Authority (**FINRA**) (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Where this is an FX-related document, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163).

Vietnam. This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand,
Ph 64 9 357 4094, e-mail nzeconomics@anz.com, http://www.anz.co.nz