

# First view

## Massive Month of May kicks off with a look into financial stability of banks, and workers

- A busy month of May kicks off with the RBNZ's Financial Stability Report (FSR) on Wednesday.
- The fanfare of the FSR has diminished somewhat with reports of the RBNZ waiting until later in the month to respond to the Minister of Finance on DTI lending restrictions.
- Also on Wednesday, the March quarter labour market report is due out. In what would be a remarkable outcome, given the covid disruption, we are picking a slight fall in the unemployment rate to 4.8%.



### Here's our take on current events.

The month of May is action-packed with the Government's Budget (May 20) and the RBNZ's Monetary Policy Statement (May 26). And this week, we get the RBNZ's semi-annual Financial Stability Report (FSR). Unfortunately, even before its release, the FSR has lost some of its allure. We learnt last week [in the media](#) the RBNZ will not include a response to the Minister of Finance on DTI and interest only lending restrictions. The RBNZ is likely to release a response toward the end of May. So without DTIs, the RBNZ will update us on the stability of the financial system, after a near 25% spike in house prices. The RBNZ will also provide a preliminary assessment of the change to its remit, to take into consideration of the Government's aim of sustainable house prices. Housing will continue to generate headlines this week.

The RBNZ will no doubt point to the reintroduction and tightening of LVR restrictions this year. In addition, the Government's recent housing policy announcement is expected to impact house price and credit growth. It's far too early to determine the effects of recent changes, particularly on making property investors' interest payments a non-deductible expense for tax purposes. But anecdotes and realestate.co.nz activity data suggest an immediate cooling, albeit from very heated levels. We're likely to hear from the RBNZ before month's end on DTIs and interest only lending. Of course, demand side measures such as these do not address the actual problem, which is a supply shortage. We hope the Government's Budget takes a few more steps to "accelerate" supply – and [here's why](#).

Beyond housing, the RBNZ will take heart from the performance of the economy in the Covid world. The global economy has emerged with vigour, after a difficult 2020. Tremendous monetary

and fiscal policy support combined with a speedy vaccine rollout in the developed world has buoyed confidence. Kiwi export commodity prices continue to lift and support indebted areas of the primary sector such as dairy. Furthermore, the unemployment rate now looks more likely to have peaked at an astonishing low 5.3% in the current cycle. The welcome surprise in the labour market has eased fears around mortgage defaults and has given banks the confidence to continue lending. Of course it wouldn't be much of an FSR without highlighting risks. And covid remains a major risk as NZ is early in its quest to vaccinate the population.

On the same day as the FSR, StatsNZ releases the March quarter labour market report. The labour market confounded forecasters last year. The unemployment rate peaked at 5.3% in the third quarter as the impact of covid took its toll. However, by the end of the year the jobless rate had fallen back to 4.9%. A double-digit unemployment rate had seemed possible during the depths of lockdown. Significant policy support, such as the wage subsidy, protected jobs through the worst of last year's disruption. Looking at the March quarter we are picking a further fall in the unemployment rate to 4.8%. Despite the turbulence in activity caused by a closed border, labour market indicators held up surprisingly well (see COTW below). But with a closed border an expected increase in the participation rate will be more than offset by job creation in the quarter.

Wage growth, as measured by the private sector labour cost index, is expected to remain unchanged at 1.5%yoy. On a quarterly basis we see wage growth easing to 0.3%. Firms are expected to have held back on wage increases ahead of the minimum wage hitting \$20/hr from 1 April. We are expecting a gear shift in wage growth in the second quarter as a result of

minimum wage increases and base effects of subdued pay movements during lockdown.

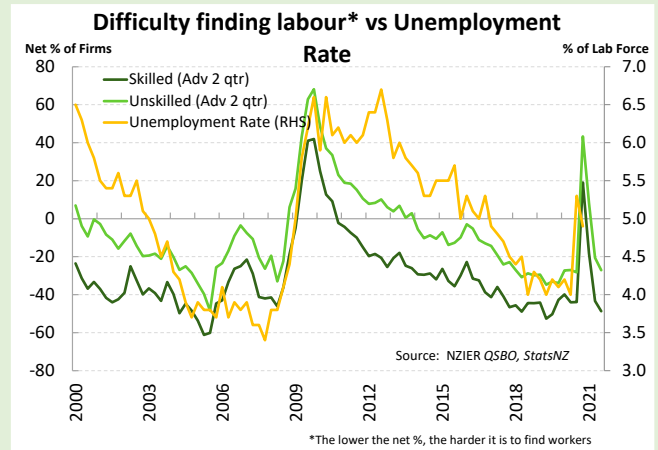
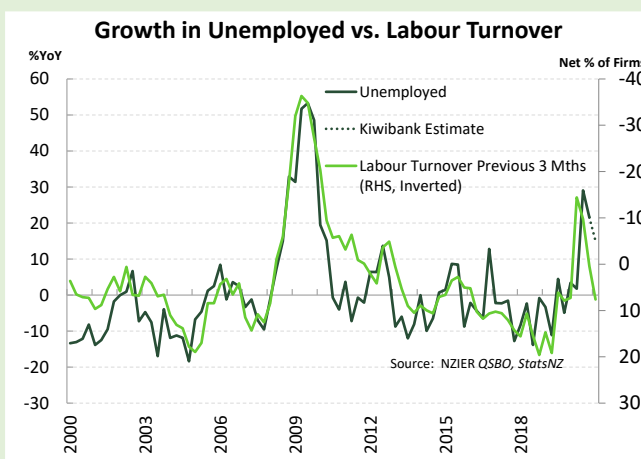
## Charts of the week: A welcome surprise.

Supporting our view of a fall in the unemployment rate has been surprisingly resilient employment indicators and business confidence surveys. Anecdotes suggested that the closed border was weighing on firms' employment decisions. But while the closed border was felt deeply in areas reliant on tourism, the damage doesn't appear widespread across the labour market. Indicators from NZIER's business survey, such as labour turnover and difficulty finding labour have snapped back with astonishing speed (see charts below). Firms are finding it just as difficult to find staff as experienced prior to covid. The closed border has made it extremely difficult to filling roles with offshore candidates.

Back in the depths of lockdown we and many other forecasters had expected the worse, with an unemployment rate forecast to hit 10%+. However, the dynamics of the Covid crisis are vastly different from past economic downturns.

The behaviour of the labour market is vastly different from the experience of the GFC of 2008. For starters, the current pandemic is a health crisis not a financial crisis. The hit to the economy last year was manufactured as the we were forced into lockdown to avoid a runaway surge in covid cases. In contrast, exacerbating the GFC was a reluctance of banks to lend to each other, let alone businesses and households. Another key difference has been the policy response to the crisis. Fiscal policy took centre stage, with monetary policy playing an important supporting role. In addition, fiscal support was delivered in double-quick time. The Government's wage subsidy allowed firms to keep staff on the books while in lockdown, preserving many jobs in the process. We've also avoided further complete national lockdowns.

For the Government, a stronger-than-expected labour market has seen tax revenue consistently exceed forecast, and kept unemployment expenses contained.



## Financial Markets

The comments below were provided by Kiwibank traders. Trader comments may not reflect the view of the research team.

### In rates, things are bubbling away.

"You'd be forgiven for thinking the NZ rates market was closed last week given the lack of movement. However, under the surface there are some themes bubbling away. Ranges are slowly lifting and narrowing as the market gets more comfortable with a slowly improving outlook offset by a consistently dovish RBNZ. That has seen the 2-year swap range narrow from 0.40-0.50%...to 0.45-0.50% currently. The topside to that range is being capped by the end of May RBNZ decision on Debt to

Income (DTI) ratio's, any implementation obviously acting as further cooling to the housing market. The lifting in the ranges in shorter tenors (<3years) a result of slightly better data and consistent mortgage based paying by domestic balance sheets. The longer end (>5years) feels like a restart of a mini re-steepening, after the mini flattening on the reflation trade unwind, aided by consistently better data and a solid US earnings season. The Fed reassuring markets last week that the Fed Funds rate is not heading higher anytime soon, but the market still reactive to solid US data/rapid vaccine rollout driving US long end yields mildly higher. This week the NZ unemployment report should be supportive of the higher ranges noted above, the RBNZ Financial Stability Report has lost its fanfare for rates as we awaited the DTI announcement at the end of May before the interest rate picture becomes clearer." **Ross Weston, Senior Portfolio Manager.**

## In currency markets, inoculations are the focus.

“Supported by a continued accommodative FOMC, the NZ Dollar performed relatively well for most of last week. Upon trading back to mid-March highs above 0.7280 on a combination of factors including the unchanged policy stance of the Fed, NZDUSD fairly aggressively gave up the weeks hard-fought gains in an 'up the escalator, down the elevator' price action into the Saturday close of play. Friday's fall from favour for the NZ Dollar, driven by end of month rebalancing, a technically overbought picture, and most importantly from the Fed's viewpoint on inflation - a strong Core PCE Deflator reading, saw the Kiwi barely changed on a weekly perspective. For the week ahead, investor focus will include Wednesday's Q1 NZ employment figures and RBNZ Financial Stability Report locally, while offshore, Tuesday's RBA event, and Friday nights US Non-Farm Payrolls numbers will be ones to watch. Having achieved our interim resistance level at 0.7260 mentioned in last week's update, the technical picture still remains much of the same as last week also - strong support at 0.7100/10, whilst the 0.7260/80 region must be now conquered before the possible confirmation of further upside moves. Tapping out a high of 0.9337 last week, NZDAUD ran into the previously discussed converging triangle resistance zone following the release of a softer than expected Australian Q1 CPI reading. For now, the converging triangle pattern remains intact, but Tuesday's RBA event, specifically any mention on extended 3 year yield control, may have the potential to change the picture.” **Hamish Wilkinson, Senior Dealer.**

## Weekly Calendar

Date	Economic Indicator	Last	Consensus	Comment
Mon, May 03	US Apr ISM Manufacturing Index	64.7	65.0	The ISM manufacturing index hit the highest level since 1983 in March. The market is picking a higher reading still for April. The recent fiscal stimulus driven surge in retail spending will likely drive activity higher.
Tue, May 04	AU RBA Cash Rate Target (%)	0.1	0.1	No change to the cash rate is expected by the RBA. Q1 inflation surprised on the downside and there remains significant slack in the labour market. On the Bank's QE and 3-year yield target, some analysts see the RBA announcing a switch to targeting November 2024 bonds (from April 2024).
	EZ ECB Speaker - Villeroy	-	-	We'll let central bank officials speak for themselves.
	US Fed Speakers - Powell, Daly	-	-	
Wed, May 05	NZ RBNZ Financial Stability Report	-	-	This week's FSR may prove to be a fizzer. Media articles released in recent weeks, indicate that the RBNZ will wait until late May to respond to the Minister of Finance's request for information on DTIs. See front page for details.
	RBNZ Speaker - Orr	-	-	Governor Orr to front post-FSR press conference.
	Mar Qtr Employment Change (% qoq)	0.6	0.1	We are picking a small fall in the unemployment rate to 4.8%. Employment indicators and business confidence surveys held up surprisingly well over the March quarter. See front page for details.
	Mar Qtr Unemployment Rate (%)	4.9	5.1	
	Mar Qtr Employment Change (% yoy)	0.7	-0.2	
	Apr ANZ Commodity Price Index (% mom)	6.1	-	Key NZ export commodity prices continue their solid run.
	EZ ECB Speaker - Lane	-	-	We'll let central bank officials speak for themselves.
	US Fed Speakers - Evans, Mester	-	-	
Thu, May 06	NZ Mar Building Permits (% mom)	-18.2	-	Residential building consents experienced a big fall in February. But overall the pipeline of construction activity remains chocka.
	May ANZ Activity Outlook (Net % of Firms)	22.2	-	ANZ's preliminary May business confidence report. Cost and price pressures will remain a key theme.
	AU RBA Speaker - Debelle	-	-	We'll let central bank officials speak for themselves.
	UK Bank of England Policy Rate (%)	0.1	0.1	Despite an expected upgrade to it's economic outlook, the Bank of England will most likely keep policy settings unchanged. The UK has experienced success in its fight against Covid following a its winter lockdown and rollout of vaccines.
	EZ ECB Speaker - Schnabel	-	-	We'll let central bank officials speak for themselves.
	US Fed Speakers - Kaplan, Mester	-	-	
Fri, May 07	NZ Jun Qtr RBNZ 2year-Ahead Inflation Expectations (%)	1.9	-	Despite a ramp up in firms' cost pressures and pricing intentions, inflation expectations remain well anchored to the RBNZ's 2% target band mid point. As a result, the Bank will be comfortable that recent price pressures appear transitory in nature.
	CH Apr Trade Balance (US \$bn)	13.8	28.0	Base effects from last year - as exports rebounded rapidly out of last year's lockdown in Wuhan - is likely to see export growth slow, but remain robust. Import growth will work the other way and will be driven in part by the ongoing rapid rise in global commodity prices.
	Apr Exports (% yoy)	30.6	23.5	
	Apr Imports (% yoy)	38.1	43.9	
	GE Mar Industrial Production (% mom)	-1.6	2.0	Industrial production likely rebounded strongly following back-to-back monthly falls as supply chain disruption started to bite.
	EZ ECB Speaker - Lagarde	-	-	We'll let central bank officials speak for themselves.
	US Apr Change in Nonfarm Payrolls (000)	916.0	950.0	The US labour market is expected to have backed up the massive 916k jump in payrolls with a 950k rise in April. Nevertheless, employment will still severely lag pre-pandemic levels. The unemployment rate is expected to have eased in the month to 5.8%.
	Apr Unemployment Rate (%)	6.0	5.8	

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