

Weak NZ growth to keep RBNZ comfortably on hold

- NZ GDP growth sub-trend for two consecutive quarters and weaker than the RBNZ expected.
- RBNZ to retain a neutral bias at this week's OCR review, but tweak NZD language due to the higher TWI.
- Federal Reserve hikes rates but weak wage growth is coming under closer scrutiny.

The NZ economy performed poorly over the past two quarters (Q4 2016 and Q1 2017). Last week's GDP release confirmed our view that GDP only expanded 0.5% over Q1, following Q4's sluggish 0.4% growth (see our full report [here](#)). On a per-capita basis, economic output declined over both of these quarters. Contributing to sub-trend growth was **volatility in construction activity** (one anecdote suggests summer's poor weather may have played a part), **slowing retail spending** as the tourism boom reaches a peak and a **fall in transport activity**. Dairy production volatility also played a role.

It's hard to conclude if the weaker growth is due to a **series of unfortunate events** (The Kaikoura earthquake and summer's bad weather may be responsible for some of the disruption). Or, alternatively, **the economy is not quite as strong as thought** once the direct growth contributions from construction and tourism are removed. At this stage, we **remain confident on our medium-term growth outlook, supported by record high Terms of Trade, low interest rates and an improving labour market lifting household spending**. And there were signs of strength hidden in the detail, including strong plant and machinery investment and robust household spending growth. Either way, the **RBNZ has time on its side to assess the true underlying strength of the economy, as there remains no urgency to hike rates**.

The **weak GDP outcome will be a material surprise to the RBNZ**, who had pencilled in 0.9% at the May MPS. In addition, the **recent strength in the NZD** is likely to weigh on the RBNZ's tradable inflation outlook. But providing some offset to these developments is the strong lift in **NZ's Terms of Trade**. In addition, **Fonterra's bullish opening season milk price forecast (2017/18)** of \$6.50/kg may see the RBNZ review its comparably conservative milk price outlook. Like ASB, **the RBNZ is likely to remain confident that growth will be healthy in the medium term**. But the recent weak growth will likely reinforce that **capacity pressures are still soft and the economy has some way to go before it is generating a sufficient lift in domestic inflation pressures**. We expect the RBNZ to (appropriately) maintain a neutral tone, and continue to emphasise the numerous uncertainties. The RBNZ will likely tweak its NZD comments to reflect the higher TWI (see our full preview [here](#)).

The Federal Reserve hiked the Fed Funds rate on Thursday morning as widely anticipated. While the Fed's expectations for future rate hikes were unchanged, the Fed's revised its near-term wage growth and core inflation forecasts lower. This implies an increase in downside risks to the Fed's current rate outlook. Subdued wage growth in the US has been a mystery, as all other measures of US labour market strength and tightness suggest wage growth should be much higher. This is a development has implications for both US interest rates, but also NZ as the RBNZ will likely be looking to see what is driving weaker US wage growth as, as weaker wage growth is a risk the Bank has also become mindful of (see Chart of the Week below).

Foreign Exchange

- The NZD remained elevated last week, despite the soft Q1 GDP result.

Interest Rates

- NZ interest rates fell on Thursday, but were quick to recover to finish the week largely unchanged.

Week Ahead

- GlobalDairyTrade auction, Reserve Bank of New Zealand rate announcement, May's net migration.

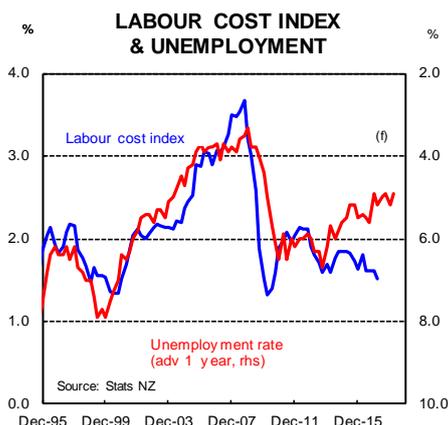
Week in Review

- The current account deficit widened, while Q1 GDP and the manufacturing PMI for May lifted.

Global Calendars

- RBA and BoJ meeting minutes, Eurozone and US current account balance are due out this week.

Chart of the Week: Where is my pay rise?



The chart opposite demonstrates the **breakdown between nominal wage growth and the unemployment rate in NZ**. Some of this could be explained by low inflation. Up until this year, inflation has been below 1%, so **inflation-adjusted wages had been growing strongly**. But this is unlikely to be the full explanation.

The **RBNZ is wary of soft wage growth** despite the tighter labour market, and recently investigated this issue at its recent round of business visits (May MPS). The RBNZ found **that lower wage inflation expectations and increased business caution** (post Global Financial Crisis) were contributing factors. But also, businesses **were using other work place incentives** (i.e. increased flexibility) to attract and retain staff.

Nonetheless, as **businesses were increasingly turning to offshore recruitment**, and with **headline inflation lifting**, the RBNZ concluded that **wage inflation was likely to pick up over coming quarters**.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7254	0.7195	0.6885	0.6977	0.7041	FLAT/DOWN	0.7150	0.7350
NZD/AUD	0.9517	0.9558	0.9275	0.9556	0.9541	FLAT/DOWN	0.9400	0.9600
NZD/JPY	80.45	79.31	76.70	82.02	73.38	FLAT/DOWN	79.50	81.50
NZD/EUR	0.6472	0.6418	0.6196	0.6670	0.6259	FLAT/DOWN	0.6400	0.6600
NZD/GBP	0.5682	0.5640	0.5314	0.5589	0.4943	FLAT/DOWN	0.5625	0.5725
TWI	78.1	77.5	74.7	77.6	75.2	FLAT/DOWN	76.00	79.00

^Weekly support and resistance levels * Current is as at 9.30 am Monday; week ago as at Monday 5pm.

The NZD remained elevated over the week, with the NZ Trade Weighted Index rising back above 78 for the first time since early March. The NZD lifted against most major currencies we monitor over the week, despite the weaker than anticipated NZ Q1 GDP reading. The NZD only fell against the AUD following the particularly strong Australian employment release. Once again, USD weakness continued to support the NZD/USD over the week, with the cross lifting comfortably above US\$0.72 last week. Weak US inflation data ahead of the Fed's rate announcement rattled markets such that the 25bp lift to interest rates and unchanged dot plots did little more than return the currency to where it had been trading before the soft data. The GBP also remained soft over the week as market participants continue to come to terms with the shock UK General Election outcome.

This week, currency movements are likely to be concentrated on Thursday's RBNZ OCR release as there is a dearth of international data. While the RBNZ is unlikely to change its tone or policy in the statement, there is the risk that it tweaks its currency comments given the recent NZD strength.

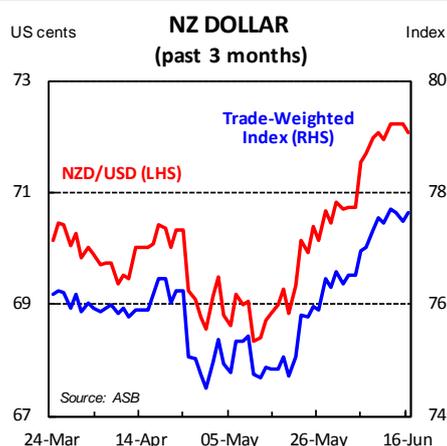
Short-term outlook:

Key data

Date

Time (NZT)

Market



RBA Meeting Minutes

20/06

1:30pm

-

GDT Auction

20/06

overnight

-

RBNZ OCR Review

22/06

9:00am

1.75

NZ travel and migration, May, 000s

22/06

10:45am

-

Key events: **NZD:** Global Dairy Trade auction (Tue); RBNZ meeting (Thu). **AUD:** Q1 home price index (Tue); RBA Minutes of June meeting (Tue). **CNY:** May house prices (today). **JPY:** BoJ April meeting minutes (Wed). **EUR:** Apr current account (Tue); Jun PMIs (Fri).

Speakers: **RBA:** Lowe (today). **FED:** voter Dudley (today), voter Evans (Tue), Vice Chair Fischer (Tue), non-voter Rosengren (Tue), Kaplan (Wed), voter Powell (Thu), non-voters Bullard & Mester (Sat). **BoJ:** Kuroda (Wed), Iwata (Thu).

Medium-term outlook:

Last Quarterly Economic Forecasts

Our FX forecasts were updated in early May to reflect the weaker near-term outlook for the USD. Expected fiscal stimulus from US President Trump was the main driver of near-term USD strength in our previous FX forecasts. However, difficulties in getting other reforms through Congress have highlighted uncertainties around the timing of the fiscal stimulus. **As a result, we expect the NZD/USD to now appreciate to around 0.7300 by the end of 2017. Further out, the NZD is now expected to further appreciate vs. the USD over the next 18 months.** Firstly, the risk of the RBNZ starting a tightening cycle is rising, but the first hike is still not expected until the end of 2018. Further, the ongoing recovery in dairy prices and continued increase in tourism earnings will help the current account deficit narrow even further, supporting the NZD. While we are expecting ongoing NZD/USD strength, further policy rate hikes by the Federal Reserve (which we expect in June and September) will limit NZD strength over 2017. **We expect the USD to stabilise (NZD/USD weaken) once the fiscal policies are signed into effect, however, this may now not occur until 2019.**

The NZD remains supported by relatively high Terms of Trade, relatively high interest rates, increased offshore investor demand and a structural improvement in the current account deficit. **Given these factors are NZD-supportive, combined with the fact the RBNZ signalled it had finished its easing cycle at the November MPS, we see little sustained downward pressure on the NZD.** Over 2017, we expect the NZD/AUD to remain in a relatively high range of 0.93-0.96.

We revised our GBP forecast higher in May on the basis the UK economy has held up better than expected following the UK's vote to leave the EU. We had, however, expected the UK election to reaffirm a Conservative majority, supporting the Pound. But, the surprise hung Parliament has dented the Pound. We expect the NZD/GBP to largely remain with a range of 0.55-0.57 until the end of 2019, though there is increased risk the cross rate drifts higher if UK political uncertainty remains rife.

In the near term we continue to see NZD/JPY hold above 75. Further out, the prospect for more BOJ easing should weaken the JPY, pushing NZD/JPY towards 77 over 2017.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	2.25	FLAT
90-day bank bill	1.95	1.94	1.97	2.02	2.35	FLAT
2-year swap	2.24	2.24	2.27	2.47	2.31	FLAT
5-year swap	2.72	2.74	2.79	3.13	2.45	FLAT
5-year benchmark gov't stock	2.45	2.46	2.25	2.69	2.11	FLAT
NZSX 50	7553	7433	7392	6786	6846	FLAT

^Weekly support and resistance levels * Current is as at 9.30am Monday; week ago as at Monday 5pm.

NZ interest rates ended the week largely unchanged and although the start of the week was relatively quiet, volatility picked up towards the end of the week. The week started quietly with markets bracing themselves for the Fed's rate announcement. And while a rate hike was largely already priced in, markets were waiting to see if there would be any changes to the Fed's projected rate hikes, given the recent soft inflation outturns. Despite the Fed making no changes to its forecasted rate hike track, another soft USD inflation data result was enough to send US Treasury yields lower as markets continue to question the likelihood of another rate hike this year.

In New Zealand, interest rates followed offshore moves early on Thursday morning. The fall in rates was then **compounded by the lower than anticipated Q1 NZ GDP growth**. The 5-year swap rate had fallen by 6bp by around midday Thursday (NZT). However, yields were quick to recover again on Friday, driven by positive US data on Thursday night.

Short-term outlook:

Key data

Date

Time (NZT)

Market

GDT Auction

20/06

overnight

-

RBNZ OCR Review

22/06

9:00am

1.75

NZ travel and migration, May, 000s

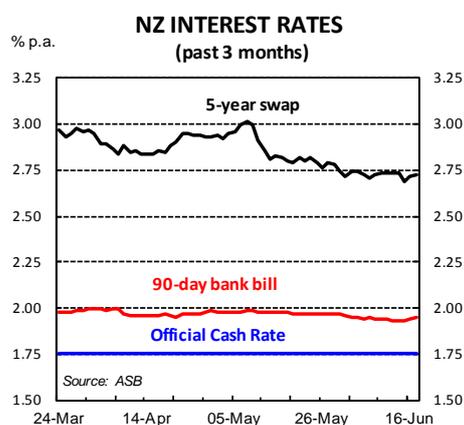
22/06

10:45am

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Comment: The main event for interest rates this week is the **RBNZ OCR Review on Thursday**. While developments since May have largely had a neutral impact on the inflation outlook, **we think that the RBNZ could tweak its NZD comments given the recent uplift in the TWI**.

As this release **does not include any updated interest rate forecasts**, the statement is likely to cause less volatility in interest rate markets than it might otherwise. We expect the **RBNZ to reiterate that it remains comfortable to leave interest rates on hold**.



Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ continued to hold the OCR at its record-low of 1.75% at its May OCR Review and Monetary Policy Statement (MPS). The RBNZ surprised markets by **retaining its neutral policy stance, despite the stronger than expected Q1 CPI result and Q2 RBNZ inflation expectations data**. Overall, the RBNZ viewed developments since the February MPS as having a neutral impact on its OCR outlook and its OCR forecast track still implies no OCR increase until late 2019. **The RBNZ continues to view the global environment as a key downside risk, but noted that the global outlook had improved marginally in recent months.**

Interestingly, the RBNZ noted that the softer than expected GDP growth over the second half of 2016 meant that domestic capacity pressures were less than initially thought. However, **the RBNZ was pleased with the recent depreciation in the TWI**, although noted that the fall needs to be sustained in order to boost the inflation outlook. **The RBNZ remains cautious on the dairy price outlook.**

The RBNZ addressed **likely volatility in upcoming headline inflation figures**. Higher petrol and food prices are boosting inflation in the near term and have pushed headline annual inflation back above 2%. However, given these price-lifts are one-off moves, their impact on inflation is not likely to be sustained. As a result, inflation is likely to dip back below 2% over 2017. **The RBNZ reminded that a sustainable move to the 2% mid-point of the target band is not likely until the medium term.**

The RBNZ's May Monetary Policy Statement OCR projections show the OCR remaining at 1.8% well into 2019. The RBNZ's outlook has a 25bp hike built in by late 2019. **We continue to view OCR increases as a long way off, towards the end of 2018.** In contrast, market pricing implies an early/mid 2018 start.

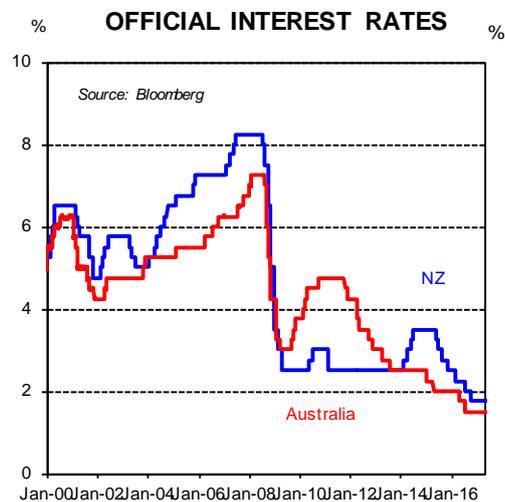
Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Australia ABS Dwelling Prices, Q1, %qoq	20/06	1:30 pm	4.1	2.2	2.7
Reserve Bank of Australia Meeting Minutes, June	20/06	1:30 pm	-	-	-
Eurozone Composite PMI, June	23/06	8:00 pm	56.8	56.6	56.6

Conditions in the **Australian housing market** were very strong going into 2017. We expect to see a 2.7% increase in house prices in Q1. This would take the annual rate of growth up to 8.1%. The timelier CoreLogic data show dwelling prices cooling in Q2.

The **Monetary Policy Statement** that accompanied the **Reserve Bank of Australia's** June no-change decision was broadly neutral. The housing market is showing some tentative signs of cooling. However, non-mining business investment remains weak and indicators of the labour market are mixed.

We anticipate the **June Eurozone composite PMI** will print around 56.6. A high print around 56.6 is consistent with hard data from the Eurozone during the survey period.



NZ Data Preview: a look at the week ahead

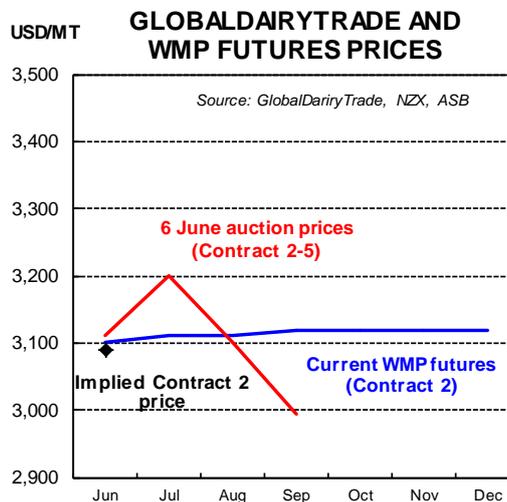
Data	Date	Time (NZT)	Previous	Market expects	ASB expects
GlobalDairyTrade auction, whole milk powder, % change	21/03	Overnight	-2.9	-	No change
RBNZ rate announcement	22/06	9:00 am	No	No	No change
International Travel & Migration, May, Net Migration, 000s	22/06	10:45 am	5,780	-	5,650

We expect prices to track sideways at the **GlobalDairyTrade auction** overnight Tuesday. A fortnight ago, prices were also largely flat with the exception of whole milk powder (WMP) prices (down 2.9%). If anything, NZ production has been better than expected over recent months as the impact of very wet weather has been small. On the other hand, demand appears firm, with the net result being largely sideways movement in prices. **At the current juncture, futures pricing suggests WMP will be unchanged at the auction.** Beyond the auction and looking over the rest of the year, we expect prices to remain firm, with global supply and demand largely in balance.

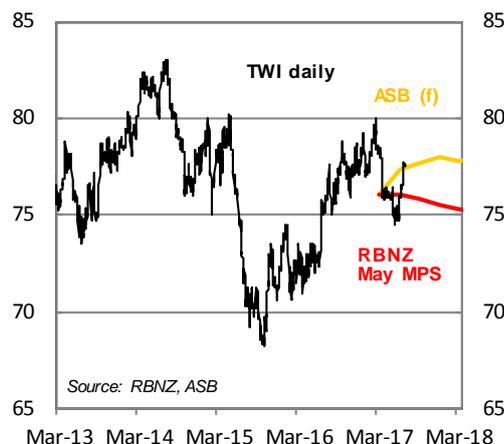
We expect the **RBNZ to leave the OCR unchanged at 1.75% in June.** On balance, developments since May have been largely neutral for the inflation outlook. **Fonterra's opening milk price** for 2017/18 suggests the dairy sector will be in good stead next year and the recent multi-year high in the **Terms of Trade (ToT)** will also lift inflation pressures. However, **soft economic growth** is calling into question how quickly domestic capacity pressures are rising. **While we expect the RBNZ to maintain an unchanged neutral tone and policy in the statement, we do expect the NZD language to be tweaked. The RBNZ is likely to reiterate that further depreciation in the NZD is needed to achieve balanced growth.**

Net migration is continuing to run close to record annual highs as arrivals hold around recent historic highs. **NZ arrivals remain buoyed by strong international student arrivals, New Zealanders returning from Australia and, more recently, by growing arrivals on work visas.** We expect net migration to remain elevated and the trend will only soften gradually as other economies' labour markets improve (in particular Australia).

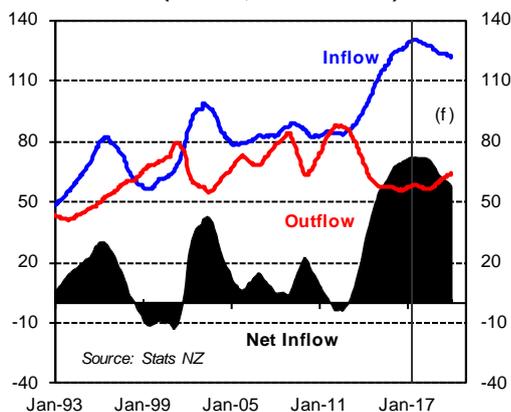
Meanwhile, **short-term visitor arrivals jumped higher in April**, as a result of the **World Masters Games in Auckland.** Tourist arrivals are likely to fall in May, but **lift again in June when the Lions Tour of NZ kicked off.**



NZ TWI FORECAST



TOTAL MIGRATION (into NZ, annual totals)



Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
Current account, Q1, % of GDP	14/05	-3.1	-2.7	-2.8
GDP, Q1, % qoq	15/05	0.5	0.7	0.5
BusinessNZ Manufacturing PMI, May, Index	16/05	58.5	-	-
Westpac consumer confidence, Q2, Index	19/05	113.4	-	-

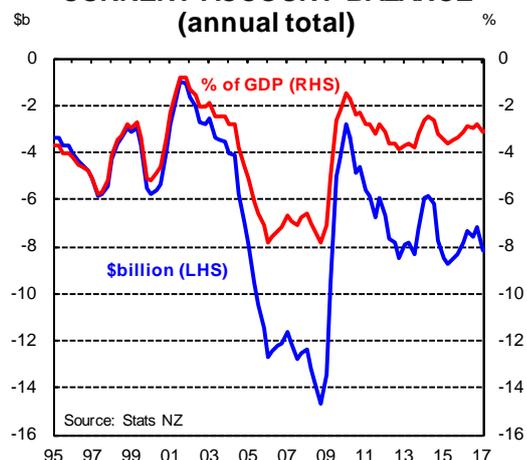
The headline current account deficit surprised over Q1 by widening more than expected on an annual basis. However, **we expect that the current dip is more of the pothole variety as opposed to something deeper.** First up, agricultural production (and thus exports) was weak over recent quarters and has since rebounded. Moreover, NZ's Terms of Trade are likely to set a record high this year. **The combination of these two factors should send the goods balance back towards surplus by year end, lifting the current account balance with it.**

Q1 GDP lifted in line with our own expectation of 0.5%, but below market expectations and the RBNZ's May MPS forecast (see table below). Lacklustre Q1 growth follows weak growth of just 0.4% in Q4, marking two quarters of sub-trend growth. As expected, a **rebound in dairy production** and lifts in retail trade and manufacturing activity were the key drivers of Q1 growth. Health care and public administration services also lifted by more than we expected. Meanwhile, a fall in construction activity and an unexpected (and surprisingly sharp) fall in transport activity weighed on growth over Q1. However, **we remain confident in the medium-term growth outlook, which will be supported by high Terms of Trade, low interest rates and population growth. We continue to expect the RBNZ to leave the OCR on hold at 1.75% until late-2018.**

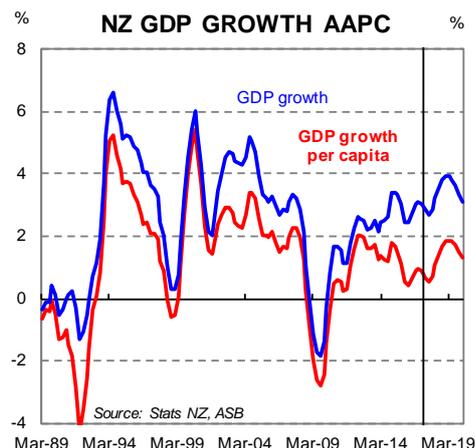
The Manufacturing PMI lifted to 58.5 in May, seeing the 3-month moving average also lift to 58. Levels above 50 indicate expansion. The lift in the PMI was supported by **high levels of new orders and production activity.** The orders-to-stocks ratio also remains elevated and another indicator of continued production growth. The Manufacturing PMI points to **continued moderate growth in non-primary manufacturing activity.** Construction and other business investment are key drivers of manufacturing demand in NZ.

Consumer confidence picked up a touch over the June quarter, and remains at a level consistent with moderate household spending growth. Notably, **household sentiment regarding the general economic outlook improved over the quarter.** In this regard, it's likely that improving dairy sector fortunes have boosted household sentiment. In turn, as dairy farm cashflows continue to improve over coming quarters we expect household spending activity to also lift.

CURRENT ACCOUNT BALANCE (annual total)



NZ GDP GROWTH AAPC



WESTPAC CONSUMER CONFIDENCE



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 19 Jun	11:30	AU	RBA's Lowe participates in Panel in Canberra					
	11:50	JN	Trade balance adjusted	May	¥bn	97.6	436.6	~
	13:30	CH	China May Property Prices					
Tue 20 Jun	11:30	AU	ANZ Roy Morgan Weekly Consumer	Jun	Index	112.9	~	~
	13:00	NZ	ANZ consumer confidence index	Jun	Index	123.9	~	~
	13:30	AU	House price index	Q1	q%ch	4.1	~	2.7
	13:30	AU	RBA June Rate Meeting Minutes					
	~	AU	NSW State Budget					
Wed 21 Jun	01:00	CH	Conference Board China May Leading					
	11:50	JN	BOJ Minutes of April 26-27 meeting					
	18:36	JN	BOJ Kuroda speaks in Tokyo					
		NZ	Global Dairy Trade auction, whole milk		%ch	-2.9		flat
Thu 22 Jun	~	AU	South Australia State Budget	Q1	q%ch	0.4	0.7	0.5
	09:00	NZ	RBNZ official cash rate	Jun	%	1.75	1.75	1.75
	10:45	NZ	Net migration	May	~	5,780	~	5,650
	15:00	NZ	Credit card spending	May	m%ch	0.9	~	~
Fri 23 Jun	12:30	JN	Nikkei Japan PMI manufacturing	Jun P	Index	53.1	~	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 19 Jun	13:00	US	Fed's Dudley holds Business Rountable in Plattsburgh, NY					
Tue 20 Jun	00:00	US	Fed's Evans speaks in New York					
	09:00	EC	ECB current account	Apr	€bn	34.1	~	~
	09:00	EC	Current account	Apr	€bn	44.8	~	~
	11:00	US	Rosengren to speak at Macroprudential					
	13:00	US	Fed's Fischer speaks in Amsterdam					
	13:30	US	Current account balance	Q1	\$bn	-112.4	-124.9	~
	20:00	US	Fed's Kaplan speaks in San Francisco					
Wed 21 Jun	15:00	US	Existing home sales	May	\$mn	5.6	5.6	~
Thu 22 Jun	09:00	EC	ECB Publishes Economic Bulletin					
	15:00	EC	Consumer confidence	Jun A	~	-3.3	~	~
	16:00	US	Kansas City Fed manufacturing activity	Jun	~	8.0	~	~
Fri 23 Jun	09:00	EC	Markit Eurozone manufacturing PMI	Jun P	Index	57.0	~	~
	09:00	EC	Markit Eurozone services PMI	Jun P	Index	56.3	~	~
	09:00	EC	Markit Eurozone composite PMI	Jun P	Index	56.8	~	56.6
	14:45	US	Markit US manufacturing PMI	Jun P	Index	52.7	~	~
	14:45	US	Markit US services PMI	Jun P	Index	53.6	~	~
	15:00	US	New home sales	May	000	569.0	600.0	~
	16:15	US	Fed's Bullard speaks about Monetary Policy in Nashville					
17:40	US	Fed's Mester speaks in Cleveland						

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