

Economic Weekly

01 April 2019

Doves come home to roost

In a dovish surprise, the Reserve Bank (RBNZ) moved last week to a clear easing bias. On the basis of this change in RBNZ rhetoric, we also moved to forecast OCR cuts in August and November (see the Chart of the Week and Page 2 for more discussion). Meanwhile, Brexit machinations dominated offshore markets last week. But one week on and it appears the Brits are no closer to a Brexit resolution.

This week, The RBA chimes in with its interest rate announcement. Market pricing suggests that the RBA could join the RBNZ and offshore brethren in moving to an easing bias. The local highlight is the Quarterly Survey of Business Opinion. On the business sentiment front, we are wary of a further fall from already-weak levels. If sentiment does prove weak, then this will reinforce our view that economic growth is likely to remain soft in Q1.

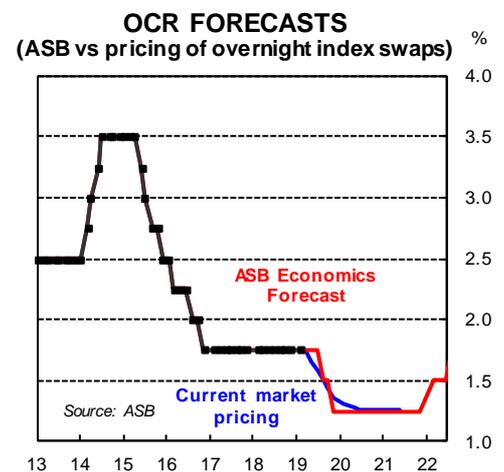
Key events and views

Key Insights	Changing our OCR call: our updated NZ interest rate forecasts.
Foreign exchange	NZD lower on RBNZ easing bias.
Interest rates	RBNZ easing bias leads NZD rates lower, with the curve also steeper.
Domestic events	Quarterly Survey of Business Opinion, Global Dairy Trade auction.
International events	RBA Interest Rate Announcement, US Non-farm Payrolls
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: Changing our OCR call

Last Wednesday, the RBNZ cited the weaker global outlook and reduced momentum in domestic spending as reasons to signal that the next move on the OCR was likely to be downwards. Forthcoming OCR decisions are expected to be 'live' and the tone of forthcoming local data, including tomorrow's Quarterly Survey of Business Opinion and the Q1 Consumers Price Index (17 April), will be pivotal.

We had earlier flagged the risk of RBNZ cuts, and last week we formally changed our OCR call (see Page 2 for our updated NZ interest rate forecasts). We now expect 25bp of OCR cuts in August and November of this year. The OCR is subsequently expected to remain at 1.25% until late 2021, before gradually drifting towards its 2.25% cyclical peak towards the end of 2023.



NZD Interest Rate Update: Changing our OCR call

- **We now expect 25bp OCR cuts in August and November of this year.** We expect the OCR to remain at its 1.25% lull until late 2021, before gradually drifting towards its 2.25% cyclical peak towards the end of 2023.
- Global developments, dovish policy outlooks from global central banks, growing downside risks to the 2019 domestic growth outlook and our low inflation view have prompted the change in call.
- **NZD interest rates are hovering at record lows. Yields will drift higher,** but low NZ inflation and strong demand for NZ assets should temper the lift in NZ yields.

Comments

In its March 2019 OCR review the RBNZ made a clear shift, dropping its neutral bias and intent to keep the OCR on hold until 2021, and instead flagging the more likely direction for the next OCR move to be **down**. In the near term the risk of an OCR cut will remain high, with every OCR announcement is now potentially 'live'. **We have moved over the line and now expect 25bp OCR cuts in August and November of this year.** A key uncertainty is whether 2019 NZ growth will pick up after a patchy 2018. The global economy is showing more signs of weakness, overseas central banks have adopted a more dovish tone, and the RBNZ has been surprised over the last year over how weak NZ growth has been.

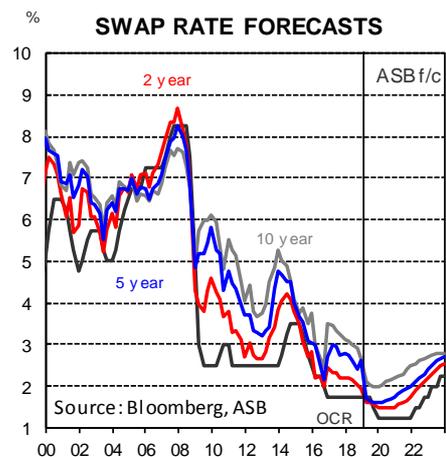
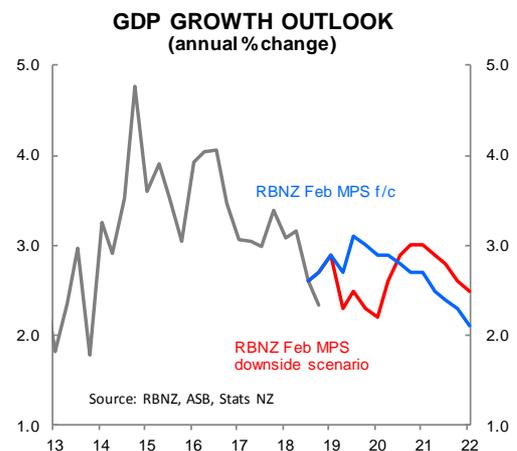
We also expect the OCR to remain at its new 1.25% record low for a considerable period. We have pencilled in an early 2022 start to the next RBNZ OCR tightening phase. But the timing is fluid and dependent on:

- The evolution of the global economy;
- The actions of overseas central banks;
- The NZD;
- Domestic prospects;
- Whether the RBNZ will be confident that the medium-term inflation outlook necessitates some removal of policy stimulus.

The proposed higher bank capital requirements, which we assume are equivalent to roughly 50bps increase on customer interest rates by late 2023, will likely tighten financial conditions, lower wholesale interest rates across the curve and keep the OCR lower than it would otherwise be. **As such, we expect very mild RBNZ policy tightening from 2022, with the OCR approaching neutral levels (around 2.25%) by late 2023.**

Global policy interest rates are expected to remain historically low. The US Federal Reserve is expected to remain "patient" and to hold policy rates at 2.25 – 2.50% over the projection period. We have also pushed back prospective monetary tightening from the Reserve Bank of Australia and European Central Bank (to late 2020). Risks are tilted towards more policy support being necessary in these countries.

Global long-term interest rates are expected to remain close to historic lows. NZD long-term yields are expected to drift higher and eventually settle at around 2.5-3%. An eventual mild RBNZ tightening cycle (from 2022), low NZ inflation, still-strong demand for NZD assets, and our historically-low outlook for global yields should cap NZ yields.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6822	0.6877	0.6809	0.7237	FLAT	0.6720	0.6950	UP
NZD/AUD	0.9581	0.9712	0.9594	0.9426	FLAT	0.9480	0.9700	FLAT
NZD/JPY	75.74	75.54	76.03	76.91	FLAT	73.90	76.90	UP
NZD/EUR	0.6076	0.6086	0.5988	0.5876	FLAT	0.5950	0.6190	FLAT
NZD/GBP	0.5231	0.5212	0.5135	0.5164	FLAT	0.5120	0.5330	UP
TWI	74.2	74.5	73.7	74.52	FLAT	73.5	75.5	UP

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

NZD Recap

The NZD fell last week following the RBNZ's unexpectedly dovish OCR review statement on Wednesday afternoon. The RBNZ surprised market participants by moving to an explicit easing bias, citing weakening global growth, slowing domestic growth and growing downside risks to the outlook. The RBNZ had been expected to make only minor changes to its policy assessment at the final OCR review under the single-decision maker model. **Subsequently, economists now expect the RBNZ to cut the OCR**, with a Bloomberg poll showing a split between May and August for the timing of the first move. **Interest rate markets moved to price in 49 basis points** (two full rate cuts) by mid-2020, from 33 basis points by the end of 2020 prior to the announcement. In the meantime, the NZD has been **supported by positive global investor sentiment** with the NZD/USD and AUD/USD making early gains at Monday morning's market open, following the stronger-than-expected Chinese manufacturing PMI data released over the weekend.

Near-term outlook

NZ interest rate expectations are likely to weigh on the NZD in the near term, with the NZD/USD potentially testing its 200-day moving average over the next week. In saying this, NZD weakness may be limited due to strong NZD commodity prices and upbeat global investor sentiment. Meanwhile, the shift in NZ interest rate expectations has seen a sharp fall in the NZ-AU 1-year overnight index swap spread, which is likely to weigh on the NZD/AUD cross. The RBNZ flagged weak business confidence as a key source of downside risk, so the **NZD is likely to take guidance from the NZIER Q1 Quarterly Survey of Business Opinion on Tuesday**. The **AUD/USD continues to face downside risks** (despite stronger China manufacturing PMI data out over the weekend) due to **Australian yield curve inversion**. **Tuesday** is likely to see elevated AUD/USD volatility, with the **RBA announcement** followed by the **Australian Federal Government's 2019/20 pre-election Budget**. We expect income tax cuts to be announced. Brexit developments will continue to drive the GBP; the odds of the UK stumbling out of the EU without a deal have significantly risen.

Medium-term outlook

We expect the NZD/USD to gradually strengthen given NZ's high Terms of Trade and continued investor interest in New Zealand assets. We expect the USD will hold some of its strength despite the market partially pricing in potential future Fed rate cuts. We have lifted our NZD/AUD forecasts and now expect the NZD/AUD to remain close to 0.96 over the next few years. We revised our AUD forecasts lower to reflect Australia's housing adjustment and the risk of slower growth in Australian household consumption. We have delayed the timing the EUR appreciation as Europe's economy has softened and we expect the ECB will now wait until the end of 2020 before raising interest rates.

ASB foreign exchange forecasts

(end of quarter)

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual		>> forecast >>					
NZD/USD	0.67	0.68	0.68	0.69	0.69	0.70	0.72	0.74
NZD/AUD	0.95	0.96	0.96	0.96	0.96	0.96	0.96	0.97
NZD/JPY	74	75	76	77	77	77	78	80
NZD/EUR	0.59	0.60	0.60	0.60	0.59	0.59	0.59	0.60
NZD/GBP	0.53	0.52	0.54	0.54	0.54	0.54	0.55	0.57
NZD TWI	73.5	73.9	73.9	74.5	74.1	74.8	75.0	76.6

Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.75	1.75	1.75	1.75	FLAT	DOWN
90-day bank bill	1.85	1.89	1.89	1.96	FLAT	DOWN
2-year swap	1.63	1.78	1.86	2.22	FLAT	DOWN
5-year swap	1.77	1.85	2.04	2.62	FLAT	FLAT
10-year swap	2.16	2.21	2.49	3.07	FLAT	FLAT/UP
10-year govt bond yield	1.81	1.91	2.18	2.71	FLAT	FLAT/UP
Curve Slope (2s10s swaps)	0.53	0.43	0.63	0.85	FLAT	FLAT/UP

* Current as at 10am today; week ago as at Monday 5pm

Market Recap

Local yields continued their march lower and the NZD interest rate curve steepened. This outstripped more modest falls in Australian yields and was in contrast to gently rising US yields. **The RBNZ surprised the market last Wednesday by adopting an explicit easing bias** (“the more likely direction of our next OCR move is down”) and dropping its intent to keep the OCR on hold until 2021. NZD interest rates fell 10-20bps across the curve and the curve steepened after the RBNZ announcement, as market pricing swung to price in likely OCR cuts. Still-weak domestic business confidence data also dampened yields. **Global yields firmed towards the end of the week as markets viewed earlier falls in global interest rates as probably being overdone**, with Fed members optimistic on the economic outlook and calling for “patience” on interest rate settings. UK yields were capped by Brexit uncertainties, with the UK parliament again rejecting PM May’s Brexit withdrawal agreement.

Near-term NZD interest rate outlook

Market pricing has firmly gravitated towards OCR cuts, with a 25bp cut fully priced in by August, with a further 25bp cut expected by mid-2020. **We expect short-term interest rates to remain under downward pressure over the next few months as the RBNZ delivers on its easing policy bias – we expect 50bps in OCR cuts over 2019.** Tomorrow’s Quarterly Survey of Business Opinion (QSBO) is the domestic highlight, and another set of subpar readings for firms’ domestic trading activity would see markets price in the greater likelihood of OCR cuts. The RBA are widely expected to hold the cash rate at 1.50% and there is scope for personal tax cuts to be announced in Tuesday night’s Australian Federal Budget. A still-solid Australian fiscal position would likely cap Australasian yields. **The direction of global yields will hinge on the tone of forthcoming data.** This week’s manufacturing PMI’s, the Japanese Tankan Survey, the US Manufacturing ISM and March payrolls will help verify whether markets have gotten too ahead of themselves. The ECB minutes will provide more insights into why ECB officials have adopted a more dovish stance. We expect concerns over the global growth outlook will continue to keep global yields low.

Medium-term outlook

We have changed our OCR call and now expect 25bp of OCR cuts in August and November of this year. The OCR is subsequently expected to remain at 1.25% till late 2021, before gradually drifting towards its 2.25% cyclical peak towards the end of 2023. The proposed higher bank capital requirements, which we assume are equivalent to roughly 50bps increase on customer interest rates by late 2023, will likely tighten financial conditions, lower swap interest rates across the curve and keep the OCR lower than it would otherwise be. Global central banks are expected to remain on hold, with risks tilting towards more policy support being necessary. NZD long-term yields could initially dip and then drift up and eventually settle at around 2.5-3%. Mild RBNZ tightening, low NZ inflation, still-strong demand for NZD assets, and our historically-low outlook for global yields should keep NZD yields low.

ASB interest rate forecasts

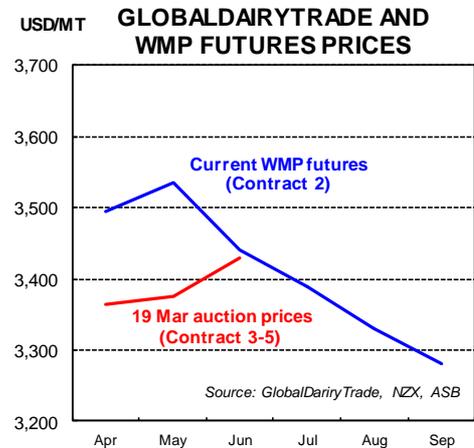
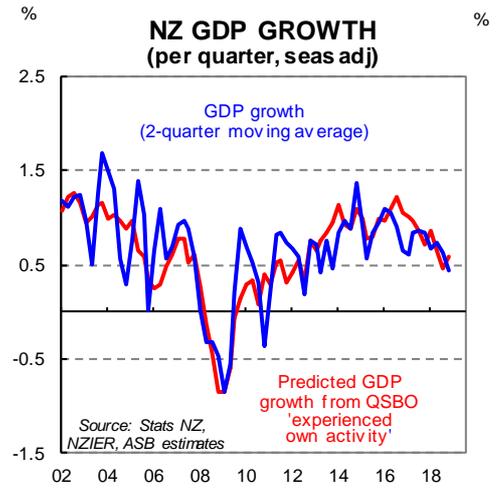
	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.75	1.75	1.50	1.25	1.25	1.25	1.50
NZ 90-day bank bill	1.97	1.9	1.8	1.6	1.4	1.4	1.4	1.8
NZ 2-year swap rate*	1.97	1.9	2.0	1.6	1.5	2.2	2.6	2.7
NZ 10-year Bond*	2.38	1.8	1.7	1.7	1.7	1.8	2.1	2.4

Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
NZIER QSBO, Experienced Activity, Q1	02/04	10:00am	+4	-	-
GlobalDairyTrade auction, whole milk powder, % change	02/04	overnight	+4.0	-	+2.0

Business confidence remained weak in February and March, according to the monthly ANZ business outlook survey. We continue to prefer the NZIER Quarterly Survey of Business Opinion over the ANZ survey, as it has remained the more accurate predictor of NZ GDP growth in recent years. **The QSBO survey's 'experienced trading activity' has correctly predicted the pace of growth over 2018** and we will be closely scrutinising the **Q1 experienced activity (seasonally-adjusted)** outcome (+4 in Q3).

We expect whole milk powder prices to post a small rise at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices rose by 4.0% and at the current juncture futures pricing points to a lift of over 4%. However, futures pricing have consistently overstated recent auction results. On this basis, we expect a smaller WMP price rise in the vicinity of 2%.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia CoreLogic House Price Index, March, %mom	01/04	12:00 pm	-	-0.8
Japan Tankan Large Manufacturing Index, Q1, %qoq	01/04	12:50 pm	13	-
Eurozone CPI, March, %yoy	01/04	10:00 pm	0.9	-
US ISM Manufacturing Index, March, points	02/04	3:00 am	54.2	54.6
Australia Building Approvals, February, %mom	02/04	1:30 pm	1.8	2.0
RBA Interest Rate Announcement, %	02/04	4:30 pm	1.5	1.5
Eurozone Retail Sales, February, %yoy	03/04	10:00 pm	2.2	2.0
ECB Meeting Minutes, March	05/04	12:30 pm	-	-
US Non-farm Payrolls, March, 000s	06/04	1:30 am	175	190

*Originally published by CBA Global Markets Research on Friday 29th March 2019 at 2.14pm.

Australian dwelling prices look set to post another solid fall over March. The price declines again look to be driven by both Sydney and Melbourne. Prices are also down in Brisbane, the first month of decent falls, as well as in Adelaide. Perth is set to fall again.

The **Bank of Japan's quarterly survey of Japanese corporates** is highly regarded. The Tankan large manufacturers' outlook index is likely to ease modestly from high levels because of the slowing global economy.

Headline and core CPI inflation in the Eurozone will likely remain muted around 1.5% yoy and 1.0% yoy in March, respectively. Disappointing economic activity and easing inflation expectations continue to contain price pressures. The European Central Bank has projected headline and core CPI inflation of 1.2% for 2019.

US regional manufacturing surveys were mixed in March. Therefore, we expect the **national ISM manufacturing index** to be roughly stable at 54.6 points.

Australian residential building approvals posted a 2.5% gain last month, led by gains in both, houses and multi-unit approvals. Approvals for both, houses and multi-units, are trending lower. We expect a partial rebound in approvals this month after sharp falls late last year.

The Reserve Bank of Australia should leave interest rates unchanged at 1.5% at the April meeting. The RBA will get the opportunity to share its thinking on the weaker Q4 GDP result, which was released after the March meeting. The RBA has focussed on the tension between the resilient labour market data and weaker GDP data. The RBA believes part of the reason is weaker growth in non-labour income sources and rising tax payment growth.

Retail sales growth in the Eurozone will likely continue to grow at a decent annual pace around 2% in February underpinned by firm household credit growth, improving consumer confidence and favourable employment conditions.

The **European Central Bank** adopted a more dovish monetary policy stance at its 7 March meeting. The central bank pushed out slightly its forward guidance and lowered its macroeconomic projections. It will be interesting to see if the ECB discussed possible measures to help mitigate the side effects of negative rates on banks' net interest margins.

We expect **US employment** to snap back in March from the weather-affected weakness in February. The low level of jobless claims suggests the unemployment rate stayed low at 3.8%. We expect growth in average earnings to remain solid at 3.3% yoy.

Key Forecasts

ASB NZ economic forecasts

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
GDP real - Q%	0.6	0.6	0.7					
GDP real - A%	2.3	2.4	2.2	2.7	3.0	3.2	3.0	2.9
GDP real - AA%	2.8	2.6	2.4	2.4	2.6	2.8	3.2	3.0
CPI - Q%	0.1	0.1	0.6					
CPI - A%	1.9	1.5	1.8	1.4	1.6	2.0	1.8	1.8
HLFS employment growth - Q%	0.1	0.7	0.4					
HLFS employment growth - A%	2.3	2.4	2.2	1.6	1.9	1.7	1.6	1.5
Unemployment rate - %sa	4.3	4.2	4.3	4.2	4.1	4.2	4.1	4.1
Annual current account balance as % of GDP	-3.7	-3.5	-3.6	-3.7	-3.7	-3.6	-3.6	-3.4

Q% = percentage change on previous quarter

A% = percentage change since same quarter the previous year

AA% = percentage change for year ending quarter since the previous year

ASB interest rate forecasts

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(end of quarter)								
NZ OCR	1.75	1.75	1.75	1.50	1.25	1.25	1.25	1.50
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ASB foreign exchange forecasts

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(end of quarter)								
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NZD/AUD	0.95	0.96	0.96	0.96	0.96	0.96	0.96	0.97
NZD/JPY	74	75	76	77	77	77	78	80
NZD/EUR	0.59	0.60	0.60	0.60	0.59	0.59	0.59	0.60
NZD/GBP	0.53	0.52	0.54	0.54	0.54	0.54	0.55	0.57
NZD TWI	73.5	73.9	73.9	74.5	74.1	74.8	75.0	76.6

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