

Economic Weekly

01 July 2019

Heading lower

The Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate (OCR) on hold at 1.5% as widely expected last week. The RBNZ's policy assessment confirmed that an easing bias was in place, noting that a lower OCR may be needed (see our full review [here](#)). We continue to expect the RBNZ to cut the OCR to 1.25% in August, and weak business confidence highlights the risk the OCR could move lower still. The NZIER Quarterly Survey of Business Opinion, released Tuesday morning, will provide further insight into economic conditions over Q2 and will be closely scrutinised by domestic economists. Across the Tasman, we expect the Reserve Bank of Australia (RBA) to cut its cash rate again this week (see chart of the week below). Offshore, investor sentiment has started the week on a more upbeat note as US and China appears set to resume trade negotiations, although a long road lies ahead.

Key events and views

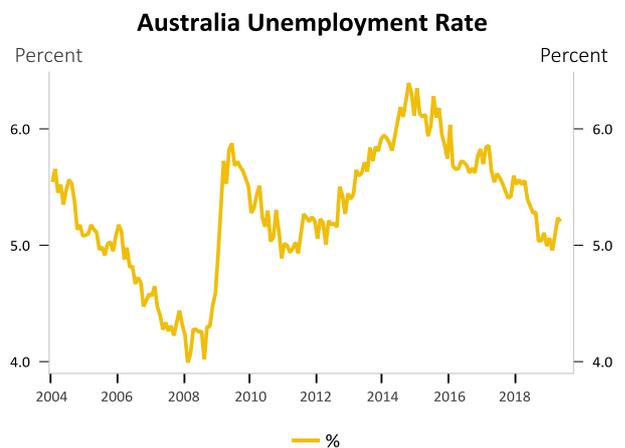
Foreign exchange	NZD was the strongest performing G10 currency last week.
Interest rates	NZ rates rise after RBNZ on hold. We retain our mild downward bias.
Domestic events	NZIER Q2 business opinion survey, building consents, Global Dairy Trade auction.
International events	RBA policy announcement, Global manufacturing surveys, US labour market.
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: RBA wants unemployment rate lower

The RBA is expected to cut its cash rate 25 basis points at its Tuesday meeting, the second cut in two months, bringing the Australian cash rate to a new record low of 1%.

The key catalyst for the RBA's sudden easing trajectory was the **RBA's reassessment of labour market conditions**. The RBA has concluded that there is considerably more spare capacity in the Australian labour market than previously thought. The Australia unemployment rate recently lifted to 5.2%, but the RBA now believes it needs an unemployment rate below 4.5% to be consistent with achieving its employment and inflation targets.

Recent commentary by the RBA Governor suggested the RBA saw the need for a sizable adjustment to policy settings as a result. **We expect a further 25bp cut the RBA towards the end of the year (likely November), bringing the Australian cash rate to 0.75%.**



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6723	0.6600	0.6509	0.6777	FLAT/DOWN	0.6615	0.6780	UP
NZD/AUD	0.9559	0.9485	0.9412	0.9169	FLAT/DOWN	0.9350	0.9650	FLAT
NZD/JPY	72.74	70.89	70.95	74.99	FLAT	71.25	74.65	UP
NZD/EUR	0.5914	70.95	0.5849	0.5816	FLAT	0.5840	0.5990	FLAT
NZD/GBP	0.5295	0.5176	0.5162	0.5167	FLAT	0.5230	0.5370	FLAT
TWI	73.4	72.1	71.8	72.43	FLAT/DOWN	N/A	N/A	FLAT

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

NZD Recap

The news coming out of the weekend's G20 was positive, with China and the US agreeing to hold off on implementing additional tariffs, although a trade deal was not reached. The associated unwinding of 'safe-haven' trades has heaped further pressure on the USD, allowing the NZD to extend its recent gains. The NZD was the strongest performing G10 currency last week. As we suspected, the on hold RBNZ decision last Wednesday added fuel to the NZD. The NZD/USD is trading at two month highs around 0.6720.

Near-term outlook

Local economic news may present something of a speed bump for the NZD this week. We expect another 2% fall in whole milk powder prices at Tuesday night's GDT dairy auction. Tomorrow's QSBO Business Confidence index also looks set to remain soft, if recent ANZ business confidence readings are anything to go by. However, we do expect some improvement in the details (see preview below).

Globally, we suspect the USD will remain soft as market participants turn their mind to the July FOMC meeting. We expect the Fed to lower interest rates 25bps at this meeting and to deliver a total of 100bps of cuts by mid-2020. This week's US economic data is expected to reinforce the case for Fed cuts. The June US ISM manufacturing index is expected to fall to 51pts, from 52.1 in May. There is a decent risk of a sub-50 (contractionary) print. June non-farm payrolls are expected to be a solid 170,000 (market +160k) but we expect a clear deceleration in the closely-watched wage growth series, to 3% yoy.

Medium-term outlook

We expect the NZD to track a sideways range in the near term. NZ monetary policy looks set to move relatively in-sync with some of our key trading partners, essentially nullifying relative interest rate expectations as a key driver of currency markets. We expect the RBA, RBNZ, and US Fed to all cut rates over the coming two months.

Further ahead, we expect the NZD to firm against most crosses from late 2019 onwards. The NZD/USD will be supported by NZ's high Terms of Trade while the USD remains under downward pressure from Federal Reserve interest rate cuts. We expect the NZD/AUD to remain close to 0.95 over 2019 and to subsequently firm.

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	0.67	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.95	0.96	0.96	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.59	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.53	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	73.2	70.2	72.7	73.1	75.1	75.8

Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.50	1.50	1.50	1.75	UNCH	UP
90-day bank bill	1.64	1.58	1.67	2.00	UNCH/DOWN	UP
2-year swap	1.37	1.30	1.45	2.15	UNCH/DOWN	UP
5-year swap	1.47	1.38	1.56	2.53	UNCH/DOWN	UP
10-year swap	1.82	1.75	1.92	3.02	UNCH/DOWN	UP
10-year govt bond yield	1.59	1.53	1.72	2.86	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.45	0.45	0.48	0.87	UNCH	UNCH/UP

* Current as at 9.30am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged

Market Recap

NZ yields firmed over the course of last week, with markets focused on central banks and trade. As we expected, the RBNZ held the OCR at 1.50% and signalled an easing bias, noting a “lower OCR may be needed over time to continue to meet our objectives.” Markets had priced a 20% chance of a June OCR cut, and yields subsequently edged up. There was limited market reaction from soft domestic business confidence data (ANZ business outlook). Australian yields edged higher, despite RBA Governor Lowe giving a clear signal that more policy easing was coming. US yields were volatile, but lower at the end of the week on increasing conviction of more policy support by the Fed. Positive signals emerged from the G20 in the weekend, with China and the US agreeing to hold off on new tariffs and proceed with trade negotiations, although a long road lies ahead, with the G20 communique warning of low global growth and downside risks. Weak Chinese manufacturing sentiment data highlighted the need for more policy stimulus.

Near-term NZD interest rate outlook

We have a mild downward bias for NZ interest rates. Our published forecasts are for the OCR plateauing at 1.25%, following a 25bp cut in August, but we are broadly comfortable with current market pricing (OCR trough of 1% by mid-2020) given our view of the risk profile. Domestic business confidence remains the elephant in the room, and the modest improvement expected in the activity gauges from the QSBO is likely to be insufficient to signal an imminent increase in economic activity and prevent more RBNZ policy easing. **Tomorrow at 4.30pm our CBA colleagues expect the RBA to cut the cash rate by 25bps to a new record low (1%).** The majority of market analysts expect a 25bp cut (market odds are about 70%) with around 50bps of cuts priced in by the end of the year. The risk is that the RBA signal the cash rate is unlikely to approach the 0.75% lull signalled by market pricing, which could push Australasian yields up. **We expect any post-G20 lift in global yields to be fleeting given our view of the global risk profile.** This week’s global manufacturing PMIs will provide a stocktake on the (slowing) pace of global growth.

Medium-term outlook

OCR moves by the RBNZ will depend on the tenor of domestic data, the NZD, global developments and actions of other central banks. Following a further 25bp cut over 2019 August, we expect the OCR to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak by late 2023. Risks are tilted to a lower OCR trough.

Global central banks are expected to further trim policy rates. We expect 25bp cuts from the RBA in July (to 1.00%) and likely November (0.75%), with the Federal Open Market Committee to start cutting the 2.25-2.5% Federal Funds rate from late July (100bps of Fed cuts in total) and for the Peoples Bank of China to cut policy rates by 40bps in 2019H2. **Global and NZD long-term interest rates are expected to drift higher, but settle at historically-low levels.**

ASB interest rate forecasts

(end of quarter)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
			<< actual	forecast >>				
NZ OCR	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.50
NZ 90-day bank bill	1.97	1.9	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.4	1.3	1.3	1.3	1.4	1.7
NZ 10-year Bond*	2.38	1.8	1.6	1.6	1.6	1.6	1.7	1.9

Major Domestic Events for the week ahead

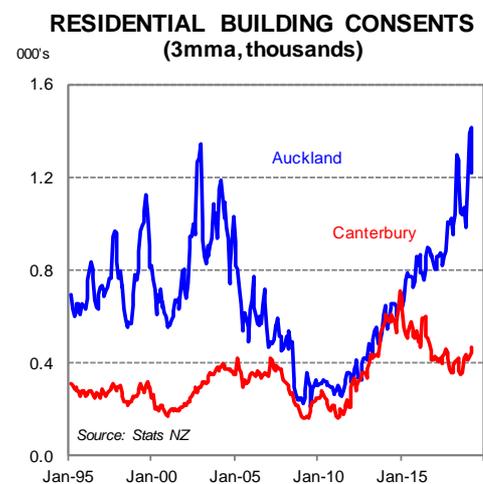
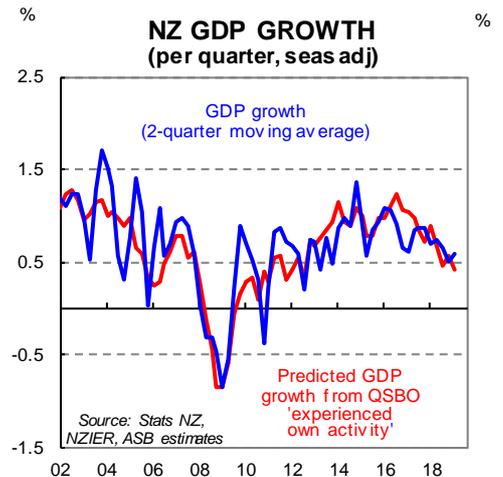
Data	Date	Time (NZT)	Previous	Market	ASB
NZIER QSBO, Experienced trading activity, s.a., Q2	02/07	10:00 am	-1	-	+6
Building Consents, Residential, May, %mom	02/07	10:45 am	-8	-	-
GlobalDairyTrade auction, whole milk powder, % change	02/07	overnight	-4.3	-	-2

Business confidence remained weak over April through to June, according to the monthly ANZ business outlook survey. We were surprised (and concerned) that business confidence did not lift at all in May or June given the Government's decision to not pursue a capital gains tax and the RBNZ's OCR cut in May. 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 expect this measure to improve in Q2 to +6 (from -1 in Q1) and to be consistent with trend GDP growth of around 0.6% per quarter.**

We see scope for residential building consents to lift in May.

Residential dwelling consent numbers fell 8% over April, extending the 7% decline in March. However, the fall over March and April follows a run of strong issuance since December last year and the underlying trend remains strong. Furthermore, consent issuance in April may have been impacted by the close proximity of Easter holidays and ANZAC day resulting in fewer working days than normal. Finally, apartment consents, which are typically volatile on a monthly basis, contributed to the fall in April.

We expect whole milk powder prices to fall 2% at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices fell by 4.3%. At the current juncture, futures pricing also points to a fall of around 2%. With auction volumes past their seasonal low, prices are likely to drift lower as they normally tend to at this juncture in the season. However, we anticipate that prices will eventually move higher as we expect NZ spring production to undershoot production levels from a year ago.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia CoreLogic dwelling prices, June, %mom	01/07	12.00 pm	-	-0.2
UK Manufacturing PMI, June, index	01/07	8:30 pm	49.5	-
RBA Interest Rate Announcement, %	02/07	4:30 pm	1.0	1.0
US ISM Manufacturing, June, index	02/07	2:00 am	51.0	-
Australia Building Approvals, May, %mom	03/07	1:30 pm	0.0	0.0
Australia Trade Balance, May, \$bn	03/07	1:30 pm	5.25	5.0
Australia Retail Trade, May, %mom	04/07	1:30 pm	0.2	0.8
Eurozone Retail Sales, May, %mom	04/07	9:00 pm	0.4	-
US Non-farm Payrolls, June, 000s	06/07	12:30 am	160	170

*Originally published by CBA Global Markets Research on Friday 28th June at 2.23pm.

Australia's CoreLogic daily data point to a fall in national capital city dwelling prices of 0.2% in June. The data indicate small falls of 0.1% in both Sydney and Melbourne. The leading indicators of dwelling prices have improved post the federal election and the central bank's rate cut.

The **UK manufacturing PMI** fell sharply in May below the neutral 50 benchmark for the first time since July 2016. Brexit and global trade uncertainties will likely further weigh on manufacturing activity. The manufacturing sector accounts for roughly 10% of the UK economy.

We expect the Reserve Bank of Australia (RBA) to cut the cash rate in July. Last week in a speech RBA Governor Lowe gave a clear signal that more policy easing is coming and he implied that it's going to be imminent. He stated *"it would, however, be unrealistic to expect that lowering interest rates by ¼ of a percentage point will materially shift the path we look to be on. The most recent data – including the GDP and labour market data – do not suggest we are making any inroads into the economy's spare capacity. Given this, the possibility of lower interest rates remains on the table. It is not unrealistic to expect a further reduction in the cash rate as the Board seeks to wind back spare capacity in the economy and deliver inflation outcomes in line with the medium-term target."*

Widespread weakness in **US** regional manufacturing surveys suggests the **national manufacturing ISM** decreased again in June. Our model estimate is 51.0 points, though there is a risk of a fall below 50pts for the first time since August 2016.

Australia's building approvals have been on a downward trend although the pace of decline has eased. We think that approvals will soon bottom out at around current levels and we have pencilled in a flat result in May. If dwelling prices inch higher we may see a lift in building approvals in H2 2019.

Australia's external sector is doing incredibly well at the moment and big monthly surpluses have become routine. The RBA's index of commodity prices pushed higher in May and we expect to see another big trade surplus posted in May.

Australia's retail trade has been soft. Sales fell by 0.1% in April. Other data, however, point to a solid lift in sales over May. As such, we have forecast a 0.8% increase in retail trade over May. There may be a post-election bounce in sales over the second half of the month (note that the election was on 18th May).

Retail sales growth in the Eurozone will likely increase in May underpinned by positive real wage growth and favourable employment conditions. However, softer consumer confidence is a headwind to household spending.

The low level of jobless claims suggests **US Non-farm Payrolls** rebounded strongly in June by 170,000 from the unusual weakness of 75,000 in May. We expect the unemployment rate to stabilise at 3.6%. The fall back in consumer's long run inflation expectations to record low levels and a stable unemployment rate suggest wage growth will decelerate again, to 3.0%yoy in June.

Key Forecasts

ASB NZ economic forecasts

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual		forecast >>					
GDP real - Q%	0.6	0.6	0.7					
GDP real - A%	2.5	2.5	2.3	2.6	2.7	2.9	2.4	2.4
GDP real - AA%	2.9	2.7	2.5	2.5	2.5	2.6	2.6	2.4
CPI - Q%	0.1	0.1	0.7	0.6				
CPI - A%	1.9	1.5	1.8	1.6	1.6	1.8	1.7	1.8
HLFS employment growth - Q%	0.0	-0.2	0.4					
HLFS employment growth - A%	2.3	1.5	1.3	0.7	1.1	1.7	1.6	1.4
Unemployment rate - %sa	4.3	4.2	4.4	4.4	4.5	4.4	4.2	4.0
Annual current account balance as % of GDP	-3.8	-3.6	-3.4	-3.4	-3.3	-3.2	-3.1	-3.0

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

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	
	<< actual			forecast >>					
(end of quarter)									
NZ OCR	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.50	
NZ 90-day bank bill	1.97	1.9	1.7	1.5	1.5	1.5	1.5	1.8	
NZ 2-year swap rate*	1.97	1.6	1.4	1.3	1.3	1.3	1.4	1.7	
NZ 10-year Bond*	2.38	1.8	1.6	1.6	1.6	1.6	1.7	1.9	

ASB foreign exchange forecasts

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	
	<< actual			forecast >>					
(end of quarter)									
NZD/USD	0.67	0.68	0.67	0.64	0.68	0.69	0.72	0.73	
NZD/AUD	0.95	0.96	0.96	0.94	0.94	0.95	0.96	0.97	
NZD/JPY	74	75	72	71	74	75	78	79	
NZD/EUR	0.59	0.60	0.59	0.57	0.58	0.58	0.59	0.59	
NZD/GBP	0.53	0.52	0.53	0.50	0.53	0.53	0.55	0.56	
NZD TWI	73.5	73.9	73.2	70.2	72.7	73.1	75.1	75.8	

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