Economic Weekly

02 September 2019

Stall speed?

Global and local economic news continues to sour, on balance. The trade war shows every sign of worsening, and the impact of such is increasingly showing up in hard data and forecasts. Indicative of such, consensus forecasts for NZ's trading partner growth have been revised down again, and now sit at 3.4% for 2019 and 2020. Local 'soft' data has tended to shift southwards too. Business confidence figures released last week fell again, with firms seeing an increasing risk the economy hits stall speed (see chart 'o' the week). We still think this outcome will be avoided given the support from a humming construction sector and the high terms of trade. Still, **the risks of a more protracted slowdown are rising**.

Key events and views

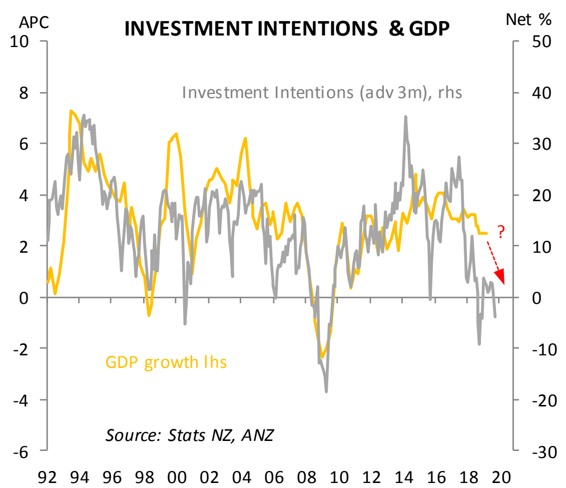
Foreign exchange	NZD weighed by global growth concerns and slowing domestic momentum
Interest rates	Domestic and global catalysts drive NZ yields lower
Domestic events	GDT auction, Q2 building work, ANZ commodity price index
International events	Global PMIs, US non-farm payrolls and ISM, RBA, UK House returns, Fed/ECB speeches
Calendars	NZ and international calendar of upcoming economic events.

Chart 'o' the Week: Mind the gap!

It was hard to find any cheer in last week's August ANZ business confidence survey. Headline confidence and firms' own activity expectations held roughly stable at very low levels according to our seasonally-adjusted estimates. The survey details were even more worrisome than the headline stats.

Firms' employment intentions fell to the lowest level since mid-2009. The index is at level consistent with outright contraction in employment growth. Our already-low employment growth forecasts of 1-2% may be too strong.

Investment intentions really caught our eye. Despite the encouragement from the RBNZ Governor, firms just don't believe it's a good time to invest. Who could blame them given the global gloom and signs of a turning in NZ's economic cycle. As the chart shows, the level of investment intentions suggests NZ economic activity is at risk of stalling. Our forecasts of a 2.5%yoy 2019 calendar year expansion look a tad lofty.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6302	0.6376	0.6539	0.6643	DOWN	0.6180	0.6420	FLAT
NZD/AUD	0.9368	0.9468	0.9602	0.9156	FLAT	0.9250	0.9550	FLAT
NZD/JPY	66.86	67.12	70.01	73.74	DOWN	65.80	68.40	UP
NZD/EUR	0.5733	0.5721	0.5899	0.5692	FLAT/DOWN	0.5630	0.5860	FLAT/UP
NZD/GBP	0.5184	0.5197	0.5400	0.5104	FLAT/DOWN	0.5080	0.5290	FLAT/UP
TWI	70.7	71.2	72.4	71.89	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 NZD remained weighed by global growth concerns and weak business confidence last week, with headline monthly ANZ business confidence falling to the lowest level in 11-years (on a non-seasonally adjusted basis). The NZD fell against the USD and AUD, but remained broadly steady against the EUR, GBP and JPY.

The GBP/USD declined by over 1% after UK Prime Minister Boris Johnson asked the Queen to suspend Parliament from 12 September to 14 October. The timeframe leaves Members of Parliament opposing a no deal Brexit with very little time to pass legislation that would prevent a hard/no deal Brexit on 31 October.

The EUR was weighed by weak economic data, in particular the softer than expected German IFO data which fell to the lowest level since 2009. However, the EUR received some support later in the week after Italy's anti-establishment Five Star Movement and the centre left Democratic Party tentatively agreed to form a coalition government headed by outgoing Prime Minister Giuseppe Conte.

Near-term outlook

It will be a quiet start to the week with US Labour Day holiday in the US today. This week New Zealand economic data will likely take a back seat to global developments. **We expect the NZD/USD will continue to trade heavily** this week after dipping to a fresh 4-year low below 0.6300 last week. We expect the **USD will remain supported** by weak US economic data (we expect both the August manufacturing ISM and August non-farm payrolls to print below market expectations). **We do not expect the Reserve Bank of Australia (RBA) to cut the cash rate on Tuesday**, but we expect the RBA's post meeting statement to remain cautious about the global economic outlook. **The GBP will continue to be driven by UK political developments** this week. British MPs return from their summer break today and MPs opposing a no deal Brexit will try to pass legislation that would prevent a no deal Brexit on 31 October.

Medium-term outlook

CBA recently lowered their NZD forecasts. The mild appreciation we had expected from Q4 of this year has been removed with the NZD/USD seen at 0.6300 by year-end and 0.6200 by Q1. This downward revision is consistent with the trade war, and attendant negative global growth impacts, dragging on for longer than we anticipated. The domestic economy's failure to launch (as flagged in our Quarterly Forecasts last week) is another reason we think the NZD will hang around current low levels for longer. Our constructive view on NZ's terms of trade, and the front-loaded nature of RBNZ policy easing, are key reasons why believe further downside from here is limited.

ASB foreign exchange forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.68	0.67	0.64	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.96	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	75	72	68	66	64	70	71	71
NZD/EUR	0.60	0.59	0.58	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.52	0.53	0.53	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.9	73.2	70.5	69.3	68.3	71.7	72.1	72.1

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.50	1.75	UNCH	UP
90-day bank bill	1.18	1.20	1.45	1.91	UNCH	UP
2-year swap	0.91	0.94	1.20	1.98	UNCH/DOWN	UP
5-year swap	0.93	0.95	1.23	2.32	UNCH/DOWN	UP
10-year swap	1.19	1.20	1.54	2.83	UNCH/DOWN	UP
10-year govt bond yield	1.05	1.01	1.37	2.54	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.28	0.27	0.34	0.85	UNCH/DOWN	UNCH/UP

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

Market Recap

Lower yields were commonplace globally as increasing risk aversion dominated. The 2-year NZ swap yield hit a record low 0.905% after headline ANZ business confidence fell to an 11-year low, with firms' own activity expectations, employment and investment intentions in negative territory. Rather than resolving pressing issues, the G7 summit highlighted divisions amongst participants, with little in the way of progress. The trade war continued to ratchet up, with the US collecting 15% tariffs on more than USD125bn in Chinese imports and with China imposing additional tariffs on some USD75bn of US goods in September. Unrest also continued in Hong Kong. The US Treasury yield curve (2s10s) spent most of last week inverted, with 30-year Treasury yields touching record lows (1.90%) late last week. UK yields fell after UK Prime Minister Boris Johnson suspended the UK Parliament from 12 September until 14 October 2019, raising the odds of the UK leaving the EU without a deal on 31 October. It was not all doom and gloom. Outgoing Italian Prime Minister Conte was given permission to form a coalition government.

Near-term NZD interest rate outlook

We have maintained our (mild) downward (and curve flattening) bias for local yields. The local events calendar is light, and we expect headlines on trade and Brexit to dictate market direction. In the **absence of a breakthrough in both arenas we don't see much upside to yields.** Confirmation of slowing growth from global PMI's could further dampen yields. With UK MPs returning from their summer break, a motion of no confidence in the Government could be raised before the next parliamentary recess. The October 17-18 EU Summit looms and with time running out a no deal Brexit or a General Election looks likely. Speeches by various Fed voters (Williams, Bowman, Bullard, Evans) may provide clues on the Fed's course of action in September. We expect the RBA to leave the cash rate on hold at 1.00% at its September meeting, but to leave the door open to a further rate cut (or two) "if needed". Australasian yields are likely to come under downward pressure if Q2 GDP (mkt: +0.5% qoq, 1.4% yoy) disappoints. The Bank of Canada will meet on Wednesday no change in rates (1.75%) but anticipate them to turn dovish due to a less favourable global growth outlook (we expect a 25bp cut in October).

Medium-term outlook

Our forecast is for the curve to initially steepen and then to flatten as policy easing this year precedes mild policy tightening. **However, the growing risk is that longer-term yields could rally further (i.e. fall) if downside global risks crystallise.** We expect a 25bp OCR cut in November and a 0.75% OCR trough this cycle, with downside risks. Gradual OCR tightening is expected from early 2022, with an OCR endpoint of just 2.25% by late 2024. We also expect 50bp of cuts by the RBA (Nov 2019, Feb 2020), a further 75bp of cuts by the Fed (Sep 2019, Dec 2019, Mar 2020), and policy easing in Canada, the Eurozone and China. Inflation looks set to remain low and interest rate normalisation from global central banks a long way off, capping long-term interest rates at historically-low levels.

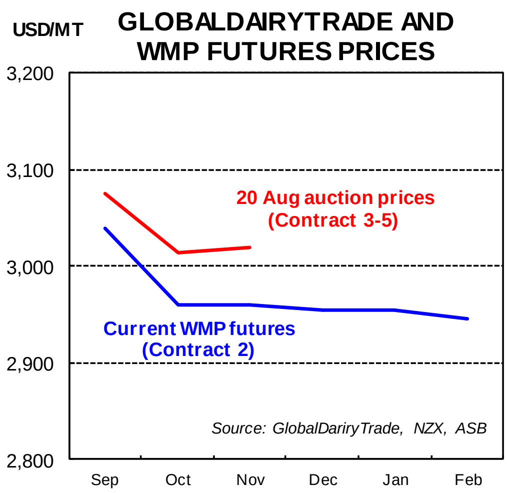
ASB interest rate forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.50	1.00	0.75	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.9	1.7	1.2	1.0	1.0	1.0	1.2	1.7
NZ 2-year swap rate	1.6	1.4	1.0	0.9	0.9	0.9	1.2	1.7
NZ 5-year swap rate	1.8	1.4	1.0	1.0	1.0	1.0	1.4	1.9
NZ 10-year swap rate	2.2	1.8	1.2	1.1	1.1	1.2	1.6	2.0
NZ 10-year Bond	1.8	1.6	1.0	0.9	0.9	1.0	1.4	1.8

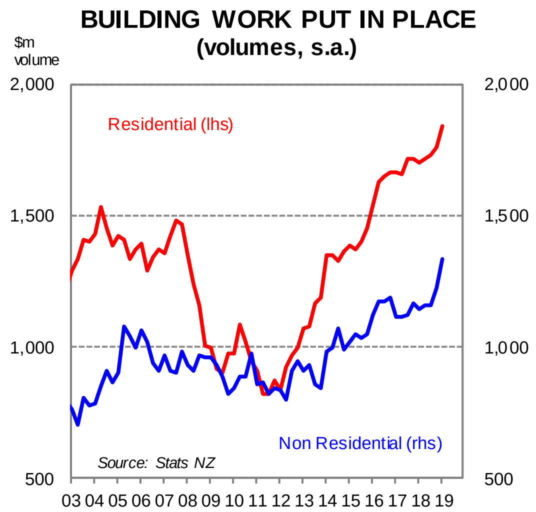
Domestic events

Data	Date	Time (NZT)	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	04/09	Overnight	-	-1.0
Building work put in place, volume, Q2, %	07/06	10:45 am	1.3	1.3

We expect whole milk powder prices to fall 1% at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices posted a 2.1% rise. At the current juncture, futures pricing also points to a drop of around 1%. We anticipate that the fall will largely reflect the decline in the CNY against the USD since the last auction. Note that Chinese buyers are the largest group participating on the platform and that auction prices are set in USD. Notably, fallout from the US-China trade war escalation has been relatively modest in global dairy markets so far.

We expect the volume of building work put in place to lift 1.3% over Q2, building on to the previous quarter's 6.2% increase. We expect the lift in building activity to be led by a 4.6% increase in residential construction activity, while we expect non-residential activity to ease back 3.3% following a strong increase in the previous quarter.





Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia Dwelling Prices, August, %mom	02/09	12:00 pm	-	0.9
Australia Current Account Deficit, Q2, $Abn	03/09	1:30 pm	1.5	1.4
Australia Retail Trade, July, %mom	03/09	1:30 pm	0.2	0.2
RBA Interest Rate Announcement, %	03/09	4:30 pm	1.0	1.0
Australia GDP, Q2, %qoq	04/09	1:30 pm	0.5	0.5
Bank of Canada Interest Rate Announcement, %	05/09	2:00 am	1.75	1.75
Australia Trade Balance, July, $Abn	05/09	1:30 pm	7.2	7.3
US Non-farm Payrolls, Aug, 000s	06/09	12:30 am	158	150
Eurozone GDP, Q2, %qoq	06/09	9:00 pm	0.2	0.2

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Australian dwelling prices have stopped falling; they recorded the first monthly gain in July 2019 – the first in almost two years. Based on the daily data we expect prices nationwide to lift 0.9% in August, driven by gains in Sydney and Melbourne. Interest rate cuts by the Reserve Bank of Australia (RBA), re-election of the Coalition government and changes to serviceability tests have helped lift sentiment.

A record quarterly trade surplus of $A19.021bn was recorded in Q2 19. This should see **Australia** record a **current account surplus** for the first time since 1975. We expect a result of $A1.4bn over Q2 and for net exports to contribute 0.4%pts to Q2 19 GDP growth.

We expect **Australia's retail trade** to lift by 0.2% in July. Our internal data show tax refunds are flowing into customer accounts now. The value of the refunds are higher and the number of people completing them is also higher than normal. We do not think this has translated into higher rates of consumer spending in July, but we do expect to see some improvement over the coming months.

We expect the RBA to hold the official cash rate steady at 1%. The central bank remains ready to cut rates again "if needed". We expect rate cuts in November 2019 and February 2020.

We expect a fairly moderate outcome for **Australia's Q2 GDP** of around 0.5%qoq following the Q1 outcome of 0.4%qoq. This would see the annual rate dip to around 1.4%yoy. We will firm up our estimates in the days leading up to GDP once the remainder of the partial data is released.

Australia's trade balance is booming with a record trade balance of $A8,036mn recorded in June. Rising commodity prices, particularly iron ore led to this outcome as well as falling imports. We expect another stellar result in July of $A7,300mn. Commodity prices were higher but values could reduce the surplus compared to June.

The Bank of Canada (BoC) is expected to maintain the overnight rate at 1.75%. We anticipate the BoC to turn more dovish this week because of a less favourable global growth outlook. Our base case scenario is for the BoC to cut the policy rate by 25bps to 1.50% in October.

US jobless claims remain low and are consistent with the unemployment rate stable at 3.7%. We estimate **non-farm Payrolls** expanded by 150,000. Manufacturing employment is likely to feel the negative impacts of the ongoing trade tensions with China. With unemployment low and inflation expectations lifting slightly, we expect growth in average earnings to lift to 3.3%yoy.

The **Eurozone's final GDP estimate** is expected to confirm the economy grew at a quarterly pace of 0.2% (or 1.1%yoy). The European Central Bank has projected 2019 GDP growth of 1.2%.

Key Forecasts

ASB NZ economic forecasts

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>						
GDP real - Q%	0.6	0.6	0.5					
GDP real - A%	2.5	2.2	2.3	2.5	2.6	2.8	2.3	2.4
GDP real - AA%	2.7	2.5	2.4	2.4	2.4	2.7	2.5	2.3
CPI - Q%	0.1	0.6	0.5	0.2				
CPI - A%	1.5	1.7	1.3	1.4	1.8	1.8	2.0	1.9
HLFS employment growth - Q%	-0.1	0.8	0.2	0.4				
HLFS employment growth - A%	1.5	1.7	0.9	1.3	1.9	1.7	1.4	1.2
Unemployment rate - %sa	4.2	3.9	4.1	4.1	4.2	4.0	3.9	4.1
Annual current account balance as % of GDP	-3.6	-3.2	-3.3	-3.6	-3.7	-4.0	-4.0	-4.1

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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NZ 90-day bank bill	1.9	1.7	1.2	1.0	1.0	1.0	1.2	1.7
NZ 2-year swap rate	1.6	1.4	1.0	0.9	0.9	0.9	1.2	1.7
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NZD/AUD	0.96	0.96	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	75	72	68	66	64	70	71	71
NZD/EUR	0.60	0.59	0.58	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.52	0.53	0.53	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.9	73.2	70.5	69.3	68.3	71.7	72.1	72.1

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