Economic Weekly

02 December 2019

Pre-Christmas miracle

The ANZ monthly business confidence survey staged a fairly stunning turnaround in November – just in time for Christmas! The November lift confirms confidence has at a minimum stabilised, and hopefully marks the first step towards a steady recovery. **The bounce in confidence occurred earlier than we expected**, but does follow tentative signs that interest-rate sensitive parts of the economy are improving, with the housing market springing back to life and retail sales proving surprisingly strong over Q3. **To celebrate the good news, we have scrubbed out one of our forecast 25bp OCR cuts** and now only expect one further cut in 2020 – largely to offset the pending increase in bank minimum capital requirements (see page 2 for more details). **Thursday this week is all important on this front, with the RBNZ revealing its final decision on by how much minimum capital requirements must increase and by when.**

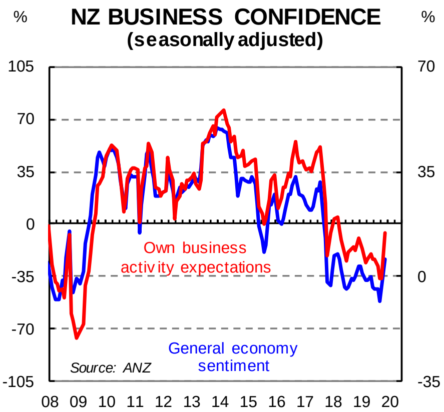
Key events and views

Key Insights	Change in OCR view and new interest rate forecasts.
Foreign exchange	Risks to the upside as NZ economic momentum improves.
Interest rates	We maintain our downward bias for NZ yields despite the change in OCR view.
Domestic events	We expect prices to rise at this week's global dairy trade auction.
International events	Australian Q3 GDP, Bank of Canada rate announcement, US employment data.

Chart of the Week: Business confidence bounces back

ANZ monthly business confidence bounced in November, following a number of very weak months. The **improvement was fairly broad based**, with key industries leading the positive turnaround including retail, services and agriculture. Improved business confidence appears to have been **underpinned by improved trading conditions**, as firms reported a turnaround in profitability expectations.

This development occurred earlier than we had expected. If this improvement is sustained and is corroborated with other leading indicators, it points to some **upside risk to our GDP growth forecasts – particularly over H1 2020.**



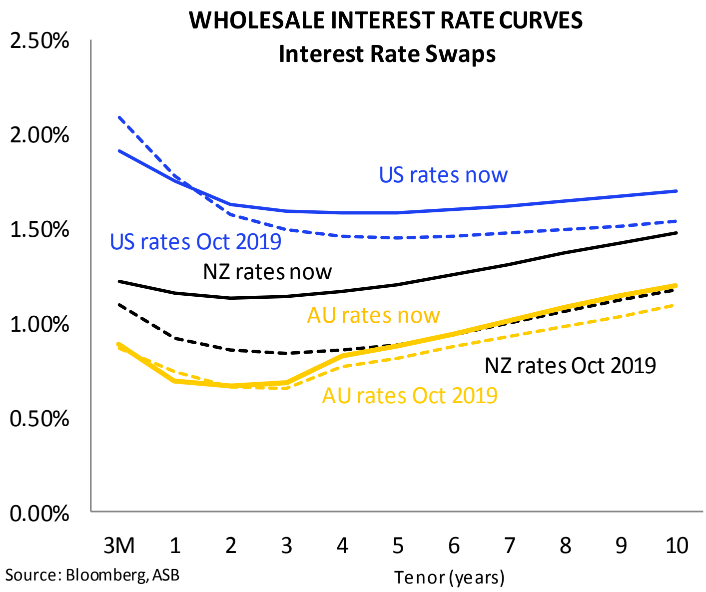
For now, however, **business confidence remains at low levels** and is still consistent with sub-trend economic growth. **Further sustained improvement in confidence is required before the RBNZ can relax.** We will be watching the December survey results very closely – unfortunately there is no monthly survey in January, so we cannot confirm an upward trend vs stabilisation in confidence until late February.

Key insights this week: Change to our OCR call and new interest rate forecasts

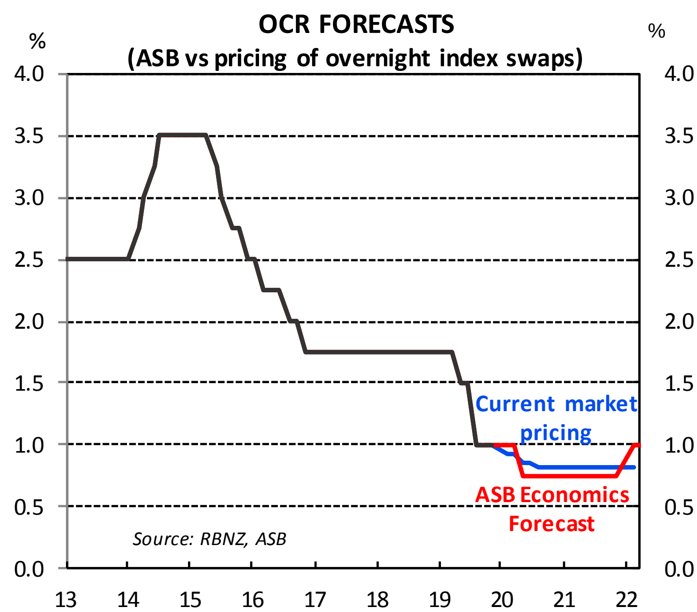
- We now expect just one 25bp OCR cut to be delivered over 2020 (May) and a 0.75% OCR floor this cycle. NZ yields are still expected to fall, albeit not to the same extent as previously assumed.
- The change in view is motivated by the more settled global environment and signs that interest-rate sensitive pockets of the NZ economy are responding to the 75bps of OCR cuts delivered so far over 2019.
- We expect NZ yields to remain at historically-low levels over next few years. Low global yields, an eventual mild tightening by the RBNZ and low inflation should cap the eventual increase in NZ yields.

Comments

We have changed our OCR call and no longer expect a 25bp cut to be delivered in February 2020. This follows our assessment that conditions are not yet in place to validate a further OCR cut on top of the 75bps delivered over 2019. The last couple of months have shown signs of stabilisation in global financial markets, with global yields and the NZD having firmed (see chart). Recent NZ data has also shown signs of resilience, with interest-rate sensitive pockets of the NZ economy responding to recent OCR cuts. The NZ commodity price backdrop and outlook is healthy and there is a likely pending fiscal boost in the policy pipeline. As such, the RBNZ seems likely to join the chorus of global central banks and pause policy easing to assess the impact of policy interest rate cuts already delivered.

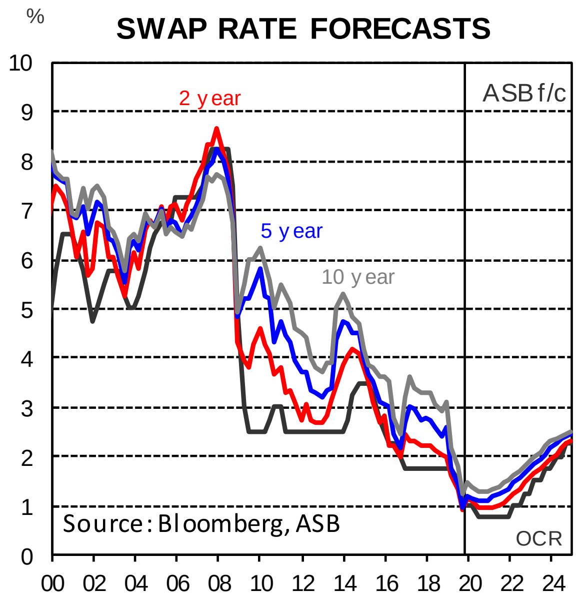


However, we still expect a 25bp OCR cut in May. The growth outlook for the NZ economy remains sub-trend, and this should force the RBNZ's hand. There is the also the likelihood that pending regulatory changes will tighten financial conditions and slow the economy, requiring a prolonged period of policy stimulus. **On Thursday the RBNZ is due to announce new (higher) bank capital requirements for locally-incorporated banks.** If they go through in their currently proposed form, all else equal, our estimates suggest a circa 50bp hit to retail interest rates for borrowers, with the OCR and NZ swap yields lower than they would otherwise be. There are already signs that the capital requirements are adversely impacting credit supply for some sectors. **NZ yields are still expected to decline over the next few months, albeit to a lesser extent than previous forecast.**



The RBNZ will not be the only ones cutting in 2020. There does not appear to be much substance behind recent buoyancy in equity markets, with slowing global growth expected to trigger more central bank support. We expect the Reserve Bank of Australia (RBA) to deliver another 25bp cut in early 2020 (February), taking the RBA cash rate to a 0.50% floor. At this stage we do not expect the RBA cash rate to hit the RBA's 0.25% lower bound and for the RBA to then undertake quantitative easing. The US Federal Open Market Committee (FOMC) is expected to continue to trim the 1.50%-1.75% Federal Funds rate by a further 75bp in 2020 (March, June and September), although we note the risks are skewed towards less Fed cuts over 2020.

We now expect 0.75% as being the lull in the OCR this cycle (from May 2020 onwards), with an early 2022 start to the next RBNZ OCR tightening phase. The exact timing of future OCR hikes is fluid and conditional on domestic and global developments. We expect a historically-low OCR endpoint of just 2.25% this cycle from late 2024. This is in a similar ballpark to our estimates of the neutral OCR. **We also expect long-term NZ yields to nudge higher,** but still note the risk of them retesting record lows if downward risks to the global outlook crystallise. More quantitative easing from central banks would further dampen yields.



We still expect NZ and global long-term interest rates to remain historically low over the next few years, given protracted low global inflation and the global expansion heavily dependent on policy support. NZ long-term yields are expected to eventually drift higher and then settle at historically-low levels (circa 2.5%). Mild RBNZ tightening, low NZ inflation, still-strong demand for NZ assets, and our historically-low outlook for global yields should cap NZ yields over the years ahead.

ASB INTEREST RATE FORECASTS

	OCR	90 day	1 yr swap	2 yr swap	3 yr swap	4 yr swap	5 yr swap	10 yr swap	10 yr bond	Slope	10y swaps less bonds
Sep-19 (a)	1.00	1.15	1.00	0.94	0.92	0.93	0.96	1.24	1.10	0.30	0.14
Dec-19	1.00	1.20	1.15	1.15	1.15	1.15	1.20	1.45	1.30	0.30	0.15
Mar-20	1.00	1.15	1.10	1.10	1.10	1.10	1.15	1.40	1.20	0.30	0.20
Jun-20	0.75	1.00	0.95	0.95	1.00	1.05	1.10	1.30	1.10	0.35	0.20
Sep-20	0.75	1.00	0.95	0.95	1.00	1.05	1.10	1.30	1.10	0.35	0.20
Dec-20	0.75	1.00	0.95	0.95	1.00	1.05	1.10	1.30	1.10	0.35	0.20
Mar-21	0.75	1.00	0.95	0.95	1.00	1.05	1.20	1.35	1.15	0.40	0.20
Jun-21	0.75	1.00	0.95	0.95	1.00	1.10	1.25	1.40	1.20	0.45	0.20
Sep-21	0.75	1.00	1.00	1.05	1.10	1.20	1.30	1.45	1.25	0.40	0.20
Dec-21	0.75	1.10	1.10	1.15	1.20	1.30	1.35	1.50	1.30	0.35	0.20
Mar-22	1.00	1.25	1.20	1.25	1.30	1.40	1.45	1.60	1.40	0.35	0.20
Jun-22	1.00	1.35	1.30	1.35	1.40	1.50	1.55	1.70	1.50	0.35	0.20
Sep-22	1.25	1.50	1.40	1.45	1.50	1.60	1.65	1.80	1.60	0.35	0.20
Dec-22	1.25	1.60	1.50	1.55	1.60	1.70	1.75	1.90	1.70	0.35	0.20
Mar-23	1.50	1.75	1.60	1.65	1.70	1.80	1.85	2.00	1.80	0.35	0.20
Jun-23	1.50	1.85	1.70	1.75	1.80	1.90	1.95	2.10	1.90	0.35	0.20
Sep-23	1.75	2.00	1.80	1.85	1.90	2.00	2.05	2.20	2.00	0.35	0.20
Dec-23	1.75	2.10	1.90	1.95	2.00	2.10	2.15	2.30	2.10	0.35	0.20
Mar-24	2.00	2.10	2.00	2.05	2.10	2.20	2.25	2.35	2.15	0.30	0.20
Jun-24	2.00	2.20	2.10	2.15	2.20	2.30	2.35	2.40	2.20	0.25	0.20
Sep-24	2.25	2.35	2.20	2.25	2.30	2.35	2.40	2.45	2.25	0.20	0.20
Dec-24	2.25	2.40	2.25	2.30	2.35	2.40	2.45	2.50	2.30	0.20	0.20

Source: ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6429	0.6421	0.6435	0.6866	FLAT/UP	0.6280	0.6445	FLAT
NZD/AUD	0.9495	0.9445	0.9314	0.9380	FLAT	0.9320	0.9520	FLAT
NZD/JPY	70.42	69.83	69.50	77.86	UP	68.30	71.10	UP
NZD/EUR	0.5832	0.5826	0.5763	0.6024	FLAT/UP	0.5680	0.5910	UP
NZD/GBP	0.4979	0.4999	0.4965	0.5371	FLAT	0.4910	0.5060	FLAT
TWI	71.5	71.2	70.8	74.79	FLAT/UP	N/A	N/A	FLAT/UP

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

NZD Recap

NZD volatility has collapsed. The kiwi spent the entirety of last week in an almost unbelievably tight 0.6400-0.6435 range. Globally, markets are just waiting around for a US-China trade deal. At the same time, economic data both in NZ and offshore has stabilised, halting the prior decline in interest rates, and contributing to the consolidation phase in asset prices.

Indicative of investors' complacency, NZ dollar implied option volatility (vols) fell to record lows last week. One to six month tenors hit record lows and 12 month vols fell to the lowest level since 1998, at around 7.5% – the long-run average is 12.5%. This not only suggests investors expect the low volatility environment to continue, but also provides opportunities for corporates to purchase options at below-average prices to help hedge 2020 FX risks.

Near-term outlook

We've long been suggesting the near-term balance of risks around the currency were tilted to the upside. Our conviction on this front increased a little last week, as yet more evidence accumulated of a turning in NZ economic momentum. Business and consumer confidence bounced, retail spending is tracking above expectations, and the housing market is heating up. We changed our call to expect just one more RBNZ OCR cut (from two).

Our short-term valuation model still points to a 'fair-value' range well above current spot rates. The current combination of commodity prices, NZ-US interest rate differentials, and global risk appetite point to 'fair value' somewhere in a 0.6750-0.7150 range. The risk is that NZD/USD breaks above resistance in the 0.6445/60 window.

Admittedly, there is a lot of event risk that could affect the kiwi this week. The biggest is probably the RBNZ's decision on bank capital requirements on Thursday. Market expectations are probably not too far from the set of proposals released early in the year. More stringent-than-expected requirements would see the NZD decline.

Medium-term outlook

Our medium-term forecasts have the NZD/USD drifting lower for the best part of the next four months, to a low of 0.6200 in March 2020. This slow and low forecast profile reflects the drag from the NZ growth slowdown and associated RBNZ interest rate cuts, and the subdued global backdrop. From late 2020, we expect the currency to begin trending higher again as fiscal and monetary stimulus eventually drive a recovery in the NZ economy, and NZ's Terms of Trade remain elevated.

mike.jones@asb.co.nz

ASB foreign exchange forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.71	0.72
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	72	72
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.61	0.62
NZD/GBP	0.53	0.51	0.49	0.46	0.51	0.53	0.54
NZD TWI	73.2	70.2	69.1	67.9	71.5	74.3	75.0

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH/DOWN	UP
90-day bank bill	1.23	1.21	1.12	1.98	UNCH/DOWN	UP
2-year swap	1.14	1.13	1.02	2.09	UNCH/DOWN	UP
5-year swap	1.21	1.21	1.09	2.44	UNCH/DOWN	UP
10-year swap	1.48	1.49	1.39	2.90	UNCH/DOWN	UP
10-year govt bond yield	1.29	1.33	1.28	2.01	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.34	0.36	0.37	0.81	UP	UNCH/UP

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

Market Recap

NZ yields were little changed compared to this time last week, with a slightly flattening bias evident. Stronger than expected NZ retail sales data and a larger than expected bounce in domestic business confidence provided some upward impetus to local yields. There was little impact from the RBNZ's decision not to relax the loan-to-value restrictions on mortgage lending. **The settled global scene and improved domestic outlook has seen us tweak our OCR view: we now expect a 25bp cut in May and a 0.75% OCR floor this cycle, rather than 25bp cuts in February and May.** US yields were little changed on few trade headlines and comments by US Federal Reserve Chairman Powell signalling little urgency to change monetary settings. Improved Chinese PMI's signalled a possible stabilisation in Chinese growth. **Australian yields fell on speculation of more RBA policy easing** (and potential quantitative easing (QE)) after the speech by RBA Governor Lowe. Lowe affirmed a lower bond of 0.25% for the cash rate (currently 0.75%), but reiterated that the threshold for QE in Australia had not been reached. Some economists then lowered forecasts for the cash rate and have floated the likelihood of RBA quantitative easing (bond purchases) next year.

Near-term NZD interest rate outlook

We have retained a modest downward bias for NZ yields given the OCR floor implied by current market pricing (around 0.82%) is higher than our forecasts imply (0.75%). **NZ yields are currently 30-40bps above October lows, and there is the risk that NZ yields may already have bottomed for longer-dated tenors. Thursday's RBNZ announcement on the final form of bank capital requirements will be pivotal for the domestic market.** ASB Economics view is that the RBNZ has overestimated the benefits and underestimated the costs of higher bank capital on the economy. If the RBNZ proceeds with significant increases to bank capital requirements, this will dampen NZ swap yields and firm up pricing for an OCR cut in our view. There should be little market reaction if the RBA hold the cash rate at 0.75% tomorrow (less than 10% odds for a cut) and maintain an easing bias. Sub-trend Australian Q3 GDP growth (ASB expects: 1.5% yoy) should keep markets biased to a RBA rate cut in early 2020. Signals from the Bank of Canada policy decision will be of interest given the neutral FOMC/dovish RBA view**. The direction of longer-term yields over the next few weeks will largely depend on global trade headlines and this week's dataflow** (including US non-farm payrolls). Brexit is likely to be largely ignored by Australasian markets despite the looming UK election.

Medium-term outlook

We expect a further 25bp cut in May 2020, with the OCR on hold at 0.75% until a series of mild and gradual hikes from 2022 (OCR endpoint of 2.25%). The RBA is expected to cut the 0.75% cash rate by 25bp in February, with the effective lower bound of the RBA cash rate at 0.5%. The 1.50%-1.75% Federal Funds rate is expected to be cut by 75bps in 2020 (Mar 20, Jun 20, Sep 20). **Low inflation, low global growth and a negatively skewed risk profile should cap NZ and global long-term interest rates at historically-low levels.** mark.smith4@asb.co.nz

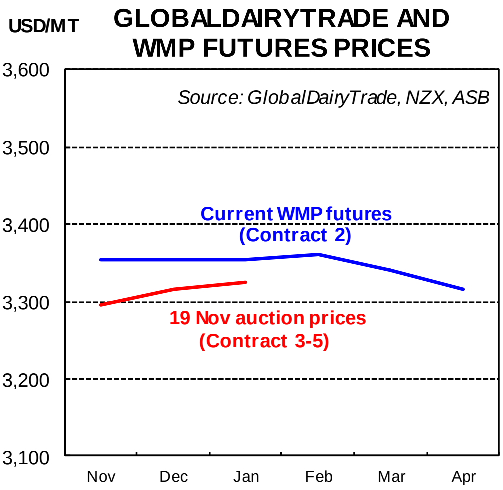
ASB interest rate forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.50	1.00	1.00	1.00	0.75	1.00	1.50
NZ 90-day bank bill	1.7	1.2	1.2	1.2	1.0	1.3	1.8
NZ 2-year swap rate	1.4	0.9	1.2	1.1	1.0	1.3	1.7
NZ 5-year swap rate	1.4	0.9	1.2	1.2	1.2	1.5	1.9
NZ 10-year swap rate	1.8	1.2	1.5	1.4	1.4	1.6	2.0
NZ 10-year Bond	1.6	1.1	1.3	1.2	1.2	1.4	1.8

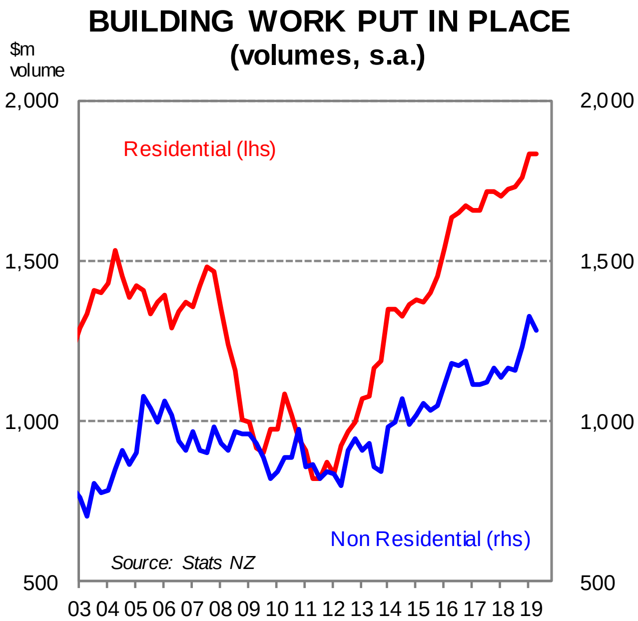
Domestic events

Data	Date	Time (NZT)	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	03/12	Overnight	-	+1.0
Building work put in place, volume, Q3, %	05/12	10:45 am	-	0.3

We expect whole milk powder (WMP) prices to lift 1.0% at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago WMP prices firmed 2.2%. At this stage, the futures market is pointing to a 1% lift in prices at next week's auction as well. NZ production growth is slowing and it's likely this will help push dairy prices higher.

We expect the volume of building work put in place to lift 0.3% qoq over Q3, following the previous quarter's 1.5% qoq decline. We expect the lift in building activity to be led by a 1.1% increase in non-residential construction activity, while we expect residential activity to remain broadly steady, with a 0.2% qoq decline pencilled in.





Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia CoreLogic Dwelling Prices, November, %yoy	02/12	12:00 pm	-	2.0
Australia Building Approvals, October, %mom	02/12	1:30 pm	-1.0	3.0
US ISM Manufacturing, November, points	03/12	4:00 am	49.2	49.5
Australia Balance of Payments, Q3, $bn	03/12	1:30 pm	6.1	4.0
RBA Interest Rate Announcement, %	04/12	4:30 pm	No chg	No chg
Australia GDP, Q3, %qoq	04/12	1:30 pm	0.5	0.5
Australia Retail Trade, October, %mom	05/12	1:30 pm	0.3	0.4
Eurozone Retail Sales, October	05/12	11:00 pm	-0.4	-
US Non-farm Payrolls, November, 000s	07/12	2:30 am	188	175

**Originally published by CBA Global Markets Research on Friday 29th November at 2.22pm*

Australian CoreLogic daily price data indicate that dwelling prices rose sharply in November, particularly in Sydney and Melbourne. We expect to see the 8 capital city combined index rise by a large 2.0% over November.

Australian building approvals should trend higher from here given the backdrop of record low interest rates, rising dwelling prices and strong population growth. We have pencilled in a 3% lift over October.

Another stellar set of monthly trade results in **Australia** over the September quarter points to another **current account surplus** (the Q2 19 current account surplus was the first one Australia has posted since 1974). By our calculations, however, net exports will not make any contribution to growth over the quarter.

We expect the Reserve Bank of Australia (RBA) to leave the cash rate on hold at 0.75% in December. The latest wages and employment data were soft. And the RBA is clearly considering the case to ease monetary policy further. But having already cut the cash rate by 75bps over the past six months, the RBA are content to, "assess the effects of the recent easing as well as global developments." It is also clear that the RBA is cognisant of the potentially negative impacts that rate cuts are having on consumer sentiment. We expect the Governor in his post meeting Statement to retain the line that, " the Board will continue to monitor developments, including in the labour market, and is prepared to ease monetary policy further if needed to support sustainable growth in the economy, full employment and the achievement of the inflation target over time."

Australia's GDP growth has slowed over the past year. Growth in private demand is particularly soft. We expect another quarter of modest GDP growth. Retail sales contracted by 0.1% over the quarter, business investment was flat and residential construction declined. Growth is likely to be supported by public demand and a modest lift in household consumption.

Australia's retail trade growth remains sluggish, largely due to weak growth in household income and some consumer concerns around the economic outlook. Credit and debit card usage over October points to a lift in retail trade of 0.4% in October.

US regional manufacturing surveys portrayed a mixed picture in November. Nevertheless, the recent easing in US-China trade tensions suggests the national **manufacturing ISM** increased from 48.3pts in October to around 49.5pts in November.

Firm consumer credit growth, resilient consumer confidence and favourable employment conditions point to faster **retail sales growth in the Eurozone** over October.

We expect a solid 175,000 increase in **US Non-farm Payrolls** in November, helped by the end of the GM strike and historically low jobless claims. We estimate strong jobs growth will keep the unemployment rate steady at 3.6%. The low unemployment rate will support wage growth at 3.0%yoy.

Key Forecasts

ASB NZ economic forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	0.5	0.5	0.3				
GDP real - A%	2.1	2.2	1.9	1.7	2.6	2.5	2.5
GDP real - AA%	2.4	2.3	2.2	2.0	2.1	2.6	2.5
CPI - Q%	0.6	0.7	0.3	0.5			
CPI - A%	1.7	1.5	1.7	2.1	1.7	1.8	1.8
HLFS employment growth - Q%	0.7	0.2	0.2	0.2			
HLFS employment growth - A%	1.4	0.8	1.1	1.4	1.5	1.5	1.6
Unemployment rate - %sa	3.9	4.2	4.1	4.4	4.4	4.3	4.1
Annual current account balance as % of GDP	-3.4	-3.4	-3.3	-3.1	-2.7	-2.9	-2.9

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	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.50	1.00	1.00	1.00	0.75	1.00	1.50
NZ 90-day bank bill	1.7	1.2	1.2	1.2	1.0	1.3	1.8
NZ 2-year swap rate	1.4	0.9	1.2	1.1	1.0	1.3	1.7
NZ 5-year swap rate	1.4	0.9	1.2	1.2	1.2	1.5	1.9
NZ 10-year swap rate	1.8	1.2	1.5	1.4	1.4	1.6	2.0
NZ 10-year Bond	1.6	1.1	1.3	1.2	1.2	1.4	1.8

ASB foreign exchange forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.71	0.72
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	72	72
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.61	0.62
NZD/GBP	0.53	0.51	0.49	0.46	0.51	0.53	0.54
NZD TWI	73.2	70.2	69.1	67.9	71.5	74.3	75.0

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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