

Economic Weekly

08 April 2019

Best foot forward

Last week, we updated our interest rate view. **We now expect the RBNZ to cut the OCR in May and August**, whereas previously we had expected the cuts in August and November. The catalyst for the shift was weaker than expected Q1 business confidence data. Indeed, the Quarterly Survey of Business Opinion points to a slowing in annual average growth from 2.8% in Q4 to 2.6% in Q1.

The soft domestic picture confronting the RBNZ adds to the concerns around the global economy. On the global front this week, we get an update from the ECB on the outlook for the Eurozone economy, while the US Federal Reserve publishes its Meeting Minutes. Generally we expect both central banks – like the RBNZ – to reiterate their dovish messages of late.

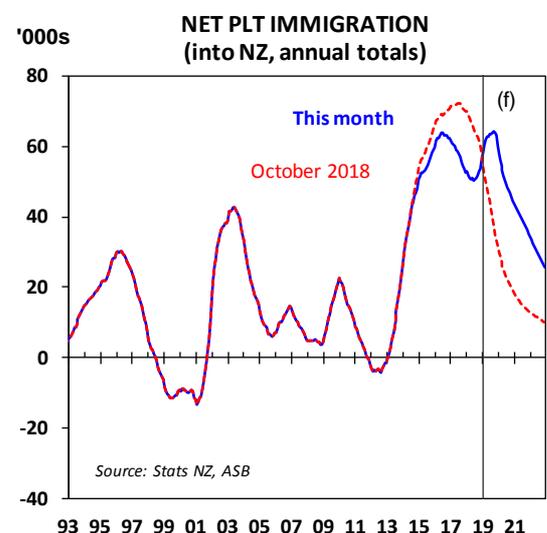
Key events and views

Foreign exchange	NZD lower on weak business confidence data.
Interest rates	NZD rates find a floor after the major move lower in the week prior.
Domestic events	Business NZ PMI, Electronic Card Transactions, International Travel and Migration.
International events	ECB Interest Rate Announcement, US Federal Reserve Meeting Minutes.
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: Making sense of migration data

On Friday, Statistics NZ releases migration figures for February. January's data were strong, with annual net immigration at 58,400. Migration had looked to be plateauing, but the January result suggested a strengthening, courtesy of elevated arrival numbers.

Unfortunately, Friday's migration figures should be taken with a pinch of salt. In November 2018, Statistics NZ changed its method of measuring migration. Stats NZ believes its new method is more accurate, but it has led to deviation from the historical series and increased the likelihood of significant revisions to past data. Indeed, last month, December net migration was revised upward by 1,810 persons. **The volatility in the figures makes it difficult to interpret the data and make forecasts.** It will be particularly tough for the government when it comes to policymaking, with fiscal policy, monetary policy, infrastructure and housing provision all impacted.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6735	0.6822	0.6757	0.7257	FLAT/DOWN	0.6650	0.6880	UP
NZD/AUD	0.9479	0.9581	0.9634	0.9449	FLAT/DOWN	0.9350	0.9600	FLAT/UP
NZD/JPY	75.23	75.77	75.27	77.90	FLAT/DOWN	73.70	76.70	UP
NZD/EUR	0.6003	0.6073	0.6034	0.5929	FLAT	0.5880	0.6120	FLAT
NZD/GBP	0.5164	0.5234	0.5160	0.5184	FLAT	0.5060	0.5270	UP
TWI	73.3	74.0	73.6	74.76	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 against all the major crosses over the past week, weighed by weak business confidence data from the NZIER Q1 Quarterly Survey of Business Opinion released on Tuesday. In light of weak Q1 activity indicators from the QSBO, we now expect the RBNZ to cut the OCR at the May meeting (August previously). The NZD was further weighed by soft results at the fortnightly Global Dairy Trade auction, with whole milk powder prices falling by 1.3%. The AUD received support from gains in key Australian commodity prices (including iron ore), positive signs of progress on US-Chinese trade talks and stronger-than-expected Australian retail trade. The NZD weakness contrasts with AUD support, contributing to further decline in the NZD/AUD over the past week. The GBP was supported after news that UK PM May would seek cross-party support to break the impasse in the Brexit process. In her statement, PM May said she will seek a further extension of Article 50 and a deal to leave the EU. The USD lifted modestly following Friday's Non-farm Payrolls report for March.

Near-term outlook

The NZD is likely to continue to trend lower this week, although we expect downside to be limited with the NZD/USD likely to receive some support at 0.6700. Any positive news about a trade deal between the US and China may provide some support to the NZD/USD but could further weigh on the NZD/AUD because of Australia's heightened exposure to Chinese domestic demand (compared to NZ). In addition, the 1-year interest rate differential between NZ and Australia also points to further falls in the NZD/AUD. The RBA Deputy Governor Debelle is speaking on the state of the economy on Wednesday, and market participants will be looking to Debelle to provide clarity around the RBA statement last week. Some market participants saw the statement as hinting a possible rate cut at upcoming meetings. The USD is unlikely to be moved by either of the two US data highlights this week. We expect core CPI inflation to remain steady, while we do not expect the release of the FOMC meeting minute to alter market pricing for a Fed rate cut.

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. However, the NZD/AUD is currently below these expectations due to the likelihood of an imminent rate cut from the RBNZ. We have delayed the timing of the forecast 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

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.75	1.75	1.75	1.75	FLAT/DOWN	DOWN
90-day bank bill	1.82	1.85	1.88	1.97	FLAT/DOWN	DOWN
2-year swap	1.65	1.64	1.84	2.25	FLAT/DOWN	DOWN
5-year swap	1.83	1.80	1.98	2.69	FLAT	FLAT
10-year swap	2.25	2.19	2.38	3.14	FLAT	FLAT/UP
10-year govt bond yield	2.00	1.84	2.08	2.80	FLAT	FLAT/UP
Curve Slope (2s10s swaps)	0.60	0.55	0.54	0.89	FLAT	FLAT/UP

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

Market Recap

Local yields troughed early last week after the release of weak 2019Q1 business confidence data from the NZ Quarterly Survey of Business Opinion, after which two major NZ locally incorporated banks (ASB and Westpac) formally shifted to calling a 25bp cut at the RBNZ's May decision. **Yields subsequently firmed through the remainder of the week on improved risk sentiment.** The RBA held the cash rate at 1.5% and, while the Australian Federal budget conveyed a responsible fiscal message, the prospect of higher election-related spending likely pushed Australian yields higher. Manufacturing sentiment gauges for the US and China improved in March, with positive signs on US and China trade negotiations supporting yields and equity markets. The weekend's US Payrolls data were solid (+196k) and the unemployment rate low, but slowing wage growth dampened US Treasury yields, with President Trump publicly calling on Fed policymakers to cut the Funds rate and restart quantitative easing.

Near-term NZD interest rate outlook

Domestic market pricing is currently about 45% priced for a May OCR cut, with a full rate hike priced in by August and close to 50bps of OCR cuts priced in by mid-2020. **Our core view is that the OCR will be cut by 25bps in May, but the timing is fluid and conditional on global events, the NZD as well as the tone of local data.** The next critical local event for markets will be next Thursday's Q1 CPI and softer than expected prints for headline and core inflation will likely firm market pricing towards a near-term OCR cut. **Global yields could drift higher if continued progress is made on US-China trade negotiations, although slowing global growth and subdued global inflation should keep yields historically low.** Offshore, this week's Fed minutes will provide more insight on why the 2019 hikes were removed from the 'dot plots'. US core inflation is expected to remain around 2%. There are a few speeches by RBA Deputy Governor Debelle that might provide insights on the Australian economic and interest rate outlook. A generally dovish ECB policy announcement is expected this week. With the April 12 Brexit deadline fast approaching, and with little clarity having emerged, volatility in UK interest rates and Sterling is to be expected, containing global yields.

Medium-term outlook

We have changed our OCR call and now expect 25bp of OCR cuts in May and August of this year. The OCR is subsequently expected to remain at 1.25% until early 2022, 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

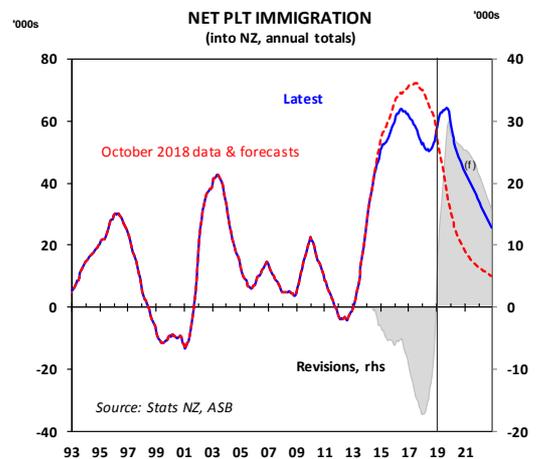
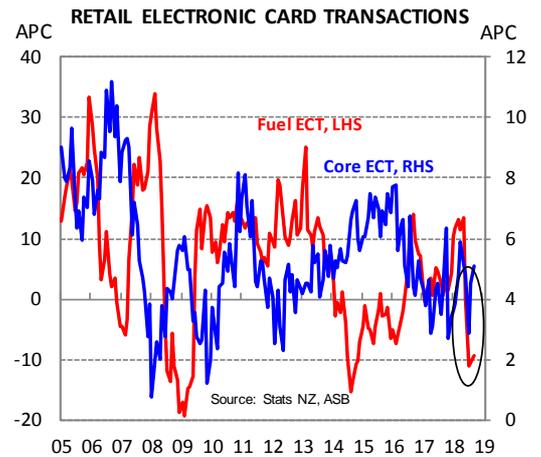
	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.50
NZ 90-day bank bill	1.97	1.9	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.6	1.5	1.5	1.5	1.6	1.9
NZ 10-year Bond*	2.38	1.8	1.8	1.8	1.8	1.8	2.1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

Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
Electronic Card Transaction, retail, March, %mom	12/04	10:45 am	+0.9%	-	+0.5%
International Travel and Migration, Net migration, Feb	12/04	10:45am	6,300		5,800

Card spending started 2019 on an improving note as lower fuel prices and the boost to household incomes from the Government’s Families Package underpinned a pick-up in retail and core spending. **Fuel prices increased in February and March, and likely lifted March fuel spending, but we still expect a slower pace of monthly retail and core spending growth in March.** The March quarter should show a 1% increase in retail and approximately a 2% quarterly increase in core spending. We expect the flat housing market backdrop, slowing population growth, modest wage increases and cooling employment growth to cap retail spending growth over 2019.

We expect a net permanent and long-term inflow of around 5,800 persons in February. The introduction of the new ‘outcomes-based’ methodology following the phasing out of departure cards has resulted in considerable volatility in the historical migration figures and has made picking the migration figures a lottery. We expect some modest pullback from the very strong December/January figures, which showed the highest 3-monthly annualised net inflow on record (close to 75,000 persons). Annual net PLT inflows are expected to moderate over the next few years, driven by easing PLT arrivals and climbing PLT departures. However, continued historical revisions are a distinct possibility, reducing the market and policy relevance of the migration statistics. We expect annual tourist arrival numbers to test record highs and remain a key support to the NZ economy. Capacity constraints in the tourism sector and slowing global growth are expected to moderate the growth in visitor arrival numbers.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia Lending to Owner-Occupiers, February, %mom	09/04	1:30 pm	1.0	3.0
RBA Debelle speech in Adelaide	10/04	2:30 pm	-	-
ECB Interest Rate Announcement, %	10/04	11:45 pm	0.0	0.0
UK GDP, February, %mom	10/04	8:30 pm	0.0	-
UK Industrial Production, February, %mom	10/04	8:30 pm	0.1	-
US CPI, March, Headline, %yoy	11/04	12:30 am	1.8	1.8
US Fed Meeting Minutes	11/04	6:00 am	-	-
RBA Financial Stability Review	12/04	1:30 pm	-	-
China Trade Balance, March, US\$bn	12/04	-	8.1	4.0

*Originally published by CBA Global Markets Research on Friday 5th April at 2.25pm.

Lending for housing in Australia is a good leading indicator of movements in dwelling prices. Partial data are showing a decent lift in lending to owner-occupiers in February. We expect a flat outcome for lending to investors. There are some signs that the downward momentum in house prices is losing steam. The falls in Sydney and Melbourne prices were smaller in March, and auction clearance rates in Sydney are lifting.

Reserve Bank of Australia's (RBA) Deputy Governor Debelle is slated to speak in Adelaide at the American Chamber of Commerce event around lunch time on Wednesday on "The state of the economy". Debelle may get questions around the latest Budget and how the RBA sees the latest round of personal income tax cuts as impacting on consumer spending. He may also be asked to clarify the change in wording in the last paragraph of the latest RBA post-meeting Statement.

The **RBA's Financial Stability Report** provides the central bank's assessment of the current condition of the financial system and potential risks to financial stability. In terms of the domestic financial stability risks, high household debt levels are likely to be a key feature.

We estimate **China's exports** rebounded by 6% yoy in March after the interruption from the Lunar New Year holiday. We expect a 1% yoy rise in **imports** because of a rise in the February import PMI and fiscal stimulus. As a result, the trade surplus might have narrowed to US\$4bn.

The European Central Bank (ECB) is widely expected to leave key interest rates unchanged. We do not anticipate any changes to the ECB's forward guidance. Also, ECB President Draghi will likely highlight again during his post-meeting press conference that the risks surrounding the Eurozone growth outlook are tilted to the downside and that an ample degree of monetary accommodation is necessary.

Nominal **UK GDP** expanded in January at its fastest monthly pace since December 2016. But the rolling three-month growth remained subdued after slowing since August 2018. The composite PMI points to more muted GDP growth in February.

UK industrial production recovered by more than expected in January. But industrial production still declined by 1.1% on a yoy basis. The manufacturing PMI and CBI business sentiment surveys suggest industrial production could recover further in February.

We estimate a 6% increase in **US retail petrol prices** will push **headline inflation** higher from 1.5% yoy in February to around 1.8% yoy in March. But we estimate core inflation will remain solid at 2.1% yoy.

The **US Fed's Meeting Minutes** may provide details on the discussion of the slower US economic outlook, reasons for removing two interest rate increases in 2019 and 2020 and the reinvestment policy for maturing assets.

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	0.4	0.9					
GDP real - A%	2.3	2.2	2.2	2.7	2.9	3.1	2.4	2.4
GDP real - AA%	2.8	2.6	2.3	2.4	2.5	2.7	2.6	2.4
CPI - Q%	0.1	0.1	0.6					
CPI - A%	1.9	1.5	1.7	1.4	1.5	1.9	1.8	1.9
HLFS employment growth - Q%	0.1	0.6	0.4					
HLFS employment growth - A%	2.3	2.4	2.2	1.6	1.9	1.7	1.6	1.3
Unemployment rate - %sa	4.3	4.3	4.3	4.3	4.2	4.2	4.2	4.4
Annual current account balance as % of GDP	-3.7	-3.5	-3.3	-3.2	-3.0	-2.7	-2.5	-2.2

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	1.50	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	1.6	1.5	1.5	1.5	1.6	1.9
NZ 10-year Bond*	2.38	1.8	1.8	1.8	1.8	1.8	2.1	2.4

ASB foreign exchange forecasts

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)								
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

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