# Economic Weekly

08 July 2019

## Business confidence remains low

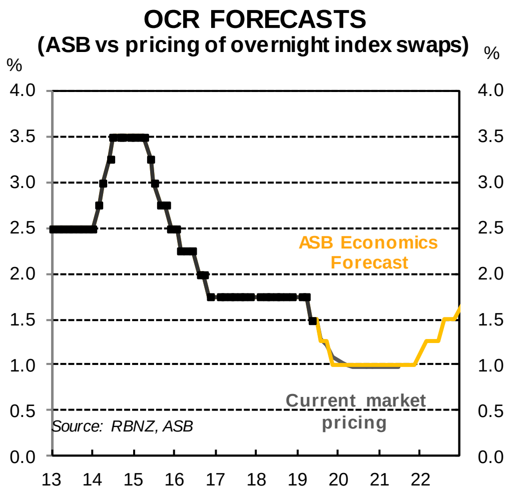
The Q2 NZIER Quarterly Survey of Business Opinion was weaker than we expected – again. The survey suggests **underlying trend GDP growth remained weak in Q2**, with the soft demand backdrop accompanied by firms' margin pressure intensifying. We have changed our OCR call and now expect the **Reserve Bank of New Zealand (RBNZ)** to cut the Official Cash Rate (OCR) by 50bps (to 1%) by the end of the year. As was widely expected, the **Reserve Bank of Australia** cut its cash rate to 1% last week, and we expect another 25bps of RBA cuts later this year. Following the weekend's strong US payrolls print, the focus for markets will be whether the US Federal Open Market Committee will signal that the 2¼-2½% Federal Funds rate is likely to head lower, with markets still expecting 2019 Fed rate cuts.

### Key events and views

| | |
|---|---|
| Foreign exchange | NZD ends the week lower, with offshore drivers set to dictate NZD direction. |
| Interest rates | NZ yields likely to start firmer, but we retain our mild downward bias. |
| Domestic events | Electronic card spending, food prices and dwelling rents. |
| International events | Federal Reserve meeting minutes, US CPI, Bank of Canada policy announcement. |
| Calendars | NZ and international calendar of upcoming economic events. |

### Chart of the Week: RBNZ to join the race to the bottom

**We now expect the RBNZ to cut the OCR an additional 50 basis points over the second half of 2019**, which would bring the OCR to a new record low of 1%. The RBNZ confirmed a strong easing bias at the June OCR review, and the weak details within the NZEIR Quarterly Survey of Business Opinion have increased our conviction that the OCR will be cut by 25bps at the August Monetary Policy Statement on August 7. We expect the RBNZ will follow up with another 25bp cut at the November MPS, although the time of this cut will be dependent on domestic economic data, global events, the NZD and the actions of offshore central banks.




For NZ, the **question is whether a 1% OCR will prove to be the floor**. There appear to be three main factors that could drive an even lower OCR. The first is if we see further deterioration of the global environment. The second is if continued weak domestic business sentiment persists and flows through into actual outcomes for economic activity and employment. The third would be if the RBNZ materially reassesses its view of how much additional slack there is in the labour market and the economy more generally.

## Foreign Exchange Market

| FX Rates | Current* | Week ago | Month ago | Year ago | ST Bias | Support^ | Resistance^ | MT Bias |
|---|---|---|---|---|---|---|---|---|
| NZD/USD | 0.6627 | 0.6706 | 0.6617 | 0.6802 | FLAT/DOWN | 0.6615 | 0.6780 | UP |
| NZD/AUD | 0.9494 | 0.9576 | 0.9489 | 0.9203 | FLAT/DOWN | 0.9350 | 0.9650 | FLAT |
| NZD/JPY | 71.86 | 72.58 | 71.76 | 75.27 | FLAT | 71.25 | 74.65 | UP |
| NZD/EUR | 0.5903 | 71.76 | 0.5873 | 0.5821 | FLAT | 0.5840 | 0.5990 | FLAT |
| NZD/GBP | 0.5290 | 0.5280 | 0.5211 | 0.5146 | FLAT | 0.5230 | 0.5370 | FLAT |
| TWI | 72.8 | 73.1 | 72.6 | 72.76 | 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 ended last week on the back foot.** Friday's strong US non-farm payrolls employment report saw investors suddenly doubting whether a US Fed rate cut as early as July is justified. The 224k (160k expected) jobs gain and small rise in the unemployment rate to 3.7% was indicative of a labour market still in relatively good health. The associated USD bounce following the data pushed the NZD/USD lower. The NZD rounded out the week 1 US cent lower than where it began (around 0.6625 USD), with the NZD TWI around 0.6% lower at around 72.8.

### Near-term outlook

**The focus for the NZD will switch back to offshore drivers this coming week.** Last week's QSBO business confidence survey was even weaker than we expected and prompted us to change our rate call to now expect a further 50bps of RBNZ OCR cuts by year end (previously -25bps). The NZD barely budged, possibly because interest rate markets already have around 40bps of OCR cuts priced by November. There's only really second tier data out in Australasia this week (with REINZ housing data and retail spending the NZ highlights) so the currency will look offshore for direction.

**FOMC chair Powell's testimony to Congress could move the USD significantly.** Market participants will be looking for whether market pricing of a 25bps Fed rate cut in July will be ratified. But the recent positive news on trade, coupled with Friday blockbuster employment report, may well see Powell depict a more neutral outlook for the US Federal Funds rate. This turn of events could see the USD recover further and NZD/USD pushed down into the low 0.6600s. Other key events to keep an eye on this week include the June Fed minutes and various Fed speakers lined up to speak on Friday, and Chinese trade balance and CPI data (out Friday and Wednesday respectively).

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

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## Interest Rate Market

| Wholesale interest rates | 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 | 1.63 | 1.64 | 1.63 | 1.99 | UNCH/DOWN | UP |
| 2-year swap | 1.33 | 1.36 | 1.42 | 2.18 | UNCH/DOWN | UP |
| 5-year swap | 1.41 | 1.45 | 1.55 | 2.57 | UNCH/DOWN | UP |
| 10-year swap | 1.76 | 1.80 | 1.92 | 3.04 | UNCH/DOWN | UP |
| 10-year govt bond yield | 1.55 | 1.58 | 1.71 | 2.82 | UNCH/DOWN | UP |
| Curve Slope (2s10s swaps) | 0.43 | 0.45 | 0.50 | 0.85 | UNCH | UNCH/UP |

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

### Market Recap

**NZ and global yields eased last week, with the NZ curve flattening and with yields re-approaching record lows.** As we had suspected, optimism from the G20 agreement on trade proved fleeting as weaker global data underscored the need for more policy support. The RBA cut its cash rate to 1%, a fresh record low, with Governor Lowe noting further monetary policy easing could be required to meet the RBA's inflation and labour market objectives. **Weak NZ business confidence (Q2 Quarterly Survey of Business Opinion) also dampened NZD yields, and we formally changed our OCR call to include a further 50bps of OCR cuts in 2019 (August and November).** Global markets had priced in considerable policy easing (particularly for US rates), with the stronger than expected US non-farm payrolls report over the weekend triggering an approximate 10bp increase in Treasury yields (10Y 2.03%), and paring back of US interest rate expectations (65bps of cuts over 2019 now expected). NZ longer-term yields have firmed, but those for 10-year Government bonds (1.53%) and their Australian counterparts (1.28%) have remained in the lower part of recent trading ranges and close to record lows.

### Near-term NZD interest rate outlook

Local yields are likely to start this week on a firming trajectory, following global moves. **However, we have maintained our downward bias for NZ interest rates, given our lower OCR view and view of the risk profile.** Current market pricing has the about 80% odds of a 25bp OCR cut priced in for August and about 40bps of cuts by November before the OCR troughs at around 1% in mid-2020. **We note, however, markets have already have priced in considerable policy easing (particularly for US rates) and global yields could move higher before they go lower.** This week's House testimony by Fed Chair Powell, Fed Minutes and Bank of Canada decision (market odds of 98% in favour of no change to the 1.75% policy rate) could generate volatility as could forthcoming US CPI data. Forthcoming local data prints for Q2 CPI (July 16) and the labour market (Aug 6) will have to be strong to delay an August OCR cut in our view.

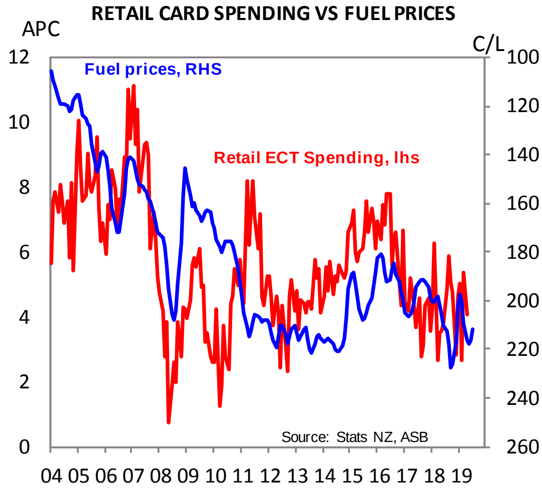
### Medium-term outlook

**We now expect 50bps of OCR cuts in the second half of 2019 (August and November**), with the OCR to remain at 1%, until a gradual RBNZ tightening cycle commences from early 2022 (OCR peak at 2.25% by mid-2024). Slowing global growth is expected to result in more policy stimulus. We expect interest rate cuts by the Fed (-25bp in July, 100bps by mid-2020), RBA (-25bps in November to 0.75%), ECB (10bp cut to lower the -0.5% deposit rate in Q3), and the Peoples Bank of China (-40 bps in 2019H2). We expect inflation to remain low and interest rate normalisation from global central banks to be a long way off, capping long-term interest rates at historically low levels. **Our bias is for the curve to initially steepen and then to progressively flatten as policy easing precedes mild policy tightening.**

| 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 | 1.25 | 1.00 | 1.00 | 1.00 | 1.25 | 1.75 |
| NZ 90-day bank bill | 1.9 | 1.7 | 1.5 | 1.3 | 1.3 | 1.3 | 1.6 | 2.0 |
| NZ 2-year swap rate | 1.6 | 1.4 | 1.3 | 1.2 | 1.2 | 1.2 | 1.6 | 2.0 |
| NZ 5-year swap rate | 1.8 | 1.4 | 1.4 | 1.4 | 1.4 | 1.5 | 1.9 | 2.3 |
| NZ 10-year swap rate | 2.2 | 1.8 | 1.8 | 1.8 | 1.8 | 1.9 | 2.1 | 2.3 |
| NZ 10-year Bond | 1.8 | 1.6 | 1.6 | 1.6 | 1.6 | 1.7 | 1.9 | 2.1 |

## Major Domestic Events for the week ahead

| Data | Date | Time (NZT) | Previous | Market | ASB |
|---|---|---|---|---|---|
| Electronic Card Transactions, June, retail, %mom | 11/07 | 10:45 am | -0.5 | - | +0.9 |
| May visitor arrivals and net immigration, net PLT | 15/07 | 10:45 am | 4,870 | - | 4,700 |
| REINZ Housing Market data | 10/07 | - | - | - | - |




**We expect a June rebound in retail (up 0.9% mom) and core card spending (up 1.1% mom) following 0.5% monthly falls for both in May.** Underpinning the turnaround is likely to be higher spending in the core components, including durables, consumable and apparel spending. Consumer sentiment ticked a little higher in the June month, and, combined with lower fuel prices (down around 4% in the month according to our estimates) is expected to support discretionary spending (fuel spending is likely to be lower). **Despite strong producer income growth and more government policy support, we expect still-low wage inflation and low housing turnover to contain consumer spending appetites and prevent a large retail spend-up.**

**Monthly net migration figures have quickly become largely irrelevant for markets and policy makers**. A new statistical method introduced late last year for estimating depatures means the data are now subject to huge volatility and revisions. Drawing any sort of insight from monthly data is thus pointless. For the record, **we expect a net permanent and long-term (PLT) inflow of around 4,700 persons in May, a modest slowing in the monthly pace of net immigration.** Along with the RBNZ, we expect net PLT inflows to trend lower over the next few years.

Visitor arrivals figures, released at the same time, are expected to continue to moderate. The prior tourism 'boom' – an important source of growth stimulus in recent times – looks to have peaked in late 2018

REINZ housing market figures may be released towards the end of the week. **We expect the data to show the 'Auckland vs. the Rest' divergence becoming even more marked in June**. Prices and activity are expected to remain soft for markets where non-resident buying restrictions are biting like Auckland and Queenstown-Lakes. Regional markets are expected to pick-up driven by record low mortgage rates and the recent clearing of tax-related uncertainty.

## Major International Events for the week ahead*

| Data | Date | Time (NZT) | Market | ASB |
|---|---|---|---|---|
| China CPI, June, %yoy | 09/07 | 1:30 pm | 2.7 | 2.7 |
| China PPI, June, %yoy | 09/07 | 1:30 pm | 0.3 | 0.3 |
| UK Industrial Production, May, %mom | 10/07 | 8:30 pm | 1.5 | 2.0 |
| Bank of Canada Interest Rate Announcement, % | 11/07 | 2:00 am | 1.75 | 1.75 |
| US Federal Reserve Meeting Minutes | 11/07 | 6:00 am | - | - |
| Australia Owner-Occupier Loan Value, May, %mom | 11/07 | 1:30 pm | flat | flat |
| China Trade Balance, June, US$bn | 11/07 | NA | 45.25 | 46 |
| US CPI, June, %yoy | 12/07 | 12:30 am | 1.6 | 1.6 |
| RBA Deputy Gov. Debelle speech at US FX Conference | 12/07 | 1:10 am | - | - |

*Originally published by CBA Global Markets Research on Friday 5th July at 2.07pm.*

We estimate **inflation in China** will remain steady at 2.7% yoy in June. We expect rising fruit and pork inflation will offset the impact of easing vegetable and oil prices. We expect core inflation to remain stable. The drop in the June Producer Price PMI indicates PPI inflation decreased to 0.3% yoy.

We expect **UK industrial production** to snap back in May by 2% following the 2.7% mom slump in April. The slump in April mainly reflected temporary closures in the car manufacturing industry.

**We expect the Bank of Canada to keep its policy interest rate on hold** at 1.75%. Inflation is comfortably in the target range, the unemployment rate is at very low levels, and Canadian oil prices have recovered strongly since late 2018.

Market participants will be looking for guidance on the **US Federal Reserve's view** on risks facing the US economy such as tensions with trade partners and low inflation expectations.

We are expecting a flat outcome for **Australian housing loan growth in May**. This follows a small increase in April where a lift in owner-occupier lending was offset by a fall in lending to investors. There are some signs that conditions are stabilising in the housing market. The key stabilisation indicator will be a pick-up in the demand for credit.

We expect **China's** exports to fall by 1% yoy in June because of the high base effect and a softening in global demand. We estimate imports decreased by 4% yoy after a contraction of 8.5% yoy in May because of sluggish domestic demand and falling oil prices. As a result, the June **trade surplus** might widen slightly to US$ 46bn.

We expect headline **US CPI** to be flat in June, in part, because retail gasoline prices decreased by 4%. We also expect core CPI to increase by only 0.1% mom (1.9% yoy) because of the deceleration in wage costs.

**The Reserve Bank of Australia's Deputy Governor Debelle** will speak early on Friday morning at the US FX Week conference. The topic is "the shape of the US economy and global markets". It's an unusual topic for an Australian central banker. We think he may focus on how developments in the US economy and financial markets impact Australia.

# Key Forecasts

## ASB NZ economic forecasts

| | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Mar-21 | Mar-22 |
|---|---|---|---|---|---|---|---|
| | << actual | forecast >> | | | | | |
| GDP real - Q% | 0.6 | 0.7 | 0.7 | | | | |
| GDP real - A% | 2.5 | 2.3 | 2.6 | 2.7 | 2.9 | 2.4 | 2.4 |
| GDP real - AA% | 2.7 | 2.5 | 2.5 | 2.5 | 2.6 | 2.6 | 2.4 |
| CPI - Q% | 0.1 | 0.7 | 0.5 | | | | |
| CPI - A% | 1.5 | 1.8 | 1.5 | 1.6 | 2.0 | 1.7 | 1.9 |
| HLFS employment growth - Q% | -0.2 | 0.4 | 0.4 | | | | |
| HLFS employment growth - A% | 1.5 | 1.3 | 0.7 | 1.1 | 1.7 | 1.6 | 1.4 |
| Unemployment rate - %sa | 4.2 | 4.4 | 4.4 | 4.5 | 4.4 | 4.2 | 4.0 |
| Annual current account balance as % of GDP | -3.6 | -3.4 | -3.3 | -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

| (end of quarter) | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Mar-21 | Mar-22 |
|---|---|---|---|---|---|---|---|
| | | << actual | forecast >> | | | | |
| NZ OCR | 1.75 | 1.50 | 1.25 | 1.00 | 1.00 | 1.00 | 1.25 |
| NZ 90-day bank bill | 1.9 | 1.7 | 1.5 | 1.3 | 1.3 | 1.3 | 1.6 |
| NZ 2-year swap rate | 1.6 | 1.4 | 1.3 | 1.2 | 1.2 | 1.2 | 1.6 |
| NZ 5-year swap rate | 1.8 | 1.4 | 1.4 | 1.4 | 1.4 | 1.5 | 1.9 |
| NZ 10-year swap rate | 2.2 | 1.8 | 1.8 | 1.8 | 1.8 | 1.9 | 2.1 |
| NZ 10-year Bond | 1.8 | 1.6 | 1.6 | 1.6 | 1.6 | 1.7 | 1.9 |

## ASB foreign exchange forecasts

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