

# Economic Weekly

09 September 2019

## Brief relief

After a few weeks of nervous hand wringing, financial market participants finally received some good geo-political news. US and Chinese trade talks are back on (for now), meanwhile in Hong Kong leader Lam has withdrawn the contentious extradition bill that sparked months of violent protests. In the UK, politicians moved swiftly to try prevent PM Boris Johnson from crashing the UK out of the EU with a hard Brexit at the end of October. This week remains fairly quiet on the economic data front, with political headlines continuing to drive sentiment for the time being.

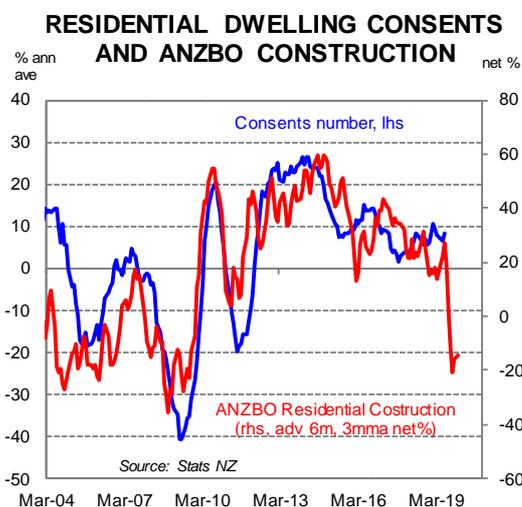
## Key events and views

<a href="#">Foreign exchange</a>	NZD short squeeze has further to run.
<a href="#">Interest rates</a>	Recent sell-off and lift in yields likely to prove fleeting.
<a href="#">Domestic events</a>	Electronic card transactions, REINZ house sales.
<a href="#">International events</a>	ECB policy announcement, US CPI and Retail sales.
<a href="#">Calendars</a>	NZ and international calendar of upcoming economic events.

## Chart 'o' the Week: Building outlook fragile

**Q2 residential construction activity was a bit softer than we expected.** The volume of residential building remained broadly flat over the quarter despite a strong pipeline of residential consent activity from late 2018-early 2019. The softer result may reflect that much of the growth in residential building consents has been for more complicated builds, such as apartments and town houses, while demand for standalone houses has remained flat. **More complicated builds take longer to construct, and as a result we should see additional building activity come through over H2 2019.**

**While consents have held up well, the outlook for housing construction is fragile.** Business confidence has fallen sharply and taking the monthly ANZ residential construction expectations at face value there is some risk we may see a sharp fall in housing construction demand. The financial incentives to build have waned as annual growth in construction costs and median section prices have outstripped the annual growth in house prices. In addition, the prospect for a more conservative approach to Kiwibuild adds downside risk to our housing construction outlook, particularly over the 2-year-ahead horizon. Nonetheless, we remain cautiously upbeat, as we expect lower mortgage interest rates will boost housing demand and construction over the coming year.



## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6424	0.6305	0.6490	0.6579	UP	0.6330	0.6500	DOWN
NZD/AUD	0.9383	0.9373	0.9532	0.9178	FLAT	0.9340	0.9440	FLAT
NZD/JPY	68.68	66.94	68.77	72.77	UP	64.00	65.50	UP
NZD/EUR	0.5827	0.5737	0.5796	0.5656	UP	0.5760	0.5900	FLAT/UP
NZD/GBP	0.5232	0.5185	0.5348	0.5086	FLAT	0.5160	0.5280	FLAT
TWI	71.6	70.6	72.0	71.50	FLAT/UP	N/A	N/A	DOWN

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

### NZD Recap

The kiwi posted its first weekly gain in seven weeks last week. Easing fears about the state of the global economy provided a circuit-break to the general climate of risk aversion. Trade war news flicked back to positive, an end-October hard Brexit will seemingly be avoided, and global service sector data were solid. US stock indices rose around 2% over the week, commodity prices rallied, and the VIX index (a proxy for risk aversion based on the implied volatility of the S&P500) fell back to late July levels around 15%.

Speculative positioning no doubt exacerbated the corresponding movements in currencies. As we'd noted prior, speculative short positions in the NZD had reached "extreme" levels, flagging the risk of a snap-back. As these positions were rapidly unwound last week, the NZD/USD was squeezed just over a cent higher to around 0.6430 currently.

### Near-term outlook

Global sentiment remains in the driving seat. And with investors' worst fears about the global economy being parked for now, we suspect the short-term NZD uptrend has further to run. We wouldn't rule out a test of 0.6500 as long as risk appetite can remain resilient against the expected trade-war/Brexit/Hong Kong headlines that will no doubt buffet markets over the week. We suspect NZD/USD dips will be limited to 0.6330.

NZD/EUR in particular looks to be biased higher over the week. The ECB meeting on Thursday is the main event for market's this week. We expect a 10bps rate cut, and some form of liquidity package. Should the ECB beef-up its forward guidance and/or restart QE, EUR/USD could be knocked lower still and NZD/EUR push on towards 0.5850.

### Medium-term outlook

Our updated forecasts have the NZD/USD dribbling lower for the best part of the next nine months, to a low of 0.6200 in March 2020. We'd characterise them as a sideways NZD/USD trend inside a low 0.6200-0.6400 range. The recent downward revision is consistent with the trade war, and attendant negative global growth impacts, dragging on for longer than we'd anticipated. The domestic slowdown is also occurring at a slightly faster rate than we'd expected. Our constructive view on NZ's terms of trade, and the front-loaded nature of RBNZ policy easing, are key reasons why believe there is only limited NZD downside from here.

### ASB foreign exchange forecasts

(end of quarter)

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< 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	1.00	1.75	UNCH	UP
90-day bank bill	1.18	1.19	1.21	1.90	UNCH	UP
2-year swap	0.94	0.91	0.99	1.97	UNCH/DOWN	UP
5-year swap	1.00	0.93	0.99	2.28	UNCH/DOWN	UP
10-year swap	1.30	1.20	1.29	2.80	UNCH/DOWN	UP
10-year govt bond yield	1.15	1.05	1.09	2.53	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.35	0.29	0.30	0.83	UNCH/DOWN	UNCH/UP

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

### Market Recap

**Local and global yields edged higher towards the end of last week, with curves steepening.** Local yields remained sandwiched between lower Australian yields and higher US yields. Yields were initially lower given weak global manufacturing data. The RBA left the cash rate on hold at a record low of 1.0 % in September, but looks to have retained its easing bias. Australian GDP growth was in line with expectations, with weak underlying details and the 1.4% annual growth rate the lowest since 2009. Weaker than expected Q2 NZ construction work lowered our Q2 pick for GDP growth to +0.5% qoq (+2.1%yoy) and dampened local yields. **Yields then jumped sharply and curves steepened** after it was announced the US and China will resume trade talks in early October, and with global services data generally sound. Markets were also reassured by the prospect that a hard Brexit will be delayed following a series of parliamentary defeats of PM Boris Johnson, the withdrawal of the contentious extradition bill by Hong Kong leader Lam and the unveiling of a new Cabinet by Italian Prime Minister Conte. Softer than expected US Payrolls data modestly dampened yields and flattened curves. Fed Chair Powell pushed back against notions of a pending US recession, but kept alive the prospect of Fed interest rate cuts to sustain the US economic expansion.

### Near-term NZD interest rate outlook

**The recent journey towards higher yields and steeper curve is likely to have been a short one and we retain our downward (and curve flattening) bias for local yields.** The softer tone of global data is expected to continue to trigger more policy support. Weak August Chinese trade data (imports contracted yoy and exports to the US were down 16% yoy) coincided with the People's Bank of China announcing a 50bp reduction in banks' reserve requirements over the weekend. More PBOC policy easing, via both RRR cuts and interest rates cuts, looks likely in coming months. The European Central Bank (ECB) is widely expected to cut the deposit rate by 10bps to -0.50%, beef up its forward guidance and introduce some liquidity measures to assist banks. **Politics and trade headlines look set to play a key role in market direction, and we see more downside risks to yields than up from these channels.** This week's data – including NZ card spending, REINZ housing market data, Australian business and consumer confidence, US CPI and retail sales – will largely take a back seat.

### 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.** There is still the risk that longer-term yields could 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. 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.

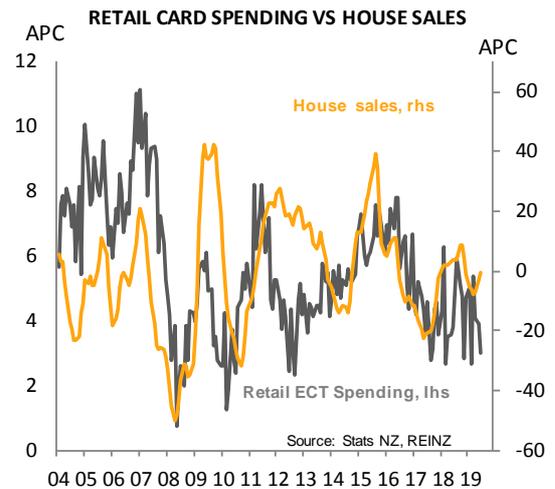
### ASB interest rate forecasts

	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
Electronic Card Transactions, August, retail, %mom	10/09	10:45 am	+0.5	+0.5
August REINZ House Sales	10/09-15/09	9am	-	-

**Card spending over the last few months has been on a softening trajectory, with falls for both retail (-0.1% mom) and core card spending (-0.5% mom) in July.** In August, the RBNZ cut the OCR to a record low 1.00%, and encouraged consumers to go out and spend. While consumer confidence did firm slightly in August, we don't think consumers will be fully heeding the RBNZ's message, with only a moderate August lift. Consumable and apparel retail should likely rebound and durable retail might too. Rising petrol prices should further lift fuel spending but weigh on discretionary spending. Recent climbs in housing market activity could provide a tailwind to retail spending, although increased consumer caution over the NZ economic outlook and the disquieting global scene could still result in consumers maintaining tight control of the purse strings. Risks to our forecast outlook of moderate consumer spending growth are to the downside. We expect a 25bp cut to the OCR in November, with the risk that the OCR heads lower over 2020.



**August REINZ house sales data** will be released either late next week or early the following. Monthly data are volatile, but squinting your eyes through the recent volatility, a tentative turn higher in housing is evident. We expect the upturn to slowly gather pace in coming months, bringing about a spring lift in national house prices

## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
Australia Owner-Occupied Lending, July, %mom	09/09	1:30pm	1.0	5.5
UK GDP, July, %mom	09/09	8:30pm	0.1	-
China CPI, August, %mom	10/09	1:30pm	2.6	2.6
UK Labour Market, July	10/09	8:30pm	-	-
Eurozone Industrial Production, July, % mom	12/09	9:00pm	-0.1	-
European Central Bank, Interest Rate Announcement, %	12/09	11:45pm	-0.5	-0.5
US CPI, August, %yoy	13/09	12:30am	1.8	1.8
US Retail Sales, August, %mom	14/09	12:30am	0.2	0.2

\*Originally published by CBA Global Markets Research on Friday 6<sup>th</sup> September at 2:10pm

Partial data are showing a large lift in the **value of lending for Australia's housing in July**. We are expecting a 5.5% lift in owner-occupier lending and a 7% lift in investor lending. While these are big numbers, they come after solid falls over the past few years, particularly for investors. Stronger lending in July lines up with the big lift in house prices in August.

The increase in the volume of July retail sales points to a modest monthly pick-up in **UK GDP** growth. But the soft composite PMI suggests risks to growth are skewed to the downside.

We anticipate **China's consumer price inflation** to ease to 2.6%yoy in August due to lower overall food prices. Pork prices should have risen again. Falling commodity prices in August indicate PPI inflation might have fallen to -0.7%yoy.

**UK labour market conditions** remain tight. The UK unemployment rate has been below the Bank of England's (BoE) equilibrium rate of unemployment (of 4.25%) since February 2018. The BoE projects the unemployment rate to fall slightly to 3.7% in Q3, consistent with surveys of employment intentions. The BoE also projects pay growth to stabilise around 3.5%yoy over the rest of 2019 – consistent with survey indicators of pay growth.

Regional data and the manufacturing PMI in the **Eurozone** point to a sharp contraction in **industrial activity** in July.

**US** retail petrol prices decreased by 3%mom in August. The fall in petrol prices will keep headline **CPI** inflation at 1.8%/yr. Core inflation will stay around 2.2%yoy, supported by solid growth in consumer demand.

**The European Central Bank is expected to cut the deposit rate by 10bps to -0.50%** and trim its macroeconomic projections. The ECB is expected to beef up its forward guidance and introduce some liquidity measures to assist banks.

The fall in petrol prices will keep headline **US retail sales** soft at 0.2%. The core and control measures of retail sales should also show modest increase in August following the surge in July.

## Key Forecasts

### ASB NZ economic forecasts

	Mar-19 << actual	Jun-19 forecast >>	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.6	0.5	0.5					
GDP real - A%	2.5	2.1	2.2	2.1	2.1	2.4	2.4	2.4
GDP real - AA%	2.7	2.5	2.3	2.2	2.1	2.3	2.4	2.3
CPI - Q%	0.1	0.6	0.5	0.2				
CPI - A%	1.5	1.7	1.3	1.4	1.7	1.7	1.9	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	4.3	4.2	4.0	4.0
Annual current account balance as % of GDP	-3.6	-3.2	-3.3	-3.5	-3.5	-3.7	-3.6	-3.8

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

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### ASB foreign exchange forecasts

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(end of quarter)								
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

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