Economic Weekly

10 June 2019

Construction…BOOM!

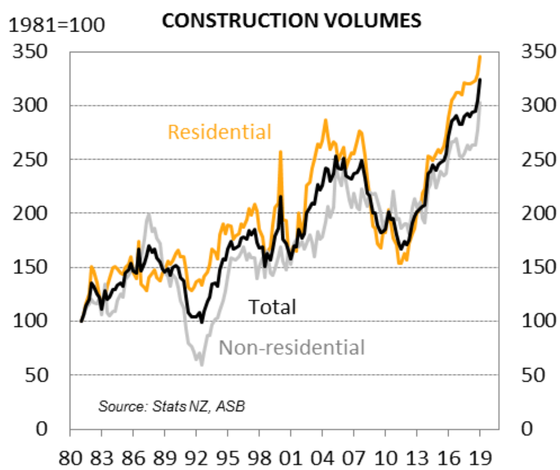
It was a week of contrasting fortunes for Antipodeans. At 0.4% qoq, Q1 Australian GDP data undershot already subdued expectations, with the 1.8% annual growth the lowest in ten years. April retail sales figures didn't provide much cause for cheer either, unexpectedly going backwards. **Data on this side of the Tasman provided some welcome sunshine.** Not only did Q1 figures confirm that NZ's Terms of Trade continue to trend higher (with more to come), but construction activity was revealed to have boomed 6.2% over the quarter. We've lifted our Q1 NZ GDP pick by 0.2 percentage points to 0.6% qoq (2.4% yoy) as a result, well above that of our Trans-Tasman neighbours.

This week sees the release of more partial NZ GDP inputs ahead of Q1 GDP (released June 20), and a selection of data that will shed light on the activity pulse beyond that. Trade headlines, market gyrations and a selection of offshore data releases - US inflation, Chinese activity and Australian labour market data – will be scrutinised for how quickly global growth is slowing. **Our view of the risk profile suggests a new record low for the OCR awaits (1.50%).**

Key events and views

Chart of the Week: Sky-high Construction

Building Work Put in Place was much stronger than expected in Q1, rising a whopping 6.2% over the quarter. The lift in building work was led by a massive 9% qoq increase in non-residential building activity. Activity in both the residential and non-residential sectors touched record highs (see chart) and the lift in activity was also regionally broad-based. The extent of the Q1 increase is remarkable given reported capacity constraints and the poor productivity track record of the construction sector. It is likely that more labour and capital resources were deployed to generate the extra building work, which will likely exacerbate capacity constraints in other sectors. In the absence of improving productivity, trade-offs will have to be made.



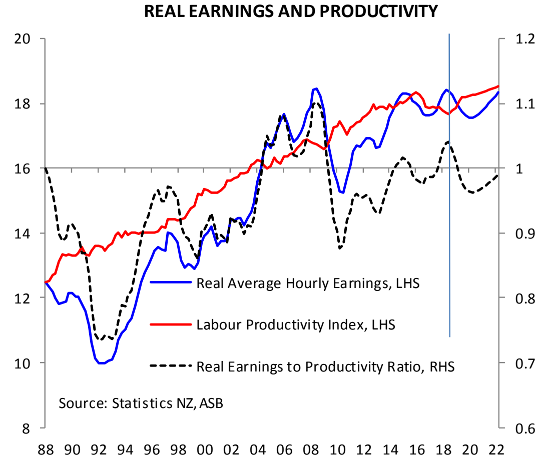
Key insights this week: Explaining low wage growth

- A recent puzzle has been why wage growth has remained low despite stretched labour market capacity.
- Our analysis identifies low consumer price inflation and low productivity growth as potential explanations.
- There are a number of sector outliers, suggesting other determinants matter.

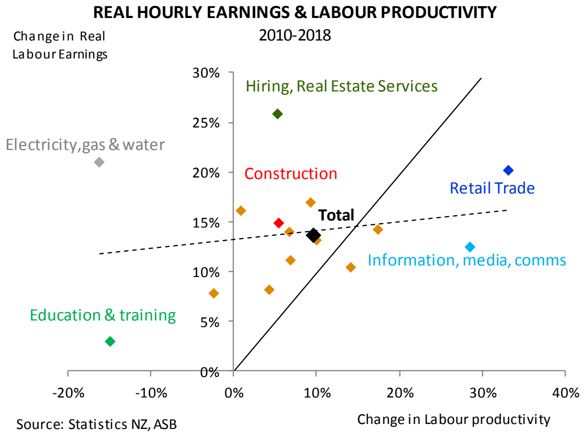
This is abridged version of a note we released last week on the NZ productivity outlook.

One of the puzzles of late has been why wage growth has been so subdued given stretched labour market capacity and the limited significant flow-through of the higher minimum wage. **Low wage growth may be the result of low consumer price inflation.** Annual CPI inflation has averaged just 1.3% since the start of the decade, a significant drop from the 2.7% average in the 2000's. Our estimates suggest that in inflation-adjusted terms (ex-GST), average hourly earnings Quarterly Earning Survey (QES) have averaged a 1.1% annual increase since the start of the decade, the same rate as in the 2000's and above the 0.7% annual average over the 1990's. It could also mean that instead of wage increases, firms are offering more flexible working arrangements and non-cash incentives that may have not been fully picked up by the statistics.

Low productivity growth may also be a factor. To assess whether broad trends in productivity are related to trends in labour earnings, the chart compares nationwide movements in labour productivity with real average earnings based on data from the Quarterly Earning Survey (QES). Over the last 30 years real average earnings have increased roughly 30%, with labour productivity increasing by a similar magnitude. In the 1990s, nationwide increases in labour productivity outstripped rises in real wages, although income tax cuts over this period would likely to have partly compensated wage earners. The 2000's saw steady improvement in labour productivity and real wages. Since the Global Financial Crisis (GFC) there has been a flat-lining in labour productivity, while real wages have risen.



Using the more detailed data, the scatter plots in the charts compare changes in productivity with those in real average hourly earnings, for the total NZ measured sector ('Total' in the plots) and various measured sectors from the 2010 to 2018 period. **For the measured sector as a whole, increases in real average earnings post the GFC (13% from 2010 to 2018) have slightly outpaced increases in productivity** (10% for labour, 9% for total factor productivity). So have real earnings for most of the individual measured sectors. **Comparing the trend relationship based on the results for individual sectors (dotted lines in the plots) show there is a weak positive relationship between growth in productivity and labour earnings.** Sectors that have posted higher productivity growth have tended to achieve larger than average increases in real average hourly earnings. For example, more sizeable wage increases in the retail sector may have been facilitated via higher productivity growth.



There are also a number of outliers. Despite little (or no) improvement in productivity performance, wage growth has been more sizeable for employees in the real estate and utilities sectors. However, wage increases have been more subdued in relation to productivity gains for the Information, media and communications sector. Competitive pressures and a lack of pricing power for both labour inputs and final outputs may be playing a role here as might measurement difficulties.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6659	0.6509	0.6587	0.7025	UP	0.6520	0.6780	UP
NZD/AUD	0.9507	0.9412	0.9425	0.9228	UP	0.9350	0.9650	UP
NZD/JPY	72.25	70.95	72.25	77.03	FLAT/UP	70.70	73.50	UP
NZD/EUR	0.5881	0.5849	0.5867	0.5949	FLAT/UP	0.5760	0.6000	UP
NZD/GBP	0.5230	0.5162	0.5064	0.5232	FLAT/UP	0.5130	0.5340	UP
TWI	73.1	71.8	72.1	73.52	FLAT/UP	71.00	74.00	UP

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

NZD Recap

The **NZD** lifted against all the major crosses over the past week. A key catalyst for the lift was a **weaker USD**, as commentary from Federal Reserve officials indicated the door was open for cuts to the Federal Funds rate. US employment figures for May (released Friday night) underperformed expectations, with jobs growth continuing to slow and annual wage growth falling to an 8-month low. Interest rates markets have priced an 80% likelihood of a 25 basis point cut to the Fed Funds rate at the July meeting. The **NZD** lifted on Wednesday following a speech by RBNZ Deputy Governor Christian Hawkesby who said the RBNZ's central view was that "New Zealand's interest rates will remain broadly around current levels for the foreseeable future". However, Hawkesby also noted that the RBNZ needs "to be ready to adapt when changes beckon" and that New Zealand has "further room to provide conventional monetary stimulus if required (using the OCR)".

Near-term outlook

The **NZD** will likely take its direction from offshore events this week. Australian labour market data on Thursday could result in some volatility for the **NZD/AUD** cross. We expect modest jobs growth in May and the unemployment rate to remain unchanged at 5.2%. However, the market median expectation is for the unemployment rate to ease to 5.1% and a weaker result will likely add to market expectations for a 25 basis point rate cut at the RBA's July meeting. We expect the **USD t**o remain heavy this week as markets continue to focus on the growing likelihood of Federal Reserve rate cuts. We expect US core CPI to ease in May and for core inflation to continue to slow this year as wage inflation pressures also decelerate. Trade tension headlines will continue to drive volatility. The **NZD** has been buoyed by improved sentiment at the start of this week, with US President Trump announcing it had indefinitely suspended proposed tariff hikes on US imports from Mexico. Chinese trade date due for release this week could be soft and may resurrect global growth fears. China-US trade tensions escalated materially in May and falls in the May net export orders and import PMIs suggest weak demand.

Medium-term outlook

We updated our FX forecasts in May reflecting our change in central bank forecasts, with the RBNZ and RBA cutting cash rates over 2019, and the Federal Reserve likely to be cutting the Fed funds rate from late 2019. The **NZD** is expected to soften in the near term, weighed by a lower OCR, weaker global growth and elevated trade tensions. However, we expect the NZD to remain supported over the medium term, firming against most crosses from late 2019 onwards. The **NZD/USD** will be supported by NZ's high Terms of Trade while the USD will be led lower by interest rate cuts from the Federal Reserve from late 2019. We expect the NZD/AUD to remain close to 0.94 over 2019 and to subsequently firm.

ASB foreign exchange forecasts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.67	0.68	0.65	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.95	0.96	0.94	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.58	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.52	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	71.3	70.2	72.7	73.1	75.1	75.8

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/DOWN	UP
90-day bank bill	1.63	1.67	1.70	2.01	UNCH/DOWN	UP
2-year swap	1.42	1.45	1.62	2.23	UNCH/DOWN	UP
5-year swap	1.54	1.56	1.75	2.71	UNCH/DOWN	UP
10-year swap	1.92	1.92	2.14	3.21	UNCH/DOWN	UP
10-year govt bond yield	1.68	1.72	1.82	3.00	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.50	0.48	0.52	0.98	UNCH/UP	UNCH/UP

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

Market Recap

Australasian short-term yields continued to grind lower, with curves modestly steepening. NZ yields drifted lower and touched record lows after the Reserve Bank of Australia (RBA) cut the cash rate by 25bps to 1.25%, with RBA Governor Lowe subsequently reiterating "it is not unreasonable to expect a lower cash rate", which was followed by a softer than expected Q1 Australian GDP print (0.4% qoq). The tone from the Fed and ECB was dovish Fed Chair Powell vowed to "act as appropriate" to sustain the US expansion and the ECB pledged to keep policy interest rates unchanged through to the first half of 2020, with the possibility of more asset purchases. NZ yields nudged higher following Friday's strong NZ Q1 construction data. Despite Mexico looking to have avoided higher US tariffs for now, soft US labour market data, concerns over global growth, IMF warnings over "self-inflicted" wounds from trade wars, and unresolved trade frictions between the US and China, saw global 10-year government bond yields finish the week towards the bottom of recent trading ranges.

Near-term NZD interest rate outlook

There is about 30bps of policy interest rate cuts priced in by the end of the year. We only expect one further 25bp cut from both the RBA and RBNZ (August). Risks are tilted to a later move by the RBNZ if Q1 GDP surprises on the upside relative to the RBNZ's +0.4% qoq pick (our current pick is +0.6% qoq). **However, we are reluctant to shift to an upward bias for NZ rates given the global risk profile and our low inflation view.** Australian labour market data on Thursday could result in some volatility to Australasian rates markets, particularly if there is a sizeable shift in the current 5.2% unemployment rate. Chinese retail sales, industrial production, US CPI inflation data, politics and trade could trigger further volatility. The leadership ballot for the UK Conservative Party is set to begin later this week and drag on for a number of weeks. **Despite the sizeable falls evident in local and global yields since the start of the year, we believe they still have scope to move lower if concerns over global growth escalate.**

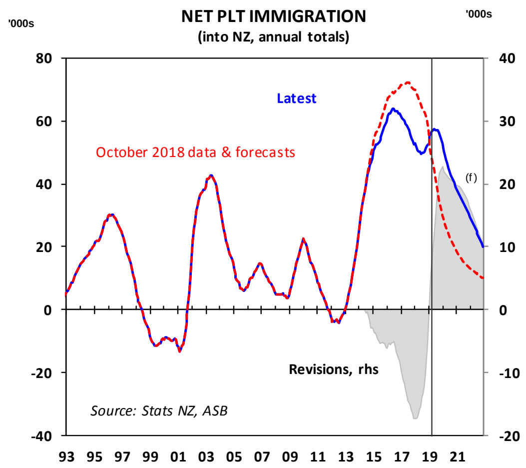
Medium-term outlook

OCR moves by the RBNZ will depend on the tenor of domestic data, the NZD, global developments and actions of other central banks. Following a further 25bp cut over 2019 August, we expect the OCR to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak by late 2023. **Global central banks are expected to trim policy rates.** We expect a follow-up 25bp cut from the RBA in August (to 1.00%), with the Federal Open Market Committee to start cutting the 2.25-2.5% Federal Funds rate from late 2019 (100bps of Fed cuts in total). **Global and NZD long-term interest rates are expected to remain capped at historically-low levels**, although we expect NZD yields to drift higher.

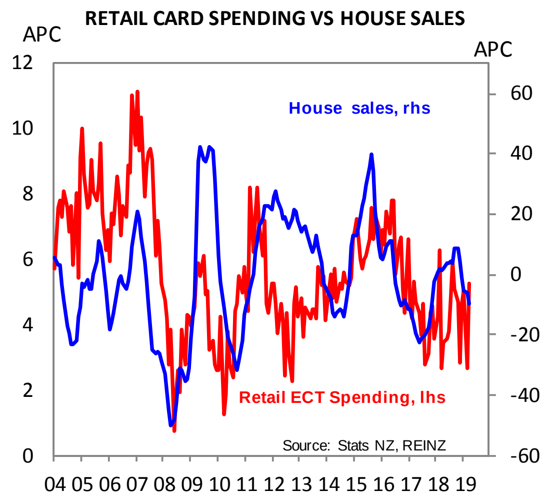
ASB interest rate forecasts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.50
NZ 90-day bank bill	1.97	1.9	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.5	1.4	1.4	1.4	1.4	1.8
NZ 10-year Bond*	2.38	1.8	1.7	1.7	1.6	1.7	2.1	2.3

Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
April visitor arrivals and net immigration, net PLT	12/06	10:45am	5,020	-	4,800
Electronic Card Transactions, May, retail, %mom	12/06	10:45am	+0.6	-	+0.5



We expect a net permanent and long-term inflow of around 4,800 persons in April, a further modest slowing in the monthly pace of net immigration. This would nevertheless see annual PLT net immigration lift slightly to just under 57,000 persons. Stats NZ's 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. As such, the May RBNZ MPS didn't adopt the more recently published figures in the RBNZ policy assessment and forecasts, sticking to the February MPS view of slowing net immigration**. If the recent strength in net immigration is genuine and continues, the upshot will likely be a stronger pace of population growth, domestic demand and labour supply growth than what the RBNZ has assumed.** Abstracting from a bit more near-term volatility, we expect annual net PLT inflows to trend lower over the next few years, driven by easing PLT arrivals and climbing departures. In terms of visitor arrival numbers, these are expected to show tourism inflows continuing to moderate as the prior boom continues to wind down.



We expect a modest monthly increase for card spending. A moderate 0.4% increase is expected for core retail spending. May 2019 was the 3rd warmest on record for NZ, albeit with differences by region. We expect modest increases in hospitality and spending, with scope for consumable, durable and apparel retail to register monthly gains. Fuel prices were little changed since April, with the approximate 25 c/l climb since the start of the year expected to weigh on discretionary spending. **We expect still-low wage inflation and the cooling nationwide housing market to prevent a pick-up in retail spending despite strong producer income growth and more government policy support**.

Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Japan Current Account Balance, April, ¥tn	10/06	11:50 am	1.5	1.3
China Trade Balance, May, US$bn	10/06	-	22	19
UK Employment, April,	11/06	8:30 pm	-1,000	-
RBA Asst. Gov. Ellis speaks in Melbourne	12/06	9:00 pm	-	-
US CPI, May, %yoy	12/06	12:30 am	1.9	2.0
US Retail Sales, May, %mom	12/06	12:30 am	0.6	0.5
Australia Unemployment, May, %	13/06	1:30 pm	5.1	5.2

**Originally published by CBA Global Markets Research on Friday 6th June at 1:12 pm.*

The small narrowing in Japan's customs-cleared trade deficit suggests **Japan's current account surplus** increased slightly in April. As a share of Japan's nominal GDP, the current account surplus remains large around 3½% of GDP.

We expect **China's exports and imports** fell 5% yoy and 3% yoy, respectively, in May. The China-US trade tensions escalated materially in May. The falls in the May net export orders and import PMIs suggest weak demand. As a result, we see the trade surplus narrowing to US$19bn.

The Reserve Bank of Australia's Assistant Governor Luci Ellis speaks in Melbourne later this week. The title of the speech is "Watching the Invisibles". It's not clear from the title as to what topics the speech will cover.

Employment growth in Australia is solid but the unemployment rate has lifted a little in recent months because of a lift in the participation rate. We expect a reasonable 15k lift in employment in May. On an unchanged participation rate this would keep the unemployment rate at 5.2%. Leading indicators of employment growth have pulled back but, overall, point to reasonable jobs growth ahead.

UK labour market conditions remain robust. The UK unemployment rate (3.8% in March) is the lowest since December 1974 and pay is growing at its strongest sustained pace since 2008. The Bank of England projects the unemployment rate to average around 3.75% and average weekly earnings (excluding bonus) to average around 3.25% yoy during in Q2-Q4 2019.

The small lift in **US** retail petrol prices suggests **headline inflation** will remain at 2.0% yoy. Base effects suggest core inflation will ease to 2.0% yoy in May. The steep deceleration in unit labour costs in the past year suggests core inflation will continue to ease further.

The small lift in retail petrol prices suggests total **US retail sales** rebounded by 0.5% in May from the small dip in April. The core "control group" measure of retail sales should lift solidly in May by 0.4% after the flat result in April.

ASB

Key Forecasts

ASB NZ economic forecasts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual	forecast >>						
GDP real - Q%	0.6	0.6	0.8					
GDP real - A%	2.3	2.4	2.2	2.6	2.8	2.9	2.5	2.4
GDP real - AA%	2.8	2.6	2.4	2.4	2.5	2.6	2.7	2.4
CPI - Q%	0.1	0.1	0.7	0.6				
CPI - A%	1.9	1.5	1.8	1.6	1.6	1.8	1.7	1.8
HLFS employment growth - Q%	0.0	-0.2	0.4					
HLFS employment growth - A%	2.3	1.5	1.3	0.7	1.1	1.7	1.6	1.4
Unemployment rate - %sa	4.3	4.2	4.3	4.4	4.4	4.4	4.2	4.1
Annual current account balance as % of GDP	-3.7	-3.4	-3.0	-2.9	-2.7	-2.6	-2.5	-2.4

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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NZD/AUD	0.95	0.96	0.94	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.58	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.52	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	71.3	70.2	72.7	73.1	75.1	75.8

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