

Economic Weekly

11 November 2019

The RBNZ giveth and the RBNZ taketh away

We're entering another important week. The hump day RBNZ meeting promises to be one of the more eventful in recent times given financial markets and economists are split on what the Bank will do. Unusually, interest rate markets and economists are both around 65% priced for a cut (12/18 economists are calling a cut, while OIS pricing is at 65%). The RBNZ has asked us to focus more on what it "should" do rather than what it "will" do. And in this spirit **we've retained our long-held view that the RBNZ should cut 25bps** (full preview [here](#)). Admittedly, the global scene is looking a little brighter, and some interest rate sensitive parts of the NZ economy are starting to stir. But global growth is still sub-par, business confidence is woeful, and a few cracks are appearing in the [labour market](#). There's also the RBNZ's pending introduction of higher bank capital requirements to think about, and the impacts of such on credit supply. Early indications are that these impacts could be material – see below.

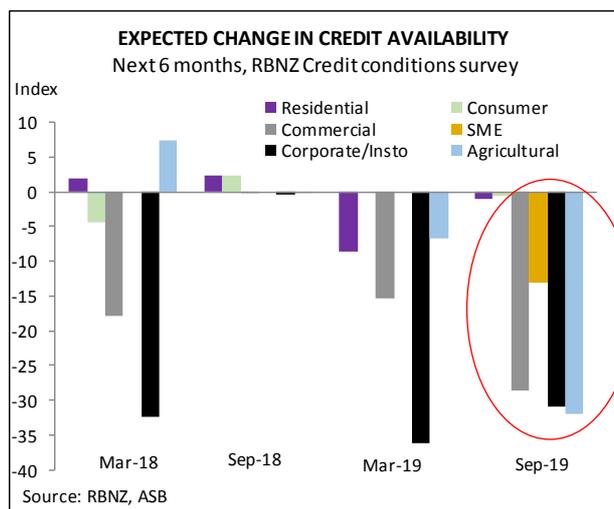
Key events and views

Foreign exchange	The NZD fell last week and we see additional downside this week.
Interest rates	We expect a 25bps cut on Wed, with risks that yields move higher in RBNZ disappoints.
Domestic events	REINZ housing data, RBNZ inflation expectations, RBNZ meeting, PMI.
International events	UK GDP, AU business confidence & employment, US/UK CPI, October China data, US/UK retail

Chart of the Week: Give me some credit here!

There's always plenty of focus on what the RBNZ will do with the *price* of credit (i.e. interest rates), but we shouldn't forget about what is happening with credit *supply*. After all, if the flow of credit around the economy is restricted, the impact of lowering the price will be blunted.

Against this background, the RBNZ's latest (Q3) credit conditions survey makes for slightly concerning reading. Banks' perception of credit availability over the next 6 months took a dive. The corporate/insto, agricultural, and commercial sectors were hit particularly hard, despite expected credit *demand* in these sectors generally increasing. These are all sectors for which lending can be particularly capital intensive, suggesting concerns about the RBNZ's proposed bank capital increases are a key driver. So, increasing demand but falling supply? The implications on price would appear obvious, and a key part of why we think the RBNZ will be called into action twice more.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6335	0.6442	0.6323	0.6731	DOWN	0.6220	0.6500	FLAT
NZD/AUD	0.9234	0.9311	0.9327	0.9298	DOWN	0.9100	0.9380	FLAT
NZD/JPY	69.16	69.69	68.26	76.67	DOWN	67.80	70.50	UP
NZD/EUR	0.5747	0.5767	0.5740	0.5932	FLAT/DOWN	0.5630	0.5860	UP
NZD/GBP	0.4949	0.4981	0.5083	0.5158	FLAT/DOWN	0.4860	0.5050	FLAT
TWI	70.1	71.0	70.4	73.58	FLAT/DOWN	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

The NZD fell over the past week, unwinding the previous week's lift. Offshore market sentiment was generally positive over the week, with the **USD buoyed** by growing optimism that a US-China trade deal will be reached and reduced expectations of another Federal Reserve rate cut this year. In addition, the **NZD underperformed** against all of the major crosses as interest rate market pricing for a RBNZ rate cut edged slightly higher over the week. Economists and market participants appear divided on the likelihood of the RBNZ cutting the OCR 25 basis points this week, but the lift in the unemployment rate (from 3.9% to 4.2%) did sway market expectations slightly in favour of a cut. **The AUD outperformed** most major currencies following the RBA's decision to leave the cash rate unchanged, as the market may have been expecting slightly more 'dovish' statement.

Near-term outlook

NZD/USD faces further downside risks this week, with the **USD receiving support** (see below) whilst we expect the RBNZ to cut the OCR 25 basis points at this week's announcement (Wednesday 2pm). A soft **RBNZ Q4 inflation expectations survey** on Tuesday could lift market pricing for a rate cut and weigh on NZD leading into the meeting. On the day of the **RBNZ announcement**, FX markets will be volatile given that the **market currently has only priced in a 65% chance of an OCR cut**. The **USD could edge higher** this week (NZD lower), driven by US China trade developments and diminishing expectations for further Federal Reserve rate cuts. Federal Reserve Chairman Powell recently noted that "it would take a material reassessment of the outlook" to cut interest rates further. Powell's address to the congressional Joint Economic Committee will be closely watched by market participants this week. **GBP** is likely to continue to depreciate this week after credit rating agency Moody's reaffirmed the UK's sovereign credit rating at Aa2, but lowered the outlook on the credit rating from "stable" to "negative". The decision by Moody's reflects constant Brexit paralysis.

Medium-term outlook

Our forecasts have the NZD/USD essentially trending sideways for the best part of the next nine 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.

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ASB foreign exchange forecasts

(end of quarter)

	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>				
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	71	71
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.53	0.51	0.49	0.46	0.51	0.52	0.52
NZD TWI	73.2	70.2	69.1	67.9	71.5	72.0	72.0

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	DOWN	UP
90-day bank bill	1.15	1.13	1.03	1.99	DOWN	UP
2-year swap	1.06	1.04	0.89	2.20	DOWN	UP
5-year swap	1.19	1.12	0.94	2.64	UNCH	UP
10-year swap	1.54	1.39	1.26	3.11	UNCH	UP
10-year govt bond yield	1.38	1.33	1.16	2.80	UNCH	UP
Curve Slope (2s10s swaps)	0.48	0.35	0.37	0.91	UP	UNCH/UP

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

Market Recap

Local and global yields continued to drift higher. China and the US appeared to be moving closer to rolling back tariffs on each other's goods, which along with solid US data and growing US Treasury supply has likely helped to lift global yields/steepen curves. US 10-year Treasury yields have hit 3-month highs (1.94%). **NZ yields have joined the march higher in global yields with NZ swap yields up 20-40bps since early October lulls and with NZ 10-year Government bond yields (1.36%) up about 40bps since early October lows.** The modest climb in the Q3 NZ unemployment rate (to 4.2%), and rising wage inflation garnered little lasting market reaction. Market pricing for a RBNZ November cut waxed and waned (15-17bps cuts), well below the 25-30bps of cuts priced in a month or so ago. There was also little reaction following the RBA decision to hold the cash rate at 0.75% and maintain an easing bias, with the RBA Statement of Monetary Policy reinforcing that the official cash rate will stay low for a prolonged period of time.

Near-term NZD interest rate outlook

With markets sitting on the fence (16bps of OCR cuts priced in), market reaction to Wednesday's November Monetary Policy Statement is a given. **Our view is that the response of interest rate markets to the decision is likely to be asymmetric.** If, as we suspect, the OCR is cut by 25bps and the door is left open to future potential easing, modest falls to NZ rates are on the cards. If, however, the RBNZ do not cut or deliver a 'one and done' type message, we expect much larger (upward) movements for NZ short-to medium-term yields given market positioning, possible extra demand for mortgage fixing and potentially lower offshore receiving interest. **We don't see much substance behind their recent climb, but suspect that the recent drift in longer-term yields may have further to run.** Look out for positive signals on trade and signs that current US interest rate settings are 'appropriate' from this week's Fed speeches (notably Powell, Evans, Williams, Clarida and Bullard). A weak Australian employment print could firm up 35% February rate cut odds for the RBA, with markets sensitive to Australian business confidence data tomorrow. US CPI, and signposts on global growth provided by UK/Japanese/Eurozone GDP and Chinese industrial production/retail sales data could generate additional volatility.

Medium-term outlook

Our forecast is for the curve to initially steepen and then to flatten as policy easing precedes mild policy tightening. We expect 50bps of OCR cuts (-25bps Nov 19, -25bps Feb 20), with the OCR to plateau at 0.5% this cycle. This will be followed by mild and gradual OCR hikes from 2022, with an OCR endpoint of just 2%. We also expect a further 25bp cut by the RBA in February (0.5% floor). The Fed is expected to cut the 1.75%-2% Federal Funds rate by 75ps by mid-2020 (Oct 19, Dec 19, Mar 20, Jun 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.**

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ASB interest rate forecasts

(end of quarter)	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>				
NZ OCR	1.50	1.00	0.75	0.50	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.0	0.9	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	0.8	0.7	0.7	1.0	1.4
NZ 5-year swap rate	1.4	0.9	0.9	0.8	0.9	1.3	1.7
NZ 10-year swap rate	1.8	1.2	1.2	1.1	1.2	1.6	2.0
NZ 10-year Bond	1.6	1.1	1.0	0.9	1.0	1.4	1.8

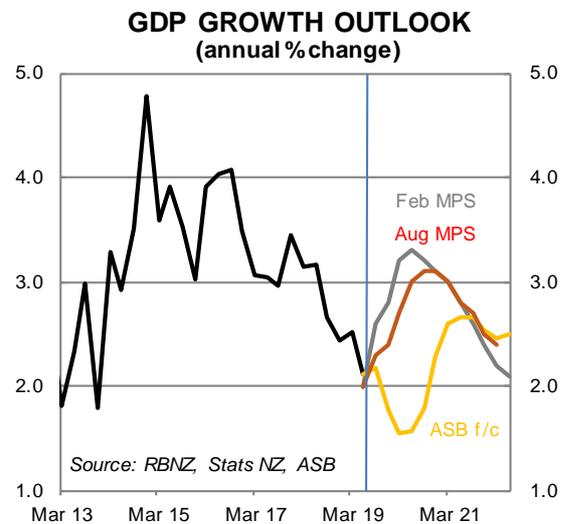
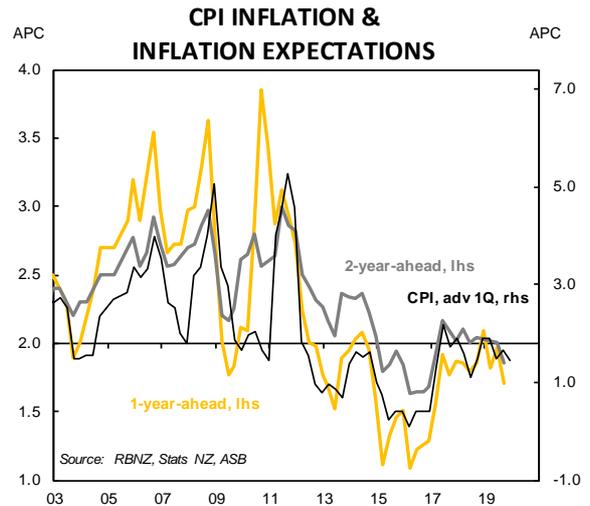
Domestic events

Data	Date	Time (NZT)	Market	ASB
RBNZ Survey of Expectations, Q4	12/11	3:00 pm	-	-
November MPS, Official Cash Rate, %	13/11	2:00 pm	0.75	0.75

Inflation expectations from the RBNZ survey are likely to hover below the midpoint of the 1-3% CPI inflation target. Lower annual headline CPI inflation (1.5% yoy) and contained readings for core inflation should dampen upward impetus from rising wage and non-tradable inflation. The RBNZ seems to place considerable weight on this survey and will have had access to the Q4 survey results during the November Monetary Policy Statement deliberations.

Current market pricing is sitting on the fence, but we believe there is a strong case for cutting the OCR, with the RBNZ to follow through and deliver a 25bp cut in the November Monetary Policy Statement (MPS). The NZ growth outlook still looks subpar, which should prompt the RBNZ to take out additional insurance to keep the economy on track. **We also expect that the MPS will leave the door open to prospective further easing.** We do not expect 0.75% to be the lull in the OCR this cycle, with several catalysts that could prompt follow-up action next year.

Tuesday's September immigration and visitor arrivals figures will only really be useful for their tourism implications, given net migration data remain far too revision-prone to take at face value. We expect the wind down from the prior tourism boom to have continued in September with solid arrivals from Australia continuing to buffer the sharp decline in Asian arrivals



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Bank of Japan Summary of Opinion	11/11	12:50 pm	-	-
UK GDP, Q3, %qoq	11/11	11:30 pm	0.4	0.5
Australia Wage Price Index, Q3, %qoq	13/11	1:30 pm	0.5	0.5
Eurozone Industrial Production, September, %qoq	13/11	11:00 pm	-0.2	-0.4
UK Inflation, October, %yoy	13/11	11:30 pm	1.6	1.7
Australia Employment, October, 000s	14/11	1:30 pm	16	20
Japan GDP, Q3, %qoq	14/11	12:50 pm	0.2	0.3
China Retail Sales, October, %yoy	14/11	3:00 pm	7.8	7.8
US CPI, October, %yoy	14/11	2:30 am	1.7	1.7
US Retail Trade, October, %mom	16/11	2:30 am	0.2	0.3

*Originally published by CBA Global Markets Research on Friday 8th November at 1.57pm

The brief **minutes from the Bank of Japan's October meeting** may highlight the discussion of options to ease monetary policy. At the October meeting, the Bank of Japan decided to change its forward guidance to be open-ended.

Wages growth in Australia is being suppressed by elevated spare capacity in the labour market. We expect modest wages growth of 0.5% in Q3, which would see the annual rate inch lower from 2.3% to 2.2%.

Australian employment rose by 15k in September, enough to push the unemployment rate a touch lower as the participation rate fell. In trend terms, employment is growing at 20k a month and we expect to see a lift of a similar magnitude in jobs over October. Such an outcome would be enough to hold the unemployment rate steady on an unchanged participation rate. The RBA will focus not only on the level of unemployment, but also on the underemployment rate.

We estimate **Japanese GDP** expanded by 0.3% in Q3 2019. Industrial production contracted by 0.6%, retail sales surged ahead of the 1 October tax increase, and the trade balance expanded.

We estimate **China's retail sales growth** steadied at 7.8%yoy. Increased spending during the National Day holiday was offset by falling car sales. Industrial production growth might slow to 5.4%yoy as indicated by a fall in the October manufacturing production sub-PMI. Fixed asset investment growth might lift to 5.5%yoy because faster infrastructure investment outweighed the weakness in real estate and manufacturing investment.

The monthly GDP report suggests **UK GDP** rebounded solidly in Q3 2019 following a small contraction in Q2 2019. The main threat to the UK growth is falling business investment.

The Eurozone manufacturing PMI remains very weak and suggests **Eurozone industrial production** will continue to ease.

We expect core **UK inflation** to continue its gentle trend lower because of the softness in the UK economy this year.

Retail petrol prices in the US increased modestly in October, helping keep headline inflation at 1.7%yoy. We expect core inflation to remain higher at 2.4%yoy because of the tightening market.

The strong decrease in manufacturing employment in October and the weak reading for the ISM manufacturing index suggest **US industrial production** was also weak in October.

The modest lift in retail petrol prices and solid growth in employment will support **US retail sales in October**.

Key Forecasts

ASB NZ economic forecasts

	Jun-19 << actual	Sep-19 forecast >>	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.5	0.5	0.2				
GDP real - A%	2.1	2.3	1.8	1.6	2.6	2.5	2.5
GDP real - AA%	2.4	2.3	2.2	1.9	2.0	2.6	2.5
CPI - Q%	0.6	0.7	0.3				
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				
HLFS employment growth - A%	1.4	0.8	1.1	1.4	1.5	1.5	1.3
Unemployment rate - %sa	3.9	4.2	4.1	4.4	4.4	4.3	4.5
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

(end of quarter)	Jun-19 << actual	Sep-19 forecast >>	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
NZ OCR	1.50	1.00	0.75	0.50	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.0	0.9	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	0.8	0.7	0.7	1.0	1.4
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ASB foreign exchange forecasts

(end of quarter)	Jun-19 << actual	Sep-19 forecast >>	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	71	71
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.53	0.51	0.49	0.46	0.51	0.52	0.52
NZD TWI	73.2	70.2	69.1	67.9	71.5	72.0	72.0

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