

Economic Weekly

13 May 2019

Clear cut

As we expected the RBNZ cut the OCR to 1.5% last Wednesday. Indeed, the Monetary Policy Committee – in its inaugural OCR decision – reached a consensus on implementing a cut. But what was not quite as clear was the path forward. The RBNZ interest rate forecasts showed an easing bias, but at the same time, it's clear that incoming data over coming months will dictate whether or not the Bank cuts again this year.

In contrast, **President Trump announced a tariff increase to 25% on \$200bn worth of Chinese imports** (we discuss this in the *Chart of the Week* below). Looking at the week ahead, there are mostly minor local data scheduled. Across the Tasman, April employment data are due and this has the potential to influence the prospects for an RBA cut. Otherwise, markets will remain squarely focused on US-China trade headlines.

Key events and views

Foreign exchange	RBNZ interest rate cut has short-lived impact on NZD.
Interest rates	We retain our modest downward bias following the OCR cut last week.
Domestic events	International Travel & Migration, BusinessNZ Manufacturing PMI, Producers Price Index
International events	Australian Employment, Chinese Monthly Activity Indicators, US-China trade headlines
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: Trump tightens trade screws

President Trump caught markets off guard last week by announcing a tariff increase to 25% on \$200bn worth of Chinese goods. The increase came into effect on Friday, and was timed to put pressure on Chinese officials as they arrived in Washington for trade talks on Thursday. Trump also threatened to impose 25% tariffs on an additional \$325 billion of Chinese goods "shortly."

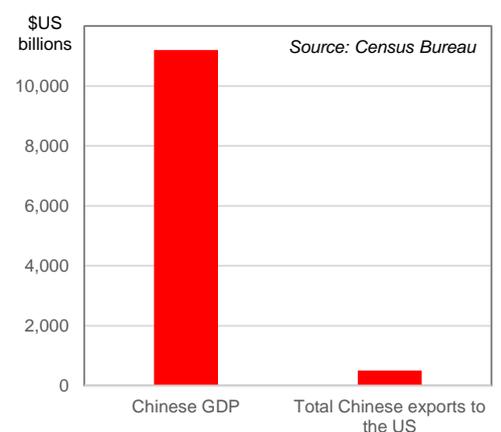
This announcement broke the uneasy truce that had held since December.

Indeed, we had speculated at the time that the truce may not hold. Meanwhile, China has responded, vowing to use "necessary countermeasures."

On the surface, the tariff increase fits with Trump's modus operandi of forcing trade partners into negotiations, before quietly reaching an agreement.

Accordingly, we expect an outcome along similar lines. Nonetheless, **Trump's tactics make markets nervous, and in the meantime, the tit-for-tat tariffs impose costs on importers and exporters on both sides.** As such, financial markets are likely to remain volatile until a US-China trade agreement is reached.

CHINESE EXPORTS TO THE US



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6600	0.6623	0.6737	0.6961	FLAT	0.6450	0.6750	UP
NZD/AUD	0.9432	0.9474	0.9440	0.9239	FLAT	0.9300	0.9600	UP
NZD/JPY	72.47	73.39	75.28	76.17	FLAT	71.10	74.00	UP
NZD/EUR	0.5875	0.5917	0.5967	0.5842	FLAT	0.5750	0.5990	FLAT
NZD/GBP	0.5077	0.5046	0.5152	0.5144	FLAT	0.4970	0.5180	UP
TWI	72.4	72.4	73.1	72.72	FLAT	71.00	74.00	UP

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

NZD Recap

The **RBNZ cut the OCR to 1.5% on Wednesday as we expected**, but what was seen as a 50/50 call by financial market participants. The NZD fell in a knee-jerk reaction against the USD and AUD on Wednesday, although the fall was not sustained over the week. RBNZ forecasts signalled a 50% chance of another OCR cut, but comments from Governor Orr suggest the Monetary Policy Committee is not yet convinced of the need for another OCR cut. We continue to expect the OCR will eventually be cut to 1.25%, but the timing of the second move will be highly data dependent and likely also require global catalysts. **The RBA left its cash rate unchanged on Tuesday** (also seen as a 50/50 call by financial markets), providing some brief support to the AUD. However, the **AUD was ultimately weighed by the escalation in US-China trade tensions, which weighed on the CNY and triggered USD weakness against the EUR and JPY**. On Friday, the US raised the tariff rate on about US\$200 billion worth of Chinese imports to 25% from 10%. China's Ministry of Commerce warned it will be forced to retaliate against the US with "necessary countermeasures". **GBP, however, was dampened** as cross-party Brexit negotiations between PM May and the opposition Labour party did not go as well as hoped.

Near-term outlook

The major currency events this week include **China's monthly 'data dump'** on Wednesday, **US-China trade tensions**, potential **US government decisions on 'currency manipulation'** and **Australian labour market data**. The US Treasury may release its twice yearly report on the currency practices of US trading partners this week. Market participants are likely to remain focused on US-China trade tensions. Any ratcheting up of rhetoric in the Treasury report about China may lift market volatility, dampen the CNY (and by association the AUD and NZD), and support the JPY (and likely the EUR). Meanwhile, Australia's labour market remains in focus, with wage data (Wed) and employment data (Thurs) **likely to influence market pricing for an RBA rate cut** (an RBA rate cut is 31% priced in) and the AUD.

Medium-term outlook

In the medium term and looking beyond any short-term reaction to possible OCR cuts, we expect the NZD/USD to gradually strengthen given NZ's high Terms of Trade. 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 reflecting the RBNZ's May OCR cut. 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	73.8	74.4	73.9	74.6	75.3	76.6

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.50	1.75	1.75	1.75	UNCH/DOWN	UP
90-day bank bill	1.70	1.79	1.82	2.05	UNCH/DOWN	UP
2-year swap	1.62	1.62	1.69	2.21	UNCH/DOWN	UP
5-year swap	1.75	1.76	1.84	2.68	UNCH/DOWN	UP
10-year swap	2.14	2.17	2.26	3.16	UNCH/DOWN	UP
10-year govt bond yield	1.81	1.87	2.02	2.72	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.52	0.55	0.57	0.95	UNCH	UNCH/UP

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

Market Recap

NZD yields start this week fractionally lower for most tenors, with the curve flattening. **As we had foreshadowed, the RBNZ cut the OCR by 25bps to a new record low of 1.50%, which saw an immediate rally (i.e. fall) in NZD yields.** NZD yields subsequently recovered some lost ground after Governor Orr reiterated that the Monetary Policy Committee (MPC) had a “more balanced outlook” for the OCR and that future cuts were not a fait accompli. Supporting short-term yields was the balanced outlook from the Reserve Bank of Australia (RBA), who held the cash rate at 1.50% and with the Statement of Monetary Policy not providing the smoking gun confirming that the RBA had adopted an easing bias. US core inflation was stable at 2.1% yoy, but **escalating trade tensions dampened long-term interest rates.** Yields for NZ 10-year bonds eased to 1.80%, their lowest since late March. Negotiations between the US and China failed to achieve a breakthrough, with the US increasing tariffs rates to 25% on USD200bn of imports from China last week, and with plans to impose tariffs on a further USD325bn of Chinese goods. If a trade deal cannot be reached the likelihood will be more policy stimulus by the Chinese authorities and lower yields globally.

Near-term NZD interest rate outlook

We have retained a modest downward bias on NZ yields given our OCR view, although we do not see any domestic catalysts in the next few weeks that will shift local yields. We are interpreting the “more balanced outlook” on the OCR as meaning that the MPC have still a (slight) easing bias, but do not appear in a hurry to exercise it. The local dataflow over the next few weeks is light and unlikely to trigger much market reaction, and with the RBNZ expecting a sub-trend Q1 0.4% qoq GDP print (released June 20), the hurdle to a June OCR cut is high. If the RBNZ do cut the OCR in the coming months, this will also likely need a global catalyst. We will be keeping close tabs on the global scene and watching the RBA and other central banks. With the labour market in the RBA’s focus, this week’s Australian employment (Thursday) and wage data (Wednesday) will be pivotal for Australasian market pricing. **Global long-term yields are expected to remain sensitive to trade headlines** and curves could come under flattening pressure if concerns over global growth escalate.

Medium-term outlook

We expect another 25bp OCR cut in August, with risks tilted towards a later start. The OCR is then expected to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak by late 2023. Proposed higher bank capital requirements, which we assume are equivalent to an increase of roughly 50bps 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 maintain historically-low interest rate settings. NZD long-term yields could initially dip and then drift up, before eventually settling at around 2.5-3.0%.

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	1.6	1.6	1.6	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
March visitor arrivals and net immigration, net PLT	14/05	10:45am	6,570	-	6,300

We expect a net permanent and long-term inflow of around 6,300 persons in March, which will see annual PLT net immigration lift to just under 64,000 persons, close to mid-2016 peaks, and with annualised net PLT inflows over the last three months running at around 75,000 persons. 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. As such, in the May Monetary Policy Statement (MPS), the RBNZ have not adopted the more recently published figures in their policy assessment and forecasts, sticking to the February MPS view of slowing net immigration. **If the recent strength in net immigration is genuine and persistent, the upshot will likely be a stronger pace of population growth, domestic demand and labour supply growth than what the RBNZ asserts.** The implications for OCR settings are broadly balanced. We expect annual net PLT inflows to moderate over the next few years, but not before they touch multi-decade highs, with the subsequent moderation driven by easing PLT arrivals and climbing PLT departures. **Seasonally adjusted tourism inflows have been slowing in recent months, and we expect to see further with slowing growth in annual visitor numbers.** This is likely to reflect slowing annual increases from Asia and the Americas combined by lower numbers of visitors from Europe.

Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia Owner-Occupied Loan Value, March, %mom	13/05	1:30 pm	-0.5	1.0
RBA Panel Discussion	13/05	7:00 pm	-	-
Japan Trade Balance, March, ¥bn	14/05	11:50 am	839	1,500
UK ILO Unemployment, March	14/05	8:30 pm	3.9	
Australia Wage Price Index, Q1, %qoq	15/05	1:30 pm	0.6	0.6
China Retail Sales, April, %yoy	15/05	2:00 pm	8.6	8.7
Eurozone GDP, Q1, %yoy	15/05	9:00 pm	1.2	1.2
Australia Employment, April, 000s	16/05	1:30 pm	15	20
US Retail Sales, April, %mom	16/05	12:30 am	0.2	0.0

*Originally published by CBA Global Markets Research on Friday 10th May at 2:13pm.

House lending in Australia is a good leading indicator of movements in dwelling prices. Partial data are showing mixed results for March after the uplift in February. We expect a flat outcome for lending to investors and a small gain for owner-occupiers. There are some signs that the downward momentum in house prices is losing steam. The falls in Sydney and Melbourne prices were smaller in April and auction clearance rates in Sydney are lifting.

The Reserve Bank of Australia is due to have a **panel session on *The End of Libor and the Impact on Australian Financial Markets***. This has been a topic the central bank has spoken about before. The panel discussion follows a letter sent to major financial institutions by APRA, ASIC and the RBA.

Customs data show **Japan's trade balance** dipped back into a deficit in March. This suggests Japan's current account surplus eased somewhat to ¥1,500 bn in March but still remained large.

UK labour market conditions remain robust. The UK unemployment rate (3.9% in February) is the lowest since December 1974 and pay is growing at its strongest sustained pace since 2008. The CBI's expected pay-for-the-year-ahead index and elevated surveys of recruitment difficulties point to continued solid wage growth in the near term. 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 Q2-Q4 2019.

We expect **Australia's Q1 Wage Price Index** to have risen 0.6% over the quarter, with the annual rate at 2.4%. While there has been continued improvement in the labour market there are only limited signs of improvements in wages growth with the underemployment rate remaining high.

We expect **China's retail sales growth** to stay steady at 8.7% yoy supported by faster food inflation and an expected stabilisation in car sales growth. We forecast industrial production growth to ease to 6.6% yoy in April following the fading impact of seasonality and the implementation of the Valued Added Tax cut.

The **Eurozone's second GDP estimate** will likely confirm the economy increased at an annual pace of 1.2% over Q1, the same as in Q4 2018.

We are expecting a 20k lift in the number of **Australian jobs** and the unemployment rate to remain steady at 5.0%. Last month there was a 25.7k gain in employment, in line with recent trends and what the leading indicators suggest. The RBA made it clear that the near-term direction of the unemployment rate will drive the next move in the official cash rate.

We expect no growth in **US retail sales in April** after the surge in March. Already-released data show car sales slumped by 6% in April. The main source of strength in retail sales will be petrol sales because of the 7% increase in petrol prices.

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	0.8	0.6				
CPI - A%	1.9	1.5	1.9	1.6	1.7	1.9	1.8	1.8
HLFS employment growth - Q%	0.0	-0.2	0.4					
HLFS employment growth - A%	2.3	1.5	1.3	0.8	1.2	1.8	1.6	1.4
Unemployment rate - %sa	4.3	4.2	4.3	4.4	4.3	4.4	4.3	4.2
Annual current account balance as % of GDP	-3.7	-3.3	-2.9	-2.5	-2.2	-2.0	-2.0	-1.7

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

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(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	1.6	1.6	1.6	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	73.8	74.4	73.9	74.6	75.3	76.6

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