

Economic Weekly

14 October 2019

Deal or no deal?

The weekend produced a lot of high drama that in some cases will set the tone for the next 2 to 3 weeks. The Brave Blossoms are through to the World Cup quarterfinals, Bathurst had a nail-biting Kiwi 1-2 finish, and Trump may or may not have agreed to a temporary trade truce. The first two will have resonated with the sports-mad parts of the country, but the last has had a marked impact on financial markets, pushing equity prices and bond yields up in response. The deal, apparently yet to be formally signed, means the US will suspend the introduction of tariffs that were set to come into effect this week, and China will buy around \$US50 bn of US agriculture products. If the deal is followed through on, it will help calm the heightened tensions of late. However, the big issues for the US, such as China's treatment of intellectual property, remain outstanding. **This week the big NZ focus will be on our Q3 inflation figures** (see Chart of the Week), with annual inflation expected to take a step down. And, apt given the US-China backdrop, there will be a smattering of US and Chinese data that give further insights into the toll the trade war is taking on them.

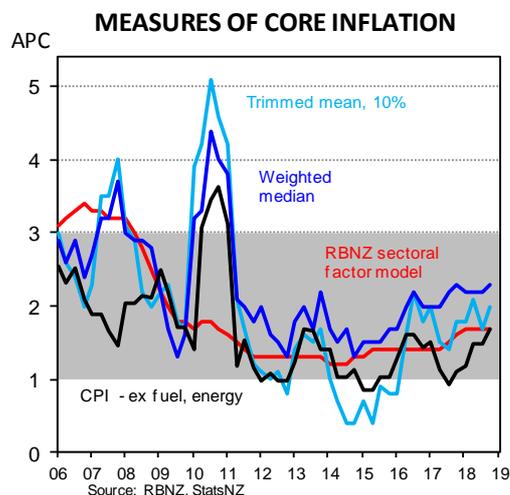
Key events and views

- [Foreign exchange](#) Tentative NZD recovery expected to continue.
- [Interest rates](#) Notwithstanding some near-term volatility, we retain a downward bias for yields.
- [Domestic events](#) Q3 CPI, international travel and migration, GDT auction
- [International events](#) RBA meeting minutes; US retail sales, industrial production, China data dump

Chart of the Week: Core inflation moderate

One key rationale for the RBNZ's OCR cuts is that the economy is not running 'hot' enough to generate increased inflation, and may not do so if the RBNZ (or the Government) doesn't give demand a nudge. To underscore the issue, we expect headline inflation for Q3 to soften temporarily to 1.4%. **Since the 2010 increase in the GST rate, annual inflation has only spent one quarter above the 2% mid-point of the inflation target.**

The various 'core' measures of inflation strip out some of the outliers that can distort the message from the 'headline' figure. The varying measures show a gradual uptrend and are clustered closer to 2% than they were a few years ago. **The RBNZ's calculated sectoral factor model, which the RBNZ has put weight on in the past, still shows sub-2% inflation.**



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6333	0.6310	0.6404	0.6518	UP	0.6285	0.6440	FLAT
NZD/AUD	0.9325	0.9347	0.9316	0.9148	FLAT/DOWN	0.9240	0.9375	FLAT
NZD/JPY	68.63	67.40	69.24	73.24	UP	67.00	69.75	UP
NZD/EUR	0.5739	0.5746	0.5784	0.5617	FLAT/UP	0.5685	0.5840	UP
NZD/GBP	0.5013	0.5119	0.5186	0.4924	DOWN	0.4990	0.5180	UP
TWI	70.5	70.4	71.0	71.15	FLAT/UP	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

There wasn't a lot for currency markets to go on last week. A bit of tradewar/Brexit headline fatigue, and a dearth of top tier data, meant it was all consolidation and narrow ranges.

At the start of the week we'd suggested the kiwi would track sideways in a 0.6240-6400 range, with the topside of the range most at risk. The range over the week proved even narrower than that at 0.6290-0.6350. The trade 'mini-deal' seemingly agreed by the US & China on Friday saw the kiwi finish the week at the upper end of the range.

Near-term outlook

We're looking for the tentative NZD recovery to continue this week.

The US-China trade talks last week certainly didn't result in a breakthrough, but the fact there has been progress and in particular that the US has agreed to postpone the mid-October tariff hike, will help heal global growth sentiment. Witness the Friday 'un-inversion' of the US yield curve (inversion is a well-regarded US recession indicator). Slightly more encouraging signs that a Brexit deal can be reached before the 19 October deadline are also helping soothe investor risk aversion.

Assuming the more positive global vibe continues this week, speculative investors may be forced to trim a little more of their large net short positions in the NZD, pressuring the currency higher. Notably, the 'fair-value' range implied by our NZD short-term valuation model lifted last week, to 0.6500-0.6900.

The big event risk this week comes via NZ Q3 CPI, for which we expect a 0.6% quarterly expansion (1.4% yoy - same as market) and the Chinese data dump on Friday. China's GDP growth is expected to have slowed to 6.1% in Q3. Aussie employment on Thursday will also have relevance for the NZ & AU monetary policy outlooks and hence currencies. We expect the Australian unemployment rate held at 5.3% in September.

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.

Mike.jones@asb.co.nz

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	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.2	70.2	69.3	68.3	71.7	72.1	72.1

Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH/DOWN	UP
90-day bank bill	1.04	1.04	1.14	1.89	UNCH/DOWN	UP
2-year swap	0.91	0.82	1.02	2.03	UNCH/DOWN	UP
5-year swap	0.98	0.83	1.09	2.41	UNCH/DOWN	UP
10-year swap	1.30	1.11	1.42	2.92	UNCH/DOWN	UP
10-year govt bond yield	1.20	0.99	1.33	2.66	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.39	0.29	0.40	0.89	UNCH/DOWN	UNCH/UP

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

Market Recap

NZ interest rates lifted over the week, led by lifts in US Treasury yields, with the NZ yield curve steepening.

Financial markets spent much of the week **anxiously awaiting the US-China trade talks**, with interest rates edging slightly higher mid-week as market participants were hopeful of a productive negotiation. **Interest rates leapt higher on Friday after President Trump said trade talks were “going really well”**, also announcing later in the weekend that an agreement had been reached. However, with **China not confirming the some of the details** announced by the US, there is some risk that the positive market sentiment does not last long this week.

The Federal Reserve September meeting minutes, released Thursday morning, had little market impact. However, the meeting minutes did **highlight that some committee members were becoming concerned about the gap between market pricing and Federal Reserve forecasts** (market pricing is consistent with 75bps of cuts over the next 12 months). **NZ data over the week were mixed, also having little impact on rates markets as global events dominated.** The BusinessNZ Manufacturing PMI remained sub-50 and consistent with contraction, but September card spending proved surprisingly firm.

Near-term NZD interest rate outlook

While some near-term volatility in rates markets may persist over the coming week, we retain a downward bias for yields. The Q3 CPI is the domestic focus for the week ahead, ASB expects a 0.6% increase – in line with the market median expectation and slightly stronger than the RBNZ’s 0.5% qoq August MPS forecast. A stronger inflation outcome will likely be ignored by local markets as “old news” as weak business confidence points to further slowing in NZ GDP growth and hence a softening in 2020 inflation pressures. The Tuesday release of the RBA meeting minutes (from the early October meeting when the RBA cut the cash rate to 0.75%), will likely refocus Australasian rate markets on the RBA’s and RBNZ’s easing biases.

Medium-term outlook

Our forecast is for the curve to initially steepen and then to flatten as policy easing precedes mild policy tightening. We now expect 50bps of OCR cuts (-25bps Nov 19, -25bps Feb 20), with the OCR to plateau at 0.5% this cycle. We expect extremely 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 100bps by mid-2020 (Oct, Dec, Mar 2020, June 2020), and with policy easing elsewhere. **Low inflation, low global growth and a negatively skewed risk profile should cap NZ and global long-term interest rates at historically-low levels.**

Jane.turner@asb.co.nz

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

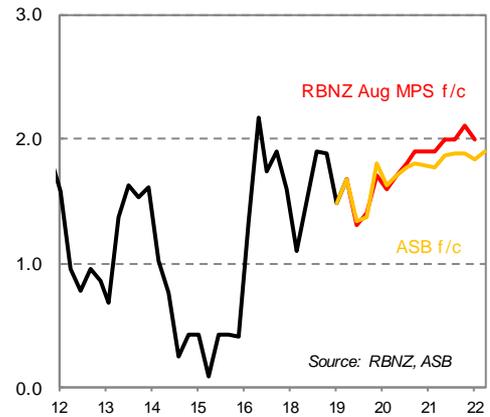
Domestic events

Data	Date	Time (NZT)	Market	ASB
Consumers Price Index, 2019 Q2, %qoq	16/07	10:45 am	+0.6	+0.6
GlobaDairyTrade auction, whole milk powder, % change	17/07	Overnight	-	0.0

We expect overall consumer prices to rise 0.6% in the September quarter (+1.4% yoy), just a tenth of a percentage point above the RBNZ's August Monetary Policy Statement (MPS) forecast. Risks are broadly balanced. Tradable prices are expected to climb 0.4% (-0.4% yoy), with non-tradable prices up 0.8% qoq (2.8% yoy). We expect core inflation from the RBNZ sectoral factor model to remain below 2%. While our short-term inflation forecasts for inflation are almost a carbon copy of the RBNZ's, we doubt whether the NZ economy will have sufficient impetus to readily meet the RBNZ's medium-term inflation and employment objectives. We expect a further 50bps of OCR cuts (-25bp in November, -25bp in February 2020) and a 0.5% OCR floor.

We expect whole milk powder (WMP) prices to be unchanged at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago WMP prices fell 0.2%. At this stage, the futures market is pointing to no significant change and we expect price movement along similar lines.

CONSUMER PRICE INDEX



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
China Trade Balance, September, US\$bn	14/10	-	34.75	32
RBA Minutes, October	15/10	1:30 pm	-	-
China CPI, September, %yoy	15/10	2:30 pm	2.9	2.7
IMF World Economic Outlook	15/10	-	-	-
UK CPI, September, %yoy	16/10	9:30 pm	1.8	
US Retail Trade, September, %mom	17/10	1:30 am	0.2	0.4
Japan CPI, September, %yoy	18/10	12:30 pm	0.2	0.3
China GDP, Q3, %yoy	18/10	3:00 pm	6.1	6.1

*Originally published by CBA Global Markets Research on Friday 11th October at 2:09pm

We expect **China's exports and imports** to contract by 3.5%yoy and 4.0%yoy in September, respectively. As a result, we estimate the trade surplus narrowed to US\$32bn. Both the net exports orders and import PMI sub-indices lifted in September but remain in contractionary territory.

The **Reserve Bank of Australia (RBA)** cut the cash rate to a record low of 0.75% in October. The Governor's accompanying statement was dovish and reiterated the Bank's easing bias. Specifically, the Governor said, "the Board will continue to monitor developments, including in the labour market, and is prepared to ease monetary policy further if needed to support sustainable growth in the economy, full employment and the achievement of the inflation target over time". The stated aim of "full employment" rather than simply "reducing unemployment" (as was the case in the September Statement) is a more ambitious aim. Overall, the **October Minutes** will be dovish and will confirm the Bank's willingness to lower the cash rate if needed.

We estimate **China's consumer inflation** eased to 2.7%yoy in September because of lower food prices. Wholesale pork prices have stabilised since pork supply is stabilising. We estimate producer price inflation eased to -1%yoy because of weaker commodity prices.

Based on the already-released Tokyo inflation, we estimate **Japan's national inflation** was steady at 0.3%yoy (headline) and 0.6%yoy (core) in September. We expect a significant one-off jump in inflation in October because of the increase in the consumption tax from 8% to 10%.

We estimate **China's GDP growth** will have continued decelerating to 6.1%yoy in Q3 2019. We expect retail sales growth to rebound to 7.8%yoy in September because of holiday spending ahead of the mid-autumn Festival and National Day holidays.

The **International Monetary Fund (IMF)** is expected to deliver a sombre assessment of the global economic outlook. New Managing Director of the IMF Kristalina Georgieva warned of an economic slowdown in 2019 in 90% of the world during her first speech at the helm of the multilateral organisation. "The global economy is now in a synchronized slowdown," Georgieva said at the IMF headquarters, Efe news reported.

UK core and headline CPI inflation slowed in August to multi-year lows of 1.5%yoy and 1.7%yoy, respectively. The Bank of England projects headline CPI inflation to remain sticky near 1.7%yoy in Q3, reflecting lower energy prices. The central bank also expects core inflation (excluding the effects of energy, food, alcohol and tobacco) to be closer to 1.8% over much of 2019 H2.

US retail trade has expanded at a solid rate in recent months. Lower gasoline prices and a solid labour market have helped. Gasoline prices were stable in September and we predict another solid 0.4% in retail sales in September.

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	0.4	0.3				
GDP real - A%	2.1	2.2	1.8	1.8	2.4	2.4	2.4
GDP real - AA%	2.4	2.3	2.2	2.0	2.2	2.4	2.4
CPI - Q%	0.6	0.6	0.2				
CPI - A%	1.7	1.4	1.5	1.9	1.8	1.9	1.9
HLFS employment growth - Q%	0.8	0.2	0.3				
HLFS employment growth - A%	1.7	0.9	1.2	1.6	1.5	1.4	1.2
Unemployment rate - %sa	3.9	4.2	4.2	4.4	4.4	4.2	4.2
Annual current account balance as % of GDP	-3.4	-3.4	-3.3	-3.1	-3.0	-3.1	-3.1

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
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

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	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.2	70.2	69.3	68.3	71.7	72.1	72.1

ASB Economics & Research

Chief Economist
Senior Economist
Senior Economist
Senior Economist
Senior Rural Economist
Senior Economist, Wealth
Publication & Data Manager

Nick Tuffley
Mark Smith
Jane Turner
Mike Jones
Nathan Penny
Chris Tennent-Brown
Judith Pinto

nick.tuffley@asb.co.nz
mark.smith4@asb.co.nz
jane.turner@asb.co.nz
mike.jones@asb.co.nz
nathan.penny@asb.co.nz
chris.tennent-brown@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 301 5657
(649) 301 5853
(649) 301 5661
(649) 448 8778
(649) 301 5915
(649) 301 5660

www.asb.co.nz/economics

[@ASBMarkets](https://twitter.com/ASBMarkets)

Disclaimer

This document is published solely for informational purposes. It has been prepared without taking account of your objectives, financial situation, or needs. Before acting on the information in this document, you should consider the appropriateness and suitability of the information, having regard to your objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this document. Any opinions, conclusions or recommendations set forth in this document are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by ASB Bank Limited. We are under no obligation to, and do not, update or keep current the information contained in this document. Neither ASB nor any person involved in the preparation of this document accepts any liability for any loss or damage arising out of the use of all or any part of this document.

Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. ASB does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met.