

Economic Weekly

15 January 2018

Setting the scene

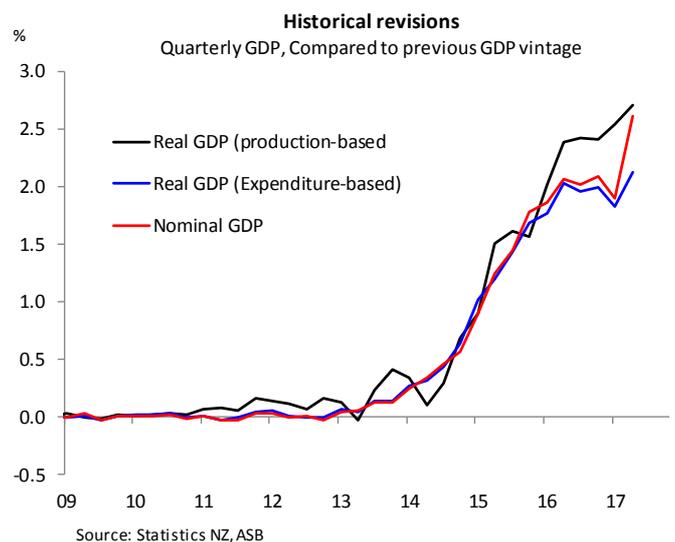
We welcome readers to 2018. As 2017 came to a close it became evident that the New Zealand economy had been in better shape than originally thought (see chart of the week, below). **What will 2018 bring? We are in the process of updating our forecasts, but on page 2 we provide initial observations on some of the key influences for 2018.** Suffice to say, there are local and global challenges aplenty, but there are also opportunities.

Key events and views

Key Insights	Setting the scene for 2018.
Foreign exchange	The NZD lifted higher against most major currencies we monitor last week.
Interest rates	Little change in local short-term yields expected with steepening bias for curve.
Domestic events	Q4 NZIER QSBO, December Electronic Card Spending, Dairy auction
International events	Q4 China GDP, December UK CPI, Australia employment, Fed Beige Book
Calendars	NZ and International calendar of upcoming economic events.

Chart of the Week: Changing History

History, they say, is written by the victors, or we might add the Statisticians. The Q3 GDP outturn incorporated chunky annual benchmark revisions, which collectively raised the historical level of GDP by around 3%. Does this change anything? The bulk of the revisions occurred from 2015 and produced a much perkier rewrite of recent history and potentially a narrower margin of spare capacity. The key test, however, will be the pricing side of the economy. Forthcoming readings of inflation are particularly important given the greater uncertainty over the cyclical position of the economy and how this will translate into core inflation and subsequent interest rate settings.



Setting the scene for 2018

We are in the process of updating our forecasts, but here we provide initial observations on some of the key influences for 2018. Historically, the number 8 has not been particularly kind to the NZ economy, with the late 1970's oil shocks (1978), after-effects of the 1987 equity market crash (1988), Asian crisis and droughts (1998), and Global Financial Crisis (GFC) (2008) triggering local downturns. These, in turn, have seen local interest rates and the NZ dollar fall. Time will tell whether a similar fate beckons for 2018.

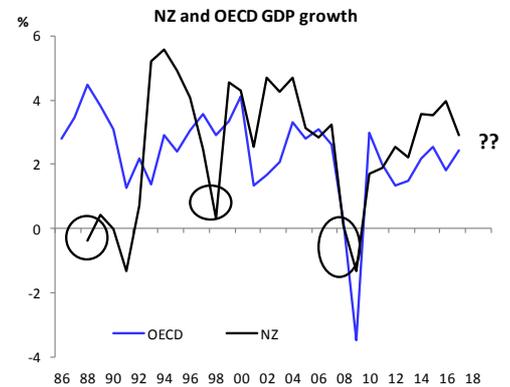
What then are some of the key things to watch over 2018? These include:

The global economy. A synchronised upswing is underway as the global economy emerges from the GFC. Policy support has played a crucial role as historically low interest rates have pushed up global asset prices to eye-watering levels across most (if not all) asset classes. Global equity markets are close to (or at) record highs. Measures of market volatility are historically low. Despite increasing pressures on capacity, consumer price and wage inflation remains tepid for this stage of the economic cycle. There are hopes that the global upswing has become self-sustaining and less dependent on policy support, but this has not been fully tested. There is the risk that if inflation finally stirs then asset prices will feel the brunt as interest rates move toward historical norms. Geopolitical tensions between North Korea and the US remain high. We have been here before, however, and are wary of crying wolf.

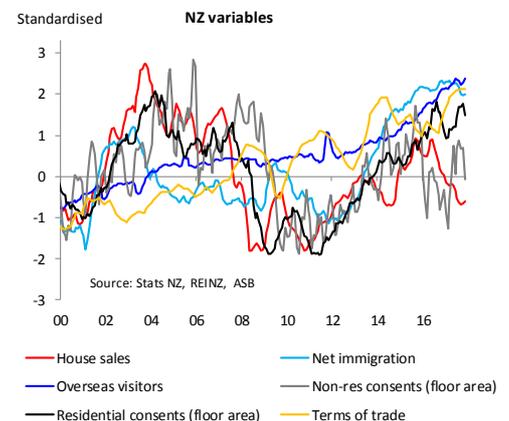
Finding a new growth driver for NZ. Some cyclical variables, including net permanent and long-term immigration, housing market activity and house price inflation have already peaked. Others, such as construction sector activity, are facing capacity challenges, which are making it difficult to meet strong demand without significant cost over-runs. The NZ economy is more than a one-trick pony and the historically high goods Terms of Trade, fiscal support and record numbers of overseas visitors are expected to underpin strong demand.

The housing market. Stretched domestic affordability and policy measures to slow investor demand are running head to head with housing shortages, underbuilding and still-strong population growth in most of the major cities (notably Auckland and Wellington). Is the housing market due for its 4th wind since the GFC? This looks a stretch given low housing affordability. However, an imminent correction still looks some way off.

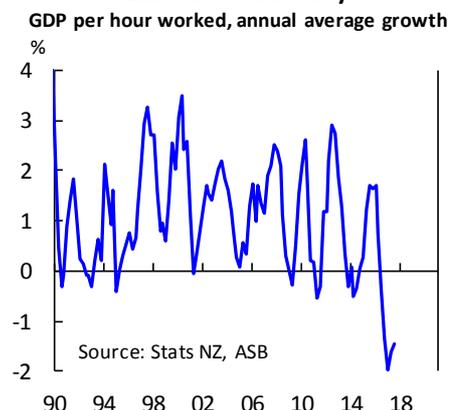
Working smarter. The New Zealand economy is in a sweet-spot of low inflation, low unemployment and steady growth. As always, there are a number of events that could derail the expansion. The focus is typically on elevated equity markets, the Chinese economy and geopolitical risks (global risks) and high household debt levels/Auckland house prices (local risks). However, low productivity growth has long been our structural weakness. Lengthening the expansion will entail working smarter when capacity constraints become more binding. Giving each other pay-rises without corresponding increases in productivity is not a recipe for sustained growth.



Source: Statistics NZ, OECD, ASB



Labour Productivity



Source: Stats NZ, ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.7105	0.7024	0.6830	0.7317	FLAT	0.7100	0.7300	UP
NZD/AUD	0.9101	0.9105	0.9030	0.9534	FLAT/DOWN	0.9100	0.9250	DOWN
NZD/JPY	80.02	79.55	76.84	82.34	FLAT	79.00	81.50	DOWN
NZD/EUR	0.5916	0.5917	0.5733	0.6409	FLAT	0.5800	0.6000	UP
NZD/GBP	0.5263	0.5255	0.5047	0.5629	FLAT	0.5200	0.5350	FLAT
TWI	74.1	74.0	72.1	78.4	FLAT/DOWN	74.00	76.00	FLAT

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

NZD Recap

NZD/USD has continued to steadily lift since Adrian Orr was announced as the new Governor, and reached our March-end forecast of 0.7200 last week. In our view, the **NZD strengthening reflects unwinding of previous overly-bearish views** of the change in Government's impact on the NZ economy. The improvement in the world economy, particularly the Australian economy, has also supported the NZD.

EUR lifted strongly late in the week following the release of the ECB's December meeting minutes which illustrated the ECB will increasingly emphasise the Eurozone's robust economic performance over the coming year.

Consequently, the **probability implied by interest rate futures of a 10 basis point ECB rate hike by year end has increased to roughly 90% from 30% earlier this week**. Encouraging German political developments also supported the EUR, with German Chancellor Angela Merkel's CDU party and the Social Democrats (SD) have agreed to move towards formal coalition talks.

Near-term NZD outlook

There are no policy-relevant US economic data releases this week, so NZ developments are likely to drive volatility in the NZD/USD. The **NZIER Q4 Quarterly Survey of Business Opinion is likely to match the sharp fall in business confidence already seen in the monthly ANZ survey**. While technically not a new development, the weak result is could weigh on market sentiment at the time of release (10am Tuesday). However, the NZD may find support from midweek as **dairy prices are likely to lift further at this week's GlobalDairyTrade auction**.

The AUD can outperform most major currencies this week, underpinned by encouraging Chinese economic activity and favourable Australian December employment conditions. On Thursday we expect the Bank of Canada to raise the policy rate by 25bps to 1.25% (85% priced in). Canadian employment conditions are good, wages are growing at an above trend annual pace, underlying CPI inflation is accelerating and export volumes are recovering.

Medium-term outlook

Our medium-term bias is for a weaker USD, reflecting narrowing USD interest rate differentials as other central banks contemplate policy tightening ahead of the Fed. **The NZD is expected to remain broadly supported by** its solid economic outlook, strong NZ commodity export prices and historically high terms of trade, still-positive NZD differentials and strong demand as global central banks/other real money managers continue to increase NZD exposures.

ASB foreign exchange forecasts

(end of quarter)

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
			<< actual	forecast >>					
NZD/USD	0.73	0.72	0.71	0.72	0.73	0.74	0.75	0.76	0.79
NZD/AUD	0.95	0.92	0.91	0.90	0.90	0.90	0.90	0.90	0.90
NZD/JPY	82	81	80	79	78	78	79	79	79
NZD/EUR	0.64	0.61	0.59	0.61	0.61	0.61	0.61	0.61	0.60
NZD/GBP	0.56	0.54	0.53	0.53	0.53	0.54	0.54	0.53	0.54
NZD TWI	78.4	76.4	74.3	74.9	74.9	75.3	75.4	75.8	76.6

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.75	1.75	1.75	1.75	FLAT	UP
90-day bank bill	1.88	1.88	1.91	1.99	FLAT	UP
2-year swap	2.21	2.20	2.14	2.37	FLAT	UP
5-year swap	2.68	2.69	2.58	2.93	FLAT/UP	UP
10-year swap	3.14	3.16	3.08	3.42	UP	UP
10-year govt bond yield	2.73	2.75	2.72	3.03	UP	UP
Curve Slope (2s10s swaps)	0.92	0.96	0.95	1.05	UP	DOWN

* Current as at 9.30am Monday; week ago as at Monday 5pm

Market Recap

Local shorter-term rates have started the year little changed from late last year, with rising medium and long-term yields contributing to the steeper interest rate curve. The Australian curve is also modestly steeper, whilst broadly uniform rises in US rates have been experienced. Market pricing has close to 20 basis points of OCR hikes till late 2018, which is slightly ahead of our OCR view, whilst short-term rate expectations are also broadly unchanged in Australia. The solid US data pulse and signs of firming inflation (US core CPI inflation over the weekend at 1.8% yoy was stronger than expected) have seen two-year US government bond yields approach 2%, their highest since 2018. European short-term yields have also firmed, with the continuing disconnect with Australasian short-term yields.

Long-term interest rates have moved up. Catalysts include the improving global backdrop, rising oil prices (near-dated Brent crude prices are hovering around USD 70 per barrel), the reduction in bond purchases by the Fed and ECB, with signs that the Bank of Japan and Chinese authorities are looking at paring back government bond purchases. The alleviation of political uncertainty has also pushed up longer-term yields. German 10-year bund yields spiked up towards the end of last week on news that Angela Merkel's party and the Social Democrats had agreed a plan for a formal coalition agreement. Moves in longer-term rates have been geographically widespread, with more modest climbs for local yields than US counterparts.

Near-term NZD interest rate outlook

Our bias is for the local curve to continue to steepen, driven by firming longer-term yields. Short-term local yields are expected to remain broadly constant. We expect this week's local data to print at the softer side of the ledger, suggesting little need for the RBNZ to hurry in terms of lifting the OCR. We also expect that the firm NZD (the TWI is currently above 75) will encourage the RBNZ to keep the OCR on hold. A solid print is expected for Q4 Chinese GDP, whilst another strong Australian jobs print could contribute to volatility and push up local short-term rates. The Bank of Canada is widely expected to hike rates this week to 1.25%, but this is largely priced in. Longer-term local yields are expected to take direction from offshore developments, with the bias towards higher rates.

Medium-term outlook

Our core macro view is that the RBNZ will start lifting the OCR in early 2019. We expect a moderate pace of tightening by historical standards, and a low OCR endpoint of around 3.5% this cycle. **This should help push up short-term NZD rates and help to flatten the local curve. Our expectation of a flatter NZD curve crucially depends on the assumption that local yields remain reasonably well anchored to global counterparts and that the lift in global yields is modest.** With still considerable uncertainties over the persistence of low global inflation and a downward global risk profile, we expect long-term global yields to drift higher.

ASB interest rate forecasts	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
(end of quarter)			<< actual	forecast >>					
NZ OCR	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.50
NZ 90-day bank bill	1.96	1.96	1.88	1.9	1.9	2.0	2.1	2.3	2.8
NZ 2-year swap rate	2.33	2.21	2.21	2.3	2.4	2.5	2.7	2.8	3.3
NZ 10-year Bond	2.97	2.96	2.75	3.1	3.2	3.3	3.4	3.4	3.6

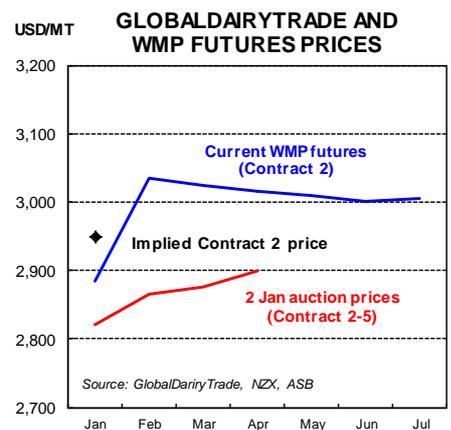
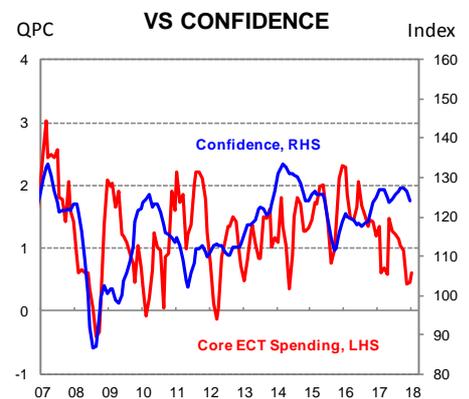
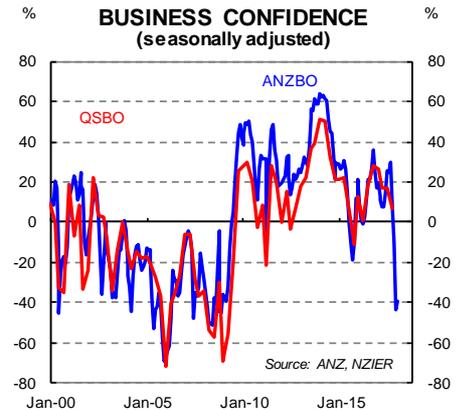
Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
NZIER QSBO, Business Confidence (Q4) s.a.	16/1	10.00 am	6.7	-	-38
Electronic Card Transactions, September, Total, %mom	16/1	10.45 am	+1.2	-	+0.2
GlobalDairyTrade Auction, whole milk powder, % change	16/1	Overnight	+4.2	-	+1 to +3
Business NZ Manufacturing PMI, December	19/1	10.30 am	57.7	-	-

We expect the Q4 NZIER Quarterly Survey of Business Opinion measure of general economic confidence to fall sharply, in line with the sharp post-election decline in the monthly ANZ business outlook survey. Businesses were remarkably complacent about election uncertainty in July and August, but as the election race tightened up in September, monthly business confidence dropped. **Once it was announced there would be a change in Government, business confidence fell further** (although it is not unusual for businesses to remain relatively pessimistic during a Labour Government compared to a National Government). We also expect a sharp fall in businesses' expectations for their own activity over the next three months, reflecting heightened economic uncertainty due to a number of changes in policies. However, as this period of uncertainty passes, we expect own activity expectations, along with employment and investment intentions, to recover in the New Year.

Electronic Card Transaction (ECT) spending finally rebounded in November after a soft number of months. Firmer fuel spending contributed more than one-third of the 1.2% mom increase in retail card spending. However, other pockets of the retail sector also showed signs of vigour, including consumer durables, apparel and hospitality. **Given the strong November outturn, there is some likelihood of recoil for retail card spending in December.** Nonetheless, we expect a positive December month increase, consistent with anecdotal reports of strong Christmas retail spending (notwithstanding the impact of higher fuel prices on consumer cash-flow). Card spending in the December quarter is expected to accelerate from its Q3 lull, with annual growth in spending lifting towards the circa 4-5% growth in labour incomes. The scene is set for a solid 2018 for the retail sector, given the stirring in the housing market, tightening labour market, strong tourism spending and still-resilient consumer sentiment.

We expect prices to rise at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices rose by 4.2%. **At the current juncture, futures pricing suggests WMP will lift by between 4% and 6%.** However, the futures market has overestimated price moves at recent auctions. Accordingly, we discount this indicator. Also on the back of recent dry weather, Fonterra has cut both its production and auction volumes forecasts. All up, we expect WMP prices to lift by between 1% and 3% at this auction.



Major International Events for the week ahead

Data	Date	Time (NZT)	Market	ASB
UK CPI, December, %yoy	16/01	10:30 pm	3.0	3.0
Australia Owner-Occupier Loan Value, Nov %mom	17/01	1:30 pm	-	1.0
Australia Consumer Confidence, January, index	17/01	12:30 pm	-	-
Australia Employment, December, 000s	18/01	1:30 pm	15	20
Australia Unemployment Rate, December, %	18/01	1:30 pm	5.4	5.4
China GDP, Q4, %qoq	18/01	8:00 pm	1.7	1.8

The number of **owner-occupier loans in Australia** is slated to have risen slightly over November.

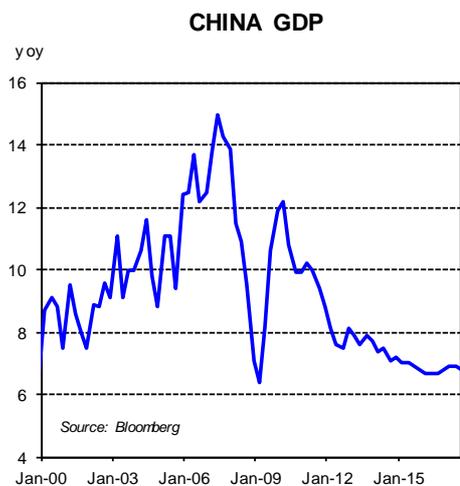
We expect an increase in **Australian consumer confidence** as a precursor to stronger consumer spending activity over January.

A moderate rise in **Australian jobs** will augment the stellar (3% p.a.) performance over 2017.

The **Australian unemployment rate** is forecast to stay around 5.4%.

China's GDP is slated to remain solid on the back of domestic demand and a recovering world economy that is supporting Chinese exports. According to the Xinhua News Agency, Premier Li Keqiang said the Chinese economy expanded by 6.9% in 2017.

Headline **UK CPI inflation** quickened at an annual pace of 3.1% in November (the highest since March 2012), driven by an increase in the cost of imports. We anticipate annual headline CPI inflation to ease slightly to 3% in December as imported inflationary pressures wane. The Bank of England projects headline CPI inflation to slow to 2.4% by Q4 2018.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Tue 16	10:00	NZ	NZIER Confidence	Q4	q%ch	5.0	~	~
	10:45	NZ	Card spending total	Dec	m%ch	1.2	0.5	0.2
	13:30	AU	Sales of New Motor Vehicles	Dec	m%ch	0.1	~	~
Wed 17	12:30	AU	WBC consumer confidence	Dec	m%ch	3.6	~	~
	13:30	AU	Housing Finance	Nov	m%ch	-0.6	0.0	1.0
	13:30	AU	Building Commencements	Q3	q%ch	~	~	~
	12:50	JN	Machinery orders	Nov	m%ch	5.0	~	~
Thu 18	12:30	AU	WBC consumer confidence	Dec	m%ch	3.6	~	~
	13:30	AU	Employment change	Dec	'000	61.6	15.0	20.0
	15:00	CH	Retail sales	Dec	y%ch	10.2	10.1	~
	15:00	CH	Industrial production	Dec	y%ch	6.1	6.0	~
	20:00	CH	GDP	Q4	q%ch	1.7	1.7	1.8
	17:30	JN	Industrial production	Nov	m%ch	0.2	~	~
Fri 19 Jan	10:30	NZ	Manufacturing PMI	Dec	Index	57.7	~	~
	13:30	AU	Overseas arrivals and departures	Nov	'000s	~	~	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 15	~	US	Martin Luther King's Birthday					
Tue 16 Jan	05:15	UK	Bank of England Economist Silvana	Nov	y%ch	2.8	~	~
	09:30	UK	CPI	Dec	m%ch	0.3	0.4	~
	09:30	UK	Retail price index	Dec	Index	275.8	~	~
	20:15	UK	Bank of England Deputy Governor Sam Woods speaks					
Wed 17	10:00	EC	Inflation (Final)	Dec	m%ch	0.1	~	~
	1:15	US	Industrial production	Dec	m%ch	0.2	0.4	~
	2:00	US	NAHB housing market index	Jan	Index	74	73	~
	2:00	CA	Bank of Canada (BoC) rates decision	Jan	%	1.00	1.25	1.25
	8:00	US	Foreign buying T-Bonds	Nov	\$USbn	-22.1	~	~
	8:00	US	Overall capital flows	Nov	\$USbn	151.2	~	~
Thu 18 Jan	13:30	US	Housing starts	Dec	m%ch	3.3	~	~
	13:30	US	Building permits	Dec	m%ch	-1.0	~	~
	13:30	US	Philly Fed Index	Jan	Index	26.2	24.0	
	19:00	US	Fed Reserve Bank of Chicago's Evans and Fed Reserve Bank of Dallas' Kaplan speak					
	20:30	US	Federal Reserve Bank of Cleveland's Mester speaks					
Fri 19 Jan	10:00	EC	Current account balance, seas.adj.	Nov	€bn	30.8	~	~
	9:30	UK	Retail sales	Dec	m%ch	1.1	~	~
	15:00	US	Uni Michigan sentiment (prelim)	Jan	Index	95.9	97.0	~

Key Forecasts

ASB NZ economic forecasts

	Jun-17 << actual	Sep-17 forecast >>	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
GDP real - Q%	1.0	0.6	1.0	1.2	1.1	1.0	1.0		
GDP real - A%	2.8	2.7	3.3	3.8	4.0	4.3	4.4	4.0	3.4
GDP real - AA%	3.3	3.0	3.0	3.2	3.4	3.9	4.1	4.2	3.5
CPI - Q%	0.0	0.5	0.5	0.4	0.2	0.5	-0.1		
CPI - A%	1.7	1.9	1.9	1.3	1.5	1.6	1.0	1.3	1.7
HLFS employment growth - Q%	-0.1	2.2	-0.6	1.0	0.7	0.5	0.6		
HLFS employment growth - A%	3.1	4.1	2.7	2.5	3.3	1.6	2.8	2.3	1.8
Unemployment rate - %sa	4.8	4.6	4.9	5.0	5.0	4.3	4.1	4.0	3.7
Annual current account balance as % of GDP	-2.7	-2.6	-2.6	-2.2	-2.4	-2.6	-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

ASB interest rate forecasts

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
(end of quarter)			<< actual	forecast >>					
NZ OCR	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.50
NZ 90-day bank bill	1.96	1.96	1.88	1.9	1.9	2.0	2.1	2.3	2.8
NZ 2-year swap rate	2.33	2.21	2.21	2.3	2.4	2.5	2.7	2.8	3.3
NZ 10-year Bond	2.97	2.96	2.75	3.1	3.2	3.3	3.4	3.4	3.6

ASB foreign exchange forecasts

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
(end of quarter)			<< actual	forecast >>					
NZD/USD	0.73	0.72	0.71	0.72	0.73	0.74	0.75	0.76	0.79
NZD/AUD	0.95	0.92	0.91	0.90	0.90	0.90	0.90	0.90	0.90
NZD/JPY	82	81	80	79	78	78	79	79	79
NZD/EUR	0.64	0.61	0.59	0.61	0.61	0.61	0.61	0.61	0.60
NZD/GBP	0.56	0.54	0.53	0.53	0.53	0.54	0.54	0.53	0.54
NZD TWI	78.4	76.4	74.3	74.9	74.9	75.3	75.4	75.8	76.6

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