

# Economic Weekly

15 July 2019

## More inflation please

For most of the ten or so years since the GFC, central banks globally have been fighting a (sometimes losing) battle to lift inflation back up towards target levels. This week's round of global inflation figures will provide an update on how they're going. Last Friday saw a mild lift in US core inflation (to 2.1%yoy). And this week we get numbers for Japan, the UK, Canada and New Zealand. For the latter, we're expecting a lift in annual inflation to 1.7%. But don't be fooled. We don't expect inflation to rise much further from here. In our view, slack in the labour market and wider economy will ensure medium-term inflation remains low. More policy support is needed keep inflation consistent with the RBNZ's 1-3% target. We expect the OCR to be cut twice more this year.

### Key events and views

<a href="#">Foreign exchange</a>	The NZD lifted against all the major crosses over the week.
<a href="#">Interest rates</a>	NZ and global curves steepen. Our bias is for lower NZ yields.
<a href="#">Domestic events</a>	GDT dairy auction and June quarter CPI.
<a href="#">International events</a>	Inflation for Canada, UK, and Japan. Australian employment & RBA minutes, Chinese GDP
<a href="#">Calendars</a>	NZ and international calendar of upcoming economic events.

### Chart of the Week: Fed Hedging Its Bets

Last week's FOMC minutes and 'Fed speak' all but confirmed the US Federal Reserve will kick-start a cash rate easing cycle at the end of the month. Our CBA colleagues now expect 25bps cuts to the Fed Funds rate in July, September, December, and March 2020. It's not so much a story of a terribly weak economy. After all, US economic growth is near potential, the unemployment rate is near generational lows, and core inflation close to target. It's more about the Fed taking out insurance against the risks of falling core inflation (see chart opposite) and stuttering business investment.

**So what does it mean for NZ?** First, the RBNZ will probably feel more comfortable lowering the OCR given its concerns about running monetary policy out of sync with the rest of the world. Second, downward pressure on the long-end of the NZ yield curve will continue, or even intensify (US long-rates tend to be the biggest driver of longer-term NZ yields). Third, support for the currency. Lower US interest rates means more juice for the NZD/USD via the interest rate differential channel, another reason the RBNZ will be keen to stop NZ interest rates getting too far out of sync with those in the US.



## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6694	0.6638	0.6534	0.6768	FLAT/UP	0.6520	0.6800	UP
NZD/AUD	0.9536	0.9499	0.9467	0.9126	FLAT/UP	0.9350	0.9680	FLAT
NZD/JPY	72.22	71.90	70.78	76.25	FLAT	70.80	73.70	UP
NZD/EUR	0.5939	70.78	0.5796	0.5805	FLAT	0.5820	0.6060	FLAT
NZD/GBP	0.5324	0.5296	0.5154	0.5137	FLAT	0.5220	0.5430	FLAT
TWI	73.3	72.7	71.9	72.52	FLAT/UP	N/A	N/A	FLAT

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

### NZD Recap

**The NZD lifted against all the major crosses over the week.** The **USD** fell sharply on Wednesday night after expectations for a July Fed Funds rate cut were reinforced by both comments from the Federal Reserve Chairman Powell and the Committee meeting minutes. Powell said, in his testimony to Congress, that because of heightened uncertainties at the June meeting, *“many FOMC participants saw that a case for a somewhat more accommodative monetary policy had strengthened”*. At his second day of testifying to congress Powell reiterated that there were numerous downside risks facing the US economy, including declines in global manufacturing and business confidence due to heightened trade tensions. Meanwhile, echoing the Fed’s global growth concerns, **the Bank of Canada** left rates on hold overnight as expected, but signalled caution over the economic outlook noting *“the outlook is clouded by persistent trade tensions”*. The **EUR** fell on Thursday night following the release of the European Central Bank June meeting minutes, which reiterated that policy makers are ready to further ease monetary policy. The **AUD** remained weighed down as business confidence continued to fall in June, despite the Coalition’s election win in May.

### Near-term outlook

We expect the USD to consolidate this week ahead of the Federal Reserve’s 31 July policy meeting, with some **risk of a weaker USD**. We expect the Federal Reserve to cut the Fed Funds rate three times over 2019 (July, September and December). **The NZD/USD and NZD/AUD could drift higher this week.** We expect Q2 CPI to lift 0.6% qoq (released Tuesday 10.45am), in line with the Reserve Bank of New Zealand (RBNZ) May MPS forecast. We expect the RBNZ’s core inflation measure to remain below 2% and for the RBNZ to further cut the OCR 50 basis points over 2019. We expect the AUD to be influenced by Chinese economic data (released Monday), the minutes of the Reserve Bank of Australia’s July meeting (released Tuesday) and the June labour force report (released Thursday). We see some downside risk to both Chinese economic data and Australian June jobs growth, which could weigh on the AUD.

### Medium-term outlook

**We expect the NZD to track a sideways range in the near term.** NZ monetary policy looks set to move relatively in-sync with some of our key trading partners, essentially nullifying relative interest rate expectations as a key driver of currency markets. We expect the RBA, RBNZ, and US Fed to all cut policy interest rates over the coming months.

**Further ahead, we expect the NZD to firm against most crosses from late 2019 onwards.** The NZD/USD will be supported by NZ’s high Terms of Trade while the USD remains under downward pressure from Federal Reserve interest rate cuts. We expect the NZD/AUD to remain close to 0.95 over 2019 and to subsequently firm.

### ASB foreign exchange forecasts

(end of quarter)

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual		forecast >>				
NZD/USD	0.68	0.67	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.96	0.96	0.94	0.94	0.95	0.96	0.97
NZD/JPY	75	72	71	74	75	78	79
NZD/EUR	0.60	0.59	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.52	0.53	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.9	73.2	70.2	72.7	73.1	75.1	75.8

## Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.50	1.50	1.50	1.75	UNCH	UP
90-day bank bill	1.58	1.62	1.57	1.94	UNCH/DOWN	UP
2-year swap	1.36	1.31	1.37	2.16	UNCH/DOWN	UP
5-year swap	1.47	1.39	1.48	2.55	UNCH/DOWN	UP
10-year swap	1.86	1.74	1.84	3.03	UNCH/DOWN	UP
10-year govt bond yield	1.62	1.55	1.65	2.86	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.50	0.42	0.47	0.88	UNCH	UNCH/UP

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

### Market Recap

**NZ and global yields start the week higher for most tenors, with steeper curves.** As we had foreshadowed, NZ and global yields initially ticked higher last week, as solid US payrolls data had markets questioning whether they had gotten too far ahead of themselves in terms of US rate cut expectations. In the middle of the week, global and NZD yields eased lower on concerns over the global growth outlook and the likelihood of more policy support after dovish congressional testimony from Fed Chair Powell and Fed Minutes. Global and NZ yields then rose following the stronger than expected print for US core inflation, which saw the US Treasury 2s10s curve steepen the most since October (2Y 1.85%, 10Y 2.12%), with close to 70bps of Fed cuts over 2019 now expected. The Bank of Canada held the policy rate at 1.75% but provided a dovish policy assessment, citing concerns on ongoing uncertainty. Soft Chinese trade data over the weekend suggests more policy support is likely forthcoming.

### Near-term NZD interest rate outlook

Current market pricing has close to 85% odds of a 25bp OCR cut priced in for August and about 40bps of cuts by November before the OCR troughs at around 1% in mid-2020. **We have maintained our downward bias for NZ interest rates, given our lower OCR view and view of the risk profile.** Tomorrow's Q2 CPI outturn is expected to be close to May Monetary Policy Statement (MPS) projections (+0.6% qoq, 1.7% yoy), with risks tilted to the downside and with no inflationary smoking guns on the horizon. Nor do we expect Q2 domestic labour market (Aug 6) data to be strong enough to delay an August OCR cut. Tomorrow's RBA Minutes from the July meeting will provide more insights into the reasons why the RBA cut the cash rate to a record low 1%, and whether it could move lower still. A tick higher in the 5.2% unemployment rate on Thursday (mkt: 5.2%) could see market expectations of RBA interest rate cuts bought forward (the next cut is not fully priced in until next March), likely dampening NZ yields. We expect longer-term NZ yields (10Y NZGB 1.61%) to remain range-bound, but sensitive to movements in US Treasury yields.

### Medium-term outlook

**Our bias is for the curve to initially steepen and then to progressively flatten as policy easing this year precedes mild policy tightening.** We expect 25bp cuts in August and November, with the OCR to remain at 1%, until a gradual RBNZ tightening cycle commences from early 2022. Slowing global growth is expected to result in more policy stimulus offshore. We expect 100bps of interest rate cuts by the Fed (July, September, December, and March 2020), 25bps of cuts by the RBA (November), with policy easing by the ECB and Peoples Bank of China. Inflation looks set to remain low and interest rate normalisation from global central banks a long way off, capping long-term interest rates.

### ASB interest rate forecasts

(end of quarter)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual		>> forecast >>					
NZ OCR	1.75	1.50	1.25	1.00	1.00	1.00	1.25	1.75
NZ 90-day bank bill	1.9	1.7	1.5	1.3	1.3	1.3	1.6	2.0
NZ 2-year swap rate	1.6	1.4	1.3	1.2	1.2	1.2	1.6	2.0
NZ 5-year swap rate	1.8	1.4	1.4	1.4	1.4	1.5	1.9	2.3
NZ 10-year swap rate	2.2	1.8	1.8	1.8	1.8	1.9	2.1	2.3
NZ 10-year Bond	1.8	1.6	1.6	1.6	1.6	1.7	1.9	2.1

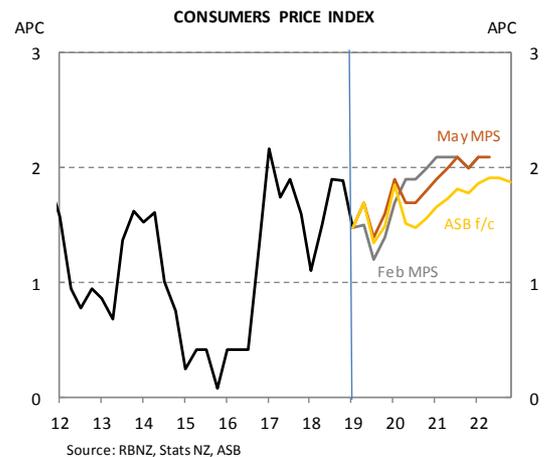
## Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
Consumers Price Index, 2019 Q2, %qoq	16/07	10:45 am	+0.1	+0.6	+0.6
GlobalDairyTrade auction, whole milk powder, % change	17/07	Overnight	-4.3	-	+1.0

**Courtesy of higher fuel prices, we expect overall consumer prices to rise 0.6% in the June quarter (+1.7% yoy),** in line with the RBNZ’s May Monetary Policy Statement (MPS) forecast. Risks are tilted to the downside. Tradable prices are expected to climb 1.0% (+0.2% yoy), with non-tradable prices up 0.3% qoq (2.9% yoy). Abstracting from seasonal and transitory influences on the inflation process, we expect annual readings from the core inflation measures produced by Statistics NZ to oscillate around 2%, with annual inflation from the RBNZ sectoral factor model stuck below 2%. Our view is that downside risks to the inflation outlook have continued to grow, with the NZ economy looking increasingly unlikely to be able to comfortably meet the RBNZ’s inflation and labour market objectives.

We believe the RBNZ will cut the OCR by a further 50bps over 2019 (August and November).

**We expect whole milk powder prices to lift 1% at the GlobalDairyTrade auction overnight Tuesday.** A fortnight ago, whole milk powder (WMP) prices fell by 4.3%. At the current juncture, futures pricing also points to rise of around 1%. Over the next few auctions, dairy auction prices are likely to continue to post small changes either way until it becomes clearer as to the strength, or otherwise, of NZ spring production.



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
China Retail Sales, June, %yoy	15/07	2.00 pm	8.5	8.4
China Industrial Production, June, %yoy	15/07	2.00 pm	5.2	5.2
China GDP, Q2, %qoq	15/07	2.00 pm	6.3	6.2
Australia Meeting Minutes, July	16/07	1:30 pm	-	-
US Retail Sales, June, %mom	17/07	12:30 am	0.1	0.2
UK CPI, June, %mom	17/07	8:30 pm	0.0	0.0
Australia Employment, June, 000s	18/07	1:30 pm	9	5
Japan CPI, June, %yoy	19/07	11:30 am	0.7	0.8

\*Originally published by CBA Global Markets Research on Friday 12<sup>th</sup> July at 1.34pm.

We forecast **China's retail sales** growth to ease to 8.4%yoy in June, following May's sharp rebound, because of fading holiday effects. **Industrial production** growth should have rebounded to 5.2%yoy as holiday effects fade away and the number of working days increased in June. We forecast **Q2 GDP** growth to be 6.2%yoy as partial indicators have been soft, particularly investment.

On Tuesday, **the Reserve Bank of Australia will publish its minutes from the July Board meeting** at which the central bank cut the cash rate for the second month in a row. In a post-meeting speech, Governor Lowe left the door open for another rate cut down the track, saying "the Board is prepared to adjust interest rates again if needed to get us closer to full employment and achieve the inflation target." We think that the RBA will now want to wait and assess the impact of the latest cash rate cuts and personal income tax cuts. We expect another cut to the cash rate towards the end of the year – most probably November. The RBA wants to see the unemployment rate down around the 4.5% mark.

**Australian jobs numbers** lifted by a very strong 42,000 last month. The participation rate rose to a record 66% high. The Federal election may have impacted the result with around 80,000 temporary workers hired. Some of these workers may have already had a job. But some may have been out of the work force so their involvement in the election would have boosted jobs and the participation rate. With these temporary jobs rolling off after the election we expect only a small 5,000 lift in jobs in June. Combined with a tick down in the participation rate to 65.9%, we expect the unemployment rate to stay at 5.2%.

The already-released Tokyo CPI suggests **Japan's headline CPI** accelerated modestly to 0.8%yoy in June. Likewise, the national core CPI (excluding fresh food and energy) accelerated to 0.6%yoy. However, both inflation measures are well below the Bank of Japan's 2%yoy target.

We estimate a modest 0.2%mom increase in **US headline retail sales** because gasoline prices decreased by 4% in June. However, we expect the 'control group' to increase solidly by 0.4%mom because of the strong labour market and growth in wages.

We expect headline **UK CPI** remained unchanged at 2.0%yoy in June. UK wage growth is running above 3%yoy and is supporting UK inflation, despite ongoing economic uncertainty related to Brexit.

## Key Forecasts

### ASB NZ economic forecasts

	Mar-19 << actual	Jun-19 forecast >>	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
GDP real - Q%	0.6	0.7	0.7				
GDP real - A%	2.5	2.3	2.6	2.7	2.8	2.4	2.4
GDP real - AA%	2.7	2.5	2.5	2.5	2.6	2.6	2.4
CPI - Q%	0.1	0.6	0.5				
CPI - A%	1.5	1.7	1.3	1.5	1.9	1.7	1.9
HLFS employment growth - Q%	-0.2	0.4	0.4				
HLFS employment growth - A%	1.5	1.3	0.7	1.1	1.7	1.6	1.4
Unemployment rate - %sa	4.2	4.4	4.4	4.5	4.4	4.2	4.1
Annual current account balance as % of GDP	-3.6	-3.4	-3.3	-3.3	-3.2	-3.1	-3.0

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

	Mar-19 << actual	Jun-19 forecast >>	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)							
NZ OCR	1.75	1.50	1.25	1.00	1.00	1.00	1.25
NZ 90-day bank bill	1.9	1.7	1.5	1.3	1.3	1.3	1.6
NZ 2-year swap rate	1.6	1.4	1.3	1.2	1.2	1.2	1.6
NZ 5-year swap rate	1.8	1.4	1.4	1.4	1.4	1.5	1.9
NZ 10-year swap rate	2.2	1.8	1.8	1.8	1.8	1.9	2.1
NZ 10-year Bond	1.8	1.6	1.6	1.6	1.6	1.7	1.9

### ASB foreign exchange forecasts

	Mar-19 << actual	Jun-19 forecast >>	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)							
NZD/USD	0.68	0.67	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.96	0.96	0.94	0.94	0.95	0.96	0.97
NZD/JPY	75	72	71	74	75	78	79
NZD/EUR	0.60	0.59	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.52	0.53	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.9	73.2	70.2	72.7	73.1	75.1	75.8

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