

Economic Weekly

17 June 2019

Super Thursday

Local financial markets are bracing themselves for volatility on ‘Super Thursday’ this week, with a trifecta of events taking place for the US, NZ and Australian interest rate outlooks. The **US Federal Reserve** kicks off the action on Thursday morning and is widely expected to leave interest rates unchanged this week. But the accompanying statement and subsequent press conference will be closely scrutinised as the market now expects the Fed to start cutting the Fed Funds in the second half of 2019. The Fed is followed by **release of NZ Q1 GDP** on Thursday morning which is expected to be weak but may be overshadowed by US and Australian events taking place either side of it. Super Thursday is capped off with a potentially market-moving speech from the Reserve Bank of Australia Governor.

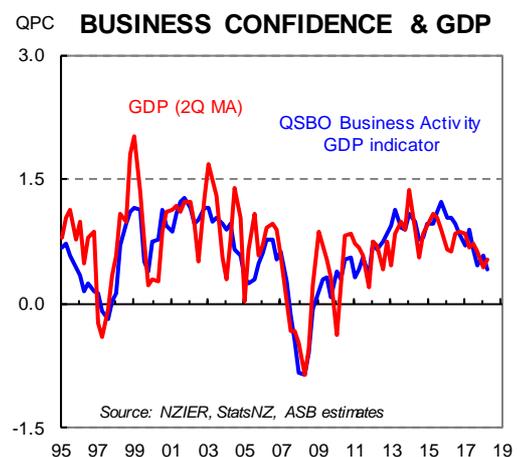
Key events and views

Foreign exchange	NZD underperforming, but Fed may provide support
Interest rates	NZ yields continued to decline and are currently hovering around record lows.
Domestic events	Global Dairy Trade auction, Q1 Current Account and GDP.
International events	RBA meeting minutes, RBA speech, Federal Reserve interest rate announcement.
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: Economic anxiety

The **first estimate of NZ Q1 GDP is released on Thursday** and is likely to confirm **the third consecutive quarter of sub-par growth**. We expect Q1 GDP growth of 0.5% qoq, while the RBNZ assumed 0.4% in the May Monetary Policy Statement. Despite strong supports from high Terms of Trade and low interest rates, the NZ economy is still losing momentum. **Business confidence surveys suggest rising costs coupled with weak demand have ground down profitability**. The NZ economy does not appear to be alone in its recent deceleration, with many other key global trading partners experiencing a slowdown in growth.

With growth slowing more than expected, the **RBNZ has been prompted to action by cutting the OCR in early May**. However, the monthly ANZ business outlook survey showed business confidence remained low in May. The June survey will be closely watched for signs of improving sentiment, as will the **Q2 Quarterly Survey of Business Opinion (released in early July)**. **The latter has had a very strong track record in estimating the underlying trend in NZ GDP growth**. Continued signs of economic anxiety will likely prompt the RBNZ into cutting the OCR again in August.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6497	0.6633	0.6537	0.6954	UP	0.6445	0.6530	UP
NZD/AUD	0.9454	0.9514	0.9489	0.9314	FLAT/UP	0.9350	0.9650	UP
NZD/JPY	70.49	72.06	71.72	77.01	FLAT/UP	70.00	71.10	UP
NZD/EUR	0.5795	0.5865	0.5847	0.6010	FLAT/UP	0.5707	0.5830	UP
NZD/GBP	0.5158	0.5217	0.5109	0.5247	FLAT/UP	0.5130	0.5200	UP
TWI	71.9	72.9	72.1	73.47	FLAT/UP	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 NZD was the weakest performing G10 currency last week. The local market appears to be gunning for more RBNZ rate cuts, and last week's NZ economic data played into its hands. The NZ manufacturing PMI was particularly weak, slipping 2.8 index points to the lowest level since 2012. Other data was a little more mixed, but the local rates market nevertheless moved to price a 20% chance of a RBNZ rate cut next week. Globally, **the USD managed to recoup some of its recent losses** last week. The combination of a stronger USD and further falls in local wholesale interest rates (to record lows) saw the NZD/USD fall around 2.5% to key support levels around 0.6490.

Near-term outlook

The NZD/USD has scope to lift this week if the FOMC hints at near-term rate cuts on Thursday, as we expect. Recent speeches by Fed officials have indicated a growing wariness of the inflation outlook and a willingness to act if required. We expect the FOMC to formalise this view on Thursday. While the Fed Funds rate will be left at 2.25-2.5%, we expect the accompanying statement to play up the downside risks facing the US economy and hint that the Fed Funds rate could be lowered at upcoming meetings (the market is basically fully priced for a cut by July). The other big event of the week (also on Thursday) is **Q1 NZ GDP**. Market expectations are for a 0.6%q/q lift in GDP, higher than the RBNZ's forecast of 0.4% (ASB 0.5%). Given local markets already price a 20% of a July RBNZ rate cut, we believe a strong downside surprise would be required to push NZD/USD lower on the day against an under-pressure USD.

Finally, **NZD/AUD has been strongly range-bound for weeks.** It's a sign of the synchronous nature of antipodean monetary policy. Growth in NZ and Australia is slowing and both the RBA and RBNZ are cutting rates and have easing biases. The cross is currently flirting with key support around 0.9445. We suspect this will hold for now. The RBA Governor is speaking this week and the risk is he toes a dovish line. Coupled with a solid result from NZ GDP, this could see the NZD/AUD recover over the week.

Medium-term outlook

The **NZD** is expected to soften in the near term, weighed by a lower OCR, weaker global growth and elevated trade tensions. However, we expect the NZD to remain supported over the medium term, firming against most crosses from late 2019 onwards. The **NZD/USD** will be supported by NZ's high terms of trade while the USD will be led lower by interest rate cuts from the Federal Reserve from late 2019. We expect the NZD/AUD to remain close to 0.94 over 2019 and to subsequently firm.

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	0.65	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.95	0.96	0.94	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.58	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.52	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	71.3	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/DOWN	UP
90-day bank bill	1.58	1.61	1.71	2.00	UNCH/DOWN	UP
2-year swap	1.37	1.42	1.55	2.24	UNCH/DOWN	UP
5-year swap	1.48	1.55	1.68	2.68	UNCH/DOWN	UP
10-year swap	1.84	1.93	2.07	3.14	UNCH/DOWN	UP
10-year govt bond yield	1.63	1.68	1.79	2.92	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.47	0.51	0.53	0.90	UNCH/UP	UNCH/UP

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

Market Recap

NZ yields continued to decline and are currently hovering around record lows. Catalysts were mostly global, although the NZ manufacturing PMI fell to its lowest level since 2012. Low US inflation and concerns over global growth have seen market pricing for Fed cuts firm, with a July cut close to fully priced and nearly 70bps of cuts by the end of the year. Australasian yields declined following mixed Australian labour market data, with the current 5.2% unemployment rate still well above the Reserve Bank of Australia's (lower) sub-4.5% estimate of the non-accelerating inflation rate of unemployment (NAIRU). Markets are currently about 60% priced for a July RBA cut. Pressuring Australasian yields lower was the release of a media article on what quantitative easing might look like in Australia. Global yields remained marooned in the lower part of recent trading ranges, although UK yields spiked higher as odds of a Bank of England cut eased following stronger labour market data. Generally soft May Chinese data were met by signals that the Peoples Bank of China would potentially be increasing policy stimulus.

Near-term NZD interest rate outlook

There has been a sizeable fall in NZ wholesale interest rates and flattening of the curve since the start of the year: down 43bps (3-months) to 130bps (10-years). An August OCR cut is about 80% priced in, with current market pricing suggesting the OCR (currently 1.50%) will trough just above 1% by mid-2020. The low Q1 GDP pick by the RBNZ (+0.4% qoq, ASB +0.5% qoq, mkt: +0.6% qoq), likely reduces downside risk to NZ yields. **Our published forecasts have the OCR plateauing at 1.25%, but we are reluctant to deviate from our mild downward bias for NZ rates given the global risk profile.** The increasingly dovish tone by global central banks, and concerns over global growth could likely dampen global yields and further flatten curves. RBA Governor Lowe is speaking on Thursday ("The labour market and spare capacity"), and minutes from the June meeting are released tomorrow. On Thursday, the Federal Open Market Committee is expected to keep the Fed funds rate unchanged, but we expect a more dovish accompanying statement. Focus will be on whether the published 'dot plots' - the March plots had no 2019 moves and one 25bp 2020 hike - signal a formal easing bias. There is also a non-negligible risk of that the Bank of Japan increases policy accommodation, although the Bank of England is likely to maintain its "gradual" and "limited" tightening bias.

Medium-term outlook

OCR moves by the RBNZ will depend on the tenor of domestic data, the NZD, global developments and actions of other central banks. Following a further 25bp cut over 2019 August, we expect the OCR to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak by late 2023. **Global central banks are expected to trim policy rates.** We expect a follow-up 25bp cut from the RBA in August (to 1.00%), with the Federal Open Market Committee to start cutting the 2.25-2.5% Federal Funds rate from late 2019 (100bps of Fed cuts in total). **Global and NZD long-term interest rates are expected to drift higher, but settle at historically-low levels.**

ASB interest rate forecasts

(end of quarter)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
		<< 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	1.6	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.5	1.4	1.4	1.4	1.4	1.8
NZ 10-year Bond*	2.38	1.8	1.7	1.7	1.6	1.7	2.1	2.3

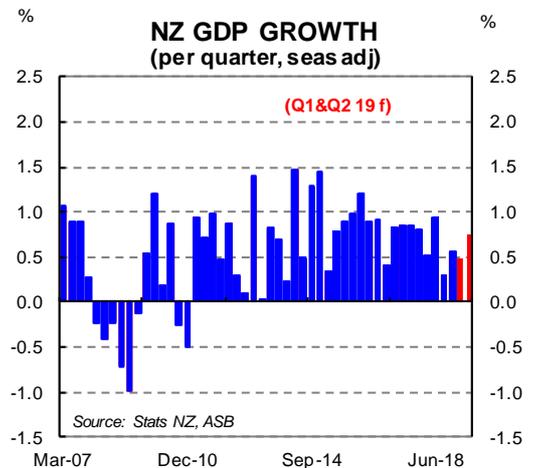
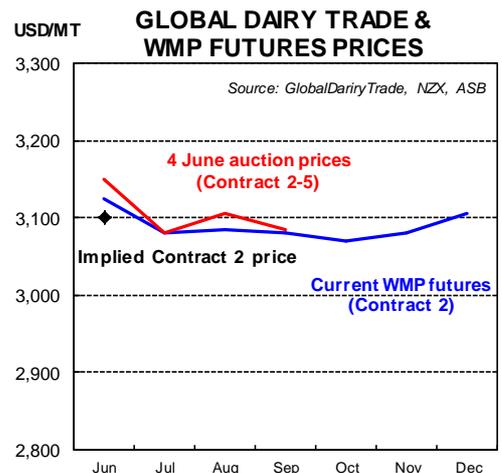
Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	18/06	overnight	-1.5	-	-2.0
Current Account balance, Q1, % of GDP	19/06	10:45am	-3.7	-3.5	-3.4
GDP, Q1, %qoq	20/06	10:45am	0.6	0.6	0.5

We expect whole milk powder prices to fall 2% at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices fell by 1.5%. At the current juncture, futures pricing points to a fall of around 1%. With prices relatively high, it appears that buyers are sitting on their hands and waiting for the spring lift in NZ production. This situation is leading prices to drift lower. However, we anticipate that prices will eventually move higher as we expect NZ spring production to undershoot production levels from a year ago.

We expect NZ's current account deficit to narrow to 3.4% of GDP over Q1. The Q4 deficit came in at 3.7% of GDP, widening from 3.6% in Q3. That said, the seasonally-adjusted balance actually strengthened over the quarter. Over Q1, NZ posted record dairy export values, which will boost the current account balance. Over the remainder of 2019, we expect the deficit as a % of GDP to narrow further, as export values strengthen and global interest rates remain very low.

We expect Q1 GDP lifted by 0.5% qoq (production basis) which should see annual growth remain steady at 2.3%. NZ economic growth slowed over the second half of 2018, and looks to have remained subdued over the first quarter of 2019. The Reserve Bank of New Zealand (RBNZ) has taken note and has assumed Q1 GDP growth of just 0.4% qoq at the May Monetary Policy Statement (MPS), with the economy currently growing below its potential. The low GDP pick by the RBNZ suggests it is less likely it will be surprised this time around by a weaker than expected outcome. Our focus is whether the foreshadowed strengthening in economic activity eventuates. We expect more policy support may be needed for the RBNZ to meet its inflation and labour market objectives, with the OCR likely to move lower in the second half of 2019.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Meeting Minutes, June	18/06	1.30pm	-	-
UK CPI, May, %mom	19/06	8.30pm	0.3%	-
RBA Governor Lowe Speech	20/06	2.35pm	-	-
US Fed Interest Rate Announcement, %	20/06	6.00am	2.25-2.50	2.25-2.50
Bank of England Interest Rate Announcement, %	20/06	11.00pm	0.75	0.75
Bank of Japan Interest Rate Announcement, %	20/06	-	-	No change
Japan CPI, May, %yoy	21/06	11.30am	0.7	0.7
European Union Summit	20/06-21/06	-	-	-

*Originally published by CBA Global Markets Research on Friday 14th June at 12:52 pm.

The Reserve Bank of Australia's (RBA) June meeting minutes are due out Tuesday. The central bank has emphasised the need to bring the unemployment rate lower to push inflation back up to target. We expect the RBA to cut the cash rate to 1.0% in August and will be looking for any commentary that may suggest the RBA will move sooner than this.

The **UK's headline and core CPI inflation** figures are expected to slow in May at an annual pace of 2.0% and 1.6%, respectively. Overall, the UK's inflation dynamic is tracking the Bank of England's (BoE) projection. The BoE forecast headline CPI inflation sitting at 2.1% in Q2.

RBA Governor Lowe is slated to speak on "the labour market and spare capacity". The RBA has recently updated its estimates and now sees full employment at an unemployment rate around 4.5%. Previously the central bank had estimated full employment at an unemployment rate around the 5% mark. With the unemployment rate currently sitting at 5.2% there is still plenty of capacity in the labour market.

We expect the US Federal Reserve to leave the Fed funds rate unchanged. However, we expect a more dovish accompanying statement. Low consumer inflation expectations and falling non-farm unit labour costs are weighing on the inflation outlook. Previously, the Fed had largely viewed weak inflation as transitory. However, Fed officials have been increasingly cognisant of the risk that inflation falls further. We expect the central bank to formalise this view on Thursday by hinting that near-term cuts to the Fed funds rate are possible.

The Bank of England (BoE) is widely expected to leave the Bank Rate at 0.75% and maintain the stock of its asset purchases at £445bn. Judging from recent comments from BoE policymakers, the UK central bank will also reiterate its "gradual" and "limited" tightening bias.

We expect the Bank of Japan to leave rates unchanged, but there is a non-negligible risk that the BoJ eases monetary policy further. Inflation remains low and GDP growth risks are slowing further. BoJ Governor Kuroda said as recently as last week that he is open to more easing if required. But, the BoJ is also conscious of the negative side effects of very accommodative monetary policy.

Already-released Tokyo inflation suggests **Japan's national headline CPI** eased slightly to 0.7% yoy due to slowing gas and electricity prices. We expect core inflation (excluding fresh food & energy) to ease to 0.5% yoy.

European Union (EU) leaders are set to meet in Brussels to appoint new Presidents for the European Commission, European Council and European Central Bank (ECB). As a background, the European Council sets the EU's overall political direction but has no powers to pass laws. The European Commission proposes and implements new laws. And the European Parliament adopt the laws. The top three contenders for European Commission President are: Manfred Weber (Germany), Frans Timmermans (Netherlands) and Margrethe Vestager (Denmark). The top contenders for ECB President are: Jens Weidmann (Germany), Benoit Coeure (France), Francois Villeroy (France), Olli Rehn (Finland) and Erkki Liikanen (Finland). The new Presidents of the ECB and European Commission take office on 1 November.

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	0.5	0.8					
GDP real - A%	2.3	2.3	2.1	2.5	2.7	2.9	2.5	2.4
GDP real - AA%	2.8	2.6	2.3	2.3	2.4	2.6	2.7	2.4
CPI - Q%	0.1	0.1	0.7	0.6				
CPI - A%	1.9	1.5	1.8	1.6	1.6	1.8	1.7	1.8
HLFS employment growth - Q%	0.0	-0.2	0.4					
HLFS employment growth - A%	2.3	1.5	1.3	0.7	1.1	1.7	1.6	1.4
Unemployment rate - %sa	4.3	4.2	4.3	4.4	4.4	4.4	4.3	4.1
Annual current account balance as % of GDP	-3.7	-3.4	-3.0	-2.9	-2.7	-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

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(end of quarter)								
NZ OCR	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.50
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NZ 2-year swap rate*	1.97	1.6	1.5	1.4	1.4	1.4	1.4	1.8
NZ 10-year Bond*	2.38	1.8	1.7	1.7	1.6	1.7	2.1	2.3

ASB foreign exchange forecasts

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(end of quarter)								
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NZD/AUD	0.95	0.96	0.94	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.58	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.52	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	71.3	70.2	72.7	73.1	75.1	75.8

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