

Economic Weekly

18 February 2019

NZD outlook: firm with a chance of firmer

The RBNZ was on hold last week as expected and pushed out the timing of its first OCR hike by around six months. However, the RBNZ's statement wasn't as cautious as financial markets had expected. This apparent lack of caution sent NZ interest rates higher following the announcement, taking the NZD with it. On the currency, we have updated our suite of currency forecasts and discuss them on Page 2. On the whole, we expect the NZD to be stronger against all major crosses than we had forecast previously.

Key events and views

[Key Insights](#)

Currency Forecast Update.

[Foreign exchange](#)

NZD up against all the major crosses following RBNZ statement on Wednesday.

[Interest rates](#)

NZ yields lift as RBNZ not as dovish as markets had expected.

[Domestic events](#)

GlobalDairyTrade auction.

[International events](#)

Australian January employment; US Federal Reserve meeting minutes.

[Calendars](#)

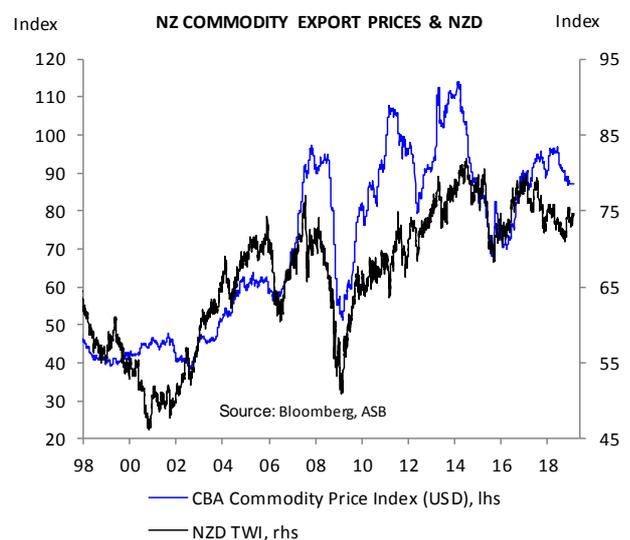
NZ and international calendar of upcoming economic events.

Chart of the Week: Robust commodity prices helping elevate NZD

The NZD firmed against most crosses last week as the RBNZ announcement was not as dovish as expected by the market. The trade-weighted index (TWI) starts this week about 1½% higher than a week ago. **Whilst the TWI lies below 2014 and 2016 highs, its resilience has been notable.** The NZD strength has occurred despite falling NZD interest rates, with NZ 10-year bond yields close to 50 basis points below US counterparts.

One explanation for the NZD's strength has been New Zealand's **elevated Terms of Trade**, which have been bolstered by higher export commodity prices. New Zealand's strong public finances and perception as being a **safe and stable economy has also likely supported the dollar.**

On page two, we summarise our updated FX forecasts, which depict a solid NZD outlook. However, if the global outlook was to deteriorate significantly, the NZD would likely fall, lessening the adjustment needed from NZD interest rates and the wider economy.



Key insights this week: Currency Forecast Update

- We expect the NZD to strengthen, given the well-performing New Zealand economy, upgrade to New Zealand's sovereign outlook by selected international credit rating agencies, persistently high New Zealand terms of trade, and the continued investor interest in New Zealand assets.
- The global economy has slowed notably in early 2019 and the Fed has halted raising interest rates.
- We don't see the USD depreciating much because we can't see what the USD will weaken against.
- In response to the Eurozone's slowdown, the ECB will now lift interest rates in Q4 2020. EUR appreciation is delayed.
- AUD forecasts are slightly lower reflecting the global slowing and lift in Australian domestic economic risks.

This summarises a report by CBA FX Strategy – "Forecasts Changed as Global Economy Slows" that was published by CBA Global Markets Research at 3.20pm on Thursday, February 14, 2019)

Alteration to the currency forecasts

With the global economy slowing notably in early 2019, and the Fed signalling it will remain "*patient as it determines what future adjustments to the target range for the Federal funds rate may be appropriate*", we have decided to adjust our foreign exchange forecasts. This is our first change since 22 August 2018.

Our NZD forecasts have been lifted slightly to reflect the well-performing New Zealand economy, the upgrade to New Zealand's sovereign outlook by selected international credit rating agencies, the persistently high New Zealand terms of trade, and the continued investor interest in New Zealand assets.

We have also tweaked our strong USD view in light of the Fed shifting to a neutral bias. Despite the Fed halting interest rate rises, and the rates market partially-pricing in potential future Fed rate cuts, we don't believe the USD will weaken much in H1 2019. That is because we can't see what the USD will weaken against. Neither the Eurozone, UK, Chinese or Japanese economies are obvious recipients of currency strength at this point in the economic cycle.

Our AUD forecasts have been lowered slightly because the risks to Australia's economy have now become more evenly-balanced. Previously there were upside risks to Australia's economy. The RBA have revised down their GDP growth and inflation forecasts, and noted a fifty-fifty chance the next move in interest rates is either a rate rise or a rate cut. In the short-term, the slowing global economy, and the risk of slower growth in Australian household consumption as Australia's housing adjustment continues, will limit AUD upside.

Europe's economy has softened notably, with a negative quarter of growth recorded in Germany during Q3, and a technical recession currently underway in Italy. Furthermore, the Eurozone leading indicators are not yet suggesting a pick-up in Eurozone economic activity. **We have delayed our forecast of when ECB raises interest rates from Q4 2019 to Q4 2020 and delayed the timing of when the EUR appreciates.**

The U.K. economy has slowed because of structural and cyclical reasons associated with Brexit, and the global economic slowdown. There remains a tremendous amount of uncertainty associated with the final terms of the Brexit outcome, and hence the immediate direction of GBP. But it is clear the U.K. economy has been negatively affected by the political uncertainty and it will take some time before the GBP can fully recover to its pre-Brexit level. We currently don't have GBP reaching its pre-Brexit level in the forecast

profile. We have not changed our twelve-month GBP forecasts, but have tweaked our forecasts further out than this.

China's economy continues to slow at an orderly pace. However, the risks of an even slower economic outcome have risen. The Chinese authorities have responded with fiscal and monetary stimulus, and the likelihood is that more policy stimulus will be delivered. **We still expect the CNH to weaken, but we are now forecasting less CNH depreciation than previously.** This is because we have lowered our forecast for China's current account deficit, and because of higher capital inflows into China associated with China's inclusion into major global benchmark equity and bond market indices.

Japan's economy has slowed and the economy is expected to find it challenging adjusting to a planned VAT increase in October 2019. **We have adjusted our JPY forecasts to show slightly less JPY strength over the next two-years.** But our longer-term JPY forecast still reflects a moderately stronger JPY, reflecting Japan's sizeable current account surplus.

NZD vs.	USD	GBP	AUD	JPY	EUR	NZ TWI	NZD/CNY
Mar-19	0.68	0.55	0.96	75.48	0.60	74.15	4.62
Jun-19	0.68	0.54	0.96	76.16	0.60	73.90	4.66
Sep-19	0.69	0.54	0.96	77.28	0.60	74.53	4.76
Dec-19	0.69	0.54	0.96	76.59	0.59	74.10	4.83
Mar-20	0.70	0.54	0.96	77.00	0.59	74.78	4.97
Jun-20	0.70	0.53	0.96	76.30	0.58	74.15	4.90
Sep-20	0.70	0.53	0.95	75.60	0.58	73.59	4.83
Dec-20	0.71	0.55	0.96	76.68	0.58	74.31	4.83
Mar-21	0.72	0.55	0.96	77.76	0.59	75.02	4.90
Jun-21	0.73	0.55	0.97	78.11	0.59	75.88	4.96
Sep-21	0.74	0.57	0.99	78.44	0.59	76.60	5.03
Dec-21	0.73	0.56	0.97	78.11	0.59	75.69	4.96
Mar-22	0.74	0.57	0.97	79.92	0.60	76.62	5.03
Jun-22	0.75	0.58	0.97	81.00	0.61	77.51	5.10
Sep-22	0.75	0.58	0.97	81.75	0.61	77.54	5.10
Dec-22	0.75	0.58	0.97	82.50	0.61	77.59	5.10

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6857	0.6896	0.6760	0.7413	FLAT	0.6720	0.7000	UP
NZD/AUD	0.9611	0.9514	0.9399	0.9313	FLAT	0.9450	0.9720	FLAT
NZD/JPY	75.72	75.51	73.93	78.63	FLAT	74.40	77.40	UP
NZD/EUR	0.6069	0.6016	0.5931	0.5911	FLAT	0.5950	0.6200	FLAT
NZD/GBP	0.5311	0.5274	0.5210	0.5249	FLAT	0.5220	0.54300	UP
TWI	74.6	74.6	73.2	75.56	FLAT	73.0	75.0	UP

^ Weekly support and resistance levels * Current as at 11.25am Tuesday; week ago as at Tuesday 5pm

NZD Recap

NZD lifted against all the major crosses following the RBNZ's February OCR announcement and Monetary Policy Statement. The **RBNZ was less "dovish" than the market was expected**, only delaying rate hikes by 6 months compared to an informal market expectation that the RBNZ would completely remove hikes in its OCR forecast. Meanwhile, offshore sentiment remained reasonably upbeat last week, with the USD firm despite weak US economic data. Market participants remain optimistic a deal can be reached between US and Chinese officials in the current round of trade talks. The GBP weakened last week after the latest failed UK House of Commons vote takes the U.K. one step closer to a "no deal" exit from the European Union.

Near-term outlook

The tone of the RBA and Federal Reserve meeting minutes will be the key driver of currency direction this week.

The RBA meeting minutes (Tuesday) should provide further details on the shift to a neutral monetary stance. Meanwhile, the RBA emphasised the importance of the labour market in regard to the direction of future cash rate moves, making Wednesday's Australian wage data and Thursday employment data highly influential for the NZD/AUD this week. The USD will take direction from the tone of the U.S. Federal Reserve Meeting Minutes released on Thursday morning. The minutes could also provide clarity around future balance sheet operations. In an interview with CNBC, Federal Reserve Governor Brainard said that the "balance sheet normalisation process probably should come to an end later this year". In addition, there are a number of Federal Reserve members speaking this week. Bostic is speaking on the economy and monetary policy (Thursday), Williams is discussing inflation (Friday) and Bullard will speak on the balance sheet (Friday US time).

Medium-term outlook

We expect the NZD/USD to gradually strengthen given NZ's high Terms of Trade and continued investor interest in New Zealand assets. 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 is to remain close to 0.9600 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. We have delayed the timing the EUR appreciation as Europe's economy has softened notably and we expect the ECB will now wait until the end of 2020 before raising interest rates.

ASB foreign exchange forecasts

(end of quarter)

	Sep-18	Dec-18	Mar-19	Jun-19	Mar-20	Mar-21	Mar-22
	<< actual		forecast >>				
NZD/USD	0.66	0.67	0.68	0.68	0.70	0.72	0.74
NZD/AUD	0.92	0.95	0.96	0.96	0.96	0.96	0.97
NZD/JPY	75	74	75	76	77	78	80
NZD/EUR	0.57	0.59	0.60	0.60	0.59	0.59	0.60
NZD/GBP	0.51	0.53	0.55	0.54	0.54	0.55	0.57
NZD TWI	72.1	73.5	74.1	73.9	74.8	75.0	76.6

Interest Rate Market

<u>Wholesale interest rates</u>	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	1.90	1.91	1.90	1.86	FLAT	UP
2-year swap	1.91	1.82	1.91	2.17	FLAT	UP
5-year swap	2.09	1.97	2.15	2.73	FLAT	UP
10-year swap	2.49	2.41	2.61	3.29	FLAT	UP
10-year govt bond yield	2.21	2.13	2.32	2.98	FLAT	UP
Curve Slope (2s10s swaps)	0.58	0.59	0.69	1.12	FLAT	FLAT

* Current as at 9.55am today; week ago as at Monday 5pm

Market Recap

NZD interest rates start the week higher, undoing falls earlier in the month. Markets were positioned for a dovish RBNZ statement and NZD interest rates sold off aggressively (i.e. yields rose) after the RBNZ delivered a balanced assessment, pledged to leave the OCR on hold over 2019 and 2020 and maintained the option to move the OCR up or down. The published RBNZ projections did show a weaker short-term inflation outlook, with OCR increases being pushed out by six months and with a 20bp lower endpoint relative to November. This was similar in spirit to our published interest rate view. Australian yields retraced previous week falls that were triggered by the official switch to a neutral bias by the Reserve Bank of Australia (RBA). Global yields have traded in broad ranges; initially rising as the US Congress approved a budget deal that would prevent a pending government shutdown, but then moving lower on soft global data and President Trump declaring a state of emergency to build his border wall.

Near-term NZD interest rate outlook

We have a neutral bias for NZD interest rates. Following the large swings in NZD interest rate markets over the past few weeks, a quieter week ahead potentially looms, particularly with few events on the local calendar. **However, NZD rates still remain susceptible to shifts in global sentiment.** A softening tone is generally expected for the tenor of global data. This week's minutes from the US Federal Reserve, European Central Bank (ECB) and RBA will shed more light on the shift to neutral policy stances as will speeches from policymakers from the Fed, ECB, RBA and Bank of Canada. UK PM May will be in talks with European leaders and the odd Brexit headline could emerge. Trade will remain in focus, with President Trump hailing the "very productive" nature of US and Chinese trade talks. Global yields could nudge up if a trade deal is reached, but negotiations look set to continue for a while yet. Even if a trade deal is reached it may not be sufficient to prevent for more Chinese policy stimulus.

Medium-term outlook

Slowing global growth and increasingly prominent downside risks have us pushing out the timing of policy hikes by overseas central banks. We expect the Fed to remain "patient" and to hold policy rates at 2.25 – 2.50% over the projection period. We have also pushed back prospective monetary tightening from the Reserve Bank of Australia and European central bank (to late 2020). **We had earlier changed our OCR call and shaded down our NZD interest rate forecasts,** in light of global developments, our low inflation outlook and higher proposed bank capital requirements for locally-incorporated NZ banks. We now expect the OCR to remain on hold until February 2021 (previously August 2020). **We also expect a historically-low OCR endpoint of just 2.25% this cycle** (from late 2021). NZD long-term yields are expected to gradually firm, but mild RBNZ tightening and contained NZ inflation should cap NZ yields at low levels.

ASB interest rate forecasts

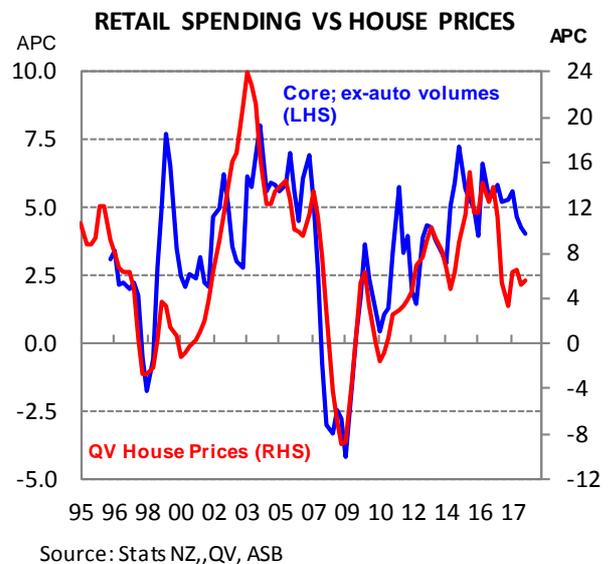
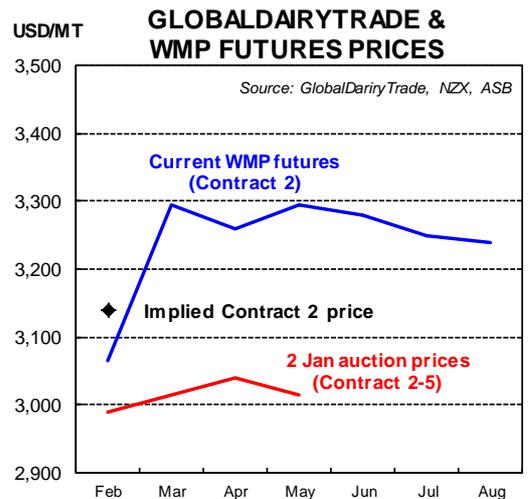
	Sep-18	Dec-18	Mar-19	Jun-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.75	1.75	1.75	1.75	1.75	2.00	2.25
NZ 90-day bank bill	1.91	1.97	1.9	2.0	2.0	2.3	2.5
NZ 2-year swap rate*	2.04	1.97	1.9	2.0	2.2	2.6	2.7
NZ 10-year Bond*	2.65	2.38	2.2	2.3	2.5	2.7	2.8

Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	19/02	Overnight	+8.4	-	+6.0
Retail Sales Volumes, Q4, % qoq	25/02	10:45am	0.0	-	+0.3

We expect whole milk powder prices to continue their recent lift at the GlobalDairyTrade auction overnight Wednesday. Two weeks ago whole milk powder (WMP) prices jumped by over 8%, and a similar result appears likely this auction. At the current juncture, futures pricing suggests WMP prices will rise by over 6%. We take this indicator at face value, particularly as key Chinese buyers return to the market after their New Year holidays.

We expect a sluggish quarter for retail sector volumes. Card spending was little changed in the December quarter (-0.1% qoq), with broadly-unchanged consumer prices over Q4. Falling vehicle registrations also point to a weak quarter for overall retail volumes. **We, do, however, expect a stronger quarterly print for core retail volumes (around 0.7% qoq), with recent falls in petrol prices likely to have supported discretionary spending.** We are also mindful of not putting too much weight on the card spending figures given the recent disconnect between the card spending data and retail sales values. The outlook for retail spending over 2019 looks finely balanced given the various headwinds (less supportive housing backdrop, slowing population growth) and tailwinds (tight labour market, prospective wage increases) facing the retail sector.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Meeting Minutes, February	19/02	1:30 pm	-	-
UK ILO Unemployment, December	19/02	10:30 pm	4.0	-
Australia Wage Price Index, Q4, %qoq	20/02	1:30 pm	0.6	0.6
US FOMC Meeting Minutes	21/02	8:00 am	-	-
Australia Unemployment Rate, January, %	21/02	1:30 pm	5.0	5.0
RBA Governor Lowe semi-annual testimony to Government	22/02	11:30 am	-	-
Japan, CPI, January, %yoy	22/02	12:30 pm	0.2	0.3

*Originally published by CBA Global Markets Research on Friday 15th February 2019 at 2.17pm.

The Reserve Bank of Australia will release its February meeting minutes on Tuesday. These minutes will discuss in detail the reasons behind the shift to a neutral bias. The Statement of Monetary Policy and Governor Lowe's speech largely date the minutes but the discussion around the change in bias will be of interest.

We expect **Australia's Q4 Wage Price Index** to have risen 0.6% over the quarter with the annual rate poised to come in at 2.3%. While there has been continued improvement in the labour market, there are limited signs of improvement in wage growth, with the underemployment rate remaining high.

We are expecting a 10,000 lift in **Australian jobs over January** with the unemployment rate likely to stay at 5.0%. Rotation effects point towards a softer headline number in January. Leading indicators of employment have also softened from very strong readings. We expect the participation rate to hold steady at 65.6%.

RBA Governor Lowe is due to appear before the House of Representatives Standing Committee on Economics. This is the Governor's semi-annual testimony. We can expect Governor Lowe to outline the reasons behind the recent shift to a neutral bias and changes to economic forecast.

Japanese headline inflation for January is likely to be depressed by weak fuel prices. We expect it to come in at only around 0.3%yoy. We estimate the Bank of Japan's preferred measure of core inflation edged higher to 0.5%yoy. However, Japanese inflation remains well below the Bank of Japan's 2%yoy target.

Leading indicators suggest the **UK unemployment rate** is projected to remain near a 43-year low of 4% in December. According to the Bank of England, the number of vacancies relative to the size of the workforce (a key indicator of labour demand) has risen to a historical high, survey indicators of recruitment difficulties are above their past averages and the ratio of redundancies to employees is close to its historical low. Tight labour market conditions also point to a further improvement in average weekly earnings growth.

The **US Federal Reserve minutes** – due out Thursday – will reveal the debate and reasons for removing the forward guidance and being “patient” on the next move in the Funds rate. The minutes may also provide insight into the committee's options for changing the balance sheet.

Key Forecasts

ASB NZ economic forecasts

	Sep-18 << actual	Dec-18 forecast >>	Mar-19	Jun-19	Mar-20	Mar-21	Mar-22
GDP real - Q%	0.3	0.5	0.8				
GDP real - A%	2.6	2.4	2.6	2.5	3.3	3.0	2.9
GDP real - AA%	3.0	2.8	2.7	2.5	3.0	3.1	2.9
CPI - Q%	0.9	0.1	0.1	0.5			
CPI - A%	1.9	1.9	1.5	1.6	2.0	1.8	1.9
HLFS employment growth - Q%	1.1	0.1	0.5	0.5			
HLFS employment growth - A%	2.8	2.3	2.3	2.2	1.6	1.3	1.1
Unemployment rate - %sa	4.0	4.3	4.1	4.1	3.9	3.9	3.9
Annual current account balance as % of GDP	-3.6	-3.9	-3.7	-3.7	-3.6	-3.5	-3.6

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

	Sep-18	Dec-18	Mar-19	Jun-19	Mar-20	Mar-21	Mar-22
(end of quarter)	<< actual		forecast >>				
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NZ 90-day bank bill	1.91	1.97	1.9	2.0	2.0	2.3	2.5
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ASB foreign exchange forecasts

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NZD/USD	0.66	0.67	0.68	0.68	0.70	0.72	0.74
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NZD/JPY	75	74	75	76	77	78	80
NZD/EUR	0.57	0.59	0.60	0.60	0.59	0.59	0.60
NZD/GBP	0.51	0.53	0.55	0.54	0.54	0.55	0.57
NZD TWI	72.1	73.5	74.1	73.9	74.8	75.0	76.6

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