

Economic Weekly

18 March 2019

In our hearts

NZ has faced another gut-wrenching tragedy, in a city that has already had to overcome a huge amount of adversity since 2010. The **people of Christchurch** will remain uppermost in the hearts and minds of everyone.

ASB has set up a Christchurch support fund bank account (12-3149-0137463-00) for those wanting to make donations to help the affected families, with the proceeds going to the Christchurch Foundation's Our People, Our City Fund (please note that ASB will be unable to issue tax receipts).

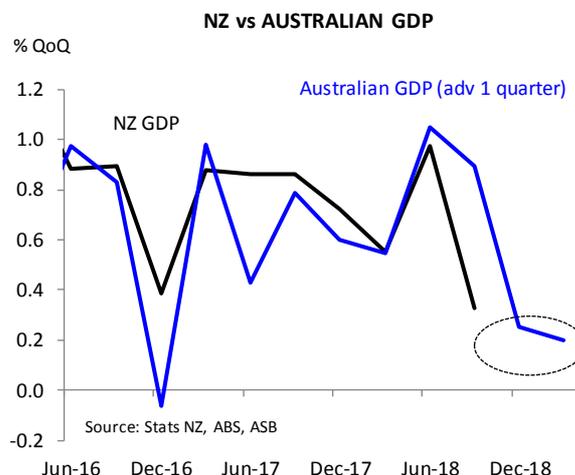
Although their significance now seems to pale into the background, this week still brings a **number of key economic events**. Thursday morning has NZ's all-important Q4 GDP release, preceded by the US Federal Reserve's latest interest rate decision. Tuesday night has the latest GlobalDairyTrade auction.

Key events and views

- [Foreign exchange](#) NZD rose against the USD and JPY, and edged down against the GBP.
- [Interest rates](#) Local yields rose towards the end of last week to end unchanged on a week ago.
- [Domestic events](#) GlobalDairyTrade Auction, Balance of Payments and GDP.
- [International events](#) US Federal Reserve and BoE interest rate announcements, UK CPI, RBA Meeting Minutes.
- [Calendars](#) NZ and international calendar of upcoming economic events.

Chart of the Week: All eyes on Thursday

Thursday will be pivotal for markets, with the US Fed expected to remain on hold and signal the intent to remain "patient" for a while yet. **Thursday's Q4 NZ GDP is the key domestic event**. ASB expects a modest 0.3% qoq outturn (+2.2% yoy), weaker than the +0.6% qoq market consensus and the RBNZ +0.8% qoq pick. In recent years, Australian GDP growth outturns have tended to lead those in NZ, although the relationship is not exact (correlation coefficient of 0.5 for quarterly movements since mid-2016). **Slowing growth in Australian GDP in 2018H2 highlights the risk that NZ growth will be weak over late 2018/early 2019**. We won't have long to wait to find out if this is indeed the case.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6846	0.6796	0.6824	0.7242	FLAT	0.6720	0.6950	UP
NZD/AUD	0.9666	0.9656	0.9622	0.9308	FLAT	0.9520	0.9750	FLAT
NZD/JPY	76.32	75.50	75.27	76.67	FLAT	74.80	77.80	UP
NZD/EUR	0.6046	0.6050	0.6045	0.5883	FLAT	0.5920	0.6160	FLAT
NZD/GBP	0.5149	0.5238	0.5332	0.5198	FLAT	0.5050	0.5250	UP
TWI	74.4	74.0	74.2	74.40	FLAT	73.0	75.0	UP

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

NZD Recap

The NZD finished the week broadly unchanged against the AUD and EUR, down against the GBP and up against the USD and JPY. Early in the week, **the NZD was supported by lingering market optimism** around a US-China trade deal and higher Asian equity markets. Meanwhile, the USD was weighed by weaker-than-expected inflation data. The **GBP lifted over the week as UK Parliament voted against a hard Brexit** and voted on a motion to extend the Article 50 Brexit deadline beyond 29 March. UK House of Commons also voted against the option of a second referendum.

Near-term outlook

We expect the NZD/USD upside to remain limited this week. We expect the **USD will be capped by a “dovish” Federal Reserve policy announcement.** We expect the Fed will lower its 2019 GDP forecast and potentially remove one or two of the interest rate hikes in the ‘dot plot’. Meanwhile, **our below-consensus NZ Q4 GDP forecast of 0.3% (market 0.6%) suggests there is some downside risk to the NZD.** Meanwhile, another lift in Australian employment should support the AUD, and may add some downward pressure to the NZD/AUD later on Thursday.

We expect **GBP volatility to remain elevated this week**, with Brexit-related headlines driving direction. The length of the Brexit extension will depend on whether PM Theresa May can get her Brexit deal passed by the House of Commons by the 20 March (which is the 3rd vote on the proposed Withdrawal Agreement). Any extension has to be agreed by the EU at this week’s EU summit (21-22 March). **There is some risk that the EU will not approve the postponement, so a hard Brexit scenario cannot be fully eliminated.**

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 to remain close to 0.96 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 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

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	1.89	1.88	1.90	1.87	FLAT/DOWN	UP
2-year swap	1.84	1.84	1.91	2.26	FLAT/DOWN	UP
5-year swap	1.96	1.97	2.08	2.72	FLAT	UP
10-year swap	2.36	2.37	2.49	3.19	FLAT	UP
10-year govt bond yield	2.06	2.09	2.20	2.88	FLAT	UP
Curve Slope (2s10s swaps)	0.53	0.53	0.58	0.93	FLAT/UP	DOWN

* Current as at 10am today; week ago as at Monday 5pm

Market Recap

Local yields rose towards the end of last week to end unchanged on a week ago. This was in contrast to falls in global yields which were weighed down by increased risk aversion and concerns over the global economy, triggered by generally weak Chinese and Australian data, and weaker than expected US manufacturing data. The tone of recent comments from global central banks was dovish. The Bank of Japan offered a bleaker picture on the global economy, and left its ultra-easy monetary policy settings on hold. Global yields eased at the end of last week and remained in the lower part of recent trading ranges. The maturity of the 2019 NZ government bond likely provided strong support to this week's \$250m tender of 2029 bond by the NZ Debt Management Office (DMO). **Last week NZ 10-year Government bond yields touched a new record low (2.02%).** Brexit dominated international headlines with UK yields firming after the UK Parliament rejected a no-deal Brexit and voted to extend the Brexit Date beyond 29 March.

Near-term NZD interest rate outlook

We have a mild downward bias for local short-term interest rates. This week's local focus is Thursday's Q4 GDP, with our 0.3% qoq pick well below the 0.6% qoq market median and 0.8% qoq RBNZ pick. If our pick is close to the actual GDP outcome, we expect local yields to ease and market pricing to add to the more than 20bps on OCR cuts priced in by early 2020. Central banks remain in focus offshore. The Fed is widely expected to leave its policy rates unchanged, depict a neutral assessment and pledge to remain "patient". We expect the FOMC to decrease its US GDP forecasts for 2019 and remove one or two interest rate hikes from the 'dot plot' (The December plot had 2 hikes for 2019 and 1 hike for 2020). The FOMC may also reach a consensus on a plan for ending the shrinkage in its balance sheet later this year. The March RBA Minutes pre-dates the softer Q4 GDP release and Governor Lowe's speech on the Housing Market and the Economy, which likely diminishes their market relevance. **We have a neutral outlook for longer-term yields, which are expected to remain historically low.** We expect this week's \$200m tender of the 2037 NZ Government bond to be well supported. This week's Bank of England policy decision will be overshadowed by Brexit, with the European Union (EU) needing to grant the UK an extension to the Brexit date at this week's EU Summit.

Medium-term outlook

In February, we 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). The Fed should remain "patient" and hold policy rates at 2.25-2.50% over the projection period, with the Reserve Bank of Australia and European Central Bank expected to delay policy tightening. **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

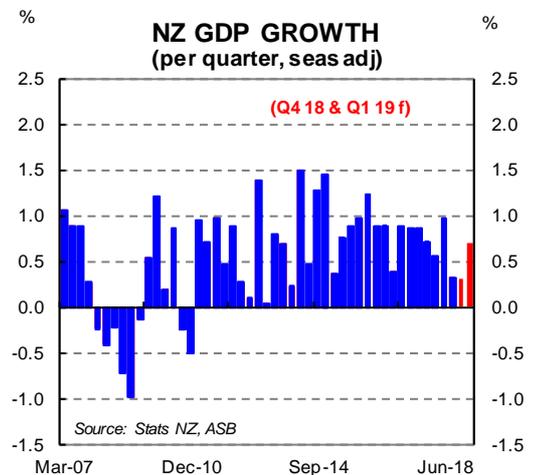
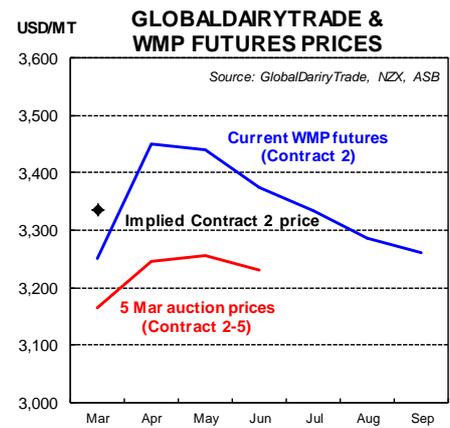
Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	19/03	overnight	6.0	-	2.0
Current Account Balance, Q4, % of GDP	20/03	10:45am	-3.6	-	-3.8
GDP, Q4, %qoq	21/03	10:45am	0.3	-	0.3

We expect whole milk powder (WMP) prices to build on recent gains at the GlobalDairyTrade auction overnight Wednesday. WMP prices have lifted by over 20% so far this year. At the current juncture, futures pricing suggests WMP prices will rise by 5%. We are not as bullish as that, but still expect a rise in the vicinity of 2%.

We expect NZ's current account deficit to widen to 3.8% of GDP over Q4. The Q3 deficit came in at 3.6% of GDP, widening from 3.3% in Q2. That said, the seasonally-adjusted balance actually strengthened over the quarter, with the income balance lifting while the goods and services balance was effectively unchanged. Over coming quarters, we expect the deficit as a % of GDP to narrow and then track sideways, as previously-high oil prices fall out of the annual calculation.

We expect that Q4 GDP increased by 0.3% qoq, seeing annual growth slump to 2.2% yoy, with momentum weighed down by soft services and goods production growth. The muted Q4 lift follows soft GDP growth in Q3 (also rising just 0.3% qoq). An outturn of 0.3% qoq will be much weaker than the RBNZ's February Monetary Policy Statement forecast of 0.8% qoq.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Asst. Gov. Kent speech	19/03	11:00am	-	-
Australia CoreLogic House Price Index, Q4, %mom	19/03	1:30pm	-2.0	-2.8
RBA Meeting Minutes	19/03	1:30pm	-	-
UK ILO Unemployment, January, %	19/03	10:30pm	4.0	4.0
RBA Asst. Gov. Bullock speech	20/03	1:00pm	-	-
UK CPI, February, Headline, %yoy	20/03	10:30pm	1.8	1.9
US Federal Reserve Interest Rate Announcement, %	20/03	7:00am	2.25-2.50	2.25-2.50
Australia Unemployment Rate, February, %	21/03	1:30pm	5.0	5.0
Bank of England Interest Rate Announcement, %	22/03	1:00am	0.75	0.75
Japan CPI, February, Headline %yoy	22/03	12:30pm	0.3	0.4

*Originally published by CBA Global Markets Research on Friday 15th March 2019 at 2.09pm.

The **Reserve Bank of Australia's (RBA) Assistant Governor (Financial Markets) Christopher Kent** will deliver a speech titled *Bonds and Benchmarks* at the KangaNews DCM Summit in Sydney on Tuesday.

Already-released monthly Australian data from **CoreLogic** suggest the **House Price Index** will likely record a 2.8% fall over Q4 2018.

The **RBA Meeting Minutes** will be released on Tuesday discussing in detail the Bank's current view of the Australian economy. Any details around the hurdle to cut rates will be watched.

Higher job vacancies suggest the **UK ILO unemployment rate** will remain near a 43-year low of 4% in January. Meanwhile, survey indicators of recruitment difficulties are trending higher consistent with a further improvement in average weekly earnings growth.

RBA Assistant Governor (Financial System) Michele Bullock will deliver a speech at the Urban Development Institute of Australia in Perth. The theme of the conference is "The housing credit squeeze in a post Royal Commission economy" with a discussion of the increased risk to property developers from tighter lending standards likely on the agenda.

UK headline CPI inflation is expected to quicken at an annual pace of 1.9% in February from 1.8% the previous month, mainly reflecting higher energy price inflation and faster wage growth. Overall, the UK's inflation dynamic is tracking the Bank of England's projection.

Market pricing and US economists agree the Federal Reserve will not change monetary policy at its next meeting. We expect the Fed to decrease its US GDP forecasts for 2019 and remove one or two interest rate hikes from the 'dot plot'. The central bank may also reach a consensus on a plan for ending the shrinkage in its balance sheet later this year.

We expect the number of **Australian jobs** to have lifted 15,000 over February with the unemployment rate pegged to stay at 5.0%. We expect the participation rate to hold steady at 65.6%.

The Bank of England meets later this week and is widely expected to make no monetary policy changes. We also anticipate the bank to maintain its "gradual" and "limited" tightening bias.

Already-released Tokyo inflation suggests **Japan's national headline CPI** will lift modestly to 0.4% yoy because oil prices have increased again. In addition, we expect the Bank of Japan's preferred inflation measure to lift modestly to 0.5% yoy, well below the 2% yoy target.

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	0.3	0.7				
GDP real - A%	2.6	2.2	2.3	2.1	3.2	3.0	2.9
GDP real - AA%	3.0	2.7	2.6	2.3	2.7	3.1	2.9
CPI - Q%	0.9	0.1	0.1	0.6			
CPI - A%	1.9	1.9	1.5	1.7	2.0	1.8	1.8
HLFS employment growth - Q%	1.1	0.1	0.5	0.4			
HLFS employment growth - A%	2.8	2.3	2.3	2.1	1.5	1.3	1.1
Unemployment rate - %sa	4.0	4.3	4.2	4.2	4.0	3.9	4.0
Annual current account balance as % of GDP	-3.6	-3.8	-3.6	-3.6	-3.5	-3.5	-3.3

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 << actual	Dec-18 forecast >>	Mar-19	Jun-19	Mar-20	Mar-21	Mar-22
(end of quarter)							
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
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ASB foreign exchange forecasts

	Sep-18 << actual	Dec-18 forecast >>	Mar-19	Jun-19	Mar-20	Mar-21	Mar-22
(end of quarter)							
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

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