

# Economic Weekly

19 February 2018

## Calm returns

Calm appears to have returned to financial markets after a rocky few weeks. Markets are likely to enjoy a quiet start to the week, with Chinese markets closed for the Lunar New Holiday and the US having a long weekend with the US Presidents' Day Holiday. The domestic focus this week is on the Q4 Retail Trade Survey, released on Friday, and should show a bounce back in spending from a soft Q3. Meanwhile, on Page 2 we recap our thoughts on the NZ and Global Economic outlook from our [Quarterly Economic Forecasts](#), released last week.

### Key events and views

[Key Insights](#)

Update on ASB's latest Quarterly Economic Forecasts.

[Foreign exchange](#)

The NZD elevated over the past week, supported by weak USD.

[Interest rates](#)

NZ longer-term interest rates start the week a touch lower as the markets calm.

[Domestic events](#)

Q4 retail spending should bounce back from soft Q3, latest Global Dairy Trade auction.

[International events](#)

RBA meeting minutes, Australian wage inflation, Federal Reserve Meeting Minutes.

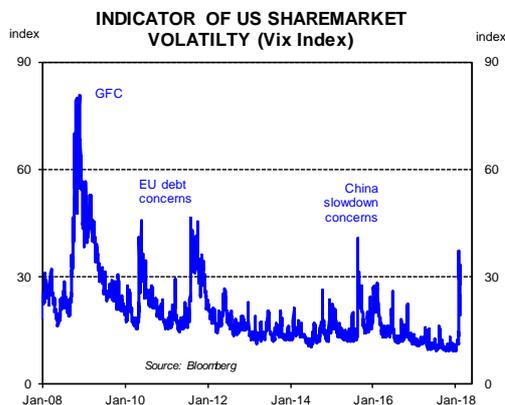
[Calendars](#)

NZ and International calendar of upcoming economic events.

### Chart of the Week: Putting the current spike in volatility in context

The US-led equity market correction over the past few weeks has seen **measures of market volatility spike considerably higher**. Volatility in financial markets reflects increased uncertainty on the economic and financial outlook from financial market participants. Spikes in volatility measures, particularly the VIX Index, can be unnerving for market watchers as it has often coincided with the start of significant economic events, such as the 2008 Global Financial Crisis (GFC) or the European Sovereign debt crisis.

**This recent spike in volatility has been worrisome as it is the highest level of uncertainty since the Chinese growth slowdown fears from late 2015.** In addition, the current spike also comes at a time where some economic commentators (including The Economist) are questioning the longevity of the current synchronised global upswing. However, **rest assured, measures of volatility remain well below those of the 2008 GFC.** Global economic fundamentals remain solid, equity markets have since stabilised and volatility has subsequently eased from its peak.

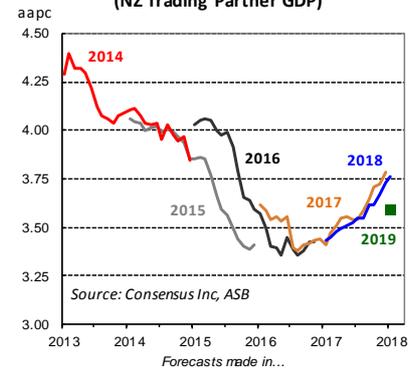


## Key Insights this week: Forecast Update

Last week we published our updated [Quarterly Economic Forecasts](#), which provides an updated stocktake of the key influences and drivers underpinning the New Zealand economy.

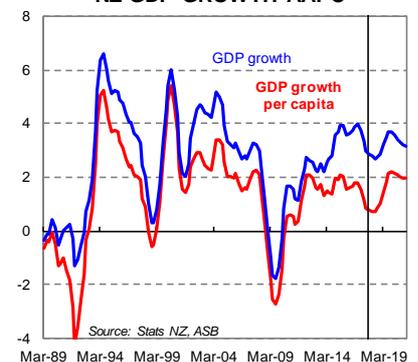
Despite recent ructions in global financial markets, the global economy looks to be on a solid footing. A synchronised global expansion is underway, with trading partner growth strengthening for most of our trading partners. The current upswing has considerable momentum, which should see trading partner growth maintain its above-trend pace over 2018. **Consensus growth forecasts suggest that trading partner growth will remain at 3.8% for 2018, a similar rate to what was achieved in 2017.** Growth is expected to moderate to on-trend rates over 2019 as growth supports fade. **Growth of 3.6% is expected for 2019**, broadly in line with historical averages.

EVOLUTION OF CONSENSUS FORECASTS (NZ Trading Partner GDP)



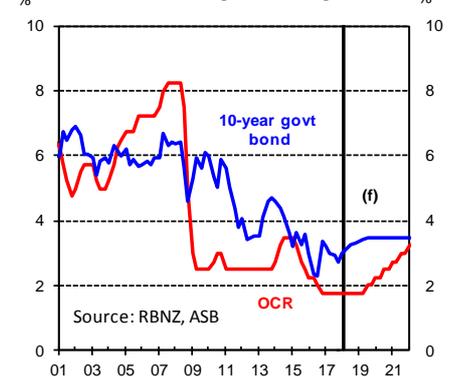
**New Zealand's growth outlook appears a little rosier**, thanks to extensive revisions after Statistics NZ improved its measurement of GDP. The economy has grown faster over the past 3 years than previously reported, and more in keeping with what was expected from the many underlying boosters that have been there all along. The NZ economy is the recipient of a number of supports including the historically high Terms of Trade (which are expected to remain close to record highs over the next few years), strong (but abating) population growth (courtesy of high net permanent and long-term immigration), record overseas tourism inflows, supportive fiscal settings, and historically low interest rates. **We are now expecting annual growth in the New Zealand economy to exceed 3.5% over the next couple of years. Per-capita growth also looks healthier, and set to gradually return to the 2% pace it has hit for much of the post-GFC period.**

NZ GDP GROWTH AAPC



**Capacity constraints are expected to remain a key theme within our forecasts.** The labour market is expected to tighten further, with the unemployment rate expected to fall below 4% by the end of the year. Wage inflation, a key driver of core inflation, is expected to firm. With the labour market looking increasingly stretched and with population growth set to moderate as net immigration slows, our forecasts assume that more of the growth in economic activity will need to be driven by strengthening labour productivity. Our forecasts assume that business investment outside of construction sector activity will firm. **However, as suggested by soaring construction costs, capacity constraints are already biting in the construction sector. The tourism sector is also facing capacity challenges.** Prolonging the domestic expansion will entail working smarter with what we already have, whilst more investment in infrastructure and visitor accommodation and more targeted marketing towards higher spending visitors could pave the way for a renewed growth spurt in tourism value added.

NZ INTEREST RATES

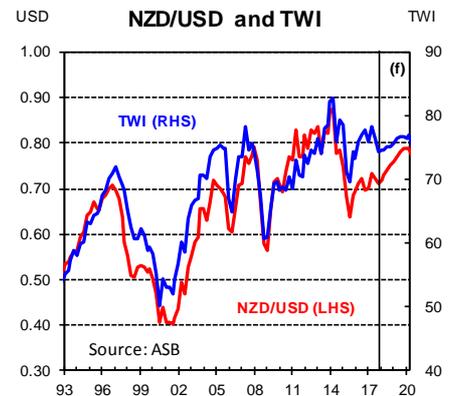


Despite **NZ's relatively strong economic performance, the inflation outlook remains benign.** We expect NZ inflation to remain around the bottom half of the RBNZ's target band (1-3%), with core inflation pressures slow to lift. Outside of the housing sector, there is very little evidence of stronger domestic inflation. Meanwhile, global inflation pressures are likely to remain subdued and a drag on NZ's CPI inflation rate. **The subdued inflation outlook will ensure NZ interest rates will remain low over the next few years.**

With inflation yet to pick up materially, we expect the **RBNZ to leave to OCR on hold at 1.75% until the second half of 2019.** Further, **once the RBNZ does resume lifting the OCR, it is likely to be a gradual process, with the OCR not**

approaching neutral levels (around 3.50%) until late 2022. **Longer-term NZ interest rates are expected to drift higher as global interest rates firm from historically low levels.** Given that the RBNZ is towards the end of the queue for rate hikes and due to strong allure for NZD assets, spreads for NZD interest swaps and NZ Government bonds with global comparators are expected to remain historically low over the next few years.

**The NZD has also recovered from its post-election lows.** Much of the NZD/USD's directional change reflects a period of sustained USD weakness. More recently, the USD has recovered slightly, in line with higher US interest rate expectations. **Although narrowing NZD interest rate differentials relative to global counterparts have likely to weigh on the kiwi, we expect the NZD to remain broadly supported** by the historically-high Terms of Trade, solid NZ domestic outlook and strong demand for NZD exposures by global central banks and other real money managers.



Since the GFC, economic forecasters (and many others) have kept a vigilant lookout for threats to the ongoing economic recovery, aware that a number of fragilities are not far below the surface. **Looking ahead for 2018 there are still a number of risks to be wary of.** Local risks include weather (regularly swinging from 'too much' to 'too little' rain) and the potential for businesses to talk themselves into a downturn, although the initial sticker shock of the new government looks to have passed, with firms just getting on with it. We are more relaxed about housing market risks, despite the noticeable cooling off over the past 18 months. **Global risks remain centre stage.** Political risks and geopolitical tensions remain, and there is never a dull moment with President Trump at the helm. As recent volatility in financial markets suggests, it is also unclear how well the global economy will manage the transition to the eventual normalisation in global interest rate settings.

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.7384	0.7267	0.7304	0.7207	FLAT	0.7250	0.7520	UP
NZD/AUD	0.9333	0.9275	0.9107	0.9360	UP	0.9200	0.9500	DOWN
NZD/JPY	87.55	79.01	80.94	81.65	FLAT	77.30	79.60	FLAT
NZD/EUR	0.5950	0.5914	0.5954	0.6751	FLAT	0.5870	0.6040	FLAT
NZD/GBP	0.5267	0.5243	0.5247	0.5764	FLAT	0.5190	0.5340	FLAT/UP
TWI	75.8	74.7	74.9	78.4	FLAT	74.00	76.50	FLAT

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

### NZD Recap

**The NZD remained elevated last week, with the NZ trade-weighted index lifting 1.4% over the week.** USD weakness continued to support the NZD/USD, as did the stronger than expected 2-year-ahead RBNZ inflation expectation release on Wednesday. On Friday night, the NZD/USD lifted above 74 US cents to its highest level since the 24<sup>th</sup> of January following US Special Council Muller's indictment of 13 Russians for meddling in the 2016 US election.

The stronger than expected NZ inflation expectation data also supported the **NZD/AUD over the second-half of the week.** And, although the strong Australian employment release on Thursday stopped the cross from reaching a six-month high on the day, it reached a six-month high on Friday. **ANZ pushed out its expectations for RBA rate hikes, which appears to still be weighing on the AUD at the margin.**

Meanwhile, the NZD finished the week higher against the GBP, EUR and the JPY.

### Near-term Impact

**Currency markets are likely to be subdued over the start of the week, with a US holiday tonight and Chinese markets closed until Wednesday for Chinese New Year celebrations.** However, immediate NZD downside risks have eased after last week's solid inflation expectations data (following McDermott's comment that the RBNZ would cut if inflation expectations fell). However, key to USD direction this week will be how markets interpret the Federal Reserve meeting minutes, released on Thursday morning. After rate hike expectations were pared back following the sharemarket correction, there is a risk that hike expectations lift back towards three hikes in 2018 following the release of the minutes.

Following last week's comments by ANZ, Tuesday's RBA meeting minutes risks moving the NZD/AUD, as does Wednesday's Australian Wage Price Index release. Ongoing soft wage growth risks further watering down of RBA rate hike expectations.

### Medium-term outlook

**Despite recent strengthening, our medium-term bias remains a weaker USD,** reflecting the stronger environment for global growth and narrowing USD interest rate differentials as other central banks contemplate policy tightening ahead of the Fed. **The NZD TWI is expected to remain broadly supported** by its solid economic outlook, strong NZ commodity export prices and historically high Terms of Trade 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	0.60	0.59	0.59	0.59	0.60	0.60
NZD/GBP	0.56	0.54	0.53	0.53	0.53	0.53	0.53	0.53	0.54
NZD TWI	78.4	76.4	74.3	74.6	74.7	75.0	75.1	75.7	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	1.91	1.91	1.88	2.03	FLAT	UP
2-year swap	2.17	2.16	2.26	2.37	FLAT	UP
5-year swap	2.73	2.74	2.78	3.04	FLAT/UP	UP
10-year swap	3.28	3.31	3.29	3.56	FLAT/UP	UP
10-year govt bond yield	2.98	2.99	2.97	3.34	FLAT/UP	UP
Curve Slope (2s10s swaps)	1.11	1.15	1.03	1.20	UP	FLAT

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

### Market Recap

**An element of calm returned to financial markets as equity markets rebounded from earlier lows, whilst measures of financial market volatility receded.** US shorter-term yields have held onto much of their sharp rise following last week's stronger than expected US CPI print, with the US curve bear flattening (larger rises for short-term yields). US 10-year Treasury yields start the week at around 2.88% after spiking as high as 2.94% on Thursday, with the 2-year yield approaching 2.20%. This was in contrast to the flatter curves evident in Australia and more modest moves in local and European markets. Local yields start the week a touch lower for longer-term maturities, with the curve shape marginally flatter.

### Near-term NZD interest rate outlook

**A quieter week beckons for rate markets,** given the lack of major data or events and with Chinese markets closed for the Lunar New Holiday and the US having a long weekend with the US President's Day Holiday. **The focus will be on whether financial markets remain settled or whether we are braced for another bout of volatility.** With central banks on inflation watch, tomorrow's RBA meeting minutes and Wednesday's Australian wage data will be the major focus for Australasian markets. While the RBA Minutes should reaffirm the upbeat tone for the growth outlook, contained wage inflation should provide the RBA with the luxury of holding off any rate increases until the end of the year. There are some Fed officials speaking over the week on the growth outlook, with the January Fed meeting Minutes (Thur) expected to reaffirm pending Fed hikes, albeit gradually. Europe's growth outlook continues to improve and there are clear prospects for an ECB rate rise by year end, with market odds of more than 60% for a May BOE hike. Last week's tender of NZ Treasury bills attracted solid interest, whilst the tender of the 2025 bond proved to be a mixed bag. On Thursday the DMO will tender \$150m on the 2033 bond. Q4 retail sales are expected to rebound from the soft Q3, with soft signals expected from the retail trade deflators (flat to falling). We expect a flat outcome for this week's dairy auction. **Our bias remains for firming longer-term rates to drive more steepening in the local curve, but this depends on global yields edging higher.**

### Medium-term outlook

Our core macro view is that the RBNZ will start lifting the OCR in Q3 of 2019. We expect a moderate pace of tightening by historical standards, and a low OCR endpoint of around 3.5% this cycle. Combined with our expectation of at least two Fed hikes over 2018, this should see local wholesale interest rate yields lie below US counterparts out to the mid part of the curve, with further narrowing in NZD spreads for longer maturities. **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.**

### ASB interest rate forecasts

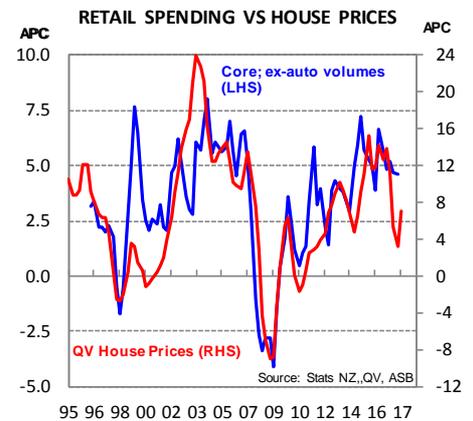
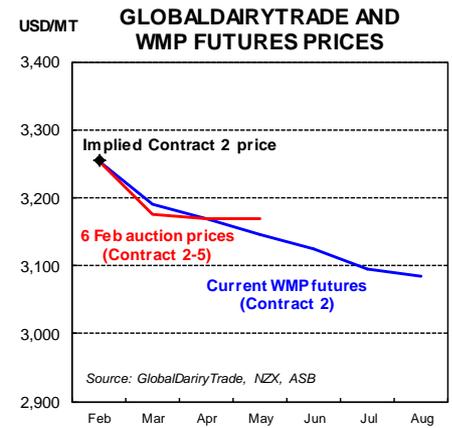
(end of quarter)	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
			<< actual	forecast >>					
NZ OCR	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.25
NZ 90-day bank bill	1.96	1.96	1.88	1.9	1.9	1.9	2.0	2.0	2.5
NZ 2-year swap rate	2.33	2.21	2.21	2.2	2.2	2.3	2.4	2.5	3.0
NZ 10-year Bond	2.97	2.96	2.75	3.0	3.2	3.3	3.3	3.4	3.5

## Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
GlobalDairyTrade Auction, whole milk powder, %chg	20/02	Overnight	+7.6	-	No change
Q4 Retail Sales, Q4, %qoq	23/02	10:45 am	0.2%	-	1.2%

**We expect prices to be unchanged at the GlobalDairyTrade auction overnight Tuesday.** A fortnight ago whole milk powder (WMP) prices rose by 7.6%. At the current juncture, futures pricing suggests WMP prices will be flat. Recent rainfall has helped ease concerns over falling production following dry weather earlier in the season. As a result, the impetus for further price rises has waned.

**Following a lacklustre Q3, we envisage that both total and core (ex-auto and fuel) retail volumes will rebound in the final quarter of 2017.** The lift in quarterly volumes is expected to be underpinned by rebounding sales volumes for supermarket sales, furniture and food and beverage services. Firming vehicle registrations also point to a rebound in vehicle retail volumes. Not all retail components are expected to increase, with liquor retailing and non-store and commission-based retail volumes most likely to fall following strong recent increases, as could apparel retail. High fuel prices could likely result in consumers continuing to redirect expenditures to other areas. **Despite the beleaguered housing market, the prospect of increased government support, increasing wages and higher producer incomes are expected to translate into solid rates of consumer spending going forward.** We expect annual growth in retail spending volumes to remain around 4-5% over 2018.



## Major International Events for the week ahead

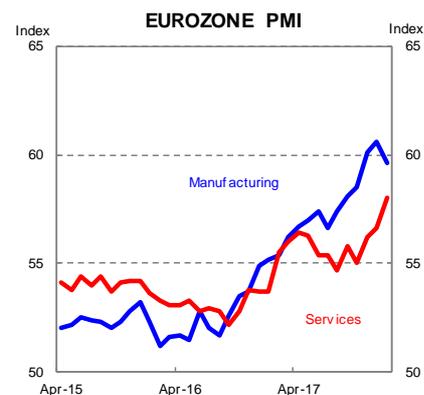
Data	Date	Time (NZT)	Market	ASB
Reserve Bank of Australia Board Minutes for February	20/02	1:30 pm	-	-
Australia Wage Price Index, Q4, %qoq	21/02	1:30 pm	0.5	0.5
UK ILO Unemployment, December, %yoy	21/02	10:30 pm	4.3	4.3
Eurozone Composite PMI, February, Index	21/02	10:00 pm	58.4	58.6

The **Reserve Bank of Australia** is due to put out its **board minutes** for the month of February on Tuesday this week. Comments on growth, inflation and the AUD will likely be in line with its Statement of Monetary Policy that was released on the 6<sup>th</sup> of February.

The annual growth rate of **Australia's wage price index** is expected to stay around 2% and offer a relatively benign inflation outlook for the next few quarters. Most models of the jobs market and wages outlook are indicating a pick-up in wages by the year end.

We anticipate the **December UK ILO unemployment rate** will print at 4.3%. Average hourly earnings will print around 2.5%.

We anticipate the preliminary **February Eurozone composite PMI** will print at levels around 58.6, reflecting robust demand conditions across industries.



## Global Data Calendars

### Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Perio	Unit	Last	Forecast	
							Market	ASB
Mon 19	1250	JP	International Trade	Jan	¥bn	359	~	~
Tues 20	1900	JP	Machine tool orders	JanF	y%chg	48.8	~	~
Tues 20	1330	AU	RBA Board Meeting Minutes	Feb	~	~	~	~
Tues 20		NZ	Global Dairy Trade auction, WMP		%chg	7.6	~	flat
Wed 21	1330	AU	Construction Work Done	Q4	%chg	15.7	6.0	5.0
Wed 21	1330	AU	Wage Price Index	Q4	%chg	0.5	0.5	0.5
Fri 23 Feb	1045	NZ	Retail sales – inflation adjusted	Q4	%chg	0.2	1.3	1.2
Fri 23 Feb	1230	JP	CPI	Jan	y%chg	1.0	~	~

### Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 19 Feb		US	Presidents' Day Holiday					
Wed 21 Feb	0900	EZ	Eurozone Composite PMI	Feb	index	58.8	58.2	58.6
Wed 21 Feb	0930	UK	ILO Unemployment rate 3mths	Dec	%	4.3	~	~
Wed 21 Feb	1500	US	Existing home sales %mom	Jan	%	-3.6	0.5	0.5
Thu 22 Feb	0800	US	US Fed Reserve Meeting Minutes	Jan	~	~	~	~
Thu 22 Feb	0930	UK	GDP F	Q4	q%chg	0.5	~	0.5
Thu 22 Feb	1500	US	Leading Index	Jan	%	0.6	0.6	0.6
Fri 23 Feb	1000	EZ	CPI	Jan	m%	0.4	-0.9	-0.9
Fri 23 Feb	1000	EZ	Core CPI	Jan	y%chg	1.0	1.0	1.0

## Key Forecasts

### ASB NZ economic forecasts

	Jun-17 << actual	Sep-17 forecast >>	Dec-17 forecast >>	Mar-18 forecast >>	Jun-18 forecast >>	Sep-18 forecast >>	Dec-18 forecast >>	Mar-19	Mar-20
GDP real - Q%	1.0	0.6	0.6	0.5	0.9	1.0	1.0		
GDP real - A%	2.8	2.7	2.9	2.6	2.6	3.0	3.4	3.9	3.3
GDP real - AA%	3.3	3.0	2.9	2.8	2.7	2.8	2.9	3.2	3.6
CPI - Q%	0.0	0.5	0.1	0.4	0.4	0.5	-0.2		
CPI - A%	1.7	1.9	1.6	1.0	1.4	1.5	1.1	1.5	1.7
HLFS employment growth - Q%	0.0	2.2	0.5	1.0	0.6	0.7	0.6		
HLFS employment growth - A%	3.1	4.2	3.7	3.7	4.4	2.9	3.0	2.5	1.8
Unemployment rate - %sa	4.8	4.6	4.5	4.3	4.2	3.9	3.7	3.6	3.3
Annual current account balance as % of GDP	-2.7	-2.6	-2.7	-2.4	-2.5	-2.6	-2.7	-2.6	-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	1.75	2.25
NZ 90-day bank bill	1.96	1.96	1.88	1.9	1.9	1.9	2.0	2.0	2.5
NZ 2-year swap rate	2.33	2.21	2.21	2.2	2.2	2.3	2.4	2.5	3.0
NZ 10-year Bond	2.97	2.96	2.75	3.0	3.2	3.3	3.3	3.4	3.5

### 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	0.60	0.59	0.59	0.59	0.60	0.60
NZD/GBP	0.56	0.54	0.53	0.53	0.53	0.53	0.53	0.53	0.54
NZD TWI	78.4	76.4	74.3	74.6	74.7	75.0	75.1	75.7	76.6

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