

Economic Weekly

20 January 2020

Looking back to look forward

The first key NZ economic data releases of the year painted a mixed picture for the current state of the economy. The NZIER Quarterly Survey of Business Opinion confirmed a stabilisation in business confidence over the final quarter of 2019, but levels of confidence and reported activity remained weaker than ASB had expected and suggests any rebound in growth over 2020 will be gradual. On the other hand, the housing market continues to fire, with Auckland demand bouncing back to life and low supply fuelling house price growth.

Looking at the week ahead, we get to look back at Q4 inflation on Friday. We expect 0.4% qoq inflation and for annual inflation to pick up to 1.8%. Despite the overall pick-up, we don't expect Q4 to reveal an inflationary smoking gun. With this in mind, we continue to anticipate that the RBNZ will cut the OCR once this year (in May). Meanwhile on Tuesday night, we expect the second dairy auction of the month to show further price gains. Offshore, Australian Employment data for December will be the key focus.

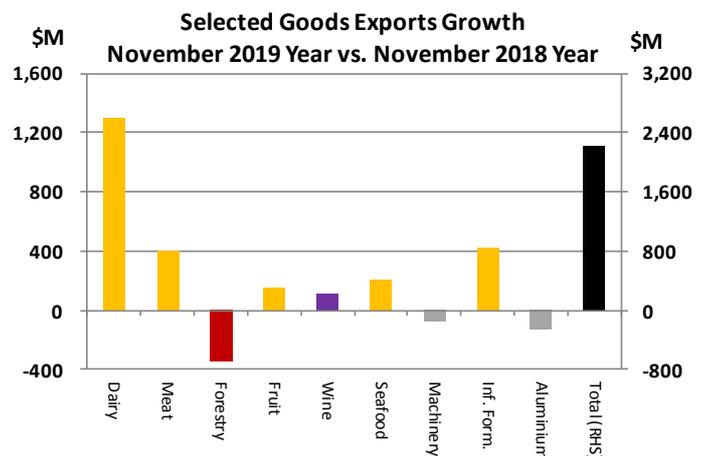
Key events and views

Foreign exchange	Fundamentals continue to move in support of the NZ dollar.
Interest rates	Local yields start the week a touch firmer.
Domestic events	Performances of Services Index, Global Dairy Trade Auction, CPI inflation
International events	Bank of Japan, Bank of Canada and ECB rate announcements; Australian Employment

Chart of the Week: NZ tops China food imports

The NZ Herald reported last week that NZ has overtaken Australia and the US as the number one exporter of food to China. According to the China Chamber of Commerce for Import and Export of Foodstuffs, NZ's total food exports to China in 2018 were worth US\$6.4 billion (NZ\$9.65b). In 2017, food imports from New Zealand ranked third behind the US and Australia.

This interesting factoid gels with our view over 2019 that NZ export sector would emerge largely unscathed from the US-China trade war and the general slowing in global growth. Data for the year to November 2019, showed that was the case, at least as it applied to our food exports. The full year's trade data is due next week. We anticipate that these data will further confirm our view. As we said at the time, it's comforting to be a food exporter in times of uncertainty.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6617	0.6651	0.6603	0.6760	FLAT	0.6480	0.6720	FLAT/UP
NZD/AUD	0.9622	0.9615	0.9572	0.9399	UP	0.9400	0.9700	UP
NZD/JPY	72.82	72.90	72.18	73.93	FLAT	70.70	73.60	DOWN
NZD/EUR	0.5965	0.5976	0.5939	0.5931	FLAT	0.5810	0.6050	FLAT
NZD/GBP	0.5091	0.5100	0.5070	0.5210	FLAT	0.4915	0.5200	FLAT
TWI	72.7	72.7	72.7	73.18	UP	N/A	N/A	UP

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

NZD Recap

Last week was fairly uneventful for FX markets. Investors spent most of the week in a holiday-induced slumber waiting for the signing of the US-China trade agreement (which proceeded without incident). The NZD/USD shuffled sideways in a narrow 0.6585-0.6665 range. The NZD/AUD continued to feel the updraft of the AUD's New Year underperformance, settling back above 0.9600.

Near-term outlook

Fundamentals continue to move in support of the NZ dollar, although we doubt we'll see any substantive moves this week absent a big CPI surprise on Friday.

NZ commodity export prices and NZ-US interest rate differentials continue to trend slowly higher, the latter on signs that NZ economic momentum has picked up. Global risk appetite, meanwhile, has been emboldened by improved global growth and the (temporary) resolutions of both Brexit and US-China trade relations. NZD implied volatility last week fell to the lowest level in over 20 years. Short-term "fair-value" for NZD/USD is eyed closer to 0.7000 than 0.6500.

This week's key event risk comes from Friday's Q4 inflation report. The ASB and consensus forecast is for a 0.4% qoq (1.4% yoy) gain in inflation but we think the risk is for a slightly stronger outcome. Globally, Aussie employment (Thursday) and the ECB policy meeting (Friday) will be the highlights. We suspect markets will largely ignore the impeachment trial that gets underway in the US Senate on Tuesday.

Medium-term outlook

We expect the NZD to remain on a gradual uptrend through the first half of 2020, although our view of a still-strong USD is expected to cap the extent of NZD/USD strength. The US election is the key risk to our FX forecasts over the coming year.

We also expect the NZD/AUD to continue rising over 2020, as the NZ economy continues to outperform that of Australia. This is reflected in our central bank views and hence NZ/AU interest rate forecasts. In NZ we expect only one more OCR cut from the RBNZ while in Australia we expect two more RBA cuts and quantitative easing.

mike.jones@asb.co.nz

ASB foreign exchange forecasts

(end of quarter)	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH	UP
90-day bank bill	1.29	1.25	1.24	1.90	UNCH/UP	UP
2-year swap	1.22	1.18	1.26	1.91	UNCH/UP	UP
5-year swap	1.35	1.30	1.45	2.15	UNCH/UP	UP
10-year swap	1.69	1.62	1.79	2.61	UNCH/UP	UP
10-year govt bond yield	1.54	1.47	1.63	2.32	UNCH/UP	UP
Curve Slope (2s10s swaps)	0.47	0.45	0.53	0.69	UNCH/DOWN	DOWN

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

Market Recap

Local yields start the week a touch firmer. The NZ economy has continued to display resilience pointing to a higher hurdle to prospective OCR cuts. The NZ housing market is tightening and house prices are firming. Retail card spending undershot December expectations, but remained strong for the December quarter. **Global yields were little changed, with curves mildly flattening.** The Phase 1 trade agreement did not provide a boost to long-term global yields with Treasury yields ending the week a touch lower. Concerns over the UK being able to secure a trade deal with the European Union dampened European yields. NZ yields were a notable outlier having firmed compared to a week ago. Australian yields were little changed on a week ago, with about 30bps of cuts priced in for 2020, and about 50% odds of a 25bp cut by the Reserve Bank of Australia in February.

Near-term NZD interest rate outlook

We now see marginally more upside than downside risk for local short-term yields. The 12bps of OCR cuts priced in looks about right, given our view of the risk profile and our current forecasts (which include a 25bp cut in 2020). However, we acknowledge markets could price out the possibility of the OCR being cut if domestic data continues to show resilience or if inflationary pressure starts to stir. We expect a 0.4% qoq (+1.8% yoy) rise in NZ Q4 consumer prices (mkt: +0.4% qoq, +1.8%), but are wary of the risk of a potential lift in non-tradable and core inflation that could push local yields higher. With our CBA colleagues expecting a 25bp RBA cut in February, NZ spreads with (lower) Australian yields are biased to widen unless Thursday's Australian employment report is especially strong. **There also looks to be some marginal upside for longer-term yields.** With the Phase 1 trade deal out of the way, markets can concentrate on the dataflow and upcoming central bank announcements. No changes to settings are expected from the Bank of Japan, Bank of Canada and European Central Bank this week. Downside risks to the global outlook have receded and global growth is likely to have based, with limited downside to yields for now.

Medium-term outlook

We expect a further 25bp RBNZ cut in May 2020, with the OCR on hold at 0.75% until a series of mild and gradual hikes from 2022 (OCR endpoint of 2.25%). The RBA is expected to cut the 0.75% cash rate by 50bps in 2020 (Feb, Aug), with the RBA cash rate at the 0.25% effective lower bound. The 1.50%-1.75% Federal Funds rate is expected to be cut by 50bps in 2020 (Jun 20, Sep 20). Weak UK growth and low inflation is expected to prompt a 25bp UK interest rate cut in late January (to 0.50%). **Low inflation, moderate global growth and negative (but receding) risks should cap NZ and global long-term interest rates at low levels.** mark.smith4@asb.co.nz

ASB interest rate forecasts

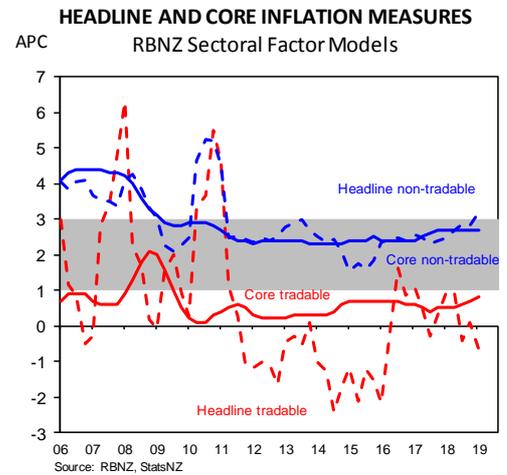
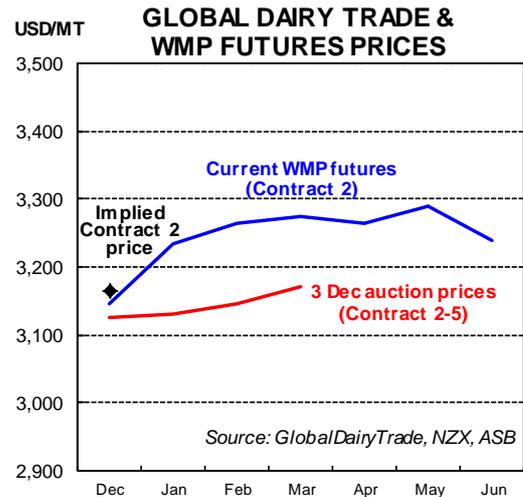
(end of quarter)	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>				
NZ OCR	1.00	1.00	1.00	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.2	1.3	1.2	1.0	1.0	1.3	1.8
NZ 2-year swap rate	0.9	1.3	1.1	1.0	1.0	1.3	1.7
NZ 5-year swap rate	0.9	1.4	1.2	1.1	1.2	1.5	1.9
NZ 10-year swap rate	1.2	1.8	1.4	1.3	1.4	1.6	2.0
NZ 10-year Bond	1.1	1.7	1.2	1.1	1.2	1.4	1.8

Domestic events

Data	Date	Time (NZT)	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	21/01	overnight	-	+2.0
Consumers Price Index, Q4, qoq	24/01	10:45am	+0.4	+0.4

We expect whole milk powder (WMP) prices to lift 2.0% at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago WMP prices firmed 1.7%, recovering some of the lost ground from the prior auction. At this stage, the futures market is pointing to a 2% lift in prices at next week's auction as well. NZ and global production growth is soft and this is likely to continue to support dairy prices.

Our 0.4% qoq (1.8% yoy) pick for Q4 headline CPI is modestly firmer than the 0.2% qoq (+1.6% yoy) RBNZ November MPS forecast. We expect firmer tradable CPI prices than the RBNZ, with fuel and food prices likely to have been stronger than the RBNZ had expected. Much like the Q3 GDP print, however, the details should provide more reassurance to the RBNZ. **We do not expect the Q4 CPI outturn to reveal an inflationary smoking gun.** Core inflation outcomes are expected to remain clustered around 2%. Annual inflation could move higher in the coming quarters, but should remain close to the midpoint of the 1-3% medium-term inflation target range. We have pencilled in a 25bp cut for 2019, but acknowledge that the odds of the OCR moving lower have subsided in recent months. With inflation well contained and the labour market looking well behaved, the OCR could stay at 1% for a while yet.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Bank of Japan Interest Rate Announcement, %	21/01	-	-0.1	-0.1
UK Unemployment, November, %	21/01	10:30 pm	3.8	-
Australia Unemployment, December, %	23/01	1:30 pm	5.2	5.2
Bank of Canada Interest Rate Announcement, %	23/01	4:00 am	1.75	1.75
ECB Interest Rate Announcement, %	24/01	1:45 am	0.0	-
Japan CPI, December, %yoy	24/01	12:30 pm	0.7	0.8
Eurozone PMI Manufacturing, January, points	24/01	10:00 pm	46.8	-
UK PMI Manufacturing, January, points	24/01	10:30 pm	48.7	-

*Originally published by CBA Global Markets Research on Friday 17th January at 2:20 pm

We expect the **Bank of Japan to keep monetary policy on hold** for two reasons. First, the Bank of Japan Governor's favoured inflation measure has lifted to the highest rate since 2016. Second, the Japanese government's budget package is sizeable at around 1.0% of GDP.

Leading indicators of **Australia's labour market** suggest modest employment growth of around the 15-20k mark should continue. This will see the unemployment rate hold steady at current levels. For December we are forecasting a 20k lift in the number of jobs. A slight lift in the participation rate to 66.1% would see the unemployment rate remain unchanged at 5.2%.

Already-released Tokyo CPI suggests **Japan's CPI inflation** accelerated to 0.8%yoy over December. But we estimate CPI inflation excluding fresh food and energy stabilised to 0.8%yoy – the highest since 2016.

UK labour market conditions remain tight. The unemployment rate has been below the Bank of England's (BoE) equilibrium rate of unemployment of 4.25% since February 2018. However, slower UK average weekly earnings growth, the sharp fall in the number of job vacancies and weaker surveys of hiring intentions suggest the labour market is no longer tightening.

The **European Central Bank (ECB) is widely expected to make no monetary policy changes**. The ECB is also expected to reiterate its open-ended easing bias and emphasise again the need for an ample degree of monetary accommodation for a prolonged period of time.

We expect the Bank of Canada (BoC) to leave the overnight rate at 1.75% and maintain a neutral bias. We don't expect material changes to the BoC's macroeconomic projections. In December, the BoC highlighted the Canadian economy is growing in line with the Bank's projections and inflation is still expected to track close to the 2% target over the next two years.

Eurozone PMIs are projected to confirm signs of stabilisation in the area's growth slowdown.

UK PMIs are projected to remain low, consistent with disappointing UK economic activity.

Key Forecasts

ASB NZ economic forecasts

	Sep-19 << actual	Dec-19 forecast >>	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.7	0.3	0.6	0.6			
GDP real - A%	2.3	1.5	1.7	2.2	2.8	2.5	2.7
GDP real - AA%	2.7	2.2	1.9	1.9	2.5	2.6	2.6
CPI - Q%	0.7	0.4	0.4	0.4			
CPI - A%	1.5	1.8	2.1	1.9	2.0	2.0	1.8
HLFS employment growth - Q%	0.2	0.3	0.3	0.4			
HLFS employment growth - A%	0.8	1.1	1.6	1.2	1.8	1.8	1.9
Unemployment rate - %sa	4.2	4.2	4.2	4.3	4.1	3.9	4.0
Annual current account balance as % of GDP	-3.3	-2.8	-2.4	-2.2	-2.3	-2.7	-2.5

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-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.00	1.00	1.00	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.2	1.3	1.2	1.0	1.0	1.3	1.8
NZ 2-year swap rate	0.9	1.3	1.1	1.0	1.0	1.3	1.7
NZ 5-year swap rate	0.9	1.4	1.2	1.1	1.2	1.5	1.9
NZ 10-year swap rate	1.2	1.8	1.4	1.3	1.4	1.6	2.0
NZ 10-year Bond	1.1	1.7	1.2	1.1	1.2	1.4	1.8

ASB foreign exchange forecasts

	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

ASB Economics & Research

Chief Economist
Senior Economist
Senior Economist
Senior Economist
Senior Rural Economist
Senior Economist, Wealth
Publication & Data Manager

Nick Tuffley nick.tuffley@asb.co.nz
Mark Smith mark.smith4@asb.co.nz
Jane Turner jane.turner@asb.co.nz
Mike Jones mike.jones@asb.co.nz
Nathan Penny nathan.penny@asb.co.nz
Chris Tennent-Brown chris.tennent-brown@asb.co.nz
Judith Pinto judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 301 5657
(649) 301 5853
(649) 301 5661
(649) 448 8778
(649) 301 5915
(649) 301 5660

www.asb.co.nz/economics

[@ASBMarkets](https://twitter.com/ASBMarkets)

Disclaimer

This document is published solely for informational purposes. It has been prepared without taking account of your objectives, financial situation, or needs. Before acting on the information in this document, you should consider the appropriateness and suitability of the information, having regard to your objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this document. Any opinions, conclusions or recommendations set forth in this document are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by ASB Bank Limited. We are under no obligation to, and do not, update or keep current the information contained in this document. Neither ASB nor any person involved in the preparation of this document accepts any liability for any loss or damage arising out of the use of all or any part of this document.

Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. ASB does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met.