

# Economic Weekly

20 May 2019

## 'I believe in miracles'

In a shock result, **the sitting Coalition government is poised to retain power**, following the Australian election held over the weekend. Pollsters had had the opposition Labour party as heavy favourites to win power. However, Australian Prime Minister, Scott Morrison, told his supporters that he had "always believed in miracles". See the Chart of the Week below for more analysis.

Turning to the week ahead, dairy is likely to dominate local headlines as **Fonterra updates its 2018/19 milk price forecast and issues its opening forecast for the 2019/20 season**. We anticipate a healthy opening forecast in the \$7.00/kg range. Other local data this week include: the fortnightly Dairy Auction (Tue overnight), Q1 Retail Sales data (Wed) and Trade Balance data (Fri). Offshore, both the RBA and the US Federal Reserve issue their Meeting Minutes on Tuesday and Thursday (NZ time), respectively.

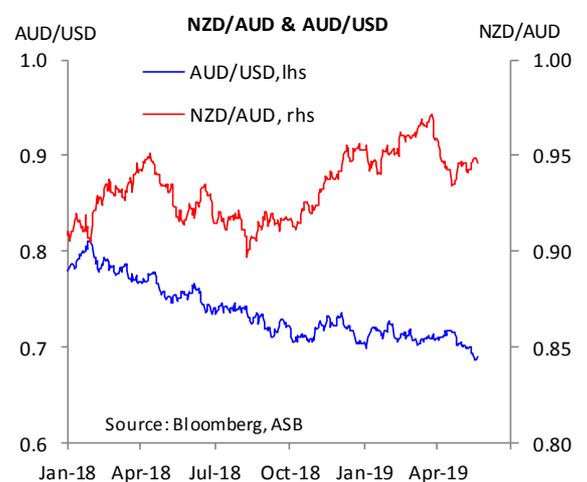
### Key events and views

<a href="#">Foreign exchange</a>	NZD lower on the week on heightened global trade concerns.
<a href="#">Interest rates</a>	NZ rates approach record lows.
<a href="#">Domestic events</a>	Dairy auction, Retail Trade, Trade Balance
<a href="#">International events</a>	RBA Meeting Minutes, US Federal Reserve Meeting Minutes, Global Manufacturing PMIs
<a href="#">Calendars</a>	NZ and international calendar of upcoming economic events.

### Chart of the Week: Aussie election – back to business as usual

**After the surprise win for Scott Morrison's Coalition government, focus will quickly return back to business.** While the election count is still to be finalised, the Coalition will form the next Government. The main question is whether this will be a minority or majority Government. The Senate outcome is closer, but it's likely that the Coalition will remain short of a majority in the upper house.

**As a returning government, there will be little change in policy direction.** Indeed what was a little surprising was how restrained Coalition election promises were during the campaign proper. **The returning government is likely to introduce some fiscal stimulus**, highlighted by tax cuts. Economic growth is likely to remain at 2¾%pa over the next couple of years, which will generate modest Budget surpluses. With this in mind, Australia's AAA rating looks secure. **As such financial market focus will quickly return to the next RBA interest rate decision.**



## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6529	0.6581	0.6716	0.6884	FLAT	0.6430	0.6630	UP
NZD/AUD	0.9472	0.9426	0.9355	0.9160	FLAT	0.9370	0.9570	UP
NZD/JPY	71.87	72.23	75.13	76.35	FLAT	70.80	72.80	UP
NZD/EUR	0.5849	0.5859	0.5945	0.5831	FLAT	0.5750	0.5950	FLAT
NZD/GBP	0.5128	0.5058	0.5147	0.5095	FLAT	0.5030	0.5230	UP
TWI	72.3	72.2	72.7	72.26	FLAT	71.00	74.00	UP

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

### NZD Recap

**NZD/USD eased over the week**, trading at more than six-month lows weighed by expectations of a further RBNZ rate cut and by soft global sentiment due to **heightened global trade concerns**. Global markets were rattled by news of the escalation of trade tensions between the US and China last week. The **AUD/USD has depreciated to fresh three-year lows** during the week on a combination of soft Australian and Chinese economic data, weak energy prices and soft global investor sentiment. Australian Q1 wage growth was softer than expected. Meanwhile, Chinese April data were also soft, with slowing annual growth in industry production, fixed asset investment and retail sales highlighting the downside risks to the Chinese economy. The **GBP** was weighed on reports of Brexit negotiations between UK's two main political parties was unsuccessful in reaching a deal along with reports that UK PM May is again facing calls from some in her party to step down.

### Near-term outlook

The AUD/USD opened 70 pips higher on Monday morning in early illiquid-Asian trade following the national election that returned the Liberal-National Government. The AUD has started to retrace some of these gains as trading continued during the morning. **We anticipate downward pressure will remain on AUD/USD** as the chances the RBA cuts interest rates increase. The next major event to watch is a speech next Tuesday 21 May, by RBA Governor Phil Lowe, on "The Economic Outlook and Monetary Policy". It is highly likely the Governor will outline the case for a rate cut in this speech, which will see AUD/USD depreciate further. The RBA's next policy meeting is on 5 June. The NZD/USD temporarily spiked higher by almost 40 pips in sympathy with AUD/USD in thin Asian trading. The re-escalation in US-China trade tensions and concerns around the consequences for global growth should weigh on the **NZD/USD** this week. The **GBP** will continue to be driven by Brexit developments. UK PM May announced that she will put the Withdrawal Agreement Bill (WAB) before Parliament during the week of 3 June.

### Medium-term outlook

**In the medium term, and looking beyond any short-term reaction to any further OCR cuts, we expect the NZD/USD to gradually strengthen** given NZ's high Terms of Trade. 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. However, the NZD/AUD is currently below these expectations reflecting the RBNZ's May OCR cut. We have delayed the timing of the forecast 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)

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
		<< actual	forecast >>					
NZD/USD	0.67	0.68	0.68	0.69	0.69	0.70	0.72	0.74
NZD/AUD	0.95	0.96	0.96	0.96	0.96	0.96	0.96	0.97
NZD/JPY	74	75	76	77	77	77	78	80
NZD/EUR	0.59	0.60	0.60	0.60	0.59	0.59	0.59	0.60
NZD/GBP	0.53	0.52	0.54	0.54	0.54	0.54	0.55	0.57
NZD TWI	73.5	73.9	73.8	74.4	73.9	74.6	75.3	76.6

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.50	1.50	1.75	1.75	UNCH/DOWN	UP
90-day bank bill	1.71	1.70	1.77	2.00	UNCH/DOWN	UP
2-year swap	1.55	1.60	1.65	2.24	UNCH/DOWN	UP
5-year swap	1.68	1.73	1.81	2.75	UNCH/DOWN	UP
10-year swap	2.08	2.12	2.26	3.28	UNCH/DOWN	UP
10-year govt bond yield	1.79	1.81	1.98	2.87	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.52	0.51	0.61	1.04	UNCH	UNCH/UP

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

### Market Recap

**Global and NZD yields ground lower last week.** Yields on the 1- to 5-year part of the NZ swap curve dipped close to record lows, with markets about 50:50 for a 25bps OCR cut in August. Australian yields dipped and market pricing towards RBA cuts firming after the release of weaker than expected wage data and an increase in the headline unemployment rate (to 5.2%). **Dampening global yields were weaker Chinese data, geopolitical tensions between the US and Iran, and concerns over trade,** with the Chinese state media reporting China may not want to continue trade negotiations with the US. Brexit continued to cast a shadow, with the failure of major UK political parties to come to an agreement after six weeks of negotiations. US 10-year Treasury yields (2.40%) remained around 3-month lows despite China cutting its US Treasury holdings to their lowest levels in two years. NZ 10-year government bond yields (1.77%) moved closer to record lows, with solid interest in the tender for the 2037 bond (2.09%). In the weekend the incumbent Australian coalition government defied the polls and looks set to be returned to power.

### Near-term NZD interest rate outlook

**We have retained a modest downward bias on NZ yields over the next few months given our OCR view, but we have a broadly neutral bias for NZD interest rates this week.** The pledge by the incoming Australian government to pass signature tax cuts will likely provide a brief lift to Australian rates. The RBA Meeting Minutes will likely be of less relevance given the election result, with markets awaiting the Tuesday night speech by RBA Governor Lowe for cues on the RBA's policy biases. Thursday's Fed Minutes will be useful for ascertaining whether Fed members were willing to remain "patient". Next week's NZ Budget is expected to be fiscally responsible and show a little changed bond tender, which should help cap NZD yields. We are also keeping tabs on the NZD, as all-else-equal a lower currency will reduce the adjustment necessary from domestic interest rates. **Global long-term yields are expected to remain sensitive to trade headlines and signals on global growth. Yields could ease and curves come under flattening pressure if concerns over global growth escalate.** This week's May manufacturing PMI's for Australia, the US, Eurozone and Japan and Q1 GDP for Japan will provide a stocktake on global growth.

### Medium-term outlook

**We expect another 25bp OCR cut in August, with risks tilted towards a later start.** The OCR is then expected to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak by late 2023. Proposed higher bank capital requirements, which we assume are equivalent to an increase of roughly 50bps on customer interest rates by late 2023, will likely tighten financial conditions, lower swap interest rates across the curve and keep the OCR lower than it would otherwise be. Global central banks are expected to maintain historically-low interest rate settings. NZD long-term yields could initially dip and then drift up, before eventually settling at around 2.5-3.0%.

### ASB interest rate forecasts

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< 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	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.6	1.5	1.5	1.5	1.6	1.9
NZ 10-year Bond*	2.38	1.8	1.8	1.8	1.8	1.8	2.1	2.4

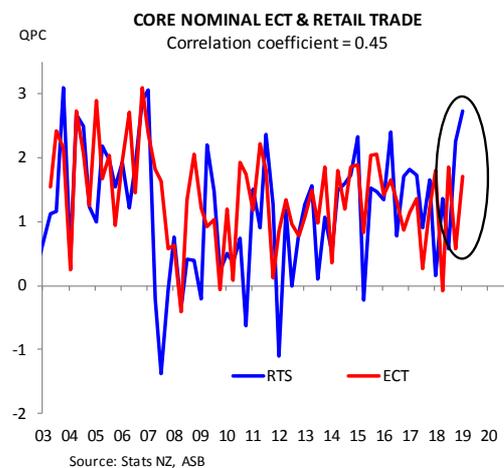
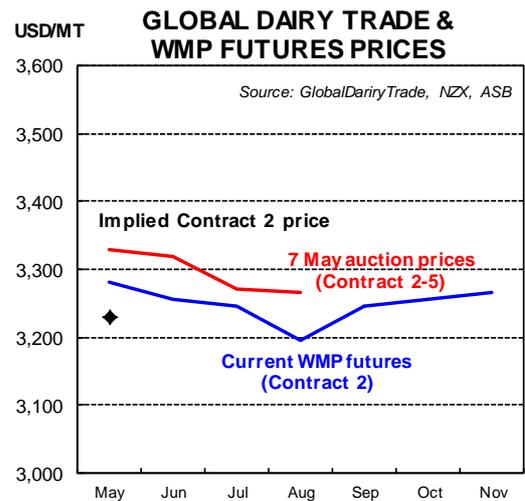
## Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
GlobalDairyTrade auction, whole milk powder, % chg	21/05	Overnight	-0.5	-	-2.0
Retail Sales, Q1, % qoq	22/05	10:45am	1.7	0.6	0.2
Merchandise Trade Balance, April, \$m	24/05	10:45am	922	400	-

**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 0.5%. At the current juncture, futures pricing also points to a fall of around 2%. 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 markets are likely to be disappointed as we expect NZ spring production to undershoot production levels from a year ago.

**The best times for the retail sector look to be behind it, and we expect a sluggish 0.2% increase in quarterly retail volumes, with annual retail volume growth at around 3%.** Given the strong Q4 lift in retail volumes, some pullback is to be expected in Q1, particularly for non-store and commission-based retail, apparel, and electrical goods retailing. Partly offsetting this will be the expected rebound in recreational goods and hardware retailing. **We also expect growth in core spending volumes (+0.5% qoq, 4.5% yoy) to continue to outperform total retail.** Lower vehicle registrations point to a Q1 decline in motor vehicle retail, with consumers expected to trim fuel use in response to climbing fuel prices. We are mindful of not putting too much weight on the card spending figures (which strengthened in Q1) 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 employment and population growth, low wage growth) and tailwinds (Government Families package) facing the retail sector.

We expect a **modest trade surplus of circa \$350m in April.** Looking over the month, dairy export values are likely to consolidate after the surge in March. On the import side, we expect import values to rebound a touch after the weak outturn over March, helped by the rise in oil prices. **The annual trade deficit is likely to narrow towards \$5.5 billion.**



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
Japan GDP, Q1, %qoq	20/05	11:50 am	-0.1	-0.3
RBA May Meeting Minutes	21/05	1:30 pm	-	-
RBA Governor Lowe speech in Brisbane	21/05	2:15 pm	-	-
Australia Construction Work Done, Q1, %qoq	22/05	1:30 pm	0.0	1.0
UK CPI, April, %yoy	22/05	8:30 pm	2.1	2.2
Australia PMIs, May	23/05	11:00 am	-	-
US Federal Reserve Meeting Minutes	23/05	6:00 am	-	-
Japan CPI, April, %yoy	24/05	11:30 am	0.9	1.1
UK Retail Sales, April, %mom	24/05	8:30 pm	-0.5	0.0

\*Originally published by CBA Global Markets Research on Friday 17<sup>th</sup> May at 1:21pm.

Japanese industrial production slumped by 2.6% in Q1. The high correlation between GDP growth and industrial production growth suggests **Japanese Q1 GDP** will have contracted by 0.3%.

Recent communications from the **Reserve Bank of Australia** have been somewhat confusing. But taking the May post-meeting Statement together with the Statement on Monetary Policy it didn't sound like the RBA had moved to an easing bias. The meeting Minutes will be closely scrutinised for any signs in the change in the RBA's bias.

**Governor Lowe is slated to speak at a lunch on Tuesday** in Brisbane. The title of the speech is the *Economic Outlook and Monetary Policy*. This speech will be a good opportunity for the RBA to either confirm its current monetary policy guidance or flag a move to an easing bias.

We are expecting a 1.0% fall in **Australian construction work done in Q1**. Lower building work done should be partly offset by strong public sector infrastructure work.

The lift in oil prices and some weakness in the Pound will push **UK headline inflation** up to around 2.2%yoy. The tight labour market and firming growth in wages will push core inflation higher to 1.9%yoy.

**The Commonwealth Bank of Australia's Purchasing Managers Index (PMI)** has showed some deterioration in sentiment over late 2018/early 2019. In last month's survey, respondents noted some genuine weakening in demand, especially on the services side of the equation. The impact of the drought is also biting in some areas.

With the **US Federal Reserve** indicating it will be "patient" as it determines the next move in the Funds rate, the Minutes are unlikely to move financial markets.

Already-released Tokyo inflation suggests **Japan's national headline CPI** will likely spike higher to 1.1%yoy because of higher energy prices. However, excluding fresh food and energy, we estimate inflation accelerated to only 0.6%yoy.

We expect the **UK's April retail sales** to stabilise after a strong 1.1% surge in March. The UK's strong labour market is supportive of consumer spending.

## 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	0.4	0.9					
GDP real - A%	2.3	2.2	2.2	2.7	2.9	3.1	2.4	2.4
GDP real - AA%	2.8	2.6	2.3	2.4	2.5	2.7	2.6	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	1.8	1.8
HLFS employment growth - Q%	0.0	-0.2	0.4					
HLFS employment growth - A%	2.3	1.5	1.3	0.8	1.2	1.8	1.6	1.4
Unemployment rate - %sa	4.3	4.2	4.3	4.3	4.3	4.3	4.2	4.1
Annual current account balance as % of GDP	-3.7	-3.3	-2.9	-2.5	-2.2	-2.0	-2.0	-1.7

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

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)								
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	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.6	1.5	1.5	1.5	1.6	1.9
NZ 10-year Bond*	2.38	1.8	1.8	1.8	1.8	1.8	2.1	2.4

### ASB foreign exchange forecasts

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)								
NZD/USD	0.67	0.68	0.68	0.69	0.69	0.70	0.72	0.74
NZD/AUD	0.95	0.96	0.96	0.96	0.96	0.96	0.96	0.97
NZD/JPY	74	75	76	77	77	77	78	80
NZD/EUR	0.59	0.60	0.60	0.60	0.59	0.59	0.59	0.60
NZD/GBP	0.53	0.52	0.54	0.54	0.54	0.54	0.55	0.57
NZD TWI	73.5	73.9	73.8	74.4	73.9	74.6	75.3	76.6

#### ASB Economics & Research

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

Nick Tuffley  
Mark Smith  
Jane Turner  
Nathan Penny  
Chris Tennent-Brown  
Judith Pinto

[nick.tuffley@asb.co.nz](mailto:nick.tuffley@asb.co.nz)  
[mark.smith4@asb.co.nz](mailto:mark.smith4@asb.co.nz)  
[jane.turner@asb.co.nz](mailto:jane.turner@asb.co.nz)  
[nathan.penny@asb.co.nz](mailto:nathan.penny@asb.co.nz)  
[chris.tennent-brown@asb.co.nz](mailto:chris.tennent-brown@asb.co.nz)  
[judith.pinto@asb.co.nz](mailto:judith.pinto@asb.co.nz)

#### Phone

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

[www.asb.co.nz/economics](http://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.