

Now the fight really begins

- US House of Representatives pass USD1.5 trillion tax cut bill, but the higher hurdle will be getting tax reform past the Senate.
- NZ retail data are expected to show a flat quarter, with annual growth in retail volumes expected to slow over the remainder of the year. Net immigration and visitor arrivals are expected to remain strong, but look to have either peaked (net immigration), or will face capacity-related challenges to strengthen further (visitor arrivals).
- Prices are expected to track sideways at this week's dairy auction. Our \$6.75 milk price forecast for 2017/18 remains under review. The lower NZD and elevated commodity prices will help underpin producer incomes and the economic rebalancing, but spending restraint will be required to cap the current account deficit.

Late last week the House Republicans passed legislation to overhaul the US tax code, the largest such change in more than 30 years. The House bill, estimated to add nearly USD \$1.5 trillion to the US fiscal deficit over 10 years, would consolidate individual and family tax brackets and would cut corporate tax rates from 35 percent to 20 percent. Some deductions will be maintained, whilst others will either be scaled back or scrapped altogether, resulting in tax hikes for some Americans. The US Senate is now considering its own tax bill. The stakes are high, with the White House signalling its willingness to repeal the removal of mandatory health insurance if it became "an impediment" to pushing through the tax bill. Despite this, getting this package through the Senate looks to be a much tougher prospect given the small Republican Senate majority and its impact on the US fiscal deficit. Even if the Senate Bill gets through, the House and Senate will still need to come up with (and pass) the final package through both houses before President Trump can sign in into law.

The main global event this week is probably the FOMC Minutes of the November meeting (Thursday am). ASB and the market expect a Fed hike next month, whilst our expectation of at least two further fed hikes over 2018 is higher than current market pricing. RBA minutes on Tuesday should be a non-event given their close proximity to the RBA's November Statement on Monetary Policy (SMP). Indeed, RBA rate rises remain some way off given muted inflationary pressures. The ECB's minutes from its October monetary policy meeting will reveal any concerns regarding the length and scope of the ECB's tapering program. Eurozone and US PMI's are expected to depict still-strong momentum. Thursday sees the release of the UK Budget and Q3 UK GDP.

This week's domestic data. A flat quarter is expected for Q3 retail activity as the Q2 boost from the Lions Tour and World Master's Games unwinds. Election-related uncertainty and the flat housing market are expected to contribute to sluggish retail activity in the second half of this year. Prices are expected to track sideways at this week's dairy auction and our \$6.75 Fonterra milk price forecast for 2017/18 remains under review. The moderation in annual net PLT immigration is expected to continue.

Foreign Exchange

- NZD TWI hovering around 15-month low on generalised NZD weakness.

Interest Rates

- Lower local rates compared to last week, with the curve flattening. Spreads narrowing with US rates.

Week Ahead

- Dairy auction, International travel & migration, Q3 retail sales, Trade, 2017 National accounts.

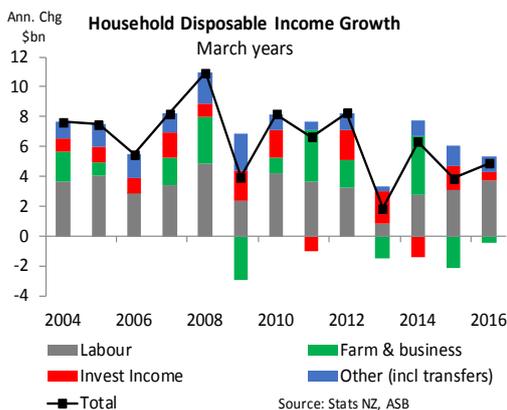
Week in Review

- No major data was released last week.

Global Calendars

- RBA Minutes, US Fed Minutes, ECB Minutes, US/European November PMI's, UK Budget, Q3 UK GDP.

Chart of the Week: Drivers of Household Incomes



We expect annual retail sales growth to slow to around 3½% by the end of the year, given election-related uncertainty and the sluggish housing market. With little (or no) household saving to access and with homeowners generally reluctant (or unable to) use their wealth as an ATM, maintaining growth in consumer spending will need to be financed by lifting incomes.

National Accounts data have confirmed that more than three-quarters of the growth in household disposable incomes since 2015 has come from strengthening labour incomes. We expect the labour market to continue to do the heavy lifting, with increasing wages expected to offset the likely deceleration in employment growth as capacity limits are reached. Supplementing this will be improved farm incomes, courtesy of historically-high commodity export prices. Provided that consumers and government show spending restraint, strong export receipts should assist with the economic rebalancing of the NZ economy and will help cap the magnitude of future current account deficits.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6806	0.6925	0.6990	0.6935	0.7015	DOWN	0.6680	0.6950
NZD/AUD	0.8998	0.9040	0.8907	0.9320	0.9486	FLAT	0.8880	0.9150
NZD/JPY	76.31	78.70	79.08	77.33	77.54	DOWN	75.20	77.50
NZD/EUR	0.5774	0.5943	0.5914	0.6197	0.6614	DOWN	0.5700	0.5870
NZD/GBP	0.5152	0.5277	0.5331	0.5334	0.5655	DOWN	0.5080	0.5240
TWI	72.3	73.5	73.7	75.1	77.2	DOWN	71.00	74.00

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

The NZD was the worst performer of all the major currencies we monitor last week. The NZD/USD hit a 17-month low on Friday night, dipping as low as \$US0.6780 in Friday's New York session. The TWI has also fallen and is now sitting around 72.3, lower than both ours and the RBNZ's Q4 TWI forecasts. **Given the currency tends to have a lagged impact on inflation, the most recent fall in the NZD signals upside risk to inflation forecasts in early/mid 2018.**

The NZD was mixed against the AUD over the week, as various Australian data resulted in a fair degree of volatility in the cross. Strong Australian business conditions data supported the AUD on Tuesday before Wednesday's soft wage price index data saw this reverse. However, **the NZD/AUD still ended the week lower, falling below \$AU0.9000 late on Friday.**

This week attention will be on Thursday's Federal Reserve meeting minutes as market participants are expecting a rate hike on the 14th of December. As has been the case recently, any comments around inflation pressures will be closely scrutinised. In New Zealand, the Q3 retail sales release on Thursday is expected to be soft, reflecting election uncertainty and the soft housing market.



Medium-term outlook:

Last Quarterly Economic Forecasts

We updated our FX forecasts in early November, to reflect the weaker NZD following the outcome of the NZ General Election and growing likelihood of a US fiscal tax package being delivered. In NZ, **political uncertainty associated with a change in Government has weighed on the NZD,** but we expect this to have mostly a fleeting impact. **The NZD remains the recipient of some key supports -** including the near-record Terms of Trade, relatively high interest rates and a solid domestic outlook – which are expected to keep the NZD elevated over the forecast horizon.

Meanwhile, a **strengthening USD will cap the extent of the NZD recovery,** reflecting the growing likelihood of a stimulatory fiscal tax package which is likely to boost US GDP growth by 0.3% in 2018 and 2019. All up, we expect the NZD/USD to recover to 0.72 by early 2018 and climb to 0.75 by then end of 2018.

The NZD/AUD fell following the Labour-NZ First coalition announcement and we expect the **NZD/AUD will average between 0.90 and 0.91 over the next year.**

Supportive growth prospects, pending ECB tapering, and prospective ECB rate hikes next year will support the euro. We expect **NZD/EUR to average between 0.60 and 0.61 over the coming year.** With EU-UK Brexit negotiations weighing on the UK economic outlook, the NZD is expected to remain elevated against the GBP. **We expect the NZD/GBP to average between 0.53 and 0.54 until the end of 2018.** We expect the **NZD/JPY to average around 78-80 level over the next couple of years.** The large Japanese current account surplus and low US Treasury yields, and no indication of further easing by the BOJ, are expected to support the JPY.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	1.75	FLAT
90-day bank bill	1.91	1.92	1.94	1.97	2.05	FLAT
2-year swap	2.16	2.20	2.17	2.25	2.27	DOWN
5-year swap	2.65	2.71	2.68	2.78	2.78	DOWN
5-year benchmark gov't stock	2.44	2.48	2.48	2.26	2.45	DOWN
NZSX 50	8062	7976	8131	7406	6859	DOWN

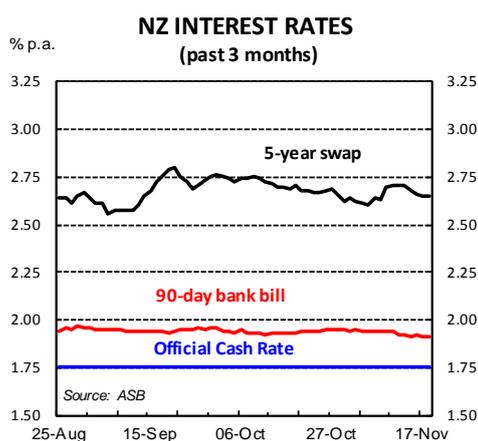
^Weekly support and resistance levels * Current is as at 9.30am Monday; week ago as at Monday 5pm.

Interest rates fell over the past week, following declines in offshore interest rates. These moves lower were led by falls in longer-term rates, resulting in a slight flattening in the NZ yield curve and unwinding some of the previous week's steepening.

There was **no major NZ economic data released last week so the focus remained offshore**. In the US, long-term interest rates edged lower early in the week and remained at these levels despite decent economic data later in the week. Meanwhile, short-term US interest rates remain firm on expectations for Federal Reserve rate increases. The US-two-year bond yield lifted to 1.71% on Friday – the highest level in nine years. Firm US short-term rates contrasts to subdued longer-term rates, and as a result the U.S. 10-2 year yield curve is at its flattest level in 10 years, since November 2007.

Australian-related data also reinforced the outlook for lower interest rates. Australian wage inflation printed weaker than expected, reinforcing a steady Cash Rate outlook given inflation indicators remains subdued. Furthermore, October Chinese economic data also printed weaker than expected, highlighting the prospect for slowing Chinese growth to reduce Australian growth prospects.

Short-term outlook:



Week Ahead: The week ahead sees a number of important local data releases. Most of these releases are likely to underwhelm and highlight the near-term downside risks to the NZ growth outlook. First up is the Global Dairy Trade auction, where we see some risk that prices could remain flat or continue to fall. Meanwhile, net migration data should continue to slow as permanent departures lift, confirming a turning point in immigration. Q3 retail trade data are also likely to print weak; we expect a flat quarter for overall retail volumes and risks are tilted to the downside – a negative quarter is a distinct possibility.

Meanwhile, the key events in offshore markets this week will be the release of RBA meeting minutes and FOMC meeting minutes. We expect offshore markets to remain very quiet heading into the weekend, due to US Thanksgiving holiday.

Medium-term outlook:

Last Quarterly Economic Forecasts

The Reserve Bank of New Zealand (RBNZ) kept the Official Cash Rate (OCR) on hold at 1.75% in November, and maintained a neutral policy outlook. The growth outlook was broadly in line with the August MPS, but the short-term trajectory for inflation was higher. The key development with the Monetary Policy Statement (MPS) is the inclusion of assumptions around some key government policy changes. The assumptions, whilst preliminary, largely focus on policy shifts that are likely to have the most significant impact on the inflation outlook. The published interest rate path signalled a slightly earlier start to OCR hikes (H1 2020 instead of H2), but with just 50bp of hikes till the end of 2020. We expect the RBNZ will have to move sooner than this, with policy tightening starting in 2019, but for a gradual path of policy tightening and a historically low OCR endpoint this cycle.

Meanwhile, the new Government announced that is instigating a two-stage review of the Reserve Bank Act. We expect key recommendations to include adding a dual mandate, including employment alongside price stability. A shift to a formal committee for policy decisions is highly likely. **The changes are unlikely to change the average level of NZ interest rates over the longer-term.** Provided that the employment target is a worded one, rather than an explicit numerical target, **we also see few implications for monetary policy operations over the cycle.** RBNZ comments during the November MPS media conference suggest they share a similar view. But the target changes will be an added consideration next year for the RBNZ, along with the Government policy changes the RBNZ is already starting to factor in.

Local long-term interest rates are expected to drift up in tandem with global counterparts. With ASB now expecting three Fed hikes by the end of 2018 (and the possibility of a fourth), upside risks are building. Low global inflation, however, and a downward global risk profile suggest that the drift up will be gradual, with a historically low endpoint.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Reserve Bank of Australia Meeting Minutes	21/11	1:30 pm	-	-	-
RBA Governor Lowe at the Australian Business Economists	21/11	10:00 pm	-	-	-
Australia Construction Work Done, Q3, %qoq	22/11	1:30 pm	9.3	-2.3	-2.0
UK Chancellor Hammond to present Budget to Parliament	23/11	1:30 am	-	-	-
EZ Composite PMI, November, %mom	23/11	10:00 am	56.0	56.0	56.3
ECB Account of the Monetary Policy Meeting	24/11	1:30 am	-	-	-

The **Reserve Bank of Australia (RBA)** left the cash rate unchanged in November for the 15th consecutive month. Although the labour market has improved, muted inflationary pressures and plenty of slack in the economy mean that a rate rise is still a long way off. Given the close proximity to the RBA's November *Statement on Monetary Policy (SMP)*, the **Minutes** are unlikely to contain any surprises and thus should have limited market impact.

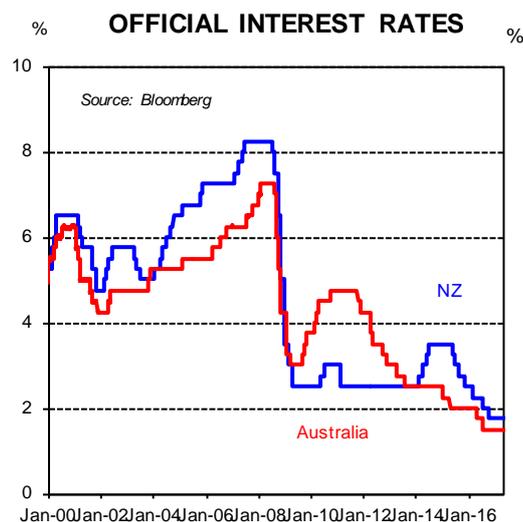
RBA Governor Lowe will address the annual Australian Business Economists dinner in Sydney. The topic has not yet been announced. An extended Q&A session is generally the feature of this event.

Underlying **Australian construction** is running at a robust pace in part due to a healthy contribution from public investment. But a big 9.3% lift in construction over Q2 suggests some statistical payback in Q3 is likely. As such, we expect to see a decline in the headline number over the September quarter.

UK Chancellor Philip Hammond is due to present the **UK's budget** for 2018. Hammond is expected to resist calls to aggressively increase spending.

We anticipate the **November Eurozone composite PMI** will print around 56.3, illustrating solid economic expansion in the Eurozone.

The **European Central Bank's minutes** from its October monetary policy meeting will reveal any concerns regarding the length and scope of the ECB's tapering program.



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
GlobalDairyTrade Auction, whole milk powder, % change	21/11	overnight	-5.5	-	No change
International Travel & Migration, Oct, Net Migration, 000s	22/11	10.45 am	5,200	-	5,100
Retail Sales, Q3, %qoq	23/11	10:45 am	1.9	0.1	0.0
Trade balance, Oct, \$m	24/11	10:45 am	-1,143	-	-600

We expect prices to track sideways at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices slid by 5.5%. **At the current juncture, futures pricing suggests WMP will lift by between 1% and 3%.** However, the futures market has overestimated price moves at recent auctions. Accordingly, we discount this indicator. Moreover, NZ production for October was better than expected, rising 2.9% compared to October 2016. Firmer than expected NZ production is likely to lead to downward pressure on prices at this auction.

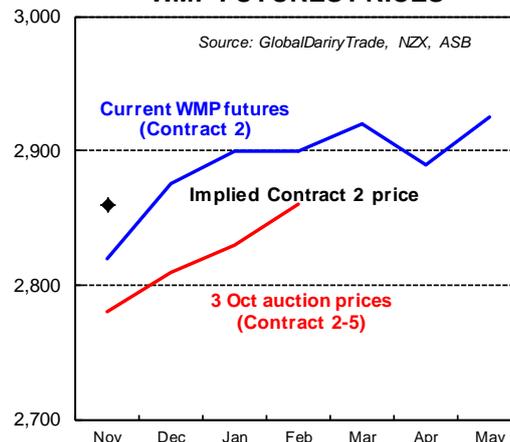
A net permanent and long-term inflow of around 5,100 persons is expected for October, with the annual net inflow slightly below 70,000 persons, the lowest in a year. **Easing levels of PLT arrivals and strengthening PLT departures are driving this moderation. This trend is expected to continue,** given the signalled tightening in NZ migration policy, strengthening global economy and improving Australian labour market. We expect annual net PLT inflows to ease from a peak of just over 72,000 persons in mid-2017 to around 50,000 persons by the end of next year and 40,000 persons by late 2019.

Another flat month is expected for seasonally-adjusted **tourism arrivals**, which should see annual tourism arrivals plateau at around 3.7 million visitors for the October year. Increasing flight connectivity and New Zealand’s reputation as a safe tourist destination have proved to be important drawcards. However, given constraints over accommodation capacity and tourism infrastructure, **we are cautious over the ability of the sector to continue to generate ever-growing tourism numbers.**

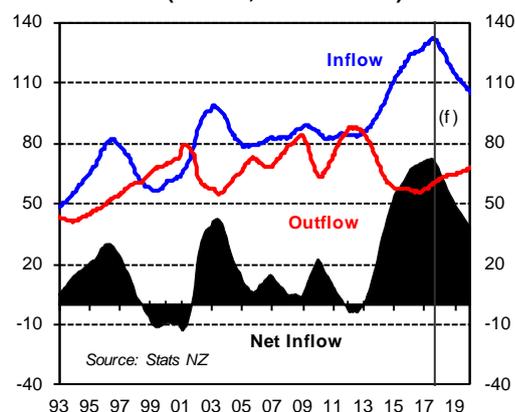
The retail sector was one of the star performers in the first half of the year, with both total and core (ex-fuel and vehicle-related) spending volumes advancing at more than 3.5% in the first half of the year. **Part of this earlier strength is expected to be unwound in Q3.** Retail indicators, including lower Q3 card spending, falling visitor arrivals and vehicle registrations, point to a sluggish quarter for retail volumes. **We expect a flat quarter for overall retail volumes. Risks are tilted to the downside, and a negative quarter is a distinct possibility.** Falls are expected for the accommodation and food and hospitality sectors that were boosted by the Lions and World Master’s Games. Durables-related retail over the remainder of the year is likely to be weighed by election-related uncertainty and the sluggish housing market. Offsetting this will be higher grocery retail volumes. **We expect annual growth in retail spending volumes to slow from the circa 5.2% rate in the middle of this year to below 4% by the end of the year.** Beyond that, more government support, increasing wages and higher producer incomes are expected to underpin solid, rather than spectacular rates of consumer spending going forward, as consumers continue to strive to live within their means.

We expect a **trade deficit of \$600m in October**, reflecting seasonal weakness in agricultural exports. Looking over the month, we expect dairy export volumes to rise after recent temporary weakness. At the same time, import values are likely to lift on the back of the weaker NZD and higher oil prices. Looking at the annual balance, **we expect the annual trade deficit to narrow to \$2.71 billion.**

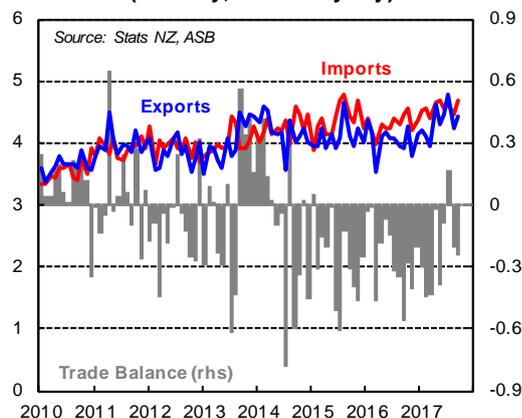
USD/MT GLOBALDAIRYTRADE AND WMP FUTURES PRICES



'000s TOTAL MIGRATION (into NZ, annual totals)



\$ billion EXPORT & IMPORTS (Monthly, seasonally adj.)



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 20 Nov	12:50	JN	Trade balance adjusted	Oct	¥bn	240.3	~	~
	14:35	AU	RBA's Kearns gives Speech in Sydney					
	16:45	AU	RBA's Kohler gives Speech in Sydney					
Tue 21 Nov	11:30	AU	ANZ Roy Morgan Weekly Confidence Index	Nov	Index	114.8	~	~
	13:30	AU	RBA November Rate Meeting Minutes					
	15:00	NZ	Credit card spending	Oct	m%ch	0.7	~	~
	17:30	JN	All industry activity index	Sep	m%ch	0.1	~	~
Wed 22 Nov	21:00	AU	RBA Governor Lowe gives Speech in Sydney					
	10:45	NZ	Net migration	Oct	~	5,190	~	5,100
	12:30	AU	WBC leading index	Oct	m%ch	0.1	~	~
Thu 23 Nov	13:30	AU	Construction work done	Q3	%	9.3	~	-2.0
	10:45	NZ	Retail sales ex inflation	3Q	q%ch	1.9	0.1	0.0
Fri 24 Nov	10:45	NZ	Trade balance	Oct	NZD mn	-1,143	~	-600
	13:30	JN	Nikkei Japan PMI manufacturing	Nov P	Index	52.8	~	~
	18:00	JN	Leading index CI	Sep F	Index	106.6	~	~
	18:00	JN	Coincident index	Sep F	Index	115.8	~	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 20 Nov	14:00	EC	ECB's President Draghi speaks in Brussels					
	15:00	US	Leading index	Oct	%	-0.2	0.6	~
	16:00	EC	Draghi speaks in Brussels in his capacity as ESRB Chair					
Tue 21 Nov	09:30	UK	Public finances (PSNCR)	Oct	£bn	11.2	~	~
	13:30	US	Chicago Fed National Activity Index	Oct	Index	0.2	~	~
	15:00	US	Existing home sales	Oct	\$mn	5.4	5.4	~
Wed 22 Nov	23:00	US	Fed's Yellen speaks at Stern Business School					
	12:30	UK	UK Chancellor Hammond makes Autumn Statement to Parliament					
	13:30	US	Initial jobless and continuing claims	Nov	~	~	~	~
	13:30	US	Durable goods orders	Oct P	%	2.0	0.3	~
	15:00	EC	Consumer confidence	Nov A	~	-1.0	~	~
	15:00	US	Uni. of Michigan sentiment	Nov F	Index	97.8	98	~
Thu 23 Nov	19:00	US	FOMC Meeting Minutes	Nov	~	~	~	~
	09:00	EC	Markit Eurozone manufacturing PMI	Nov P	Index	58.5	~	~
	09:00	EC	Markit Eurozone services PMI	Nov P	Index	55.0	~	~
	09:00	EC	Markit Eurozone composite PMI	Nov P	Index	56.0	~	~
Fri 24 Nov	12:30	EC	ECB account of the monetary policy meeting					
	09:30	UK	UK finance loans for housing	Oct	~	41,584	~	~
	14:45	US	Markit US manufacturing PMI	Nov P	Index	54.6	~	~
	14:45	US	Markit US services PMI	Nov P	Index	55.3	~	~
	14:45	US	Markit US composite PMI	Nov P	Index	55.2	~	~

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