Economic Weekly

21 October 2019

Boris' bumbling Brexit bumbles on

Financial markets remained in a holding pattern last week, with economic data and geo-political developments failing to nudge markets materially in either direction over the week. **The Brexit saga continues to drag on**, as the UK Parliament withheld approval of PM Boris Johnson's updated Brexit deal with the EU over the weekend (for now), legally forcing the PM to seek yet another extension to Brexit. At the very least, it appears the risks of a no-deal Brexit have been reduced – spurring a bit of relief in the market.

Last week's NZ and Australian economic data was 'ok', as Australian unemployment rate edged lower to 5.2% in September and NZ CPI inflation was slightly stronger than expected. However, **the sharper than expected slowdown in Q3 Chinese economic growth provides gives plenty of reasons to remain anxious on the economic outlook.**

Key events and views

Foreign exchange	The mild NZD upside bias will remain intact this week.
Interest rates	There is scope for yields to push higher if the current positive risk sentiment persists.
Domestic events	NZ trade balance to register seasonal deficit.
International events	European Central Bank (ECB) is widely expected to make no monetary policy changes.

Chart of the Week: Celebrating Diwali

It's Diwali this coming weekend, so our Senior Rural Economist Nathan Penny decided to take a look at NZ's exports to India. **India accounts for just 1.2% of NZ's total good exports by value, which puts India in 18th position.**

Interestingly, NZ's exports an eclectic mix of goods to India. **NZ's largest export to India is forestry, with around $300m of forestry exports per annum over the last three years.** The next biggest exports are fruit and vegetables, followed by oil. Dairy and meat, traditionally NZ's largest exports, are only the seventh and eighth largest exports to India by value.

While small now, **given India's population and income growth, the Indian market offers NZ huge potential. But for now, the Indian economy is highly protected and large export barriers are likely to remain,** meaning NZ will have its work cut out for it to materially grow its exports to India over the next few years.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6379	0.6311	0.6293	0.6560	FLAT/UP	0.6285	0.6440	FLAT
NZD/AUD	0.9314	0.9296	0.9260	0.9228	FLAT	0.9240	0.9375	FLAT
NZD/JPY	69.18	68.34	67.86	73.72	FLAT/UP	67.00	69.75	UP
NZD/EUR	0.5715	0.5721	0.5690	0.5725	FLAT/UP	0.5685	0.5840	UP
NZD/GBP	0.4924	0.5006	0.5010	0.5036	FLAT/DOWN	0.4890	0.5180	UP
TWI	70.7	70.0	69.9	71.89	FLAT/UP	N/A	N/A	FLAT/UP

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

NZD Recap

The tentative NZD recovery continued last week, as we'd expected. The NZD remains largely beholden to global growth sentiment. And there were enough positives in the global news flow last week to lift the kiwi up through 0.6350, as investors' risk appetite recovered a little further.

We wouldn't say we've seen a material breakthrough on either of the two 'deals' currently dominating market sentiment. But things at least appear to be (slowly) moving in the right direction. A no-deal Brexit looks to have been avoided, and the foundations of a UK-EU Brexit deal appear to be in place (regardless of whether it passes through UK Parliament this week). Similarly, US-China trade talks have at least become a little more conciliatory, even if the two sides remain a long way from reaching a substantive deal.

Near-term outlook

It's a relatively quiet week in terms of events and data, aside from the usual Brexit/tradewar headlines.

We expect the mild NZD upside bias will remain intact this week, in the absence of any news that upsets the slightly more constructive global applecart. In this regard, it will be worth paying attention to this week's European PMIs/ECB meeting double-act. It's already clear Europe is one the global weak spots, but any signs that the European manufacturing recession is spreading/deepening would undoubtedly knock back global growth sentiment.

We're also cognisant that speculative investors remain extremely short NZD/USD, and our estimated 'fair-value' range for the kiwi is still some way above current spot rates. These factors suggest the path of least resistance is higher absent any negative global news.

Medium-term outlook

Our forecasts have the NZD/USD essentially trending sideways for the best part of the next nine months, to a low of 0.6200 in March 2020. This slow and low forecast profile reflects the drag from the NZ growth slowdown and associated RBNZ interest rate cuts, and the subdued global backdrop. From late 2020, we expect the currency to begin trending higher again as fiscal and monetary stimulus eventually drive a recovery in the NZ economy, and NZ's Terms of Trade remain elevated.

Mike.jones@asb.co.nz

ASB foreign exchange forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	71	71
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.53	0.51	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.2	70.2	69.3	68.3	71.7	72.1	72.1

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/DOWN	UP
90-day bank bill	1.05	1.04	1.14	1.90	UNCH/DOWN	UP
2-year swap	0.95	0.89	0.95	2.03	UNCH/DOWN	UP
5-year swap	1.03	0.96	0.97	2.39	UNCH/DOWN	UP
10-year swap	1.34	1.29	1.25	2.90	UNCH/DOWN	UP
10-year govt bond yield	1.25	1.19	1.16	2.66	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.39	0.40	0.31	0.86	UNCH/DOWN	UNCH/UP

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

Market Recap

NZ interest rates continued to drift higher and the curve steepened, with the climb in Australasian yields outpacing those in the US. NZ yields edged up after stronger than expected headline and non-tradable CPI prints, although moves were capped by stable prints for core inflation and latter signals by RBNZ Deputy Governor Bascand that the OCR would likely move lower still. The RBA Minutes highlighted downside local and global risks and the intent to front-foot policy easing and cut the 0.75% cash rate further if needed. However, Australasian yields firmed after the Australian unemployment rate eased to 5.2% and RBA Governor Lowe reiterated recent rate cuts had supported the economy, with the move to negative rates "extraordinary unlikely". In the weekend, the UK parliament voted to rule out a no-deal Brexit and did not vote on the Brexit deal UK PM Johnson had brokered with the European Union. The US dataflow was soft (retail sales, Beige book), with 6% yoy Chinese Q3 GDP growth the lowest since the early 1990s.

Near-term NZD interest rate outlook

We have retained our downward bias, but note there is scope for yields to push higher if the current bout of positive risk sentiment persists. Market pricing has moved from pricing close to a further 30bps of RBNZ OCR cuts by the end of 2019 and a 0.45% OCR trough at the start of the month, to just shy of 25bps of OCR cuts and a 0.60% OCR trough at present. The move higher in local and global yields has largely been sparked by increased optimism on Brexit and the resolution of US/China trade tensions. **Brexit will likely focus market attention, particularly if PM Johnson's Brexit agreement is subject to a parliamentary vote. If this vote is unsuccessful, it is back to square one.** Further signs of softness in the global dataflow this week- including global manufacturing/services PMIs could also push global yields lower. There are no Fed speeches scheduled ahead of the October 31 Fed decision (85% odds for a 25bp cut). Friday's ECB decision is the last for outgoing President Draghi. Considering the ECB cut the key deposit rate last month to a record low -0.5% last month, no change to policy settings are expected. However, Draghi is expected to call for more (fiscal) policy stimulus to help push stubbornly low inflation higher.

Medium-term outlook

Our forecast is for the curve to initially steepen and then to flatten as policy easing precedes mild policy tightening. We expect 50bps of OCR cuts (-25bps Nov 19, -25bps Feb 20), with the OCR to plateau at 0.5% this cycle. This will be followed by mild and gradual OCR hikes from 2022, with an OCR endpoint of just 2%. We also expect a further 25bp cut by the RBA in February (0.5% floor). The Fed is expected to cut the 1.75%-2% Federal Funds rate by 100bps by mid-2020 (Oct 19, Dec 19, Mar 20, Jun 20). **Low inflation, low global growth and a negatively skewed risk profile should cap NZ and global long-term interest rates at historically-low levels.**

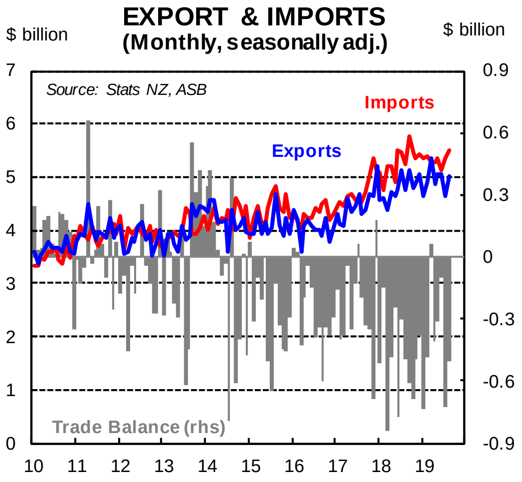
mark.smith4@asb.co.nz

ASB interest rate forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.50	1.00	0.75	0.50	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.0	0.9	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	0.8	0.7	0.7	1.0	1.4
NZ 5-year swap rate	1.4	0.9	0.9	0.8	0.9	1.3	1.7
NZ 10-year swap rate	1.8	1.2	1.2	1.1	1.2	1.6	2.0
NZ 10-year Bond	1.6	1.1	1.0	0.9	1.0	1.4	1.8

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise Trade Balance, September, $m	23/10	10:45 am	-1,375	-1,400

We expect a trade deficit of circa $1,400m in September. The September trade balance is normally in deficit as agricultural export volumes slow over winter. Looking over the month, dairy and meat export values (in seasonally-adjusted terms) are likely to be firm on the back of strengthening prices. On the import side, we expect import values growth to remain modest in line with generally modest domestic demand. The annual trade deficit is likely to narrow a touch towards $5.3 billion.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Asst. Gov. Kent panel participation	23/10	11:20 am	-	-
Australia CBA PMIs, October	24/10	11:00 am	-	-
Eurozone Composite PMI, October	24/10	9:00 pm	50.4	-
ECB Interest Rate Announcement, %	25/10	12:45 am	No chg	No chg

**Originally published by CBA Global Markets Research on Friday 18th October*

Reserve Bank of Australia Assistant Governor (Financial Markets) Christopher Kent will participate in a panel discussion at the International Swaps and Derivatives Association in Sydney (9.20am AEST).

Australia's PMI data for September signalled a pickup in growth momentum across the Australian private sector. Services business activity increased at a solid pace in September, recovering from a slight fall in August. In contrast, the Australian manufacturing sector moved into contraction territory in September. Business conditions deteriorated for the first time in the 41-month survey to date.

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 a highly accommodative stance of monetary policy for a prolonged period of time.

The **Eurozone's manufacturing PMI** is projected to remain below the 50 threshold, consistent with a contraction in manufacturing activity. The manufacturing sector accounts for about 20% of the Eurozone economy. But the main reason behind the ECB's gloomier economic outlook is ongoing weakness in the manufacturing sector. The services PMI is expected to remain resilient above 50.

Key Forecasts

ASB NZ economic forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	0.5	0.4	0.3				
GDP real - A%	2.1	2.2	1.8	1.8	2.4	2.4	2.4
GDP real - AA%	2.4	2.3	2.2	2.0	2.2	2.4	2.4
CPI - Q%	0.6	0.7	0.2				
CPI - A%	1.7	1.5	1.6	2.0	1.7	1.9	1.9
HLFS employment growth - Q%	0.8	0.2	0.3				
HLFS employment growth - A%	1.7	0.9	1.2	1.6	1.5	1.4	1.2
Unemployment rate - %sa	3.9	4.1	4.1	4.3	4.2	3.8	3.9
Annual current account balance as % of GDP	-3.4	-3.4	-3.3	-3.1	-3.0	-3.1	-3.1

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-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.50	1.00	0.75	0.50	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.0	0.9	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	0.8	0.7	0.7	1.0	1.4
NZ 5-year swap rate	1.4	0.9	0.9	0.8	0.9	1.3	1.7
NZ 10-year swap rate	1.8	1.2	1.2	1.1	1.2	1.6	2.0
NZ 10-year Bond	1.6	1.1	1.0	0.9	1.0	1.4	1.8

ASB foreign exchange forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	71	71
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.53	0.51	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.2	70.2	69.3	68.3	71.7	72.1	72.1

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets