

Economic Weekly

23 April 2019

Easter (barely) rising

The key domestic release last week was the Q1 CPI, with overall prices up a mere 0.1% qoq (+1.5% yoy), below market and RBNZ expectations. We doubt the economy will have enough steam to keep inflation within the RBNZ's 1-3% target without monetary policy action and expect 50bps in OCR cuts this year. The other important domestic news was the Government's surprise decision to rule out a capital gains tax. The Prime Minister's announcement should remove some of the policy uncertainty that has likely been weighing on business sentiment in recent months. If so, we are likely to see a recovery in upcoming sentiment measures, although headwinds to local and global growth should cap growth momentum.

Overseas, the RBA's meeting minutes were slightly dovish, but the bank is sticking to its 'no cut without a sustained unemployment rise' mantra, and March Australian employment data were fairly solid. There was some additional good news with solid Chinese and American data, but this week's Q1 GDP should confirm US growth is slowing.

Key events and views

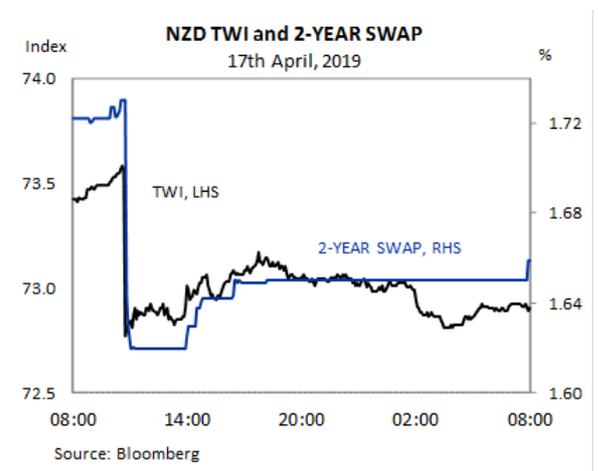
Foreign exchange	NZD down on low CPI print
Interest rates	Low CPI print drive NZD yields lower
Domestic events	March Trade Balance
International events	Australian CPI, ECB Economic Bulletin, US GDP, Bank of Canada and Bank of Japan meetings
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: TWI-ce in a day

Last Wednesday, two key events drove significant movements in the NZD and NZD interest rates.

At 10.45am, Stats NZ released its CPI figures for 2019 Q1, showing weak headline inflation. The soft reading drove a sharp fall in the NZD. The 2-year NZD swap fell by 10 basis points.

Later that day, robust Chinese data pushed the NZD higher. Q1 Chinese GDP growth of 6.4% yoy, March retail sales of 8.7% yoy and industrial production of 8.5% yoy, were above expectations. The good news buoyed the NZD over the afternoon, before it drifting downward overnight.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6680	0.6757	0.6886	0.7205	FLAT/DOWN	0.6580	0.6820	UP
NZD/AUD	0.9358	0.9450	0.9690	0.9380	FLAT/DOWN	0.9250	0.9500	UP
NZD/JPY	74.78	75.65	76.27	77.66	FLAT	73.20	76.20	UP
NZD/EUR	0.5933	0.5976	0.6051	0.5870	FLAT	0.5810	0.6050	FLAT
NZD/GBP	0.5146	0.5162	0.5240	0.5140	FLAT	0.5040	0.5250	UP
TWI	72.7	73.2	74.5	74.25	FLAT	72.00	74.00	UP

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

NZD Recap

The **NZD/USD** fell below its 0.6700–0.6900 range for the first time since January. Last week’s subdued Q1 2019 CPI release lifted market expectations of a 25bp OCR cut as soon as May (50% now priced in). Market attention will now turn to the Q1 2019 labour market data released on 1 May. RBNZ Governor Adrian Orr said that Q1 CPI and Q1 labour market data would be central in deciding the direction and timing of any interest rate changes. Meanwhile, the **AUD/USD** lifted above its 200-day moving average (0.7187) for the second time in twelve months last week after stronger than expected Chinese Q1 GDP data. Further support for AUD was generated by a strong Australian March labour market report. The weaker NZD/AUD has been consistent with narrowing New Zealand and Australian short-term interest rate spreads.

Near-term outlook

With little market-moving local data ahead, we expect the NZD/USD to trade at the low end of its recent ranges this week. Noting our OCR view – we expect 50bps of OCR cuts over 2019 - and the RBNZ Governor’s comments (above), the next major data release is the Q1 labour market (due 1 May). In the meantime, the **NZD** is likely to trade heavy on any soft global growth data. Looking across the Tasman, the Australian Q1 CPI data (due Wednesday) will set direction for the **AUD**, with a soft result likely to see the market price in a higher probability of an RBA cut and send the **AUD** lower. Q1 US GDP amongst other US data later in the week will guide direction of the USD and set the tone more generally in FX markets. There are also interest rate announcements for the BoC (Wednesday night) and the BoJ (Thursday), while the ECB publishes its economic bulletin on Wednesday night as well. Meanwhile, the **GBP** is likely to be more sensitive to UK and global economic data now that the Brexit deadline has been delayed.

Medium-term outlook

In the medium term and looking beyond any short-term reaction to possible 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 due to the likelihood of an imminent rate cut from the RBNZ. 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	73.9	74.5	74.1	74.8	75.0	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	UNCH/DOWN	UP
90-day bank bill	1.79	1.83	1.90	2.05	UNCH/DOWN	UP
2-year swap	1.65	1.72	1.82	2.31	UNCH/DOWN	UP
5-year swap	1.81	1.88	1.92	2.79	UNCH	UP
10-year swap	2.25	2.31	2.28	3.27	UNCH	UP
10-year govt bond yield	1.96	2.05	1.98	2.91	UNCH	UP
Curve Slope (2s10s swaps)	0.60	0.59	0.46	0.96	UNCH/UP	UNCH/UP

* Current as at 10am today; week ago as at Tuesday 5pm. Key UNCH = Broadly unchanged

Market Recap

Falls in local yields outpaced smaller declines in global counterparts, with the NZD curve modestly steepening.

Yields on the bellwether 2-year swap were down 10bps following the release of weaker than expected NZ CPI data, with little subsequent movement to date. Stronger than expected Chinese GDP, industrial production, and retail sales data triggered a small sell-off (i.e. yields higher) in global interest rates, with NZ yields also supported by the coalition Government's announcement that it will not be imposing a capital gains tax. Markets were relatively quiet over the Easter break. Stronger-than-expected US retail sales and higher oil prices supported yields, which came under downward pressure following the Sri Lankan terrorist attacks and signals from global manufacturing PMI gauges of cooling global growth momentum. The RBA Minutes provided a dovish tilt, but stronger-than-expected Australian employment data displayed the resilience of the Australian labour market. With RBA Governor Lowe noting it would take "a sustained rise in the unemployment rate" for the RBA to lower the cash rate, a high hurdle to RBA cuts remains.

Near-term NZD interest rate outlook

Markets are around 50% priced for a May OCR cut. **We have pencilled in a May OCR cut, but reiterate that the exact timing of OCR cuts is fluid and conditional on the global outlook, actions of overseas central banks, the NZD as well as the tone of local data.** Liquidity is expected to remain light this week, on account of the Easter and ANZAC Day holidays. With a lack of major NZ data until next week's ANZ Business Outlook and the Q1 labour market data, the direction of NZ interest rates will depend on global themes. The major focus for markets will be Australian CPI (Wednesday), and US GDP (Saturday), with the latter likely to confirm moderating US growth. We expect Australian CPI inflation to remain low, with outturns for headline and underlying inflation to remain below the bottom end of the RBA's 2-3% target. Policy decisions by the Bank of Canada (Wednesday) and the Bank of Japan (Thursday) could provide some volatility. **Global yields could drift higher if further signs point to strengthening global growth, but we expect subdued global inflation will keep yields historically low.**

Medium-term outlook

We have pencilled in 25bp of OCR cuts in May and August of this year, but once again note that the exact timing of OCR cuts is fluid. The OCR is subsequently expected to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak towards the end of 2023. The 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 remain on hold, with risks tilting towards more policy support being necessary. NZD long-term yields could initially dip and then drift up, before eventually settling at around 2.5-3%.

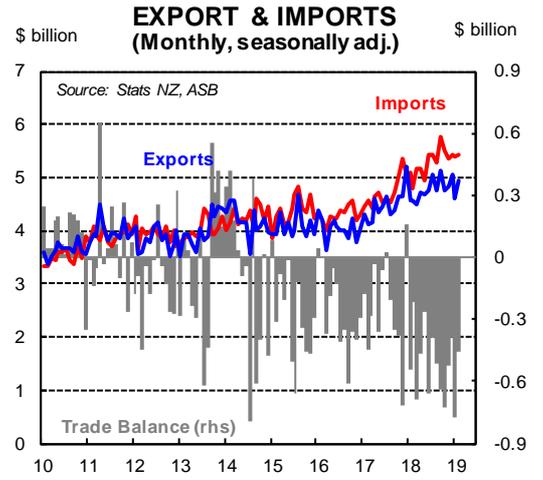
ASB interest rate forecasts

(end of quarter)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< 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
Trade Balance, Mar, \$m	26/04	10:45am	12	-	100

We expect a **small trade surplus of circa \$100m in March**. Looking over the month, we expect a modest fall in dairy export values, following the surge over February. Similarly, we expect import values to remain relatively subdued, although we do note that oil prices picked up over the month. Looking at the annual balance, **we expect the annual trade deficit to narrow to \$6.4 billion**.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia CPI, Q1, %qoq	24/04	1:30 pm	0.2	0.2
Bank of Canada Interest Rate Announcement, %	25/04	2:00 am	1.75	1.75
Bank of Japan Interest Rate Announcement, %	25/04	-	-0.1	-0.1
UK CBI Business Optimism Index, April	25/04	10:00 pm	-16	-
US GDP, Q1, saar	27/04	12:30 am	2.2	1.8

*Originally published by CBA Global Markets Research on Thursday 18th April at 3.47pm.

We expect **Australia's headline CPI** to rise 0.2% in the March quarter, after a 0.4% rise in the final quarter of 2018. This result would see the annual rate step down by 0.3 percentage points to 1.5%. Lower petrol prices will likely weigh heavily on inflation. Petrol prices – on average – were down by 9% in Q1. The fall will detract 0.29 percentage points from CPI growth. Pushing the other way, anecdotal reports suggest the combination of droughts and floods around the country have pushed up a range of food prices. The core measure should print a little higher at 1.7%yoy.

Continued subdued growth and inflation are encouraging Bank of Japan officials to comment about the risks of easing policy. However, concerns over the amount of domestic bank lending to the real estate sector are beginning to concern the central bank. Despite a soft external backdrop, domestic demand continues to hold up, and as a result, we expect the BoJ to leave rates on hold at -0.1%.

We project the Bank of Canada (BoC) to leave rates at 1.75% over our forecast horizon. At its March meeting, the BoC removed its explicit tightening bias. Instead, the bank warned of increased uncertainty about the timing of future rate increases. The central bank is also expected to revise lower its Canadian GDP growth outlook for 2019 and 2020. In March, the BoC noted “the economy will be weaker in the first half of 2019 than the Bank projected in January”.

UK business investment fell at an annual pace of 2.5% in Q4 2018 because of Brexit uncertainties. The **CBI business optimism index** for April will likely remain consistent with a deeper contraction in business investment.

We expect **US economic growth** to have continued to moderate over Q1. Slowing domestic demand is expected to have been a key drag on economic growth because of waning fiscal stimulus. On the other hand, stronger than expected trade data suggest that net exports will have contributed positively to growth over the quarter.

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	0.8	0.6				
CPI - A%	1.9	1.5	1.9	1.6	1.6	1.9	1.8	1.8
HLFS employment growth - Q%	0.1	0.7	0.4					
HLFS employment growth - A%	2.3	2.4	2.2	1.6	2.0	1.8	1.5	1.3
Unemployment rate - %sa	4.3	4.2	4.3	4.3	4.1	4.2	4.2	4.2
Annual current account balance as % of GDP	-3.7	-3.5	-3.3	-3.2	-3.0	-2.7	-2.5	-2.2

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

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(end of quarter)								
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NZ 2-year swap rate*	1.97	1.6	1.6	1.5	1.5	1.5	1.6	1.9
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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
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