ASB

Economic Weekly

23 September 2019

RBNZ musings, a low-flying bird and an AB's victory

The RBNZ makes its interest rate announcement this Wednesday. We're picking a somewhat quiet affair, after the big-bang 50 basis point cut back in August. Accordingly, **we expect the RBNZ to remain on hold at 1.00%, but after last month's surprise, we're also not ruling anything out.** Across the Tasman, markets are looking for confirmation in the RBA Governor's speech (Tuesday night) that an interest cut will be forthcoming in October. For our part, we've already pencilled one in following the lift in the Australian unemployment rate last week.

Meanwhile, **the NZD/USD has slipped to levels prevailing back in June 2009**, having traded around 0.626 on Friday and at today's open. The RBNZ will be pleased with the fall in the NZD since August. However, given the extent of short positioning in the NZD, an on-hold decision this week could cause a pause in the NZD's race lower.

Key events and views

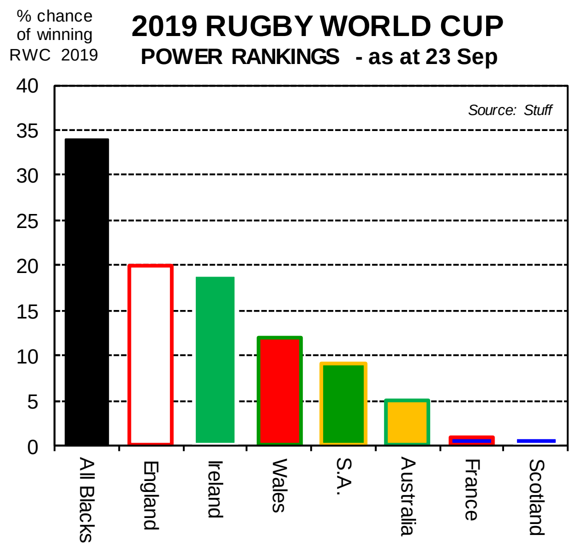
Foreign exchange	NZD/USD slides to around June 2009 levels.
Interest rates	Local yields fell last week. We retain our downward bias for NZ yields.
Domestic events	RBNZ Interest Rate Announcement, August Trade Balance, September Consumer Confidence.
International events	RBA Governor's speech, US Inflation data, Chinese Industrial Profits.

Chart of the Week: All Blacks lay down marker in victory over Springboks

The All Blacks laid down a marker in their 23-13 victory over the Springboks on Saturday. Indeed, assuming you got your Spark subscription to work, you would have seen a highly entertaining game. The Springboks were immensely committed and brutal at times, but were ultimately outgunned by the All Blacks' array of weaponry.

The victory reconfirmed the All Blacks' favouritism. For example, Stuff's Power Rankings now give the All Blacks a 34% chance of winning RWC 2019. England has the next best chance at 20%, while Ireland is 3rd favourite, at this stage, on 19%.

The All Blacks victory combined with Ireland's win over Scotland also narrows down the All Blacks' likely quarter opponents. Assuming now that the All Blacks and Ireland go on to win pools A and B, respectively, **then their likely quarter final opponent will be one out of Scotland, Japan or Samoa**. Go the ABs!



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6265	0.6385	0.6387	0.6691	FLAT/DOWN	0.6130	0.6300	FLAT
NZD/AUD	0.9254	0.9286	0.9454	0.9175	FLAT	0.9200	0.9340	FLAT
NZD/JPY	67.46	68.84	68.07	75.42	FLAT/DOWN	66.60	69.25	UP
NZD/EUR	0.5686	0.5766	0.5769	0.5680	FLAT	0.5585	0.5700	UP
NZD/GBP	0.5023	0.5120	0.5222	0.5041	FLAT	0.5000	0.5100	UP
TWI	69.9	70.7	71.2	72.28	FLAT/DOWN	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 NZD fell steadily last week, with Thursday's 'hawkish cut' from the US Federal Reserve only quickening the pace of decline. As a result, the currency currently trades at 10-year lows around 0.6260 against the USD, close to 7-year lows against the JPY, and close to one-year lows against the EUR and CNY.

A broadly stronger USD exerted downward pressure on the NZD/USD. But the kiwi still underperformed all other G10 currency pairs last week.

Near-term outlook

The NZD's recent underperformance is ostensibly a little hard to square with 'fundamentals'. Q2 GDP data printed a smidge stronger than market expectations at 2.1%yoy last week, NZ commodity prices remain lofty, and NZ-US interest rate differentials actually improved a little. Our short-term NZD/USD valuation model currently estimates a 0.6450-0.6850 'fair-value' range.

Speculative positioning largely squares the circle. The latest CFTC data shows the speculative community have built up the largest net short position in NZD since records began in 2004. This raises the stakes for Thursday's RBNZ meeting. If the RBNZ keeps interest rates unchanged, as we expect, a paring of these short positions could see the NZD pitched a fair way higher. The odds of a cut have probably risen though, and sit above the 25% chance implied by market pricing. Last week's scramble to price/call an October rate cut from the RBA probably further increase the odds of an RBNZ cut this week. We know the Bank likes to be ahead of the curve…

Outside of NZ, there are two key events for currency markets this week: (i) the UK Supreme Court ruling on PM Johnson's decision to prorogue Parliament and, (ii) US August core PCE inflation. There's also a speech by RBA Governor on Tuesday that may be used to signal a rate cut is imminent (we've shifted our view to an October cut).

Medium-term outlook

Our forecasts have the NZD/USD basically 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 the NZ economy recovers and our terms of trade remain elevated.

ASB foreign exchange forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZD/USD	0.68	0.67	0.64	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.96	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	75	72	68	66	64	70	71	71
NZD/EUR	0.60	0.59	0.58	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.52	0.53	0.53	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.9	73.2	70.5	69.3	68.3	71.7	72.1	72.1

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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	1.14	1.14	1.19	1.91	UNCH/DOWN	UP
2-year swap	0.94	1.02	0.97	2.03	UNCH/DOWN	UP
5-year swap	0.96	1.09	1.00	2.41	UNCH/DOWN	UP
10-year swap	1.24	1.41	1.29	2.93	UNCH/DOWN	UP
10-year govt bond yield	1.14	1.33	1.13	2.67	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.30	0.39	0.32	0.90	UNCH/DOWN	UNCH/UP

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

Market Recap

The recent journey to higher yields and curve steeping proved to be a short one, with NZ and global yields lower and curves flatter relative to a week ago. Fears over the global growth outlook (downward revisions to global growth by the OECD, weak Chinese industrial production/retail sales data), increasing political tensions between the US and Iran, and stalled progress on US/China negotiation set the market tone. US Interest rates were lower after the Federal Open Market Committee cut the Federal Funds rate by 25bps despite an initial spike higher after the Fed dot plots and 7-3 voting split highlighted divisions in view and no guarantee that US rates would move lower still. Issues with the short-term funding market also saw the FOMC cut interest rates on excess reserves by 30bps and with the New York Fed to announcing a series of overnight operations over the next three weeks to bolster liquidity. The tone of the Bank of Japan and Bank of England of England policy assessments was dovish despite no change in policy rates. Australasian yields fell after the Reserve Bank of Australia (RBA) Minutes flagged the likelihood of further easing, as did the rising unemployment rate (to 5.3%). We have bought forward the timing for the next 25bp RBA rate to October. There was modest market reaction to Q2 NZ GDP, which came in line with ASB/RBNZ expectations.

Near-term NZD interest rate outlook

We remain wary on the global outlook and have maintained our mild downward (and curve flattening) bias for local yields. An escalation in trade tensions between the US and China remains a real risk if a trade deal cannot be agreed upon. Tomorrow night's speech by Governor Lowe will likely provide key insights into the RBA's thinking, and a strong hint by Lowe that further monetary stimulus is imminent could see market rate cut odds firm. **We do not expect the RBNZ to trim the OCR on Wednesday, but would not rule anything out, with the RBNZ to acknowledge a modest growth outlook and the (downwardly-skewed) risk profile.** Circa 25% odds of a RBNZ cut this week look a little light in our view. There are a number of speeches by FOMC members this week which will likely highlight the variety of views on the US interest rate outlook. Brexit risks will likely resurface with the UK Supreme Court due to rule on PM Johnson's decision to prorogue Parliament. Aside from next weekend's US core inflation data (mkt: 1.8% yoy), we expect minimal interest rate reaction to this week's data.

Medium-term outlook

Our forecast is for the curve to initially steepen and then to flatten as policy easing this year precedes mild policy tightening. We expect a 25bp OCR cut in November and a 0.75% OCR trough this cycle, with downside risks. We expect 50bp of cuts by the RBA (Oct 2019, Feb 2020), up to 50bp in Fed cuts by early 2020, and policy easing in Canada, Japan, the Eurozone and China. Inflation looks set to remain low and interest rate normalisation from global central banks a long way off, capping long-term interest rates at historically-low levels.

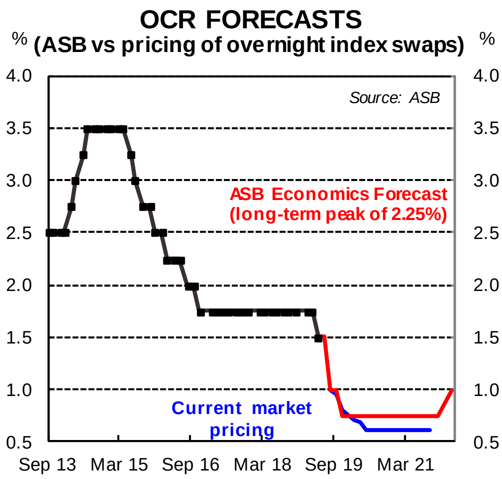
ASB interest rate forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.50	1.00	0.75	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.9	1.7	1.2	1.0	1.0	1.0	1.2	1.7
NZ 2-year swap rate	1.6	1.4	1.0	0.9	0.9	0.9	1.2	1.7
NZ 5-year swap rate	1.8	1.4	1.0	1.0	1.0	1.0	1.4	1.9
NZ 10-year swap rate	2.2	1.8	1.2	1.1	1.1	1.2	1.6	2.0
NZ 10-year Bond	1.8	1.6	1.0	0.9	0.9	1.0	1.4	1.8

Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise Trade Balance, August, $m	25/9	10:45 am	-	-1,250
RBNZ September OCR Announcement, OCR %	25/9	2:00 pm	-	1.00

We expect a trade deficit of circa $1,250m in August – note that the August 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 $5.1 billion.

The economic outlook has not shifted much since the RBNZ baked in a lot of the key risks and front-loaded monetary action with a 50bp OCR cut in August. **At next Wednesday's OCR Review we expect the RBNZ to keep the OCR steady at 1%**. The RBNZ will have been pleased with the substantial financial market and bank response to its large OCR cut. However, business and consumer confidence appears to have softened since the cut. We expect the RBNZ will cut the OCR 25bp in November, but the risk of further action in 2020 is increasing, particularly if growth appears less likely to re-gather.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Eurozone manufacturing PMI, September, points	23/09	8:00 pm	47.3	-
RBA Gov. Lowe speech	24/09	9:55 pm	-	-
US PCE Inflation, August, %yoy	28/09	12:30 am	1.8	1.9
US Univ of Michigan Inflation Expectations, September	28/09	2:00 am	-	-

**Originally published by CBA Global Markets Research on Friday 20th August at 1.46pm*

Reserve Bank of Australia's Governor Philip Lowe is slated to give "An Economic Update" at the Armidale Business Chamber Dinner on Tuesday. In light of the August employment report that showed a slight lift in the unemployment and underemployment rate, the Governor may signal a rate cut is imminent.

The Eurozone's manufacturing PMI is projected to remain below the 50-point 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 European Central Bank's gloomier economic outlook is ongoing weakness in the manufacturing sector. The services PMI is expected to point at further growth slowdown in the more important services sector.

The 3% fall in **US** retail gasoline prices suggests headline **Personal Consumption Expenditure (PCE) inflation** stayed soft in August at 1.4%yoy. The already-released core CPI suggests core PCE inflation will accelerate to 1.9%yoy.

One of the reasons the **US** Federal Reserve has been cutting the Funds rate is because of low inflation expectations. The **University of Michigan surveys of consumers' long-run expectations** has been at a record low of only 2.3%yoy in recent months and is likely to stay low without a pickup in inflation outcomes.

Key Forecasts

ASB NZ economic forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>					
GDP real - Q%	0.6	0.5	0.5	0.5				
GDP real - A%	2.5	2.1	2.2	2.1	2.1	2.4	2.4	2.4
GDP real - AA%	2.7	2.5	2.3	2.2	2.1	2.3	2.4	2.4
CPI - Q%	0.1	0.6	0.4	0.2				
CPI - A%	1.5	1.7	1.2	1.3	1.8	1.9	2.0	1.9
HLFS employment growth - Q%	-0.1	0.8	0.2	0.3				
HLFS employment growth - A%	1.5	1.7	0.9	1.3	1.7	1.5	1.4	1.2
Unemployment rate - %sa	4.2	3.9	4.1	4.2	4.3	4.2	3.8	3.9
Annual current account balance as % of GDP	-3.6	-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

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NZ 90-day bank bill	1.9	1.7	1.2	1.0	1.0	1.0	1.2	1.7
NZ 2-year swap rate	1.6	1.4	1.0	0.9	0.9	0.9	1.2	1.7
NZ 5-year swap rate	1.8	1.4	1.0	1.0	1.0	1.0	1.4	1.9
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NZD/AUD	0.96	0.96	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	75	72	68	66	64	70	71	71
NZD/EUR	0.60	0.59	0.58	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.52	0.53	0.53	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.9	73.2	70.5	69.3	68.3	71.7	72.1	72.1

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