

# Economic Weekly

24 June 2019

## RBNZ to reaffirm easing bias

This week the market's focus pivots back to NZ, with the **Reserve Bank of New Zealand (RBNZ) June OCR review on Wednesday** followed by the **latest monthly business outlook survey on Thursday**. The RBNZ is widely expected to leave the OCR on hold at the June meeting, but the risk is that recent offshore events trigger an aggressive move from the RBNZ. On Page 2, we take a **closer look at changes in foreign buyer share of housing market transactions** on a regional basis following the introduction of restrictions on non-resident housing purchases in NZ.

### Key events and views

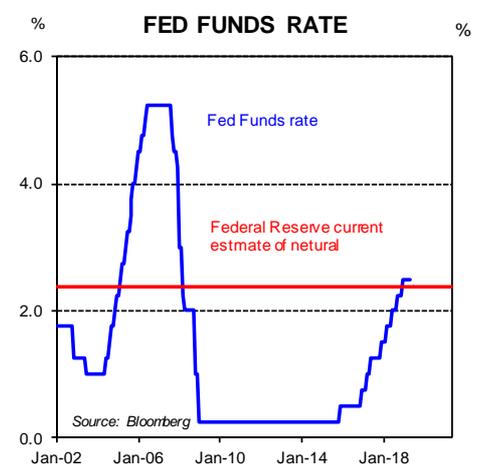
<a href="#">Key Insights</a>	Restrictions on foreign buyer housing purchases biting in Auckland and Queenstown.
<a href="#">Foreign exchange</a>	Weak USD and stronger-than-expected NZ Q1 GDP boost NZD.
<a href="#">Interest rates</a>	Record lows for NZ yields. We retain our mild downward bias.
<a href="#">Domestic events</a>	RBNZ OCR Review, trade balance, June business confidence.
<a href="#">International events</a>	US PCE deflator (key measure of inflation), Eurozone CPI.
<a href="#">Calendars</a>	NZ and international calendar of upcoming economic events.

### Chart of the Week: US policy rate not as supportive as previously thought

At last week's **Federal Reserve (Fed) monetary policy meeting**, the committee **lowered its long-run median Fed Funds rate projection by 25 basis points to 2.38%**. This revision indicates the Fed now sees a the neutral Fed Funds rate as being lower than previously thought (the neutral interest rates is the interest rate which neither stimulates or moderates economic growth and inflation pressures).

Estimates of neutral are importance in setting monetary policy as they **provide policy makers with a benchmark for how much stimulus (or dampening) current interest rates are providing the economy**. A lower estimate of neutral indicates the Fed needs to cut its policy rate to restore monetary policy settings to a stimulatory level.

On a similar note, the **Reserve Bank of Australia recently cut estimate of the neutral unemployment rate**, to 4.5%. And with the unemployment rate sitting at 5.2%, this gap has prompted the RBA's recent move to cut interest rates. At home, the Reserve Bank of New Zealand (RBNZ) has also started to cut interest rates in response to slow economic growth. **The risk is the RBNZ also lowers its estimates of either neutral interest rates or neutral unemployment rate, prompting additional rate cuts later this year.**

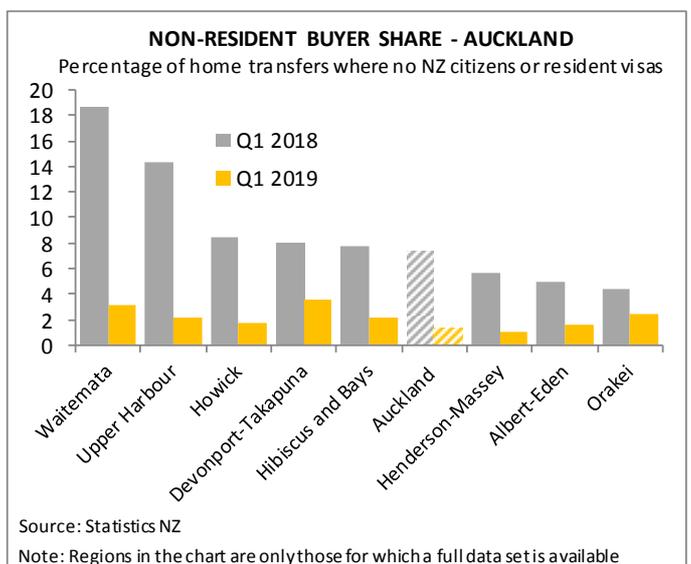
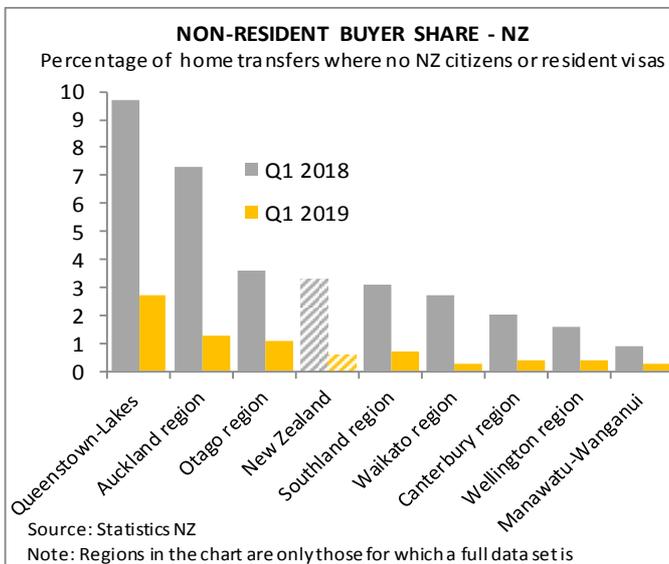


## Key insights this week: Housing – It’s Not All About Mortgage Rates

- Restrictions on non-resident house buying in NZ are biting, particularly in Auckland and Queenstown-Lakes
- These regions are underperforming the broader, and increasingly patchy, nationwide housing market
- This supports our view for only a modest pick-up in house price inflation over the second half of the year, despite plunging mortgage rates.

**There’s been a fair bit of attention recently on the impact of lower mortgage rates on the housing market.** Local term mortgage rates have fallen 40-65 basis points this year as central banks globally have taken an axe to policy rates (with more to come). Calls for an interest rate-driven boost to the housing market have become louder as result.

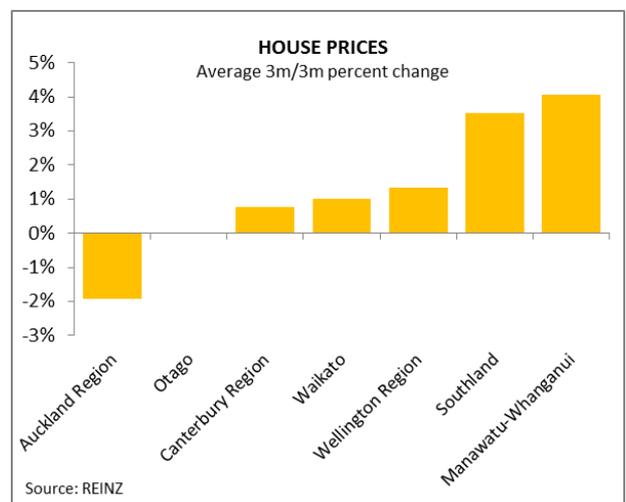
**We are more circumspect.** Yes, rock-bottom mortgage rates will provide a powerful boost to the housing market. **But we expect recent housing policies targeting investor demand to exert a restraining influence.** The latest NZ data on [Property Transfer Statistics](#) tend to support this view. In particular, the so-called ‘foreign buyer ban’ seems to have had a material impact on non-resident property purchases in NZ, and there is evidence to suggest that this is impacting the broader housing market.



The share of home buyers where there were no NZ citizens or persons with resident visas slumped from 3.3% in the March 2018 quarter to just 0.6% in March 2019. Recall the restrictions on non-resident home buyers came into effect in October 2018. The charts show that areas that previously had a comparatively large non-resident buyer component, like Auckland and Queenstown-Lakes, have unsurprisingly experienced the largest falls. The same is true for Auckland data split by region.

It’s probably no coincidence that the areas where foreign buyers were *previously* the most active have tended to experience the sharpest slowdowns in property prices. Witness recent house price performance in Auckland and Otago compared to the rest of the country (chart opposite).

Folk have previously pointed out that the overall level of non-resident buying is fairly low. This is certainly true. Over 80% of the market is transfers by residents. But, as our previous research suggests, it is often the marginal buyer that has a disproportionate impact on setting the price. And a clear reduction in non-resident housing market participation over the past year appears to be having an impact on parts of the NZ market.



## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6588	0.6506	0.6516	0.6901	FLAT/UP	0.6500	0.6700	UP
NZD/AUD	0.9505	0.9456	0.9460	0.9329	FLAT/UP	0.9350	0.9650	UP
NZD/JPY	70.68	70.65	71.40	75.91	FLAT	70.00	71.10	UP
NZD/EUR	0.5792	0.5800	0.5828	0.5941	FLAT	0.5707	0.5830	UP
NZD/GBP	0.5172	0.5165	0.5147	0.5202	FLAT	0.5130	0.5200	UP
TWI	72.2	71.7	72.0	73.33	FLAT/UP	N/A	N/A	UP

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

### NZD Recap

**USD weakness was the dominant theme in currency markets last week.** The US Federal Reserve duly delivered on expectations they would turn more dovish, driving US interest rates down even further and weakening the USD's base of support. G10 currencies all notched up gains of 1-2.5% against the softer USD. The NZD received an extra kicker from Thursday's Q1 GDP figures. The 0.6% quarterly expansion was in line with market expectations, but removed the 'tail risk' outcome that a very weak result would compel the RBNZ to cut rates this week. The resulting relief rally saw the NZD/USD finish the week up around 0.6600. Importantly, key support at 0.6490 held as expected.

### Near-term outlook

Globally, all eyes will be on this week's meeting between Presidents Trump and Xi at the G-20 Summit in Tokyo. **We suspect all the attention and media will be too tempting a platform for Trump not to announce some sort of trade deal with China.** The risk for the NZD is that the resulting boost to risk assets and global stock markets carries the NZD a little higher.

The headwinds the USD is now facing from the Fed's clear shift to an easing bias will also help shore up support for the NZD. We now expect an "insurance" rate cut from the Fed in July.

But, for the week, it all comes down to the RBNZ. Market pricing is consistent with a 20% chance of a Wednesday rate cut with a full cut priced by August. **So if the RBNZ does not cut this week, as we expect, they will have to essentially lock-in August in the market's eyes to stop the NZD from rallying.** This outcome is essentially what we are forecasting, but nevertheless adds to the modest upside risks facing the NZD this week.

### Medium-term outlook

**We expect the NZD to track a sideways range in the near term.** NZ monetary policy looks set to move relatively in-sync with some of our key trading partners, essentially nullifying relative interest rate expectations as a key driver of currency markets. We expect the RBA, RBNZ, and US Fed to all cut rates over the coming two months.

Further ahead, we expect the NZD to firm against most crosses from late 2019 onwards. The NZD/USD will be supported by NZ's high Terms of Trade while the USD remains under pressure from Federal Reserve interest rate cuts. We expect the NZD/AUD to remain close to 0.95 over 2019 and to subsequently firm.

### 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	0.65	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.95	0.96	0.94	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.58	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.52	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	71.3	70.2	72.7	73.1	75.1	75.8

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.50	1.50	1.50	1.75	UNCH/DOWN	UP
90-day bank bill	1.58	1.57	1.70	2.03	UNCH/DOWN	UP
2-year swap	1.29	1.38	1.49	2.25	UNCH/DOWN	UP
5-year swap	1.36	1.49	1.60	2.66	UNCH/DOWN	UP
10-year swap	1.73	1.84	1.97	3.12	UNCH/DOWN	UP
10-year govt bond yield	1.51	1.68	1.74	2.95	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.45	0.46	0.49	0.87	UNCH/UP	UNCH/UP

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

### Market Recap

**NZ yields touched fresh record lows last week.** Dovish central banks were the catalyst, which also triggered falls in global yields. The Australian 2-year bond yield fell below 1% (a record low) and US 10-year Treasury yields briefly dipped below 2% for the first time since late 2016. The US Federal Open Market Committee left policy interest rates unchanged, but dropped its pledge to be “patient”, instead signalling it would “act as appropriate to sustain the expansion”. The median interest rate ‘dot plots’ were little changed, but seven of the 17 members voted for 50bps of cuts in 2019. In a speech, RBA Governor Lowe signalled the possibility of a lower cash rate “remains on the table” and “it is not unrealistic to expect a further reduction in the cash rate”. As a result, we have bought forward the forecast timing of RBA and Fed cuts (see below for further details). There was minimal market reaction to the stronger than expected headline NZ Q1 GDP print, which also revealed a soft underbelly behind NZ’s growth.

### Near-term NZD interest rate outlook

**Considering the large fall in yields of late, we have shaded down our downward bias for NZ interest rates.** We do not expect the RBNZ to cut the OCR this week, but expect the decision to be more finely balanced than current market pricing suggests (around 20% odds of a June cut). An August OCR cut is more than 90% priced in, with around 50bps of cuts by next February, and with the OCR expected to plateau just below 1% by mid-2020. **Our published forecasts have the OCR plateauing at 1.25%, following a 25bp cut in August, but we are broadly comfortable with current market pricing given the global risk profile.** Thursday’s ANZ domestic business confidence report is expected to remain sub-par, underlining the need for more policy support. RBA Governor Philip Lowe will appear at a panel today, with speeches by Jerome Powell and a number of other key Fed policy-makers on Wednesday. A successful outcome of this week’s G20 summit in Japan, where President Trump and Xi are due to meet and discuss trade, could be the circuit-breaker to reverse the decline in global yields and curve flattening, although ongoing tensions between the US and Iran could continue to support safe-haven demand and dampen yields. With the results of the leadership contest for the UK Conservative Party not due until late July, Brexit risks remain unresolved and in the background.

### Medium-term outlook

OCR moves by the RBNZ will depend on the tenor of domestic data, the NZD, global developments and actions of other central banks. Following a further 25bp cut over 2019 August, we expect the OCR to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak by late 2023. **Global central banks are expected to further trim policy rates.** We expect 25bp cuts from the RBA in July (to 1.00%) and likely November (0.75%), with the Federal Open Market Committee to start cutting the 2.25-2.5% Federal Funds rate from late July (100bps of Fed cuts in total). **Global and NZD long-term interest rates are expected to drift higher, but settle at historically-low levels.**

### 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	1.6	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.5	1.4	1.4	1.4	1.4	1.8
NZ 10-year Bond*	2.38	1.8	1.7	1.7	1.6	1.7	2.1	2.3

## Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
Merchandise trade balance, May, \$m	25/06	10:45am	433	-	300
RBNZ OCR Review, OCR %	26/06	2:00pm	1.50	1.50	1.50
ANZ Business Outlook, own activity, net%	27/06	1:00pm	8.5	-	-

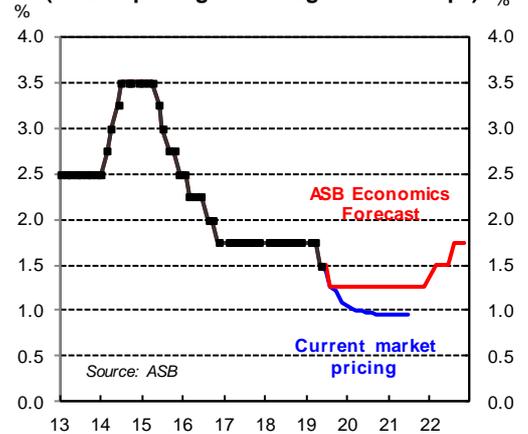
We expect a **modest trade surplus of circa \$300m in May**. Looking over the month, dairy export values are likely to soften as the dry summer weather is reflected in weaker export volumes. On the import side, we expect import values growth to remain modest in line with generally modest domestic demand. **The annual trade deficit is likely to narrow towards \$5.4 billion.**

It's been just over a month since the RBNZ cut the Official Cash Rate (OCR) to a new record low of 1.50%, deeming it was necessary to support a "more balanced" outlook for NZ interest rates. **We expect the RBNZ to hold the OCR at 1.50% in June, but to acknowledge the risk profile and signal that the future direction of the OCR is likely downwards.** This is only expected to be a temporary respite, with the OCR set to hit another record low of 1.25% in August so as to meet the RBNZ's inflation and labour market objectives under the *Remit for the Monetary Policy Committee* (the 'remit'). Nothing can be ruled out in the current juncture, but there remain a number of supports to the economic outlook that should generate sufficient inflationary pressure and keep employment sufficiently elevated as to prevent the OCR moving lower still. Absent a marked deterioration in global prospects, talk of the OCR heading towards zero (and potentially below it) and quantitative easing (QE) being required in NZ still appears a little premature.

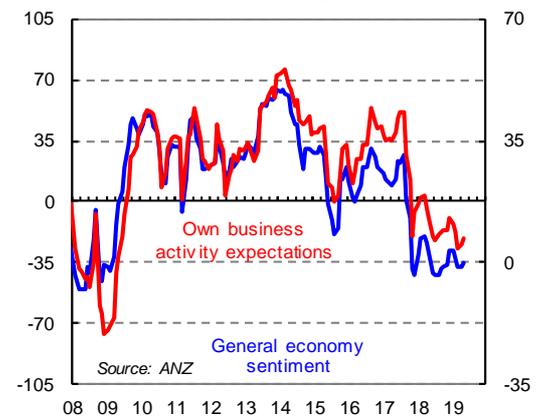
Headline business confidence and firms' own activity expectations staged a miniscule recovery in May, after being weak in the early months of 2019. The gain was less than we had expected, with the Government's decision to ditch the capital gains tax looking to have had a very minor impact on sentiment. **The ANZ monthly business confidence survey continues to paint a picture of subdued growth of investment, employment and economic activity, declining firm profitability and muted inflation pressure.** Weak sentiment maintains the case for additional policy support and we expect the RBNZ to cut the OCR by a further 25bps in August.

### OCR FORECASTS

(ASB vs pricing of overnight index swaps) %



### NZ BUSINESS CONFIDENCE (seasonally adjusted)



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
RBA Governor Lowe panel discussion	24/06	11:30 am	-	-
Australia Private Sector Credit, May, %mom	28/06	1:30 pm	0.2	0.3
Eurozone CPI, June, %yoy	28/06	9:00 pm	1.2	1.2
US PCE Deflator, May, %yoy	29/06	12:30 am	1.5	1.5

\*Originally published by CBA Global Markets Research on Friday 21<sup>st</sup> June at 1:28 pm.

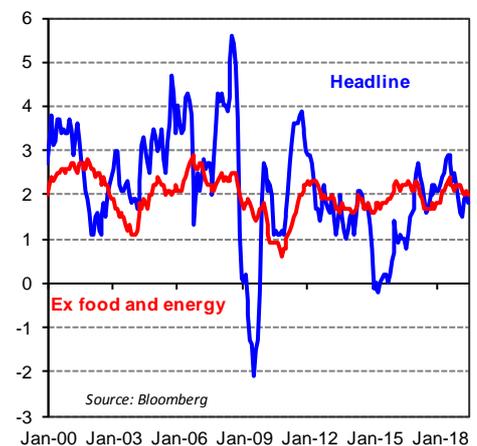
**The Reserve Bank of Australia's Governor Lowe** is due to participate in a panel discussion at the ANU Crawford Australian Leadership Forum, in Canberra at 11.30 am on Monday 24<sup>th</sup> June.

**Private sector credit growth in Australia** continues to slow, driven by ongoing softening in housing credit. Total credit growth was 3.7%yoy in April 2019 (housing credit 3.9%yoy and business credit 4.5%yoy). We expect to see another small rise in credit over May.

We expect headline **Personal Consumption and Expenditure (PCE) inflation in the US** will remain unchanged at 1.5%. Gasoline prices lifted a more modest 2% in May following two months of strong 7%mom rises. Already-released core CPI suggests that the core PCE deflator will ease to 1.5%yoy. Falling consumer inflation expectations and non-farm unit labour costs are constraining underlying inflation pressures. Low US inflation is one of the key reasons we expect the US Federal Reserve to cut the Fed funds rate in July.

**Eurozone headline and core CPI inflation** are expected to remain muted in June near 1.2%yoy and 0.8%yoy, respectively. Disappointing economic activity and subdued inflation expectations continue to contain price pressures. For 2019, the ECB projects headline CPI inflation of 1.3% and core CPI inflation of 1.1%.

### US ANNUAL CPI INFLATION



## Key Forecasts

### ASB NZ economic forecasts

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual		forecast >>					
GDP real - Q%	0.6	0.6	0.7					
GDP real - A%	2.5	2.5	2.3	2.6	2.7	2.9	2.4	2.4
GDP real - AA%	2.9	2.7	2.5	2.5	2.5	2.6	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	1.7	1.8
HLFS employment growth - Q%	0.0	-0.2	0.4					
HLFS employment growth - A%	2.3	1.5	1.3	0.7	1.1	1.7	1.6	1.4
Unemployment rate - %sa	4.3	4.2	4.4	4.4	4.5	4.4	4.2	4.0
Annual current account balance as % of GDP	-3.8	-3.6	-3.4	-3.4	-3.3	-3.2	-3.1	-3.0

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	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual		forecast >>					
(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	1.6	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.5	1.4	1.4	1.4	1.4	1.8
NZ 10-year Bond*	2.38	1.8	1.7	1.7	1.6	1.7	2.1	2.3

### ASB foreign exchange forecasts

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual		forecast >>					
(end of quarter)								
NZD/USD	0.67	0.68	0.65	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.95	0.96	0.94	0.94	0.94	0.95	0.96	0.97
NZD/JPY	74	75	72	71	74	75	78	79
NZD/EUR	0.59	0.60	0.58	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.53	0.52	0.52	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.5	73.9	71.3	70.2	72.7	73.1	75.1	75.8

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