Economic Weekly

24 October 2017

There's a new kid in town

- NZ First has chosen to support Labour, resulting in a change of government for the first time in 9 years.
- The Q3 CPI rose more than expected but, with underlying pressures remaining soft, the RBNZ has time on its side.
- Immigration numbers appear to have peaked, ahead of any changes to immigration policy under the new government.

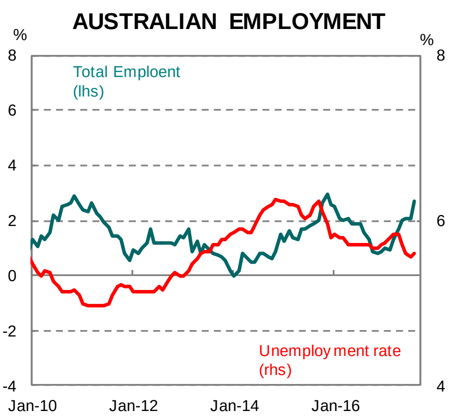
New Zealand has a new Government, albeit a little later than initially expected. Nonetheless, **Winston Peters announced that he will support a Labour-led government on Thursday evening, ending a three-term run of National-led governments**. At this stage, final policy details remain scarce. Recent reports have suggested that Winston Peters has accepted the Deputy Prime Minister role, while also taking over as Foreign Affairs Minister.

However, **we are likely to get more policy details over the next few days**. In addition, the coalition agreement between Labour and NZ First is due for release today, alongside the confidence and supply agreement with the Greens. Further, the allocation of government portfolios will be announced tomorrow, ahead of the signing in of the new Prime Minister and government Ministers on Thursday. **While details remain uncertain, we are likely to see pressure remain on the NZD. The NZD/USD has fallen over 2.5% since Thursday morning.**

Although the government announcement was perhaps the "big" event last week, it was not the only event. **Earlier in the week saw the release of the Q3 CPI figures which were stronger than most participants has expected.** The CPI rose 0.5% qoq in Q3, compared to the market median and our forecast of +0.4% qoq. **As expected, however, much of the strength stemmed from higher housing and food costs. Outside of these areas, there is little evidence of sustained price pressures.** This was reinforced when the RBNZ released its measures of core inflation on Tuesday afternoon. The RBNZ's sectoral factor model showed underlying pressures remained steady at 1.4% yoy in Q3. While the inflation picture has undoubtedly improved over the last 12 months, **the softness in underlying measures reinforce that the RBNZ will be comfortable leaving the OCR on hold for some time yet.**

We were also provided with an update on how immigration numbers were tracking last week. Immigration was one of the key points of contention during the election and **we are still waiting to see what Labour and NZ First's final immigration policy will look like, other than lower.** However, **ahead of any policy changes, immigration figures appear to be peaking.** Monthly net inflows in September were the lowest they've been since June 2015, **with annual net migration falling below 71,000 for the first time since December 2016. It has been our long-held view that net migration flows would ease as the Australian labour market recovers.** This is because much of the migration story is actually driven by New Zealanders' movements between New Zealand and Australia. And, as the chart of the week below shows, **the Australian labour market is continuing to pick up momentum, suggesting that it's likely we will see immigration numbers slow further.**

Chart of the Week: Australia keeps generating jobs



The 20,000 rise in Australian employment in September marked the 12th consecutive monthly increase in jobs. Over the past 12 months Australia has generated 372,000 jobs, taking the annual job growth rate to 3.1% (the highest rate in over 9 years).

Looking forward, **we are expecting another 250,000 jobs to be generated in Australia over the next 12 months**. Further, we are **expecting the unemployment rate to move lower to around 5%, from the current 5.5% rate.**

However, Australia is currently experiencing a similar phenomenon to NZ. That is, **while the labour market is healthy, wage growth is lagging**. However, sustained pressure in the labour market and a lower unemployment rate are expected to support Australian wage growth. **As Australian wage growth starts to pick up** this should further **encourage NZers to head to (or stay) in Australia as well as encourage Australians to stay home, weighing on NZ net migration as a result.**

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Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6968	0.7160	0.7285	0.7033	0.7168	DOWN	0.6850	0.7100
NZD/AUD	0.8926	0.9127	0.9185	0.9302	0.9394	UP	0.8850	0.9050
NZD/JPY	79.03	80.28	81.47	77.41	74.60	UP	78.80	80.00
NZD/EUR	0.5931	0.6079	0.6091	0.6477	0.6573	DOWN	0.5850	0.6050
NZD/GBP	0.5281	0.5401	0.5364	0.5494	0.5857	FLAT	0.5200	0.5300
TWI	73.8	75.4	76.2	76.2	77.2	FLAT	72.00	78.00

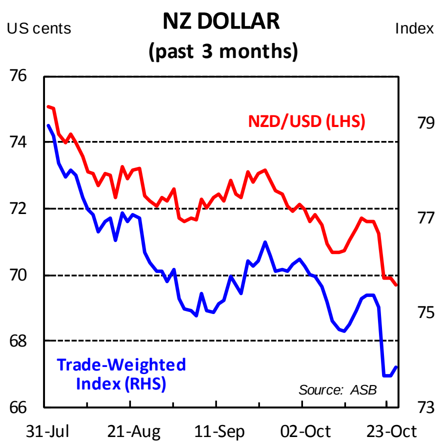
^Weekly support and resistance levels * Current is as at 9.30 am Monday; week ago as at Monday 5pm.

The **NZD fell against all major crosses from Thursday night** after it was finally revealed NZ First would form a minority Government with Labour, with Labour also seeking a supply and confidence agreement with the Greens Party to secure a majority in Parliament. **The lower NZD follows a fall in swap rates. The coalition agreement and policy details remain sparse**, and as such NZ financial markets could be sensitive to any unexpected policy agreements. **Over the medium term we expect NZ's fundamentals** (such as high Terms of Trade and falling unemployment rate) **will reassert themselves and continue to support the NZD**.

The USD lifted heading into the weekend, supported by favourable progress on US tax reform. We expect this will continue to support the USD, with the market largely looking through a weak hurricane-affected Q3 result.

In Japan, we expect the JPY to remain under pressure as Prime Minister Shinzo Abe's Liberal Democratic Party led (LDP) coalition won a two-thirds parliamentary "super majority", which is likely to prolong the Bank of Japan's super easy monetary policy.

Short-term outlook:



Key data	Date	Time (NZT)	Market
AU CPI, Q3, %qoq	25/10	1.30 pm	0.8
NZ Trade Balance, %m	26/10	10.45 am	-900
Bank of Canada, policy rate %	26/10	3.00 am	1
ECB Announcement, main refi-rate %	27/10	12.45 am	0
US GDP, saar %	28/10	1.30 am	2.5

NZD: Sep Trade Balance. **AUD:** Q3 CPI (Wed); Q3 Terms of Trade (Thurs). **USD:** Sep durable goods orders (Wed); Q3 GDP (Fri). **CNY:** 19th National Congress (Mon-Wed). JPY: Sep CPI (Fri). **EUR:** Oct PMIs (Tue); Oct German Ifo business climate (Wed); ECB meeting (Thu). **GBP:** Q3 GDP (Wed).

Medium-term outlook:

Last Quarterly Economic Forecasts

We updated our FX forecasts in early September. Political uncertainty associated with a change in Government has weighed on the NZD, but we expect this to have 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.**

Our forecasts incorporate a weaker USD. Despite a weaker starting point, we have modestly revised up our near-term NZD/USD forecasts, with the NZD/USD to end 2017 at 0.74 and 2018 at 0.77. Further USD falls are expected given the upward bias in non-USD rates and with the strengthening synchronised global economy typically bullish for commodity currencies like the NZD and AUD. However, the key risk to our bearish USD view is the Trump Administration is able to get U.S. company tax cuts passed through the U.S. Congress. If this development occurs, then the USD will no longer depreciate, but lift significantly.

The NZD/AUD fell following the Labour-NZ First coalition announcement, and is currently below our forecasts (0.93 by the end of 2017 to 0.91 by late 2018). We expect political uncertainty to have a temporary impact on the NZD/AUD, although upside to this exchange rate is expected to be capped by the **narrowing Australian current account deficit, and the strengthening trading partner growth.**

Supportive growth prospects, signals of pending tapering by the ECB before the end of the year and prospective ECB rate hikes next year will support the euro. **We expect NZD/EUR to end 2017 at 0.60 and 2018 at 0.61.** 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 remain in a 0.56-0.57 range till the end of 2018. **We expect the NZD/JPY to hover around the 79/80 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

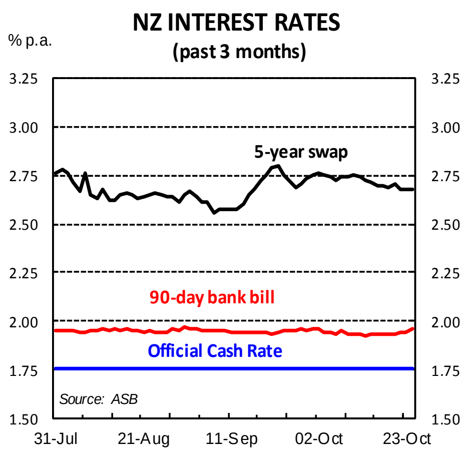
Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	2.00	FLAT
90-day bank bill	1.96	1.93	1.95	1.97	2.12	FLAT
2-year swap	2.17	2.20	2.23	2.34	2.09	FLAT
5-year swap	2.68	2.70	2.75	2.91	2.32	UP
5-year benchmark gov't stock	2.48	2.51	2.60	2.44	2.08	UP
NZSX 50	8130	8112	7815	7218	6948	UP

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

Short-term NZD interest rates start this week slightly lower in yield than immediately prior to Thursday's government announcement by NZ First, with the local curve steepening. Two-year swap yields are currently 2.18% (versus 2.20% immediately prior to the Government announcement), whilst the local ten-year rate is currently 3.22% (3.20%). We **view the close to 25bps of OCR hikes as being priced into local rates over the next 12 months as being too excessive given our OCR view, with the economy showing signs of cooling of late.**

Our bias, however, is slightly to the upside for longer-term local rates, with the curve to steepen. Higher long-term global yields are expected to be a key driver, with US Treasury yields have firmed following the adoption of the US Senate of a fiscal 2018 budget resolution, fuelling speculation that President Trump's tax package may soon be introduced. The Bank of Canada is expected to leave rates on hold this week, and while no policy changes are expected from the ECB, the provision of further details on prospective tapering of bond purchases by the ECB could add to steepening pressure at the margin.

Short-term outlook:	Key data	Date	Time (NZT)	Market



Comment: The domestic focus will be on what the new government administration means for local rates, with more details on policy are expected to emerge over the coming week. We do not expect substantive near-term changes to the RBNZ's mandate, **with our focus on the extent to which policy changes have a tangible impact on medium-term inflationary pressure**. The impact is expected to be slightly positive, but will take time to show up in the local data which have been on a weakening trajectory of late. The NZD, down 2½% on a TWI basis since the election, is playing the role as a shock absorber, minimising the extent of adjustment required from local rates. **Global near-term yields are biased higher.** We expect a firmer Q3 CPI print (+0.9% qoq versus 0.8% qoq exp) to provide a nudge to AUD yields. Further details on the US tax package should support US yields, which will be driven by the tone of US data over the coming week (including Q3 GDP). High outright NZD yields are playing a role in capping spreads with global counterparts. Today's $100m tender of the 2033 NZGB will provide a litmus test as to whether higher prospective domestic NZGB issuance will impact on investor demand.

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ continued to hold the OCR at its record-low of 1.75% at September OCR Review. The RBNZ retained its neutral bias and continued to note the numerous uncertainties. However, the key surprise was the **RBNZ downgraded its growth outlook**, commenting it expected growth to "*maintain its current pace*" whereas at the August Monetary Policy Statement (MPS), the RBNZ's forecasts assumed growth would accelerate. However, the RBNZ will be mindful that **election promises will likely boost growth further once the RBNZ has revised fiscal projections from Treasury.** Furthermore, we have for some time seen upside risks to the RBNZ's growth forecasts due to the RBNZ's relatively modest dairy price assumption.

The NZD had eased since August, when the RBNZ had been very frustrated. Nonetheless, the RBNZ continues to note that a lower NZD would be helpful in delivering more inflation and a more 'balanced' growth outlook.

The RBNZ remains confident in the medium-term inflation outlook, despite anticipated volatility in headline inflation this year. The RBNZ's August MPS forecasts show the RBNZ expects inflation will dip below 1% (due to volatility in fuel and food) before swiftly recovering to reach 2% by 2018. The RBNZ appears to be relying on a very swift pick-up in non-tradable inflation. This is a fairly bold assumption given the RBNZ is wary that price-setting behaviours have become more backward looking. Nonetheless, we expect the RBNZ will start lifting the OCR in Q1 2019, which is slightly earlier than the RBNZ's expectations for a hike in Q3 2019.

The objectives of monetary policy will likely change in 2018. At this stage we expect monetary policy shifts to be modest, but some degree of uncertainty will remain until a new Policy Targets is signed.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Australia CPI, Q3, % qoq	25/10	1.30 pm	0.2	0.9	0.8
UK GDP, % qoq	25/10	9.30 pm	0.3	0.3	0.3
Bank of Canada Rate Announcement, policy rate %	26/10	3.00 am	1	1	1
Japan CPI, headline % yoy	27/10	12.30 pm	0.7	0.7	0.7
ECB Policy Announcement, main refi-rate	27/10	12.45 am	0	0	0
US GDP, seasonally adjusted annualised %	28/10	1.30 am	3.1	2.0	2.5

A sharp rise in power prices will likely lift **Australian headline inflation** (by 0.5 ppts). However, the underlying rate is still at the bottom of the target band (i.e. 2-3%pa) and is likely to stay there until wage growth (now 1.9%pa), moves above 2.5%pa.

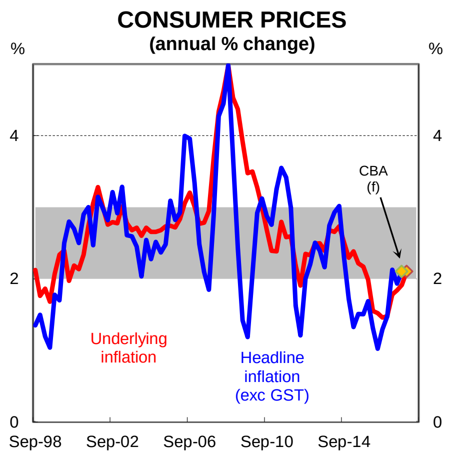
We anticipate **Q3 UK GDP** growth of around 0.3% qoq and 1.5% yoy. There are downside risks because of constrained UK consumer demand.

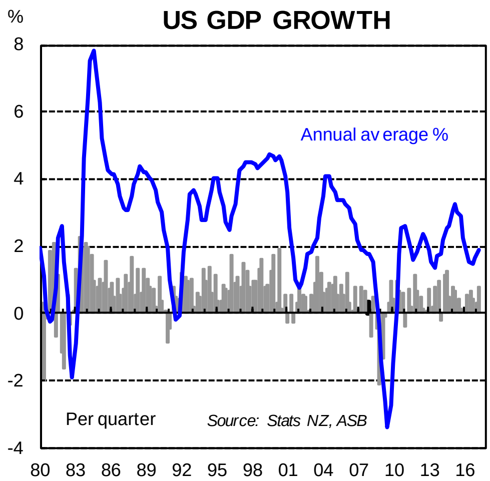
We anticipate the **BoC to keep its policy rate** at 1.00% and continue to emphasise that future interest rate adjustments will be data dependent. The BoC will likely revise higher their GDP growth and inflation projections in the October Monetary Policy Report.

We expect **Japanese headline inflation** to remain at 0.7%pa, well short of the Bank of Japan's 2%pa target. However, even that modest rate of inflation reflects food inflation. Despite a tight labour market, wage inflation and inflation expectations remain very weak.

We anticipate the **European Central Bank** will leave key interest rates unchanged at Thursday's **meeting**. The ECB will outline the details of its Quantitative Easing tapering programme.

We expect **US Q3 GDP** growth to ease to 2.0%saar from Q2's strong 3.1%saar. The hurricanes in late August significantly, although temporarily, disrupted economic activity. We expect any weakness in Q3 to unwind over Q4.

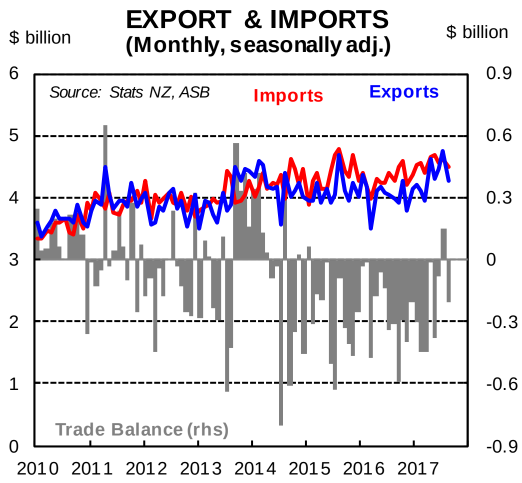




NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Trade balance, August, $m	26/10	10:45 am	-1,235	-900	-850

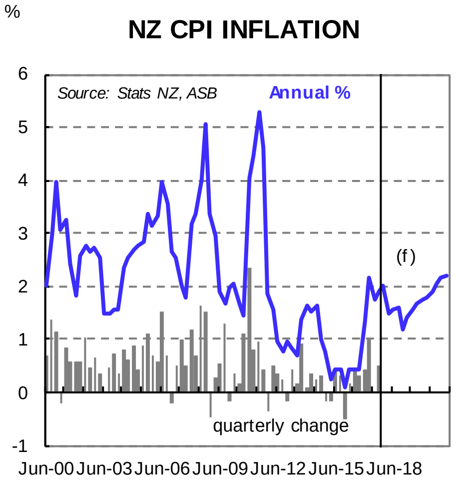
Following the very weak trade balance in August, **we expect a more modest trade deficit of $850m in September.** NZ normally posts a trade deficit over September as agricultural exports fall on a seasonal basis and as imports pick up through to the end of the year. Looking over the month, we expect dairy export volumes to rebound after the extraordinarily large fall in August. At the same time, import values remain relatively firm in line with domestic demand. **We expect the annual trade deficit to narrow to $2.66 billion.**



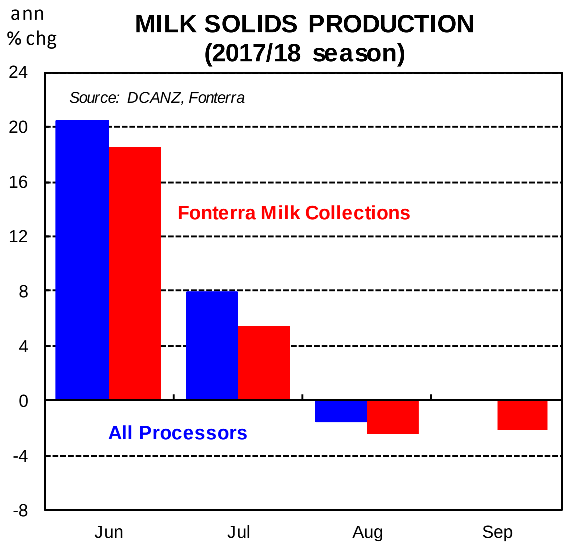
Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
CPI, Q3, %qoq	17/10	0.5	0.4	0.4
GlobalDairyTrade Auction, whole milk powder, % change	17/10	-0.5	-	+1 to +3
International Travel & Migration, Sep, Net Migration (sa), 000s	20/10	5,190	-	5,500

The CPI rose by 0.5% qoq in Q3, stronger than ourselves, the market and the RBNZ were expecting. On an annual basis, the CPI rose to 1.9%, up from 1.7% in Q2. The upside surprise in the Q3 CPI result was driven by slightly higher tradable (+0.7%) and non-tradable (+0.2%) inflation than expected. However, despite the stronger than expected result, the underlying story remains unchanged. **Higher housing and food costs continue to drive the vast majority of inflation in New Zealand.**



Dairy auction prices eased a touch last week, with overall prices down 1.0%. The result contrasts to futures pricing ahead of the auction, which had pointed to gains. The price fall was broad-based, although anhydrous milk fat – the sole product to rise – posted a record high. Whole milk powder prices fell a modest 0.5%, while skim milk powder and butter slid 5.6%. **Despite the dip in prices overnight, we expect prices to push higher over coming months.** In particular, very wet NZ weather has led to a stall in NZ production. We have revised down our nationwide (i.e. for all processors) milk production growth forecast for the season to 3%, from 4% previously.



September net immigration inflows eased to 5,190 persons, the weakest monthly net inflow in 28 months. Rising departures and falling arrivals drove the moderation. Whilst net inflows have remained at historically-high levels, the trend (3-month average) in net arrivals continued to ease and at just under 5,483 persons, was well below the 6,200 person peak achieved late last year. Annualised net inflows over the past 3 months dipped to 65,800 persons, below the 74,000 person peak at the end of last year. **Annual net PLT inflows eased to 70,986 persons in September, the lowest since late 2016.**

Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast Market	Forecast ASB
Tue 24 Oct	13:30	JN	Nikkei Japan PMI manufacturing	Oct P	Index	52.9	~	~
Wed 25 Oct	13:30	AU	CPI	Q3	q%ch	0.2	~	0.7
	14:10	JN	BOJ outright bond purchases					
Thu 26 Oct	10:45	NZ	Trade balance	Sep	NZD mn	-1,235	-900	-850
	12:50	JN	PPI services	Sep	y%ch	0.8	~	~
	13:30	AU	Import price index	Q3	q%ch	-0.1	~	-3.0
	13:30	AU	Export price index	Q3	q%ch	-5.7	~	3.0
	20:45	AU	RBA's Debelle gives speech in Sydney					
Fri 27 Oct	12:30	JN	National CPI	Sep	y%ch	0.7	~	~
	13:30	AU	PPI	Q3	q%ch	0.5	~	~
	14:30	CH	Industrial profits	Sep	y%ch	24.0	~	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast Market	Forecast ASB
Tue 24 Oct	09:00	EC	ECB Bank Lending Survey					
	09:00	EC	Markit Eurozone manufacturing PMI	Oct P	Index	58.1	~	~
	10:00	EC	Euro Area Second Quarter Government Deficit					
	14:45	US	Markit US manufacturing PMI	Oct P	Index	53.1	53.0	~
	15:00	US	Richmond Fed Manufacturing. Index	Oct	Index	19.0	16.0	~
Wed 25 Oct	09:30	UK	GDP	Q3 A	q%ch	0.3	0.3	~
	11:06	EC	European Commission Economic Forecasts					
	12:00	US	MBA mortgage applications	Oct	%	3.6	~	~
	13:30	US	Durable goods orders	Sep P	%	2.0	1.0	~
	15:00	CA	Bank of Canada rate decision	Oct	%	1.0	1.0	~
	15:00	US	New home sales	Sep	000	560.0	550.0	~
Thu 26 Oct	12:45	EC	ECB main refinancing rate	Oct	%	0.0	~	~
	13:30	US	Wholesale inventories	Sep P	m%ch	0.9	~	~
	13:30	US	Initial jobless and continuing claims	Oct	~	~	~	~
	15:00	US	Pending home sales	Sep	m%ch	-2.6	0.3	~
	16:00	US	Kansas City Fed Manufacturing. Activity	Oct	~	17.0	~	~
Fri 27 Oct	09:00	EC	ECB Survey of Professional Forecasters					
	11:03	UK	Nationwide house px	Oct	m%ch	0.2	~	~
	13:30	US	GDP annualized	Q3 A	q%ch	3.1	2.6	~
	15:00	US	Uni. of Michigan sentiment	Oct F	Index	101.1	100.8	~

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