Economic Weekly

25 November 2019

Growth grind

This morning we released our [Quarterly Forecasts](). We expect the NZ economy to be regathering momentum next year, with the lull in annual growth in the tail half of 2019 – effectively now. So to quote Yaz, the only way is up. **The growth pick-up, though, is likely to be gradual, and there is more that could be done to give the economy a rev up.** Per-capita growth has faded steadily over the past 3 years and labour productivity has essentially flat-lined.

The RBNZ has done some heavy lifting, though for now it feels it has done enough. Next Thursday sees the RBNZ reveal its final decision on bank capital requirements for locally incorporated banks. We believe the (stricter) requirements will pose a more significant headwind to the NZ economy that the RBNZ expects. This, and a myriad of (predominantly negative) local and global risks will likely push the OCR move lower over 2020.

The Government can play more of a supporting role. It has leeway to add fiscal stimulus, and that would be a good lever to pull if the global economy was to grind to a halt. By providing more clarity on its policy direction, Government can also play a role in helping reduce uncertainties facing businesses. There is also considerable scope for the Government to work in partnership with industries to address structural impediments so as to lift productivity and living standards. That is a nut that many past governments have failed to crack, but would be a fantastic achievement.

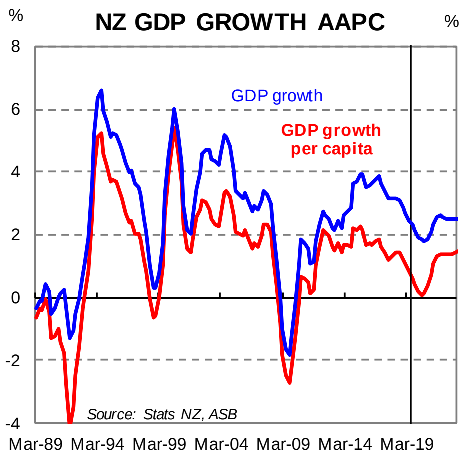
Key events and views

Foreign exchange	Global markets are consolidating, but watch for a retail sales-related boost
Interest rates	Local/global yields ease. We retain our downward bias for NZ yields.
Domestic events	Retail sales, trade balance, RBNZ Financial Stability Report, building consents.
International events	Australian private sector credit, Eurozone CPI and US Core PCE deflator due out this week.

Chart of the Week: 'headline' vs. per-capita growth

NZ's headline growth on our latest forecasts will hit a low point of 1.8% for the full 12 months to June 2020, mainly reflecting modest quarterly growth rates over calendar 2019. That performance sounds like OK momentum. It is, however, coming at a time of strong population growth: our per-capita growth forecast for the June 2020 year is flat.

Per-capita growth is important, as it is more directly linked to improvement in our living standards, by making more national income available per person to cover personal spending as well as enable governments to fund activities that improve our national well-being.



ASB Economics (649) 301 5659 nick.tuffley@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6413	0.6400	0.6369	0.6809	FLAT	0.6280	0.6445	FLAT
NZD/AUD	0.9442	0.9391	0.9340	0.9385	FLAT/UP	0.9320	0.9520	FLAT
NZD/JPY	69.69	69.64	69.20	76.89	FLAT	68.30	71.10	UP
NZD/EUR	0.5820	0.5783	0.5735	0.5964	FLAT/UP	0.5680	0.5910	UP
NZD/GBP	0.4987	0.4949	0.4959	0.5286	FLAT	0.4910	0.5060	FLAT
TWI	71.2	70.7	70.5	74.26	FLAT	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

There's not much to recap on from last week. Financial markets were in snooze-mode. Sure the odd trade-related headline disrupted the sleepy mood from time to time. But we nevertheless closed the week not much wiser about the prospects for a pre-Christmas 'phase 1' deal.

As expected, the NZD/USD closed the week not far from where it started, spending the whole week inside a relatively tight 0.6385-0.6435 range. European currencies tended to be the biggest losers over the week, reflecting the ongoing relative underperformance of European and UK economic data.

Near-term outlook

The week ahead is shaping up as a little more exciting. There's a little more on the event risk calendar to provide direction. Still, the big risk is probably a resolution to the US-China trade talks, although of course we have no way of knowing when/if/what form this will occur. Confirmation a 'phase 1' deal has been agreed would probably provide the impetus for the NZD/USD to break above troublesome resistance in the 0.6450 zone.

We doubt Wednesday's RBNZ Financial Stability Review will have any implications for the currency. Most of markets' focus will be on whether the RBNZ relaxes the current loan to value restrictions: 20% deposit for owner occupiers and 30% for investors. For choice, we think they will, but the case isn't particularly compelling at this point.

We might see a bit of a NZD boost from Tuesday's NZ retail sales report. We're expecting an above-market 0.8% qoq Q3 expansion, with upside risk. The ANZ business confidence survey (Wednesday) might actually start to read a little less negative than recent times, which would further build a base of support for the NZD.

Medium-term outlook

Our forecasts have the NZD/USD drifting lower 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	0.71	0.72
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	72	72
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.61	0.62
NZD/GBP	0.53	0.51	0.49	0.46	0.51	0.53	0.54
NZD TWI	73.2	70.2	69.1	67.9	71.5	74.3	75.0

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	1.02	1.22	1.06	2.00	UNCH/DOWN	UP
2-year swap	1.14	1.17	0.93	2.13	UNCH/DOWN	UP
5-year swap	1.22	1.25	1.01	2.50	UNCH/DOWN	UP
10-year swap	1.51	1.53	1.33	2.98	UNCH/DOWN	UP
10-year govt bond yield	1.34	1.41	1.20	2.12	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.37	0.36	0.40	0.85	UP	UNCH/UP

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

Market Recap

Both local and global yields eased last week. Markets look to be coming to the view that the spike in NZ yields following the November MPS on hold decision was overdone. Yields were also pushed lower by increased global risk aversion, given souring relations between the US and China. Political support by the US Congress to Hong Kong protestors drew a rebuke from China. Despite claims from President Trump that a Phase I trade deal between the US and China is "very close", conflicting media reports suggested delays till next year, triggering potential US tariff hikes. **Signals from global central banks suggested no immediate urgency to move rates lower.** The RBA Minutes had a dovish tone but suggested no imminent need to move the 0.50% cash rate lower. The US Federal Open Market Committee minutes showed little urgency for further cuts to the 1.50%-1.75% Federal Funds rate with rates to remain on hold as long as "incoming information did not result in a material reassessment of the economic outlook." Bank of Canada Governor Poloz, indicated Canadian interest rate settings were about right.

Near-term NZD interest rate outlook

The direction of global yields over the next few weeks will largely depend on the state of relations between the US and China. Picking what will transpire over the next week is a lottery, but we maintain our long-held view that slowing global growth and negatively-skewed risk profile will require more policy support. **There remains considerable scope for local yields to retrace their post November MPS climb and markets to price in the greater likelihood of OCR cuts.** The OCR floor of 0.84% implied by current market pricing is well above that consistent with our OCR view and some 30bps higher than that prior the November MPS decision. If the RBNZ relaxes the loan to value restrictions we suspect it will be a modest increase to the speed limit for non-investor lending (mildly positive for NZ yields). It would be best not to overthink that any changes will be related to a shifting stance by the RBNZ on bank capital requirements, which will be unveiled next Thursday. We expect a solid Q3 outturn for NZ retail trade, but have doubts over whether the pick-up will be maintained. With the majority of responses this week's NZ business and consumer confidence gauges likely received prior to the November RBNZ surprise, it will be difficult to interpret the results. Tomorrow night sees a speech by RBA Governor Phil Lowe entitled "Unconventional Monetary Policy: Some Lessons from Overseas". With only 5bps of cuts priced for next Tuesday's RBA's meeting, a dovish tone could see material market reaction.

Medium-term outlook

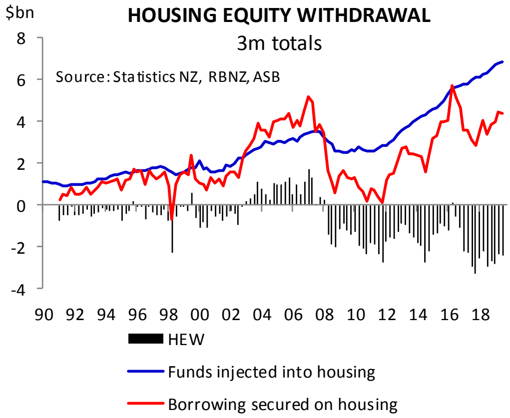
We expect 50bps of OCR cuts in 2020 (-25bps Feb, -25bps May), with the OCR held at 0.5% until a series of mild and gradual hikes from 2022 (OCR endpoint of 2%). The RBA is expected to cut the 0.75% cash rate by 25bp in February, with the effective lower bound of the RBA cash rate at 0.5%. The 1.50%-1.75% Federal Funds rate is expected to be cut by 75bps in 2020 (Mar 20, Jun 20, Sep 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	1.00	0.75	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.2	1.0	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	1.1	1.0	0.9	1.2	1.6
NZ 5-year swap rate	1.4	0.9	1.2	1.1	1.1	1.5	1.9
NZ 10-year swap rate	1.8	1.2	1.4	1.3	1.2	1.5	1.9
NZ 10-year Bond	1.6	1.1	1.3	1.2	1.1	1.3	1.7

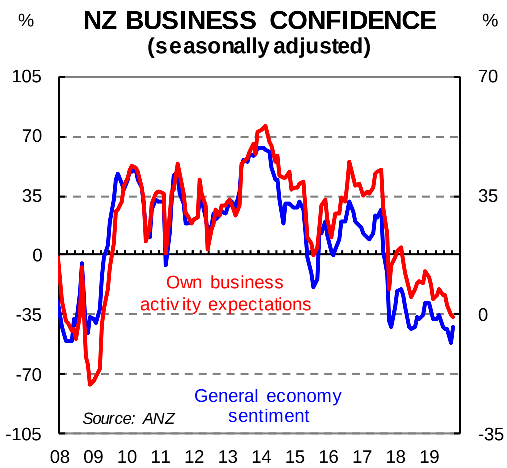
Domestic events

Data	Date	Time (NZT)	Market	ASB
Retail Sales, Q3, % qoq	26/11	10:45am	0.5	0.8
RBNZ Financial Stability Report - November	27/11	9:00am	-	-
Merchandise trade balance, October, $m	27/11	10:45am	-1000	-700
ANZ Business Outlook, own activity next 12 months, Nov	28/11	1:00pm	-	-
ANZ Consumer Confidence, Headline, Nov	29/11	10:00am	-	-
Building Consents, residential %mom, Oct	29/11	10:45am	-	-

Retail trade stumbled in Q2, driven by a broad-based contraction in about half of the 15 retail sub-groups after a late 2018 flurry. **Most indicators point to a decent lift in Q3 retail volumes.** But higher consumer prices look set to temper the increase in retail volumes. **Despite an expected solid Q3 result, the best times of the retail sector still look to be behind it** as households gravitate increasingly to income rather than borrowing-led consumption. **Without a solid consumption backbone, the expansion in growth is likely to disappoint the RBNZ view.** The OCR looks set to move lower over 2020.



The prime point of interest with the release of the RBNZ's Financial Stability Report will be whether the RBNZ's Loan-to-Value Ratio lending restrictions (LVRs) get relaxed or not. We see a further relaxation of the LVRs at this meeting is a close call compared to previous years. The fall in interest rates over the past year has resulted in slightly stronger mortgage lending growth, with household debt increasing relative to incomes. But on the other hand the RBNZ may be comfortable with this change given it has been accompanied by a fall in debt servicing as a share of nominal income. Meanwhile, the RBNZ is widely expected to announce an increase in minimum bank capital requirements on the 5th of December. **Given higher bank capital requirements are designed to reduce all financial stability risks, an easing in the high-LVR lending restrictions may be warranted as a partial offset,** at least for less risky lending (i.e. owner occupiers over investors).



We expect a trade deficit of circa $700m in October. The October trade balance is normally in deficit as agricultural export volumes remain seasonally low. Looking over the month, dairy and meat export values in seasonally-adjusted terms are to remain firm on the back of strengthening prices. On the import side, we expect growth in import values to remain modest in line with generally modest domestic demand. The annual trade deficit is likely to narrow towards $4.6 billion.

Business confidence remains weak, as lower interest rates have failed to lift business optimism over 2019. Business confidence surveys continue to depict an environment of sub-trend economic growth, continued margin compression, weak investment and employment.

Consumer confidence experienced a seasonal lift in October, driven by a better experienced and expected financial positions of respondents and less pessimism over the economic outlook. **We will be looking for this improvement to continue this month, given the improved global backdrop and strengthening domestic housing market.** Much of the responses to the ANZ survey would have been received prior to the on-hold OCR decision on November 13. We remain doubtful whether improved consumer sentiment on its own will be sufficient to push consumer spending up.

Residential consents lifted further in September, up 7.9% from August, boosted by increased demand for high density homes. Residential dwelling consent issuance is running at its highest level since the mid-1970s. Underlying house-building demand remains very high and we expect lower interest rates to provide additional support to home sales and, in turn, construction demand over the coming year.

Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Dep Gov Debelle speech in Canberra	26/11	12:50 pm	-	-
RBA Governor Lowe speech in Sydney	26/11	10:05 pm	-	-
Australia Construction Work Done, Q3	27/11	1:30 pm	-1.0	-1.0
Australia Private Sector Capex, Q3, %qoq	28/11	1:30 pm	0.0	0.5
Japan Retail Sales, October, %mom	28/11	12:50 pm	-10.4	-11
US Core PCE Deflator, October, %yoy	28/11	4:00 am	1.4	1.8
US Durable Goods Order, October, %mom	28/11	2:30 am	-0.8	-0.5
Australia Private Sector Credit, October, %mom	29/11	1:30 pm	0.3	0.2
Eurozone CPI, November, %yoy	29/11	11:00 pm	1.2	-

**Originally published by CBA Global Markets Research on Friday 22nd November at 1.58pm*

Deputy Governor Debelle is due to speak at the ACOSS National Conference on the topic "Employment and Wages". The RBA has been clear it wants the unemployment rate closer to 4.5%, where the RBA now sees the natural rate. Given low inflation, low wages growth and the unemployment rate (which is still above this natural rate), further monetary policy easing is likely necessary to achieve this.

Governor Lowe will deliver a speech at the Annual ABE dinner on "*Unconventional Monetary Policy: Some Lessons from Overseas".* The Governor's perspective on the international experience with QE will be interesting and most likely be in line with the Bank for International Settlements (BIS) Committee paper "Unconventional monetary policy tools: a cross-country analysis". That paper was written by the Committee on the Global Financial System, which is Chaired by Governor Lowe.

Australia's Construction Work Done fell 3.8% in Q2 19. Both residential and non-residential work fell with residential recording a fourth consecutive quarterly fall. We expect a further fall of 1% in Q3 19 as residential construction continues to retreat. We do expect residential construction to bottom out around mid-2020 as supply and demand fundamentals come back in-line.

We expect the volumes for **Australia's private sector capex** over Q3 19 to rise 0.5%, this would take the annual rate down to 1.1%.

We expect a large 11% fall in **Japanese retail sales** in October following the increase in the value added tax from 8% to 10% on 1 October. In September retail sales lifted by 7.2% as consumers attempted to beat the GST increase.

Credit growth in Australia remains weak, growing at just 2.7% over the year to September. Housing credit growth is just 3.1%yoy with investor credit growth now in negative territory at -0.1%yoy. The flow of new credit for housing has reaccelerated, but the stock of credit remains weak. The difference can partially be explained by the reduction in existing debt which is slowing growth in the stock of credit. Debt holders are using lower interest rates to pay down debt faster. We are expecting a 0.2% lift in credit in October.

Already-released **US** CPI data suggest the **core personal consumption expenditure deflator** remained below the US Federal Reserve's 2%yoy target at 1.8%yoy in October.

The weakness in capital spending plans in the regional US Federal Reserve manufacturing surveys suggest **durable goods orders in the US** will continue to contract by 0.5% in October.

Eurozone inflation is expected to remain muted in November. Headline CPI inflation will likely print below 1% for a third consecutive month and core CPI inflation is projected to remain sticky around 1%. Disappointing Eurozone economic activity and declining inflation expectations continue to contain price pressures. For 2019, the European Central Bank projects headline CPI inflation of 1.2% and core CPI inflation of 1.1%.

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	1.6	2.6	2.5	2.5
GDP real - AA%	2.4	2.3	2.2	1.9	2.1	2.6	2.5
CPI - Q%	0.6	0.7	0.3				
CPI - A%	1.7	1.5	1.7	2.1	1.7	1.7	1.8
HLFS employment growth - Q%	0.7	0.2	0.3				
HLFS employment growth - A%	1.4	0.8	1.1	1.5	1.5	1.5	1.3
Unemployment rate - %sa	3.9	4.2	4.1	4.3	4.3	4.2	4.4
Annual current account balance as % of GDP	-3.4	-3.4	-3.3	-3.1	-2.7	-2.7	-2.7

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	1.00	0.75	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.2	1.0	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	1.1	1.0	0.9	1.2	1.6
NZ 5-year swap rate	1.4	0.9	1.2	1.1	1.1	1.5	1.9
NZ 10-year swap rate	1.8	1.2	1.4	1.3	1.2	1.5	1.9
NZ 10-year Bond	1.6	1.1	1.3	1.2	1.1	1.3	1.7

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	0.71	0.72
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	72	72
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.61	0.62
NZD/GBP	0.53	0.51	0.49	0.46	0.51	0.53	0.54
NZD TWI	73.2	70.2	69.1	67.9	71.5	74.3	75.0

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