Economic Weekly

26 August 2019

Sluggish retail spending sets the tone

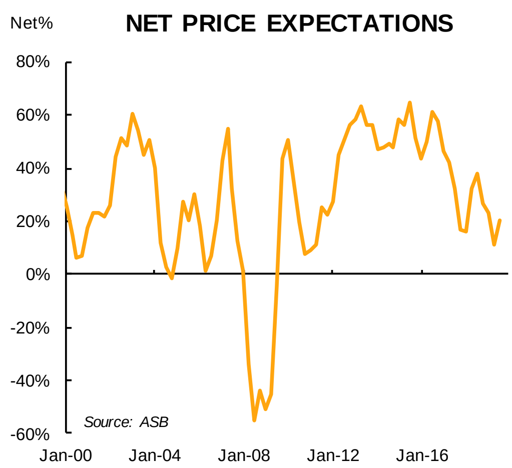
NZ economic data continue to point to the slowdown becoming more entrenched. Last week's Q2 Retail Trade Survey confirmed a soft quarter for retail spending. Slowing tourism growth weighed on accommodation spending while areas of discretionary spending were sluggish, potentially impacted by higher fuel prices over the quarter. Focus this week will be on the August ANZ Business Outlook, which may partly capture the business community's reaction to the Reserve Bank of New Zealand's move to slash the Official Cash Rate by 50 basis points to 1%. Meanwhile, the deteriorating global backdrop will likely remain a drag on sentiment. The US-China trade wars escalated over the weekend, with China announcing additional tariffs on some US exports from September and President Trump striking back, with an additional 5% duty on some Chinese exports from October.

Key events and views

Foreign exchange	NZD will remain a G10 underperformer, watch CNY
Interest rates	We retain our downward and flattening bias.
Domestic events	August business and consumer confidence, July building consents.
International events	AU capital spending plans, US PCE deflator, Eurozone CPI.

Chart of the Week: Quietly confident

The Government's back-down on implementing a capital gains tax and a fall in mortgage rates record lows have **lifted house price expectations over the three months to July**, according to ASB's housing confidence survey. **The lift in price expectations was relatively widespread across the regions**, but the South Island experienced the biggest lift. In Auckland, price expectations recovered from net 12% expect declines, to just net 3% expecting a fall.



The mild lift in house price expectations is **consistent with some of the other housing indicators we monitor that are suggesting the housing market may be slowly turning a corner.** Since ASB's latest survey, **the Reserve Bank of New Zealand has turbocharged rate cuts, slashing the Official Cash Rate by 50 basis points to 1% in August and sending mortgage rates lower again.** We expect house price inflation to lift over the coming year, particularly in areas where the housing market remains tight, such as Wellington.

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ASB

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6358	0.6417	0.6654	0.6643	DOWN	0.6280	0.6490	FLAT
NZD/AUD	0.9484	0.9462	0.9581	0.9120	FLAT	0.9400	0.9540	FLAT
NZD/JPY	66.54	68.23	72.27	74.00	DOWN	64.80	67.20	UP
NZD/EUR	0.5700	0.5784	0.5969	0.5745	FLAT/DOWN	0.5690	0.5750	FLAT/UP
NZD/GBP	0.5180	0.5278	0.5345	0.5182	FLAT/DOWN	0.5130	0.5230	FLAT/UP
TWI	71.1	71.4	73.1	72.08	FLAT/DOWN	N/A	N/A	FLAT

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

NZD Recap

The NZD remains mired at the bottom of the G10 currency leader board. It was the worst performing currency for a second straight week. NZD/USD made fresh 4-year lows, NZD/EUR hit a one-year low, and NZDJPY is trading at the weakest level since 2012.

Domestic news remains off the radar. Rather, it's the decidedly un-NZD friendly global situation that is doing the damage. Escalating trade wars and the flow-on effects to the global economy are seeing investors' risk appetite dry up. Equities\ and commodity prices are in decline, and risk aversion and volatility measures are rising. Peripheral, commodity-sensitive currencies like the NZD and AUD have underperformed as a result.

Near-term outlook

Near-term risks remain to the downside for the NZD. Global growth sentiment is deteriorating and, as a 'growth-sensitive' currency, the NZD typically underperforms in this environment. We suspect markets will trade defensively this week following the clear ratcheting up in the trade war over the weekend.

Keep a close eye on the CNY. In times of heightened trade anxiety the NZD exhibits a very close correlation to USD/CNY. The extent to which the Renminbi is allowed to weaken appears to be a market proxy for both Chinese growth sentiment, and trade war risks. Notably, USD/CNH (offshore renminbi) has jumped around 0.6% this morning to 7.18 USD. We suspect more CNY weakness is likely this week.

There are a couple of amber lights flashing suggesting the NZD is starting to become stretched to the downside. NZD net short positions held by the speculative community have increased markedly over the past two months, although they are not yet at the "extreme" levels of late last year. When spec positions get to extreme levels it can flag the risk of a snap-back in the NZD. The daily RSI – a momentum indicator – is now in "oversold" territory but, again, not to the same degree as August last year.

Medium-term outlook

CBA lowered their NZD forecasts last week. The mild appreciation we had expected from Q4 of this year has been removed with the NZD/USD seen at 0.6300 by year-end and 0.6200 by Q1. This downward revision is consistent with the trade war, and attendant negative global growth impacts, dragging on for longer than we anticipated. The domestic economy's failure to launch (as flagged in our Quarterly Forecasts last week) is another reason we think the NZD will hang around current low levels for longer. Our constructive view on NZ's terms of trade, and the front-loaded nature of RBNZ policy easing, are key reasons why believe further downside from here is limited.

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

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.50	1.75	UNCH	UP
90-day bank bill	1.19	1.20	1.49	1.91	UNCH	UP
2-year swap	0.93	0.95	1.27	2.03	UNCH/DOWN	UP
5-year swap	0.94	0.96	1.33	2.36	UNCH/DOWN	UP
10-year swap	1.19	1.23	1.68	2.86	UNCH/DOWN	UP
10-year govt bond yield	1.06	1.01	1.51	2.58	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.26	0.29	0.42	0.83	UNCH/DOWN	UNCH/UP

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

Market Recap

It was a round trip for local and global yields. Yields rose and curves steepened after the Federal Open Market Committee (FOMC) Minutes highlighted the insurance-type nature of the 25bp Fed July cut, revealed divisions between FOMC committee members over the need for future rate cut and gave the impression that the July cut was not the start of a protracted easing cycle. NZ yields also firmed and OCR rate cut expectations were pared back after RBNZ Governor Orr (who had attended the Jackson Hole Symposium) said the Monetary Policy Committee (MPC) could afford to “watch, wait and observe” after “their pre-emptive double cut” in August.

Yields then fell, curves flattened, and the US yield curve briefly inverted after China announced that it will be imposing 5% to 10% tariffs on USD75bn of US exports from September, with the US countering with an additional 5% duty on some USD550bn in targeted Chinese goods from October. **The weekend’s G7 summit highlighted numerous divisions, including trade, climate change, Iran and Brexit.** In his speech at the Fed symposium at Jackson Hole, Fed Chair Powell pledged the Fed would “act as appropriate” and kept alive the prospect of future interest rate cuts. Powell, however, noted there were limits to what the FOMC could do. RBA Governor Lowe also warned of limited monetary policy headroom to offset “a period of major political shocks”. Hopes of a Brexit deal fell after French PM Macron said the European Union was unlikely to agree to a new withdrawal agreement.

Near-term NZD interest rate outlook

We have maintained our (mild) downward (and curve flattening) bias. Markets are likely to remain reactive to headlines from the G7 summit (which ends tonight). Despite an ‘in principle’ trade deal between the US and Japan being announced at the G7 meeting, the **multitude of (predominantly downside) risks to the global scene worries us.** The escalating US/China trade war, risks to political stability in Italy, Iran, and growing risks of a no-deal Brexit could push global yields lower and flatten curves as investors’ seek safe haven assets. We expect consumer and business confidence data (on Governor Orr’s watch list) from this week’s ANZ surveys to remain subdued, helping to cap local yields and maintain the prospect of a late 2019 OCR cut.

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. **However, the growing risk is that longer-term yields could rally further (i.e. fall) if downside global risks crystallise.** We expect a 25bp OCR cut in November and a 0.75% OCR trough this cycle, with downside risks. Gradual OCR tightening is expected from early 2022, with an OCR endpoint of just 2.25% by late 2024. We also expect 50bp of cuts by the RBA (Nov 2019, Feb 2020), a further 75bp of cuts by the Fed (Sep 2019, Dec 2019, Mar 2020), and policy easing in Canada, 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.

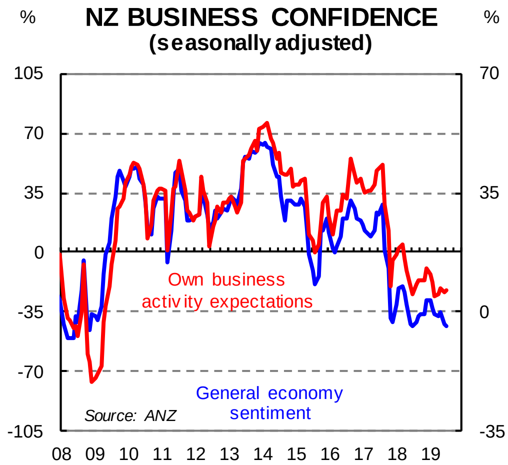
ASB interest rate forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.50	1.00	0.75	0.75	0.75	1.00	1.50
NZ 90-day bank bill	1.9	1.7	1.2	1.0	1.0	1.0	1.2	1.7
NZ 2-year swap rate	1.6	1.4	1.0	0.9	0.9	0.9	1.2	1.7
NZ 5-year swap rate	1.8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

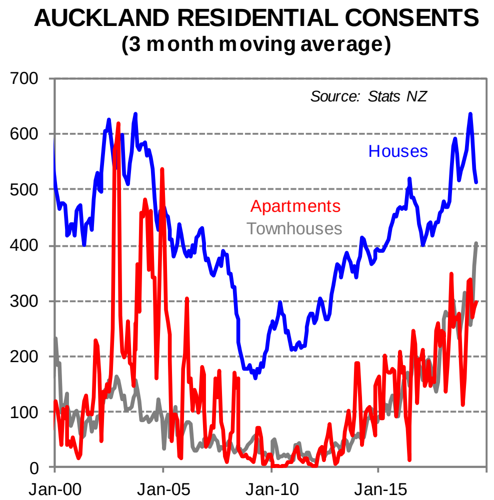
Domestic events

Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own Activity, August, net %	29/08	1:00 pm	-	-
Building Consents, residential, July, mom %	30/08	10:45 am	-	-

ANZ monthly business confidence has remained persistently weak over 2019 and continues to suggest growth will remain sub-trend over 2019. Some businesses are reporting increased difficulty in accessing credit, while global concerns are also likely to be weighing on the business mood. This is the first survey of business confidence following the RBNZ's surprise 50 basis point OCR cut in early August, although some of the responses were likely received before the OCR decision.

Residential building consents edged lower in June, following a strong first half of the year for residential building consent issuance. Although recent indicators for house building demand have been mixed, we expect lower interest rates to support housing demand and construction appetites. We expect residential construction activity to remain at high levels over 2019, so that housing supply can make up the shortfall which has emerged in recent years. Meanwhile, there are no signs of a slowdown in commercial construction issuance despite weak business confidence levels seen over the past year.





Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Dep. Gov. Debelle speech, Canberra	27/08	2:45 pm	-	-
Australia Construction Work Done, Q2, %qoq	28/08	1:30 pm	-1.0	-1.0
Australia Private Capital Expenditure, Q2, %qoq	29/08	1:30 pm	0.4	0.0
Australia Building Approvals, July, %mom	30/08	1:30 pm	0.0	Flat
Australia Private Sector Credit, July, %mom	30/08	1:30 pm	0.2	0.2
Eurozone CPI, August, %yoy	30/08	8:00 pm	1.0	1.0
US PCE Deflator, July, %yoy	31/08	12:30 am	0.2	1.4

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Guy Debelle, Deputy Governor at the Reserve Bank of Australia, is slated to speak at the Economic Society of Australia's (ACT) Lunch Address in Canberra on Tuesday.

The Australian Q2 capex survey will garner a lot of attention because the survey is both backward and forward looking. The 2nd estimate of 2019/20 spending plans three months ago was solid and implied a large lift in mining capex and a smaller lift on the non-mining side. The third reading on planned spending will give some insight into whether or not weaker business confidence is crimping capex plans. The Q2 data will finalise the 2018/19 capex outcome. We expect the actual volume of capex spending to be a flat result in Q2.

We expect **construction work done in Australia** to have slipped over Q2. Residential and engineering construction work is expected to post falls, partially offset by a lift in non-residential construction. By sector, public construction work is forecast to lift while private sector activity is expected to decline.

Australia's building approvals have trended lower but appear to be close to a trough. We expect the building approvals series to consolidate over coming months and have pencilled in a flat outcome in July.

Credit growth in Australia is weak. Housing credit growth has slowed and business credit growth has more recently softened. The stock of credit is expected to rise by 0.2% over July. We expect to see credit growth lift modestly over 2019/20 due to lower lending rates.

Eurozone headline and core CPI inflation are expected to remain muted in August near 1%yoy. Disappointing economic activity and declining inflation expectations continue to contain price pressures. For 2019, the European Central Bank projects headline CPI inflation of 1.3% and core CPI inflation of 1.1%.

We expect **US headline Personal Consumption Expenditure (PCE) inflation** lifted 0.2%mom (1.4%yoy) in July. Gasoline prices rose modestly in July after falling in June. The already-released core CPI suggests the core PCE deflator will lift 0.3%mom and 1.7%yoy. Consumer inflation expectations remain low and will continue to be a drag on inflation. However, the recent uptick in non-farm labour costs will help to offset some of the drag from low inflation expectations.

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	0.6	0.5					
GDP real - A%	2.5	2.2	2.3	2.5	2.6	2.8	2.3	2.4
GDP real - AA%	2.7	2.5	2.4	2.4	2.4	2.7	2.5	2.3
CPI - Q%	0.1	0.6	0.5	0.2				
CPI - A%	1.5	1.7	1.3	1.4	1.8	1.8	2.0	1.9
HLFS employment growth - Q%	-0.1	0.8	0.2	0.4				
HLFS employment growth - A%	1.5	1.7	0.9	1.3	1.9	1.7	1.4	1.2
Unemployment rate - %sa	4.2	3.9	4.1	4.1	4.2	4.0	3.9	4.1
Annual current account balance as % of GDP	-3.6	-3.2	-3.3	-3.6	-3.7	-4.0	-4.0	-4.1

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

ASB interest rate forecasts

(end of quarter)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
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ASB foreign exchange forecasts

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		<< actual	forecast >>					
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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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