

Economic Weekly

29 April 2019

When doves cry out

Domestically, things were quiet last week, with the Easter and ANZAC day holidays there were few local data announcements. It's just as well we had a breather, as things will kick into gear again this week. **With March business confidence out tomorrow and Q1 employment on Wednesday, the RBNZ will have two more pieces of data to examine ahead of its meeting next week.** We expect 25bps in cuts, and will have a preview out later in the week.

Friday saw the release of NZ's March trade balance, showing a much larger surplus than expected. Our strong export sector remains a support for the economy, despite soft global growth and slowing international trade flows.

Internationally, the Bank of Canada, Bank of Japan and Swedish Riksbank held meetings, where all three emphasised rates will remain low for some time to come. A weak CPI print in Australia suggests the RBA could move to an easing bias next week. **Thus, we continue to see evidence of a trend toward greater central bank dovishness globally, as well as domestically.** US GDP growth outpaced expectations ahead of this week's Fed's meeting on Wednesday.

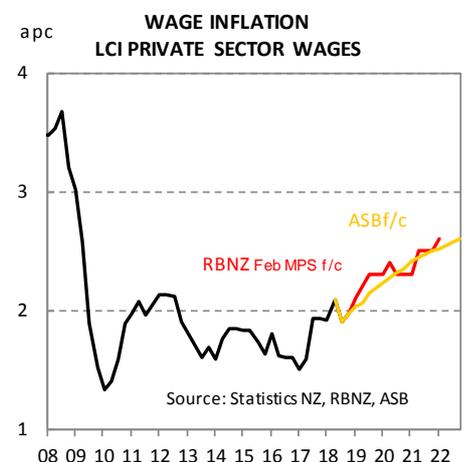
Key events and views

Foreign exchange	This week's employment data are likely to drive near-term moves in the NZD.
Interest rates	Low inflation and dovish central banks mean global yields are likely to remain subdued.
Domestic events	April Business Confidence, Q1 Employment
International events	Federal Reserve and Bank of England meetings, Eurozone GDP, US Non-farm Payrolls
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: Wage-ringing LCI growth will be soft

On Wednesday, Stats NZ releases the Household Labour Force Survey, showing Q1 employment data. The survey is volatile, so making any estimates is a gamble – but we have some educated guesses. **We expect a rebound after a soft Q4, with robust labour utilisation and historically-low unemployment.**

Whilst that implies the RBNZ is close to its goal of 'maximum sustainable employment,' we expect wage growth to be soft. We expect the Labour Cost Index (LCI) to rise just 0.4% qoq. **It looks like wage growth won't strengthen enough to keep inflation in the RBNZ's 1-3% target – boosting the odds of a rate cut on May 7th.** For a full write-up see our Labour Market Preview [note](#).



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6660	0.6671	0.6783	0.7065	FLAT	0.6560	0.6760	UP
NZD/AUD	0.9458	0.9361	0.9571	0.9353	FLAT	0.9350	0.9560	UP
NZD/JPY	74.31	74.62	75.10	77.13	FLAT	73.30	75.30	UP
NZD/EUR	0.5973	0.5928	0.6041	0.5833	FLAT	0.5880	0.6080	FLAT
NZD/GBP	0.5153	0.5135	0.5192	0.5071	FLAT	0.5050	0.5250	UP
TWI	72.9	72.4	73.7	73.44	FLAT	72.00	74.00	UP

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

NZD Recap

The **NZD/USD** fell below 0.6600 in the middle of last week on USD strength, although the cross rate firmed heading into the weekend. The late gain was possibly due to the RBNZ Governor's somewhat ambiguous comments on the prospects of an OCR cut as well as stronger-than-expected trade data. Market attention now turns to the Q1 2019 labour market data (due Wednesday). RBNZ Governor Adrian Orr said that Q1 CPI and Q1 labour market data would be central in deciding the direction and timing of any interest rate changes. Also, the ANZ Business Outlook Survey (due Tuesday) has potential to drive FX volatility. Meanwhile, the **AUD/USD** dipped nearly a cent following the release of soft Australian Q1 inflation data last week. In the aftermath of the release, market pricing for a RBA rate cut on 7 May settled at 50% from 10% prior to the inflation data.

Near-term outlook

This week, the **NZD/USD** will take its direction from the consolidation of the USD and New Zealand's Q1 2019 labour market report (Wed). After moving to an easing bias in March, RBNZ Governor Adrian Orr stated that changes to the cash rate were data dependent. Orr alluded to the CPI (which was weak) and the labour market data. So this week's labour market data are important for the RBNZ's interest rate decision next week and short-term moves in NZD. Nevertheless, Orr's public comments suggest he is giving himself some wiggle room to leave the cash rate on hold in May. The market is currently pricing a 54% chance of a May rate cut. Meanwhile, the Fed and BoE make interest rate announcements this week, with no change expected from both central banks. Also, April US Non-farm Payrolls data are due over the weekend, with the release having potential to drive volatility in the **USD** crosses.

Medium-term outlook

In the medium term and looking beyond any short-term reaction to possible OCR cuts, we expect the NZD/USD to gradually strengthen given NZ's high Terms of Trade. We expect the USD will hold some of its strength despite the market partially pricing in potential future Fed rate cuts. We have lifted our NZD/AUD forecasts and now expect the NZD/AUD to remain close to 0.96 over the next few years. We revised our AUD forecasts lower to reflect Australia's housing adjustment and the risk of slower growth in Australian household consumption. However, the NZD/AUD is currently below these expectations due to the likelihood of an imminent rate cut from the RBNZ. We have delayed the timing of the forecast EUR appreciation as Europe's economy has softened and we expect the ECB will now wait until the end of 2020 before raising interest rates.

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	0.68	0.69	0.69	0.70	0.72	0.74
NZD/AUD	0.95	0.96	0.96	0.96	0.96	0.96	0.96	0.97
NZD/JPY	74	75	76	77	77	77	78	80
NZD/EUR	0.59	0.60	0.60	0.60	0.59	0.59	0.59	0.60
NZD/GBP	0.53	0.52	0.54	0.54	0.54	0.54	0.55	0.57
NZD TWI	73.5	73.9	73.9	74.5	74.1	74.8	75.0	76.6

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.75	1.75	1.75	1.75	UNCH/DOWN	UP
90-day bank bill	1.79	1.77	1.85	2.02	UNCH/DOWN	UP
2-year swap	1.65	1.65	1.63	2.29	UNCH/DOWN	UP
5-year swap	1.78	1.80	1.77	2.77	UNCH	UP
10-year swap	0.00	2.24	2.16	3.25	UNCH	UP
10-year govt bond yield	1.90	1.96	1.81	2.88	UNCH	UP
Curve Slope (2s10s swaps)	0.56	0.59	0.53	0.97	UNCH/UP	UNCH/UP

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

Market Recap

Last week's weaker than expected Australian consumer price data triggered further falls in local yields in a holiday-shortened week. Headline and core CPI inflation prints were softer than expected, with Australian short-term yields down 10-12bps, touching record lows, and with market pricing for a May RBA cut jumping from 15% to around 65% after the CPI release. NZ yields also eased, albeit to a lesser extent. The message from global central banks was dovish, with the Bank of Canada, Bank of Japan and Swedish Riksbank either dropping tightening biases, increasing policy support via extending asset purchases and/or pushing out forward guidance. US yields eased despite stronger than expected US Q1 GDP (3.2% qoq annualised versus 2.3% mkt), with higher government spending, strong net exports and sizeable inventory build-up likely to weigh on future US activity.

Near-term NZD interest rate outlook

With markets pricing in more than 50% odds of a 25bp cut in May and close to 50bps of cuts priced in over the next 12 months, next weeks' policy interest rate decisions by the RBA (Tuesday 7th May) and RBNZ (Wednesday 8th May) now look to be "live". We expect domestic business confidence to strengthen in the coming months following PM Arden's April 17 announcement ruling out a capital gains tax, but only expect to see modest improvement in tomorrow's April ANZ Business Outlook. A dip in the Q1 NZ unemployment rate on Wednesday could see NZ yields edge up, but we expect mild readings for wage inflation to cap upward pressure on yields. **Global yields are expected to remain in the lower part of recent trading ranges, courtesy of soothing messages from the Fed.** On Thursday, the Fed is widely expected to leave the Fed funds rate unchanged and show little inclination to shift from its neutral and 'patient' stance. Inflation from the core PCE deflator is expected to remain below the Fed's 2% target, keeping global yields low and markets biased in favour of 2019 Fed cuts. No change to policy settings are expected by the Bank of England. Manufacturing sentiment gauges for the US, Eurozone, China, the UK and Australia could trigger some volatility in markets as could Q1 GDP in the Eurozone, US employment data, oscillations in global equity markets and trade headlines from this week's meeting between US and Chinese authorities.

Medium-term outlook

We have pencilled in 25bp of OCR cuts in May and August of this year, but note that the exact timing of OCR cuts is fluid. The OCR is subsequently expected to remain at 1.25% until early 2022, before gradually drifting towards its 2.25% cyclical peak towards the end of 2023. The proposed higher bank capital requirements, which we assume are equivalent to an increase of roughly 50bps on customer interest rates by late 2023, will likely tighten financial conditions, lower swap interest rates across the curve and keep the OCR lower than it would otherwise be. Global central banks are expected to remain on hold, with risks tilting towards more policy support being necessary. NZD long-term yields could initially dip and then drift up, before eventually settling at around 2.5-3%.

ASB interest rate forecasts

(end of quarter)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
		<< 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	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.6	1.5	1.5	1.5	1.6	1.9
NZ 10-year Bond*	2.38	1.8	1.8	1.8	1.8	1.8	2.1	2.4

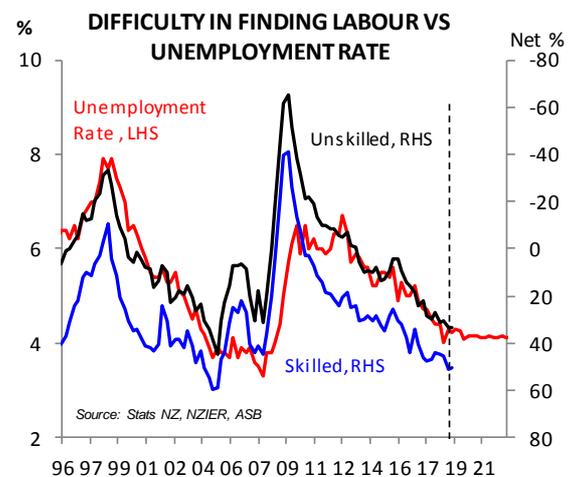
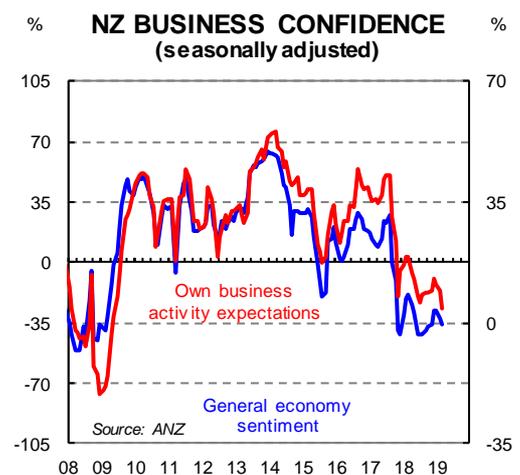
Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
ANZ Business Outlook, April, Own Activity Expectations	30/04	1:00 pm	6.3	-	-
Employment, Q1, %qoq	01/05	10:45am	0.1	0.5	0.6
Unemployment rate, Q1, %	01/05	10:45am	4.3	4.2	4.2
LCI, private sector, Q1, % qoq	01/05	10:45am	0.5	0.5	0.4
Building Consents, Residential, Mar, %	02/05	10:45 am	-2.0	-	-

ANZ headline business confidence and firms' own activity expectations remained weak in February and March, dashing hopes that business confidence would improve over early 2019. Business confidence may have been impacted over March and April by concerns of a capital gains tax being implemented following the release of the Tax Working Group recommendations in late February. However, in mid-April the Government announced it would not introduce a capital gains tax after all. As most responses to this survey are typically received in the first two weeks of the month, we expect to see an improvement in business confidence in the May survey.

We expect some modest strengthening from the 'soft' Q4 HLFS labour prints, with employment growth set to firm, the unemployment rate to ease, and with measures of labour utilisation to tighten. **However, wage growth is still expected to remain modest**, with distributional measures continuing to depict a contained wage inflation backdrop. In our view, wage growth looks like it won't strengthen enough to keep CPI inflation outturns comfortably within the 1-3% inflation target. We expect 50bps of OCR cuts over 2019, with reasonable odds of a 25bp RBNZ cut next week.

Residential building consents lifted in February, adding to a strong result in January. NZ annual consent issuance remains at 44-year highs. A hefty number of apartment consents (largely in Auckland) were approved in February. Apartment consents can be volatile month to month, so dwelling consent issuance may ease back in March after a very strong start to the year.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
US PCE Deflator, March, %yoy	30/04	12:30 am	1.6	2.0
RBA Private Sector Credit, March, %mom	30/04	1:30 pm	0.3	0.3
Eurozone GDP, Q1, %qoq	30/04	9:00 pm	0.3	0.3
Australia CoreLogic Dwelling Prices, April, %mom	01/05	12:00	-	-0.5
BoE Interest Rate Announcement, %	02/05	11:00 pm	No chg	No chg
US Fed Interest Rate Announcement, %	02/05	6:00 am	No chg	No chg
Australia Building Approvals, March, %mom	03/05	1:30 pm	-12.5	-10
Eurozone CPI, April, %yoy	03/05	9:00	1.6	1.4
US Non-farm Payrolls, April, 000s	04/05	12:30	185	175

*Originally published by CBA Global Markets Research on Friday 26th April at 2.04pm.

Australia's credit growth is low. Housing credit slowed to 4.2%yoy in February, driven by softness in both credit to investors and owner-occupiers. Business credit growth has eased more recently but the annual rate has pushed higher to 5.3%yoy due to a base effect. We expect modest credit growth of 0.3% over March.

Australia's dwelling prices continue to deflate nationally although the pace of declines has eased. The CoreLogic daily data point to a national decline in prices of 0.5% over April. Dwelling prices in Sydney are expected to post a slightly larger fall (-0.6%) while prices in Melbourne are likely to contract in line with the national rate.

The highly volatile **building approvals series in Australia** posted a massive 19.1% spike in February due to a huge lift in multi-unit approvals. Some statistical payback looks probable in March; we have pencilled in a 10% fall in approvals.

We estimate the strong 6.7% lift in **US** gasoline prices boosted headline **Personal Consumption Expenditure inflation** in March. However, already-released core CPI data suggest core PCE inflation remained below the Fed's 2% target at 1.8%yoy, reinforcing the Fed's current "patient" stance.

Real GDP in the Eurozone is projected to increase at a quarterly pace of 0.3% in Q1 (or 1%yoy), supported in part by a pick-up in retail sales and a wider trade surplus. But worsening leading indicators suggest the risk to Q1 GDP growth is skewed to the downside. The ECB forecasts the Eurozone economy to grow by 1.1% in 2019 from 1.8% in 2018.

The Bank of England is widely expected to leave the Bank Rate at 0.75% and maintain the stock of its asset purchases at £445bn. The risk is the BoE removes its "gradual" and "limited" tightening bias. Other major central banks have turned more cautious lately and global growth prospects remain disappointing. The BoE is unlikely to make material changes to their macroeconomic projections. In March, the BoE noted that the macroeconomic projections detailed in the February Inflation Report appear on track. Still, the BoE is expected to warn again that Brexit uncertainties continue to weigh on confidence and short-term economic activity.

We expect the US Federal Reserve to leave the Fed funds rate unchanged. The central bank has signalled it expects to leave the Fed funds on hold over the remainder of 2019.

In March, **core Eurozone CPI** inflation eased to near a one-year low of 0.8%yoy and headline CPI inflation slowed to 1.4%yoy. Headline and core CPI inflation will likely remain muted around these levels in April. Disappointing economic activity and subdued inflation expectations continue to contain price pressures. The ECB's 2019 forecasts for core and headline CPI inflation are 1.2%.

We expect reasonable economic momentum supported another solid lift in **US employment** in April. The record low level of jobless claims suggests that the unemployment rate will remain low at 3.8%. Although the low unemployment rate supports a pick-up in wage growth, record-low consumer inflation expectations will provide some offset. As a result, we expect wage growth to ease slightly to 3.1%yoy.

Key Forecasts

ASB NZ economic forecasts

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
GDP real - Q%	0.6	0.4	0.9					
GDP real - A%	2.3	2.2	2.2	2.7	2.9	3.1	2.4	2.4
GDP real - AA%	2.8	2.6	2.4	2.4	2.5	2.8	2.6	2.4
CPI - Q%	0.1	0.1	0.7	0.6				
CPI - A%	1.9	1.5	1.8	1.5	1.6	1.9	1.8	1.9
HLFS employment growth - Q%	0.1	0.6	0.4					
HLFS employment growth - A%	2.3	2.4	2.2	1.6	2.0	1.8	1.5	1.3
Unemployment rate - %sa	4.3	4.2	4.2	4.2	4.1	4.1	4.1	4.1
Annual current account balance as % of GDP	-3.7	-3.3	-2.9	-2.5	-2.2	-2.0	-2.0	-1.7

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

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(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	1.7	1.5	1.5	1.5	1.5	1.8
NZ 2-year swap rate*	1.97	1.6	1.6	1.5	1.5	1.5	1.6	1.9
NZ 10-year Bond*	2.38	1.8	1.8	1.8	1.8	1.8	2.1	2.4

ASB foreign exchange forecasts

	Dec-18 << actual	Mar-19 forecast >>	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)								
NZD/USD	0.67	0.68	0.68	0.69	0.69	0.70	0.72	0.74
NZD/AUD	0.95	0.96	0.96	0.96	0.96	0.96	0.96	0.97
NZD/JPY	74	75	76	77	77	77	78	80
NZD/EUR	0.59	0.60	0.60	0.60	0.59	0.59	0.59	0.60
NZD/GBP	0.53	0.52	0.54	0.54	0.54	0.54	0.55	0.57
NZD TWI	73.5	73.9	73.9	74.5	74.1	74.8	75.0	76.6

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