Economic Weekly

29 July 2019

Finally, here comes the Fed

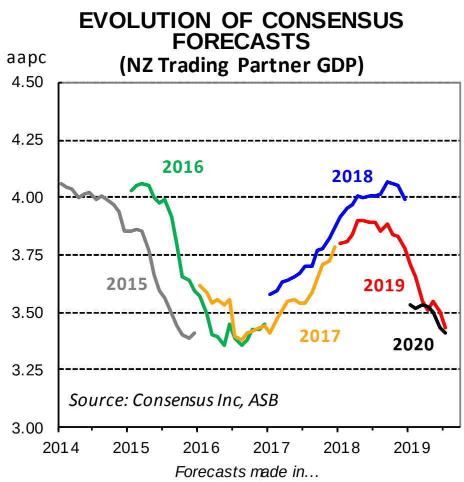
“Don’t fight the Fed” is the old markets adage. We’ve taken heed. T**he US Federal Reserve has all but told us that it will begin lowering interest rates this Thursday**. And the Fed even took the unusual step recently of steering markets away from an aggressive 50bps cut, when speculation of such got out of hand. We’re duly forecasting a regulation 25bps cut to the Fed Funds rate on Thursday, with a total of 75bps of further cuts by March. Does this mean we’re on the cusp of a secular downtrend in the US dollar? We don’t believe so. First, the cutting cycle has been well flagged and is now well priced. Second, evidence from past cycles suggests if anything the USD tends to *rise* during cutting cycles. And last, the Fed is not lowering rates in response to a stalling US economy – it’s more about insurance against downside risks. For these reasons we expect the fallout for the USD, and hence upward pressure on NZD/USD, to be limited. Kiwi exporters will be relieved.

Key events and views

Foreign exchange	Fed rate cut not necessarily curtains for the USD.
Interest rates	NZ yields hit fresh record lows; we retain our downside bias.
Domestic events	July ANZ business confidence and June building consents.
International events	Chinese PMIs, Aussie CPI, US ISM, Non-Farm Payrolls, BoE & FOMC meetings.
Calendars	NZ and international calendar of upcoming economic events.

Chart of the Week: Global Gloom

The focus last week was offshore, amid a dearth of local news. Unfortunately, the global news wasn’t flash. For example, European PMIs – one of the better forward indicators – went from bad to worse. Not only did they show manufacturing activity remaining in contractionary territory, but the pace of contraction unexpectedly quickened. Not surprisingly, the ECB turned dovish at its meeting last week. President Draghi summed things up nicely: “this outlook is getting worse and worse”.



This week’s US and Chinese PMIs are expected to fare a little better. But overall, analysts are getting more negative on the global picture as trade war impacts show up in the hard data. According to Consensus Economics, **trading partner growth is expected to print well below trend for the next two years**. 2019 growth is expected at 3.4% and the same is expected in 2020, with the small pick-up in growth previously expected in 2020 having been revised away.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6634	0.6773	0.6698	0.6779	FLAT/UP	0.6600	0.6790	UP
NZD/AUD	0.9605	0.9619	0.9555	0.9177	FLAT/DOWN	0.9500	0.9680	UP
NZD/JPY	72.10	73.11	72.10	75.26	FLAT	71.70	73.70	UP
NZD/EUR	0.5961	0.6037	0.5894	0.5819	FLAT	0.5900	0.6050	FLAT
NZD/GBP	0.5358	0.5416	0.5286	0.5171	FLAT	0.5300	0.5425	FLAT/UP
TWI	73.1	74.1	73.1	72.94	FLAT	N/A	N/A	UP

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

NZD Recap

There's been a notable 'hero to zero to hero' pattern in the NZD's weekly performances of late. And last week it was back to 'zero' - the kiwi was the weakest performing G10 currency.

A stronger USD was the main theme across FX markets. US economic data painted a picture of an economy still performing well, and speculation of an outsized 50bps Fed rate cut this Thursday was thus dialled back accordingly. Alongside the firmer USD, snippets of NZD/AUD selling provided an extra weight on the kiwi.

Near-term outlook

Once again, NZD direction will be set offshore this week with just business confidence and building consents data released locally. There's plenty to watch on this score but, as flagged on the previous page, Thursday morning's Fed meeting will be critical. The 25bps rate cut we expect is fully priced, so currency reaction will be all about the Fed's signalling of future rate cuts. The market has plenty priced (around three cuts by March) so the risk is probably for a slightly stronger USD if Fed rhetoric fails to validate this pricing.

The NZD/AUD has been range-bound for weeks. This is perhaps not surprising given the broadly synchronous nature of the NZ-AU monetary policy and commodity cycles at present. However, we see some risk of NZD/AUD downside this week if July ANZ business confidence remains weak and Australian Q2 CPI rebounds as expected.

Medium-term outlook

We expect the NZD to track in a broadly sideways range over the rest of the year. 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 RBNZ, RBA and US Fed to all cut policy interest rates over the coming months.

Further ahead, we expect the NZD to firm against most currencies from late 2019 onwards. Ongoing strength in NZ's Terms of Trade will be an important source of support for the NZD. We expect NZD/AUD to remain close to 0.95 over 2019 and to subsequently firm.

ASB foreign exchange forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
(end of quarter)		<< actual	forecast >>				
NZD/USD	0.68	0.67	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.96	0.96	0.94	0.94	0.95	0.96	0.97
NZD/JPY	75	72	71	74	75	78	79
NZD/EUR	0.60	0.59	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.52	0.53	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.9	73.2	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	UP
90-day bank bill	1.50	1.52	1.64	1.91	UNCH/DOWN	UP
2-year swap	1.26	1.33	1.35	2.13	UNCH/DOWN	UP
5-year swap	1.32	1.41	1.44	2.55	UNCH/DOWN	UP
10-year swap	1.67	1.77	1.79	3.03	UNCH/DOWN	UP
10-year govt bond yield	1.50	1.58	1.57	2.74	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.41	0.44	0.44	0.90	UNCH	UNCH/UP

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

Market Recap

Local yields continued to drift lower, with the curve under flattening pressure. NZ wholesale interest rates touched record lows for most tenors late last week, with yields on the bellwether 2-year swap down roughly 70bps since the star of the year, and with yields on the 10-year swaps roughly 100bps lower. Australian yields also touched record lows, after RBA Governor Lowe said it would be unwise to lower the RBA's 2-3% inflation target, maintaining the likelihood of more policy easing. Global yields fell in the earlier part of the week driven by weak global manufacturing sentiment data and downward revisions to global growth by the IMF. US Treasury yields nudged higher towards the end of the week, given reported 'soft" demand at auctions and optimism on a trade deal between China and the US. US Q2 GDP was slightly better than expected, although it confirmed US growth was slowing. European yields firmed as the ECB kept left all key interest rates on hold, but the lift was modest given the downbeat assessment delivered by ECB president Draghi. German 10-year yields are just shy of record lows. The selection of Boris Johnson as UK Prime Minister had a fleeting impact on yields, which lifted towards the end of last week.

Near-term NZD interest rate outlook

We have maintained our downward bias for NZ interest rates, given our lower OCR view. NZ yields on an outright sense are already extremely low, but they could move lower still. The major local data event this week is Wednesday's ANZ Business Outlook, which we expect to deliver a soft set of readings. We do not expect next week's NZ Q2 labour market data to be an impediment to the RBNZ cutting the OCR by 25bps in August. The major focus for markets will be Thursday's policy decision by the US Federal Open Market Committee. We expect a 25bp cut, with current market pricing of just shy of 30bps of cuts**. The tone of the Fed statement will be critical in setting the direction of US and global yields**. Other events potentially impacting interest rate markets, include this week's meeting between the US and China on trade (expectations of a breakthrough are modest), Q2 Australian CPI (mkt: 1.5% yoy) and this week's policy meetings by the Bank of England (just 1% odds of a cut) and Bank of Japan (small risk of further easing).

Medium-term outlook

Our bias is for the curve to initially steepen and then to flatten as policy easing this year precedes mild policy tightening. We expect 25bp cuts in August and November, with the OCR to remain at 1%, until a gradual RBNZ tightening cycle commences from early 2022. Risks to our OCR view are tilted to the downside. Slowing global growth is expected to trigger 100bps of interest rate cuts by the Fed (July, September, December, and (possibly) March 2020), 25bps of cuts by the RBA (November), with policy easing by the ECB and People's Bank of China. Inflation looks set to remain low and interest rate normalisation from global central banks a long way off, capping long-term interest rates.

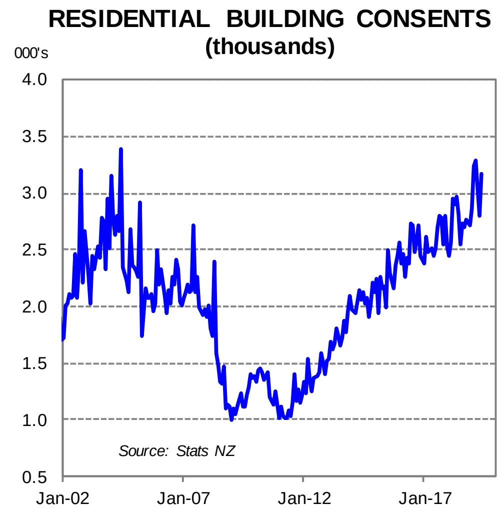
ASB interest rate forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>					
NZ OCR	1.75	1.50	1.25	1.00	1.00	1.00	1.25	1.75
NZ 90-day bank bill	1.9	1.7	1.5	1.3	1.3	1.3	1.6	2.0
NZ 2-year swap rate	1.6	1.4	1.3	1.2	1.2	1.2	1.6	2.0
NZ 5-year swap rate	1.8	1.4	1.4	1.4	1.4	1.5	1.9	2.3
NZ 10-year swap rate	2.2	1.8	1.8	1.8	1.8	1.9	2.1	2.3
NZ 10-year Bond	1.8	1.6	1.6	1.6	1.6	1.7	1.9	2.1

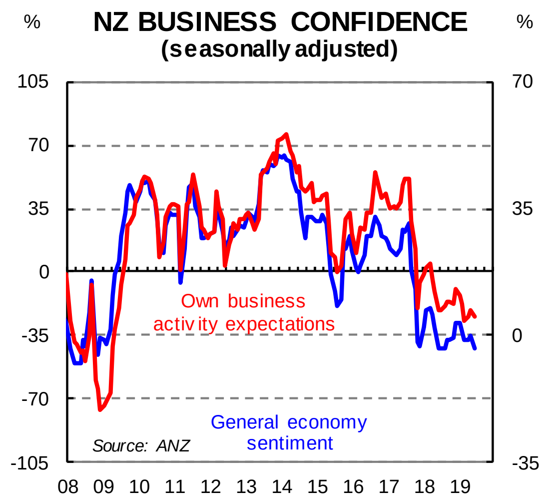
Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market	ASB
Building Consents, Residential, June, %	30/07	10:45 am	+13.2	-	-
ANZ Business Outlook, July, Own Activity Expectations	31/07	1.00 pm	+9.4	-	-

Residential dwelling consent numbers rose 13% (on a seasonally-adjusted basis) over May, reversing most of the combined decrease over March and April. We believe house-building activity is likely close to a peak, but we expect residential construction activity to remain at high levels over 2019 in order for housing supply to make up the shortfall which has emerged in recent years. Meanwhile, there are no signs of a slowdown in commercial construction despite weak business confidence levels seen over the year.

Business confidence remains weak and has not budged despite the Government's decision to ditch introducing a capital gains tax and the Reserve Bank of New Zealand's (RBNZ) Official Cash Rate (OCR) cut in May. **The ANZ monthly business confidence survey** continues to paint a picture of subdued growth in investment, employment and economic activity, as well as 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 50bps over 2019.





Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia Building Approvals, June, %mom	30/07	1.30 pm	0.2	0.4
Bank of Japan Interest Rate Announcement, %	30/07	-	-0.1	-0.1
Australia CPI, Q2, %yoy	31/07	1:30 pm	1.5	1.6
Australia CoreLogic House Prices, July, %mom	01/08	12:00 pm	-	0.2
Australia Terms of Trade, Q2, Export Price Index	01/08	1:30 pm	2.8	2.8
US Fed Interest Rate Announcement, %	01/08	6:00 am	2.00-2.25	2.00-2.25
US ISM Manufacturing, July, points	02/08	2:00 am	52.0	52.0
Australia Retail Trade, June, %mom	02/08	1:30 pm	0.3	0.4
US Non-farm Payrolls, July, 000s	03/08	12:30 am	169	145

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Australian building approvals have been on a downward trend although the pace of decline has eased. We think that approvals will trough at around current levels. We have pencilled in a small lift in June. If dwelling prices lift modestly higher from here as we expect, we may see a lift in building approvals in 2019/20.

We **expect no change in monetary policy by the Bank of Japan**. However, there are growing downside risks to Japan's economy from the slowing global economy. Therefore, there is a risk, albeit small, that the Bank of Japan eases policy further at this meeting.

Our forecasts have **Australian headline and underlying inflation** running at 1.6%yoy in Q2. Swings in petrol prices continue to drive the quarter-to-quarter moves in headline inflation. The impact of the drought adds some upside risk to the large food component of the CPI.

Australia's daily CoreLogic data indicate that dwelling prices have lifted a little in July, driven primarily by modest rises in Sydney and Melbourne. The leading indicators of dwelling prices suggest that prices are poised to lift modestly over H2 2019.

Firmer commodity prices mean that **Australian Terms of Trade** are expected to post another rise over Q2. Higher oil prices and a softer AUD will boost import prices.

Australia's retail trade has been soft, with sales having inched up 0.1% in May. Tax cuts and lower mortgage rates will support the retail sector over H2 2019, but June is likely to be another modest month of sales, albeit we expect a bigger lift compared to prior months. We forecast June sales to have lifted 0.4%mom.

The US Federal Open Market Committee (FOMC) has telegraphed that a cut to the Funds rate is coming this week. The FOMC is cutting because of persistent low inflation and downside risks to the US economy. We expect the FOMC to cut by 100bps in total by early 2020.

The overall message from the four regional **US Fed manufacturing surveys** suggests the national manufacturing ISM increased modestly to 52.0 points.

US jobless claims remain very low and are consistent with strong growth in **Non-farm Payrolls** of 145,000 over June. We expect the unemployment rate to remain low at 3.6%. We expect growth in average earnings to firm further to 3.3%yoy.

Key Forecasts

ASB NZ economic forecasts

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
	<< actual	forecast >>					
GDP real - Q%	0.6	0.7	0.7				
GDP real - A%	2.5	2.3	2.6	2.7	2.8	2.4	2.3
GDP real - AA%	2.7	2.5	2.5	2.5	2.6	2.5	2.3
CPI - Q%	0.1	0.6	0.6	0.2			
CPI - A%	1.5	1.7	1.4	1.5	1.8	1.7	1.9
HLFS employment growth - Q%	-0.2	0.5	0.5				
HLFS employment growth - A%	1.5	1.4	0.9	1.3	1.9	1.5	1.4
Unemployment rate - %sa	4.2	4.3	4.3	4.3	4.3	4.2	4.1
Annual current account balance as % of GDP	-3.6	-3.4	-3.5	-3.6	-3.7	-3.4	-3.3

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
		<< actual	forecast >>				
NZ OCR	1.75	1.50	1.25	1.00	1.00	1.00	1.25
NZ 90-day bank bill	1.9	1.7	1.5	1.3	1.3	1.3	1.6
NZ 2-year swap rate	1.6	1.4	1.3	1.2	1.2	1.2	1.6
NZ 5-year swap rate	1.8	1.4	1.4	1.4	1.4	1.5	1.9
NZ 10-year swap rate	2.2	1.8	1.8	1.8	1.8	1.9	2.1
NZ 10-year Bond	1.8	1.6	1.6	1.6	1.6	1.7	1.9

ASB foreign exchange forecasts

(end of quarter)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22
		<< actual	forecast >>				
NZD/USD	0.68	0.67	0.64	0.68	0.69	0.72	0.73
NZD/AUD	0.96	0.96	0.94	0.94	0.95	0.96	0.97
NZD/JPY	75	72	71	74	75	78	79
NZD/EUR	0.60	0.59	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.52	0.53	0.50	0.53	0.53	0.55	0.56
NZD TWI	73.9	73.2	70.2	72.7	73.1	75.1	75.8

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