Economic Weekly
30 October 2017

Labour market and monetary policy to share the spotlight

- Employment is in the spotlight this week, with quarterly employment data released on Wednesday.
- The Labour-led Government is likely to add employment as a RBNZ target, throwing additional scrutiny on these figures.
- Policy changes are also a hot topic in the US, with Trump expected to announce a new Federal Reserve Chairperson this week.

Employment is in the spotlight this week. The quarterly employment statistics are released on Wednesday, including employment, the unemployment rate and wage growth. **We are expecting robust lift in employment** (in part a statistical payback for the previous quarter's weak result), and **the unemployment rate to edge lower to 4.7%. Wage inflation is set to accelerate to a three-year high due to recent pay equity settlements** (see our full preview here).

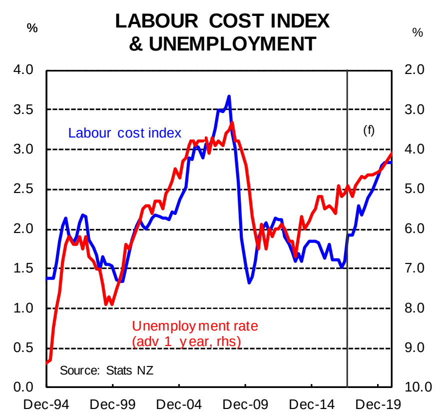
The **employment statistics will come under further scrutiny over the next few months, with the Labour-NZ First Government set to introduce an employment target into the Reserve Bank of New Zealand's objectives.** The details of Labour's plans are light, but **preferences appears to be for similar set up to the Reserve Bank of Australia and the Federal Reserve**, where an objective to foster employment (or full employment) is referred in the Policy Targets Agreement (and possibly the Reserve Bank Act), but no hard numerical target is explicitly set. **A hard target would be undesirable, reducing the flexibility and effectiveness of the RBNZ**. It is not easy achieving one goal with one policy instrument, let alone achieving two with one instrument. The dual goals are likely to come into direct conflict at times, which would ultimately increase volatility and potentially reduce the credibility of the RBNZ. Not to mention NZ labour statistics are notoriously volatile from one quarter to the next, which runs the risk of policy reacting to the volatility rather than the trend. All up, a hard target would likely cause unnecessary volatility in financial markets and the economy. We will be releasing a full note with some thoughts on the issue shortly.

Last week saw some key developments in our major trading partners. **In Australia**, **the CPI undershot market expectations** in both headline and underlying terms. The annual rates of both headline and underlying inflation printed at 1.8%, below the RBA's 2-3% inflation target. The result reaffirms the Reserve Bank of Australia will be in no hurry to raise interest rates.

Meanwhile, in the **US a joint budget resolution has been passed which will allow for tax cuts and a US$1.5 trillion increase to the budget deficit over the next ten years.** This news saw shares, bond yields rise and the USD appreciate. Tax cuts should be positive for US economic growth. **The next step in the process is for the tax legislation to be drafted and then approved**. We expect that this legislative process will run until late December.

Finally, an announcement on the new Federal Reserve Chair is expected this week. Markets have been sensitive to various rumours over recent weeks. The pick of monetary policy hawks John Taylor or Kevin Warsh as Fed Chair would be the most bullish USD outcome. In contrast, if the selection for Fed Chair turns out to be Jerome Powell (as current rumours imply) or Janet Yellen the USD will likely face some intra-day headwinds. According to Predictit.com, Jerome Powell remains the front runner.

Chart of the Week: Looking for a pay rise?



One of the puzzles of late has been why wage inflation has remained so low this cycle. Globalisation (low wage inflation is not a NZ-specific phenomenon), low headline rates of NZ CPI inflation (modest indexation for wages) and strong competition for jobs look to have played a key role in tempering wage increases.

Stronger wage inflation, which in turn will boost services and non-tradable inflation, is a **key step for domestic inflation pressures** returning to the RBNZ's target (on a sustained basis).

Looking ahead, the odds of this happening have strengthened with further pay equity increases, pending increases in the minimum wage and the still-tight labour market set to drive wage inflation higher over the next few years. In addition, the **recent lift in headline inflation**, even if it was largely due to volatility in food and fuel, **will help lift wage growth through the benchmarking effect.**

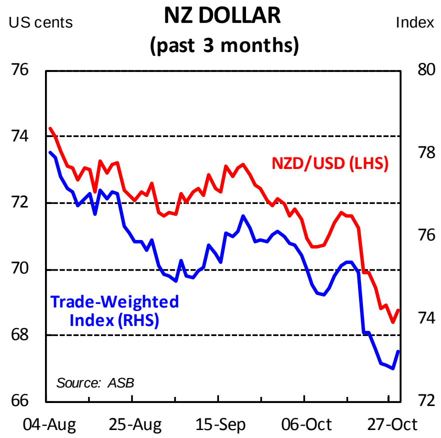
Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6874	0.6990	0.7215	0.6855	0.7140	FLAT/UP	0.6815	0.7000
NZD/AUD	0.8956	0.8907	0.9191	0.9160	0.9398	FLAT/UP	0.8900	0.9050
NZD/JPY	78.18	79.08	81.24	76.52	75.07	FLAT/UP	77.80	79.50
NZD/EUR	0.5922	0.5914	0.6122	0.6294	0.6545	FLAT/UP	0.5850	0.6050
NZD/GBP	0.5236	0.5331	0.5376	0.5310	0.5861	FLAT/UP	0.515	0.5350
TWI	73.2	73.7	76.1	74.5	77.1	FLAT/UP	72.00	75.00

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

Heighted uncertainty over the potential economic impact and direction of the new NZ coalition government and generalised USD strength has been the major influences driving NZD direction. Optimism that a US tax package will soon be announced and a positive tone of data (e.g. Q3 US GDP) have buoyed the USD, with the NZD down close to 3 US cents since NZ First's announcement and nearly 5 US cents since the September 23 election. **Other NZD TWI bilaterals have faced their own specific headwinds, which are expected to cast a shadow over their near-term-outlook.** The ECB signalled an early 2018 taper to quantitative easing, but the lack of a definitive endpoint for QE weighed on the euro as did the additional instability caused by issues in Catalonia. Soft Australian CPI and the lost citizenship ruling for Deputy PM Joyce (the coalition government are without a majority until at least the December by-election) did the AUD no favours. **Given our more positive medium-term view of the NZD, the question is how close we are to a turning point for the NZD**. Domestic activity and confidence prints are expected to remain soft until election-related uncertainties subside, although the impact on the NZD could be fleeting given the strengthening wage outlook. Further USD strength will depend on the positive tone of US data continuing, the tax package being introduced, and with the FOMC policy path moving closer for the Fed DOT plots (3 hikes for 2018) than the market (1¼). **All this looks to be a tall order given our medium-term USD view.** A November BOE hike is almost fully priced-in, with the tone of this week's BOE assessment expected to impact on GBP direction.

Short-term outlook:



Key data	Date	Time (NZT)	Market
US Core PCE inflation, y/y - Sep	31.10	1.30am	1.3%
NZ ANZ Business Outlook, Sep	31/10	1.00 pm	-
NZ labour market report, Q3	1/11	10.45 am	-
FOMC Announcement, main refi-rate %	2/11	7:00am	nc
US October Non-farm Payrolls, change	4/11	1.30 am	310k

NZD: ANZ Business Outlook, Q3 Labour Market Report (Wed), QV House prices (Thu) Sep Trade Balance. **AUD:** Oct Manufacturing PMI (Wed), Sep Trade Balance (Thu), Q3 Retail sales (Fri). **USD:** Sep PCE Deflator (Tue), Oct ISM Manufacturing (Thu), FOMC Decision (Thu), Oct Non-farm Payrolls (Sat). **CNY:** Oct Manufacturing PMI (Tue). **JPY:** Sep CPI (Fri). **EUR:** Q3 GDP (Tue), Oct CPI (Tue), Oct Manufacturing PMI (Thu). **GBP:** Oct Manufacturing PMI (Wed), BOE rates decision (Fri).

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, pending ECB tapering, 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

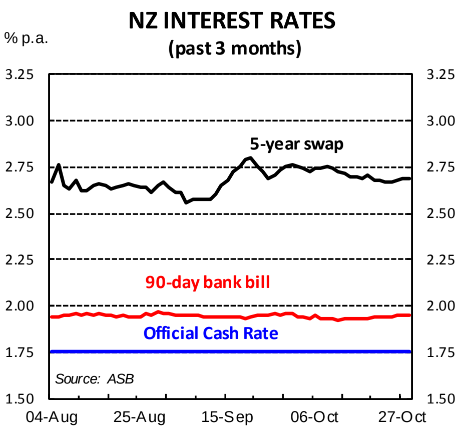
Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	2.00	FLAT
90-day bank bill	1.95	1.94	1.96	1.99	2.12	FLAT
2-year swap	2.16	2.17	2.21	2.30	2.15	FLAT
5-year swap	2.69	2.68	2.75	2.89	2.44	UP
5-year benchmark gov't stock	2.52	2.48	2.53	2.41	2.18	UP
NZSX 50	8085	8131	7909	7392	6928	UP

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

The NZ interest rate curve steepened last week, with a number of events driving moves. On Tuesday, the **publication of the Labour/NZ First coalition kicked off the steepening theme**. Short-term local yields moved lower following the announcement, while longer-term yields increased on the expectations of higher future inflation under this government.

Although NZ politics continues to be a key driver of NZ interest rates, offshore moves also influenced our market last week. For example, **Australia's softer than expected Q3 CPI weighed on NZ short-term interest rates**. On the other hand, the **US House of Representatives passed the Senate's version of the budget in the US on Thursday night, bringing us one step closer to US tax reform**. This saw US rates sell off (the 10-year US government bond yield lifted 2-3bp higher) and NZ longer-term interest rates also followed this move higher. However, **this upward pressure eased over the weekend amid speculation that Jerome Powell was in the running to become the next Fed Chair** (Powell is considered to be at the more dovish end of the spectrum of potential Fed Chairs).

Short-term outlook:



Comment: Key focus this week will be on the several central bank announcements that are due. Market participants will be looking to the Fed, in particular, for indications that the December meeting remains live.

However, ahead of Thursday's Fed announcement is tonight's US PCE deflator (the Fed's preferred measure of inflation). A result in line with, or below, expectations will put even more emphasis on any comments by the Fed committee members on Thursday over whether or not they still view the current low inflation environment as transitory.

Closer to home, Wednesday's employment release will be key for NZ, for which we expect employment growth to rebound and for wage growth to lift as a result of the July pay equity settlement. NZ politics will also continue to impact on NZ rates, especially as we get more clarity on policy details.

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
US Personal Consumption Deflators, September, %yoy	31/10	1:30 am	1.5	1.6	1.6
Bank of Japan Interest Rate Announcement, %	31/10	-	-0.1	-0.1	-0.1
Eurozone GDP, Q3, %qoq	31/10	11:00 pm	0.6	0.5	0.5
Australia CoreLogic House Prices, October, %mom	01/11	12:00 pm	0.3	-	0.0
US ISM Manufacturing, October, Index	02/11	3:00 am	60.8	59.4	60
US Federal Reserve Interest Rate Announcement, %	02/11	7:00 am	1.00-1.25	1.00-1.25	1.00-1.25
Australia Trade Balance, September, $mn	02/11	1:30 pm	+989	+1200	+950
Australia Building Approvals, September, %mom	02/11	1:30 pm	0.4	-1.0	-2.5
Bank of England Interest Rate Announcement, %	03/11	1:00 am	0.25	0.5	0.5
Australia Retail Trade, September, %mom	03/11	1:30 pm	-0.6	0.4	0.3
US Non-farm Payrolls, October, 000s	04/11	1:30 am	-33	+310	+270

We expect no change in **monetary policy** until, at the earliest, the **Bank of Japan** Governor Kuroda leaves in April 2018. Japanese inflation remains weak despite an economy growing well above potential and at full employment.

Australian house price growth has slowed, largely driven by a cooling in the Sydney property market. The daily data suggest a flat outcome for house prices in October.

We are forecasting a broadly unchanged **trade surplus for Australia** with, both, bulk commodity prices and the AU dollar largely unchanged over the month.

Australian residential building approvals are off their peaks but holding up at a fairly high level. Low interest rates and solid population growth are supporting the construction cycle.

Australian retail trade fell over the previous two months. The falls may reflect consumers' early reactions to the 1 July electricity and gas price hikes. We expect a soft 0.3% increase in September. We think real retail trade will post a small fall over Q3.

The already-released **US CPI** suggests the recent hurricanes had a significant, although temporary, effect on prices in September. Nevertheless, we predict the **Personal Consumption Expenditure** (PCE) deflators will have remained well below the FOMC's 2%pa target.

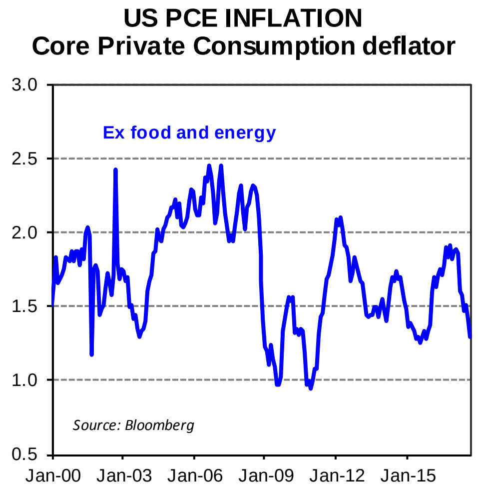
We anticipate **Q3 Eurozone GDP** will print at 0.5% qoq and 2.3% yoy. The strong lift in Q3 Eurozone GDP reflects robust domestic demand and increasing investment in the Eurozone core and periphery.

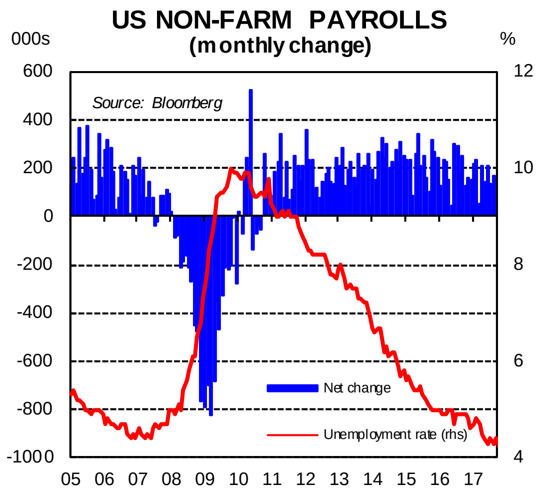
The Philadelphia, Kansas and Empire regional manufacturing surveys increased strongly in October while the Richmond survey eased. Overall, we expect the **US ISM index** to come in at a very strong 60 points.

The **US Federal Open Market Committee (FOMC)** is widely expected to make no changes to policy at its November meeting. However, guided by comments from FOMC voters, we expect the Federal Reserve to increase the Funds rate at its December meeting.

We anticipate the **Bank of England** will raise interest rates by 25bps, lifting the central bank's base rate to 0.5%.

We expect a reversal in the **US labour market** in October following the disruption caused by the September hurricanes. We expect payrolls to surge, monthly average earnings to stabilise, the participation rate to ease and the unemployment rate to lift to 4.3%. Overall, the picture of a labour market close to full employment remains unchanged.

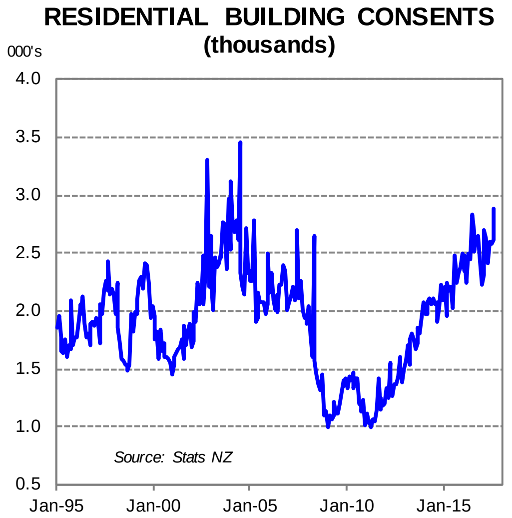




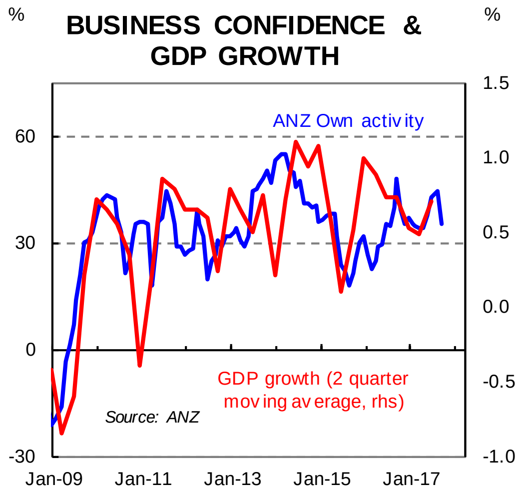
NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Building Consents, residential, September, %mom	31/10	10:45 am	+10.2	-	-
ANZ Business Outlook, headline confidence, October	31/10	1.00 pm	0	-	-
RBNZ Credit Aggregates, household lending, September, % yoy	31/10	3.00 pm	+6.7	-	-
HLFS Unemployment Rate	1/11	10:45 am	+4.8	+4.8	+4.7
HLFS Employment growth, qoq	1/11	10:45 am	-0.2%	+0.7	+0.9
LCI Wage Growth, private sector ordinary time, % qoq	1/11	10:45 am	+0.4	+0.5	+0.7

Residential consent issuance has effectively flat-lined over the past few months. Residential construction is still running short of what is needed to meet current population growth, let alone alleviate dwelling shortages in Auckland and Wellington. Credit conditions and a slowing housing market could be constraining house-building demand. The change in government and likely substantial changes in housing-related polices adds an additional layer of uncertainty, which will likely continue to weigh on consents in coming months.



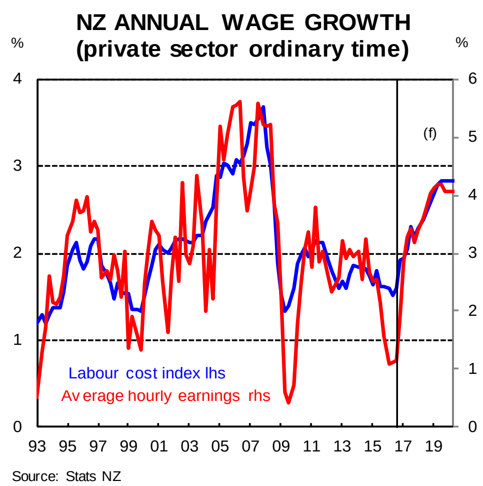
Business confidence fell as the election race came close in September. We expect business confidence to **remain subdued in October as the country sat in a state of uncertainty while waiting for the final election vote count to be released and for coalition negotiations to begin.** The change in government means that uncertainty will continue for the rest of the year, weighing on economic growth, until policy details become clearer.



We expect **mortgage credit growth to continue to slow**, in line with the slowing in the housing market. Annual mortgage credit growth slowed to 6.7% yoy in August, well below the recent peak of 9.3% yoy in December 2016. On the other hand, consumer and business credit growth have been holding up at reasonable levels, in line with confidence surveys. There is a chance that we see a short-term dip in September, reflecting election-related uncertainty. Agricultural credit growth is expected to remain modest as dairy farmer cash-flows continue to improve (and the need for finance remains relatively low).

We expect to see Household Labour Force Survey (HLFS) employment to increase 0.9% in Q3 (+2.6% yoy), following the small fall over Q2. Despite a small lift in labour force participation, **the Q3 unemployment rate is expected to ease to 4.7%, its lowest since 2008.** More moderate quarterly increases are expected from Quarterly Employment Survey (QES) filled jobs and hours worked/hours paid measures from both the QES and HLFS surveys, consistent with moderate quarterly growth rates in overall GDP.

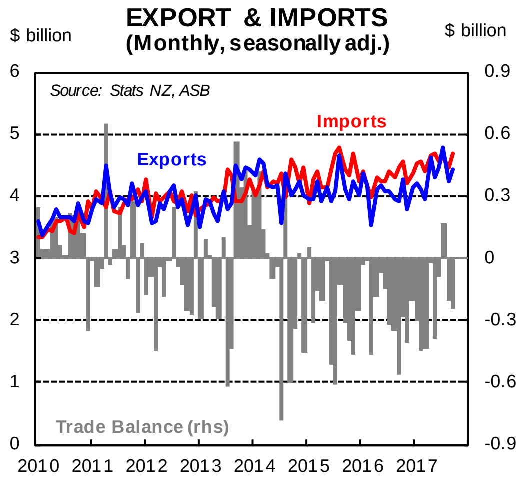
Following a run of eight consecutive 0.4% qoq increases**, the impact of the July pay equity settlement for health care workers should help push up LCI wage inflation**, which we expect to strengthen to 0.7% qoq for the private sector (+1.9% yoy) and 0.8% qoq for public sector workers (+1.8% yoy). Pay equity settlements, proposed increases in the minimum wage and still-tight capacity constraints in the labour market are expected to see wage inflation modestly strengthen over the next few years, which should dispel the notion of OCR cuts. Given the considerable uncertainties on the outlook and a still-fluid government and monetary policy backdrop, the RBNZ is expected to sit tight on OCR settings for a while yet.



Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
Trade balance, August, $m	26/10	-1143	-900	-850

NZ recorded a larger-than-expected monthly trade deficit over September. The $1,143m deficit compares with our forecast deficit of $850m (market $900m deficit). Note, NZ normally posts a trade deficit over September as agricultural production and exports are low during winter and early spring. **Soft meat and fruit export values accounted for most of the surprise.** In seasonally-adjusted terms, meat export values dipped 1.7% on top of last month's 16.2% decline.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast Market	Forecast ASB
Mon 30 Oct	12:50	JN	Retail sales	Sep	m%ch	-1.6	~	~
Tue 31 Oct	~	JN	BOJ Policy Balance Rate	Oct	%	-0.1	~	-0.1
	10:45	NZ	Building permits	Sep	m%ch	10.2	~	~
	11:30	AU	ANZ Roy Morgan Weekly Confidence Index	Oct	Index	113.3	~	~
	12:50	JN	Industrial production	Sep P	m%ch	2.0	~	~
	13:00	NZ	ANZ business confidence	Oct	~	0.0	~	~
	13:30	AU	Private sector credit	Sep	m%ch	0.5	~	0.5
	14:00	CH	Manufacturing PMI	Oct	Index	52.4	52.2	~
	15:00	NZ	RBNZ Credit Aggregates (household lending)	Sep	y%ch	6.7	~	~
Wed 1 Nov	10:45	NZ	Unemployment rate	QIII	%	4.8	~	4.7
	11:00	AU	CBA Australia PMI manufacturing	Oct	Index	53.8	~	~
	12:00	AU	CoreLogic house px	Oct	m%ch	0.3	~	0.0
	13:30	JN	Nikkei Japan PMI manufacturing	Oct F	Index	52.5	~	~
	14:45	CH	Caixin China PMI manufacturing	Oct	Index	51.0	51.0	~
	18:00	JN	Vehicle sales	Oct	y%ch	0.4	~	~
Thu 2 Nov	05:00	NZ	QV house prices	Oct	y%ch	4.3	~	~
	13:30	AU	Trade balance	Sep	$mn	989.0	~	950
	13:30	AU	Building approvals	Sep	m%ch	0.4	~	-2.5
	18:00	JN	Consumer confidence index	Oct	Index	43.9	~	~
Fri 3 Nov	11:00	AU	CBA Australia PMI services	Oct	Index	53.2	~	~
	13:30	AU	Retail sales	Sep	m%ch	-0.6	~	0.3

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast Market	Forecast ASB
Mon 30 Oct	12:30	US	Personal income/spending	Sep	%	0.2/0.1	0.4/0.8	~
	12:30	US	PCE core deflator	Sep	m%ch	0.1	0.1	~
	14:30	US	Dallas Fed manufacturing activity	Oct	Index	21.3	21.0	~
Tue 31 Oct	00:01	UK	GfK consumer confidence	Oct	~	-9.0	~	~
	10:00	EC	Unemployment rate	Sep	%	9.1	~	~
	10:00	EC	GDP	Q3 A	q%ch	0.6	~	0.5
	10:00	EC	CPI headline/core	Oct	y%ch	1.5/1.1	~	1.5/1.2
	14:00	US	Conf. Board consumer confidence	Oct	Index	119.8	120.8	~
Wed 1 Nov	07:00	UK	Nationwide house PX	Oct	m%ch	0.2	0.2	~
	09:30	UK	Markit UK PMI manufacturing	Oct	Index	55.9	~	~
	13:45	US	Markit US manufacturing PMI	Oct F	Index	54.5	~	~
	14:00	US	ISM manufacturing	Oct	Index	60.8	59.0	60.0
	18:00	US	FOMC rate decision (upper bound)	Nov	%	1.0-1.25	1.0-1.25	1.0-1.25
Thu 2 Nov	09:00	EC	Markit Eurozone manufacturing PMI	Oct F	Index	58.6	~	~
	09:30	UK	Markit/CIPS UK construction PMI	Oct	Index	48.1	~	~
	12:00	UK	Bank of England Bank rate	Nov	%	0.25	0.50	0.5
	12:30	US	Nonfarm productivity	Q3 P	%	1.5	2.1	~
Fri 3 Nov	12:30	US	Change in nonfarm payrolls	Oct	000	-33.0	308.0	270
	12:30	US	Trade balance	Sep	$bn	-42.4	-43.8	~
	14:00	US	ISM non-manufacturing	Oct	Index	59.8	58.1	~

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