

Economic Weekly

29 October 2019

Make or break

Markets think they might be past the worst. Over the past fortnight, global equities have leapt to fresh highs and global yield curves have lifted and steepened as investors have latched onto signs global growth momentum is stabilising. The NZ market has got in on the action too. **The local data pulse has slowly improved**, led by interest rate-sensitive sectors like housing. NZ back-end yields have lifted and RBNZ rate cut pricing dialled back a little (see chart below). Is this the start of a trend? This week could be Make or Break in this regard. **There's a veritable feast of top-tier data and central bank meetings due**, including the FOMC and the US data 'big four'. In NZ, we're looking for some stabilisation in business and consumer confidence data this week which, if realised, would add to our sense monetary stimulus is slowly having the desired effect. Strap yourselves in.

Key events and views

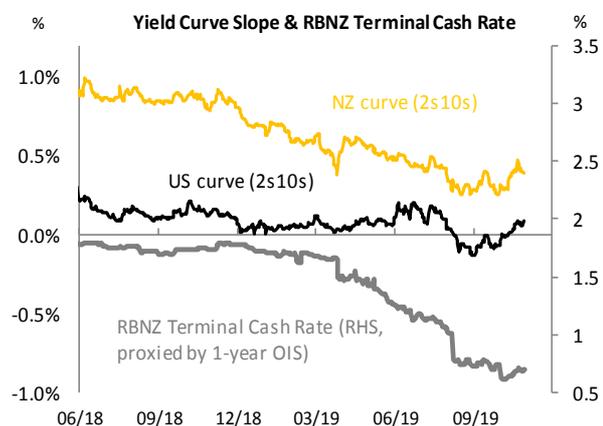
Foreign exchange	Last week's recovery gives way to range-trading
Interest rates	Limited imminent downside to NZ rates despite Fed and BoJ cuts
Domestic events	Building consents, ANZ building consents
International events	FOMC, BoJ, BoC meetings; US payrolls, GDP, PCE, and ISM; Aussie CPI; EU GDP; China PMI

Chart of the Week: We're not feeling as flat as we were

As we've written about before, yield curves have been in focus this year. The near relentless global curve flattening, and inversion of the US Treasury curve, have added to fears of a stalling in global growth.

The recent stalling in this trend is therefore notable. Markets can now see a way forward in the two big 'deals' (Brexit/US-China trade) confronting the global economy, and data surprises have tended slightly to the upside for a change (on average). These factors have seen yield curves steepen a little. **The US Treasury curve has even "un-inverted", and analysts have lowered their recession probability estimates accordingly.**

In NZ, terminal RBNZ rate cut pricing (proxied in the chart by 1-year OIS) has lifted 10-15bps. It's a positive sign but we're not out of the woods yet. Caution is warranted. We haven't changed our view and still expect two further RBNZ rate cuts, taking the cash rate to 0.5% by February. This is (now) slightly more than current market pricing.



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6353	0.6423	0.6289	0.6532	FLAT	0.6200	0.6480	FLAT
NZD/AUD	0.9289	0.9343	0.9306	0.9200	FLAT	0.9120	0.9420	FLAT
NZD/JPY	69.22	69.78	67.71	73.09	FLAT	67.80	70.60	UP
NZD/EUR	0.5724	0.5761	0.5758	0.5731	FLAT	0.5610	0.5830	UP
NZD/GBP	0.4940	0.4949	0.5101	0.5088	FLAT	0.4840	0.5030	UP
TWI	70.5	70.9	70.3	71.73	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

NZD fell against all the major crosses over the past week, with Australasian currencies ignoring the improvement in risk sentiment over the weekend. The NZD/USD spent the past two sessions consolidating around 0.6350. The **technical picture looks consistent with a period of range-trading, absent a big surprise from this week's event risk**. The Brexit saga was the main focus of financial markets over the past week, while sentiment around the US-China trade war was relatively positive. US Trade Representative Robert Lighthizer confirmed that negotiations were on track for the US and Chinese Presidents to sign an initial phase one deal at the APEC Summit in Chile on 16-17 November.

Near-term outlook

In New Zealand, the **October ANZ business outlook survey on Thursday** is the key release. We are still optimistically hoping for an interest rate induced lift in business confidence to transpire, and **any improvement in business confidence is likely to support the NZD/USD**.

We expect the Federal Reserve to cut the Fed Funds rate by 25 basis points to a range of 1.50%-1.75% at this week's meeting (Thursday, 7am NZT). While the market has largely priced the committee delivering a 25bp rate cut at this week's meeting, economists are divided with a slight majority picking no change in the Fed Funds rate (as polled by Bloomberg). **There is some risk that the Fed will indicate a pause in its policy rate adjustment cycle, which would lift US yields and the USD**.

Australian Q3 CPI, released on Wednesday, is one of the last major economic data releases before the RBA's monetary policy meeting on 5 November. Interest rate markets are pricing in just a 20% chance of another 25bp rate cut at the November meeting, so **any unexpected weakness in the inflation figures will likely weigh on the AUD**.

Medium-term outlook

Our forecasts have the NZD/USD essentially trending sideways 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.

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ASB foreign exchange forecasts

(end of quarter)

	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	71	71
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.53	0.51	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.2	70.2	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	1.00	1.75	UNCH/DOWN	UP
90-day bank bill	1.06	1.05	1.14	1.89	UNCH/DOWN	UP
2-year swap	0.96	1.01	0.95	1.99	UNCH/DOWN	UP
5-year swap	1.06	1.12	0.95	2.30	UNCH/DOWN	UP
10-year swap	1.40	1.46	1.21	2.78	UNCH/DOWN	UP
10-year govt bond yield	1.27	1.33	1.10	2.52	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.44	0.46	0.26	0.79	UNCH/DOWN	UNCH/UP

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

Market Recap

NZ and global interest rates start modestly firmer on a week prior, as risk sentiment was supported by optimism over a US-China trade deal and receding risks of a hard Brexit. Equity and interest rates rose and yield curves steepened (10-year Treasury yields touched 6-week highs of 1.86%) after President Trump noted trade talks with China were “ahead of schedule”. China also confirmed parts of a text for the first phase of the trade deal were “basically completed. Today’s UK Parliamentary vote for an early election did not get the two-thirds majority required, although risks of a hard Brexit dropped after the European Union (EU) granted a 3-month Brexit extension (end January 2020). As expected, the ECB made no changes to official interest rate settings and depicted a gloomy economic assessment, pledging to hold rates at historic lows until inflation picks up. Australasian yields were earlier dampened by weak Australian data and the acknowledgement from the Australian Treasury Secretary (and RBA board member) Kennedy that recent RBA rate cuts had yet to deliver sharp improvement in the household sector.

Near-term NZD interest rate outlook

We have retained a mild downward bias given our conviction that slowing global growth will likely require lower interest rates. **However, we acknowledge the potential for local and global yields to push higher if positive sentiment continues and no downside risks crystallise. The Federal Open Market Committee (FOMC) is widely expected to trim the 1.75%-2% Federal Funds rate by 25bps on Thursday** (around 90% priced in) and to continue to pledge to “act as appropriate”, but a balanced policy assessment could limit the downside to global yields. We expect the Bank of Japan to deliver a 0.1% cut to the -0.1% policy rate, while we expect the Bank of Canada will hold rates at 1.75%. **We could see signs of improvement for both local business (Thur) and consumer confidence reports (Fri) this week, but this is unlikely to be enough to prevent a 25bp OCR cut in November** (just under 90% priced in). Australian Q3 CPI should remain low, but we expect the RBA to delay a further cut till early 2020. Brexit is likely to provide a continued distraction. **It’s also a huge week for key global data**, including Q3 US and Eurozone GDP, PCE deflator, Eurozone CPI, the US manufacturing ISM and non-farm payrolls data. Signs of improvement could push yields higher.

Medium-term outlook

Our forecast is for the curve to initially steepen and then to flatten as policy easing precedes mild policy tightening. We expect 50bps of OCR cuts (-25bps Nov 19, -25bps Feb 20), with the OCR to plateau at 0.5% this cycle. This will be followed by mild and gradual OCR hikes from 2022, with an OCR endpoint of just 2%. We also expect a further 25bp cut by the RBA in February (0.5% floor). The Fed is expected to cut the 1.75%-2% Federal Funds rate by 100bps by mid-2020 (Oct 19, Dec 19, Mar 20, Jun 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

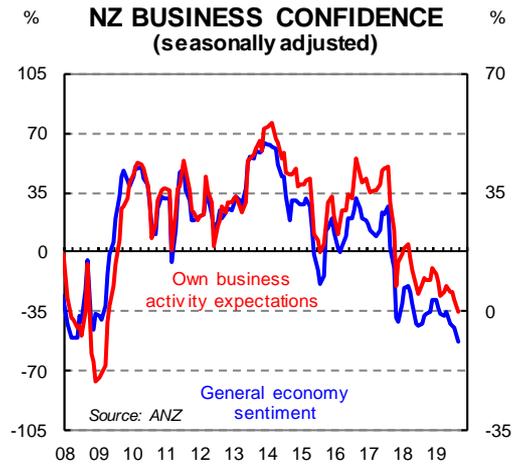
(end of quarter)	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< actual		forecast >>				
NZ OCR	1.50	1.00	0.75	0.50	0.50	0.75	1.25
NZ 90-day bank bill	1.7	1.2	1.0	0.9	0.8	1.0	1.5
NZ 2-year swap rate	1.4	0.9	0.8	0.7	0.7	1.0	1.4
NZ 5-year swap rate	1.4	0.9	0.9	0.8	0.9	1.3	1.7
NZ 10-year swap rate	1.8	1.2	1.2	1.1	1.2	1.6	2.0
NZ 10-year Bond	1.6	1.1	1.0	0.9	1.0	1.4	1.8

Domestic events

Data	Date	Time (NZT)	Market	ASB
Building Consents, Residential, September, %mom	31/10	10:45 am	-	-
ANZ Business Outlook, Own Activity, October, net %	31/10	1:00 pm	-	-

Residential dwelling consents have lifted strongly over the past few years; on an annual basis nationwide consent numbers are at their highest since the mid-1970s. We believe house-building activity is likely close to its peak, but we expect residential construction activity to remain at high levels over 2019 and into 2020. There are few signs of a slowdown in non-residential construction despite weak business confidence levels.

ANZ monthly business confidence remains weak. Factors supporting confidence – including the Government’s decision to ditch introducing a capital gains tax and the Reserve Bank of New Zealand’s (RBNZ) Official Cash Rate (OCR) cuts in May and August – look to have been swamped by business concerns elsewhere. **We continue to look for interest rate-induced lift in business sentiment, but warn that the spate of negative headlines over the global outlook could continue to dampen the business mood.** Weak levels of business confidence continue to highlight the downside risk to our economic projections.



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
RBA Governor Lowe speech	29/10	7:45 pm	-	-
Australia CPI, Q3, %yoy	30/10	1:30 pm	1.7	1.7
US GDP, Q3, %qoq	31/10	1:30 am	1.6	1.5
US Fed Interest Rate Announcement, %	31/10	7:00 am	1.50-1.75	1.50-1.75
Australia Building Approvals, September, %mom	31/10	1:30 pm	Flat	Flat
Australia Private Sector Credit, September, %mom	31/10	1:30 pm	0.3	0.3
Japan Interest Rate Announcement, %	31/10	-	-0.1	-0.2
Australia CoreLogic Dwelling Prices, October, %mom	01/11	12:00 pm	-	1.0
US Non-farm Payrolls, October, 000s	02/11	1:30 pm	85	110
US ISM Manufacturing, October, points	02/11	3:00 am	49.0	49.5

*Originally published by CBA Global Markets Research on Friday 25th October at 2.15pm

The Reserve Bank of Australia's Governor Lowe is scheduled to speak at the Sir Leslie Melville Lecture in Canberra on "Some Echos of Melville". Sir Leslie Melville (1902-2002) was a renowned Australian economist (including Chief Economic Advisor to the Commonwealth Bank), academic and public servant who helped form Australia's central banking system.

We expect another soft set of **Australian inflation numbers** in Q3, confirming CPI remains below the bottom of the RBA's 2-3% target. Elevated labour market slack is suppressing wages growth which is, in turn, weighing on consumer price inflation. Inflation expectations have also stepped down.

Australia's monthly residential building approvals have been tracking lower since early 2018 and are now back to pre-boom levels. We are expecting a flat outcome for residential building approvals in September.

Australian private sector credit grew at a very soft 2.9% over the year to August. But a lift in lending for housing is underway, which should translate into a stronger pace of credit growth if sustained. We are expecting a 0.3% lift in credit in September.

Inflation is very low and we see a high risk Japan's economy will contract in Q4 2019 following the increase in the rate of the GST from 8% to 10% on 1 October. **We expect the Bank of Japan to cut its short term policy balance interest rate from -0.1% to -0.2%.**

Daily data show Sydney and Melbourne dwelling prices have posted a third straight very strong monthly increase. Brisbane prices have also risen while prices fell in Perth. At a national level, we expect **Australian dwelling prices** to rise around 1.0% in October.

Decreasing business investment and a widening trade deficit are the main reasons we estimate that **US GDP growth** decelerated to only 1.5% saar (seasonally adjusted annual rate) over Q3 2019.

We expect the US Federal Reserve to cut the funds rate by 25bp to a range of 1.50-1.75%. Wage growth has decelerated significantly, consumers' inflation expectations are at record lows, personal consumption expenditure (PCE) inflation remains below target, and capital spending intentions continue to weaken.

We expect a solid 110,000 increase in **US Non-farm Payrolls**. Jobless claims remain very low. We estimate the solid increase in jobs will keep the unemployment rate steady at 3.5%.

Regional manufacturing surveys in the **US** generally increased in October. The increases suggest the national **manufacturing ISM** increased from 47.8pts in September to around 49.5pts in October.

Key Forecasts

ASB NZ economic forecasts

	Jun-19 << actual	Sep-19 forecast >>	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.5	0.4	0.2				
GDP real - A%	2.1	2.2	1.8	1.6	2.6	2.5	2.5
GDP real - AA%	2.4	2.3	2.1	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	1.8	1.8
HLFS employment growth - Q%	0.8	0.2	0.2				
HLFS employment growth - A%	1.7	0.9	1.2	1.6	1.5	1.5	1.3
Unemployment rate - %sa	3.9	4.1	4.2	4.3	4.4	4.2	4.3
Annual current account balance as % of GDP	-3.4	-3.4	-3.3	-3.1	-2.7	-2.9	-2.9

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

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(end of quarter)							
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(end of quarter)							
NZD/USD	0.67	0.63	0.63	0.62	0.67	0.68	0.68
NZD/AUD	0.96	0.93	0.94	0.94	0.94	0.94	0.94
NZD/JPY	72	68	66	64	70	71	71
NZD/EUR	0.59	0.57	0.57	0.57	0.59	0.60	0.60
NZD/GBP	0.53	0.51	0.53	0.53	0.54	0.52	0.52
NZD TWI	73.2	70.2	69.3	68.3	71.7	72.1	72.1

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