

Economic Weekly

30 September 2019

Timing the Trans-Tasman tweaks

The RBNZ kept the OCR unchanged last week as we expected. Nonetheless, the expectation remains that the RBNZ cuts later this year. This week, the Q3 Quarterly Survey of Business Opinion provides us with a quality steer on current economic activity and will help us fine-tune the risks around our OCR view. Recall at this stage, we expect the RBNZ to cut the OCR in November, with the risk of further cuts in 2020.

Meanwhile across the Tasman, **the RBA is odds on to cut its interest rate to 0.75% tomorrow**, with markets pricing in a 75% chance of a move. Assuming a cut is forthcoming, Australian yields are likely to head lower, with NZ yields likely to follow. Indeed, if we are correct, the RBNZ will soon match the RBA again, as mentioned above.

Key events and views

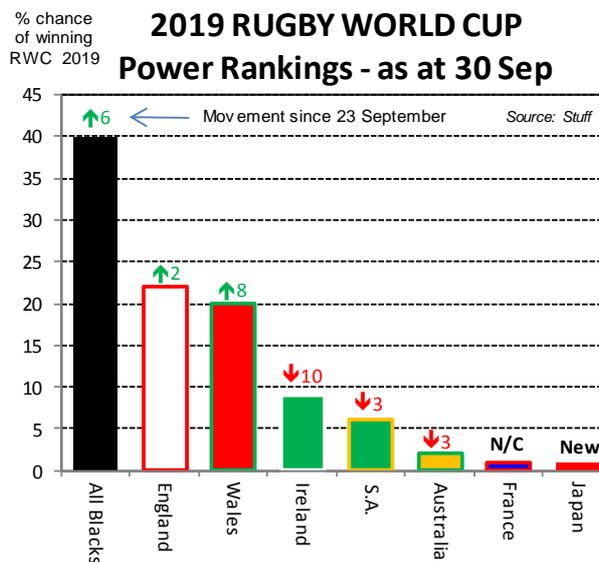
- [Foreign exchange](#) NZD lifted on RBNZ decision before USD strengthened. Business confidence key this week.
- [Interest rates](#) Expected RBA cut likely to drive NZ yields lower over the week. Business confidence also key.
- [Domestic events](#) September ANZ Business Outlook, Q3 Quarterly Survey of Business Opinion.
- [International events](#) RBA Interest Rate Announcement, US Non-farm Payrolls.

Chart of the Week: Irish run out of luck against Japan

Japan caused the upset of the World Cup so far, beating Ireland 19-12 over the weekend. Indeed, the second week of the World Cup was the week of upsets, with minnows Uruguay also knocking over Fiji.

Japan's victory, coupled with the Welsh victory over Australia, has led to significant movement in Stuff's power rankings. The All Blacks remain top (up 6%), while the biggest movers were Wales (up 8%) and Ireland (down 10%). Meanwhile, Japan's victory sees them join the top eight, displacing Scotland.

Japan's victory has also blown Group A wide open. This means that potentially the All Blacks could now face either Ireland or Japan in the quarter-finals, while Samoa and Scotland are also possibilities. Watch this space and go the ABs!



Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6288	0.6272	0.6299	0.6602	FLAT/DOWN	0.6150	0.6400	DOWN
NZD/AUD	0.9305	0.9253	0.9375	0.9152	FLAT/DOWN	0.9150	0.9400	FLAT
NZD/JPY	67.90	67.56	67.01	74.94	FLAT/DOWN	67.00	69.65	UP
NZD/EUR	0.5745	0.5689	0.5702	0.5669	FLAT/DOWN	0.5690	0.5840	FLAT/UP
NZD/GBP	0.5112	0.5024	0.5169	0.5046	FLAT/DOWN	0.5055	0.5200	UP
TWI	70.4	69.8	70.5	71.75	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

Much like a Wallabies RWC appearance, it was a game of two halves for the NZD last week. The NZD ground up in the first half from around USD0.626 to 0.634. Some of the extensive short positioning in the NZD was likely reduced ahead of the RBNZ meeting, and the AUD dragged the NZD slightly higher after RBA Governor Lowe delivered a fairly balanced economic assessment. The NZD/USD lifted around 30 pips on the RBNZ decision to remain on hold, on a combination of the short positioning and the RBNZ expressing some confidence that its stimulus to date will boost the economy. That spike was relatively short-lived as the USD itself got a lift from strong housing data and upbeat economic comments from Fed officials. Brexit, trade, and (now) impeachment headlines continue to keep markets on edge. The NZD is starting the week under USD0.63, barely up from a week ago.

Near-term outlook

There are a number of currency-sensitive events looming, particularly in the early part of the week. The double-shots of business confidence (ANZ Monday, the more influential Quarterly Survey of Business Opinion Tuesday) risk softening the NZD if they show further ebbing of sentiment after the RBNZ's 50bp August cut. The RBA rate announcement (Tuesday 5:30PM NZT) may also drag slightly on NZD/USD and bolster NZD/AUD if the RBA cuts rates as we expect – a cut is 75% priced in so reaction will be more marked on a decision to hold steady. We don't expect much currency reaction to the fortnightly dairy auction (and expect a 1% whole milk powder price lift). US data in the form of Non-farm Payrolls (Friday), ISM manufacturing (Tuesday) and non-manufacturing (Thursday) indices will also be gauges to how likely the US Fed will follow up on its recent Fed Fund rate cut.

Medium-term outlook

Our updated forecasts have the NZD/USD dribbling lower for the best part of the next nine months, to a low of 0.6200 in March 2020. We'd characterise this profile as a sideways NZD/USD trend inside a low 0.6200-0.6400 range. The recent downward revision is consistent with the trade war, and attendant negative global growth impacts, dragging on for longer than we'd previously anticipated. The domestic slowdown is also occurring at a slightly faster rate than we'd expected. Our constructive view on NZ's terms of trade, and the front-loaded nature of RBNZ policy easing, are key reasons why we believe there is only limited NZD downside from here.

ASB foreign exchange forecasts

(end of quarter)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< 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

<u>Wholesale interest rates</u>	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	1.14	1.14	1.19	1.91	UNCH/DOWN	UP
2-year swap	0.96	0.93	1.01	2.04	UNCH/DOWN	UP
5-year swap	0.96	0.95	0.98	2.40	UNCH/DOWN	UP
10-year swap	1.21	1.24	1.27	2.90	UNCH/DOWN	UP
10-year govt bond yield	1.10	1.13	1.07	2.62	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.26	0.31	0.26	0.86	UNCH/DOWN	UNCH/UP

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

Market Recap

NZ short-term interest rates edged higher after the RBNZ delivered the trifecta of holding the OCR at 1.00%, provided reassurance that policy stimulus in the pipeline will be sufficient to support domestic demand and signalled from Governor Orr that the NZ economy was in a sound position and that negative interest rates were “unlikely” for NZ. Australian yields were lower after RBA Governor Lowe highlighted downside risks generated by geopolitical developments. Concerns over the global growth outlook, mixed signs on US/China trade negotiations (reports the Trump administration is mulling investment restrictions into China), rising geopolitical tensions between the US and Iran and the announcement of a formal impeachment inquiry into President Trump helped drive a modest fall in global long-term yields, which pushed NZ long-term yields lower.

Near-term NZD interest rate outlook

We have retained our lower for longer view of the local and global interest rate outlook, with slowing global growth necessitating more central bank support. Our CBA colleagues expect the Reserve Bank of Australia (RBA) to trim the cash rate by 25bps tomorrow, with climbing labour market slack and the weaker global backdrop major catalysts. Market pricing is about 75% in favour of a 25bp cut in the RBA 1.00% cash rate, with market analysts split between a 25bp cut and on hold. Governor Lowe is due to give a speech tomorrow night. The RBNZ is on the look-out for a lower OCR-induced boost, but we don't expect tangible signs of improvement to emerge from today's ANZ Outlook nor tomorrow's NZIER Quarterly Survey of Business Opinion. **Low domestic confidence reinforces the case for more policy support and should keep markets biased towards a late 2019 OCR cut (just 70% priced in) and the potential for more support over 2020 (the market is currently pricing in an OCR floor of 0.6%).** With Chinese holidays in early October, US-China trade negotiations are likely to take a back seat. **Given the myriad of downside risks to the outlook, there is still scope for the curve to flatten if downside risks to the outlook crystallise.**

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 a 25bp OCR cut in November (to 0.75%), with the risk the OCR moves lower still over 2020. Following a 25bp cut tomorrow, we expect a 25bp cut by the RBA in February, with the cash rate to plateau at 0.50%. The Fed is expected to cut the 1.75%-2% Federal Funds rate by 50bps by early 2020 (Dec 2019, Mar 2020), and with policy easing elsewhere. 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

(end of quarter)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21	Mar-22	Mar-23
	<< 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

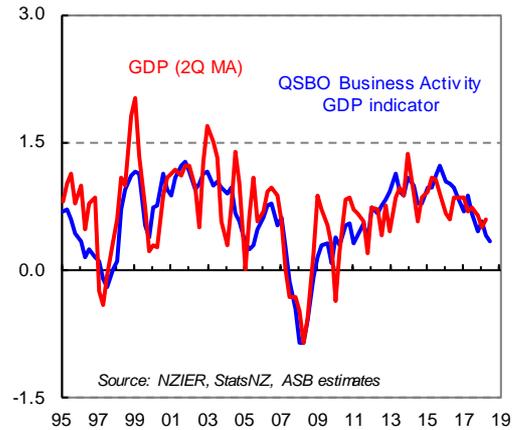
Data	Date	Time (NZT)	Market	ASB
ANZ Business Outlook, Own Activity, September, net %	30/09	1:00 pm	-	-
NZIER QSBO, Experienced trading activity, s.a., Q3	01/10	10:00am	-	0
GlobalDairyTrade auction, whole milk powder, % change	01/10	overnight	-	+1.0

ANZ monthly business confidence remains weak (with seasonal factors exaggerating the August decline). 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 will be looking for a lower OCR-induced lift in business sentiment, but warn that the spate of negative headlines over the global outlook could continue to dampen the business mood. If the ANZ monthly business confidence survey continues to paint a picture of weak investment, employment and economic activity, and contained inflation pressure, the OCR will likely move lower over the coming months.

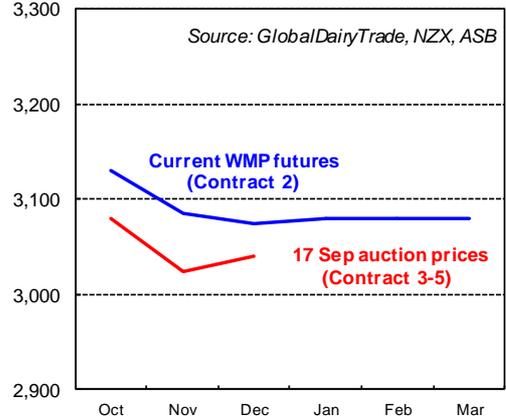
We continue to prefer the NZIER Quarterly Survey of Business Opinion, over the ANZ survey, as it has remained the more accurate predictor of NZ GDP growth in recent years. **The QSBO survey’s ‘experienced trading activity’ has correctly predicted the trend pace of growth in recent years and we expect this measure to improve in Q3 to at least zero (from -4 in Q2) and to be consistent with trend GDP growth of around 0.5% per quarter.** However, the risk is that this measure does not recover and continues to suggest weaker GDP growth relative to our forecasts. **If business sentiment remains persistently weak, it would signal an even higher chance that the OCR cut we expect in November is not the last in the easing cycle.**

We expect whole milk powder prices to rise modestly at the GlobalDairyTrade auction overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices posted a 1.9% rise. At this stage, the futures market is pointing to a 2% lift in prices. However, with the futures market often overshooting the mark, we anticipate a more subdued lift of around 1%.

QPC **BUSINESS CONFIDENCE & GDP**



USD/MT **GLOBALDAIRYTRADE AND WMP FUTURES PRICES**



Major International Events for the week ahead*

Data	Date	Time (NZT)	Market	ASB
Australia Private Sector Credit, August, %mom	30/09	2:30 pm	0.3	0.3
Bank of Japan Summary of Opinions	30/09	12:50 pm	-	-
Australia Building Approvals, August, %mom	01/10	2:30 pm	2.0	5.0
RBA Monetary Policy Meeting	01/10	5:30 pm	0.75	0.75
RBA Gov. Lowe at RBA Board Dinner	01/10	10:20 pm	-	-
Eurozone CPI, September, %mom	01/10	10:00 pm	1.0	-
Australia Retail Trade, August, %mom	04/10	2:30 pm	0.5	0.9
RBA Financial Stability Review	04/10	2:30 pm	-	-
US Non-farm Payrolls, September, 000s	05/10	1:30 am	145	140

*Originally published by CBA Global Markets Research on Friday 27th August at 1.36pm

Australian credit growth is weak. Housing credit growth has slowed and business credit growth has more recently softened. The stock of credit is expected to rise by 0.3% over July.

The **Bank of Japan's Summary of Opinions** for its 19th September meeting may shed some light on how close the Board is to easing monetary policy again and what easing options it may consider.

Australian building approvals fell a sharp 9.7% in July. We had expected building approvals to start to flatten out but last month's data was weaker than expected, driven by falls in private houses and multi units across New South Wales, Victoria and Queensland. There could be a bounce back this month given the size of the falls in July. We expect this could be in the vicinity of 5%.

We expect the Reserve Bank of Australia (RBA) to cut the cash rate by 25bp to 0.75% at its Board meeting on 1 October. The Governor has recently sounded more downbeat on the global economy and geopolitical developments. The lift in the unemployment rate to 5.3% in August also means the RBA is moving further away from its aim of a 4.5% unemployment rate and adds to the recent lift in pessimism on the global outlook.

RBA Governor Lowe is providing remarks at the RBA Board Dinner with the business community on Melbourne. This will follow the RBA Board meeting earlier in the day. We expect the Board to have delivered its third 25bp cut this cycle. These remarks could further explain the reasons why they cut rates and the outlook.

We estimate the value of **Australia's retail trade** rose by 0.9% in August. We have used the CBA Household Spending Intentions (HSI) retail measure and applied our seasonal adjustment. The HSI for August showed a clear lift in intentions, assisted by rate cuts and tax rebates. A lift in retail trade of 0.9% would see the annual rate of retail trade lift to 2.9% (revisions aside). This would show that households are responding to the stimulus.

The **RBA's semi-annual Financial Stability Review** will be released later this week. The review provides the RBA's assessment of the current condition of the financial system and potential risks to financial stability. In terms of domestic financial stability risks, any update on the possible uses of macro-prudential tools if required given the acceleration in dwelling prices would be of interest.

Eurozone headline and core CPI inflation are expected to remain muted in September 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 1.2% and core CPI inflation of 1.1%.

The low level of **US** jobless claims and the pick-up in temporary employment suggest another solid increase in **Non-farm Payrolls** of 140,000. Consequently, the unemployment should remain low at 3.7%. But very low inflation expectations suggest average earnings decelerated slightly to 3.1%yoy.

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	0.5	0.5	0.5				
GDP real - A%	2.5	2.1	2.2	2.1	2.1	2.4	2.4	2.4
GDP real - AA%	2.7	2.5	2.3	2.2	2.1	2.3	2.4	2.4
CPI - Q%	0.1	0.6	0.6	0.1				
CPI - A%	1.5	1.7	1.3	1.4	1.9	1.9	2.0	1.9
HLFS employment growth - Q%	-0.1	0.8	0.2	0.3				
HLFS employment growth - A%	1.5	1.7	0.9	1.3	1.7	1.5	1.4	1.2
Unemployment rate - %sa	4.2	3.9	4.1	4.2	4.3	4.2	3.8	3.9
Annual current account balance as % of GDP	-3.6	-3.4	-3.4	-3.3	-3.1	-3.0	-3.1	-3.1

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

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	<< actual		forecast >>					
(end of quarter)								
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

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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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