

Under Pressure

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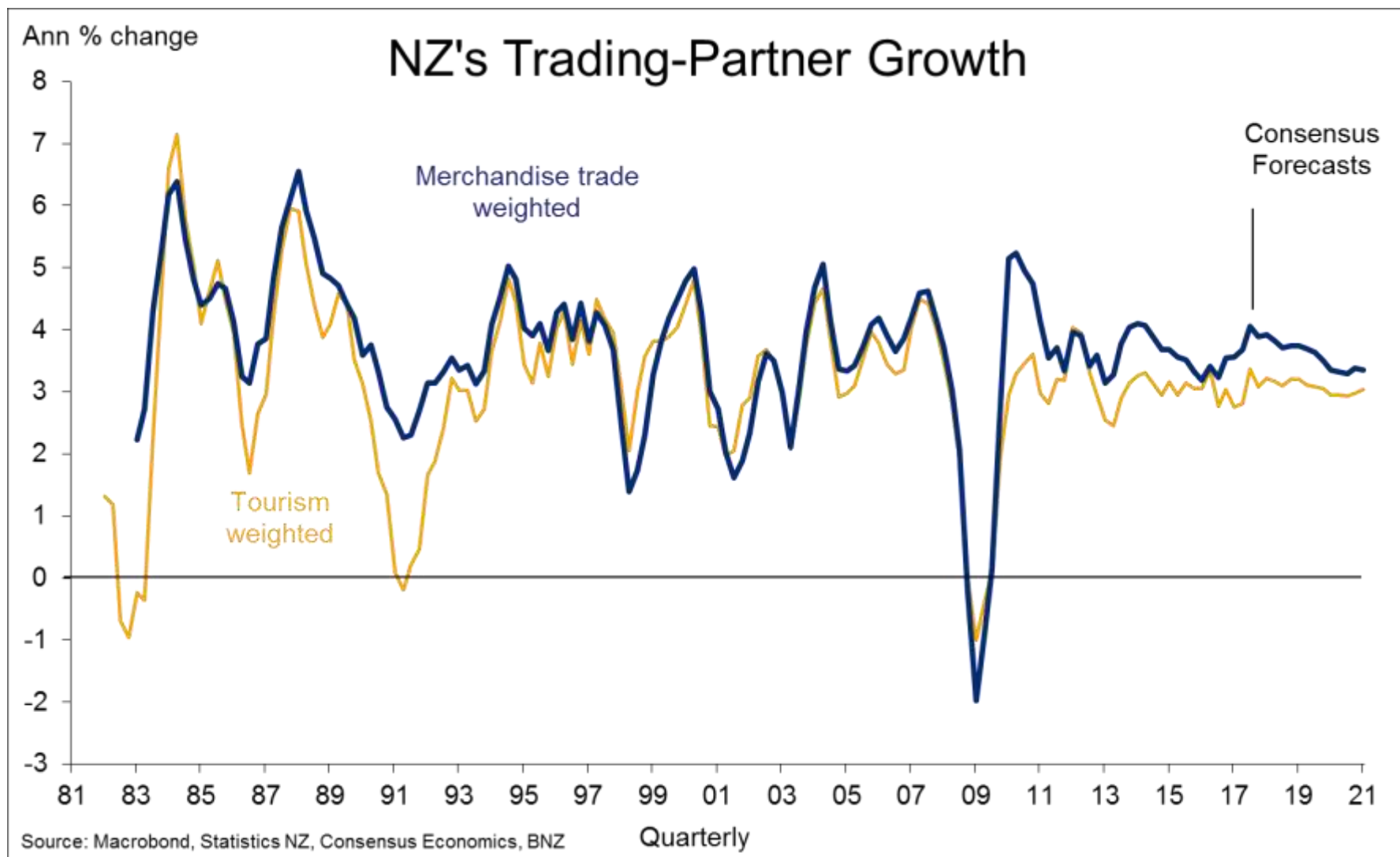


Introduction

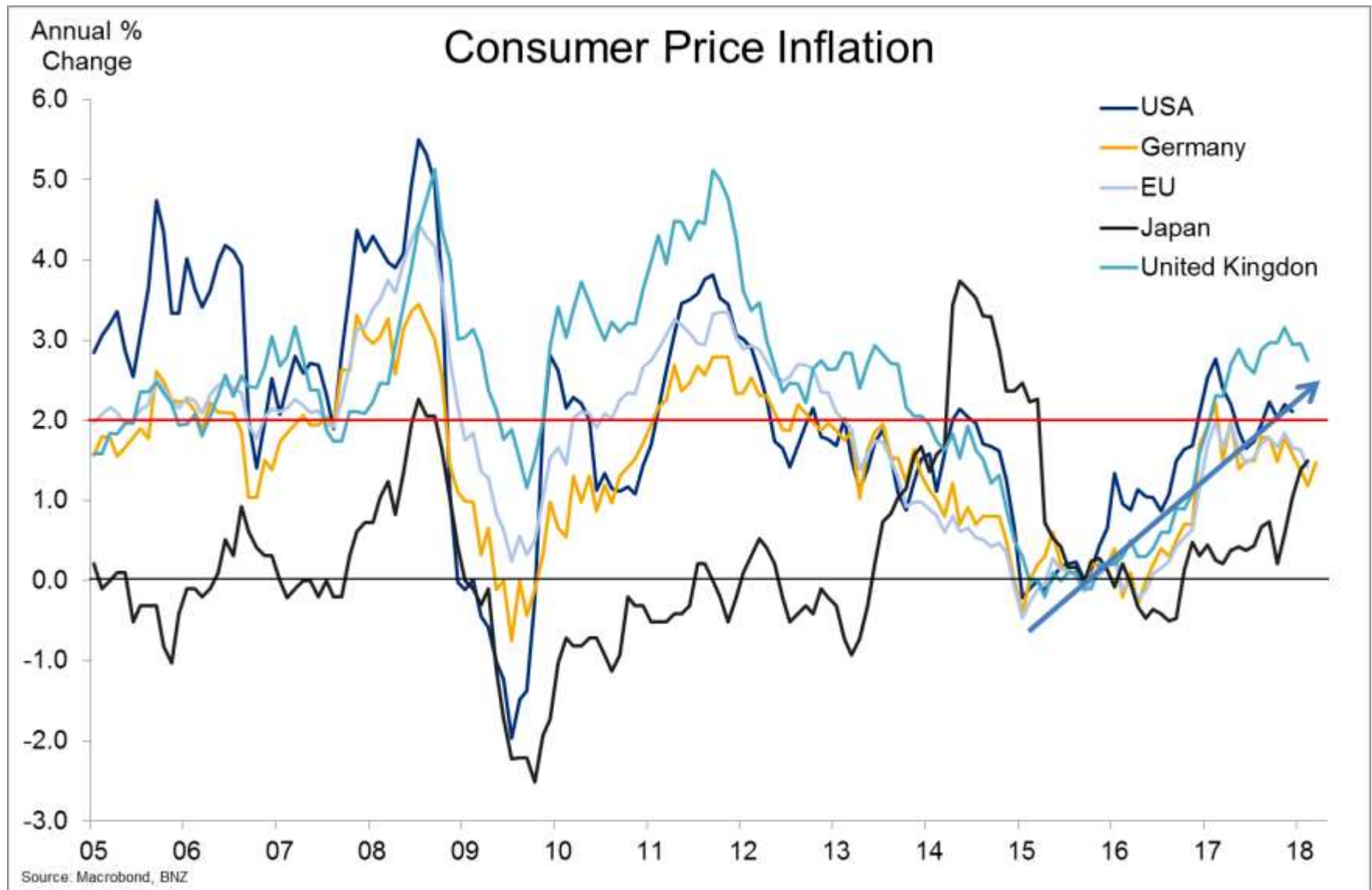
- Growth is under pressure
- Global expansion is peaking
- Political uncertainty is undermining confidence
- But plenty of momentum still
- Capacity pressures are getting aggressive
- Exchange rate drifting lower
- Inflationary pressures building
- Rates should respond eventually

Global

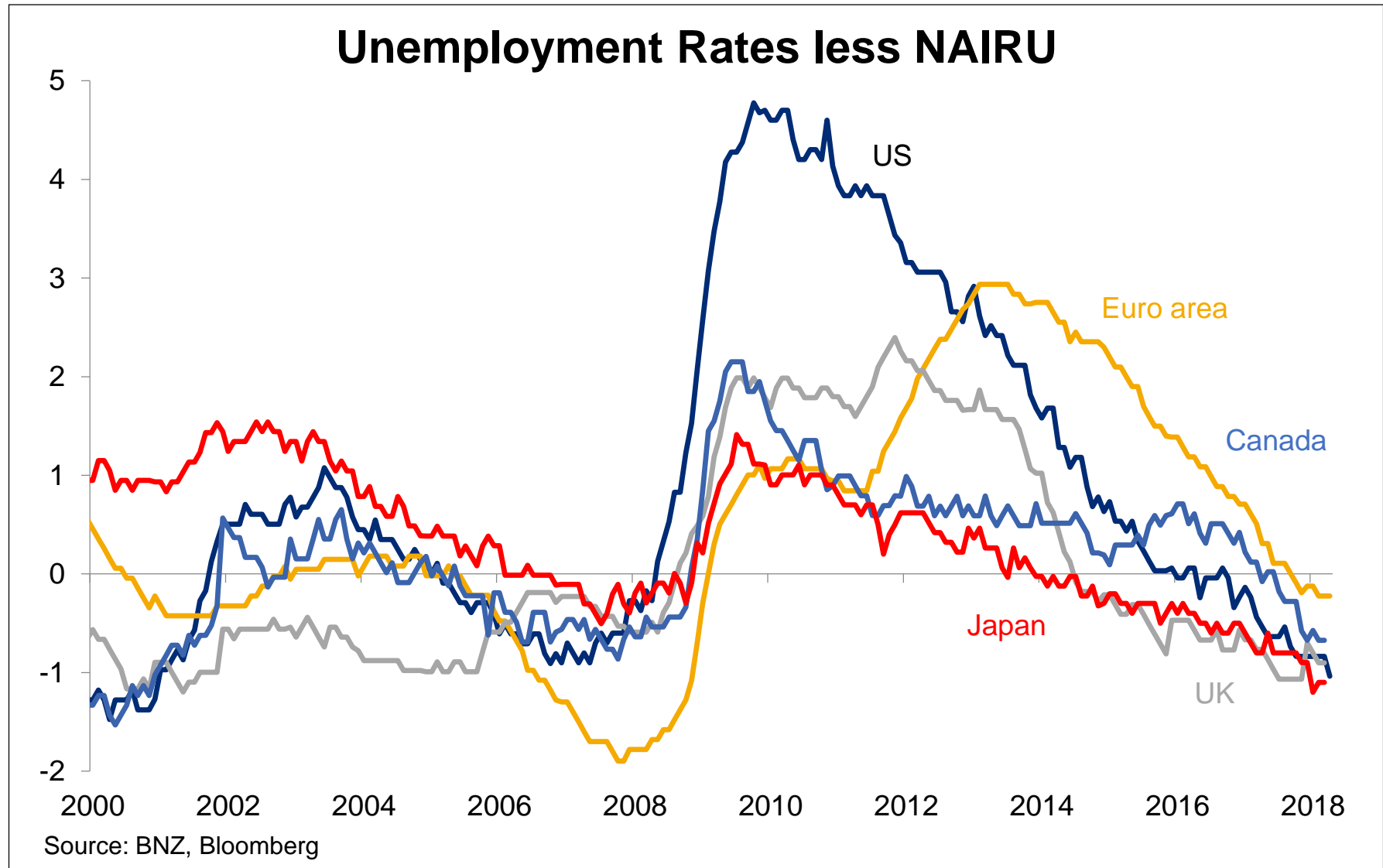
NZ Trading Partner Growth To Ease



As Global Inflation Rises

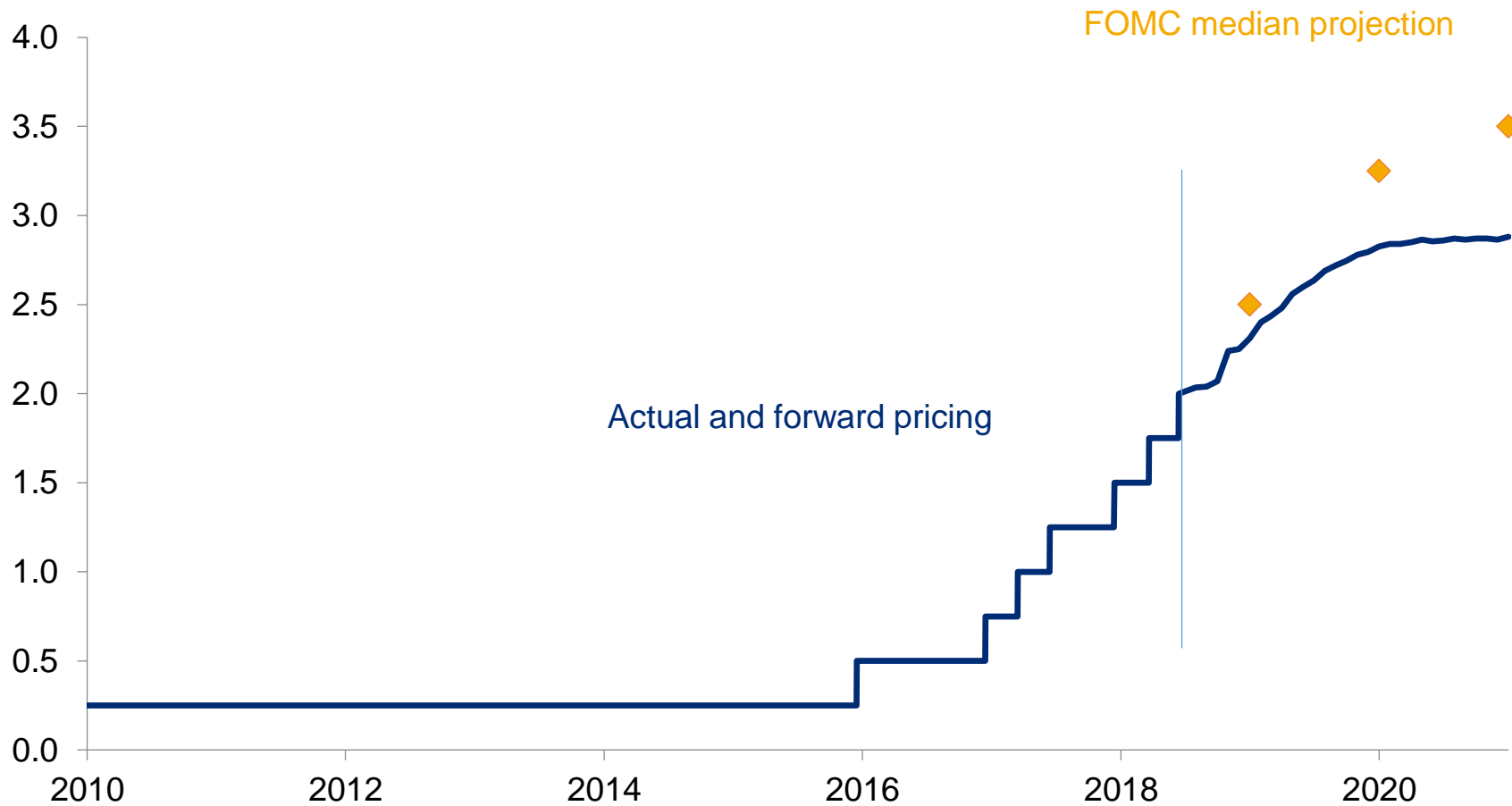


Global Unemployment Rates Below Natural Levels



Global Tightening Under Way

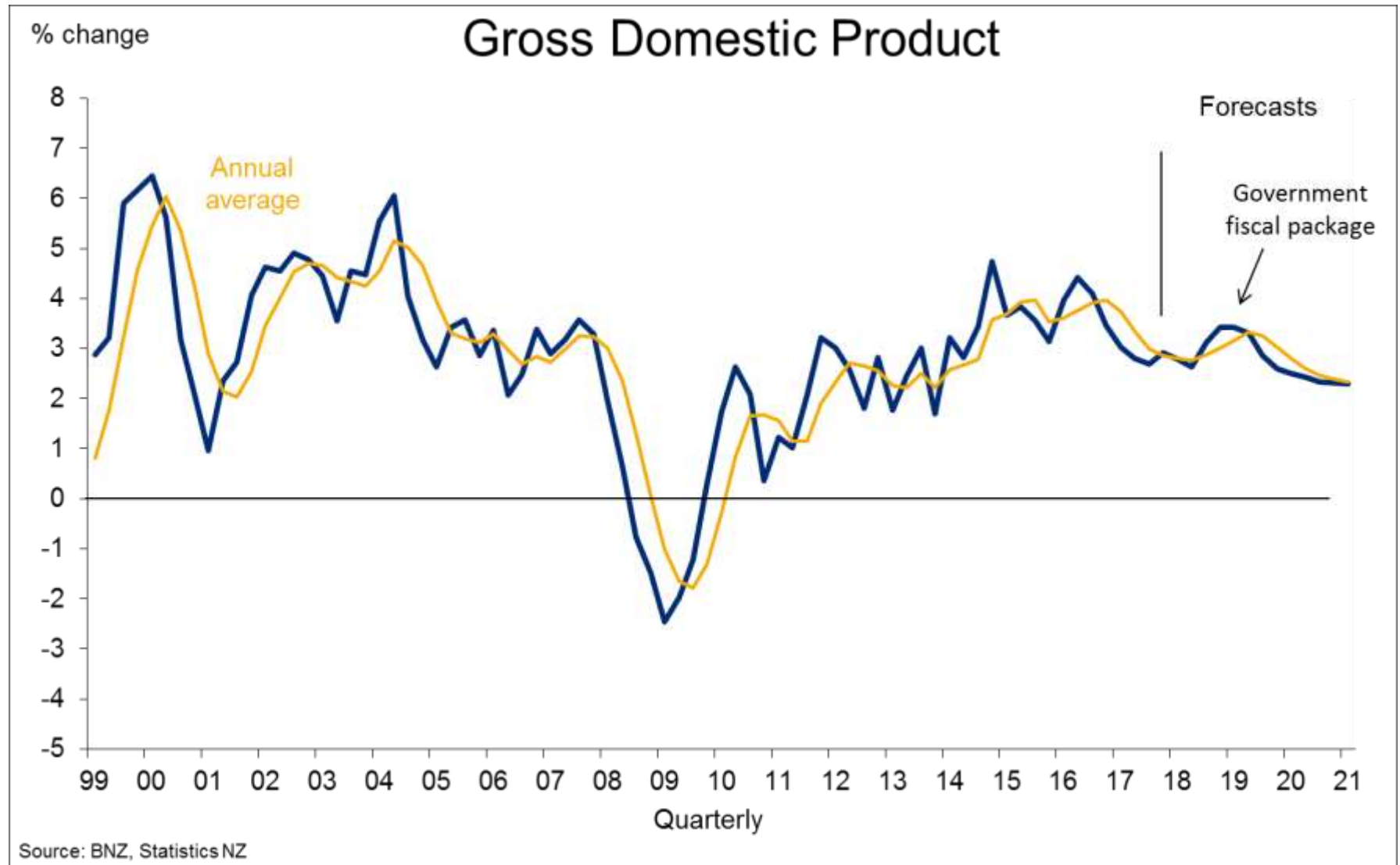
US Fed Funds Rate (top of range)



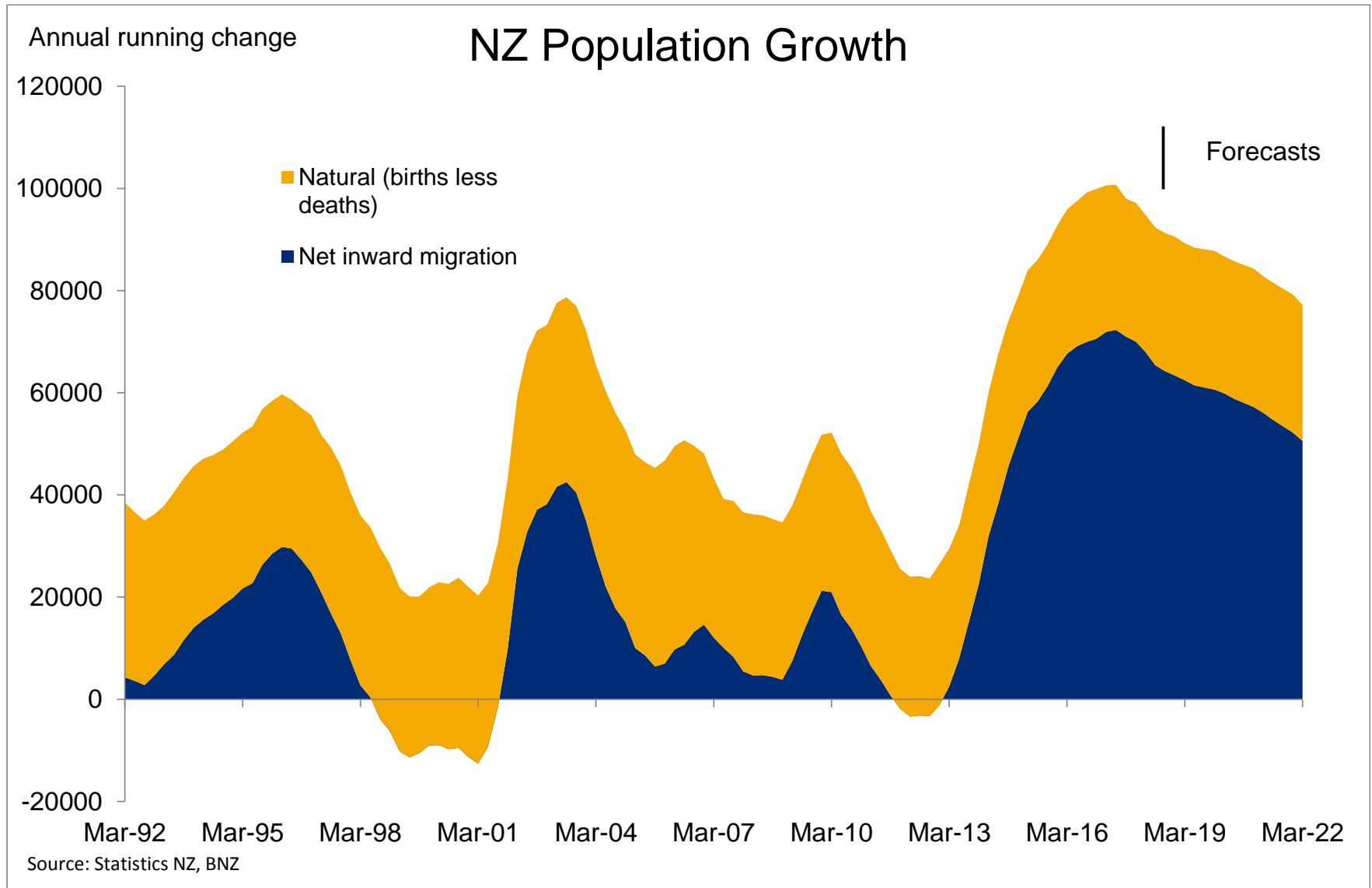
Source: BNZ, Bloomberg

Domestic Growth Faltering

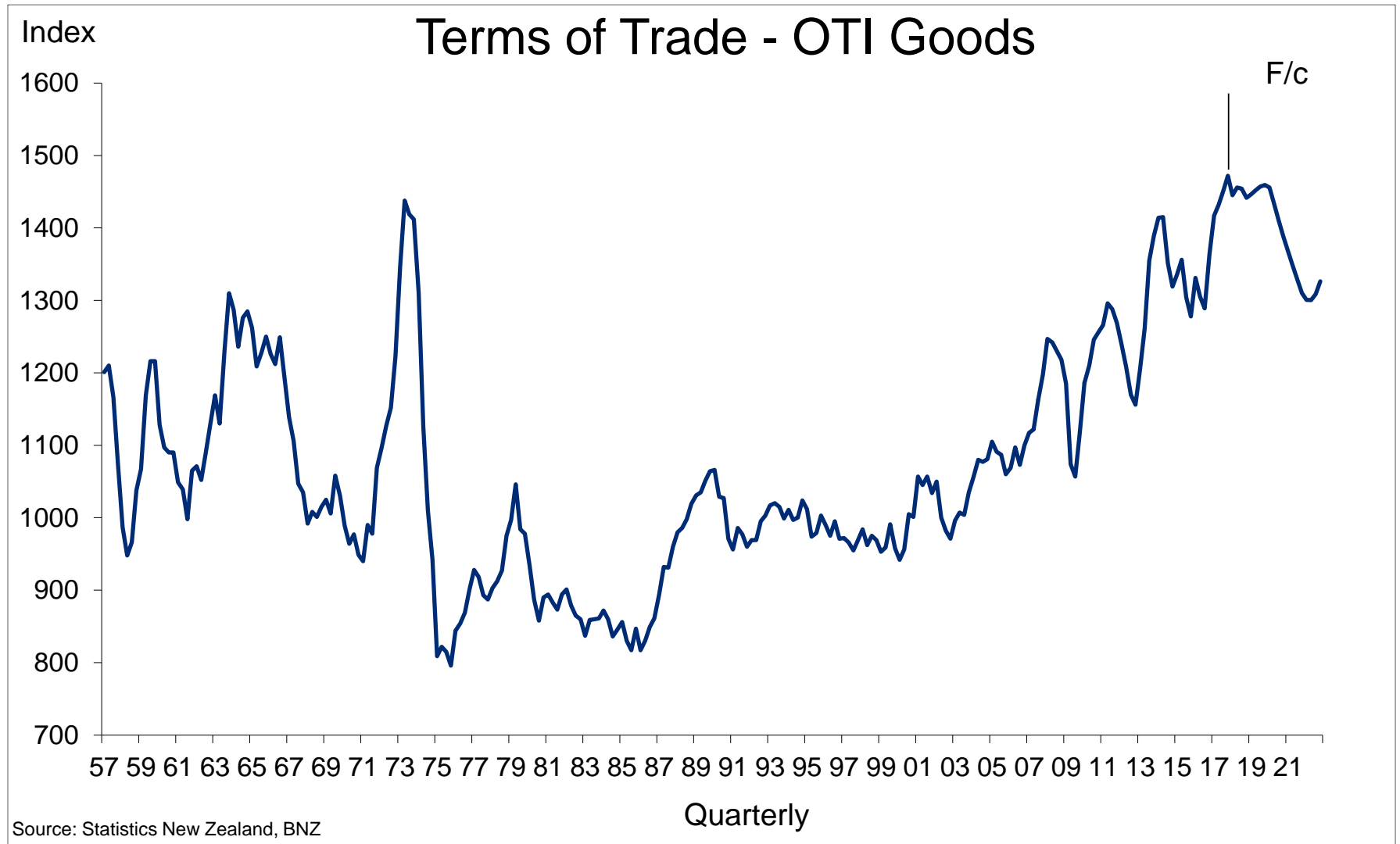
Growth Robust



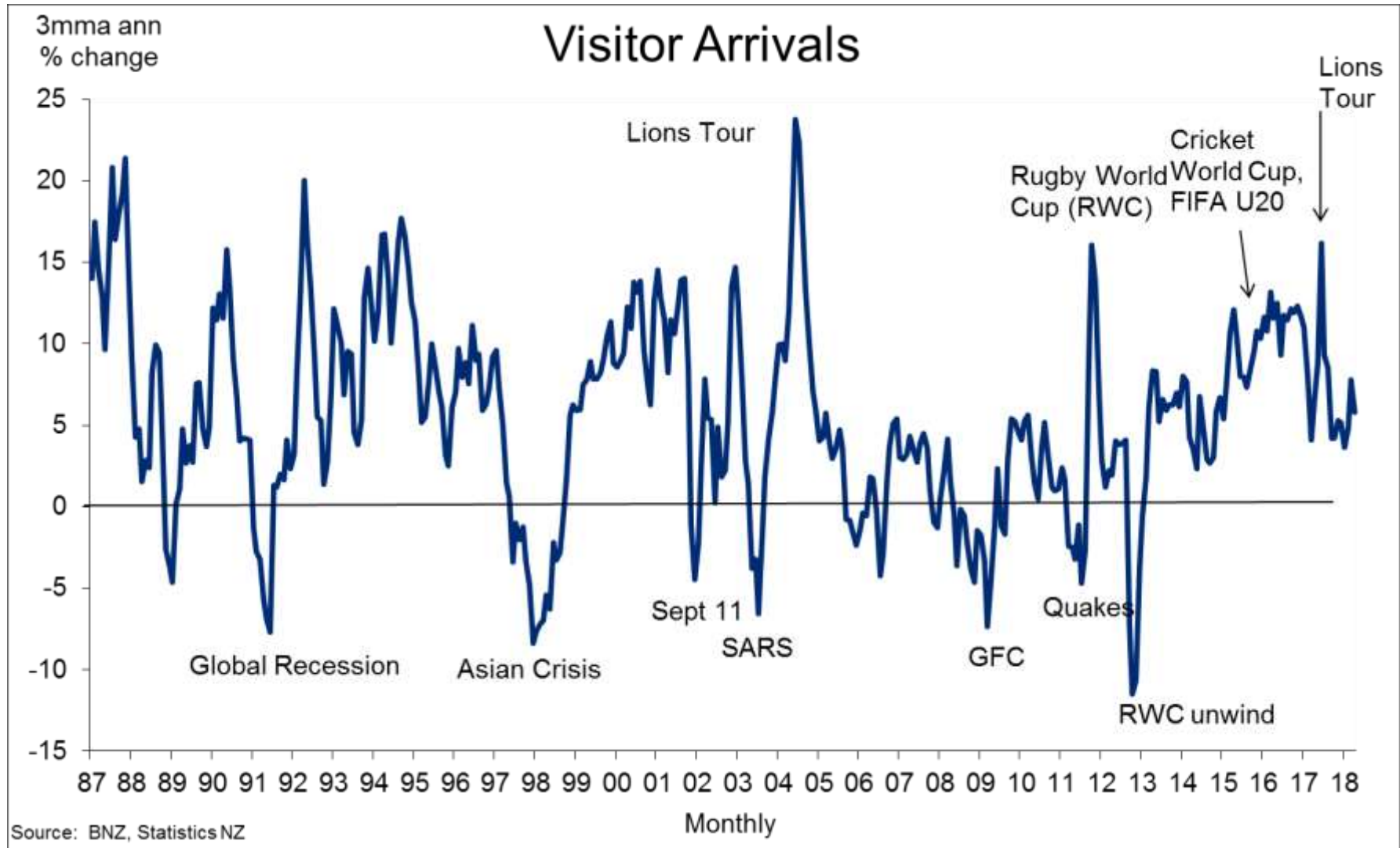
But Population Growth To Slow



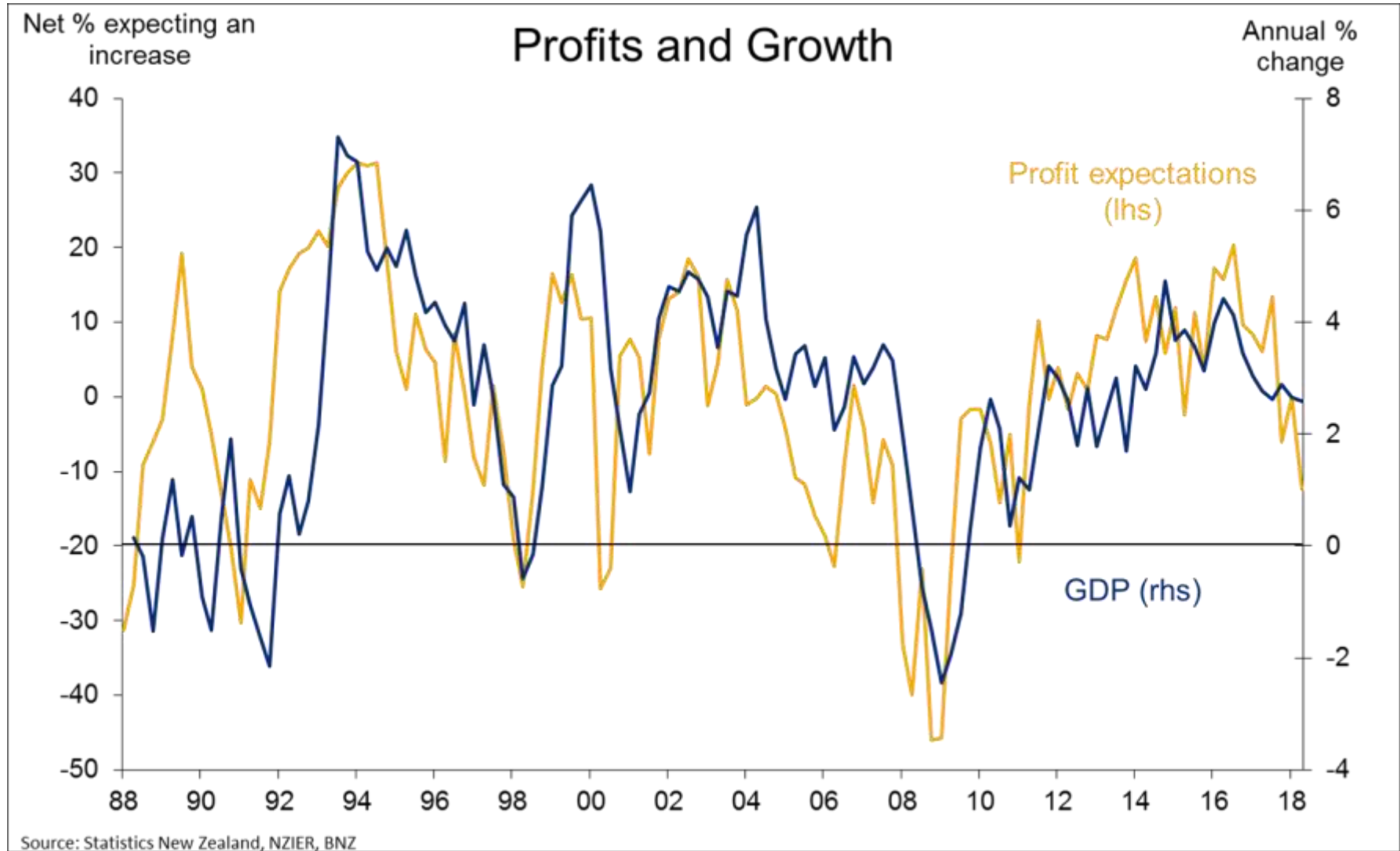
Terms of Trade Peaks



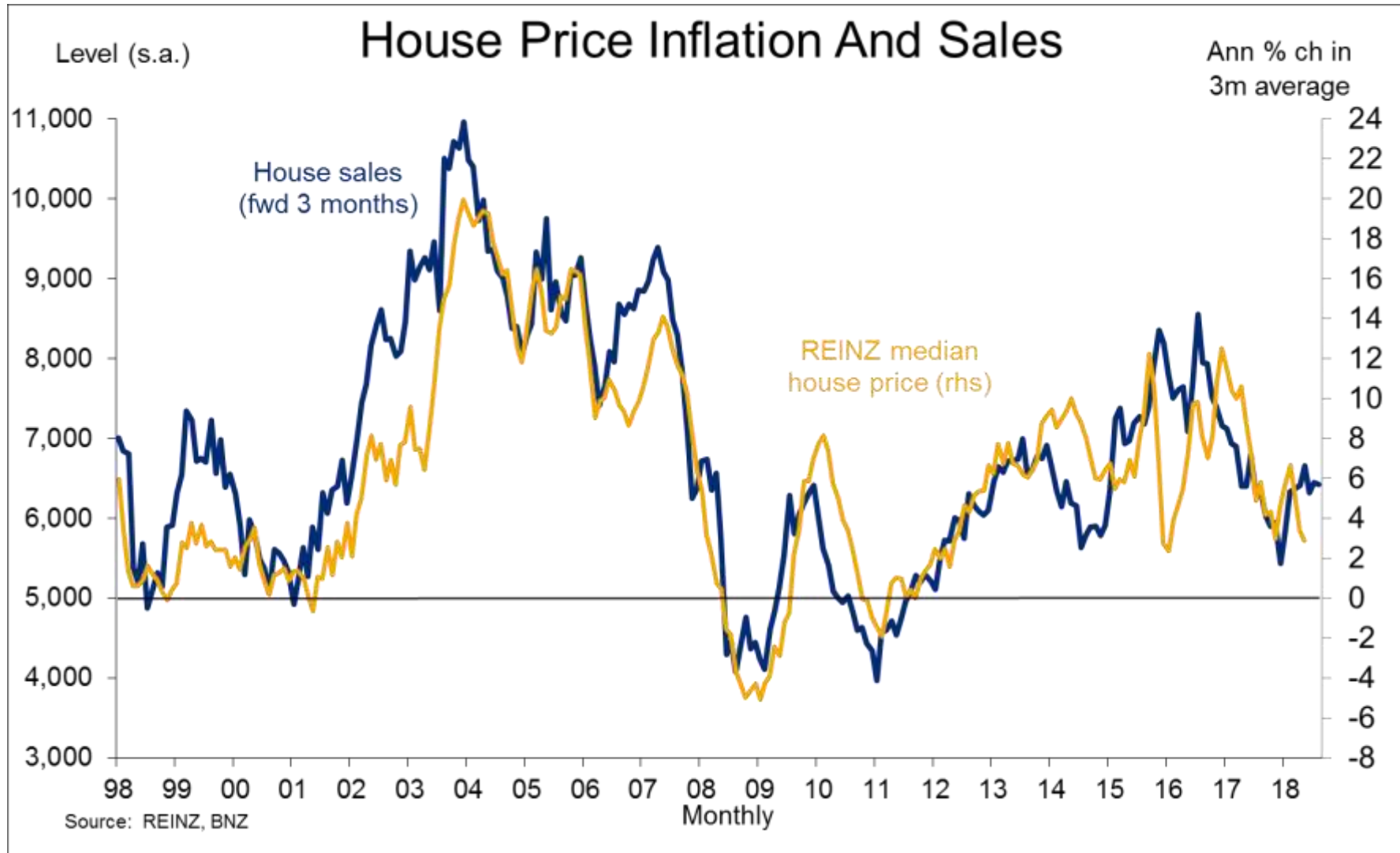
Tourism Growth Slowing



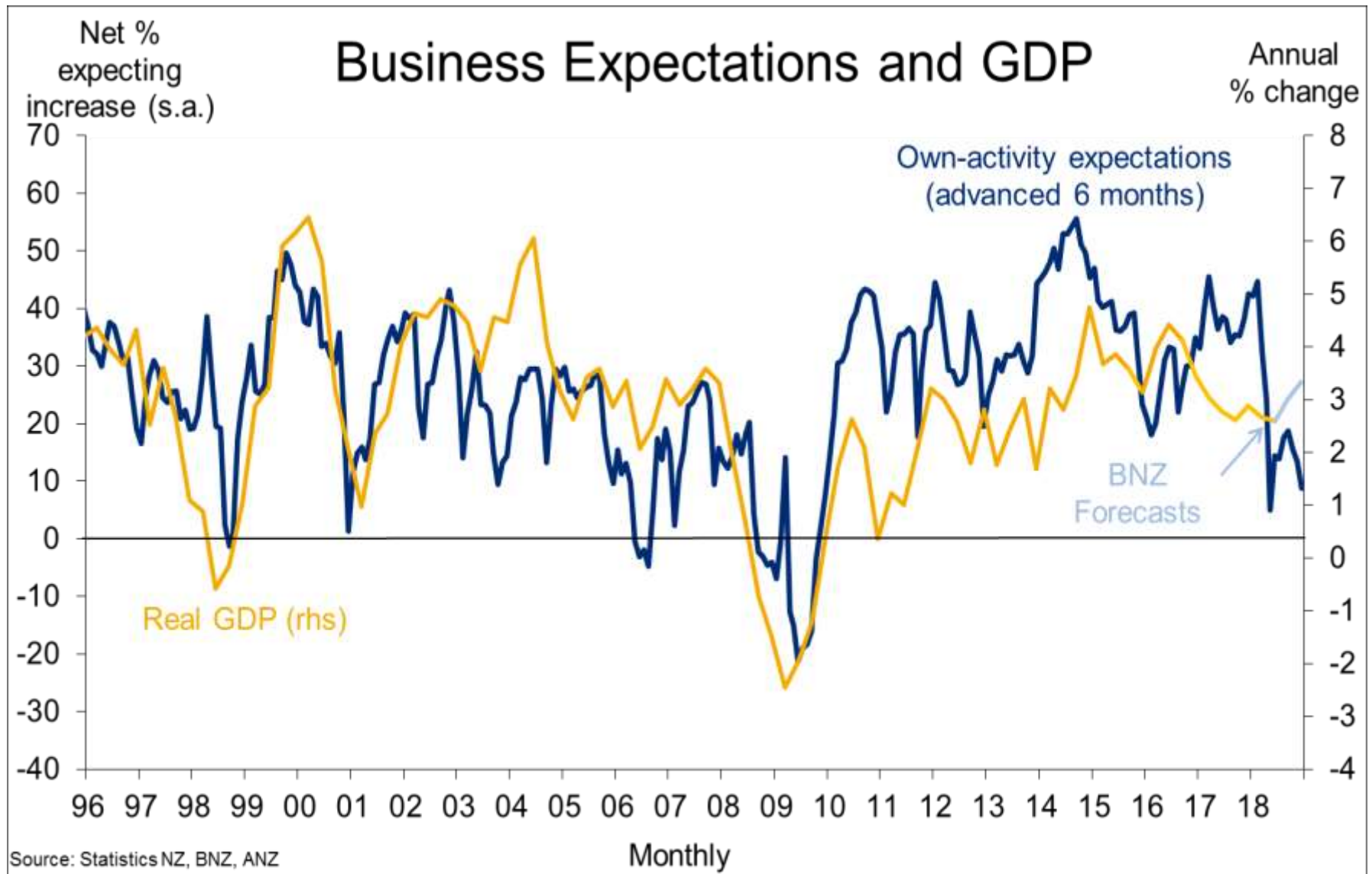
Profits Decline Disconcerting



Housing Not So Hot



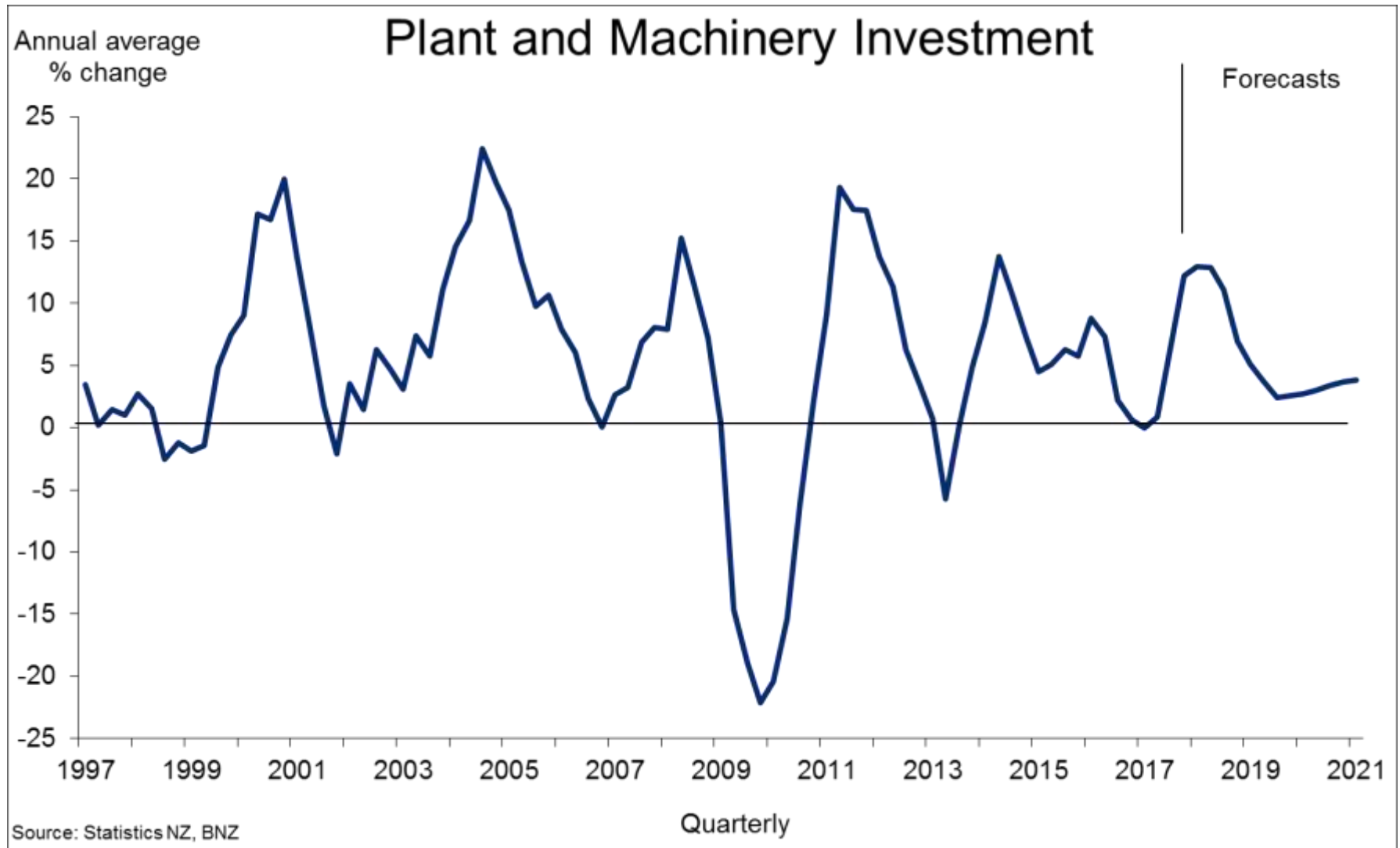
Businesses Don't Like Labour



Government Reviews and Policy Changes Galore

- Climate change and ETS
- Exploration
- Electricity
- Tax
- Overseas Investment Office land decisions
- Migration tightening
- Kiwibuild
- Minimum wage hikes
- Zero Carbon 2050
- Fully renewable 2035

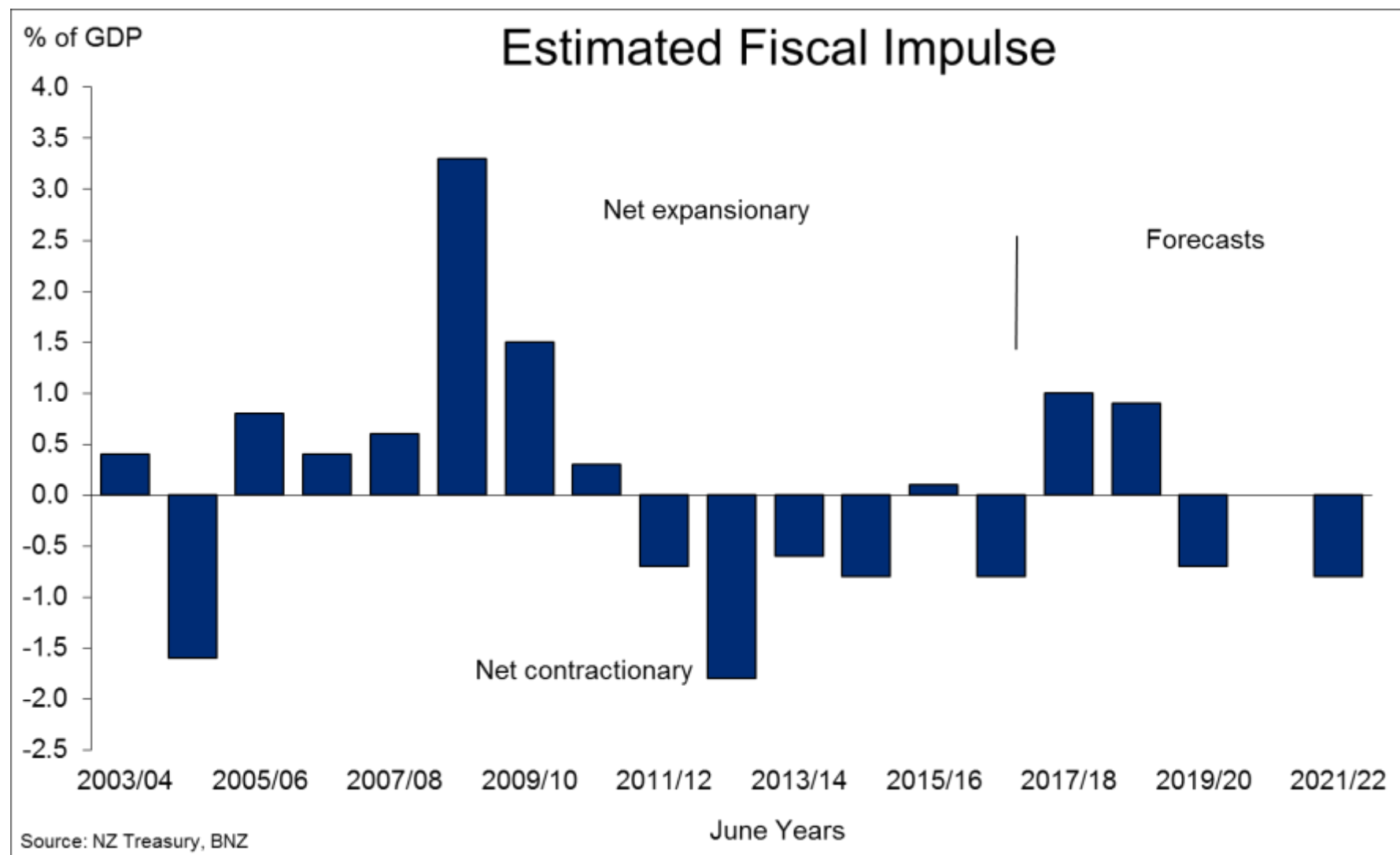
May Curb Investment Activity



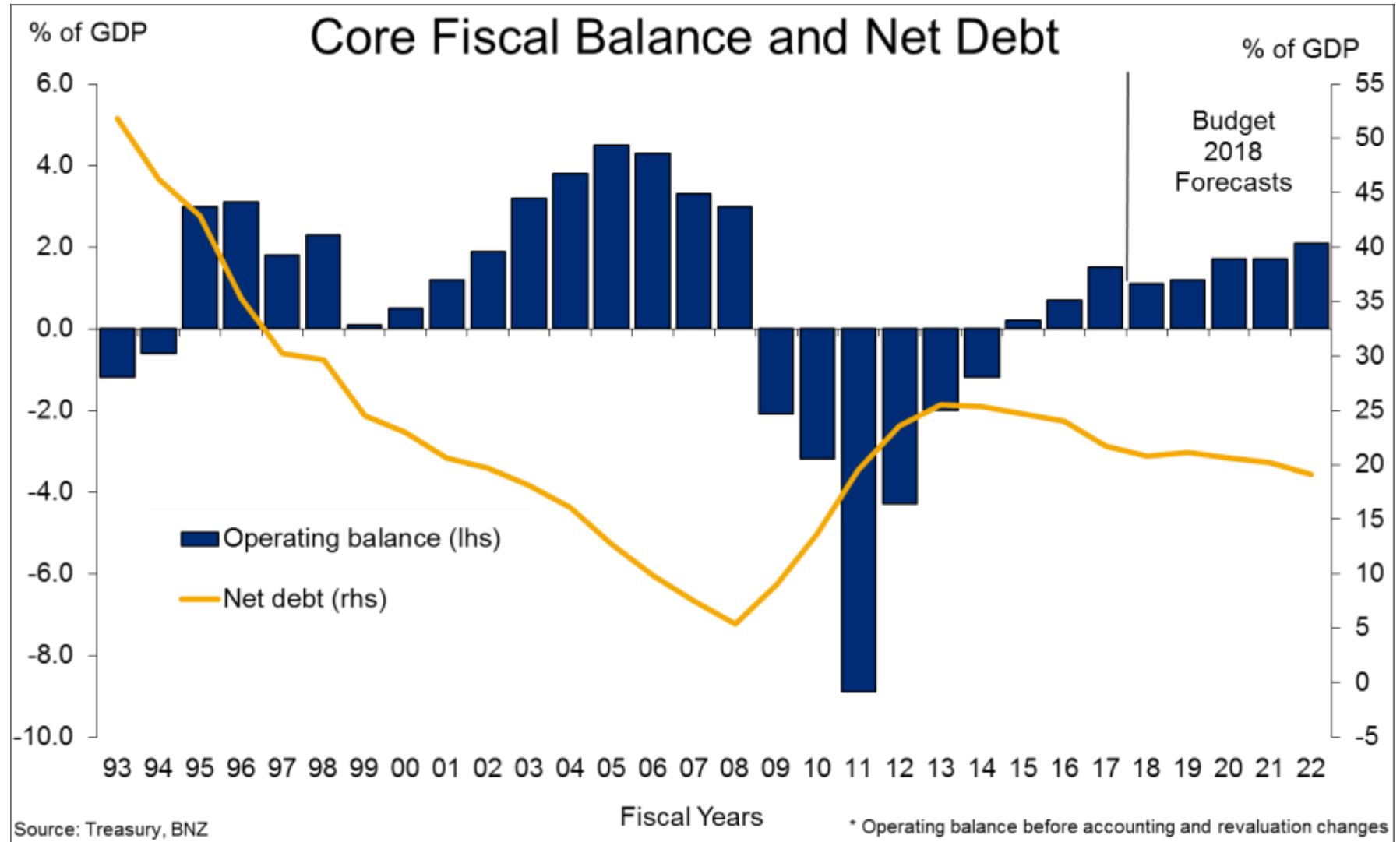
But

- Major fiscal expansion
- Strong income growth
- Significant infrastructure investment
- Construction still robust
- Tourism strong
- Terms of trade ballistic
- Solid productivity growth

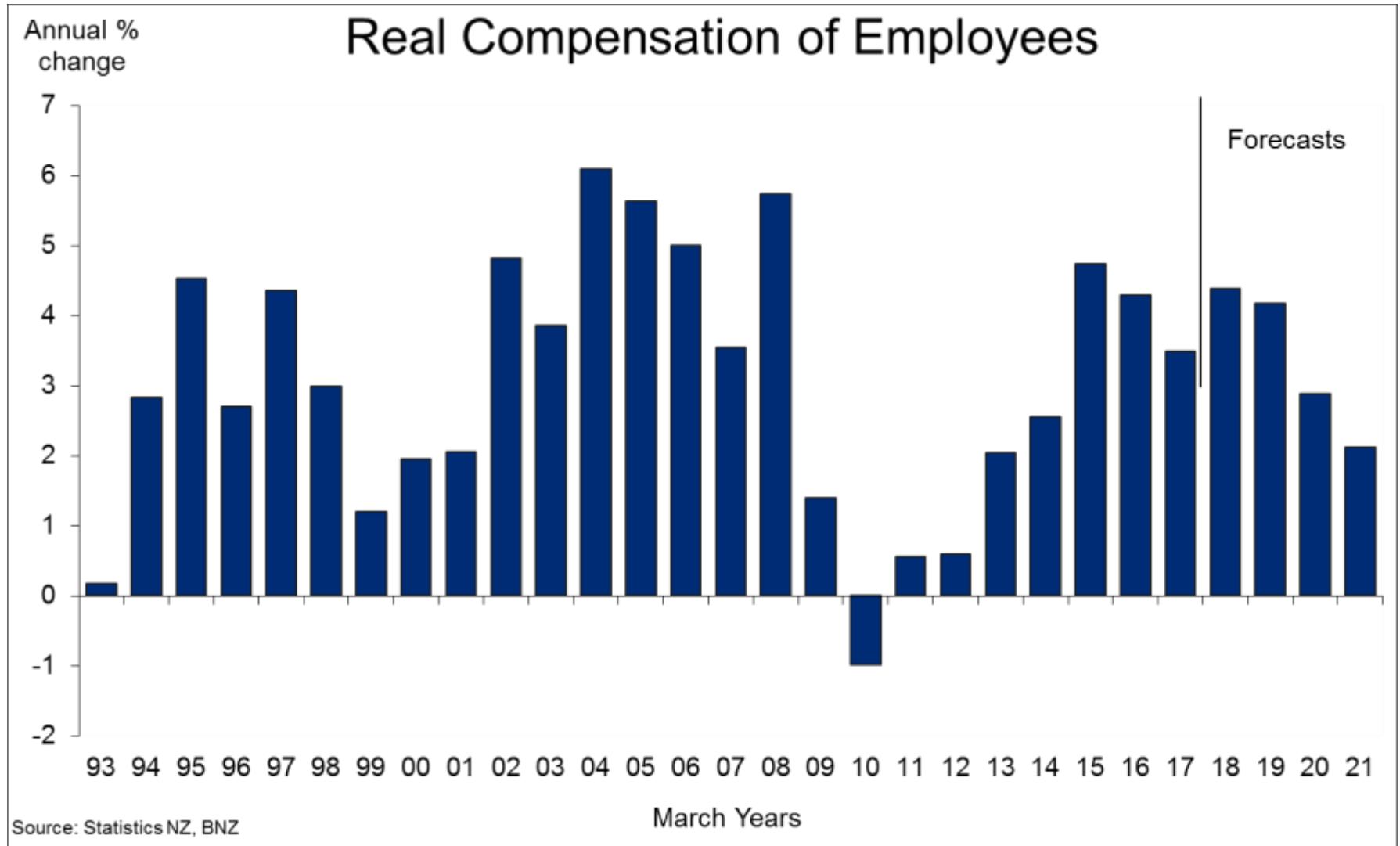
Substantial Fiscal Stimulus



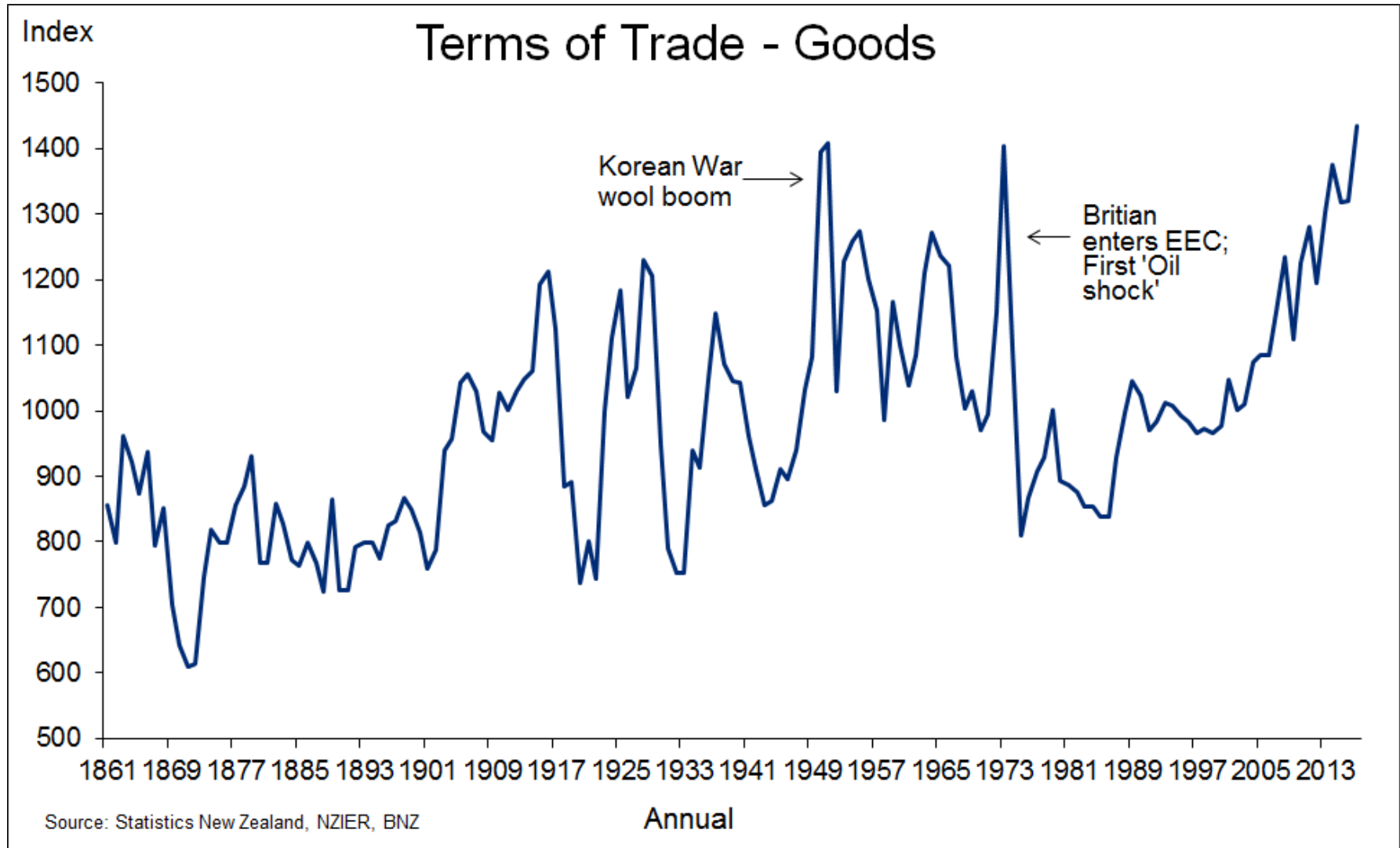
And Room For More



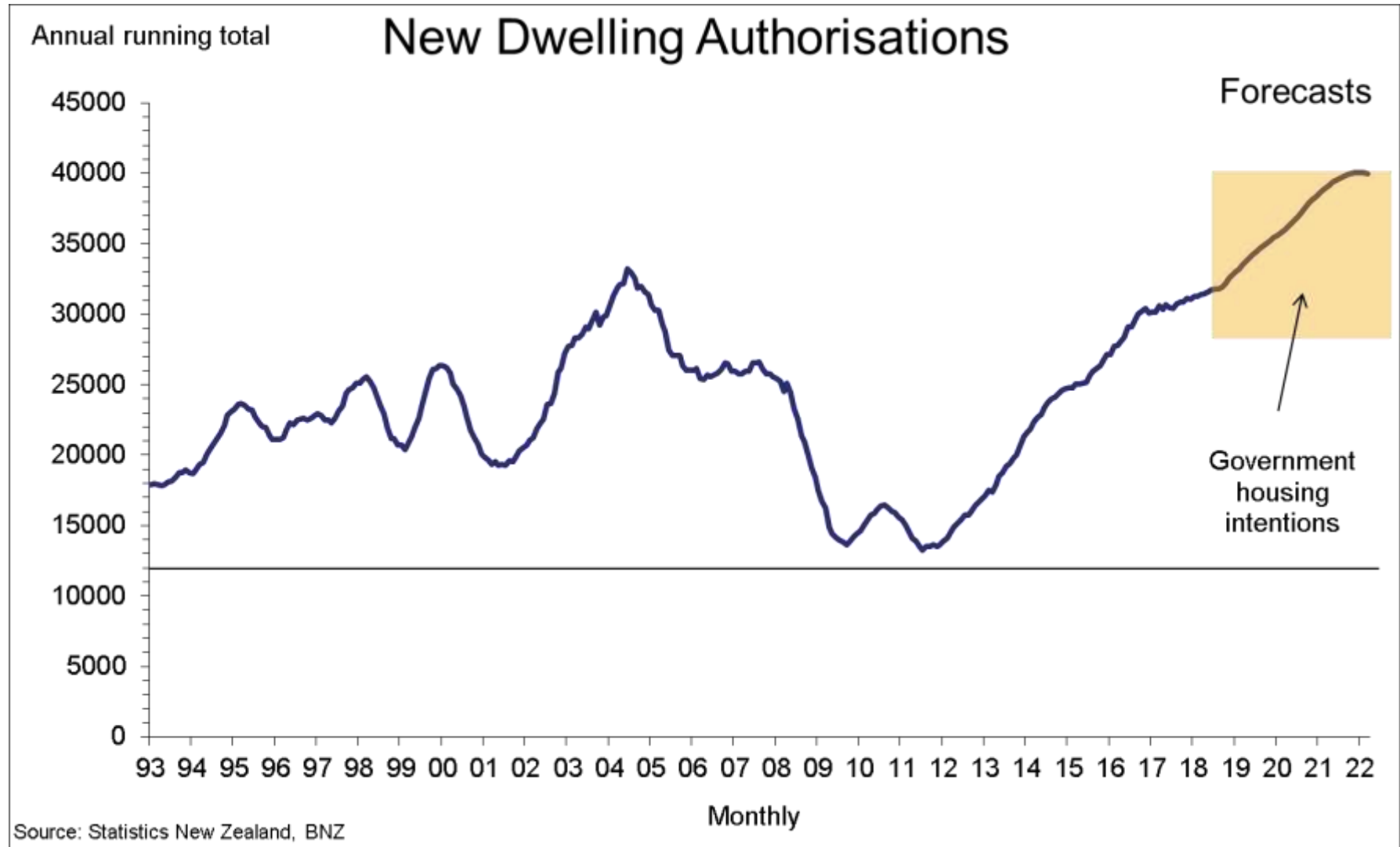
Strong Income Growth



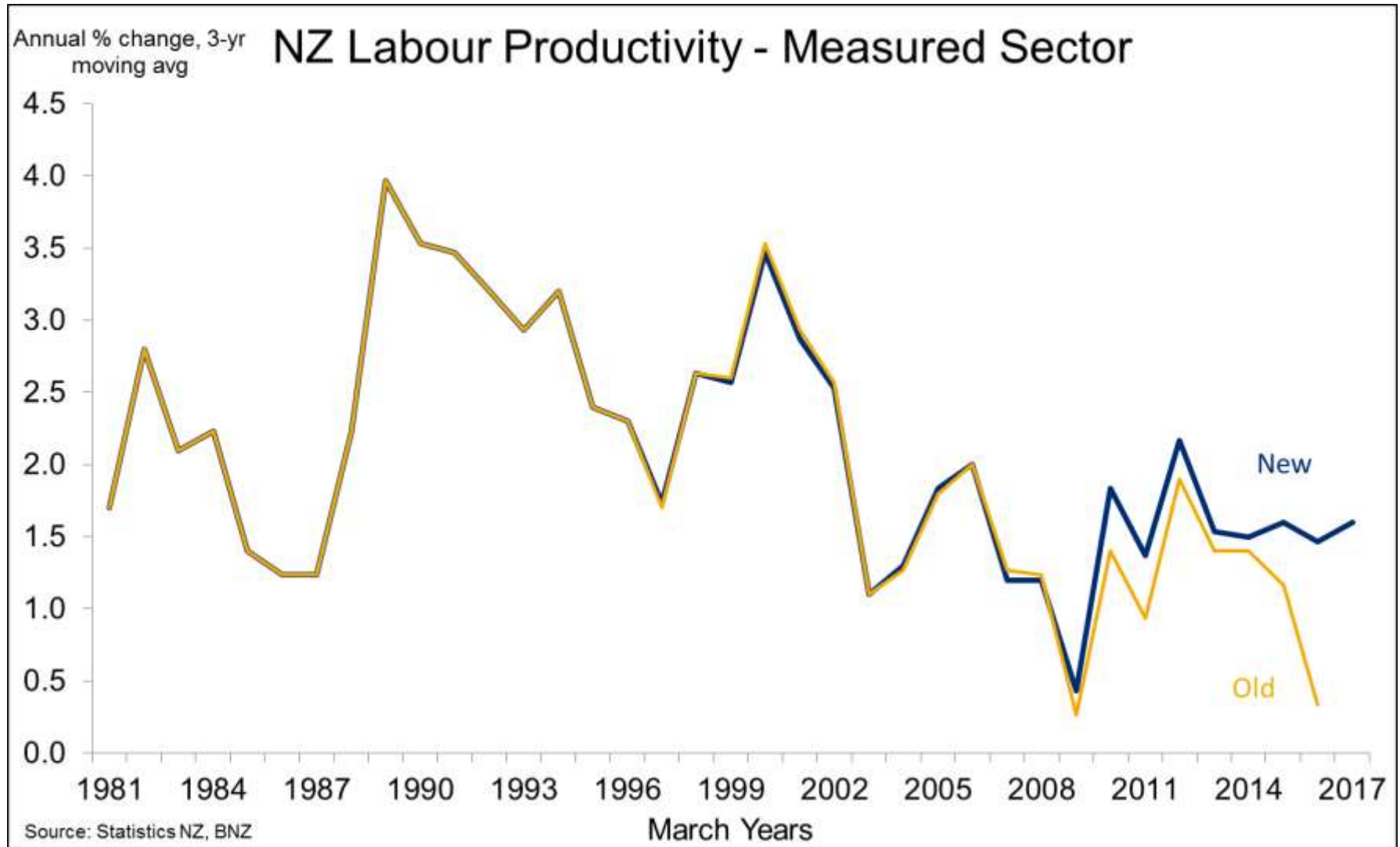
Terms of Trade Ballistic



Construction Robust

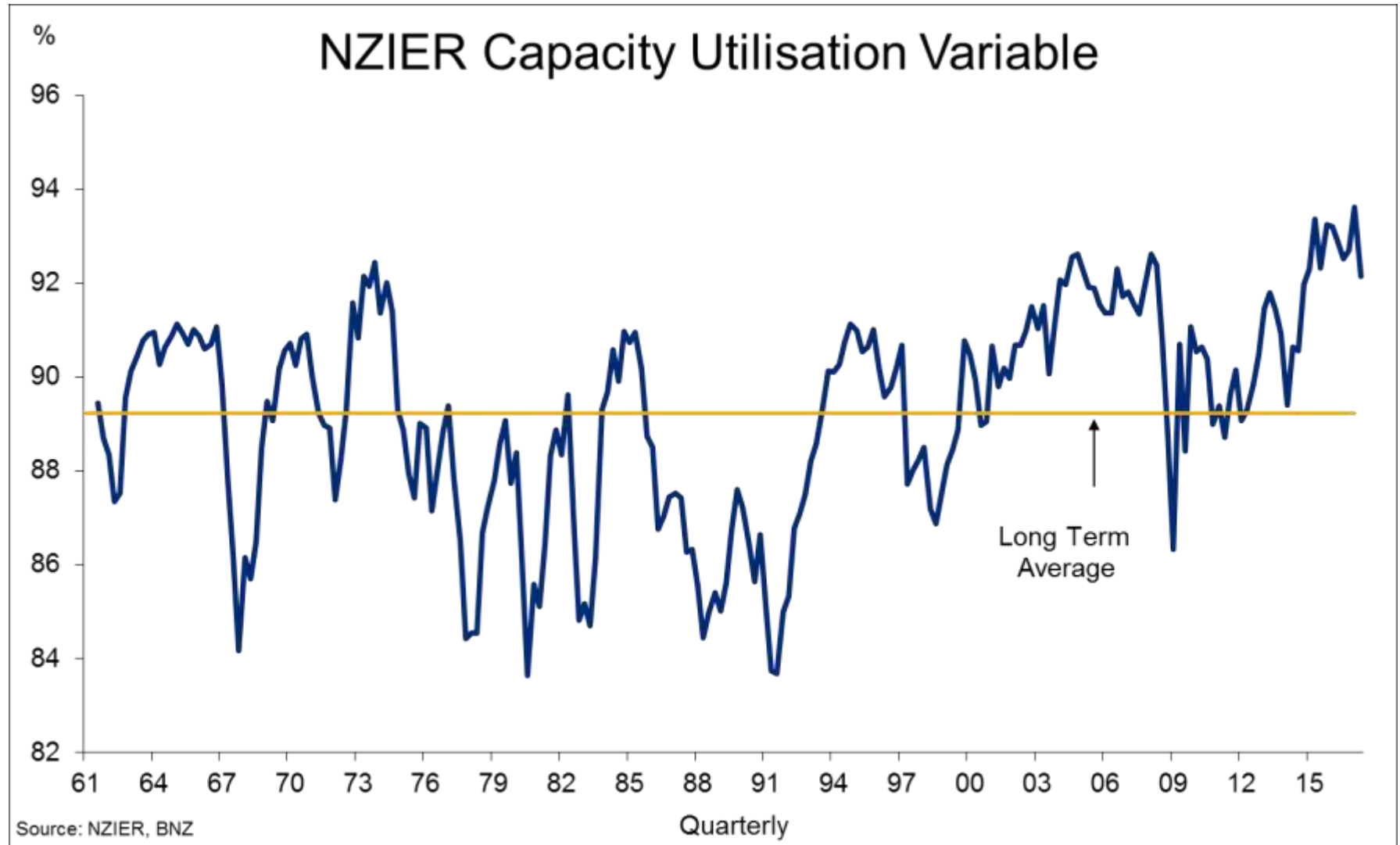


Productivity Growth Okay

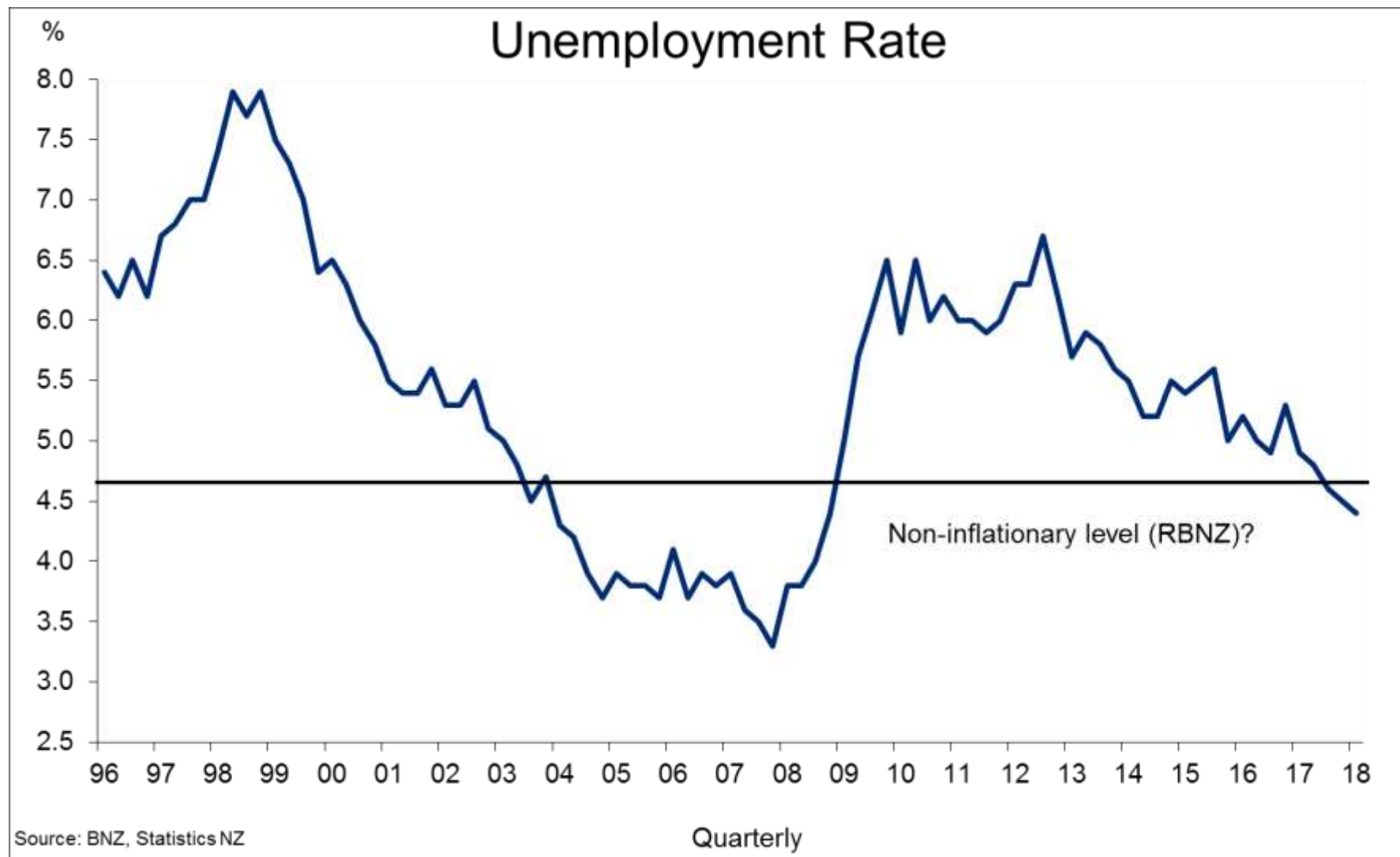


Inflation Set To Rise

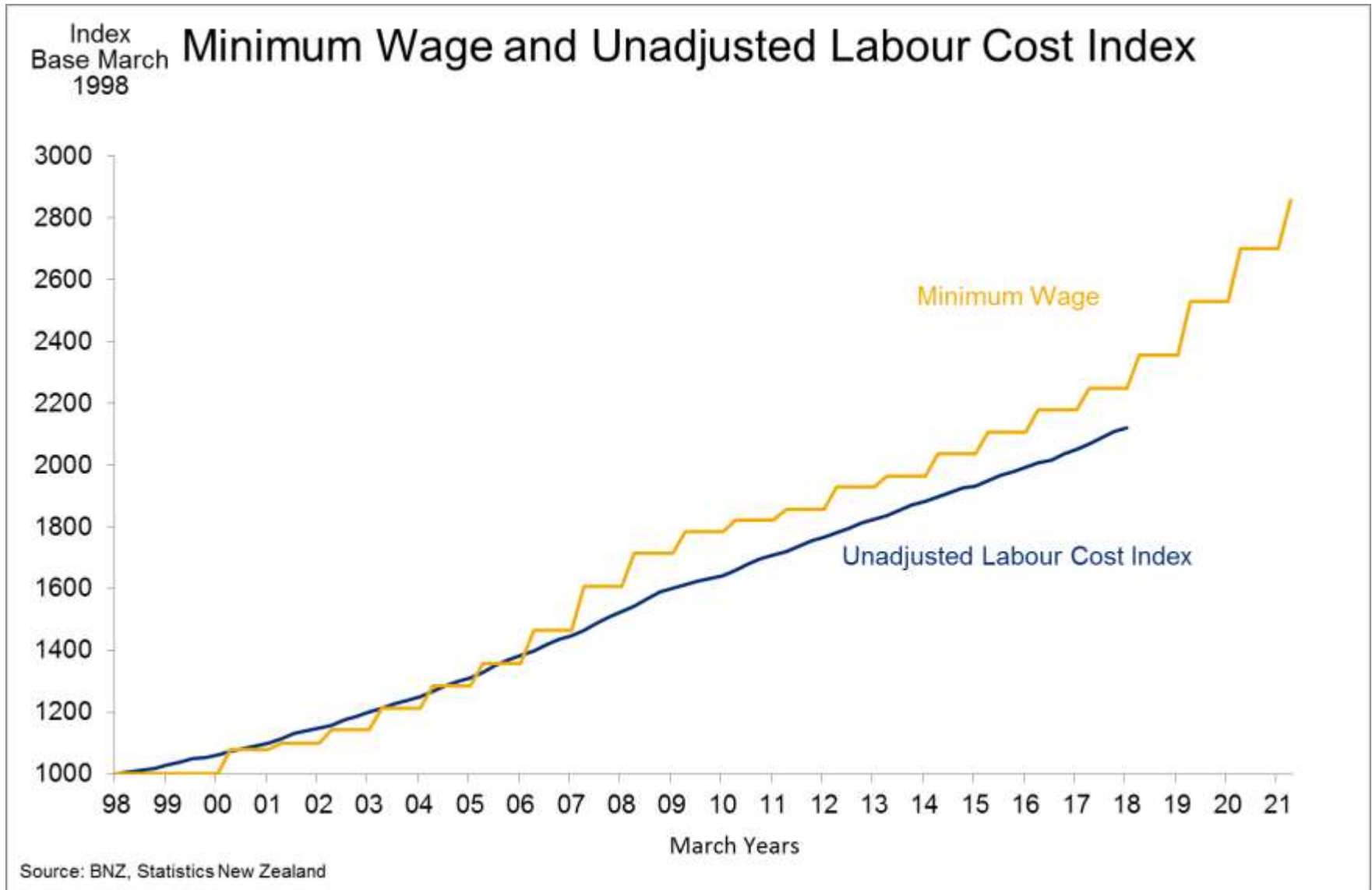
Capacity Issues Prevalent



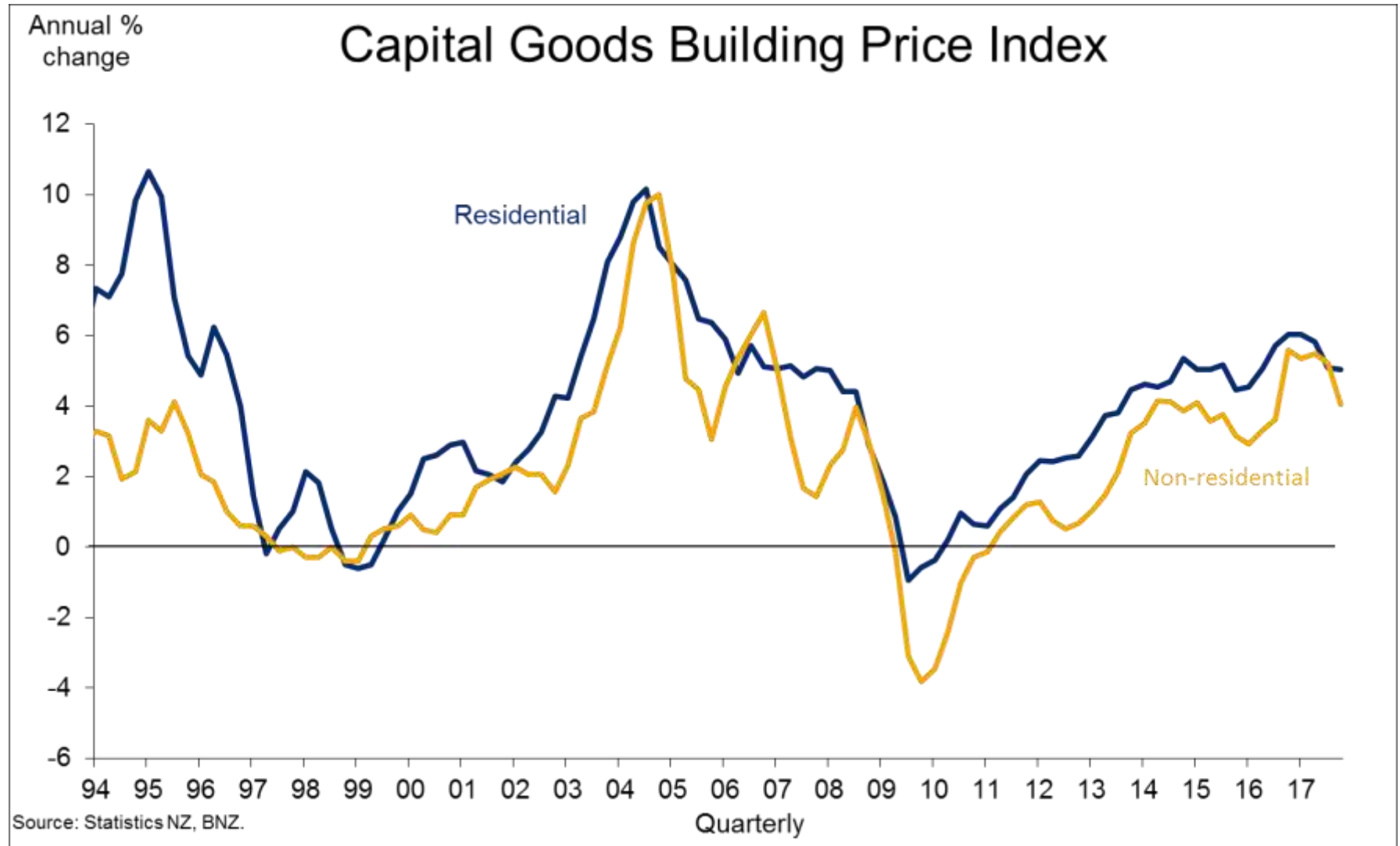
Unemployment Falls Further



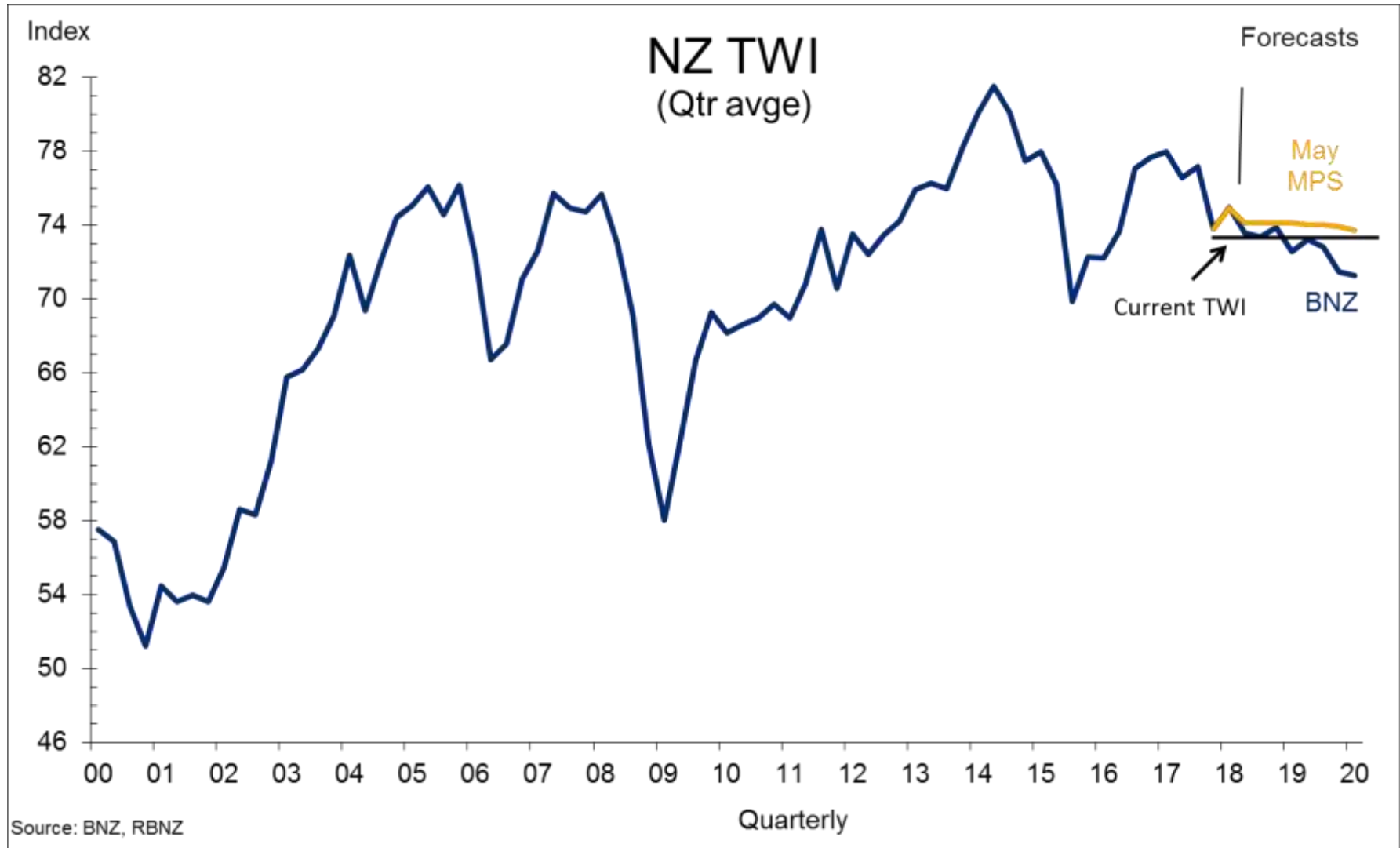
Minimum Wage Will Have An Impact



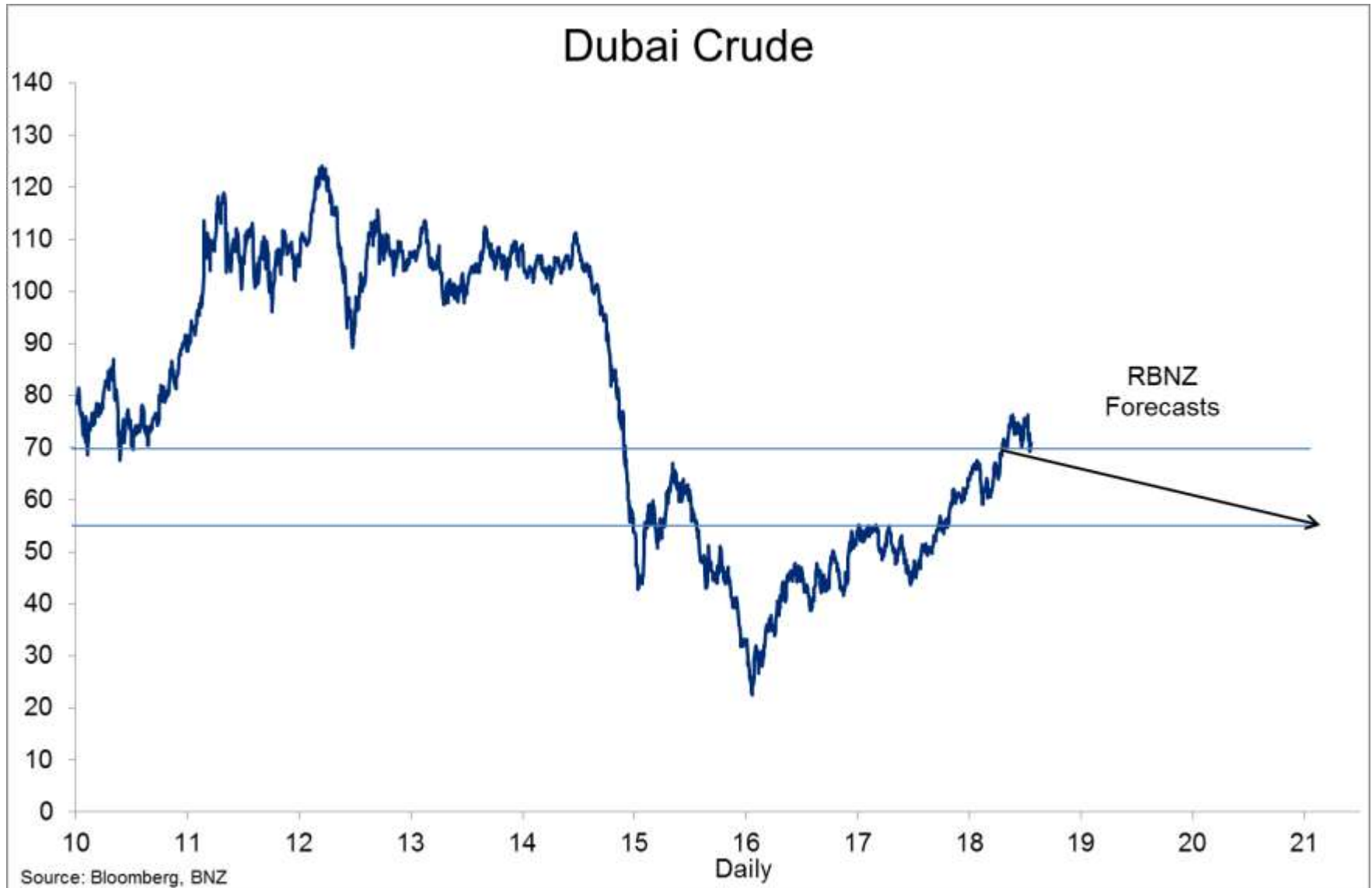
Construction Inflation Elevated



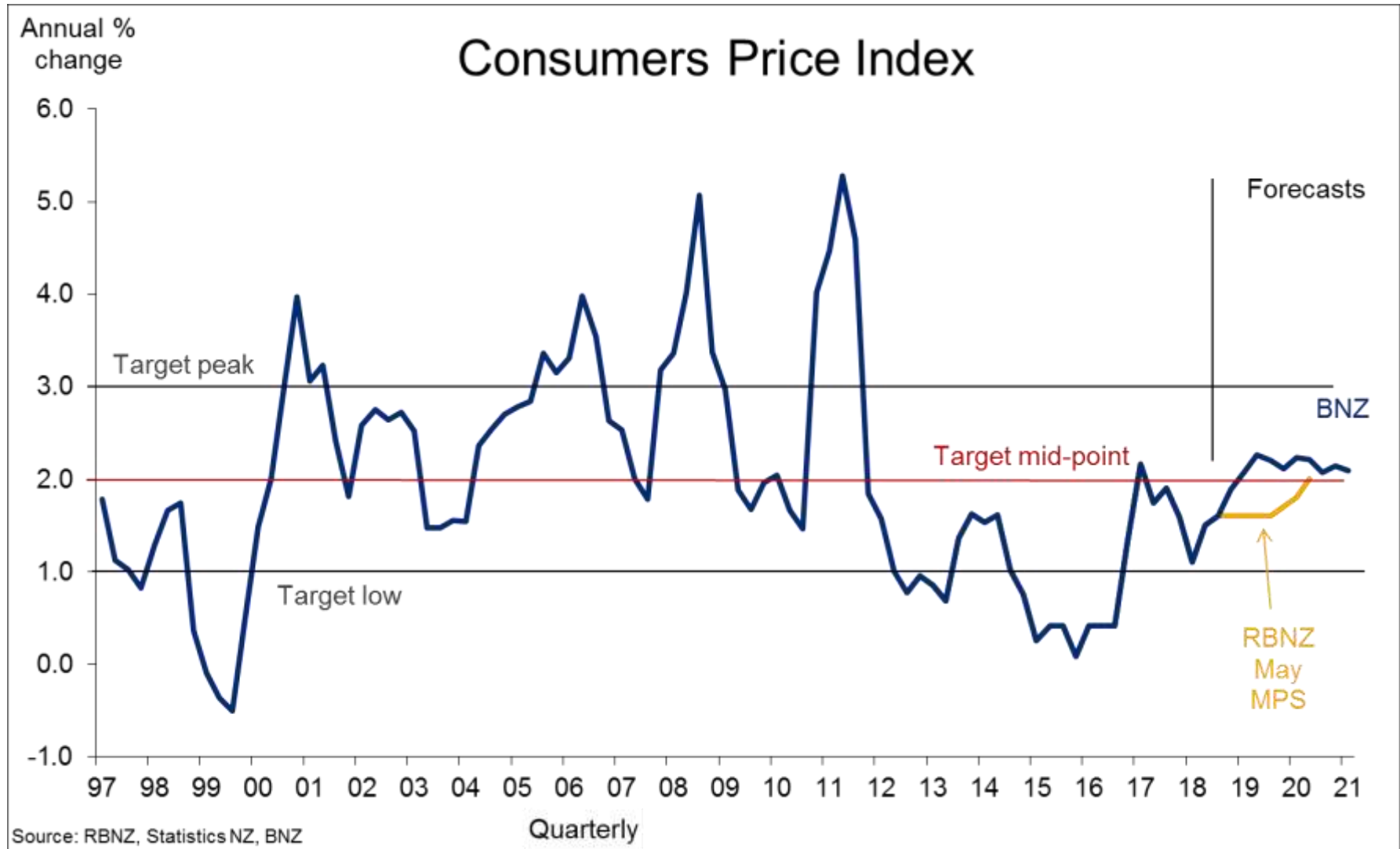
And We're Assuming A Lower TWI



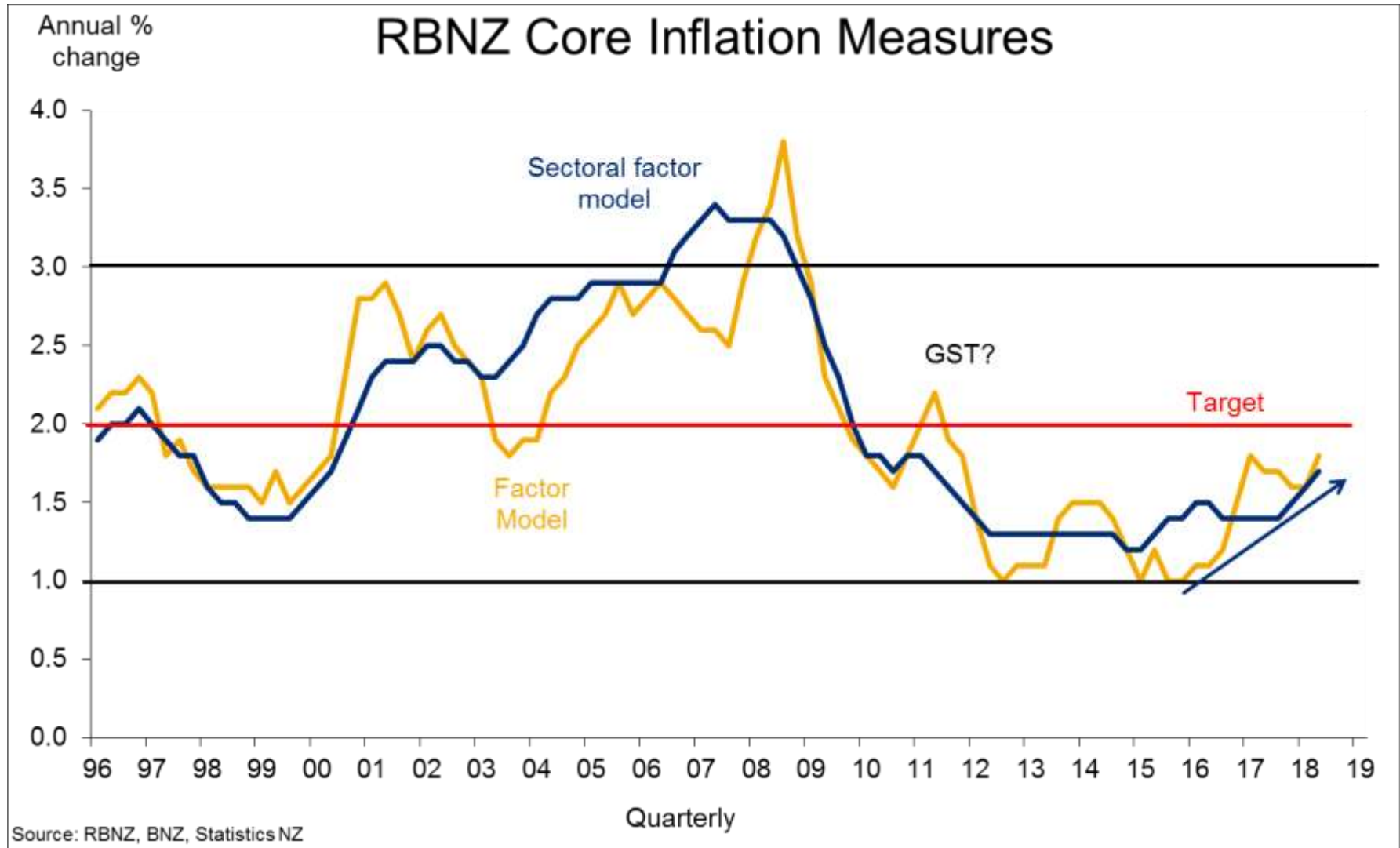
And Higher Oil Prices



So Inflation Higher Sooner



Importantly, Core Trending Upward



Interest Rates

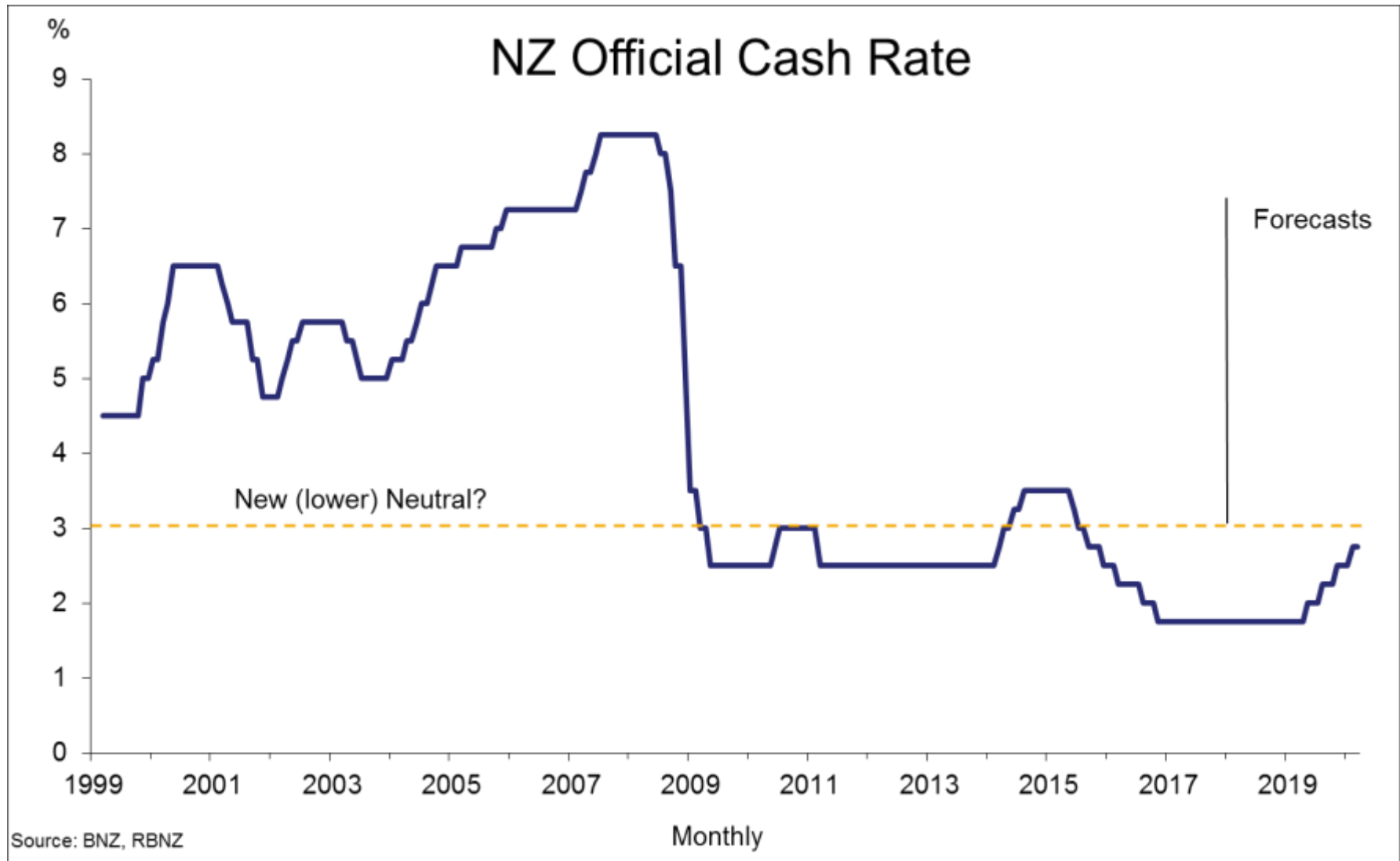
Changes At The RBNZ

- A new Governor (Adrian Orr)
 - Pragmatist, Pro-growth, Good communicator
- New PTA
 - Will not impact policy significantly

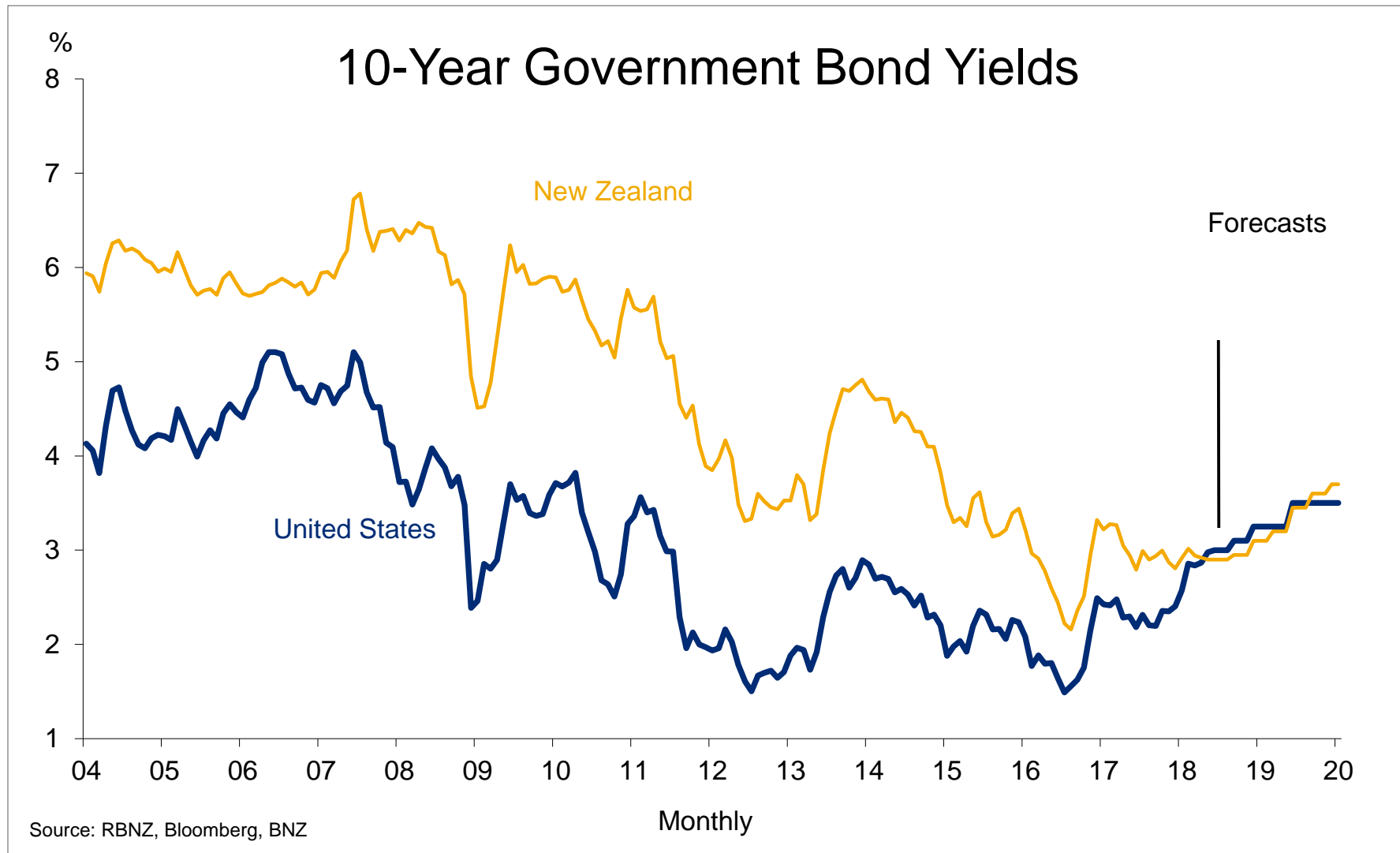
“Monetary policy will contribute to supporting maximum sustainable employment with the economy”

- A Committee
 - 5-7
 - RBNZ dominates
 - Treasury observer

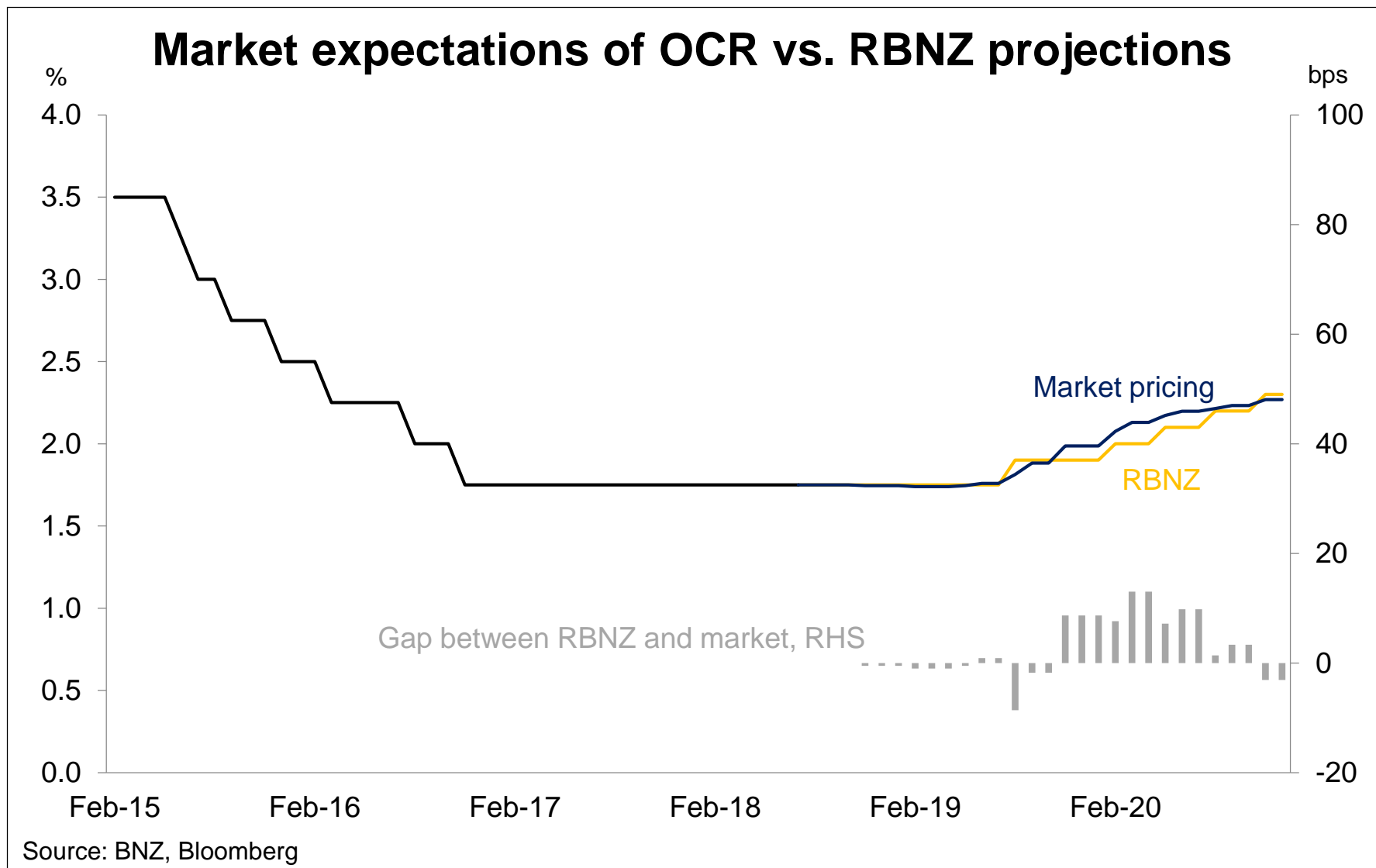
Rates Lower For Longer



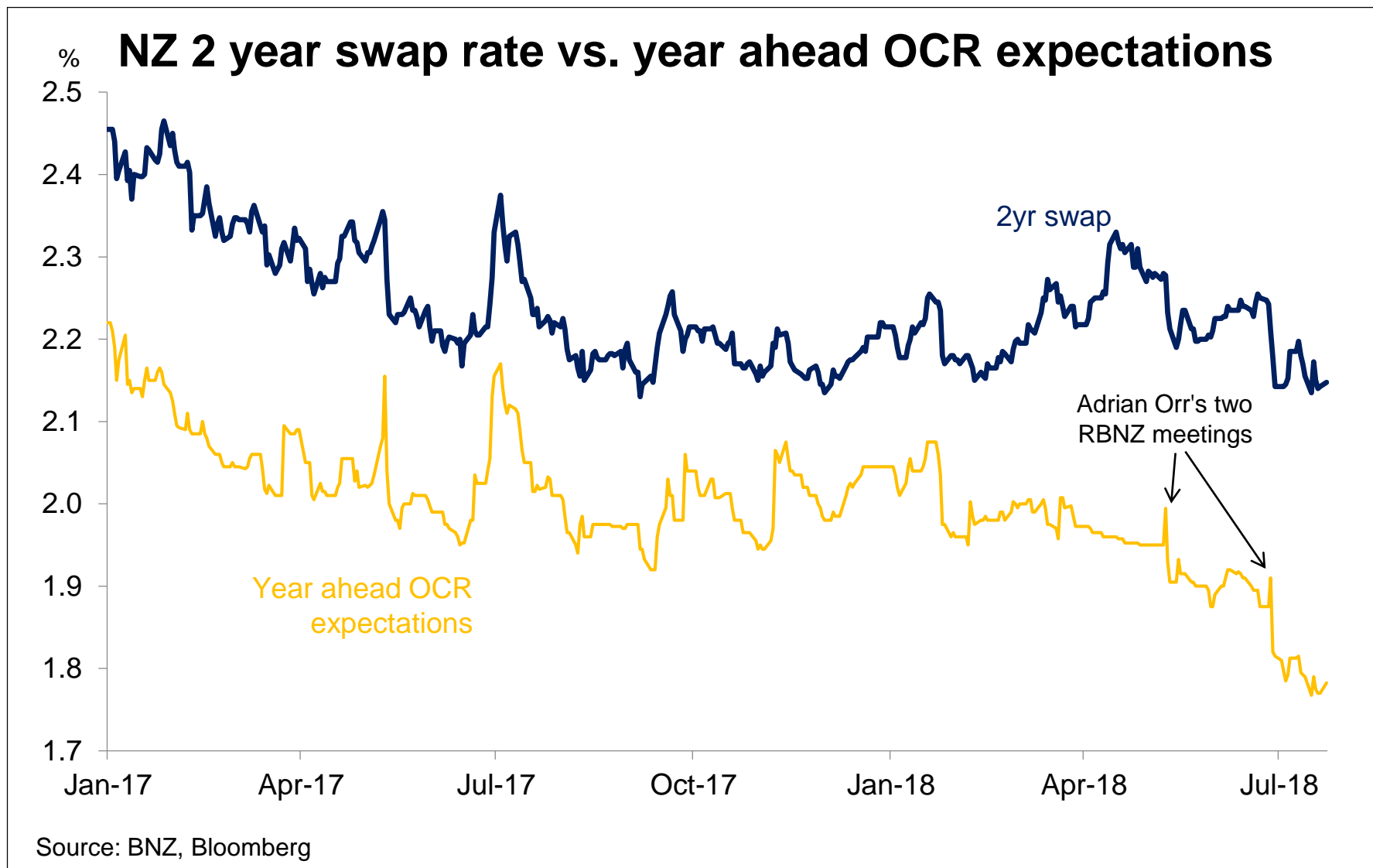
The Long Headed Higher Too



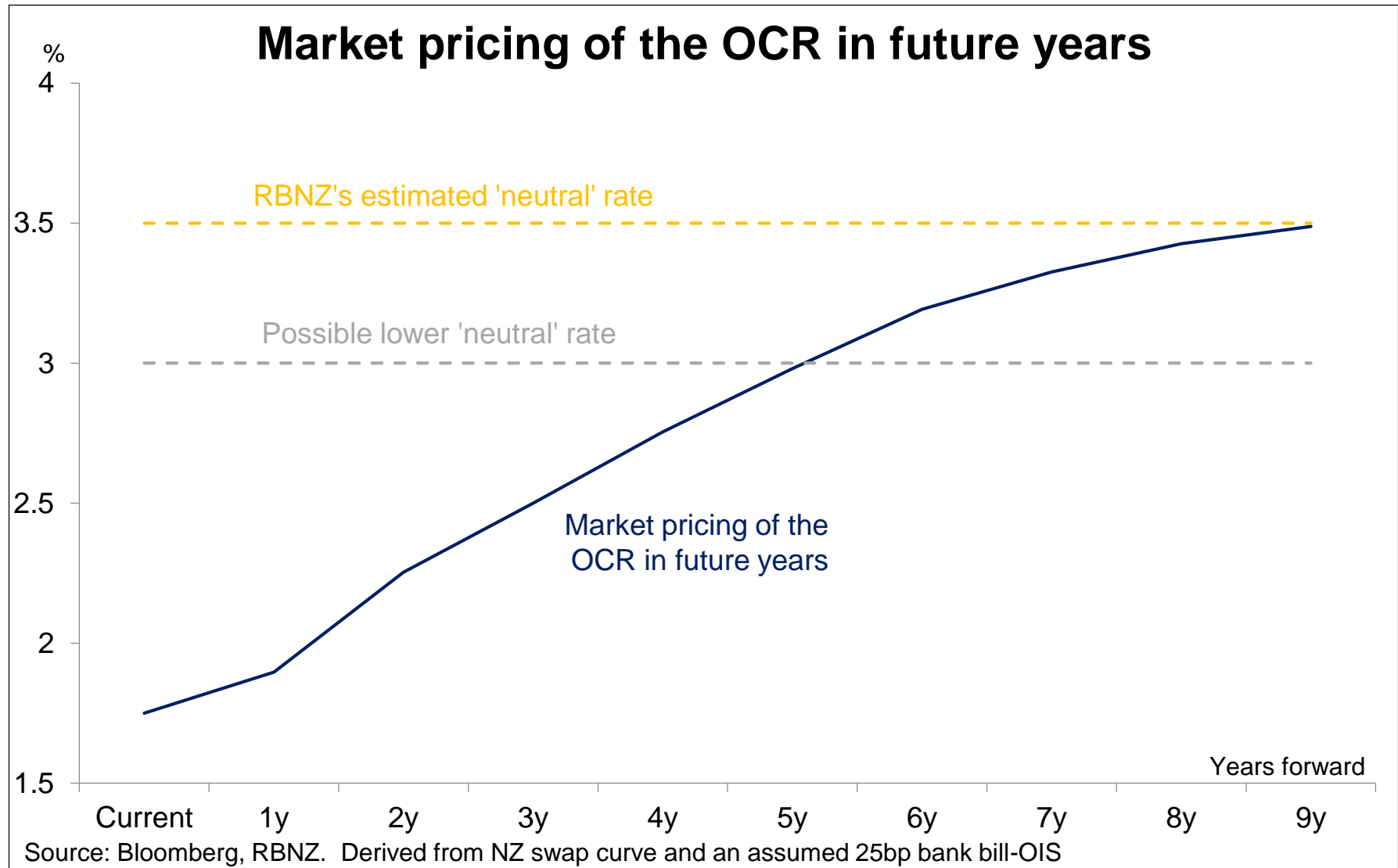
The market fully prices the first hike for Nov-19



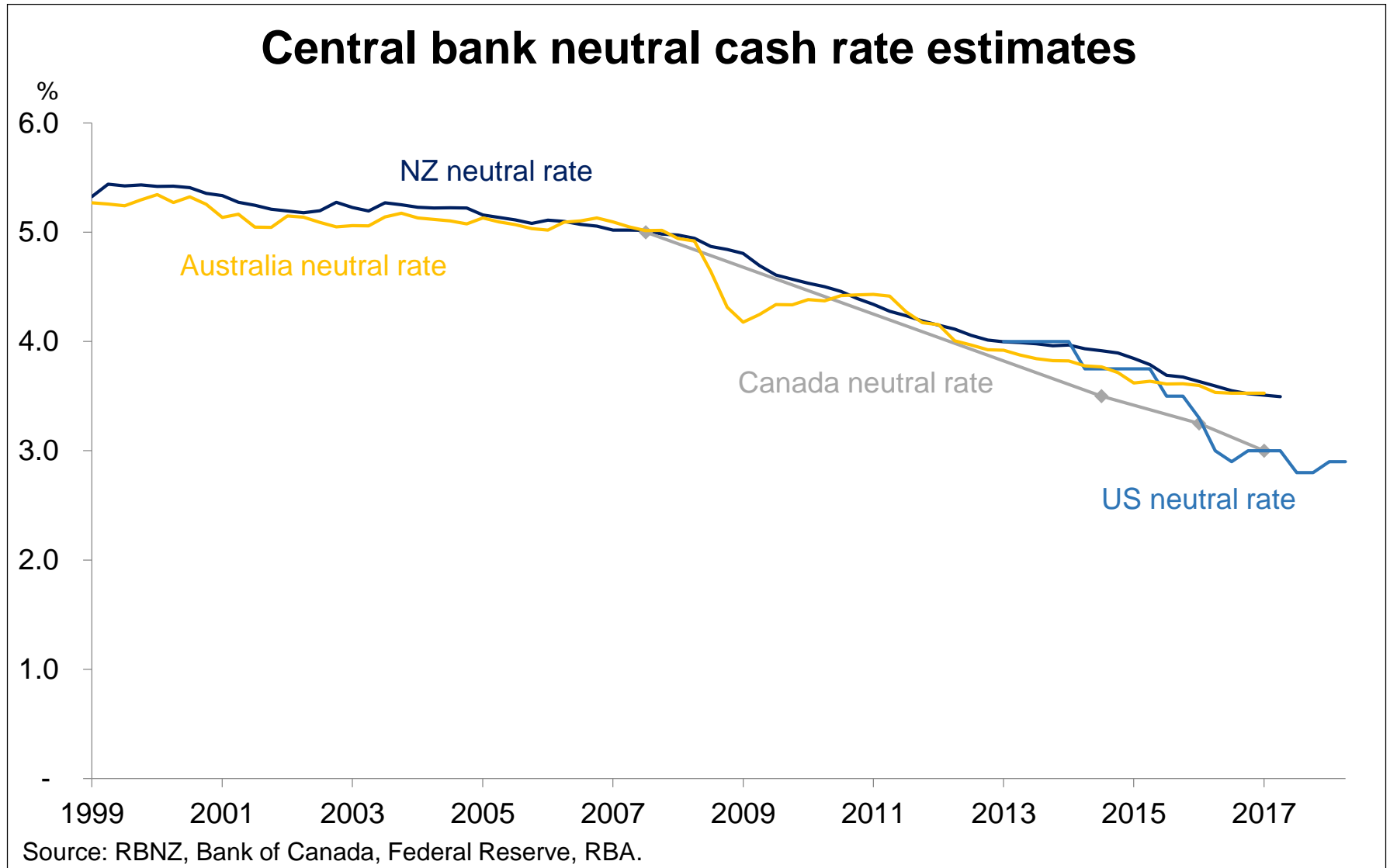
Short-end rates should be anchored for now



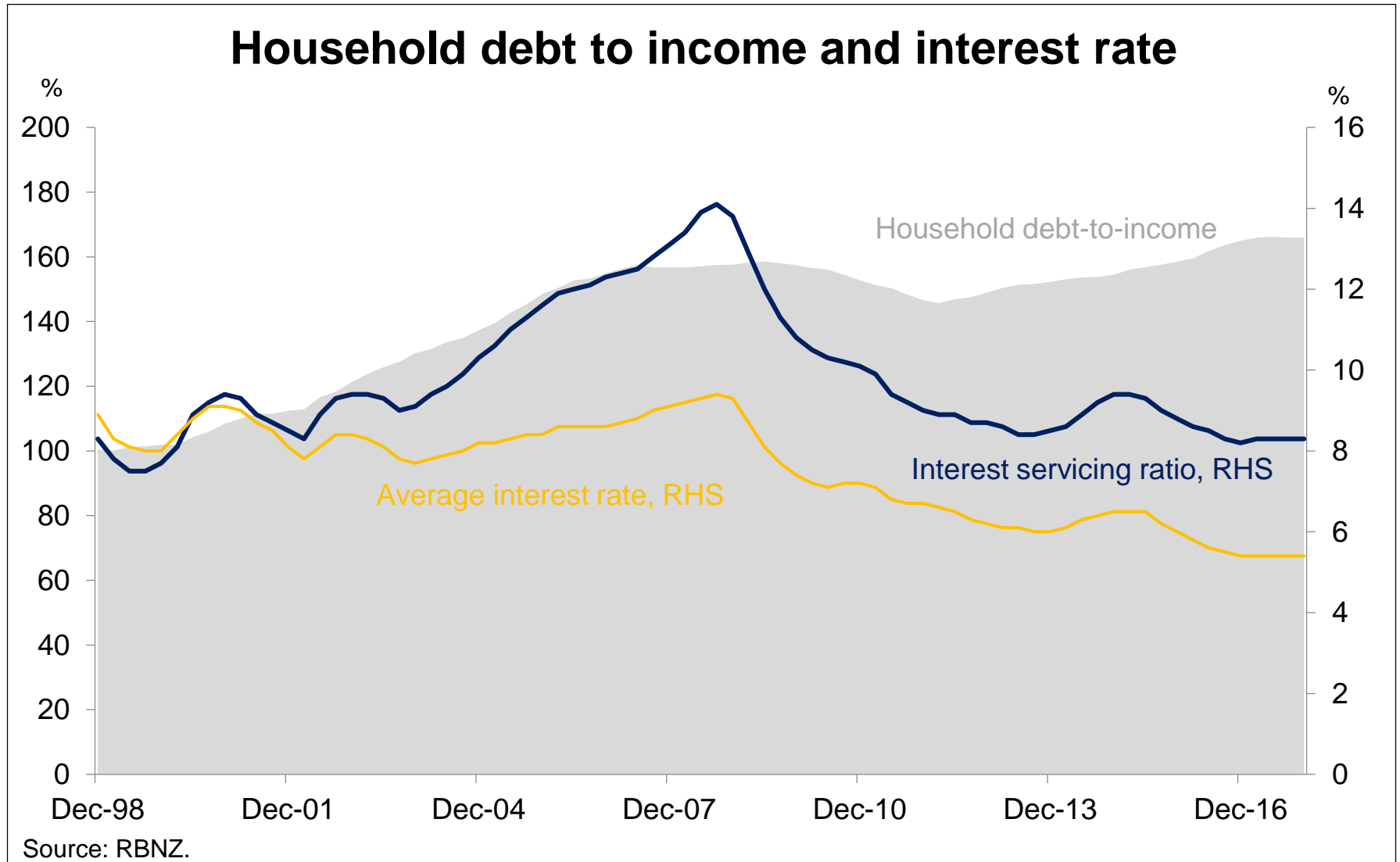
What is the market pricing for the OCR longer-term?



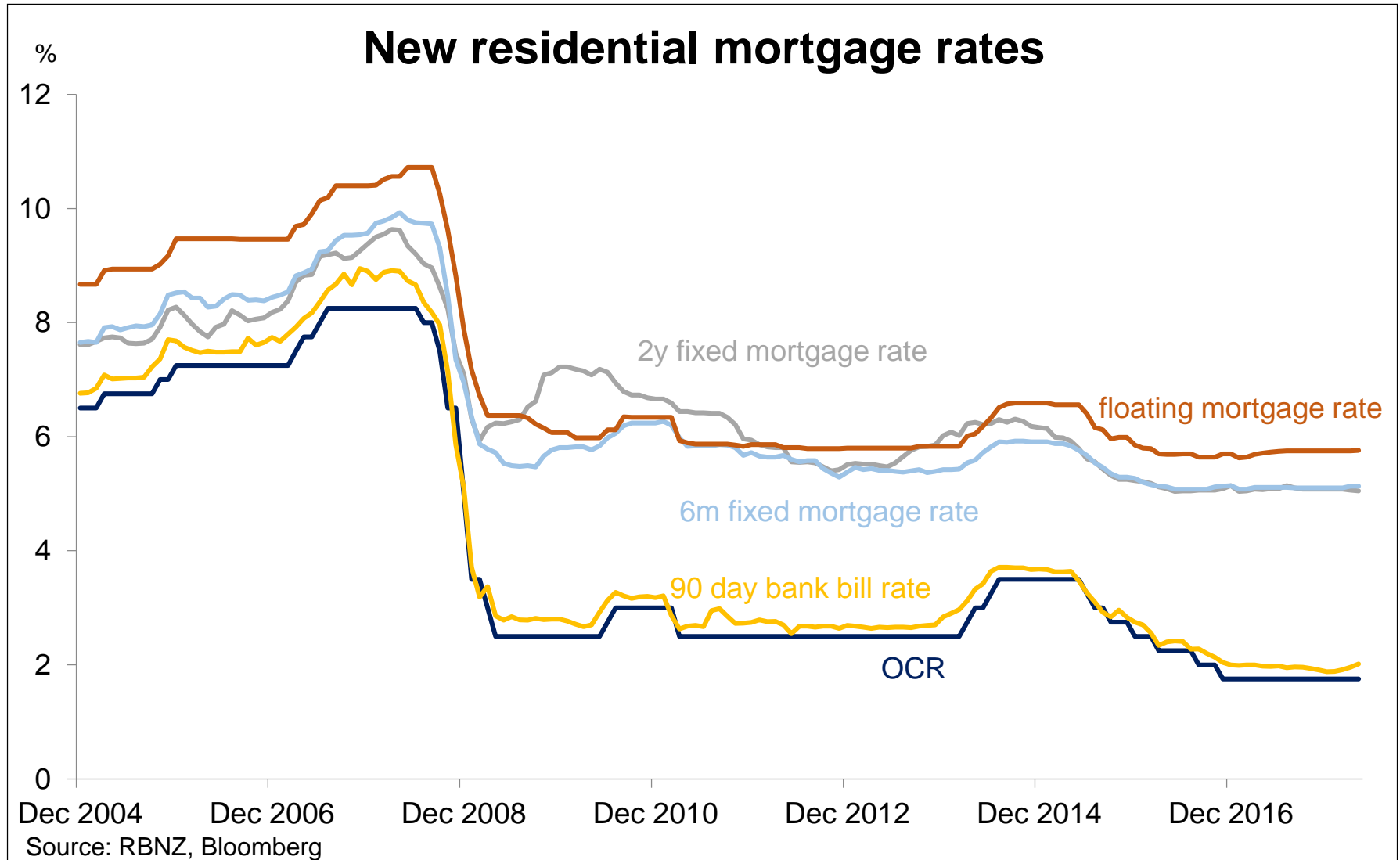
Downward trend in neutral rate estimates



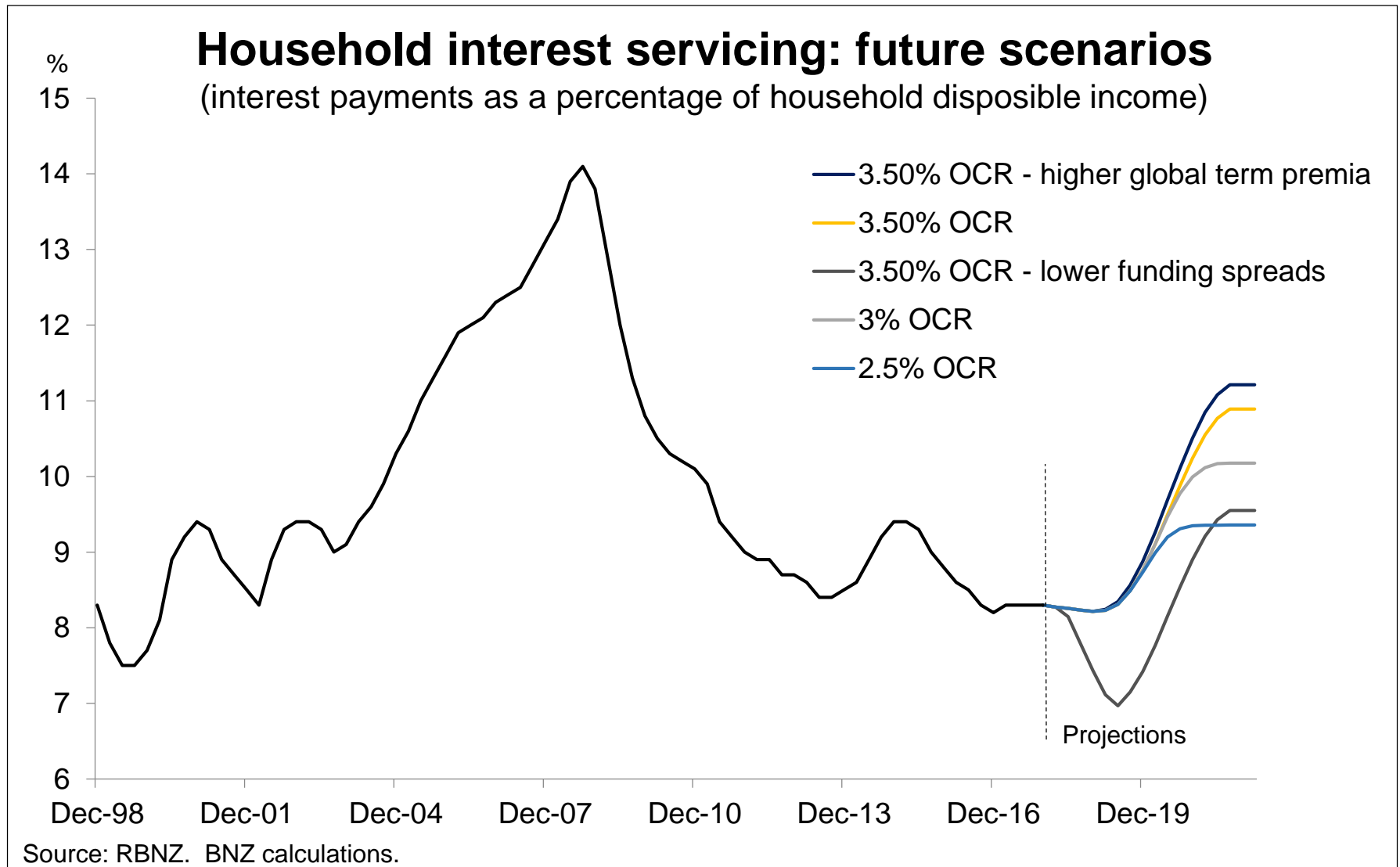
Higher debt = greater interest rate sensitivity



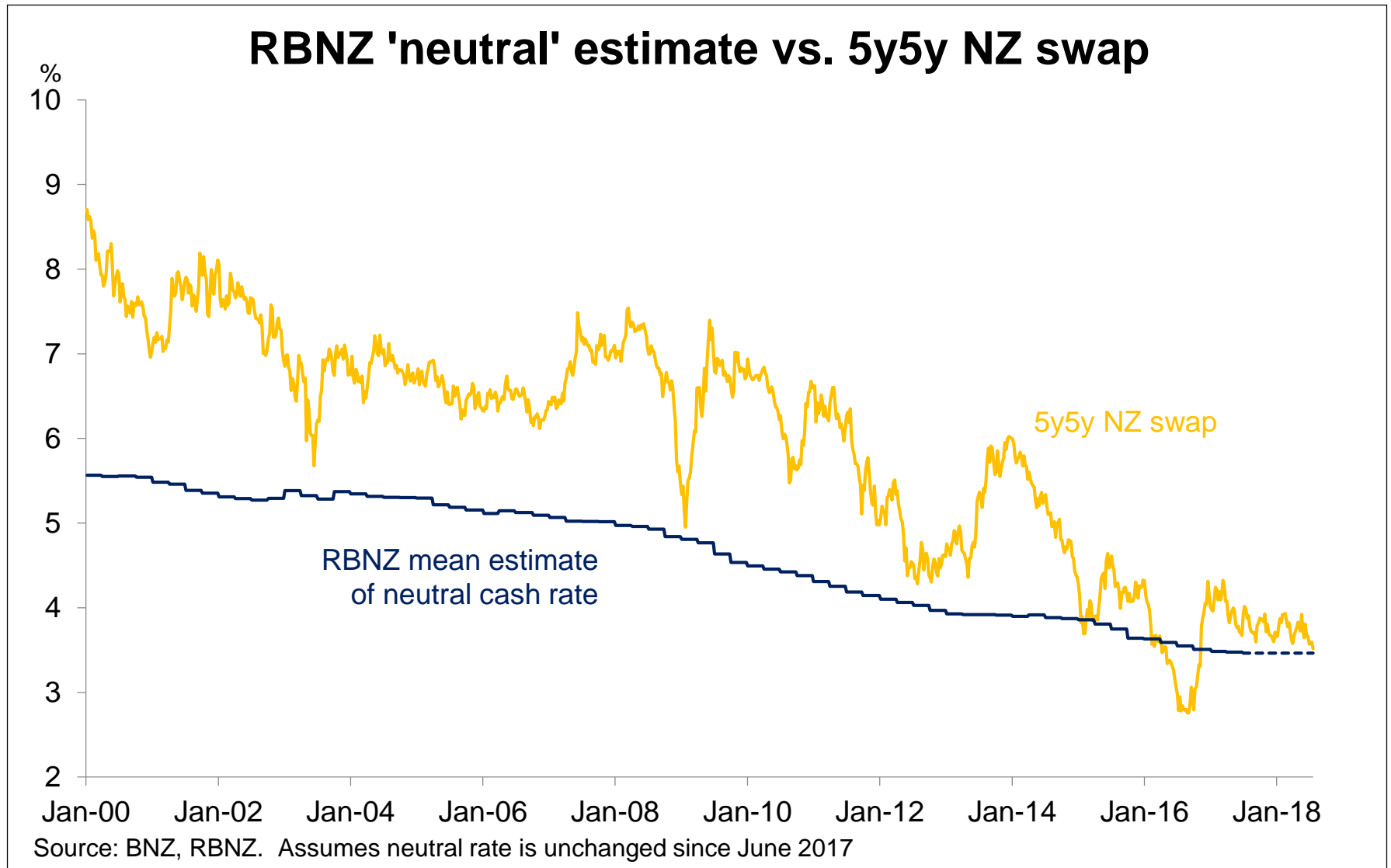
Mortgage spreads are elevated



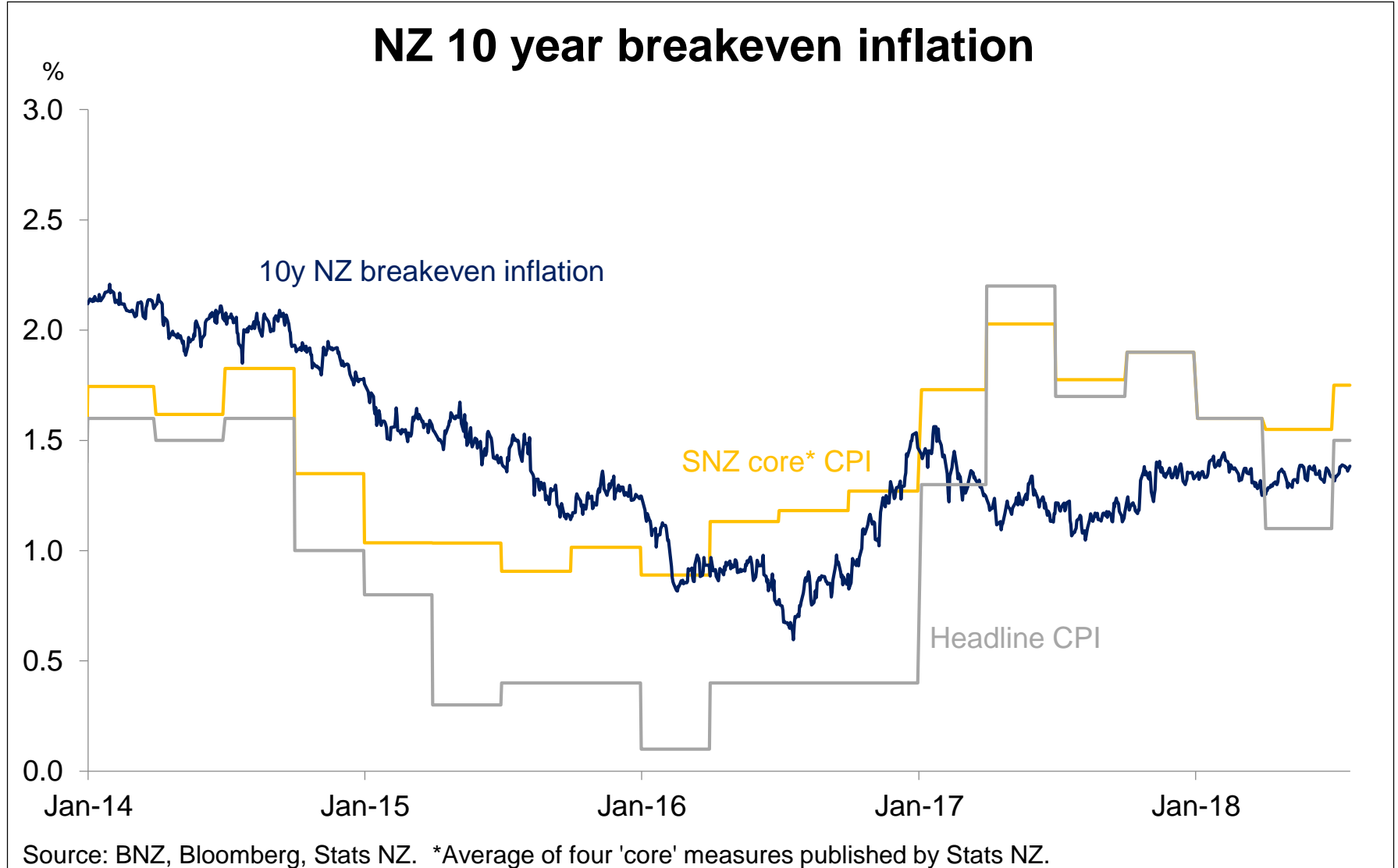
Putting it together: downside risks to neutral rate



There may be some 'risk premium' in LT rates

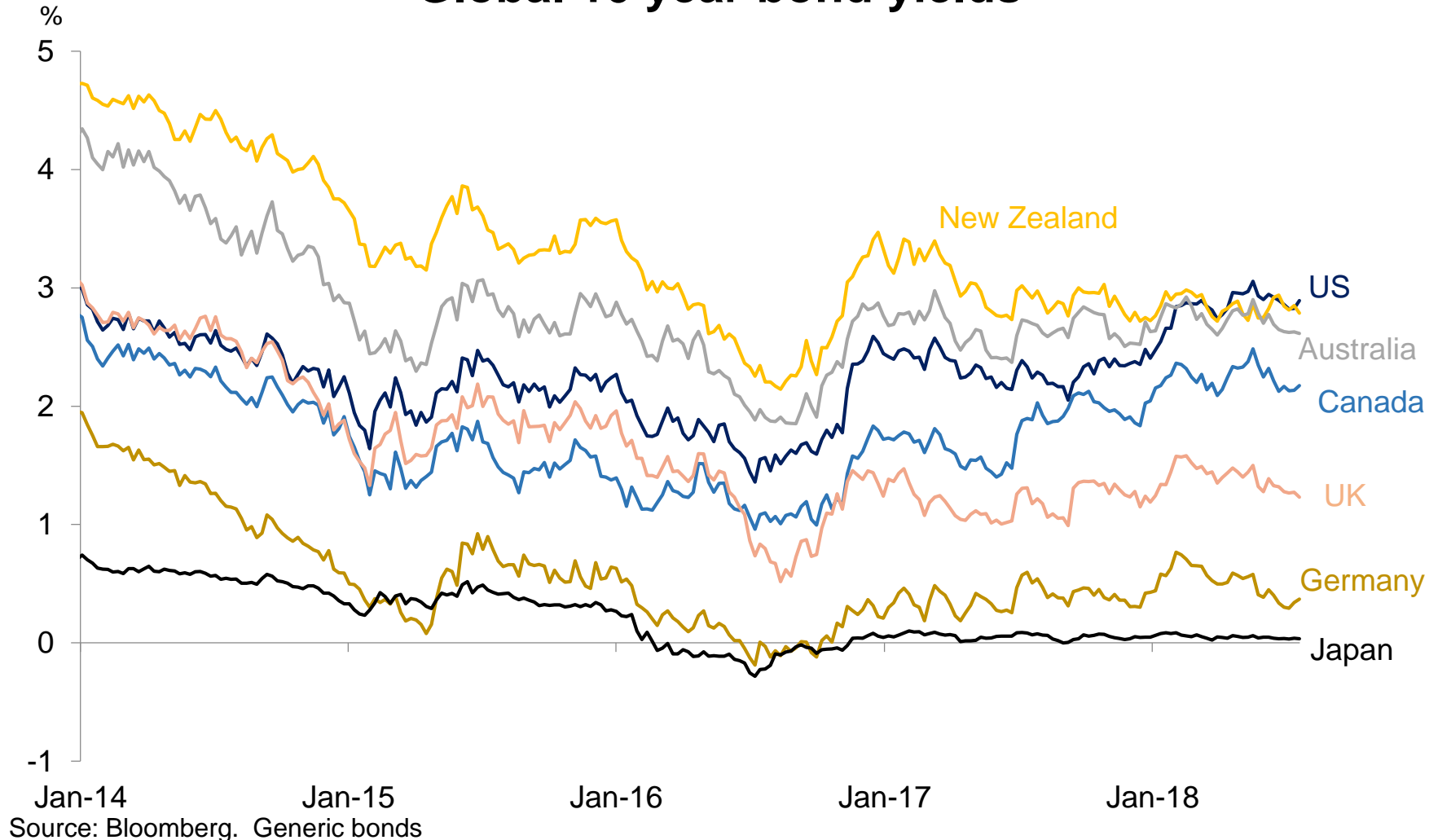


Scope for higher inflation expectations

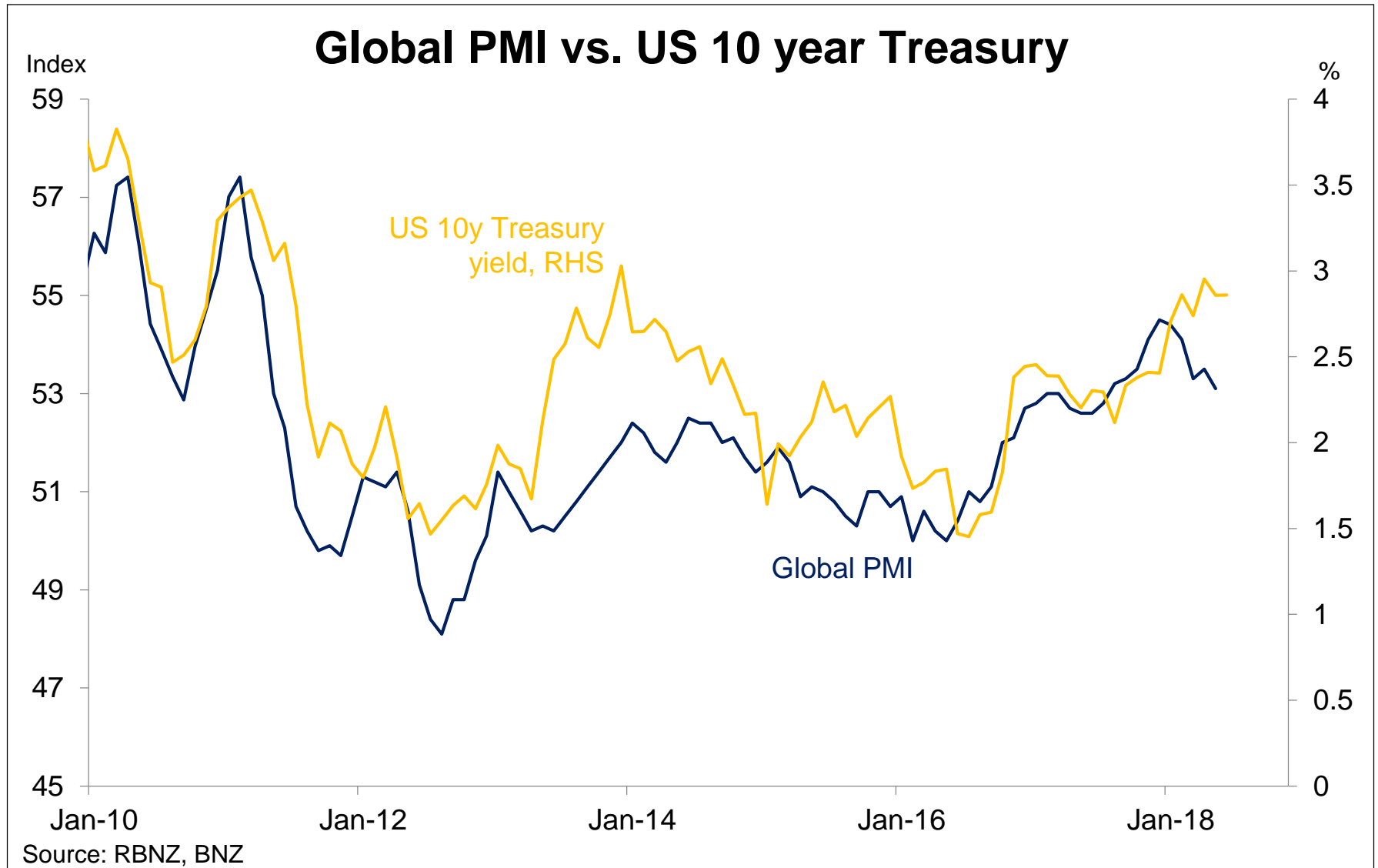


Offshore rates the other influence on the long-end

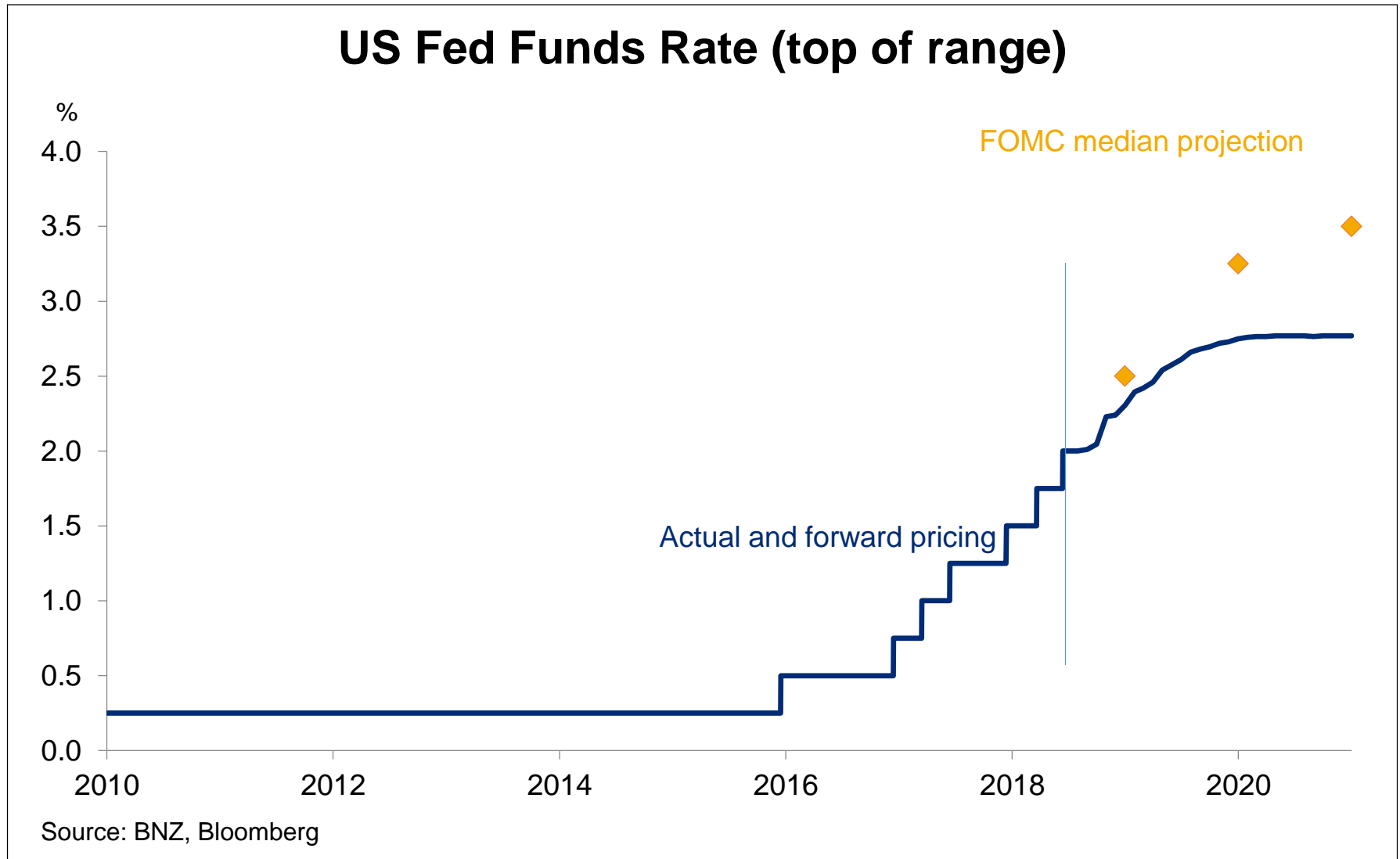
Global 10 year bond yields



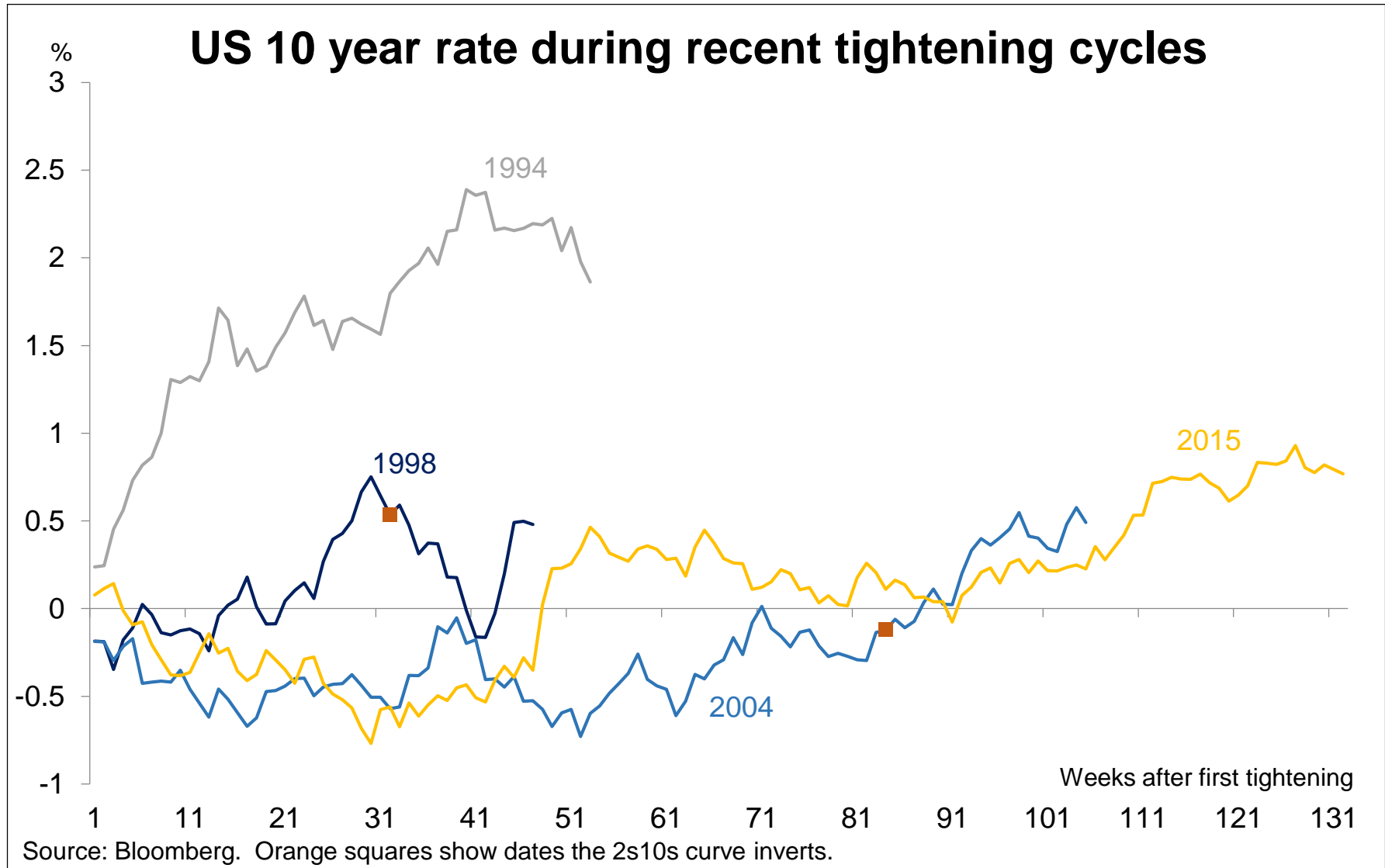
Growth still strong but momentum slowing



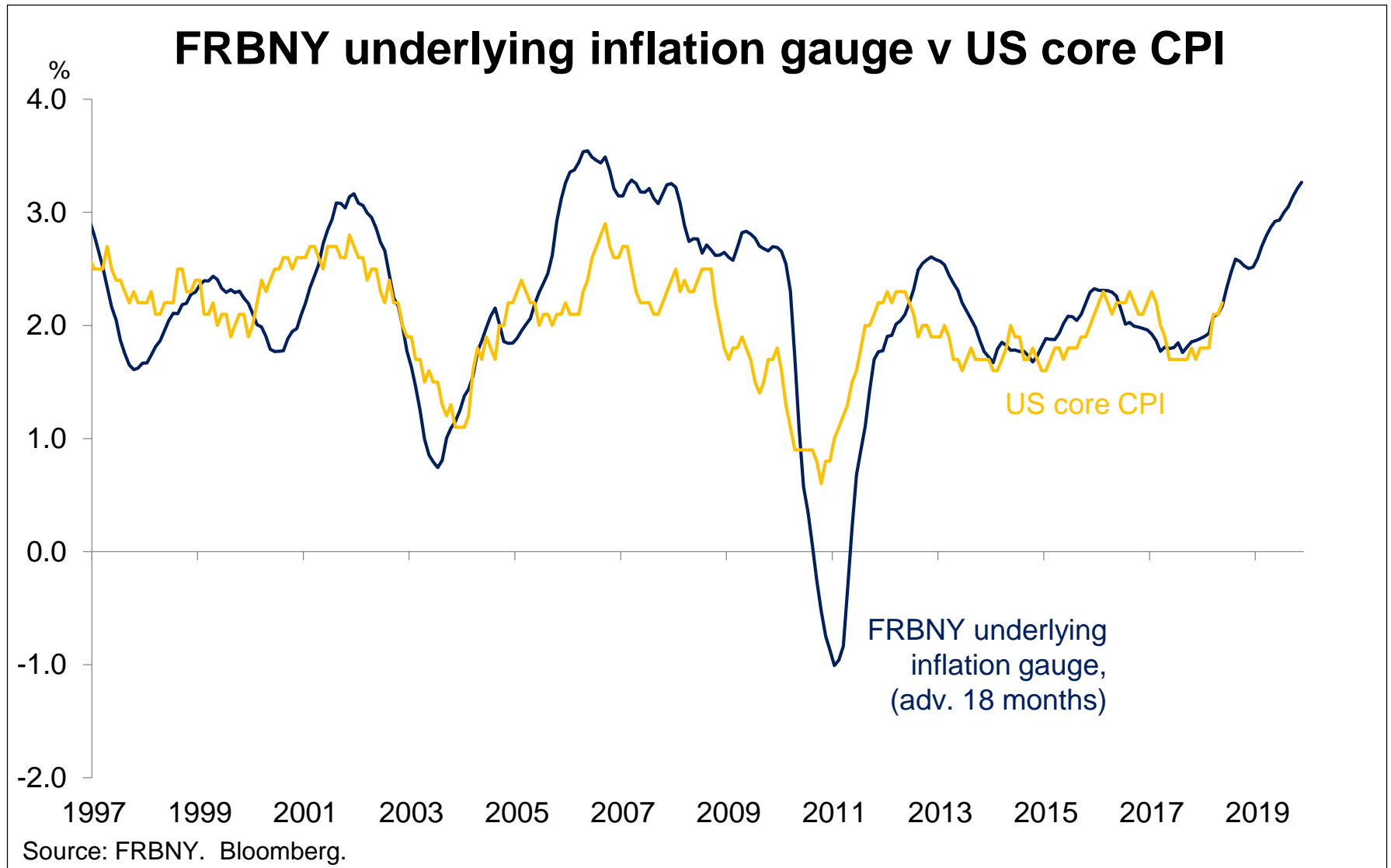
Market prices the Fed funds rate to get to 2.75%



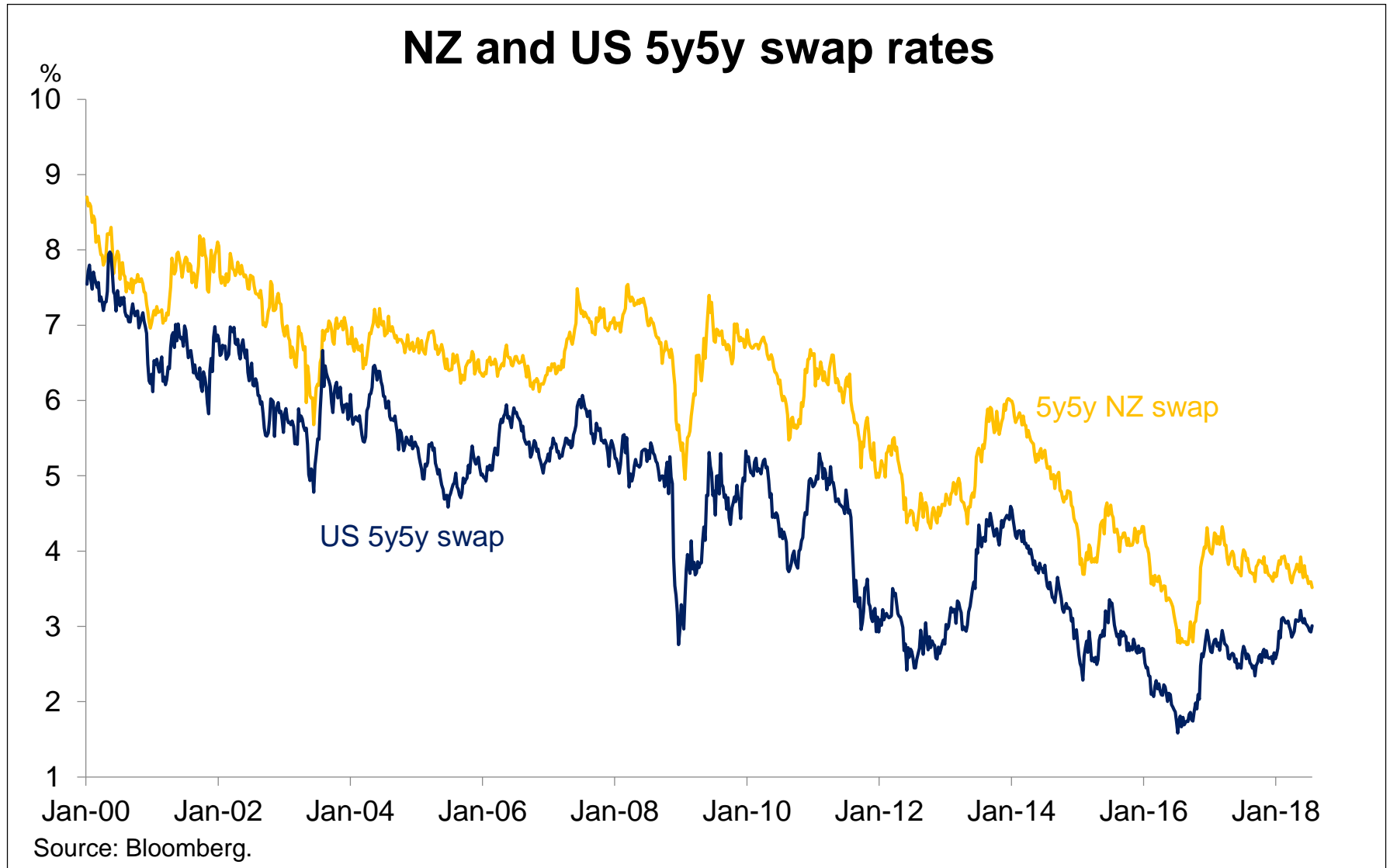
Market has underestimated Fed hikes in the past



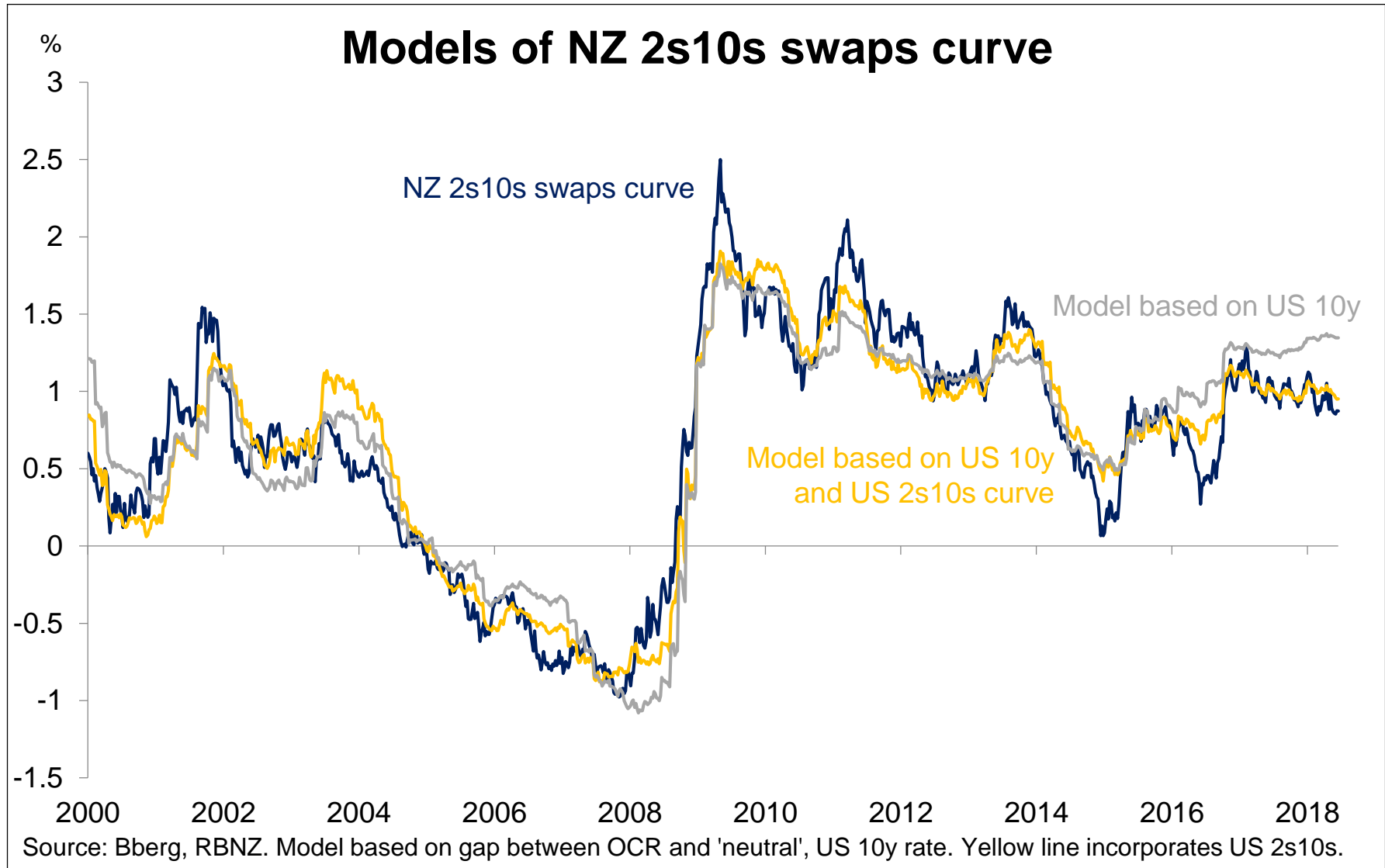
US inflation risks to the upside



Long-term NZ and US rate expectations correlated



NZ swaps curve depends on US 10y and US curve

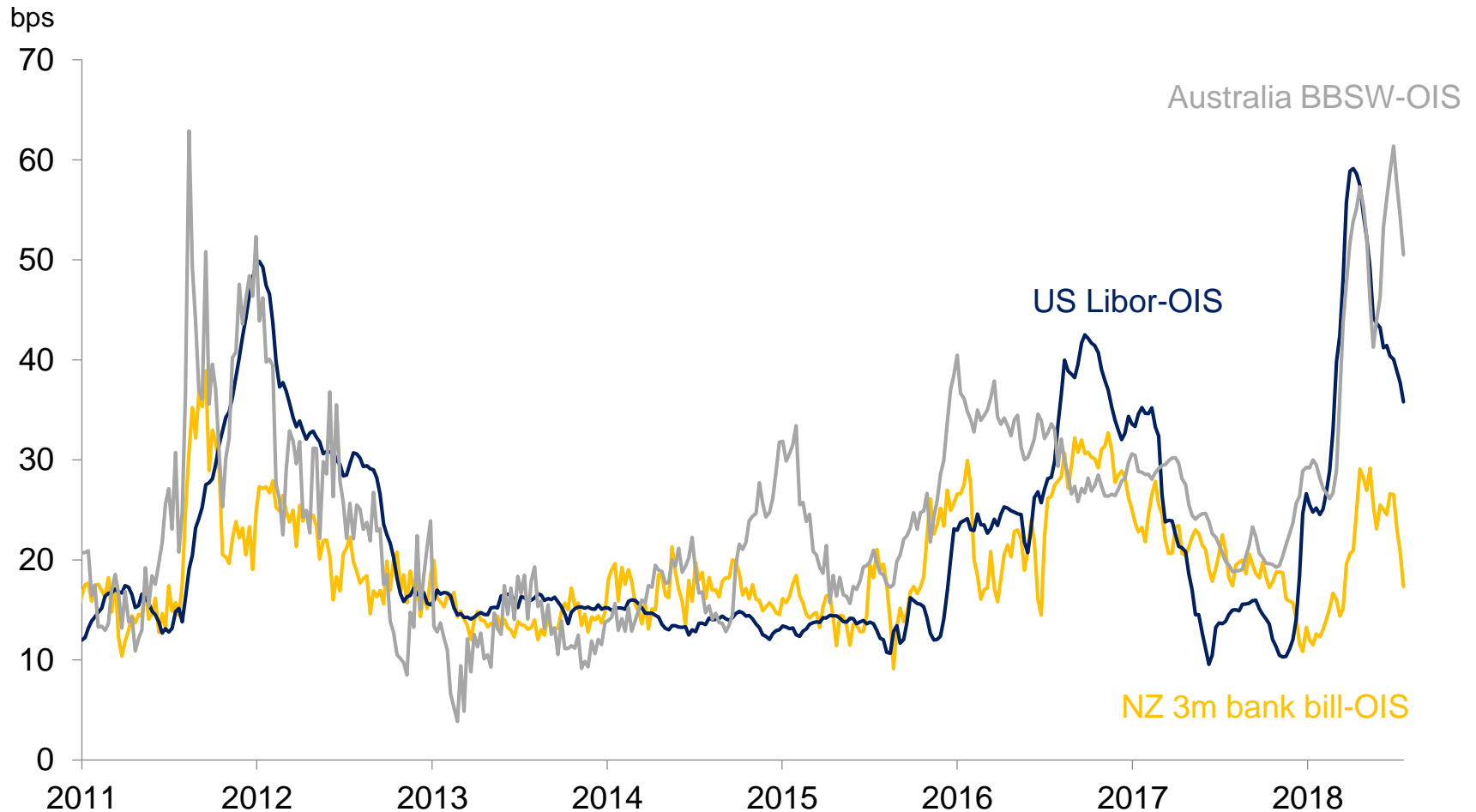


Summary

- Short-end of the NZ curve likely anchored this year
 - Although the market prices a very gradual RBNZ rate profile
- Expect long-end of NZ curve to be range-bound for most of this year
 - US yields likely range-bound until there is more clarity on Fed policy in 2019
 - OCR expectations will probably be muted
- Medium-term upside risks to NZ long-end rates
 - Global rates risks
 - Possibly higher NZ inflation risk premia at some point
 - OCR cycle

Funding spreads are a source of uncertainty

Libor-OIS, BBSW-OIS and BKBM-OIS



Source: Bloomberg. Weekly averages.

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