



# Weekly Commentary

9 October 2017



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## More of the same

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The latest *Quarterly Survey of Business Opinion* indicates that election uncertainty may have weighed on sentiment about the broader environment, but firms remain content about their own prospects. The survey suggests that the New Zealand economy is on track to continue to grow at a modest pace, but that the June quarter is likely to have marked the peak for growth this year.

General business sentiment fell from a net 17% positive to a net 7% in the September survey. The survey was conducted over the September month, so as we've seen with other measures such as our consumer and regional confidence surveys, uncertainty about the outcome of the 23 September general election may have weighed on respondents' minds.

In contrast, firms showed fewer concerns about their own performance. A net 13% of firms reported improved conditions over the last quarter, compared to a net 17% in June. Meanwhile, expectations for the quarter ahead picked up a little compared to the last survey, and have been fairly consistent over the past year.

The detailed survey questions painted a similarly positive picture. Reported hiring over the last quarter rose to an equal-record high, and intentions for the next quarter were also strong. Investment intentions were steady for plant and equipment, and up sharply for buildings. Profits were reported as broadly flat over the last quarter, but were expected to pick up.

There was some variation in fortunes across sectors. Retailers and manufacturers were generally more positive over the quarter, while the building and services sectors saw a drop in confidence. Notably, 41% of firms in the building sector reported that labour is their biggest constraint on growth, compared to 32% who cited lack of demand.

In recent times we've discussed the slowdown in construction activity, including the extent to which it has been the result of tighter finance conditions affecting demand, supply-side constraints such as skill shortages, or other factors. The results of this survey suggest that – in the commercial property space at least – demand remains strong, and capacity constraints seem to be the greater factor.

The QSBO also provides an array of information about capacity constraints and price pressures. The indicators from the September quarter survey were mixed. On the stronger side, the difficulty of finding workers rose to its highest level since 2007. Capacity utilisation fell slightly for a second quarter, but it remains at one of the highest levels on record.

However, these apparent capacity pressures haven't translated to a similar lift in the rate of inflation. More firms are reporting cost increases, but this share has remained relatively low in the years since the Global Financial Crisis. Despite the capacity constraints that were evident elsewhere in this survey, fewer builders reported a rise in costs and prices this quarter.

Similarly, the share of firms reporting that they had raised their prices or intended to do so was unchanged in the September quarter. At their current levels, these measures are consistent with inflation near the Reserve Bank's target midpoint of 2%, but they don't suggest a risk of inflation breaking to the upside in the near term.

# More of the same continued

Consumer prices for the September quarter will be published later this month. We're putting the final touches on our forecast, which currently stands at a 0.5% increase for the quarter. This would see the annual inflation rate lift from 1.7% to 1.9%. Our forecast is quite a bit higher than the Reserve Bank's pick of 0.2% for the quarter (1.6% annual). However, most of the difference is in the tradables component – including volatile factors such as food and fuel prices, which the Reserve Bank has more scope to look through.

In general, the high-level indicators of economic activity, such as the QSBO and our quarterly confidence surveys, have been only a touch softer for the September quarter compared to June. That's consistent with our view that the economy will continue to grow at a modest pace over the rest of this year, but that the 0.8% rise in June quarter GDP is likely to mark the high point for growth this year. The June quarter benefited from a range of temporary factors that won't be repeated in the September quarter figures: a boost to tourism spending from two major sporting events, and a rebound from earlier disruptions in dairy production and rail transport.

In fact, dairy output is shaping up to be a drag on near-term GDP growth again. Wet weather has hampered pasture growth in the early part of this season, and milk collections to date are down on the previous season (which were already subdued, given the pressures generated by low milk prices at the time). Fonterra's forecast of a 3% rise in milk collections for the season now looks like more of a stretch than it did at the start of the season.

All else equal, lower than expected volumes from New Zealand are often offset by higher world prices for dairy products – an idea that seemed to pervade the market ahead of last week's GlobalDairyTrade auction. The surprise 2.4% fall in auction prices served as a reminder that supply is only one side of the story, and that the strength of global demand shouldn't be taken for granted.

We have maintained our forecast of the farmgate milk price for this season at \$6.50/kg, compared to Fonterra's forecast of \$6.75/kg (with other forecasters sitting somewhere around that level). That said, the level of production and hence prices remains very sensitive to the weather over the next few months, as dairying enters its peak production period.

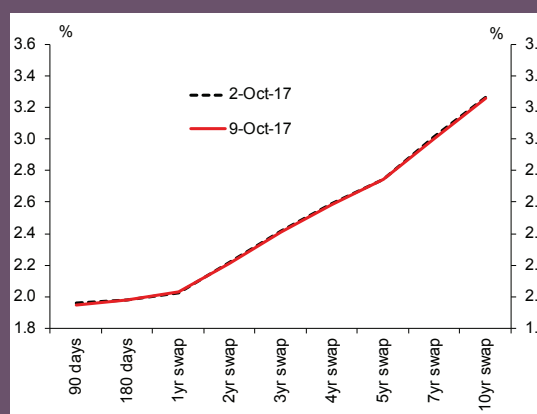
For the week ahead, the economic highlights will include updates on the housing market and consumer spending during September – and most importantly, a potential resolution about the shape of the next Government, now that the final seat allocations have been announced. NZ First leader Winston Peters has given a self-imposed deadline of 12 October for making a decision about who to align with.

## Fixed vs Floating for mortgages

For borrowers with a deposit of 20% or more, the best value lies in the two-year rate or shorter terms. Three-to-five-year rates seem high relative to where we think short-term rates are going to go over that time. Some lending and deposit rates have been falling recently, so it may be worth waiting to see if there are further modest reductions in fixed-term rates.

Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates such as the six-month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

NZ interest rates



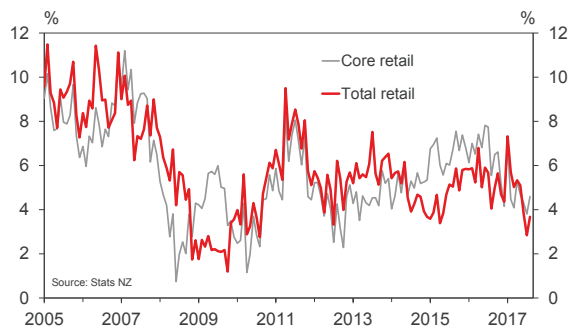
# The week ahead

## NZ Sep retail card spending

Oct 10, Last: -0.2%, Westpac f/c: 0.5%, Mkt: 0.5%

- Retail spending was softer than expected in August, with spending levels down 0.2%. That followed a fall of 0.6% in July.
- Spending levels have been broadly flat for several months now. In part, this is because of the softness in prices, particularly for imported consumer goods. However, it's likely that the softening in the housing market is also dampening household spending, particularly for items such as household furnishings.
- Increases in fuel prices should push retail spending higher in September. However, with lingering softness in the housing market, and an easing in tourist arrivals following their surge earlier in the year, the underlying pace of spending looks set to remain modest.

## Card transactions, annual % change



## NZ Sep house prices and sales

Oct 9-13 (tbc), Sales last: +0.6%, Prices last: 0.5%/yr

- New Zealand's housing market has slowed substantially over the last year. House sales are down by a quarter, and sale prices have flattened out. Prices have fallen slightly in Auckland and Christchurch, while the rate of increase in the rest of the country has slowed.
- There was a tentative stabilisation in August, with sales and prices ticking up slightly. A sharp slowdown in the rate of new listings – property owners don't sell into a weak market if they don't have to – has helped to rebalance the market.
- Nevertheless, we think this improvement could be short-lived, as higher mortgage rates and lending restrictions remain the dominant factors. And to the extent that election uncertainty has been a factor recently, it will surely have weighed on the market again in September.

## REINZ house prices and sales

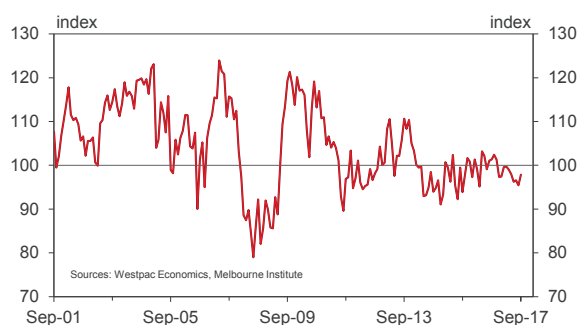


## Aus Oct Westpac-MI Consumer Sentiment

Oct 11 Last: 97.9

- The Westpac-Melbourne Institute Consumer Sentiment Index rose 2.5% to 97.9 in September from 95.5 in August. Despite the lift, pessimists continue to outnumber optimists with pressures on family finances, concerns around interest rates, deteriorating housing affordability, rising energy prices and weak wages growth offsetting any boost from improved jobs growth.
- This month's survey is in the field over the week ended Oct 8. Factors that may influence confidence include: the RBA's decision to again leave rates on hold at its Oct meeting; more signs of cooling across Australia's major housing markets; and a disappointing retail update showing a surprise fall in sales. Both the AUD and ASX are down over the last month. Against this, jobs data has continued to perform strongly.

## Consumer Sentiment Index



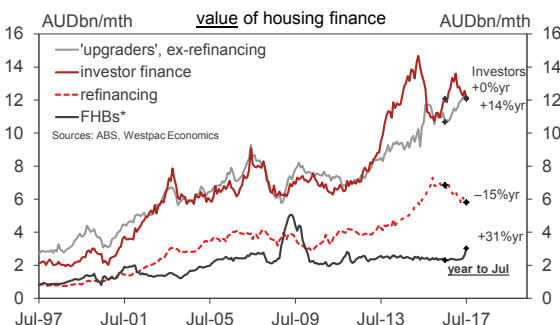
## Aus Aug housing finance (no.)

Oct 12, Last: 2.9%, WBC f/c: flat

Mkt f/c: 0.5%, Range: -1.6% to 1.5%

- The number of housing finance approvals to owner occupiers posted another surprisingly strong gain in July up 2.9% and 4.5% ex refinancing. Note that the macro prudential tightening measures introduced in late March and associated increases in rates for investor and 'interest only' loans in March and June have likely given indirect support to owner occupier loan activity. Indeed, the value of investor loans fell 3.9% in July.
- The full impact of these shifts is still coming through. Industry data suggests owner occupier loans were again firm in August but with some signs that the recent lift is levelling out. We expect owner occupier approvals to be flat in the month. The focus will again be on investor loans and to a lesser extent construction-related finance which has shown a notable lift in recent months.

## Value of finance approvals by segment



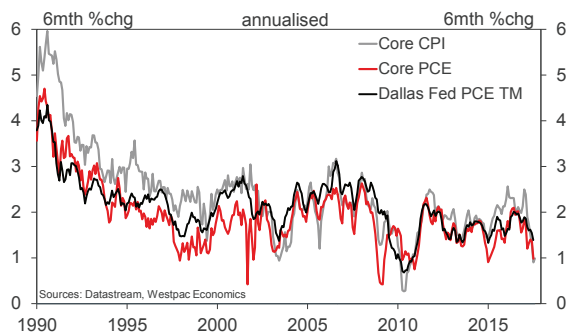
# The week ahead

## US Sep CPI

Oct 13, last: 0.4%, WBC: 0.5%

- Inflation has been an ongoing disappointment in the US in 2017, with core and headline CPI inflation having fallen back below the 2.0%yr medium-term target as the PCE measure remained there.
- However in August, headline prices rose 0.4% as gasoline prices jumped over 6% and rents also experienced a strong month. Annual headline inflation lifted from 1.7%yr to 1.9%yr.
- Come September, hurricane season will see gasoline run higher again and headline prices increase 0.5% overall. Annual inflation is therefore set to bounce back above 2.0%. These inflationary influences will prove transitory, so it is best to focus on core inflation. This measure is expected to print a more modest 0.2%, 1.7%yr. Further out, expect to see headline and core inflation settle a little below the 2.0%yr medium-term target of the FOMC.

## Core inflation to firm slowly to target

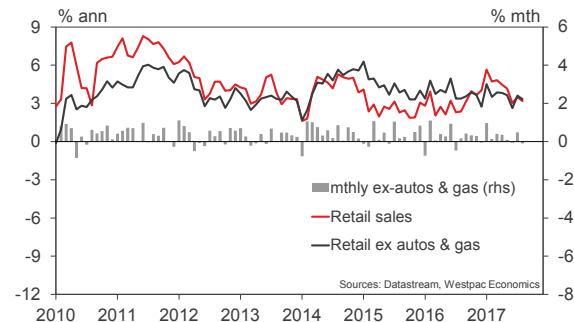


## US Sep retail sales

Oct 13, last: -0.2%, WBC: 1.2%

- Aug was a soft month for US retail, in part because the arrival of hurricanes Irma and Harvey weighed heavily on car sales in affected regions. Nationwide sales were down 1.6% as a result. That said, given both headline and core retail sales fell 0.2% in the month, households also clearly stocked up ahead of the storm, offsetting some of the weakness. Come Sep, not only will there be a sharp reversal in car sales (Reuters has reported sales of new cars in the Houston area were up 109% in the three weeks after the storm versus the three weeks prior), but significant household spending will also need to take place to replenish household stocks and make necessary initial repairs to buildings. As a consequence, retail sales will jump in Sep. It is worth highlighting however the 0.2% fall in core sales in Aug and the downward revisions to Jul. These results imply that, sans weather, the US consumer remains reluctant to spend. This is a key reason why GDP growth is likely anchored to 2.0% despite job growth and sentiment.

## Retail sales to receive boost from hurricanes



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 9</b>					
<b>NZ</b>	Sep REINZ house sales	0.6%	-	-	Due this week. Turnover likely remained weak pre election.
	Sep REINZ house prices, %yr	0.5%	-	-	Prices stabilised in August as supply of new listings dried up.
<b>Chn</b>	Sep Caixin China PMI services	52.7	-	-	Current output and orders strong across economy.
<b>Eur</b>	Oct Sentix investor confidence	28.2	28.0	-	Very positive.
<b>Tue 10</b>					
<b>NZ</b>	Sep retail card spending	-0.2%	0.5%	0.5%	Higher fuel prices to boost spending, core spending still soft.
<b>Aus</b>	Sep NAB business survey conditions	15	-	-	Conditions index strengthened in 2017, above avg levels.
	RBA Deputy Governor, Guy Debelle	-	-	-	FX global code of conduct, Hong Kong, via video, 2:20pm AEDT
<b>Chn</b>	Sep M2 money supply %yr	8.9%	9.0%	-	Tentative date, 10-18 October.
	Sep new loans, CNYbn	1090.0	1215.0	-	Tentative date, 10-18 October.
	Sep aggregate financing, CNYbn	1480.0	1586.4	-	Tentative date, 10-18 October.
<b>UK</b>	Aug industrial production	0.2%	0.2%	-	Manufacturing conditions have firmed, aided by lower GBP.
	Aug construction output	-0.9%	-0.4%	-	Private spending on residential & industrial invest softening.
	Aug trade balance, £bn	-2.87	-2.8	-	Rising import costs have been weighing on the trade balance.
<b>US</b>	Sep NFIB small business optimism	105.3	104.8	-	Small business optimism ahead of conditions.
	Fedspeak	-	-	-	Kashkari on regional economic conditions.
<b>Wed 11</b>					
<b>Aus</b>	Oct Westpac-MI Consumer Sentiment	97.9	-	-	Stuck in pessimistic territory with family finances under pressure.
<b>US</b>	Aug JOLTS job openings	6170	-	-	Depth of this report highlights strength of US labour market.
	FOMC meeting minutes	-	-	-	FOMC meeting minutes to cement December expectation.
	Fedspeak	-	-	-	Kaplan in Q&A at Stanford economic meeting.
	Fedspeak	-	-	-	Evans in moderated discussion on the economy and policy.
	Fedspeak	-	-	-	Williams gives a 'Community Leaders Speech'.
<b>Thu 12</b>					
<b>NZ</b>	Sep food price index	0.6%	-	-0.3%	Vege prices pulling back from seasonal highs.
	Oct ANZ consumer confidence	129.9	-	-	Rose to a three-year high in September.
<b>Aus</b>	Oct MI inflation expectations	3.8%	-	-	Relatively contained.
	Aug housing finance	2.9%	0.5%	0.0%	Focus on investor loans & construction-related finance.
<b>Eur</b>	Aug industrial production	0.1%	0.5%	-	Being aided by domestic and external demand.
<b>UK</b>	Sep RICS house price balance	6%	-	-	Housing market has slowed, but may be finding a base.
<b>US</b>	Initial jobless claims	260k	-	-	Very low and set to remain there.
	Sep PPI	0.2%	0.4%	-	Of little interest to markets.
	Fedspeak	-	-	-	Brainard & ECB's Draghi in a panel discussion on policy.
	Fedspeak	-	-	-	Powell gives keynote at IIF Conference on emerging markets.
<b>Fri 13</b>					
<b>NZ</b>	Sep BusinessNZ manufacturing PMI	57.9	-	-	Has remained strong in recent months.
<b>Aus</b>	RBA Financial Stability Review	-	-	-	Regular half yearly update.
<b>Chn</b>	Sep trade balance USDbn	41.92	37.53	-	Exports to developed nations have come off.
<b>US</b>	Sep CPI	0.4%	0.6%	0.5%	Core inflation to remain modest circa 0.2%.
	Sep retail sales	-0.2%	1.6%	1.2%	A big post hurricane bounce anticipated, led by autos.
	Sep monthly budget statement \$bn	-107.7	0.0	-	Focus on potential implications of reform not current deficit.
	Oct Uni. of Michigan sentiment prel.	95.1	95.0	-	Remains very positive.
	Aug business inventories	0.2%	0.5%	-	Likely to add to growth in second half of 2017.
	Fedspeak	-	-	-	Evans speaks on the economy and policy.
	Fedspeak	-	-	-	Kaplan in Q&A at CFA fixed income conference.
	Fedspeak	-	-	-	Powell is keynote at Boston Fed's economic conference.

# New Zealand forecasts

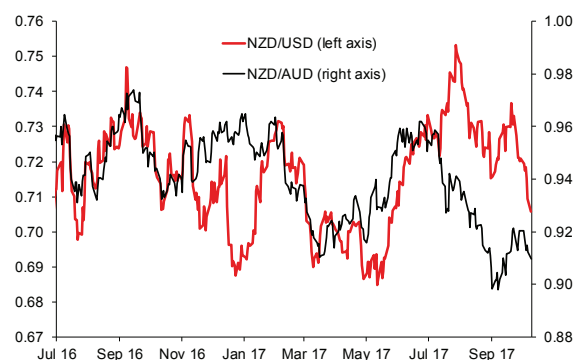
Economic Forecasts	2017				Calendar years			
	% change	Jun	Sep	Dec	Mar	2015	2016	2017f
GDP (Production) ann avg	0.8	0.7	0.6	0.8	2.5	3.0	2.6	2.9
Employment	-0.1	1.1	0.4	0.6	1.4	5.8	2.6	1.8
Unemployment Rate % s.a.	4.8	4.6	4.7	4.7	4.9	5.2	4.7	4.6
CPI	0.0	0.5	0.3	0.3	0.1	1.3	1.8	1.3
Current Account Balance % of GDP	-2.8	-2.7	-2.8	-2.5	-3.2	-2.5	-2.8	-3.3

Financial Forecasts	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.95	1.95	1.95	1.95	1.95	1.95
2 Year Swap	2.10	2.15	2.20	2.30	2.40	2.50
5 Year Swap	2.70	2.80	2.90	3.00	3.10	3.20
10 Year Bond	2.95	3.10	3.20	3.30	3.40	3.45
NZD/USD	0.70	0.69	0.68	0.67	0.66	0.66
NZD/AUD	0.92	0.92	0.92	0.93	0.94	0.94
NZD/JPY	77.7	77.3	76.8	76.4	75.9	75.4
NZD/EUR	0.60	0.59	0.59	0.59	0.58	0.58
NZD/GBP	0.55	0.54	0.54	0.54	0.54	0.54
TWI	74.5	73.9	73.4	72.9	72.6	72.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 9 October 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.84%	1.84%
60 Days	1.90%	1.89%	1.88%
90 Days	1.95%	1.96%	1.95%
2 Year Swap	2.21%	2.23%	2.14%
5 Year Swap	2.74%	2.75%	2.56%

NZ foreign currency mid-rates as at Monday 9 October 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7057	0.7316	0.7264
NZD/EUR	0.6014	0.6143	0.6045
NZD/GBP	0.5394	0.5424	0.5509
NZD/JPY	79.50	82.12	78.60
NZD/AUD	0.9098	0.9213	0.9016
TWI	75.12	76.79	75.51

# International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
<b>Australia</b>						
Real GDP % yr	2.1	2.8	2.4	2.5	2.5	3.0
CPI inflation % annual	2.7	1.7	1.7	1.5	2.0	2.5
Unemployment %	5.8	6.2	5.8	5.7	5.7	6.1
Current Account % GDP	-3.4	-3.0	-4.7	-2.7	-1.3	-2.2
<b>United States</b>						
Real GDP %yr	1.5	2.4	2.9	1.5	2.1	2.1
Consumer Prices %yr	1.5	1.6	0.1	1.3	2.0	1.8
Unemployment Rate %	7.4	6.2	5.3	4.9	4.4	4.3
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.7	-2.8
<b>Japan</b>						
Real GDP %yr	1.4	0.0	0.5	0.6	1.1	1.0
<b>Euroland</b>						
Real GDP %yr	-0.3	0.9	1.6	1.8	2.1	1.7
<b>United Kingdom</b>						
Real GDP %yr	2.2	2.9	2.2	2.0	1.6	1.6
<b>China</b>						
Real GDP %yr	7.7	7.3	6.9	6.7	6.7	6.2
<b>East Asia ex China</b>						
Real GDP %yr	4.2	4.1	3.7	3.7	4.0	3.9
<b>World</b>						
Real GDP %yr	3.3	3.4	3.2	3.2	3.6	3.5

Forecasts finalised 15 September 2017

Interest Rate Forecasts	Latest	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.70	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.81	2.70	2.75	2.85	2.95	3.00	3.00	3.00
<b>International</b>								
Fed Funds	1.125	1.375	1.375	1.625	1.625	1.875	1.875	1.875
US 10 Year Bond	2.35	2.40	2.60	2.75	2.90	3.00	3.00	3.00
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.30

Exchange Rate Forecasts	Latest	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
AUD/USD	0.7778	0.76	0.75	0.74	0.72	0.70	0.70	0.70
USD/JPY	112.85	111	112	113	114	115	115	116
EUR/USD	1.1710	1.17	1.16	1.15	1.14	1.13	1.13	1.14
AUD/NZD	1.0938	1.09	1.09	1.09	1.07	1.06	1.06	1.07

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