

# Weekly Commentary

14 August 2017



## Expect delays

The Reserve Bank left the Official Cash Rate unchanged at 1.75% in its August *Monetary Policy Statement*, and the guidance that it provided was very similar to its previous reviews. The RBNZ believes that monetary policy will need to remain accommodative for a long time, to support growth and guide inflation towards the target on a sustained basis. We agree with that view, and we think that interest rate hikes will be delayed a lot longer than the market expects.

There was surprisingly little change in the latest *MPS*. Other than updating for recent data outturns, the RBNZ made few changes to its economic forecasts compared to May. The weaker than expected consumer prices in the June quarter were treated as temporary, though they will linger in the annual inflation rate calculations over the coming year. As a result, the RBNZ now expects inflation to briefly drop below 1% in the March 2018 quarter, before rising back to the 2% midpoint of the target by early 2019.

Similarly, the softer than expected GDP growth over the last two quarters was viewed as temporary. The RBNZ expects GDP to grow by 3.4% over this year and 3.6% next year, both of which would be well above the country's potential growth rate. Indeed, since the RBNZ also expects population growth to slow over this time, this implies a faster rate of per-capita GDP growth than this economy has achieved at any point to date in this cycle. The RBNZ's forecasts imply a shift from a zero to a positive output gap over the next couple of years, and a subsequent lift in the pace of non-tradables inflation.

That lift in non-tradables inflation will be needed, because the outlook for tradables inflation remains soft. The RBNZ has for some time been highlighting that the global economy still has substantial spare capacity and that worldwide inflation remains slow. The lack of import price inflation is compounded by the lingering strength of the New Zealand dollar, which is running about 3% higher today than the RBNZ had assumed in its May forecasts.

The RBNZ still expects the New Zealand dollar to decline gradually over the next few years, so the recent rise in the currency is expected to suppress inflation over the next year but not over the medium term. Still, there was some escalation of the RBNZ's concerns in the language of the statement, which noted that a lower exchange rate is "needed" (as opposed to "would help") to rebalance the outlook for growth.

In a subsequent interview, Assistant Governor McDermott confirmed that this change of wording was meant to nudge the market towards considering the possibility of the RBNZ intervening in the foreign exchange market. The NZD fell after the interview was published, having initially risen after the *MPS*. We don't think the message was any different, though: it still feels like the RBNZ is giving the exchange rate a nudge, whereas we and others in the market were expecting more of a shove.

The RBNZ acknowledged the slowdown in the housing market over the last year, but it remains concerned about the risk of a resurgence in house prices. This is a significant point of difference for us. We believe that the rise in mortgage rates since 2016 has played a major role in cooling the housing market, and will continue to do so. A weaker housing market would mean a softer path for spending, investment and housing construction, and less home-grown inflation pressure than the RBNZ is looking for.

# Expect delays continued

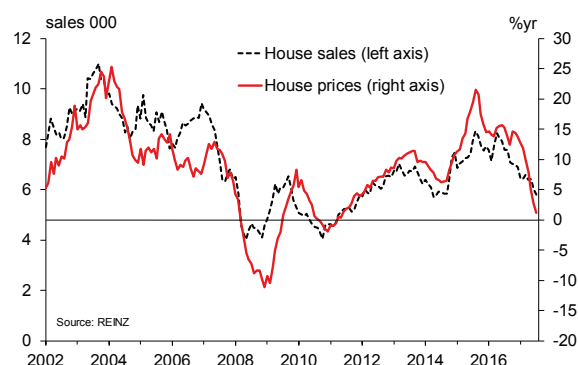
The July housing figures, released after the *MPS*, support our view. House sales have been falling steadily over the last year, and are now at a three-year low. House prices in Auckland continued their gradual decline, now down 4% from their peak, and prices were flat in the rest of the country for the second month in a row. There are still some pockets of strength, but prices are off their peaks in a growing number of regions.

We expect the rise in mortgage rates to persist, as it's the product of two factors that are beyond the control of domestic monetary policy: rising global interest rates, and increased competition among banks for deposits. That points to the housing market remaining very soft over the next year or two; the RBNZ's forecast of even a relatively modest 4% rise in prices this year looks too high.

The RBNZ's interest rate projections this time were identical to the May *MPS*, with a flat track for the next two years followed by a gentle upturn. We've been broadly in agreement with that view for some time, and if anything we see downside risks to the RBNZ's view on growth and inflation pressures.

We will be releasing our latest quarterly Economic Overview on Tuesday, which will detail how our views on the economy

House sales and price growth



have evolved. One change that we have already made to our forecasts is to push out the expected timing of OCR hikes even further. Previously, we expected the first hike to be delayed until the March quarter of 2019; we now expect it to be in the December quarter of that year.

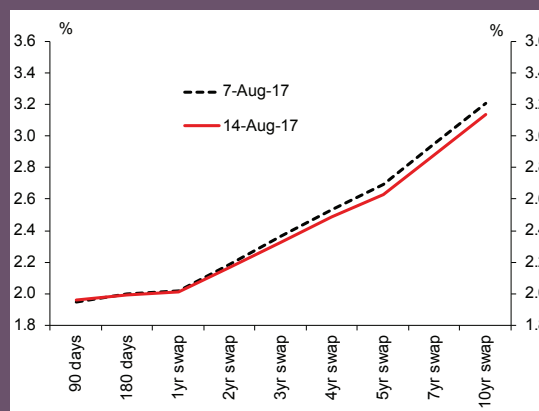
As we've noted before, it's hard to be specific about dates over that sort of time horizon. The bottom line is that we think the market's insistence on pricing in an OCR hike by August 2018 is well off the mark.

## 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. That said, these rates are most likely to be pressured higher by global market trends, so borrowers who prefer the security of a longer term still have a chance to lock in at historically quite low levels.

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



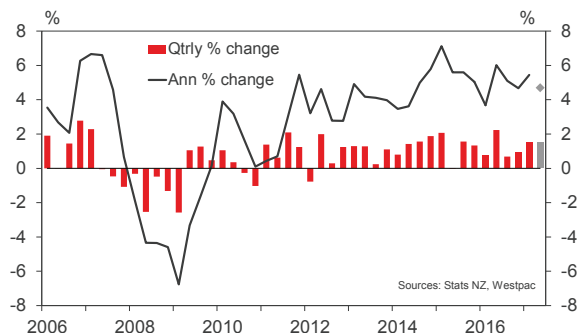
# The week ahead

## NZ Q2 real retail sales

Aug 14, Last: +1.5%, Westpac f/c: +1.5%, Mkt f/c: +0.8%

- Retail spending rebounded in March, rising by 1.5%. Much of this was the result of a very large increase in motor vehicle sales. However, there were gains in most categories including a strong lift in categories linked to the tourism sector.
- We expect another solid gain in the June quarter, underpinned by solid growth in core categories. Once again, much of the strength in spending is expected to be in areas related to tourism. During the June quarter, we saw strong tourist inflows on the back of high profile sporting events, like the Lions tour. This provided a large boost to spending in areas like food services and accommodation. We also expect to see gains in other categories, supported by softness in import prices and continued strong population growth.

### Real retail sales



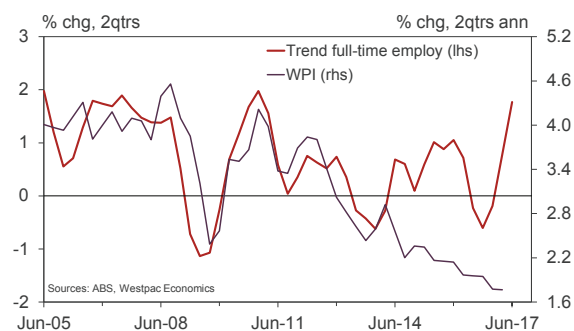
## Aus Q2 Wage Price Index %qtr

Aug 16, Last: 0.5% WBC f/c: 0.5%

Mkt f/c: 0.5%, Range: 0.5% to 0.7%

- Total hourly wages ex bonuses gained 0.5% in Q1 which was a lift from 0.4% in Q4 (which was revised down from 0.5% and is now the record low quarter print). Nevertheless it is holding surprisingly soft momentum with the annual rate at a historical low of 1.9%yr.
- The relative softness in the labour market seen in broader measures, such as underemployment where a worker is willing and able to work more hours than they do, has coincided with the record low in wage growth.
- Those looking for a minimum wage increase in the Q2 WPI are one quarter too early as the increase was not applied until July 1, 2017. So while it is true that the minimum wage rise is likely to boost wage inflation back though 2%yr in Q3, for Q2 we are looking for modest 0.5%qtr/1.9%yr print.

### Wages fail to respond to lift in employment

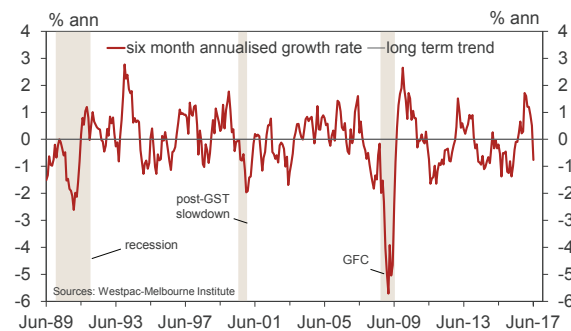


## Aus Jul Westpac-MI Leading Index

Aug 16, Last: -0.76%

- The six month annualised growth rate in the Leading Index, a guide to the pace of economic activity three to nine months into the future, fell sharply from 0.51% in May to -0.76% in June, the first below trend reading since July 2016. The abrupt slowdown in momentum mainly reflects international factors including a sharp turnaround in Australia's commodity prices in Australian dollar terms. The Jul read will include updates on: the ASX200, down -1.3% vs -0.1% last month; the Westpac-MI Consumer Expectations Index, up 1.6% vs -1.4% last month; US industrial production, up 0.2% vs 0.4% last month; commodity prices, down -16% (in AUD terms) vs -8% last month; dwelling approvals, up 10.9% vs -5.4% last month; the yield spread, widened 25.8bps vs a 12.5bps narrowing last month; the Westpac-MI Unemployment Expectations Index, down -2.6% vs -3% last month; and total hours worked, up 0.3% vs 0.5% last month.

### Westpac-MI Leading Index



## Aus June Labour Force employment '000

Aug 17, Last: 14.ok, WBC f/c: 35k

Mkt f/c: 20k, Range: 10k to 35k

- May and June were robust updates from the Labour Force survey. The recovery in employment was something that our Jobs Index had been pointing to for some time and our employment forecasts going forward incorporated on-going strength at least to year end.
- Total employment rose 14k in June compared to the market's forecast of 15k. Full-time employment surged 62.0k following on from a 53.4k gain in May. In the year full-time employment gained 175.4k/2.1%. Part-time employment fell 48k following a -15.4k in May. In the year part-time employment lifted 64.8k/1.7%, slower than full-time employment for the first time since Mar 2015.
- Employment is now running on par with our Jobs Index which is pointing to it accelerating as we near year end. Our forecast for 35k will hold the annual pace at 2.0%yr.

### Jobs Index model of employment



# The week ahead

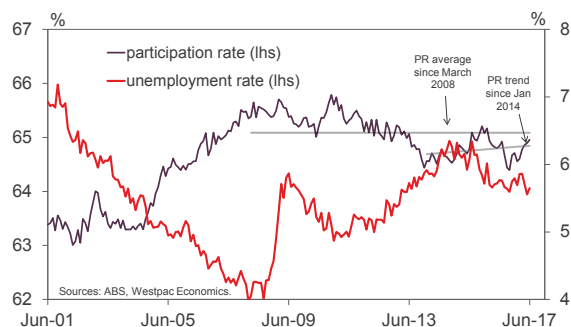
## Aus June Labour Force – unemployment %

Aug 17, Last: 5.6% WBC f/c: 5.6%

Mkt f/c: 5.6%, Range: 5.4% to 5.7%

- The solid June gain in employment was matched by a 0.1ppt lift in participation. This led to a 27.1k gain in the labour force thus holding the unemployment rate flat at 5.6%. However, at two decimal places the unemployment rate was 5.65% up almost 0.1ppt from 5.56% in May so it was a very small smidgen off being rounded up to 5.7%. We believe we have seen the low in unemployment and expect it to hold around 5.6% until it starts to drift higher as we move into 2018. Robust employment growth is drawing workers back into the labour force (and/or holding more in the labour force), lifting participation and preventing any near term dip in unemployment. For July, strong employment should again be associated with higher participation. At 65.1% participation should lift the labour force enough to hold unemployment at 5.6%.

### Unemployment and participation rates

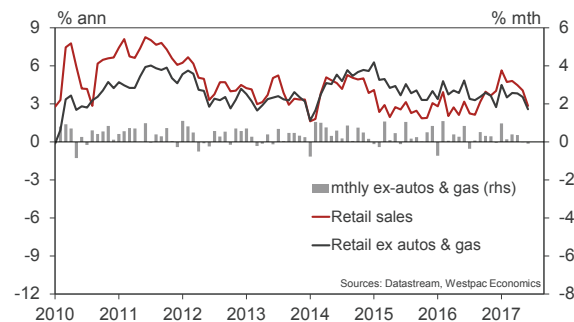


## US Jul retail sales

Aug 15, Last: -0.2%, WBC 0.5%

- During the June quarter, there was a distinct loss of momentum in retail sales – a 0.3% gain in April followed by a 0.1% decline in May and a 0.2% fall in June. Core retail sales (ex autos and gas) were a little stronger but still quite weak, with a gain of 0.4% followed by a flat outcome and a -0.1%.
- Through the quarter, weak inflation was a key cause of the soft nominal sales trend, both for gas and more broadly. Importantly, from the GDP consumption detail, it is evident that volumes were actually better in the June quarter than in the March quarter, when durables sales volumes were flat. The momentum in sale volumes in the June quarter points to a rebound in nominal retail sales from July as the negative influence of prices abates. We look for a 0.5% gain in headline retail sales and a similar result for the core series. This growth should continue in coming months.

### Retail sales lost momentum in Q2



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 14</b>					
<b>NZ</b>	Jul BusinessNZ PSI	58.6	-	-	Despite softening, service sector conditions remain firm.
	Q2 retail sales volumes	1.5%	0.8%	1.5%	Population growth & strong tourist season point to solid gain.
<b>Aus</b>	RBA Assistant Gov Financial Mkts	-	-	-	Chris Kent, speech Sydney, 9:35am.
<b>Chn</b>	Jul retail sales %yr	11.0%	10.8%	-	Softer employment growth a headwind.
	Jul fixed asset investment ytd%yr	8.6%	8.6%	-	Robust investment momentum continues.
	Jul industrial production ytd%yr	6.9%	6.9%	-	PMIs point to favourable conditions.
	Jul M2 money supply %yr	9.4%	9.5%	-	Tentative date 10-15 August.
	Jul new yuan loans CNYbn	1540	800	-	Tentative date 10-15 August.
	Jul aggregate financing	1776	1000	-	Tentative date 10-15 August.
<b>Eur</b>	Jun industrial production	1.3%	-0.4%	-	Softer month likely a one off given PMIs.
<b>Tue 15</b>					
<b>Aus</b>	Jul new vehicle sales	1.2%	-	-3.0%	Industry figures show a softer month after solid gains in Q2.
	RBA minutes	-	-	-	RBA views already widely communicated.
<b>UK</b>	Jul CPI	0.0%	0.0%	-	Earlier fall in GBP keeping annual rate well above 2%.
	Jun house price index	4.7%	-	-	Uncertainty is continuing to weigh on the housing market.
<b>US</b>	Jul import price index %yr	1.5%	-	-	Weaker USD and higher commodity prices to support.
	Aug Fed Empire state index	9.8	10.0	-	Still pointing to robust momentum.
	Jul retail sales	-0.2%	0.4%	0.5%	Autos and gas to have little net effect in July.
	Aug NAHB housing market index	64	65	-	With rates low, conditions remain favourable for sector.
	Jun business inventories	0.3%	0.4%	-	Fairly stable in first half; volatility to come?
	Jun total net TIC flows	57.3	-	-	Capital inflows into Treasury market.
<b>Wed 16</b>					
<b>NZ</b>	GlobalDairyTrade auction	-1.6%	-	-	Futures pointing to moderate pullback in milk powder prices.
<b>Aus</b>	Jul Westpac-MI Leading Index	-0.76	-	-	Sharp swing to below trend driven by commodities, yield gap.
	Q2 wage cost index	0.5%	0.5%	0.5%	The lift in minimum wages are set to appear in Q3.
<b>UK</b>	Jun ILO unemployment rate	4.5%	4.5%	-	Wage growth remained steady despite fall in unemployment.
<b>Eur</b>	Q2 GDP (preliminary)	0.6%	0.6%	0.6%	Second estimate with sectoral detail.
<b>US</b>	Jul FOMC meeting minutes	-	-	-	Watch for discussion of risks to outlook.
	Jul housing starts	8.3%	0.8%	-	Trend has stabilised in recent months...
	Jul building permits	9.2%	-2.8%	-	... though month to month, both remain a lottery.
<b>Thu 17</b>					
<b>NZ</b>	Aug ANZ consumer confidence	125.4	-	-	Pointing to firmness in near term spending.
	Q2 producer prices	1.4%	-	0.9%	Higher dairy payout and wholesale electricity prices.
<b>Aus</b>	Jul employment	14.0k	20.0k	35.0k	Leading indicator points to momentum in employment...
	Jul unemployment rate	5.6%	5.6%	5.6%	... but rising participation will prevent a fall in unemployment.
	RBA Assistant Governor Economics	-	-	-	Lucy Ellis, speech in Canberra, 6:20pm.
<b>Eur</b>	Jun trade balance Ebn	19.7	-	-	Exports outpaced imports in May. Strong income prospects.
	Jul CPI (final) %yr	1.3%	1.3%	1.3%	Core broadly stable at 1.2%yr.
	ECB minutes	-	-	-	Members thoughts on currency or APP tapering plans?
<b>UK</b>	Jul retail sales	0.6%	0.1%	-	Import price rises have eroded households' spending power.
<b>US</b>	Initial jobless claims	244k	-	-	Very low.
	Aug Philly Fed index	19.5	19.0	-	Very strong region for manufacturing.
	Jul industrial production	0.4%	0.3%	-	Much softer than ISMs and regional surveys.
	Fedspeak				Kaplan speaks with the Lubbock Chamber of Commerce.
<b>Fri 18</b>					
<b>Chn</b>	Jul property prices	-	-	-	New home price growth has converged across tiers.
<b>US</b>	Aug Uni. Mich. consumer sentiment	93.4	94.0	-	Sentiment retraced half of Trump jump but still elevated.
	Fedspeak	-	-	-	Kaplan speaks at a Dallas community college event.

# New Zealand forecasts

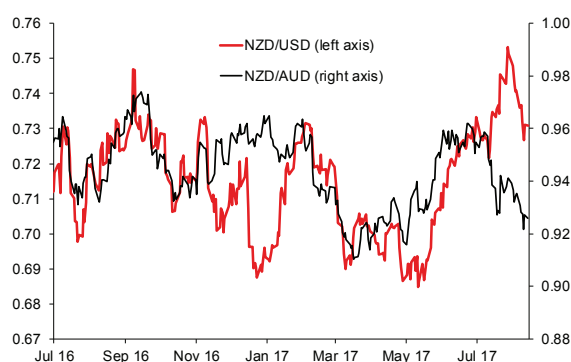
Economic Forecasts	2017				Calendar years			
	% change	Mar (a)	Jun	Sep	Dec	2015	2016	2017f
GDP (Production) ann avg	0.5	0.8	0.9	0.7	2.5	3.1	2.6	3.0
Employment	1.1	-0.1	1.3	0.5	1.4	5.8	2.8	1.8
Unemployment Rate % s.a.	4.9	4.8	4.5	4.5	4.9	5.2	4.5	4.5
CPI	1.0	0.0	0.5	0.4	0.1	1.3	1.9	1.5
Current Account Balance % of GDP	-3.1	-2.9	-2.9	-3.0	-3.4	-2.8	-3.0	-3.3

Financial Forecasts	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
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	2.10	2.15	2.20	2.30	2.40
5 Year Swap	2.65	2.70	2.80	2.90	3.00	3.10
10 Year Bond	2.90	2.95	3.10	3.20	3.30	3.40
NZD/USD	0.72	0.70	0.69	0.68	0.67	0.66
NZD/AUD	0.92	0.92	0.92	0.92	0.93	0.94
NZD/JPY	79.2	77.7	77.3	76.8	76.4	75.9
NZD/EUR	0.62	0.60	0.59	0.59	0.59	0.58
NZD/GBP	0.57	0.56	0.56	0.55	0.55	0.55
TWI	76.4	75.0	74.3	73.8	73.4	72.9

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 14 August 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.84%	1.82%
60 Days	1.90%	1.89%	1.89%
90 Days	1.96%	1.96%	1.97%
2 Year Swap	2.16%	2.22%	2.27%
5 Year Swap	2.63%	2.77%	2.85%

NZ foreign currency mid-rates as at Monday 14 August 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7309	0.7513	0.7345
NZD/EUR	0.6181	0.6388	0.6401
NZD/GBP	0.5621	0.5713	0.5605
NZD/JPY	79.77	83.04	82.61
NZD/AUD	0.9260	0.9404	0.9386
TWI	77.13	79.25	78.21

# 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	2.3	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	-1.2	-2.1
<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	1.7	1.9	1.5
<b>United Kingdom</b>						
Real GDP %yr	2.2	2.9	2.2	2.0	1.8	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	3.7	3.8
<b>World</b>						
Real GDP %yr	3.3	3.4	3.2	3.2	3.5	3.5

Forecasts finalised 11 August 2017

Interest Rate Forecasts	Latest	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.69	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.66	2.75	2.80	2.90	2.95	2.95	3.00	3.00
<b>International</b>								
Fed Funds	1.125	1.125	1.375	1.375	1.625	1.625	1.875	1.875
US 10 Year Bond	2.20	2.40	2.50	2.75	2.85	2.90	3.00	3.00
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30

Exchange Rate Forecasts	Latest	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
AUD/USD	0.7847	0.78	0.76	0.75	0.74	0.72	0.70	0.70
USD/JPY	108.98	110	111	112	113	114	115	115
EUR/USD	1.1774	1.17	1.17	1.16	1.15	1.14	1.13	1.13
AUD/NZD	1.0802	1.08	1.09	1.09	1.09	1.07	1.06	1.06

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