



# Weekly Commentary

16 October 2017



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## Signs of life

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There is growing evidence that the slowdown in the housing market over the last year is weighing on household spending decisions. We wouldn't be surprised to see a brief revival in house prices over the next few months. But the outlook for the next couple of years remains subdued, in the absence of a substantial fall in interest rates.

Retail spending on debit and credit cards rose just 0.1% in September, less than we and the market expected. That continued a string on several months where card spending has been flat or even lower. A fall in petrol prices over this year could explain some of the slowdown in spending, but there's little sign that households are taking advantage of their fuel savings to spend more elsewhere. Spending on clothing and durable goods has flatlined, and the rise in hospitality spending (which also covers international tourists) has slowed.

Consumer spending in New Zealand tends to have a strong link with the housing market, reflecting the fact that housing makes up a very high proportion of household wealth. The slowdown in spending in recent months is consistent with the cooling in house prices over the last year. Prices are down slightly from their peaks in Auckland and Christchurch, and are rising at a slower pace than before in other regions.

We believe the rise in mortgage rates over the last year has been a significant factor in the housing slowdown. Over much of 2015 and 2016, fixed-term mortgage rates were steadily declining, which incrementally added more fuel to the housing market. But from late 2016, mortgage rates ceased falling and began to rise – not by huge amounts, but the change of direction was enough to take the heat out of the housing market.

The latest round of restrictions on loan-to-value ratios, which were targeted at property investors, are also likely to have been a factor in the early stage of the slowdown. But the experience both here and overseas suggests that the impact of lending restrictions is short-lived; the current slowdown has lasted for longer than could be explained by LVR restrictions alone. Caution ahead of the 23 September election may also have been a factor, to the extent that investors feared the possible introduction of a capital gains tax for investment properties.

A key question for the economic outlook is whether the slowdown in house prices will persist. We wouldn't be surprised to see a brief rebound in house prices over the next few months. The most recent moves in mortgage rates have been down – again, not by a large amount, but the change of direction is notable. The banking system is now striking a better balance between deposits and loans than it was a year ago, reducing the pressure for banks to lift lending and deposit rates.

The election uncertainty factor remains, as the coalition talks between the main parties drag on. (The latest indication is that a decision could be announced as late as the end of next week.) But NZ First does not favour a capital gains tax, so that policy is unlikely to make it into the mix regardless of the form of the next Government.

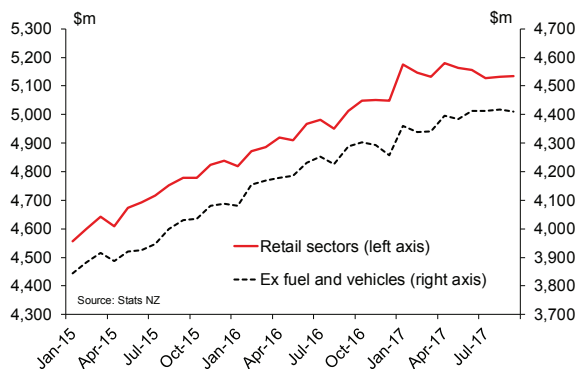
# Signs of life continued

There have in fact been some tentative signs of life in house prices already. The REINZ house price index rose 1% in September, the second monthly increase in a row. The stabilisation in prices has been supported by a sharp drop in new listings in recent months – homeowners don't sell into a soft market if they don't have to. As a result, the stock of unsold homes has actually started falling again, which has alleviated the downward pressure on prices. However, housing turnover remains very subdued, with the number of sales falling to a six-year low. That doesn't augur well for a sustained lift in prices.

Unless the Reserve Bank reduces the OCR, there is a limit to how far mortgage rates can fall in the short run. Over a longer timeframe we would expect fixed mortgage rates to rise in anticipation of OCR hikes and in response to rising global interest rates. Consequently, beyond a short-term fillip, we expect house prices to remain subdued in coming years. And consequently, we would expect consumer spending growth to be more subdued than it has been in previous years – more in line with the pace of income growth.

A slowdown in spending growth in turn implies that there is even less risk of the economy overheating. Inflation has picked up from its lows over the last two years – we expect Tuesday's CPI release to show inflation close to the Reserve Bank's 2% target midpoint in the September quarter. But with growth expected to be subdued from here, inflation is unlikely to threaten the top end of the inflation target. And that means the Official Cash Rate can remain low for a long time.

Electronic card spending

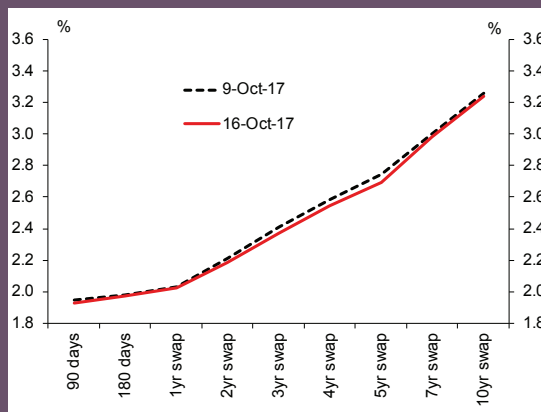


## Fixed vs Floating for mortgages

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



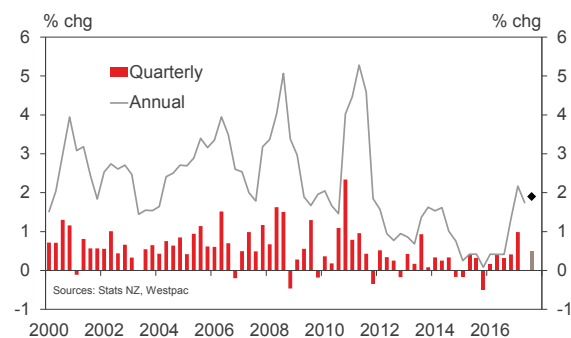
# The week ahead

## NZ Q3 CPI

Oct 17, Last: 0.0%, Westpac f/c: 0.5%, Mkt f/c: 0.5%

- We expect a 0.5% rise in the Consumer Price Index for the September quarter, lifting the annual inflation rate to 1.9%.
- Food prices rose for the quarter, while fuel prices fell. The strong New Zealand dollar was a disinflationary force over the first half of this year, but we expect its influence to have waned in the September quarter.
- We expect inflation to exceed the Reserve Bank's forecast for the quarter. However, with economic growth and house prices falling short of the RBNZ's forecasts, we think that interest rates will need to remain low for even longer than the market expects.

## NZ CPI inflation

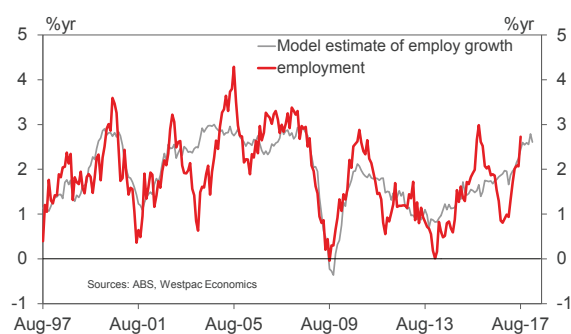


## Aus Sep Labour Force, employment '000

Oct 19, Last: 54.2k WBC f/c: 25k, Mkt f/c: 15k, Range: -10k to 32k

- Total employment rose 54.2k in August compared the market's for +20k. Full-time employment bounced 54.2k following a -19.9k correction in Jul. In the year full-time employment has gained 251.2k/3.0%/yr. Part-time employment rose 14.1k following a 49.1k bounce in Jul. In the year to Aug, part-time employment lifted 74.5k/2.0%/yr. By state, NSW, Vic and Qld were driving the strength with total employment gaining 12.9k, 18.6k and 16.7k respectively.
- The leading indicator including our preferred Jobs Index all point to ongoing robust demand for labour. We are also looking for annual growth in employment to overshoot the Index through late 2017 and into early 2018 as it rebounds from an undershoot during late 2016 early 2017.
- Our forecast 25k rise in employment will lift the annual rate to 3.1%/yr from 2.7%/yr.

## Jobs Index model of employment

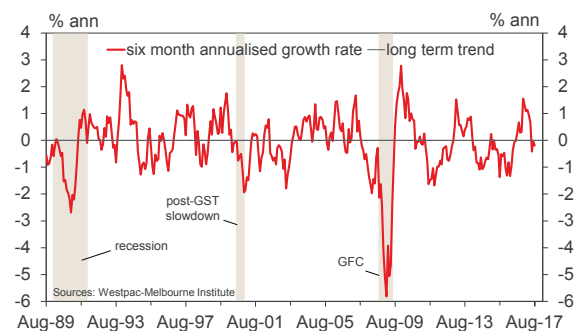


## Aus Sep Westpac-MI Leading Index

Oct 18, Last: -0.19%

- The Leading Index has swung sharply in recent months from well above trend to back below trend, the six month annualised growth rate holding at 0.19% below trend in August. The turnaround mainly reflects swings in Australia's commodity prices and to a lesser extent a shift to a rising yield curve implying tightening financial conditions.
- The Sep read will again see a mixed bag of updates: the ASX200 down -0.6% vs -0.1% last month, US industrial production contracting 0.9% vs a 0.4% gain last month, and commodity prices holding flat in AUD terms but consumer sentiment and consumer unemployment expectations showing solid improvements, dwelling approvals up 0.4% vs -1.2% last month, and the yield spread widening slightly.

## Westpac-MI Leading Index

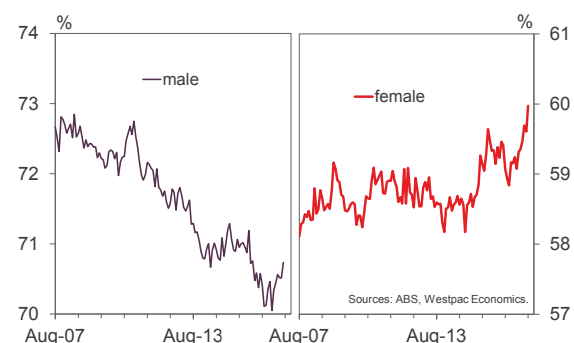


## Aus Sep Labour Force, unemployment %

Oct 19, Last: 5.6% WBC f/c: 5.6%, Mkt f/c: 5.6%, Range: 5.4% to 5.7%

- Despite the strong gain in employment, the Aug release printed a flat unemployment rate of 5.6% (5.60% at two decimal places) due to a 0.2ppt gain in the participation rate driving a solid rise the labour force. In Aug, the gain in participation came from a lift in both male and female participation but the gains from females have been somewhat greater and females do appear to be on a more solid uptrend. Males, by contrast, look more like they have found some stability in participation. By state, the strongest gains in female participation were in Qld but they are also improving in NSW while Vic continues to hold a very high level of female participation.
- In Sep, we are looking for a flat participation rate of 65.3% which will generate a 30.5k gain in the labour force which, with rounding, will leave the unemployment rate at 5.6%.

## Australian participation rates by gender



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# The week ahead

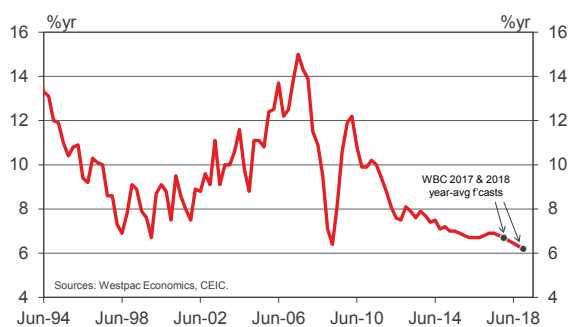
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## China Q3 GDP

Oct 19, last 6.9%, WBC 6.8%

- In the June quarter, Chinese GDP recorded a third consecutive upside surprise, with annual growth of 6.9%. Versus authorities' 2017 target of "around 6.5%yr", the six months to June was certainly a strong start.
- Come the September quarter, this momentum has endured. The PMIs continue to report robust momentum across both the manufacturing and services sector, with broad-based support from domestic and external demand.
- Looking forward, the key downside risk to growth is that subdued employment growth caps momentum in household spending. In the near term, it is unlikely to be significant. However, should household incomes not grow in a robust fashion, it could become a bigger cause for concern. In 2018, investment is also likely to be providing less support.

## China real GDP: momentum sustained



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 16</b>					
<b>NZ</b>	Sep BusinessNZ PSI	57.3	-	-	Services sector broadly signalling a strong outlook.
<b>Chn</b>	Sep CPI %oyr	1.8%	1.6%	-	Inflation remains benign.
	Sep PPI %oyr	6.3%	6.3%	-	Commodity price retreat to slow PPI in coming months.
<b>Eur</b>	Aug trade balance €bn	23.2	23.3	-	Global trade has lifted including intra EU-28 trade.
<b>UK</b>	Oct Rightmove house prices	-1.2%	-	-	Economic uncertainty dampening housing, esp. in London.
<b>US</b>	Oct Fed Empire state index	24.4	20.0	-	Conditions in NY state strong.
<b>Tue 17</b>					
<b>NZ</b>	Q3 CPI	0.0%	0.5%	0.5%	Food prices up, NZD having less of a dampening effect.
<b>Aus</b>	RBA minutes	-	-	-	Colour around housing, jobs and consumers.
	Sep new vehicle sales	flat	-	-0.3%	Industry data points to consumer-led pull back in Q3.
	RBA Assistant Governor Economics	-	-	-	Luci Ellis, panel participant, Investment Conf, Sydney 11:30am.
<b>Eur</b>	Sep CPI final %yr	1.5%	1.5%	1.5%	Core inflation remains near 1% yr.
	Oct ZEW survey of expectations	31.7	-	-	Financial markets remain positive through 2017.
<b>UK</b>	Sep CPI	0.6%	0.3%	-	Earlier fall in GBP to keep inflation at high levels.
	Aug house price index, %yr	5.1%	-	-	Housing market has slowed, but may be finding a base.
	BOE Carney testifies	-	-	-	Testimony to lawmakers with BOE's Ramsden & Tenreyro.
<b>US</b>	Sep import price index	0.6%	0.5%	-	Annual rate bounced from a low to a still subdued 2.1%.
	Sep industrial production	-0.9%	0.3%	-	Lacks the momentum of PMIs.
	Oct NAHB housing market index	64	63	-	Housing sentiment remains solid.
	Fedspeak	-	-	-	Harker on equitable transit.
<b>Wed 18</b>					
<b>NZ</b>	GlobalDairyTrade auction	-2.4%	-	-	Dairy futures suggest a persistent softness in dairy prices.
<b>Aus</b>	Sep Westpac-MI Leading Index	-0.19%	-	-	Points to momentum slowing back below trend in 2018.
<b>Chn</b>	19th National Congress begins	-	-	-	President Xi's political power and development agenda key.
<b>Eur</b>	ECB President Draghi speaks	-	-	-	Opening speech at structural reforms in the Euro Area conf.
<b>UK</b>	Aug ILO unemployment rate	4.3%	4.3%	-	Although labour market tightened, wage growth hasn't lifted.
<b>US</b>	Aug total net TIC flows \$bn	-7.3	-	-	An important release given Fed's b/sheet normalisation.
	Sep housing starts	-0.8%	0.0%	-	Have lost momentum...
	Sep building permits	3.4%	-3.3%	-	.... though multiples still in favour.
	Federal Reserve's Beige book	-	-	-	Regional Fed's reports on local economic trends.
	Fedspeak	-	-	-	Dudley & Kaplan in discussion on drivers of development.
<b>Thu 19</b>					
<b>Aus</b>	Q3 NAB business survey	7	-	-	Sep monthly survey reported conditions unchanged at +14.
	Sep employment '000 chg	54.2	15.0	25.0	The leading indicators point to a continuation of the current...
	Sep unemployment rate	5.6%	5.6%	5.6%	... momentum while a lift in participation holds unemployment.
	RBA Assist Gov. Financial System	-	-	-	Michele Bullock, speech Shareholders Association, Sydney.
<b>Chn</b>	Q3 GDP %oyr	6.9%	6.8%	6.8%	Momentum has continued in Q3.
	Sep retail sales %oyr	10.1%	10.1%	-	Employment growth a concern for spending.
	Sep fixed asset investment ytd %oyr	7.8%	7.7%	-	Momentum slowly receding.
	Sep industrial production ytd %oyr	6.7%	6.7%	-	Manufacturers experiencing robust growth.
<b>Eur</b>	European Council	-	-	-	Oct 19-20, EU leaders summit on Brexit, migration, digital, defence.
<b>UK</b>	Sep retail sales	1.0%	-	-0.2%	Sales have picked up, but annual growth remains muted.
<b>US</b>	Initial jobless claims	243k	-	-	Remains near lows.
	Oct Philly Fed index	23.8	20.5	-	Continues to show solid activity. Lately, prices have lifted.
	Sep leading index	0.4%	0.1%	-	Indicating continued growth through H2 2017.
<b>Fri 20</b>					
<b>NZ</b>	Sep net migration	5490	-	5800	Migration cycle appears to have peaked, further softening exp.
<b>UK</b>	Sep public sector borrowing £bn	5.1	-	-	Tax take has been better than expected.
<b>US</b>	Sep existing home sales	-1.7%	-0.9%	-	The upward trend has flattened over recent months.
	Fed Chair Yellen speaks	-	-	-	On monetary policy since the financial crisis.
	Fedspeak	-	-	-	Mester on the global regulatory structure.

# New Zealand forecasts

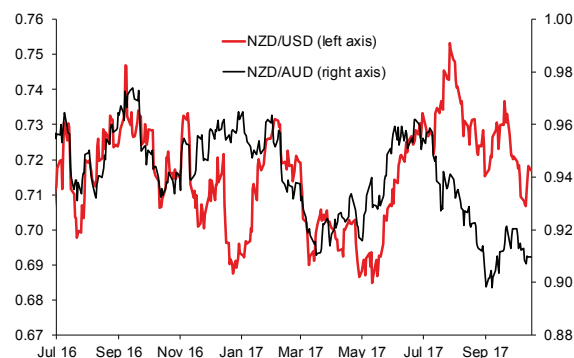
Economic Forecasts	2017				Calendar years			
	% change	Jun	Sep	Dec	Mar	2015	2016	2017f
GDP (Production) ann avg	0.8	0.7	0.6	0.8	2.5	3.0	2.6	2.9
Employment	-0.1	1.1	0.4	0.6	1.4	5.8	2.6	1.8
Unemployment Rate % s.a.	4.8	4.6	4.7	4.7	4.9	5.2	4.7	4.6
CPI	0.0	0.5	0.3	0.3	0.1	1.3	1.8	1.3
Current Account Balance % 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 16 October 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.81%	1.84%	1.82%
60 Days	1.87%	1.90%	1.88%
90 Days	1.93%	1.96%	1.94%
2 Year Swap	2.19%	2.22%	2.21%
5 Year Swap	2.69%	2.75%	2.68%

NZ foreign currency mid-rates as at 16 October 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7170	0.7217	0.7278
NZD/EUR	0.6069	0.6119	0.6100
NZD/GBP	0.5390	0.5396	0.5366
NZD/JPY	80.11	81.33	80.88
NZD/AUD	0.9097	0.9221	0.9095
TWI	75.56	76.31	76.14

# 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	2.80	2.75	2.85	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	2.33	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	0.7834	0.76	0.75	0.74	0.72	0.70	0.70	0.70
USD/JPY	112.18	113	114	114	115	115	116	116
EUR/USD	1.1847	1.17	1.16	1.15	1.14	1.13	1.13	1.13
AUD/NZD	1.0973	1.09	1.09	1.09	1.07	1.06	1.06	1.07

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