

Weekly Commentary

25 September 2017



Waiting is the hardest part

The election may be over, but it will still be some time before we know the make-up of the new government. In the meantime, signs of a slowdown in economic activity are continuing to mount. Consequently, we expect the RBNZ will stand pat this Thursday when it releases its September OCR review.

New Zealand's general election - still waiting on a final result

The election is now over, but it will be some time before we will know the make-up of the new Government. Neither of the two major parties won enough seats to govern alone in Saturday's election. The incumbent centre-right National Party received 46% of the vote, and the main centre-left opposition Labour party received 37%. Crucially, the centrist New Zealand First party won 7.5% of the vote. There are still around 384,000 special votes to be counted (around 15% of the total) which could shift the allocation of seats in the House somewhat. The final result is expected to be declared on 7 October.

Both major parties will now be entering negotiations with the minor parties to see if they can form a stable government. National could govern with support from New Zealand First, and this seems like the most likely outcome. Labour would require the support of the Greens (who polled 5.9%) as well as New Zealand First, making the negotiations more complex. We'll take a closer look at the possible outcomes and what this could mean for the economy in a Bulletin later today.

Key policy areas that New Zealand First campaigned on include immigration settings, the focus of monetary policy, foreign investment and regional development.

A temporary pop higher in GDP growth...

Turning to economic developments, recently released GDP figures showed that economic activity expanded by 0.8% through the June quarter, to be up 2.7% over the past year. That was in line with our forecast, but slightly below the 0.9% rise that the Treasury and the Reserve Bank expected.

On the face of it, 0.8% isn't a bad rate of expansion. But there are a couple of things to keep in mind. Growth in the quarter was boosted by the recovery from earlier disruptions in the dairying and transport sectors. We also had a one-off boost to spending from very strong tourist inflows during the quarter related to some high profile sporting events. Against this backdrop, the pop higher in GDP growth through the June quarter actually looks fairly modest.

... but slowdown is underway...

Notably, with the above temporary boosts now abating, it looks like June will be the high point for GDP growth for a while. As we've been highlighting in recent weeks, momentum in economic activity has been fading. The slowdown in the housing market will likely dampen household spending over the coming months. In addition, growing headwinds in the construction sector are providing a brake on building activity. In fact, nationwide construction activity has fallen in both of the past two quarters, including softness in Auckland home building.

Waiting is the hardest part continued

... with softening migration set to be a drag over the coming years

A further factor that leads us to expect softer GDP growth over the coming years is migration. For the past few years, record levels of net migration have seen New Zealand's population growing by a little over 2% per annum. That's some of the fastest population growth we've seen since the 1970s, and the resulting increase in the size of the economy has masked what has actually been quite muted economic growth on a per capita basis. The strength in net migration has been due to a couple of big trends. First is that for several years now, relatively few New Zealanders have been departing, and large numbers have been returning home, particularly from Australia. At the same time, we've seen a sharp rise in new arrivals from areas like China, India and the UK.

The above trends have resulted in a large and protracted migration cycle. However, we are now starting to see some changes. First, while we're continuing to see firmness in new arrivals and the net outflow of New Zealanders remains low, these have both levelled off in recent months. At the same time, we've seen departures of non-New Zealand citizens steadily rising since mid-2016. In fact, departures of non-New Zealand citizens are nearly 20% higher than this time last year.

Many of the new arrivals to the country in recent years came over on temporary work and student visas, with numbers in these categories rising rapidly from around 2013. Typically, those who come over on these programs stay for around three to four years. We're now seeing

the normal corresponding outflow, which we expect to continue over the coming months.

Our forecasts have long incorporated a slowdown in net migration. That slowdown may have been a little late in arriving, but now that it has, it looks like it could be coming through even faster than we had expected. This reinforces our expectations for softer GDP growth over the coming years.

Growth to underperform the RBNZ forecasts, reinforcing the case for the OCR staying on hold

The above trends don't mean the economy is heading for a crash. But a slowdown in growth is on the cards. And that will be a challenge for the Reserve Bank. In its August Monetary Policy Statement, the RBNZ forecast annual GDP growth to accelerate to 3.8%, from its current pace of 2.5%. And even then, it only expected inflation to be back around its 2% target mid-point by 2019. However, the kind of GDP acceleration the RBNZ is looking for appears increasingly out of reach, particularly as it relies partly on a strong pickup in construction, a sector that has been going backwards recently.

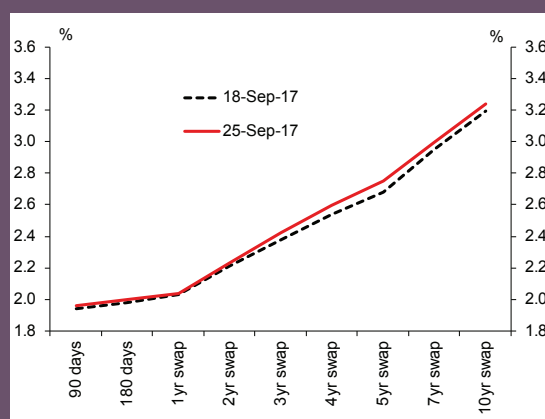
With this in mind, we expect that the RBNZ will keep the OCR on hold on at its next meeting (this coming Thursday), with the policy paragraph of the statement likely to remain largely unchanged from August. Interest rates will need to remain low for a long time in order to get inflation back up to 2% on a sustained basis. We expect the OCR to remain on hold until late 2019. In contrast, market pricing continues to suggest a hike by September next year.

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



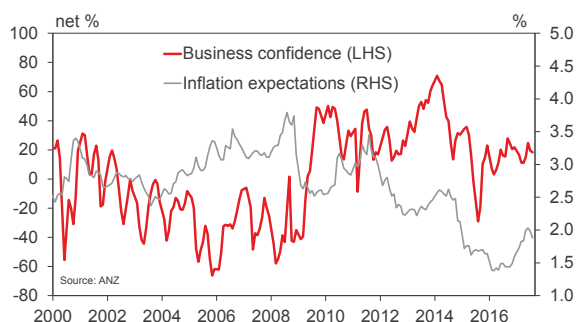
The week ahead

NZ Aug business confidence

Sep 26, Last: 18.3

- Business confidence eased a bit in August, and we expect this to continue into September. With the General Election just around the corner, uncertainty is likely to weigh on businesses' views of the economic outlook. In addition, the economy continues to face challenges regarding capacity constraints, especially in the construction sector. Nevertheless, the economy has been growing at a decent pace and confidence is expected to remain at firm levels.
- Inflation expectations dropped below 2% in the previous survey, in line with the most recent CPI outturn. We expect little change in the September survey.

NZ business confidence and inflation expectations

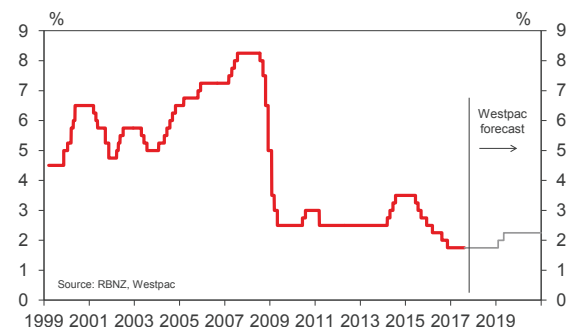


NZ Reserve Bank Official Cash Rate Review

Sep 28, Last: 1.75%, WBC f/c: 1.75%, Mkt: 1.75%

- The RBNZ is highly unlikely to alter the stance of monetary policy this week, due to election uncertainty.
- Fortunately, the economic situation is such that the RBNZ can afford to sit on its hands.
- We expect no change in the OCR this week, and a repeat of previous monetary policy guidance.
- Beneath this placid surface, there is a lot going on with monetary policy.
- In time, we expect the RBNZ will have to reduce its GDP and house price forecasts, which will affect the stance of monetary policy.

NZ Official Cash Rate

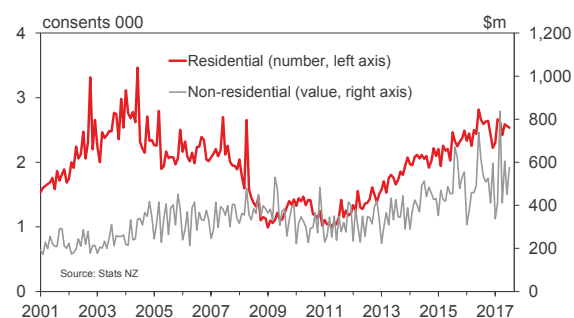


NZ Aug building consents

Sep 29, Last: -0.7%, WBC f/c: flat

- Residential building consent issuance fell 0.7% in July, following a 1.3% decline in June. We expect that issuance will remain flat in August.
- Looking through recent volatility, consent issuance has lost momentum though mid-2017. In part this reflects the structural (but expected) downtrend in Canterbury, as post-earthquake reconstruction continues to gradually wind down. More notably, however, issuance in Auckland has failed to materially accelerate over the past year, and remains below the levels needed to keep up with population growth. Constraining the rise in building activity are capacity constraints, rising cost pressures and tighter credit conditions. Pre-election uncertainty may also be having some dampening impact. While we expect Auckland issuance to rise over time, it looks like this will occur gradually.

NZ building consents

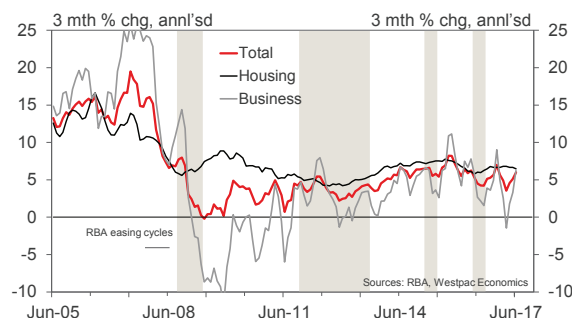


Aus Aug private credit

Sep 29, Last: 0.5%, WBC f/c: 0.4%, Mkt f/c: 0.5%, Range: 0.4% to 0.6%

- Private credit is expected to expand by 0.4% in August to be 5.4% higher than a year ago. This follows a 0.46% gain in July and a 0.4% monthly average for the year to date. This reflects the balance of two countervailing forces at present. Housing credit is expected to increase by 0.5%, 6.5%/yr. There is an emerging gradual slowing after a tightening of lending conditions. The 3 month annualised pace eases to 6.0%, down from 6.8% in March. Notably, the total value of housing finance grew by 15% in the year to January, but has stalled since. Business credit has emerged from a soft spot to record robust growth of late. We expect a gain of around 0.4%, bringing the 6 month annualised pace to 5.3%, while annual growth will be around 4.5%. Commercial finance has rebounded since February, up a trend 15%, and business investment has turned around from declines to modest gains.

Credit: momentum shift



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 25					
Eur	ECB President Draghi speaks	-	-	-	Presents latest ECB perspective on the economy and policy.
US	Aug Chicago Fed activity index	-0.01	-	-	Pointing to growth near trend.
	Sep Dallas Fed index	17.0	13.0	-	Has shown consistent strength.
	Fedspeak	-	-	-	Dudley on workforce, Evans and Kashkari on economy & policy.
Tue 26					
NZ	Aug trade balance, \$m	85	-750	-900	Seasonal deficits, but annual balance improving on dairy.
	Sep ANZ business confidence	18.3	-	-	Business confidence to ease, but remain at firm levels.
Aus	RBA Assist Gov' Financial Stability	-	-	-	Michele Bullock, on panel at conference, Sydney, 7:15am.
US	Jul S&P/CS home price index	0.11%	0.29%	-	House prices have been rising at a steady, moderate pace.
	Aug new home sales	-9.4%	3.3%	-	Looks to have lost momentum.
	Sep consumer confidence index	122.9	119.5	-	Remains strong; Conference Board measure.
	Sep Richmond Fed index	14	13	-	Positive momentum continuing in region.
	Fed chair Yellen speaks	-	-	-	On inflation, uncertainty and monetary policy
	Fedspeak	-	-	-	Brainard on labour market, Bostic 1st speech, Mester on panel.
Wed 27					
NZ	RBNZ Governor	-	-	-	Acting Governor Grant Spencer assumes role for 6 months.
	Q3 Westpac MM Employment Confid.	113.4	-	-	Confidence rose in Q2.
Eur	Aug M3 money supply %yr	4.5%	4.6%	-	Credit data also due.
US	Aug durable goods orders (prelim.)	-6.8%	0.9%	-	Underlying business investment trend remains soft.
	Aug pending home sales	-0.8%	-0.3%	-	Have been weaker than existing sales.
	Fedspeak	-	-	-	Brainard at Minority Banker Forum, Bullard on economy & policy.
Thu 28					
NZ	Sep RBNZ Official Cash Rate decision	1.75%	1.75%	1.75%	Little change in RBNZ stance expected.
Aus	RBA Deputy Governor Guy Debelle	-	-	-	BoE central bank independence conference, LDN 7pm AEST
Chn	Q2 current account balance \$bn	52.9	-	-	Remains in surplus.
Eur	Sep consumer confidence (final)	-1.2	-1.2	-	Consumer optimism around highs in 2001, 2007...
	Sep economic confidence	111.9	111.9	-	... similarly business surveys are very strong...
	Sep business climate indicator	1.09	1.11	-	... coinciding with a lift in industrial production.
UK	Sep Nationwide house prices	-0.1%	-	-	Economic uncertainty continues to weigh on house prices.
	BOE Governor Carney speaks	-	-	-	BOE central bank independence conference, London.
US	Q2 GDP (3rd estimate)	3.0%	3.1%	3.1%	Third estimate; unlikely to see a material revision.
	Aug wholesale inventories	0.6%	-	-	Flat through the first half.
	Initial jobless claims	259k	-	-	Very low.
	Sep Kansas City Fed index	16	-	-	Continuing to show strength, in line with other regions.
	Fedspeak	-	-	-	Fischer at BOE conference, + Rosengren, George & Bostic.
Fri 29					
NZ	Aug building permits	-0.7%	-	Flat	Range of factors weighing on building, esp. in Auckland.
Aus	Aug private sector credit	0.5%	0.5%	0.4%	Housing a gradual slowing emerging, business robust of late.
Chn	Sep Caixin China PMI	51.6	-	-	In line with official measure showing broad expansion.
Eur	Sep CPI %yr (preliminary)	1.5%	1.6%	-	Another lift in headline but core holds modest at 1.2%/yr.
UK	Sep GfK consumer confidence	-10	-	-	Income squeeze & uncertainty continues to dampen sentiment.
	Q2 current account balance, £b	-16.9	-	-	Lower GBP and global demand boosting export earnings.
	Aug mortgage approvals	68.7K	-	-	Softer economy weighing consumers' appetite for debt.
	Q2 GDP (final)	0.3%	-	0.3%	Softness in household spending and business investment.
	ECB President and BOE Governor	-	-	-	ECB's Draghi and BOE's Carney "In conversation".
US	Aug personal income	0.4%	0.3%	0.4%	Income gains solid...
	Aug personal spending	0.3%	0.1%	0.2%	... but retail sales disappointed...
	Aug PCE deflator	0.1%	0.3%	0.4%	... inflation pressures subdued.
	Sep Chicago PMI	58.9	57.5	-	Very positive in August.
	Sep Uni. of Mich sentiment (final)	95.3	95.2	-	Above average, but well below CB measure.
	Fedspeak	-	-	-	Harker at Fintech event on consumers & banking.
Sat 30					
Chn	Sep manufacturing PMI	51.7	-	-	Manufacturing sector receiving broad support...
	Sep non-manufacturing PMI	53.4	-	-	... services momentum has moderated.

New Zealand forecasts

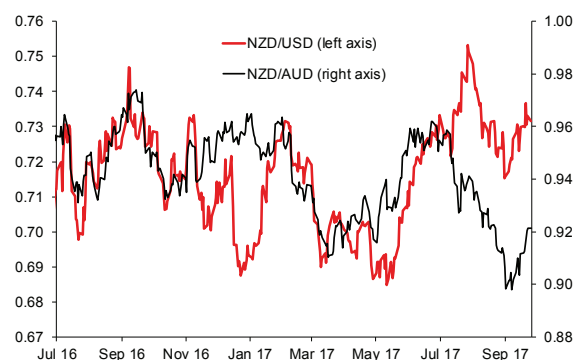
Economic Forecasts	2017				Calendar years			
	% change	Jun	Sep	Dec	Mar	2015	2016	2017f
GDP (Production) ann avg	0.8	0.7	0.6	0.8	2.5	3.0	2.6	2.9
Employment	-0.1	1.1	0.4	0.6	1.4	5.8	2.6	1.8
Unemployment Rate % s.a.	4.8	4.6	4.7	4.7	4.9	5.2	4.7	4.6
CPI	0.0	0.5	0.3	0.3	0.1	1.3	1.8	1.3
Current Account Balance % 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 25 September 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.84%	1.84%	1.83%
60 Days	1.89%	1.88%	1.88%
90 Days	1.96%	1.95%	1.95%
2 Year Swap	2.23%	2.14%	2.18%
5 Year Swap	2.75%	2.56%	2.65%

NZ foreign currency mid-rates as at Monday 25 September 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7316	0.7264	0.7241
NZD/EUR	0.6143	0.6045	0.6061
NZD/GBP	0.5424	0.5509	0.5601
NZD/JPY	82.12	78.60	79.06
NZD/AUD	0.9213	0.9016	0.9143
TWI	76.79	75.51	76.11

International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
Australia						
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
United States						
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
Japan						
Real GDP %yr	1.4	0.0	0.5	0.6	1.1	1.0
Euroland						
Real GDP %yr	-0.3	0.9	1.6	1.8	2.1	1.7
United Kingdom						
Real GDP %yr	2.2	2.9	2.2	2.0	1.6	1.6
China						
Real GDP %yr	7.7	7.3	6.9	6.7	6.7	6.2
East Asia ex China						
Real GDP %yr	4.2	4.1	3.7	3.7	4.0	3.9
World						
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
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.72	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.79	2.70	2.75	2.85	2.95	3.00	3.00	3.00
International								
Fed Funds	1.125	1.375	1.375	1.625	1.625	1.875	1.875	1.875
US 10 Year Bond	2.25	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	0.7924	0.76	0.75	0.74	0.72	0.70	0.70	0.70
USD/JPY	111.74	111	112	113	114	115	115	116
EUR/USD	1.1958	1.17	1.16	1.15	1.14	1.13	1.13	1.14
AUD/NZD	1.0878	1.09	1.09	1.09	1.07	1.06	1.06	1.07

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