

Weekly Commentary

3 September 2018



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Elephant in the room

Business confidence has fallen sharply in recent months, despite an economy that appears to be mixed rather than catastrophic. We suspect that some of this reflects firms' concerns about the planned changes to industrial relations policies, and the Government has started to move towards addressing those concerns.

The ANZ Business Outlook survey for August saw general business sentiment fall further to a net -50, setting a fresh ten-year low. Firms' own-activity expectations, which correspond more closely with GDP growth, were unchanged for the month. But they remain at their lowest level since 2009, when the economy was just starting to pull out of the Global Financial Crisis.

There is an open question as to how to interpret business confidence surveys. On the one hand, they can provide timely warnings of a genuine downturn (or an upturn) in the economy. On the other hand, respondents are not obliged to give an unbiased assessment. As we've noted before, the ANZ survey is particular tends to be biased downwards under Labour-led governments, after accounting for economic conditions at the time. However, even if opinion surveys are politically slanted, there is still cause for concern if firms act on those views by cutting back on investment and hiring.

Economic growth has clearly slowed from its 2016 peak, as some of the previous drivers of growth – population growth, earthquake reconstruction, and rising house values – have faded. But the weight of evidence points to a shift to more modest growth rather than the recessionary levels that the business confidence survey implies.

Indeed, the next GDP report is likely to be quite upbeat – we expect a 1% rise for the June quarter. Some of that simply

reflects the volatility of quarterly data, but there have been some genuine signs of improvement as well. And looking a bit further ahead, we expect increased government spending and transfers to give the economy a temporary fillip over the coming year. We are forecasting 3.1% growth over 2019, up from 2.9% in 2018.

So what is driving this steep fall in business confidence? We see parallels with the sharp drop in confidence in mid-2000, dubbed the "winter of discontent". Then, a newly minted Labour-led Government was attempting to pass the Employment Relations Act, which among other things placed a greater emphasis on collective bargaining between employers and unions. Business confidence was little changed in the first few months of the new Government, but then plunged in May. The legislation was passed in August, and by November confidence had recovered to its previous level.

The current Labour-led Government is also aiming to shift the bargaining power further towards workers (though the changes will not be as substantial as the 2000 legislation, which largely remains in place today). The planned changes include increasing unions' access to workplaces, "fair pay" agreements in some industries, and multi-employer collective agreements. Not surprisingly, these changes are not proving popular with employers or business organisations.

Elephant in the room ... continued

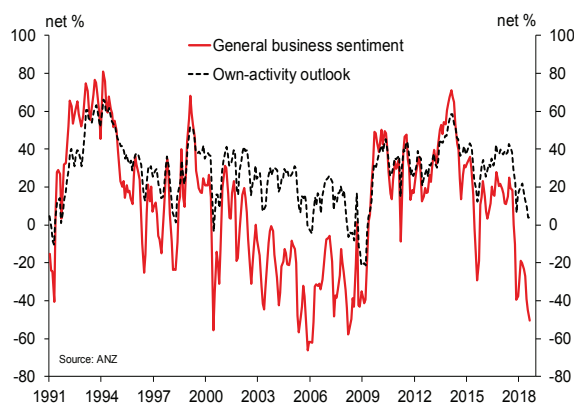
Part of the problem is that the ongoing work to develop these policies has left something of an information vacuum. For instance, it's not at all clear what "fair pay" agreements will entail. Our understanding, based on the Australian experience, is that they involve a schedule of graduated minimum wage rates by job level, determined on an industry-by-industry basis.

Prime Minister Ardern's speech last week came closer to acknowledging that the changes to industrial relations are a source of the negativity expressed in business confidence surveys. In an attempt to soften these concerns, Ardern committed to no more than one or two industry-level fair pay agreements within the Government's current three-year term. She also reaffirmed that the legislation will not allow for strike action by workers as part of fair-pay negotiations.

That still leaves several issues unresolved. One is which industries will be targeted first, and how widely the 'industry' net might be cast. Another issue is the extent of political involvement. In Australia, industry pay agreements are handled by the Fair Work Commission (FWC), an independent tribunal. The FWC also sets the national minimum wage each year, a decision that is made by the central government in New Zealand (and has already been more or less decided for the next three years, as part of the Government's coalition agreement).

Despite these lingering uncertainties, it will be interesting to see if the Government's willingness to address concerns about labour relations will lead to an improvement in future confidence surveys. In the meantime, we'll be watching the near-term data closely for any signs that confidence is having a real impact on activity. Recent indicators of retail spending, job advertisements and capital imports have remained positive, and building consents show a rapidly growing pipeline of homebuilding work in Auckland, where the housing shortage has been most apparent.

Business confidence



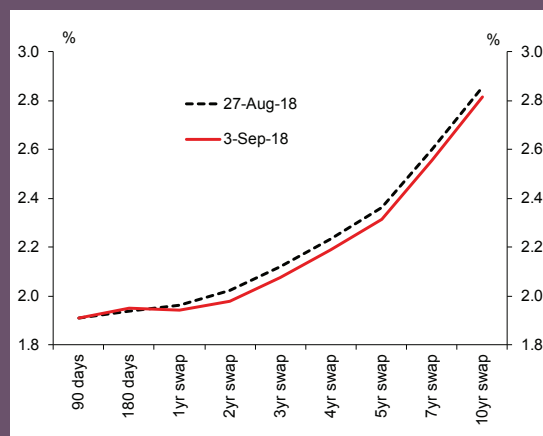
Fixed vs Floating for mortgages

We see scope for fixed-term mortgage rates to fall in the near term, as the market adjusts to the Reserve Bank's softer stance. Looking further ahead, we expect floating and short-term fixed rates to rise gradually over the next few years, so taking a fixed rate may prove worthwhile once they have settled down.

One-year fixed rates are currently the lowest on offer, and appear to offer good value for borrowers. Longer-term fixed rates are high relative to where we think one-year fixed rates are going to go. However, longer-term rates offer security against the possibility of mortgage rates rising more rapidly than expected in the future.

Floating mortgage rates usually work out to be more expensive for borrowers than fixed rates. However, floating may still be the preferred option for those who require flexibility in their repayments.

NZ interest rates



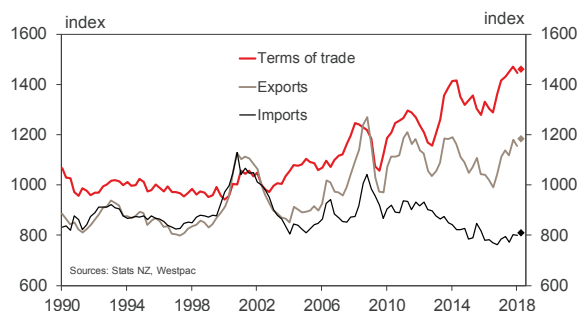
The week ahead

NZ Q2 terms of trade

Sep 3, Last: -1.9%, WBC f/c: +1.0%, Mkt f/c: +1.0%

- We estimate that New Zealand's terms of trade improved by 1% in the June quarter. This would leave the index just shy of the all-time high that was reached at the end of 2017.
- Export commodity prices rose across the board in the June quarter, largely reversing their falls in the March quarter. This volatility appears to have more to do with the timing of export shipments than with changes in world market prices.
- There was a further sharp rise in oil import prices over the quarter, but prices for New Zealand's other imports (mainly manufactured goods) are likely to have remained subdued.
- We expect the terms of trade to soften over the second half of this year, given the recent falls in some export prices and the still-high price of oil.

NZ terms of trade

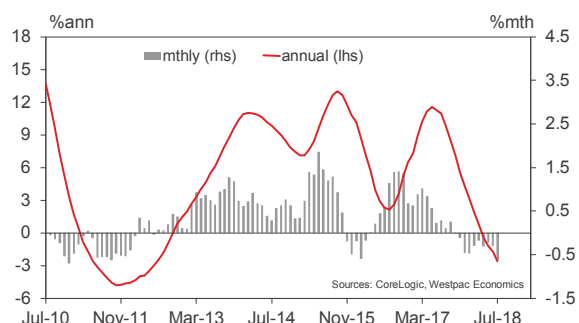


Aus Aug CoreLogic home value index

Sep 3, Last: -0.6%, WBC f/c: -0.4%

- Australia's housing market continues to correct. The CoreLogic home value index, covering the eight major capital cities, fell 0.6% in July to be down 2.4%/yr and 2.8% from its peak in September last year.
- The correction continues to be concentrated in the previously strong Sydney and Melbourne markets with Perth's longer running period of price declines also continuing. All major capital cities except Brisbane recorded price falls in July with notable weakness in Melbourne (-0.9%/mth) and Perth (-0.8%/mth).
- The daily index suggests slippage continued in August, but at a milder pace, prices nationally down about 0.4% taking the annual pace of decline to -3%/yr.

Australian dwelling prices

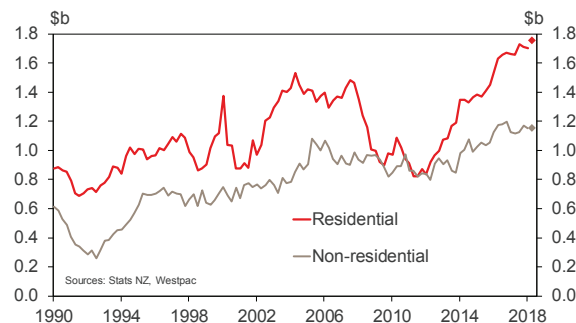


NZ Q2 building work put in place

Sep 5, Last -0.9%, Westpac f/c: +2.0%, Mkt f/c: +2.0%

- Construction activity fell 0.9% in the March quarter. That fall was mainly due to a 1.5% drop in non-residential construction, which followed a solid rise in the previous quarter. Residential building activity also fell modestly, weighed down by the ongoing wind-back in earthquake reconstruction in Canterbury.
- We're expecting a 3% increase in residential building activity in June, along with a modest 0.2% increase in the more volatile non-residential category. Underlying this are signs of a reacceleration in Auckland, with regulatory changes supporting a rise in medium-density home building.
- Construction activity is expected to remain elevated for an extended period. However, factors such as stretched capacity, rising costs, and difficulties accessing finance are providing a brake on how quickly building activity can ramp up to meet demand.

NZ real building work put in place



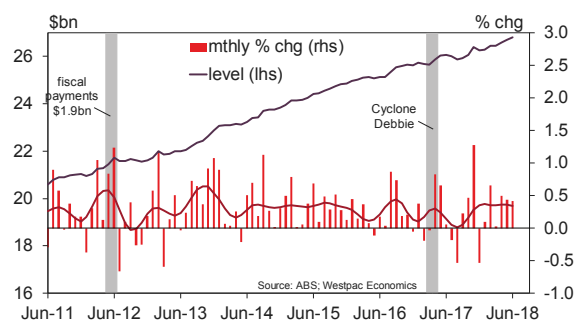
Aus Jul retail trade

Sep 3, Last: 0.4%, WBC f/c: 0.3%

Mkt f/c: 0.3%, Range: -0.1% to 0.6%

- Retail sales posted a third consecutive 0.4% gain in June, the run of reasonably solid gains following a difficult March quarter that saw nominal sales up just 0.6%qtr.
- Indicators were uneven in July. Consumer sentiment posted a surprise rally to a 5yr high boosted by the government's tax package passing into legislation. Private business surveys were mixed, retail responses to the NAB survey suggesting conditions dipped back into negative in the month but the AIG PSI suggesting some improvement. On balance, we expect July to show a 0.3% gain. Note that price discounting pressures look to have eased a touch and may ease further with GST changes on July 1 that mean low value imported goods will now be taxed.

Monthly retail sales



The week ahead

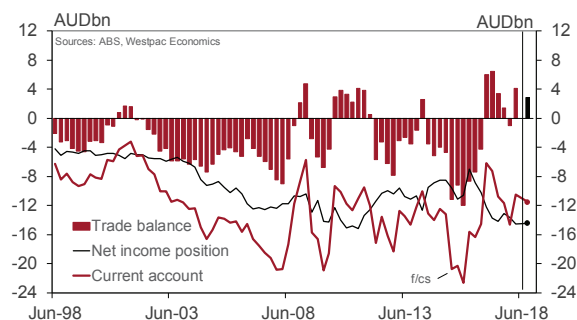
Aus Q2 current account, AUDbn

Sep 4, Last: -10.5, WBC f/c: -11.5

Mkt f/c: -11.0, Range: -13.0 to -9.0

- Australia's current account deficit fluctuated over the past year, buffeted by the impact of commodity price volatility on export earnings.
- A \$2.9bn trade surplus was recorded in Q2, down from \$4.1bn in Q1 (subsequently revised lower to \$3.35bn). Export earnings rose by 2%, eclipsed by a 2½% increase in the import bill, boosted by higher energy prices. Notably, the terms of trade declined by an estimated 1¼%.
- The net income deficit is expected to consolidate at \$14.4bn, after widening by \$1bn to \$14.6bn in Q1. Over the past couple of years, the income deficit has increased on rising returns to foreign investors in the mining sector.

Current account: f/c -\$11.5bn in Q2



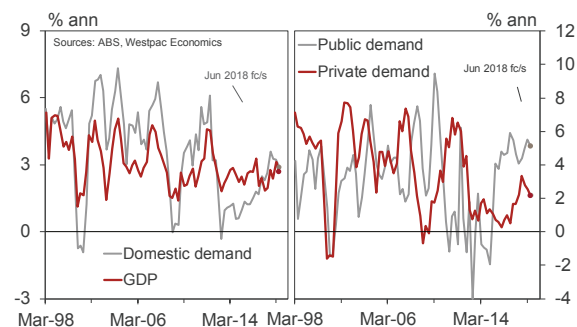
Aus Q2 GDP

Sep 5, Last: 1.1%qtr, 3.1%yr; WBC f/c: 0.6%qtr, 2.7%yr

Mkt f/c: 0.7%, Range: 0.5% to 1.0%

- The economy expanded by an above trend 3.1% in the year to March 2018, with domestic demand increasing by 3.2% and net exports subtracting 0.2ppts from activity.
- For the June quarter, we expect GDP of 0.6%qtr, 2.7%yr.
- The arithmetic is: domestic demand, 0.6%; inventories, -0.2ppts and net exports, +0.1ppt.
- Consumer spending, f/c 0.7%; home building activity, f/c 1.6%; and brisk public demand, f/c 1.0%qtr, 5.0%yr; all likely advanced in the period. Business investment is expected to be flat, dented by a decline in mining capex, but is still up on levels of a year ago.

Australian economic conditions



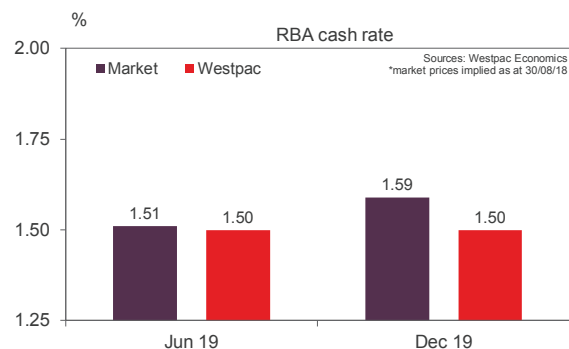
Aus RBA policy decision

Sep 4, Last: 1.50%, WBC f/c: 1.50%

Mkt f/c: 1.50%, Range: 1.50% to 1.50%

- The RBA will hold rates unchanged at their September meeting, as they have since they last cut rates in August 2016. The Governor's decision statement will repeat the line that: "further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual".
- Economic growth over the past year was above trend, at 3.1%; inflation is in the target band, at 2.1%; and unemployment has declined to a six year low, 5.3%.
- However, uncertainties and challenges remain, notably around the consumer, weak wages growth, high household debt levels and housing, as prices ease a little following strong gains and as lending conditions tighten.

Market moved to Westpac RBA forecast



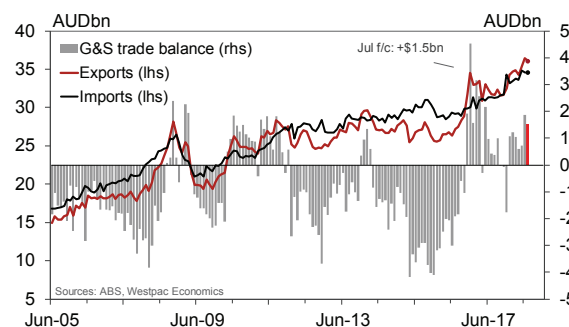
Aus Jul trade balance, AUDbn

Sep 6, Last: 1.9, WBC f/c: 1.5

Mkt f/c: 1.5, Range: 0.9 to 1.9

- Australia's trade account has been in surplus each month so far in 2018.
- In June, the surplus jumped by a little in excess of \$1.1bn to \$1.9bn. Export earnings increased by 2.6%, with relatively broad based gains.
- For July, we expect a modest reversal, with the surplus narrowing to a forecast \$1.5bn.
- Export earnings are expected to edge 1% lower. Weaker iron ore shipments in the month outweigh increased volumes for coal and LNG.
- The import bill is expected to be broadly unchanged. The currency was mixed in the month (down 1.2% against the US dollar but up 0.6% on a TWI basis), suggesting no material impact on import prices.

Australia's trade balance



The week ahead

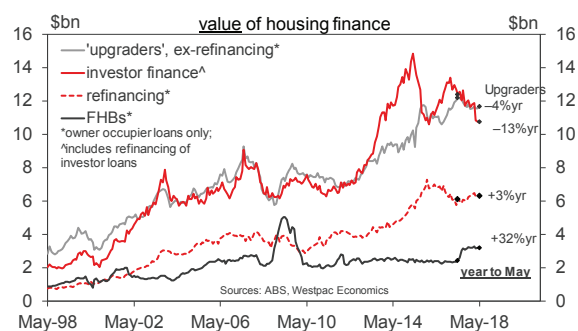
Aus Jul housing finance (no.)

Sep 7, Last: -1.1%, WBC f/c: -0.5%

Mkt f/c: -0.1%, Range: -1.5% to 1.0%

- Australian housing finance approvals softened notably in June, with the number of owner occupier loans declining 1.1% vs and the value of investor loans down 2.7%. The decline is consistent with other market indicators showing a material slowdown in activity through May-July.
- Industry data covering the major banks suggests July was more settled. However, other indicators tracking wider mortgage activity suggest flows continued to soften in the month. Overall we expect owner occupier finance approvals to be down 0.5%. The value of investor loans will again be of interest given the wider market has continued to slow materially through July-Aug.

Value of finance approvals by segment

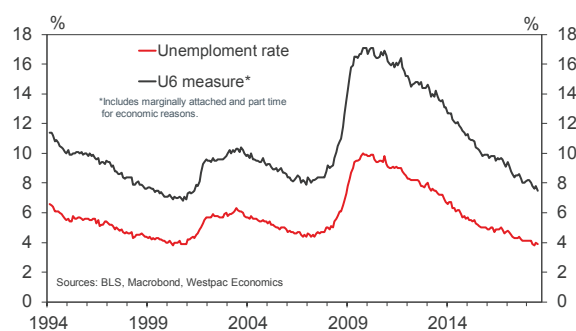


US Aug employment report

Sep 7, last 157k, WBC 185k

- To date, employment growth has run well ahead of population growth in 2018, averaging 215k jobs per month against 182k in 2017.
- Come August, we see employment growth remaining strong at 185k. To this forecast, risks are skewed to the upside. As we progress through the remainder of the year, owing to where we are in the economic cycle and amid uncertainty over trade and financial conditions, jobs growth should slow. But the deceleration is likely to be small in scale and, at all points, risks will remain skewed upward.
- Strong emphasis also needs to be placed on income growth. We remain of the view that hourly earnings growth will continue to tend towards 3.0%, but is unlikely to move materially above that benchmark until mid-to-late 2019. This will keep inflation expectations in check.

US employment continues to remove slack



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 3					
NZ	Q2 terms of trade	-1.9%	1.0%	1.0%	Exports prices bounced back from Q1 softness.
Aus	Jul retail trade	0.4%	0.3%	0.3%	Indicators were uneven in July.
	Aug CoreLogic home value index	-0.6%	-	-0.4%	Australian housing market continues to correct.
	Q2 company profits	3.4%	1.3%	1.0%	Commodity prices less supportive than in Q1.
	Q2 inventories	0.7%	0.2%	0.3%	A more modest inventory gain, impact -0.1ppt.
	Aug AiG PMI	52.0	-	-	Manufact'g expansion, boosted by construction & lower dollar.
Chn	Aug Caixin manufacturing PMI	50.8	50.7	-	To follow release of official measures last Friday...
	Aug Caixin services PMI	52.8	52.5	-	... continue to tell broadly the same story of robust g'th.
Eur	Aug Markit manufacturing PMI final	54.6	-	-	PMI's across Europe look to be settling at a still robust...
UK	Aug Markit manufacturing PMI	54.0	-	-	While still firm, momentum has cooled.
US	Fedspeak	-	-	-	Evans speaks on policy panel in Argentina.
	Labor day	-	-	-	Markets closed.
Tue 4					
Aus	Q2 current account, AUDbn	-10.5	-11.0	-11.5	Deficit widens on smaller trade surplus as terms of trade dips.
	Q2 net exports, ppts cont'n	0.3	0.1	0.1	Exports rebounded in Q1 and advanced further in Q2.
	Q2 public demand	1.5%	-	1.0%	Well above trend growth, health & infrastructure boom.
	RBA policy announcement	1.50%	1.50%	1.50%	On hold. RBA expects gradual progress in meeting targets.
	RBA Governor Lowe speaks	-	-	-	Remarks at RBA Board Dinner, Perth 7:30pm AEST
US	Aug Markit manufacturing PMI final	54.5	-	-	Continues to point to above-trend growth.
	Jul construction spending	-1.1%	0.5%	-	A partial rebound expected.
	Aug ISM manufacturing	58.1	57.6	-	Continues to point to above-trend growth.
	Fedspeak	-	-	-	Evans discusses policy normalization.
Wed 5					
NZ	GlobalDairyTrade auction	-3.6%	-	-	Fats prices have been particularly weak in recent auctions.
	Q2 building work put in place	-0.9%	2.0%	2.0%	Signs of re-acceleration of homebuilding in Auckland.
Aus	Q2 GDP	1.0%	0.7%	0.6%	Inventories & net exports less supportive than in Q1,
	Q2 GDP, %oyr	3.1%	2.8%	2.7%	consumer spend, home building & public demand +ve in Q2.
	Aug AiG PSI	53.6	-	-	Strength centred on business service segments.
US	Jul trade balance US\$bn	-46.3	-47.5	-	Will the stronger USD weigh as 2018 progresses?
	Fedspeak	-	-	-	Williams, Kashkari and Bostic speak at separate events.
Thu 6					
Aus	Jul trade balance, AUDbn	1.9	1.5	1.5	Surplus off highs, export earnings down 1%.
US	Aug ADP employment change	219k	188k	-	Continued strength likely.
	Initial jobless claims	213k	-	-	Very, very low.
	Aug ISM non-manufacturing	55.7	56.9	-	Continues to point to above-trend growth.
	Jul factory orders	0.7%	-0.5%	-	Underlying trend solid, but not strong.
Fri 7					
Aus	Jul housing finance	-1.1%	-0.1%	-0.5%	Industry data for major banks suggests July more settled.
Chn	Aug foreign reserves \$bn	3118	-	-	Have been steady, likely to remain that way.
Eur	Q2 GDP 3rd estimate	0.4%	-	-	Revisions unlikely. Full detail finally available.
US	Aug non-farm payrolls	157k	191k	185k	Employment growth will soften gradually in late 2018.
	Aug unemployment rate	3.9%	3.9%	3.9%	Unemployment rate will remain below 4.0%.
	Fedspeak	-	-	-	Mester & Rosengren at Boston Fed Conf; Kaplan in Dallas.

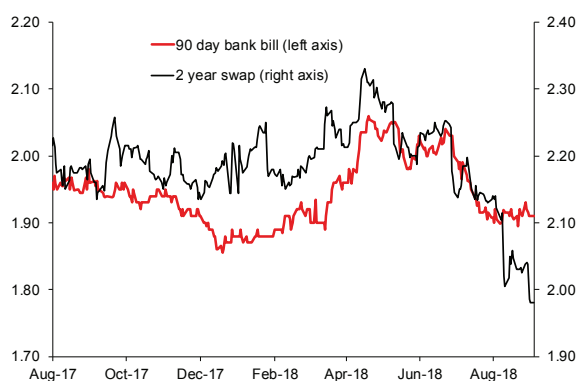
New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2018				Calendar years			
% change	Mar (a)	Jun	Sep	Dec	2016	2017	2018f	2019f
GDP (Production)	0.5	1.0	0.6	0.7	4.0	2.8	2.8	3.1
Employment	0.6	0.5	0.4	0.3	5.8	3.7	1.8	1.4
Unemployment Rate % s.a.	4.4	4.5	4.5	4.6	5.3	4.5	4.6	4.6
CPI	0.5	0.4	0.7	0.3	1.3	1.6	1.9	1.3
Current Account Balance % of GDP	-2.8	-2.9	-3.2	-3.3	-2.2	-2.7	-3.3	-3.4

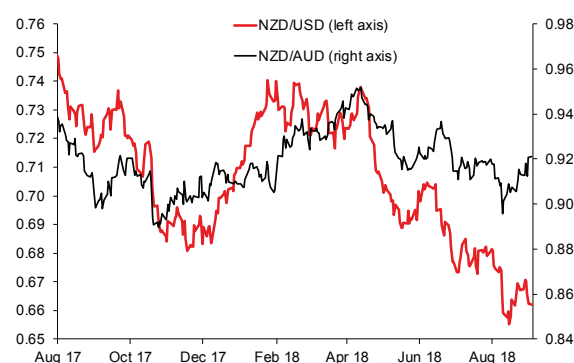
¹ Annual average % change

Financial Forecasts	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.90	1.95	2.00
2 Year Swap	2.00	2.10	2.20	2.30	2.45	2.60
5 Year Swap	2.50	2.65	2.80	2.90	3.05	3.15
10 Year Bond	2.70	2.90	3.10	3.15	3.25	3.35
NZD/USD	0.67	0.66	0.65	0.64	0.64	0.64
NZD/AUD	0.91	0.90	0.90	0.91	0.91	0.91
NZD/JPY	74.37	73.9	73.5	72.3	71.7	71.7
NZD/EUR	0.58	0.57	0.57	0.57	0.56	0.55
NZD/GBP	0.52	0.52	0.53	0.52	0.52	0.52
TWI	72.57	71.8	71.1	70.3	70.0	69.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 3 September 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.83%	1.79%	1.81%
60 Days	1.87%	1.84%	1.85%
90 Days	1.91%	1.95%	1.91%
2 Year Swap	1.98%	2.05%	2.12%
5 Year Swap	2.32%	2.40%	2.55%

NZ foreign currency mid-rates as at 3 September 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6620	0.6641	0.6747
NZD/EUR	0.5706	0.5805	0.5830
NZD/GBP	0.5114	0.5209	0.5188
NZD/JPY	73.49	73.46	75.05
NZD/AUD	0.9209	0.9080	0.9120
TWI	72.08	72.13	73.06

International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
Australia						
Real GDP % yr	2.6	2.5	2.6	2.2	2.8	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	1.7	1.7
Unemployment %	6.2	5.8	5.7	5.4	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.5	-2.4	-3.4
United States						
Real GDP %yr	2.6	2.9	1.5	2.3	2.9	2.5
Consumer Prices %yr	1.6	0.1	1.4	2.1	2.5	2.0
Unemployment Rate %	6.2	5.3	4.9	4.4	3.9	3.7
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.4	1.4	0.9	1.7	1.1	1.0
Euro zone						
Real GDP %yr	1.3	2.1	1.8	2.3	2.0	1.6
United Kingdom						
Real GDP %yr	3.1	2.3	1.9	1.8	1.2	1.5
China						
Real GDP %yr	7.3	6.9	6.7	6.9	6.3	6.1
East Asia ex China						
Real GDP %yr	4.2	3.8	3.9	4.5	4.4	4.3
World						
Real GDP %yr	3.6	3.5	3.2	3.8	3.8	3.7

Forecasts finalised 13 August 2018

Interest Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.95	2.00	1.97	1.97	1.92	1.92	1.83	1.80
10 Year Bond	2.52	3.00	3.10	3.00	3.00	2.80	2.60	2.60
International								
Fed Funds	1.875	2.375	2.625	2.875	2.875	2.875	2.875	2.875
US 10 Year Bond	2.86	3.35	3.50	3.50	3.40	3.20	3.00	2.80
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	0.00	0.20

Exchange Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
AUD/USD	0.7252	0.73	0.72	0.70	0.70	0.70	0.74	0.75
USD/JPY	110.98	112	113	113	112	112	109	106
EUR/USD	1.1664	1.15	1.14	1.13	1.14	1.16	1.22	1.28
AUD/NZD	1.0917	1.11	1.11	1.09	1.09	1.09	1.12	1.10

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