

Weekly Commentary

6 August 2018



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Working through the details

Business confidence surveys are painting an increasingly dismal picture of the state of the economy. But that hasn't been reflected in firms' actions – employment continues to grow at a solid pace, and if anything regained some momentum in the last quarter. We think this should leave the Reserve Bank broadly satisfied that both employment and inflation remain on track with its mandate.

The ANZ business confidence survey continued its slide in July, reaching levels that were last seen around the time of the 2008-09 financial crisis. The weakness in confidence is more or less equally spread across the major sectors, suggesting a more general malaise rather than specific challenges facing certain industries.

We've noted before that this survey has a political slant: the level of confidence tends to be lower under Labour-led governments, relative to economic conditions at the time. However, the direction of the survey is cause for concern. Confidence has entered a renewed decline in recent months, after a brief rebound in the early part of this year.

The question is whether businesses' expressed pessimism will translate into action. There has been only modest evidence for this to date. Growth in job advertisements has slowed, and imports of plant and machinery have eased off in the last few months, but both measures remain at high levels.

Our view is that the pace of growth in the economy has passed its peak, but that the weakness in business confidence overstates the case.

Even with an impending fillip from increased government spending, growth in the coming years is likely to remain below the peaks seen in the middle of this decade, as the economy's spare capacity disappears and net migration slows. However, this represents a slowdown in growth from

unsustainably high levels, rather than anything resembling a recession.

We expected to see some sign of the growth slowdown coming through in last week's labour market figures. But despite a slightly softer headline result, the details of the surveys were surprisingly robust.

The unemployment rate rose slightly in the June quarter to 4.5%, against expectations of a steady rate of 4.4%. That's not a significant change given the historic volatility of the unemployment rate, and the reasons behind it weren't alarming: employment grew by 0.5%, but was outstripped by a rise in labour force participation.

We've noted previously that recent changes to the Household Labour Force Survey (HLFS) have introduced a seasonal bias, where June quarters tend to be understated. So it's likely that employment growth was even stronger than the headline figures suggest. That's apparent from the fact that annual employment growth accelerated to 3.7% in June, compared to 3.1% in March. The employer-focused Quarterly Employment Survey (QES) showed a similar acceleration in jobs growth. Incidentally, the QES is a direct input to some of the services components of GDP, so these results put some upside risk on our forecast of a 0.7% rise in June quarter GDP.

The Labour Cost Index (LCI) was also in the spotlight ahead of last week's releases. Anecdotes suggest that some of

Working through the details... cont.

businesses' recent angst stems from the difficulty of finding workers and the resulting pressure to lift pay rates.

The private sector LCI measure was up 2.1% in the last year, compared to 1.9% last quarter. Some of the pickup was due to a larger minimum wage increase this year compared to previous years. But there does seem to have been a lift in private sector wage growth beyond this – not a big change, but this is a very slow-moving series, so we wouldn't have expected more than what we got at this point.

The labour market surveys were particularly important to the Reserve Bank, now that employment outcomes are part of its mandate along with price stability. We think the RBNZ should be comfortable on both fronts, ahead of Thursday's Monetary Policy Statement. The economy continues to run close to 'maximum sustainable employment', notwithstanding the small uptick in the unemployment rate last quarter. And the message from the wages data is similar to that from the inflation figures last month: underlying wage and price pressures are gradually picking up, though they are still on the lower side of what would be consistent with the RBNZ's inflation target.

The balance of those factors argues for keeping the OCR at a low level for a considerable period of time. In its May MPS the RBNZ's forecasts showed an unchanged OCR through until late 2019, and gradual increases thereafter. However, the language of the statement emphasised that the next

move in the OCR could be in either direction, if required by changing conditions.

We expect that language to be retained in this week's review. Economic developments in the past three months have been mixed: growth has been softer than expected in the near term, but underlying inflation has been a little stronger. House prices have softened in the last few months, and the international environment looks a little more hazardous as the US's various trade spats heat up. But the lower New Zealand dollar provides something of a buffer to exporters.

If anything, there is a risk of a slightly more dovish tone to the statement compared to May, reflecting the RBNZ's judgement on fiscal policy. In the June OCR review we were surprised that the RBNZ regarded the 2018 Budget as less stimulatory, in contrast to the Treasury's view that it was more stimulatory. We suspect the RBNZ will stick to its view, but until now there hasn't been an opportunity to elaborate on it.

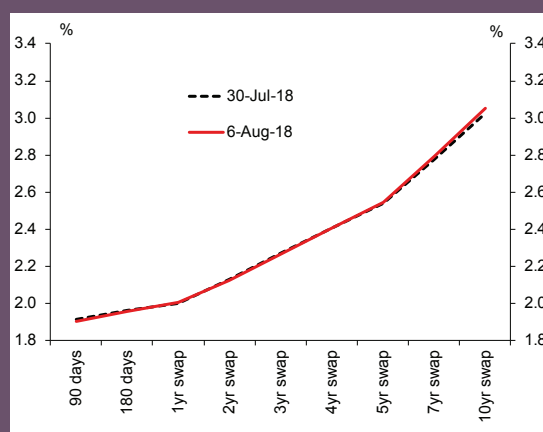
Our view remains that the next move in the OCR will be up, but not until the end of 2019. Financial markets, which for some time were picking an earlier rate hike, have now fallen into line with our view. A slightly more dovish tone to this week's statement would likely produce very little market reaction.

Fixed vs Floating for mortgages

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.

We expect floating and short-term fixed mortgage rates to rise gradually over the coming few years, meaning that taking a fixed rate may prove worthwhile. One-year fixed rates are usually 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.

NZ interest rates



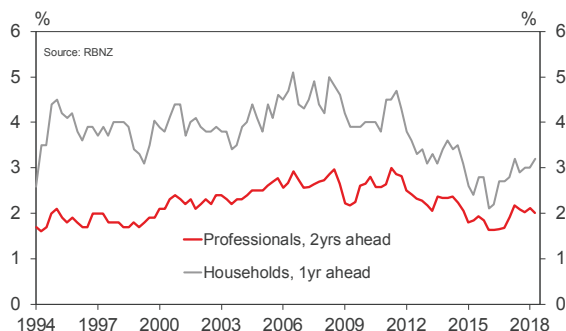
The week ahead

NZ Q3 RBNZ survey of inflation expectations

Aug 8, Two years ahead, last: 2.01%

- The latest RBNZ expectations survey was held soon after the June quarter CPI result. While headline inflation was a touch softer than expected in June, core inflation measures point to a firming in underlying pressures centred on the more persistent non-tradable components. On top of that, there have been some well publicised price increases (e.g. petrol), as well as growing concern about Government policy and rising costs.
- Inflation expectations in this and other surveys have lifted from the lows we saw in 2016/17 and are now at levels consistent with the RBNZ's 2% target mid-point. Most other surveys have pointed towards a further firming recently.

RBNZ survey of inflation expectations

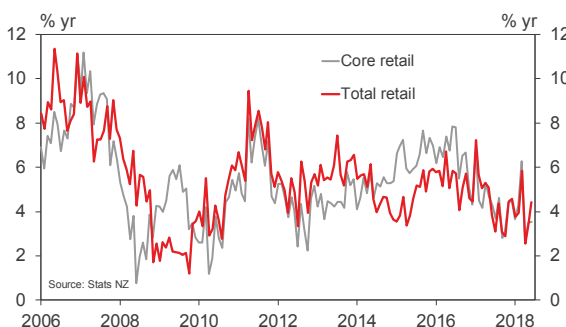


NZ Jul retail card spending

Aug 10, Last: +0.8%, WBC f/c: +0.6%

- Smoothing through month-to-month volatility, the first half of 2018 saw the momentum in spending growth fade, with overall retail spending effectively trending sideways since January. In large part, this was due to the slowdown in the housing market and related changes in household spending appetites.
- We expect to see spending picking up again through the middle part of the year, with a 0.6% gain expected in June. This is due to increases in government transfer payments, such as Working for Families payments and the accommodation supplement. Nominal spending levels will also be boosted by increases in fuel taxes (though this will limit spending growth in other areas).

Card transactions, annual % change

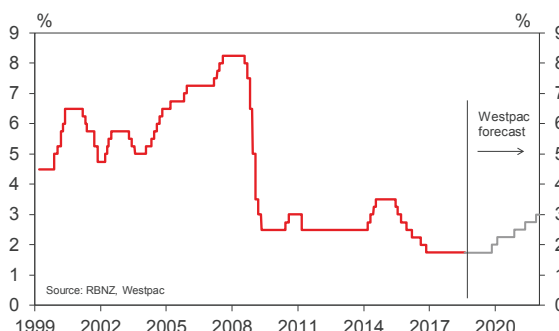


NZ RBNZ Official Cash Rate decision and Monetary Policy Statement

Aug 9, Last: +1.75%, WBC f/c: +1.75%, Mkt: 1.75%

- We expect that the RBNZ will keep the Official Cash Rate unchanged at its August policy meeting. The economy has delivered mixed messages recently, with growth slowing but inflation pressures rising. These forces will broadly offset one another in the RBNZ's thinking.
- The RBNZ is likely to retain its policy outlook from recent meetings, and will signal that the OCR is expected to remain at its current low level for a long while. The forecast track for the OCR will likely be unchanged, or perhaps a tiny smidgen lower. We expect the RBNZ to restate that the next move in the OCR could be "up or down".
- Like us, markets are primed for a neutral to slightly dovish Statement.

RBNZ Official Cash Rate



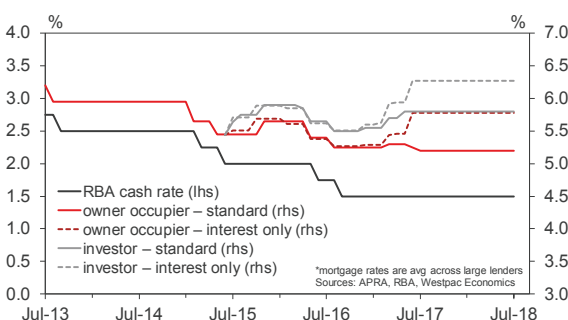
Aus RBA policy decision

Aug 7, Last: 1.50%, WBC f/c: 1.50%

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

- The RBA is certain to keep the overnight cash rate unchanged at 1.5% at its August policy meeting. The Governor's decision statement is also likely to retain the key line that: "further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual".
- This month's decision will be followed by the release of updated commentary and forecasts with the RBA's Statement on Monetary Policy on Aug 10. We expect the Bank to retain its upbeat 3.25% growth forecasts for both 2018 and 2019. There will be more interest around the trajectory for inflation, with current forecasts only just nudging into the 2-3% target band by June 2020 but the August update extending that forecast horizon to December 2020.

RBA cash rate and mortgage interest rates



The week ahead

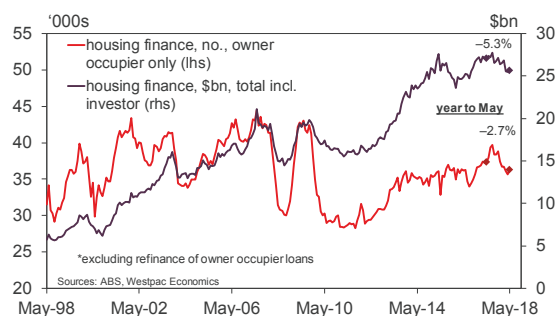
Aus Jun housing finance (no.)

Aug 8, Last: 1.1%, WBC f/c: -1.0%

Mkt f/c: 0.0%, Range: -2.0% to 2.0%

- Australian housing finance approvals were firmer than expected in May, the number of owner occupier loans rising 1.1% and the value of investor loans up 0.1% in the month. The result was against the wider 'run of play' for housing markets – auction activity and prices both pointing to a further softening through the middle of the year.
- Finance approvals should reconnect with the wider market picture in June although specific indicators are a bit mixed. Industry data covering the major banks suggest seasonally adjusted approvals posted a rise in June, but were much weaker than the ABS figures in May. Other indicators tracking wider mortgage activity look to have better captured the May resilience and point to some softening in June that accelerated in July.

New finance approvals*

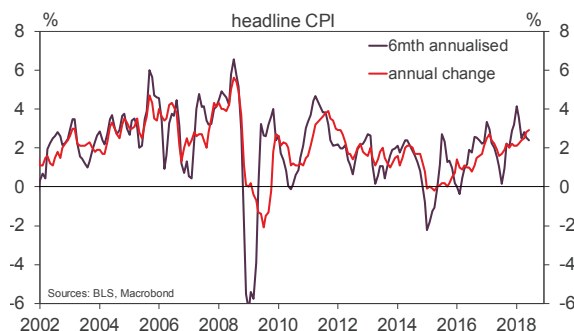


US Jul CPI

Aug 10, last 0.1%, WBC 0.2%

- Since February 2018, headline annual CPI inflation has been well in excess of the FOMC's 2.0%yr inflation target, having risen from 2.2%yr at February to 2.9%yr at June. While in part due to energy prices, core inflation (which exclude food and energy) also moved higher, from 1.8%yr to 2.3%yr.
- Shortening the time horizon assessed highlights why the FOMC has not been concerned by these well-above target outcomes. Notably, the six-month annualised pace has eased, from 3.6% to 2.4% for headline inflation and 2.5% to 2.3% for core. The three-month metric suggests a further deceleration will occur in coming months, but likely not quite yet. In July, a 0.2% gain is likely to instead hold up the annual rate.

For inflation, the tide is turning



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 06					
NZ	Jul ANZ commodity price index	-1.0%	-	-	To reflect the sharp decline in dairy prices in July.
Aus	Jul MI inflation gauge	2.0%	-	-	Was running ahead of the CPI but is now moderating.
	Jul ANZ job ads	-1.7%	-	-	Will we see an extended soft patch in the labour market?
	Bank Holiday	-	-	-	NSW (not a state wide holiday) & ACT, Picnic Day in NT.
Chn	Q2 current account balance	-34.1	-	-	Dated, but useful for information on financial flows.
Eur	Aug Sentix investor confidence	12.1	14.0	-	Investors remain positive overall.
Tue 07					
Aus	RBA policy decision	1.50%	1.50%	1.50%	Rates on hold, as tighter lending conditions cool housing.
Chn	Jul foreign reserves \$bn	3112	-	-	Has remained fairly stable over past year.
UK	Jul Halifax house prices	0.3%	-	-	Brexit uncertainty still dampening price growth, esp. in Ldn.
US	Jun JOLTS job openings	6638	-	-	Hires; fires; quits and job openings point to strength.
	Jun consumer credit \$bn	24.56	-	-	Auto credit growth yet to show material rate effect.
Wed 08					
NZ	GlobalDairyTrade auction	-1.7%	-	-	Will be watched carefully for further signs of weakness.
	Q2 RBNZ 2yr ahead inflation exp.	2.01%	-	-	Upside pressures rising, but inflation still well contained.
Aus	Jun housing finance	1.1%	flat	-1.0%	Further softening to become more apparent in June-July.
	RBA Governor Lowe speaks	-	-	-	'Demographic Change & Recent Monetary Policy', Sydney, 1pm
Chn	Jul trade balance USDbn	41.61	-	-	Tariff induced volatility might be seen in coming months.
	Jul foreign direct investment %yr	0.3%	-	-	FDI holds significant promise for China.
US	Fedspeak	-	-	-	Barkin speaking on 'Unlocking our potential' in Virginia.
Thu 09					
NZ	RBNZ policy decision	1.75%	1.75%	1.75%	Keep rates on hold for some time yet, neutral bias expected.
UK	Jul RICS house price balance	2%	-	-	Mort. fixing to limit impact of hike, but impetus still muted.
Chn	Jul PPI %yr	4.7%	-	-	Commodities continue to aid upstream prices...
	Jul CPI %yr	1.9%	-	-	... but inflation for consumer remains very subdued.
Eur	ECB bulletin	-	-	-	Detail on views and forecasts.
US	Initial jobless claims	218k	-	-	At historically low level.
	Jul PPI	0.3%	0.3%	-	Higher USD to moderate upstream price pressures.
	Jun wholesale inventories final	0.0%	0.0%	-	Inventory volatility likely to persist in coming quarters.
Fri 10					
NZ	Jul BusinessNZ manufacturing PMI	52.8	-	-	Sector indicators point to softer activity through mid-2018.
	Jul retail card spending	0.8%	-	0.6%	Boosts from govt support, but fuel prices higher also.
Aus	RBA Statement on Monetary Policy	-	-	-	Updated growth and inflation forecasts out to Dec 2020.
Chn	Jul M2 money supply %yr	8.0%	-	-	Tentative date. Increased focus given recent weakness.
	Jul aggregate financing, CNYbn	1180.0	-	-	Tentative date. Increased focus given recent weakness.
	Jul new loans, CNYbn	1840.0	-	-	Tentative date. Increased focus given recent weakness.
UK	Jun industrial production	-0.4%	0.5%	-	Bounce expected after recent softness.
	Jun trade balance, £b	-2790	-2789	-	Rising cost of goods imports offsetting firming in services.
	Jun construction output	2.9%	-	-	Activity has lifted, boosted by industrial projects.
	Q2 GDP (provisional)	0.2%	0.4%	0.4%	Recovery following weather related disruptions.
US	Jul CPI	0.1%	0.2%	0.2%	Is this the cycle peak for inflation?
	Jul monthly budget statement \$bn	-74.9	-	-	Widening deficit beginning to be seen.

New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2018				Calendar years			
% change	Mar (a)	Jun	Sep	Dec	2016	2017	2018f	2019f
GDP (Production)	0.5	0.7	0.8	0.7	4.0	2.8	2.6	3.2
Employment	0.6	0.5	0.1	0.4	5.8	3.7	1.6	1.6
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	1.4
Current Account Balance % of GDP	-2.8	-3.0	-3.2	-3.2	-2.2	-2.7	-3.2	-3.0

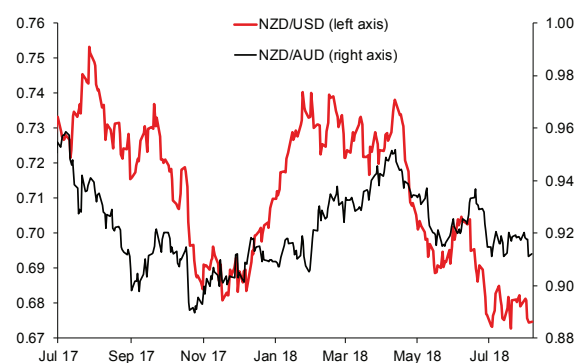
¹ Annual average % change

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	2.00
90 Day bill	2.00	2.00	2.00	2.00	2.10	2.20
2 Year Swap	2.20	2.30	2.40	2.55	2.70	2.80
5 Year Swap	2.70	2.85	3.00	3.15	3.25	3.30
10 Year Bond	2.90	3.15	3.30	3.35	3.40	3.45
NZD/USD	0.68	0.67	0.65	0.65	0.64	0.65
NZD/AUD	0.92	0.91	0.90	0.90	0.91	0.93
NZD/JPY	76.2	75.0	74.1	73.5	71.7	71.5
NZD/EUR	0.58	0.58	0.57	0.56	0.54	0.54
NZD/GBP	0.52	0.53	0.53	0.53	0.52	0.53
TWI	73.4	72.7	71.2	70.9	70.1	70.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 6 August 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.81%	1.82%	1.87%
60 Days	1.85%	1.87%	1.93%
90 Days	1.91%	1.92%	1.99%
2 Year Swap	2.12%	2.15%	2.19%
5 Year Swap	2.55%	2.53%	2.57%

NZ foreign currency mid-rates as at 6 August 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6747	0.6791	0.6839
NZD/EUR	0.5830	0.5787	0.5824
NZD/GBP	0.5188	0.5172	0.5133
NZD/JPY	75.05	75.57	75.51
NZD/AUD	0.9120	0.9153	0.9203
TWI	73.06	73.23	73.16

International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
Australia						
Real GDP % yr	2.6	2.5	2.6	2.2	2.7	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	1.8	1.8
Unemployment %	6.2	5.8	5.7	5.4	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.5	-2.8	-4.0
United States						
Real GDP %yr	2.6	2.9	1.5	2.3	2.8	2.5
Consumer Prices %yr	1.6	0.1	1.3	2.1	2.6	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	1.2	1.0
Euro zone						
Real GDP %yr	1.3	2.1	1.8	2.3	2.1	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	4.3	4.3
World						
Real GDP %yr	3.6	3.5	3.2	3.8	3.8	3.7

Forecasts finalised 6 July 2018

Interest Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.97	2.04	2.02	1.95	1.95	1.90	1.90	1.85
10 Year Bond	2.73	2.75	3.05	3.20	3.10	3.10	3.00	3.00
International								
Fed Funds	1.875	2.125	2.375	2.625	2.875	2.875	2.875	2.875
US 10 Year Bond	2.99	3.00	3.35	3.50	3.50	3.40	3.20	3.10
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	-0.10

Exchange Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
AUD/USD	0.7371	0.74	0.74	0.72	0.72	0.70	0.70	0.72
USD/JPY	111.70	111	112	114	113	112	110	109
EUR/USD	1.1594	1.17	1.16	1.15	1.16	1.18	1.20	1.21
AUD/NZD	1.0948	1.09	1.10	1.11	1.11	1.09	1.08	1.09

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
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