

# Weekly Commentary

1 October 2018



Glow Worm (*Arachnocampa Luminosa*)

## Let me make this clear

The tone of last week's Reserve Bank policy statement was a little more dovish than their last missive. However, rather than reflecting any change in stance, the details of the September press statement help to cement what the RBNZ's position is: it expects to keep the OCR on hold for an extended period, but the risks are tilted to the downside. The RBNZ is especially conscious of the downside risks for activity, and on that front the latest round of confidence surveys still points to some clouds on the economic horizon.

September's Official Cash Rate review was a 'no surprises' affair. The Reserve Bank left the OCR unchanged at 1.75%. They also repeated the key guidance phrases from the previous policy statement, noting that:

- 1) they "expect to keep the OCR at this level [1.75%] through 2019 and into 2020";
- 2) the next move could be "up or down";
- 3) and that they "expect to keep the OCR at an expansionary level for a considerable period...".

All of that was as expected, and as a result we saw very little reaction in either interest rate or exchange rate markets following the announcement.

What was more telling was the accompanying press release which provided an explicit description of the RBNZ's policy stance. In particular, the RBNZ stated that while it expects to keep the cash rate on hold for an extended period, that is dependent on the pace of growth picking up over the coming year. They went on to note that, although June quarter GDP growth was stronger than expected (up +1% vs. the RBNZ's forecast of +0.5%), they still see the risks for growth as being to the downside.

That sense of downside risk was absent from the previous August press release itself (though it was in the details of the August *Monetary Policy Statement* and related media comments). Bringing those comments into the press release

gave it a more dovish feel than in the August missive, but it did not represent a change in the RBNZ's view.

This has helped to cement our understanding of the RBNZ's policy stance. Since the August MPS, there has been a raft of stronger economic data. That includes June quarter GDP growth, rising petrol prices, and a weaker exchange rate. However, the RBNZ has effectively dismissed all of this. And a big part of the reason for that is because the RBNZ has had a change in Governor and is now operating under a new mandate. We strongly suspect that the new regime will be keener to shore up GDP growth when it flags, and more willing to take a risk when inflation is rising. It will take more than a few strong data points to deter the central bank from its soft easing bias. And if GDP growth falls short of its expectations, the RBNZ would realistically consider cutting.

Our central expectation is that the OCR will remain on hold until mid-2020. However, we still see a one-in-three chance of a rate cut over the coming year. The RBNZ's last set of published forecasts from August look optimistic to us. In particular, we are forecasting 3.1% annual GDP growth for 2019, compared to the RBNZ's forecast of 3.5%. We also expect that inflation will rise more gradually than the RBNZ expects. Downside surprises on either of these fronts, or in the labour market, could push the RBNZ over the line for a cut.

One of the lingering dark clouds on the horizon is the weakness in economic confidence, which has raised the

# Let me make this clear... continued

spectre of a downturn in spending and hiring over the coming year. Our survey of Regional Confidence has found that, although sentiment has held up better in areas linked to fast growing export sectors like horticulture and tourism, confidence is below average in nearly all regions (the notable exception being Otago). Conditions are particularly weak in upper North Island areas, especially Auckland, with factors such as rising living costs and the slowing housing market major concerns for households.

Looking at the labour market, our Westpac-McDermott Miller Employment Confidence survey highlighted that households are particularly concerned about income growth. In fact, the number of households that expect their earnings will increase over the coming year is languishing at the sort of lows we saw during the financial crisis. And while households are still optimistic about their chances of finding a job, they have noted growing concerns about the strength of economic conditions more generally over the coming year.

Confidence is especially weak in the business sector, with large declines following last year's election. Much of this pessimism stems from nervousness about coming changes in economic policy, particularly with regards to the labour market. We did see some uptick in business confidence in September, with the headline ANZBO confidence measure rising from -50.3 to -38.3. However, much of that increase

was due to normal seasonal swings. And after accounting for that, we're still left with a picture of moribund confidence in the business sector.

There's certainly no denying the sense of nervousness that has permeated through the economy in recent months. But at least for now, the fall in some confidence surveys seems to be overstating the degree of weakness in actual activity. In particular, several key gauges of business confidence are at levels that would normally be associated with a recession. However, when we look at actual economic activity, what we've seen is a cooling in growth - not a crash. GDP growth has slowed to 2.7%, and the details of the June report were encouraging for the economy's prospects. We also saw imports of capital equipment holding up in the August trade figures.

We're not completely dismissing the weakness in confidence surveys. In fact, our projections assume that this nervousness will weigh on household and business spending over the coming year. However, we expect that this dampening effect won't be as stark as some of the more pessimistic survey gauges suggests. With that in mind, we'll be keeping a close eye on this week's Quarterly Survey of Business Opinion. This tends to be one of the more reliable reads on business conditions, and will provide an early read on how GDP is shaping up in the September quarter.

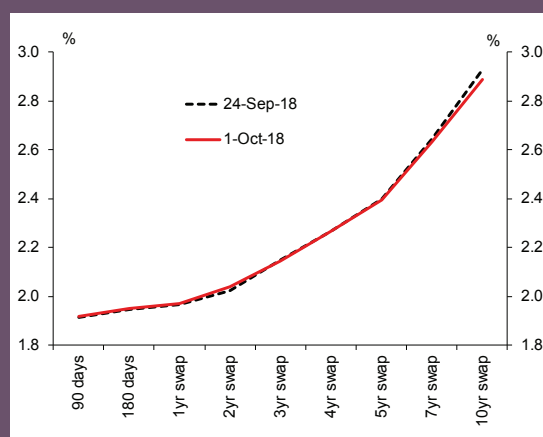
## Fixed vs Floating for mortgages

Fixed-term mortgage rates are currently falling, 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



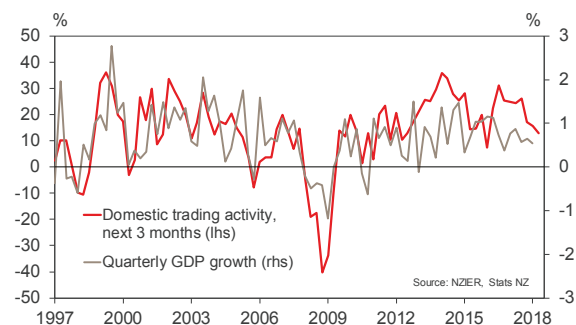
# The week ahead

## NZ Q3 Survey of Business Opinion

Oct 2, Domestic trading activity - Last: +7

- Business confidence fell sharply in the June quarter as firms became more circumspect about both their own prospects and those of the broader economy.
- Since June, monthly surveys of business confidence have remained weak. However, other data which directly measures economic activity has been stronger. The QSBO tends to be less volatile and better correlated with GDP growth than other confidence surveys.
- There were signs of emerging inflation pressures in the June quarter QSBO. Since then petrol prices have continued to rise on the back of higher oil prices, a weaker NZ dollar and increased government charges.

## QSBO domestic trading activity and GDP



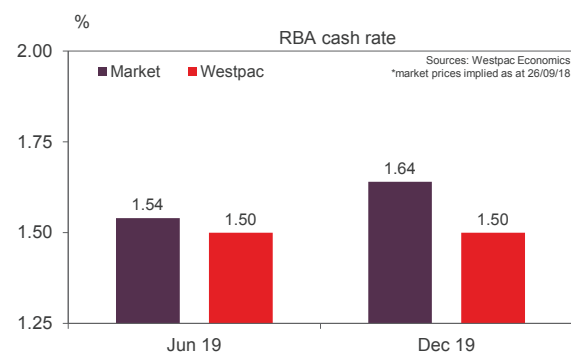
## Aus RBA policy decision

Oct 2, 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 October 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 3.4%; 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 following strong gains and as lending conditions tighten.

## 2019: Westpac sees hold; market on 50% chance

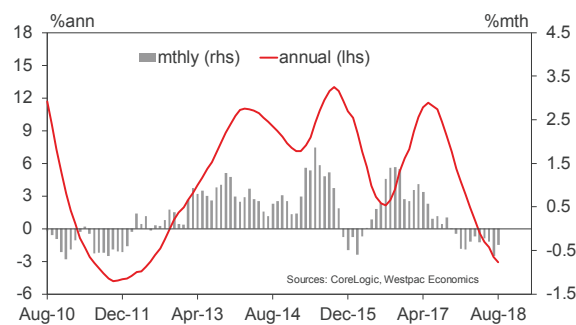


## Aus Sep CoreLogic home value index

Oct 2, Last: -0.4%, WBC f/c: -0.6%

- Australia's housing market continues to correct. The CoreLogic home value index, covering the eight major capital cities, fell 0.4% in August to be down 3.1%yr. The previously strong Sydney and Melbourne markets have driven the turnaround over the last year although most markets have seen some price slippage in recent months, suggesting tightening lending conditions are the underlying driver.
- The daily index points to a further 0.6% fall in September which would take the annual pace of decline nationally to around 4%/yr. Note that this is unlikely to capture the full impact of recent mortgage rate increases (three of the four major banks raised rates by 14-16bps in late August/early September).

## Australian dwelling prices



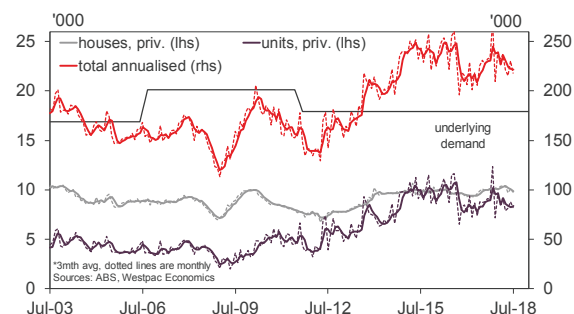
## Aus Aug dwelling approvals

Oct 3, Last: -5.2%, WBC f/c: -2.5%

Mkt f/c: 1.0%, Range: -5.0% to 3.4%

- Dwelling approvals posted a 5.2% pull back in July with all segments and states recording declines in the month. The move brings approvals more into line with Westpac's view of a further leg lower driven by weaker high rise activity, although it will take a few more similarly-sized monthly declines to confirm this.
- Approvals are expected to show a 2.5% decline in August. Construction-related finance approvals have continued to soften, pointing to a likely pull-back in non high rise approvals. Our 'second leg lower' view on high rise approvals centres on a sharp drop in site purchases in 2017. With the Sydney and Melbourne housing markets swinging into price corrections and financing conditions tightening for both home buyers and developers, we may also start to see projects proceed more slowly or be shelved.

## Dwelling approvals



# The week ahead

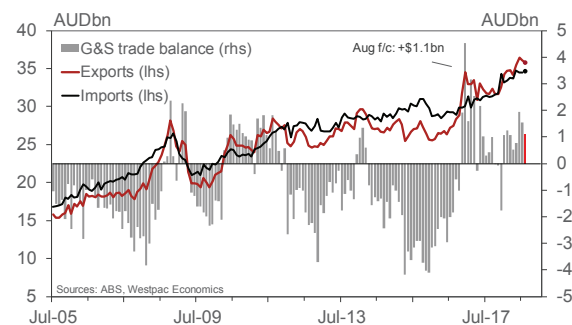
## Aus Aug trade balance, AUDbn

Oct 4, Last: 1.55, WBC f/c: 1.1

Mkt f/c: 1.45, Range: 1.0 to 2.3

- Australia's trade account has been in surplus each month so far in 2018.
- In July, the surplus remained elevated, at \$1.55bn. While down from \$1.9bn in June it still exceeds the Q2 monthly average of \$1.1bn.
- For August, we expect the surplus to ease back further, down by \$0.45bn to a forecast \$1.1bn.
- Export earnings are expected to decline, down 0.8%, -\$0.3bn. Falls are led by coal, fuels and metals (on lower volumes) only partial offset by a rise in iron ore (on prices and volumes).
- The import bill is expected to edge higher, up 0.5%, +\$0.15bn, on a combination of higher volumes and prices.

## Australia's trade balance



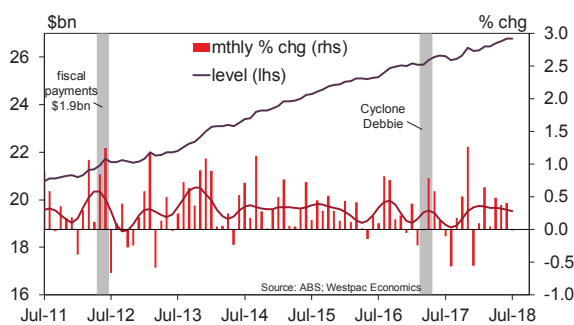
## Aus Aug retail trade

Oct 5, Last: flat, WBC f/c: 0.2%

Mkt f/c: 0.3%, Range: 0.0% to 0.7%

- Retail sales were flat in July, a lacklustre result following a reasonably solid 1.3% bounce over the course of Q2. Sales have been choppy around a modest trend through the past year, some of the noise due to shifts in the timing of sales. Note that July was the first read post the extension of the GST to low value imported goods (including those purchased online). The change may have affected the competitiveness and pricing of local retailers although impacts are uncertain and may be slow to come through.
- Indicators were on the soft side in August. Consumer sentiment remained in slight positive territory overall but slipped lower in the month. Private business surveys were mixed, retail responses to the NAB survey soft but AIG PSI suggesting holding up better. On balance, we expect August to show a 0.2% gain.

## Monthly retail sales



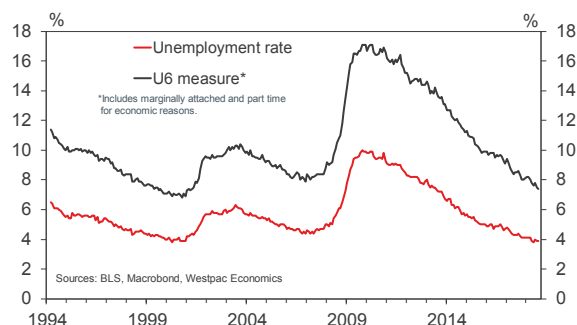
## US Sep employment report

Oct 5, nonfarm payrolls, Last: 204k, WBC f/c: 195k

Oct 5, unemployment rate, Last: 3.9%, WBC f/c: 3.8%

- In recent years, there has been no stopping the US labour market. On a three and six month average basis, nonfarm payrolls have risen 183k and 189k respectively, materially above the 100k needed to hold the unemployment rate constant. For Sep, we see another outsized gain, circa 195k.
- As a result of this continued strength, the unemployment rate is forecast to edge down to 3.8% in September, bringing it back to the cycle-low initially reported in May. Since then, higher participation has seen the unemployment rate temporarily move higher.
- At this point in the cycle, wages growth is a keen focus. An annual growth outcome near 3.0%yr for hourly earnings is our expectation. A run materially above this figure is unlikely until at least mid-2019, limiting inflation risks.

## Underemployment can be further reduced



# Data calendar

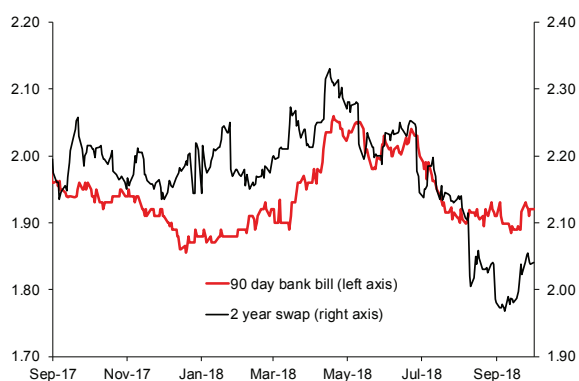
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 01</b>					
<b>Aus</b>	Public holiday in some states	-	-	-	Labour Day in SA, NSW & ACT; Queen's Birthday in Qld.
	Sep AiG PMI	56.7	-	-	Manufacturing expansion on construction + lower AUD.
	Sep MI inflation gauge	2.1%	-	-	The Gauge was running ahead of the CPI but eased back.
<b>Eur</b>	Sep Markit manufacturing PMI	53.7	-	-	Growth is cooling from 2017's well above trend pace...
	Aug unemployment rate	8.2%	-	-	... but still positive seeing slack reduced in labour market...
<b>UK</b>	Aug net lending on dwellings, £b	3.2	3.5	-	Credit growth moribund over past year.
	Sep Markit manufacturing PMI	52.8	52.5	-	Momentum in manufacturing has been easing recently.
<b>US</b>	Sep Markit manufacturing PMI	55.6	-	-	Conditions are very strong for manufacturing.
	Aug construction spending	0.1%	0.5%	-	Mixed across sectors, and volatile month to month.
	Sep ISM manufacturing	61.3	60.1	-	At 14 year high.
	Fedspeak	-	-	-	Bostic, Kashkari and Rosengren in separate events.
<b>Tue 02</b>					
<b>NZ</b>	Q3 QSBO general business situation	-19	-	-	Closely watched given weakness in other surveys.
<b>Aus</b>	Sep CoreLogic home value index	-0.4%	-	-0.6%	Prices now down around 4%/yr, back to Jan 2017 level.
	RBA policy decision	1.50%	1.50%	1.50%	On hold.
<b>UK</b>	Sep Nationwide house prices	-0.5%	0.2%	-	Economic uncertainty, rising rates weighing on prices.
<b>US</b>	Fed Chair Powell speaks	-	-	-	At NABE Conference in Boston.
	Fedspeak	-	-	-	Quarles testifies to Senate Banking Committee.
<b>Wed 03</b>					
<b>NZ</b>	GlobalDairyTrade auction	-1.3%	-	-	Stronger volumes may weigh on prices.
<b>Aus</b>	Sep AiG PSI	52.2	-	-	Strength centred in business service segments.
	Aug dwelling approvals	-5.2%	1.0%	-2.5%	Volatile monthly but July in line with our '2nd leg' lower view.
<b>Eur</b>	Sep Markit services PMI	54.7	-	-	Holding up better than manufacturing on domestic demand.
<b>UK</b>	Sep Markit services PMI	54.3	54.0	-	Signs of some easing in spending, uncertainty a drag.
<b>US</b>	Sep ADP employment change	163k	185k	-	Employment growth likely to drift a little in coming months.
	Sep Markit services PMI	52.9	-	-	Underperforming ISM, but still robust.
	Sep ISM non-manufacturing	58.5	58.0	-	Pointing to growth well above trend.
	Fed Chair Powell speaks	-	-	-	Moderated discussion with Judy Woodruff.
	Fedspeak	-	-	-	Evans, Barkin, Brainard and Mester in separate events.
<b>Thu 04</b>					
<b>Aus</b>	Aug trade balance, \$bn	1.55	1.45	1.1	Surplus to narrow, exports f/c -0.8% & imports f/c +0.5%.
<b>US</b>	Initial jobless claims	214k	-	-	Very low.
	Aug factory orders	-0.8%	1.0%	-	Underlying momentum has been robust, headline volatile.
	Fedspeak	-	-	-	Quarles at community banking conference.
<b>Fri 05</b>					
<b>Aus</b>	Aug retail sales	0.0%	0.3%	0.2%	Indicators again looking soft for August.
	RBA Head Economic Heath speaks	-	-	-	Business education event, topic TBA, Canberra 11:35 am.
<b>UK</b>	Sep Halifax house prices	0.1%	-	-	Prices muted, esp. in London. Economic uncertainty a drag.
<b>US</b>	Aug trade balance US\$bn	-50.1	-48.5	-	Deficit with China historically wide.
	Sep non-farm payrolls	201k	188k	175k	Employment growth likely to drift a little in coming months.
	Sep unemployment rate	3.9%	3.8%	3.8%	Still supportive of lower unemployment rate.
	Aug consumer credit \$bn	16.6	15.0	-	Rate rises yet to have a material impact on credit demand.
	Fedspeak	-	-	-	Bostic at financial literacy conference.

# New Zealand forecasts

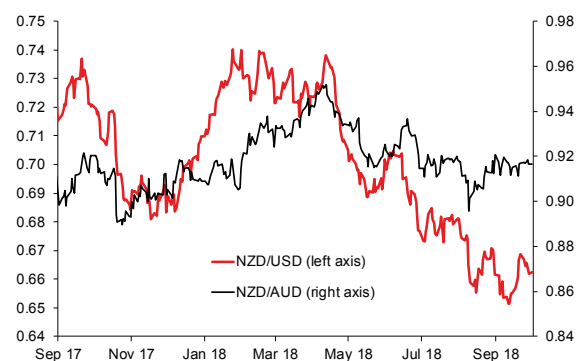
Economic Forecasts	Quarterly				Annual			
	2018				Calendar years			
	% change	Mar (a)	Jun	Sep	Dec	2017	2018f	2019f
GDP (Production)	0.5	1.0	0.7	0.7	2.8	2.8	3.1	2.9
Employment	0.6	0.5	0.4	0.3	3.7	1.8	1.4	1.7
Unemployment Rate % s.a.	4.4	4.5	4.5	4.6	4.5	4.6	4.6	4.4
CPI	0.5	0.4	0.7	0.3	1.6	1.9	1.6	1.8
Current Account Balance % of GDP	-3.0	-3.3	-3.5	-3.5	-2.9	-3.5	-3.4	-2.9

Financial Forecasts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.95	2.00	2.10
2 Year Swap	2.10	2.20	2.30	2.45	2.60	2.75
5 Year Swap	2.60	2.75	2.90	3.05	3.15	3.25
10 Year Bond	2.80	3.00	3.15	3.25	3.35	3.40
NZD/USD	0.66	0.65	0.64	0.64	0.64	0.65
NZD/AUD	0.92	0.92	0.91	0.91	0.91	0.90
NZD/JPY	73.9	73.5	72.3	71.7	71.7	72.2
NZD/EUR	0.57	0.57	0.57	0.56	0.55	0.55
NZD/GBP	0.52	0.53	0.52	0.52	0.52	0.53
TWI	72.0	71.3	70.3	70.0	69.8	69.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 1 October 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.83%	1.82%	1.83%
60 Days	1.87%	1.85%	1.87%
90 Days	1.92%	1.89%	1.91%
2 Year Swap	2.04%	1.98%	1.98%
5 Year Swap	2.39%	2.31%	2.32%

NZ foreign currency mid-rates as at 1 October 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6624	0.6552	0.6620
NZD/EUR	0.5702	0.5636	0.5706
NZD/GBP	0.5079	0.5011	0.5114
NZD/JPY	75.29	73.39	73.49
NZD/AUD	0.9166	0.9152	0.9209
TWI	72.21	71.49	72.08

# International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
<b>Australia</b>						
Real GDP % yr	2.5	2.6	2.2	3.3	2.7	2.8
CPI inflation % annual	1.7	1.5	1.9	1.7	1.8	1.6
Unemployment %	5.8	5.7	5.4	5.3	5.3	5.2
Current Account % GDP	-4.7	-3.1	-2.6	-2.6	-3.6	-3.7
<b>United States</b>						
Real GDP %yr	2.9	1.5	2.3	2.9	2.5	1.7
Consumer Prices %yr	0.1	1.4	2.1	2.5	2.0	1.9
Unemployment Rate %	5.3	4.9	4.4	3.9	3.6	3.6
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	1.4	0.9	1.7	1.1	0.8	0.7
<b>Euro zone</b>						
Real GDP %yr	2.1	1.8	2.5	2.0	1.5	1.5
<b>United Kingdom</b>						
Real GDP %yr	2.3	1.9	1.8	1.2	1.2	1.4
<b>China</b>						
Real GDP %yr	6.9	6.7	6.9	6.3	6.1	6.0
<b>East Asia ex China</b>						
Real GDP %yr	3.8	3.9	4.5	4.4	4.2	4.1
<b>World</b>						
Real GDP %yr	3.5	3.2	3.8	3.8	3.6	3.5

Forecasts finalised 12 September 2018

Interest Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.94	2.00	1.97	1.97	1.92	1.92	1.83	1.80
10 Year Bond	2.68	2.85	3.00	3.00	3.00	2.80	2.60	2.60
<b>International</b>								
Fed Funds	2.125	2.375	2.625	2.875	2.875	2.875	2.875	2.875
US 10 Year Bond	3.05	3.20	3.40	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	0.7205	0.72	0.71	0.70	0.70	0.70	0.74	0.75
USD/JPY	113.39	112	113	113	112	112	109	106
EUR/USD	1.1637	1.15	1.14	1.13	1.14	1.16	1.22	1.28
AUD/NZD	1.0899	1.09	1.09	1.09	1.09	1.09	1.12	1.10

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