

Weekly Commentary

17 September 2018



Kauri Snail (Pūpūrangī)

Not bad at all

A lot of the commentary on the New Zealand economy has turned decidedly gloomy, in part prompted by the plunge in surveyed business confidence. But indicators of real activity actually show a confluence of solid gains over the June quarter. While we think that this week's GDP figures will overstate the case a little, the underlying picture is of an economy that continues to grow slowly but steadily.

We're expecting Thursday's GDP release to show a 0.9% rise for the June quarter, following three quarters of subdued growth between 0.5% and 0.6%. Our forecast would see the annual rate of growth hold steady at 2.7%. While the economy doesn't appear to have slowed further this year, it is still well down from its peak growth rate of 4% in 2016.

In part, our forecast reflects some large one-offs in particular sectors, where the impact on GDP is uncertain and is unlikely to be repeated. Hydroelectric power generation rose sharply after a low March quarter, rail freight has rebounded back to where it was before the Kaikoura earthquake, and public sector employment appears to have risen strongly.

However, there is also likely to be a substantial negative impact on growth from temporary shutdowns in oil refining and methanol production. We expect these to knock about 0.2% off June quarter GDP, but this impact will be added back into September quarter growth (where we have revised up our forecast slightly to 0.7%).

Setting aside those temporary influences, recent surveys have pointed to solid growth across a range of sectors. Retail trade rose by 1.1%, building activity was up 0.8%, and wholesale trade rose an estimated 1.6% after adjusting for prices. A strong lift in hours worked in the Quarterly Employment Survey, along with other sectoral surveys, point to strong growth in many of the services sectors.

The manufacturing sector was mixed. Dairy and meat processing saw strong gains compared to a weak March quarter, whereas wine production fell back after a jump in Q1. There was a second quarter of strong growth in machinery and equipment manufacturing, which suggests that businesses are still prepared to invest in their productive capacity.

Our forecast of a 0.9% rise in GDP is at the top of the range of market forecasts. More notably, it's quite a bit higher than the Reserve Bank's forecast of 0.5% growth in its August *Monetary Policy Statement*. This difference is important, given the RBNZ's recent comments that it is nearing the trigger point for cutting the OCR. Financial markets have taken those comments to heart, with interest rate markets giving close to a 50% chance of a cut in the next year, and the New Zealand dollar falling to its lowest levels since early 2016.

How would the RBNZ's thinking be swayed if GDP turned out in line with our forecast? You could argue that June quarter data is dated, and that plunging business confidence suggests the possibility of a downturn yet to come. Indeed, the RBNZ's own comments seemed to gloss over the June quarter outcome, and focused on the need to see a pickup in growth in the September quarter, when increased government spending and transfers to households are expected to kick in.

Not bad at all... continued

A better than expected starting point for the economy still matters, and it's unlikely that the RBNZ would be able to dismiss all of a June quarter surprise as temporary. Nevertheless, we're also keeping a close eye on the flow of high-frequency data for any signs that the economy has taken a turn since June. The handful of indicators that we have so far don't point to any change in the economy's momentum one way or another.

Electronic card spending rose by 1% in August, more than we expected. However, that was balanced out by a surprising downward revision to the July figures, which are now reported to be up just 0.2%. The downward revision to fuel spending is curious, given we know that petrol prices increased over the month (including the introduction of Auckland's 10c a litre regional fuel tax), and that fuel spending rose sharply again in August. But averaging out the two months suggests that retail spending continued to grow at around the same pace as in recent months.

The outlook for consumer spending is torn between two factors. On the positive side, the Government's Families Package, which took effect from 1 July, will put around an additional \$1.5bn a year into households' wallets. On the other hand, the slowdown in house price growth is likely to weigh on property owners' perceived wealth and hence their willingness to spend.

August was a mixed month for the housing market. House prices have continued to fall gradually in Auckland, but

elsewhere they have risen at a slightly faster pace in the last couple of months. The latter is likely due to the recent decline in mortgage rates, something that we think will continue to support prices in the near future. (Further cuts announced last week have taken some fixed-term mortgage rates down to new record lows). Auckland's underperformance is understandable given the range of new Government policies aimed at dampening housing market speculation, as the Auckland market has tended to have a relatively high proportion of investors.

Elsewhere, the manufacturing sector PMI lifted a little in August, though it still suggests a slower pace of growth this year compared to last year. Measures of job advertisements and traffic volumes also fared well in August. However, these monthly indicators can be very choppy, and it takes some time to discern whether there have been any genuine changes in the trend.

We do think there's a real chance that the RBNZ decides to cut the OCR sometime in the next year, even without a significant downturn in the economy. Inflation has been stubbornly on the lower side of the RBNZ's inflation target midpoint, and there doesn't seem to be much risk of overheating the economy. However, we think that a stronger starting point for activity, higher near-term inflation (partly due to rising fuel prices) and a bigger than anticipated fall in the exchange rate will be enough to stay the RBNZ's hand for now.

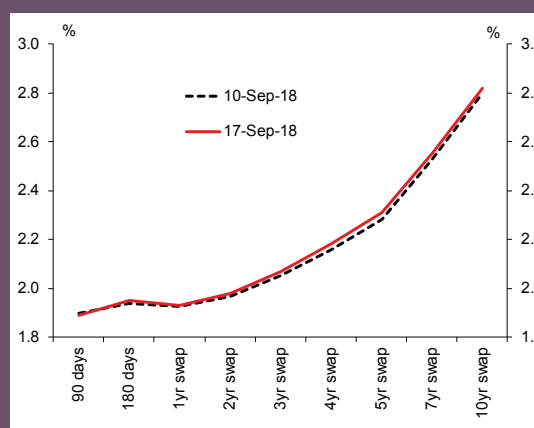
Fixed vs Floating for mortgages

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



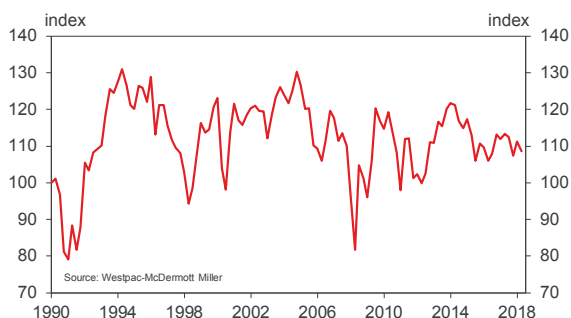
The week ahead

NZ Q3 Westpac McDermott Miller Consumer Confidence

Sep 19, Last: 108.6

- Consumer confidence fell in June, taking it slightly below its long-run average. The drop in confidence was widespread, and consistent with other signs that the edge has come off the economy's upturn. That said, the drop in confidence hasn't been particularly large to date. That speaks to more of a general malaise among households, rather than specific worries about the direction the economy is heading.
- The exception to the weaker tone of the June survey was households' perceptions as to whether it's a good time to buy a major household item, which rose for a second quarter.
- The September quarter survey will provide a look at how households' spending appetites are faring as the Government's Families Package has been rolled out.

Westpac-McDermott Miller consumer confidence

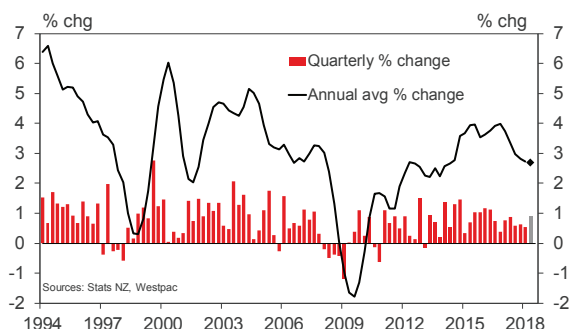


NZ Q2 GDP

Sep 20, Last: 0.5%, Westpac f/c: 0.9%, Mkt f/c: 0.8%

- After a few quarters of patchy, subdued growth, the stars seem to have aligned for the New Zealand economy during the June quarter. Recent activity indicators have shown growth ranging from modest to strong across a wide range of sectors. We expect a 0.9% rise in GDP for the quarter.
- In part, our forecast reflects some big one-off gains in particular services sectors that are unlikely to be repeated. However, there are also some temporary negatives. Shutdowns in fuel and methanol production will subtract around 0.2% from Q2 growth, but will boost Q3 growth by the same amount.
- The Q2 result could have an important bearing on the Reserve Bank's thinking, given its low expectation of 0.5% growth and its recent comments that it is nearing the trigger point for OCR cuts.

Production-based GDP

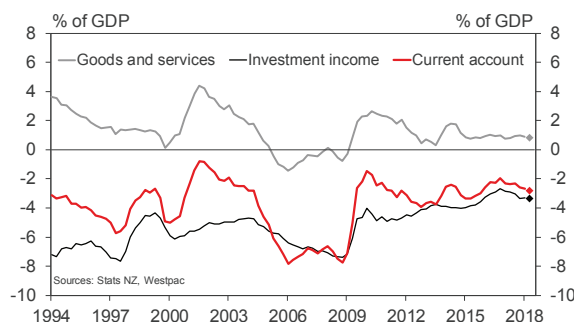


NZ Q2 current account, % of GDP

Sep 19, Last: -2.7%, Westpac f/c: -2.8%, Mkt f/c: -2.9%

- We expect a current account deficit of 2.8% of GDP for the year to June. This represents a slight widening from what we expect to be a revised 2.7% of GDP in March. Annual revisions to the balance of payments have led to a sharp lift in services exports for the last few years.
- The goods balance improved in the June quarter as export prices and volumes recovered from a weak March quarter. Imports remain elevated, particularly for plant and machinery. We expect an increase in the investment income deficit, due to higher profits for foreign-owned firms in New Zealand.
- The current account deficit remains low relative to history, and current levels support a further improvement in New Zealand's net overseas liabilities position.

Annual current account balance

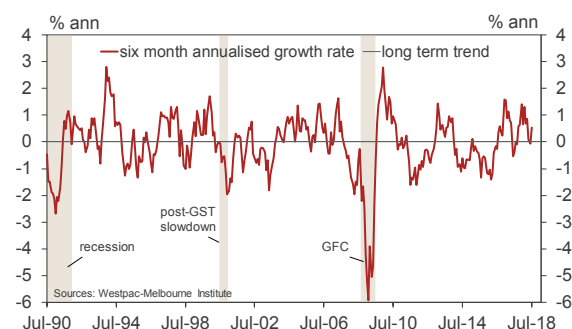


Aus Aug Westpac-MI Leading Index

Sep 19, Last: +0.55%

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, rose from -0.06% in June to +0.55% in July. Despite the solid rebound from last month's below trend read, the Leading Index growth rate has still slowed materially since the start of the year, the growth rate peaking at +1.31% in February.
- The August read will include a mixed bag of monthly updates. Dwelling approvals (down -5% vs 6.4% last month) and the Westpac-MI Consumer Expectations Index (down -3.2% vs -3% last month) recorded softer reads. Against this, commodity prices (up 1.8% in AUD terms vs -0.3% last month) and the Westpac-MI Unemployment Expectations Index posted solid gains.

Westpac-MI Leading Index



Data calendar

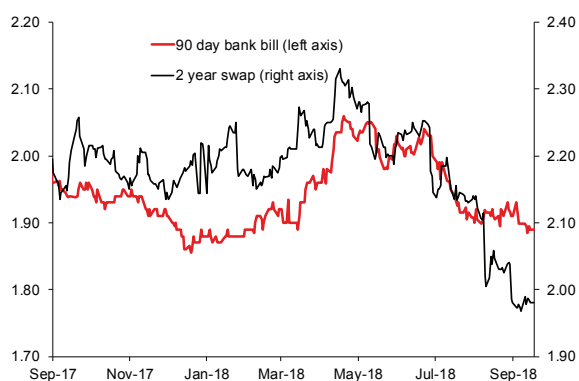
		Last	Market median	Westpac forecast	Risk/Comment
Mon 17					
NZ	Aug BusinessNZ services PSI	55.1	-	-	Business sector indicators have cooled this year.
Eur	Aug core CPI %yr final	1.0%	1.0%	-	Headline is easing from a 2.1% high.
UK	Sep Rightmove house prices	-2.3%	-	-	Price growth muted, but appears to have found a base.
US	Sep Fed Empire state index	25.6	23.0	-	Remains jubilant.
Tue 18					
Aus	RBA minutes	-	-	-	Further colour on the Board's views.
US	Sep NAHB housing market index	67	66	-	Construction g'th has waned, but prices keep rising.
	Jul total net TIC flows \$bn	114.5	-	-	Country detail always of interest.
Wed 19					
NZ	GlobalDairyTrade auction	-0.7%	-	-	Lift in volume on offer may weigh on powder prices.
	Q3 WBC-MM consumer confidence	108.6	-	-	June saw a modest but widespread easing in confidence.
	Q2 current account % of GDP	-2.7%	-2.9%	-2.8%	Improved balance for the qtr, but weaker than a year ago.
Aus	Aug Westpac-MI Leading Index	0.55%	-	-	Momentum swung back into +ve in Jul but well down on Feb.
	RBA Asst. Governor Kent speaks	-	-	-	'Money Creation' at RBA's Topical Talks for Educators.
Eur	ECB President Draghi speaks	-	-	-	At 'Making Europe's Economic Union Work' conference.
	EU Summit begins	-	-	-	Informal meeting on 'Internal Security', 19-20 in Austria.
UK	Aug CPI	0.0%	0.5%	-	Core well contained, imported pressures modest.
	Jul house price index, %yr	3.0%	-	-	House price inflation remains muted, especially in London.
	Aug retail sales	0.9%	-	-	Spending growth has firmed recently.
US	Aug housing starts	0.9%	4.6%	-	Have been weak of late...
	Aug building permits	0.9%	-0.2%	-	... pipeline of new multi-dwelling projects dwindling.
Thu 20					
NZ	Q2 GDP	0.5%	0.8%	0.9%	Big one-offs on top of slow but steady underlying growth.
Eur	Sep consumer confidence	-1.9	-2.0	-	Labour market to continue providing robust support.
US	Initial jobless claims	-	-	-	Very low, and set to remain that way.
	Sep Philly Fed index	11.9	15.0	-	Manufacturers in an optimistic mood.
	Aug leading index	0.6%	0.5%	-	Points to continued above-trend growth.
	Aug existing home sales	-0.7%	0.8%	-	Supply set to remain a major issue.
Fri 21					
NZ	Aug net migration	4720	-	4940	Annual rate continuing to trend down from high levels.
Eur	Sep Markit manufacturing PMI	54.6	54.6	-	Still positive but trend is lower...
	Sep Markit services PMI	54.4	54.4	-	... though services conditions have steadied...
UK	Aug net public sector borrowing, £bn	-2.9	-	-	Borrowing requirements have been lower than anticipated.
US	Sep Markit manufacturing PMI	54.7	55.0	-	Flash estimates...
	Sep Markit services PMI	54.8	54.8	-	... likely to keep positive tone.

New Zealand forecasts

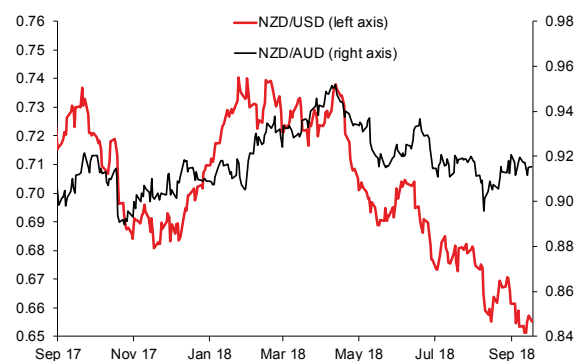
Economic Forecasts	Quarterly				Annual			
	2018				Calendar years			
	% change	Mar (a)	Jun	Sep	Dec	2017	2018f	2019f
GDP (Production)	0.5	0.9	0.7	0.7	2.8	2.8	3.1	2.9
Employment	0.6	0.5	0.4	0.3	3.7	1.8	1.4	1.7
Unemployment Rate % s.a.	4.4	4.5	4.5	4.6	4.5	4.6	4.6	4.4
CPI	0.5	0.4	0.7	0.3	1.6	1.9	1.6	1.8
Current Account Balance % of GDP	-2.8	-2.9	-3.2	-3.3	-2.7	-3.3	-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 17 September 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.82%	1.83%	1.79%
60 Days	1.85%	1.87%	1.84%
90 Days	1.89%	1.91%	1.95%
2 Year Swap	1.98%	1.98%	2.05%
5 Year Swap	2.31%	2.32%	2.40%

NZ foreign currency mid-rates as at 17 September 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6552	0.6620	0.6641
NZD/EUR	0.5636	0.5706	0.5805
NZD/GBP	0.5011	0.5114	0.5209
NZD/JPY	73.39	73.49	73.46
NZD/AUD	0.9152	0.9209	0.9080
TWI	71.49	72.08	72.13

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
Australia						
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
United States						
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
Japan						
Real GDP %yr	1.4	0.9	1.7	1.1	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.8	2.5	2.0	1.5	1.5
United Kingdom						
Real GDP %yr	2.3	1.9	1.8	1.2	1.2	1.4
China						
Real GDP %yr	6.9	6.7	6.9	6.3	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	3.9	4.5	4.4	4.2	4.1
World						
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
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.92	2.00	1.97	1.97	1.92	1.92	1.83	1.80
10 Year Bond	2.60	2.85	3.00	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	2.97	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	0.7194	0.72	0.71	0.70	0.70	0.70	0.74	0.75
USD/JPY	111.85	112	113	113	112	112	109	106
EUR/USD	1.1694	1.15	1.14	1.13	1.14	1.16	1.22	1.28
AUD/NZD	1.0927	1.09	1.09	1.09	1.09	1.09	1.12	1.10

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