

# Weekly Commentary

19 March 2018



## Few surprises

Slower GDP growth was confirmed by last week's data as the economy shifted down a gear. We expect this more subdued growth backdrop will persist in 2018 as the new Government's policies weigh on growth in the near term. And with few surprises on the data front in recent weeks, outgoing Reserve Bank Governor Grant Spencer is unlikely to make many waves with his final OCR decision on Thursday. We expect the OCR to remain unchanged at 1.75%. Once that's out of the way, we will await the announcement of the new PTA, signed by the Minister of Finance and incoming Governor Adrian Orr.

Thursday's GDP data confirmed that the pace of growth slowed over the last year. GDP increased 0.6% in the quarter, bringing the annual pace of growth to 2.9%. This was bang on our expectations, though softer than the market had anticipated. A 2.9% growth rate is a respectable outturn, but some way off the 3.5-4% pace we observed in 2015 and 2016. We expect the annual rate of growth will slow further this year as targeted policy changes cool the housing market, which in turn will impact on household spending, and as firms are more cautious around investment and hiring decisions.

Beneath the headline, the details for the quarter were also consistent with expectations. The agriculture sector was the biggest drag on growth – largely reflecting the hit to milk production on the back of the hot and dry weather the country experienced late last year. Weaker agricultural production flowed through to manufacturing activity via softer food processing.

In contrast, activity in the service sectors was a bit more lively. There were strong gains in retail, wholesaling, transport and business services. However, personal services such as healthcare and recreation were soft. Overall, services were up by 1.1%.

Firm growth in the domestic economy was also reflected in current account data released earlier in the week. The current account deficit widened from 2.5% to 2.7%, which was a little

larger than expected. However, much of the surprise was due to a widening investment income deficit on the back of a surge in earnings of overseas-owned firms. This is an encouraging story to the extent that it reflects strong trading conditions in the local economy, and is consistent with the corporate tax take running well ahead of Treasury forecasts.

More generally at 2.7% of GDP, the current account deficit remains well within a 'sustainable' range. The run of modest deficits in recent years has helped New Zealand's external imbalances to improve markedly. New Zealand's net international liabilities position has narrowed from -84% of GDP in 2009 to -55% in the December quarter. This improvement has helped to shrink the risk premium that markets demand when lending to New Zealand.

Last week's GDP and current account data were the final data releases ahead of this week's RBNZ OCR review. With the GDP data printing only a touch below the RBNZ's expectations, there was certainly nothing to prompt a change of tone from the RBNZ. Indeed, even looking more broadly at the new information available since the February Monetary Policy Statement there has been little to change the RBNZ's outlook. Q4 labour market data was released after the forecasts were finalised, but before publication, and were covered off in the press conference. The RBNZ probably had the results of its own inflation expectations survey (which showed that

# Few surprises continued

expectations were unaffected by the surprisingly weak Q4 CPI print) prior to publication.

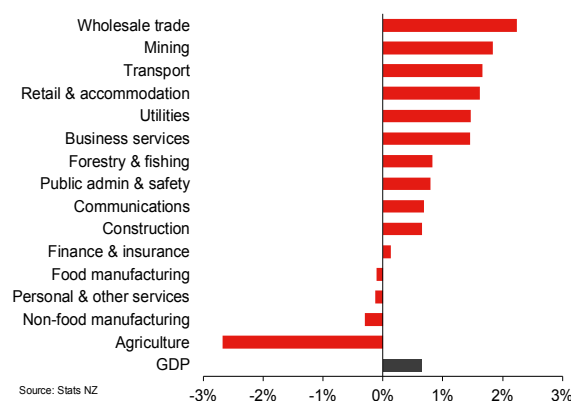
Releases more recently have been monthly data that, while timely, can be a bit more volatile. Card spending was strong in January but soft in February, business confidence has improved a little but remains well below its post-election lows, and net migration was surprisingly strong in January, though we continue to expect annual migration numbers to moderate from here.

Even the NZ dollar, so often a source of surprise for the RBNZ, has tracked in line with expectations. The TWI is currently sitting at 75, bang on the RBNZ's assumption. And despite widespread concern about the potential for a trade war to erupt on the back of President Trump's tariff threats, for now these concerns simply remain threatening clouds on the horizon while global growth remains firm.

Consequently, we expect Thursday's OCR review to contain few surprises. The OCR is expected to remain on hold at 1.75%, with the bottom line likely to remain unchanged: "Monetary policy will remain accommodative for a considerable period". Similarly, our own take on the outlook has changed little in recent weeks. We still expect that the OCR will need to remain on hold for longer than the market currently anticipates, and we don't have a rate hike pencilled in until late 2019.

This week's OCR review will be Governor Spencer's last after his short stint in the top job. Incoming Governor Adrian Orr will take office on 27 March, and before then a new Policy Targets Agreement (PTA) will need to be signed (likely at some point in the two working days after the OCR review so as not to complicate matters).

Q4 GDP changes by sector



Yet the PTA signed this month may not be the final word on the matter. The Government's two-phase review of the Reserve Bank Act is ongoing. While advice on phase one of the review was due to be provided to the Government ahead of the signing of the new PTA, the timeline for phase two of the review, which is much more wide ranging, has an even longer timeframe.

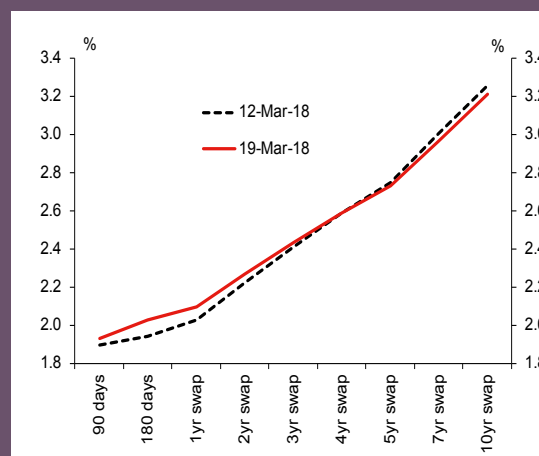
So although we could see the new PTA nudge the Governor toward giving greater consideration to maximising employment, for example, it's unlikely to fully incorporate proposed changes to the decision making structure at the RBNZ, and it's unlikely to be the final word on the matter. Indeed, a new PTA will probably need to be agreed between the Governor and the Minister of Finance when changes to the Reserve Bank Act are eventually finalised.

## 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 fixed terms. Three-to-five-year rates seem high relative to where we think short-term rates are going to go over that time. Some lending and deposit rates have been falling recently, so it may be worth waiting to see if there are further modest reductions in fixed-term rates.

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



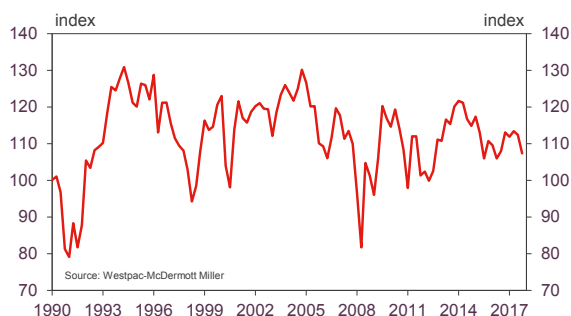
# The week ahead

## NZ Westpac McDermott Miller Consumer confidence

Mar 20, Last: 107.4

- Consumer confidence dropped to below average levels late in 2017. However, underneath the aggregate figures was a noticeable skew across households: Confidence among those households earning less than \$70,000 per annum actually rose modestly, while confidence among those households earning more than \$70,000 per annum fell sharply. In both cases, it's likely that sentiment was affected by the change of government at the end of last year.

### Westpac-McDermott Miller consumer confidence

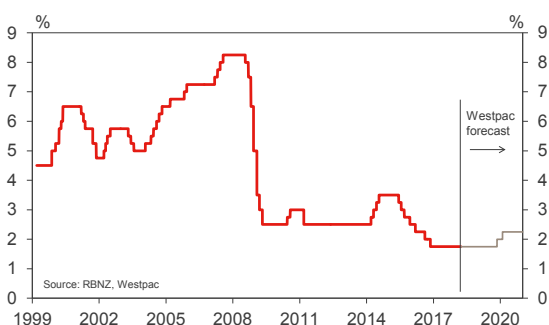


## NZ RBNZ OCR review

Mar 22, Last: 1.75%, Westpac f/c: 1.75%, Mkt f/c: 1.75%

- We expect the OCR to remain on hold at 1.75% until late 2019.
- Recent developments will have given the Reserve Bank little cause to change its stance. Low inflation and a period of more subdued growth mean that interest rates will need to remain low for a considerable time.
- This is the last OCR review for Acting Governor Spencer. The incoming Governor is due to sign a new Policy Targets Agreement shortly. Employment will be a consideration in future OCR decisions, but the details have yet to be resolved.

### RBNZ Official Cash Rate



## Aus Feb Westpac-MI Leading Index

Mar 21, Last: +0.73%

- The six month annualised growth rate in the Leading Index fell from +1.39% in Dec to +0.73% in Jan, fully reversing a 0.7ppt jump in the previous month. The swings mainly reflect extreme volatility in monthly dwelling approvals. Overall, the Index is still pointing to above trend growth momentum in the early part of 2018.
- The Feb read will include another volatile read on dwelling approvals which surged 17% in Jan. Commodity prices also firmed, up 3.8% (in AUD terms) vs 5.2% last month, and the yield spread widened a further 13bps. Other components look to have been softer, the ASX200 down -0.4%; the Westpac-MI Consumer Expectations Index down -0.1%; US industrial production down -0.1%; and the Westpac-MI Unemployment Expectations Index a touch weaker.

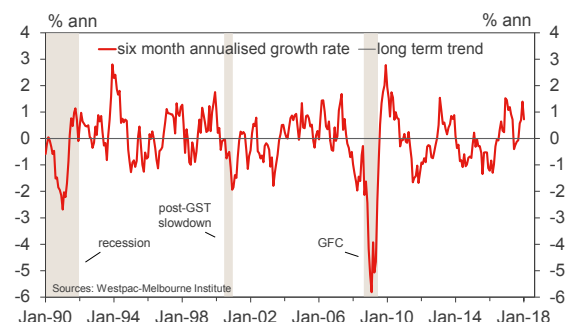
## Aus Labour Force Survey – total employment '000

Mar 22, Last: 16k, WBC f/c: 25k

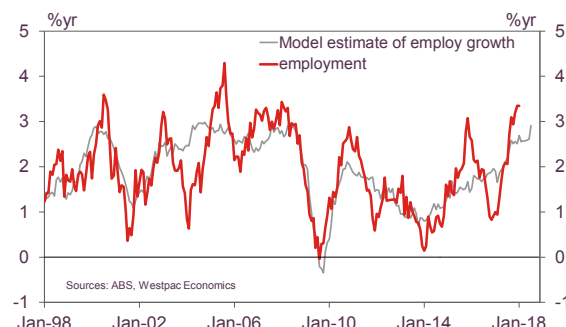
Mkt f/c: 20k, Range: 8k to 30k

- Australia posted a 16k increase in employment in January 2018 which records the longest streak of job gains with a 16th consecutive positive print. The month's increase was very close to the market and Westpac's expectation for a 15k rise. However, the composition of employment changes was quite stark with full-time employment down 49.8k and part-time employment up 65.9k. That comes after a strong 2017 for full-time employment growth and the annual growth rate is still an elevated 3.6%. The leading indicators, both from business and household surveys, have strengthened so far in 2018. Westpac's Jobs Index is suggesting that while employment growth maybe stronger than you would expect, there is no reason to be looking for a fundamental correction anytime soon.

### Westpac-MI Leading Index



### Jobs Index model of employment



# The week ahead

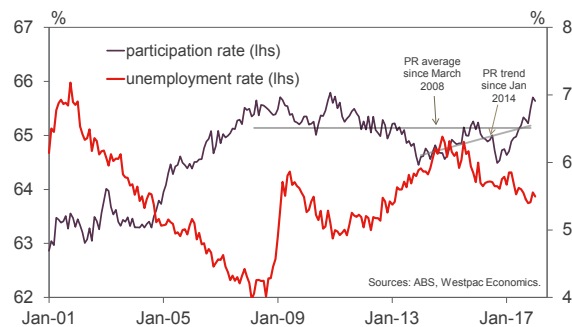
## Aus Labour Force Survey – unemployment %

Mar 22, Last: 5.5%, WBC f/c: 5.5%

Mkt f/c: 5.5%, Range: 5.3% to 5.6%

- In January, the unemployment rate fell to 5.5% from 5.6% in December (revised up from 5.5%) with participation declining to 65.6% from 65.7%. Over the past year, while the unemployment rate did fall from a peak of 5.9% in February 2017 to the current 5.5%, the drop was more muted than the gain in employment due to rising participation. The uplift in participation has been driven mainly by females joining, re-joining, or remaining for longer in the labour force. However, this spike occurred alongside a rising male participation rate which had otherwise been in a downtrend. Given there appears to be a strong cyclical lift in participation, corresponding to the rise in employment, we are forecasting participation to rise modestly to 65.7% and this will be enough to see the unemployment rate hold flat at 5.5%.

### Unemployment and participation rates

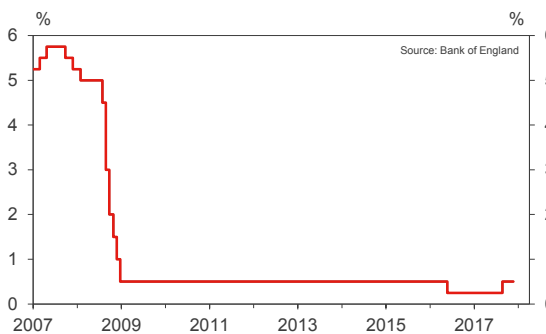


## UK Bank of England Bank Rate decision

Mar 22, Last: 0.5%, Mkt: 0.5%, WBC f/c: 0.5%

- While the Bank of England left the Bank Rate on hold in February, there was a hawkish tilt in the accompanying statement. The MPC noted that policy "would need to be tightened somewhat earlier and by a somewhat greater extent over the forecast period than anticipated at the time of the November Report". We expect that the Bank Rate will again be left hold at the March meeting and that the BOE's earlier tightening bias will remain. Since February, we haven't seen major surprises in terms of economic conditions. Inflation is sitting at the top of the BOE's target band and while growth remains sluggish, there are positive signs in parts of the economy. Developments on the external front (including Brexit negotiations) continue to signal some headwinds. We have pencilled in a hike from the BOE in June. Markets have priced in a 50% chance of a hike in May.

### Bank of England Bank Rate

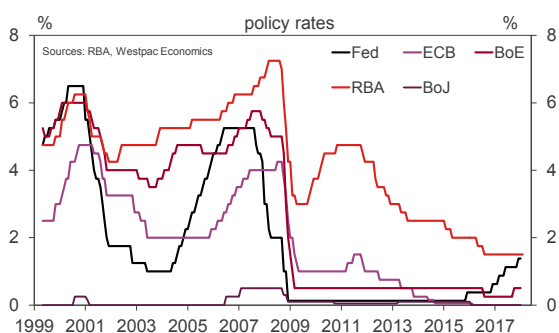


## US Mar FOMC meeting

Mar 22, last 1.375%, WBC 1.625%

- The March FOMC fed funds rate decision is as certain a prospect as markets get. From recent communications, it is evident that the Committee is in agreement of the appropriateness of a further rate increase, and the market knows this to be the case. That will see the fed funds rate rise to 1.625%. As planned, quantitative tightening will also remain on auto pilot. Market participants will therefore immediately focus their attention on the new set of Committee forecasts and follow-up comments from Chair Powell in the press conference. Expected is a confident FOMC Chair, both with respect to the economy's strength and the FOMC's approach to policy. While growth forecasts and the distribution of rate projections are likely to drift up, the median fed funds forecast should remain unchanged at three in 2018 and three more in 2019. Gradual and timely are the operative words for policy.

### US rate differential continues to widen



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 19</b>					
<b>NZ</b>	Feb BusinessNZ PSI	55.8	-	-	Service sector conditions have cooled since mid-2017.
<b>Chn</b>	Feb property prices	-	-	-	Authorities to keep lid on speculation.
<b>Eur</b>	Jan trade balance €bn	23.8	-	-	Effect of higher Euro offset by global growth.
<b>UK</b>	Mar Rightmove house prices	0.8%	-	-	Uncertainty continues to weigh on demand.
<b>US</b>	Fedspeak	-	-	-	Bostic on Community Reinvestment Act.
<b>Tue 20</b>					
<b>NZ</b>	Q1 Westpac MM consumer confidence	107.4	-	-	Confidence slipped last qtr in the wake of 2017 election.
<b>Aus</b>	RBA minutes	-	-	-	Any colour around risks to the 3.25% GDP growth forecasts.
	Q4 ABS Residential Price index	-0.2%	0.0%	-	Less relevant given timelier private sector measures.
<b>Eur</b>	Mar ZEW survey of expectations	29.3	-	-	Confidence remains very strong.
	Mar consumer confidence advance	0.1	0.1	-	Labour market has given consumers confidence.
<b>UK</b>	Feb CPI	-0.5%	0.5%	-	Impact of earlier GBP falls looks to have peaked.
	Jan house price index, %yr	5.2%	-	-	Low supply limiting downside, despite soft demand.
<b>Can</b>	Jan wholesale trade	-0.5%	-	-	Rising interest rates are weighing on demand.
<b>Wed 21</b>					
<b>NZ</b>	GlobalDairyTrade auction	-0.6%	-	-	WMP prices expected to continue softening.
	Feb net migration	6210	-	5860	Annual migration still elevated, easing back gradually.
<b>Aus</b>	Feb Westpac-MI Leading Index	-0.24%	-	-	Still pointing to above trend growth momentum.
<b>UK</b>	Jan ILO unemployment rate	4.4%	4.4%	-	Despite the recent uptick, unemployment remains very low.
	Public sector net borrowing, £bn	-11.6	-	-	Rise in tax revenues helping to reduce borrowing needs.
<b>US</b>	Feb existing home sales	-3.2%	0.9%	-	Lack of supply dictating outcomes at present.
	FOMC policy decision, midpoint	1.375%	1.625%	-	Chair Powell to deliver first hike of tenure.
<b>Thu 22</b>					
<b>NZ</b>	RBNZ OCR review	1.75%	1.75%	1.75%	Inflation well contained. Acting Gov Spencer's last meeting.
<b>Aus</b>	Feb employment '000	16k	20k	25k	The leading indicators of employment have lifted so far in...
	Feb unemployment rate	5.5%	5.5%	5.5%	...2018 but rising participation keeps unemployment steady.
<b>Eur</b>	Mar Markit manufacturing PMI prelim.	58.6	58.2	-	Momentum being sustained...
	Mar Markit services PMI prelim.	56.2	56.0	-	... domestic and external demand both robust.
	EU Summit	-	-	-	Key topics will be trade and brexit negotiations.
<b>UK</b>	Feb retail sales	0.1%	0.3%	-	Price increases continuing to weigh on spending growth.
	Bank of England Bank rate	0.5%	0.5%	0.5%	BOE to maintain tightening bias.
<b>US</b>	Initial jobless claims	226k	-	-	Remain at historically low level.
	Jan FHFA house prices	0.3%	-	-	Prices continue to march higher.
	Mar Markit manufacturing PMI prelim.	55.3	55.5	-	Early read on conditions in March.
	Feb leading index	1.0%	0.3%	-	Pointing to growth a little above trend.
	Mar Markit service PMI	55.9	56.0	-	Strength broad based. Positive outlook.
	Mar Kansas City Fed index	17	-	-	Off highs, but still very strong.
<b>Fri 23</b>					
<b>NZ</b>	RBNZ Policy Targets Agreement	-	-	-	New PTA needs to be announced before 27/3, date TBC.
<b>US</b>	Feb durable goods orders prelim.	-3.6%	1.6%	1.0%	Transport orders creating considerable volatility.
	Feb new home sales	-7.8%	4.6%	-	Home builders positive; not rate shock yet.
<b>Can</b>	Jan CPI	0.7%	0.5%	-	Underlying inflation pulse has continued to firm.
	Fedspeak	-	-	-	Bostic, Kashkari & Rosengren in separate events.

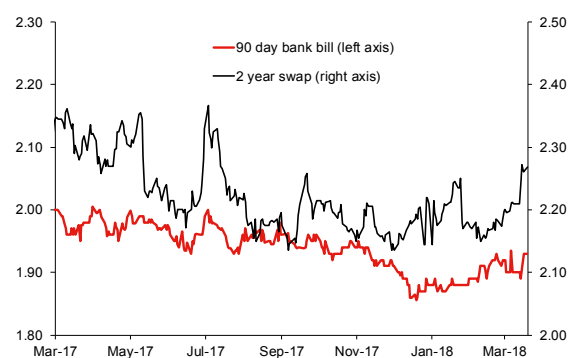
# New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2017	2018			Calendar years			
% change	Dec(a)	Mar	Jun	Sep	2016	2017	2018f	2019f
GDP (Production)	0.6	0.6	0.6	0.7	4.0	2.9	2.7	3.0
Employment	0.5	0.4	0.4	0.4	5.8	3.7	1.4	1.0
Unemployment Rate % s.a.	4.5	4.4	4.4	4.4	5.3	4.5	4.5	4.7
CPI	0.1	0.5	0.4	0.6	1.3	1.6	1.7	1.5
Current Account Balance % of GDP	-2.7	-2.2	-2.3	-2.5	-2.2	-2.7	-2.4	-2.7

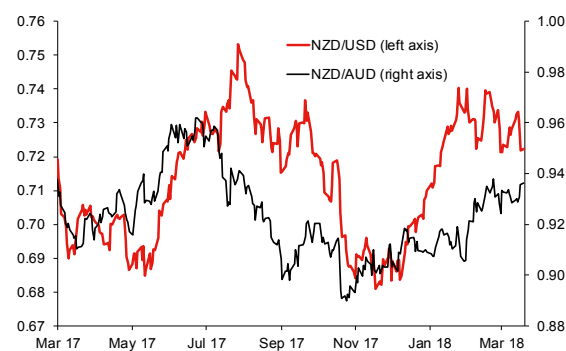
<sup>1</sup> Annual average % change

Financial Forecasts	Jun-18	Sep-18	Dec-18	Mar-18	Jun-19	Sep-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	1.90	2.05
2 Year Swap	2.10	2.20	2.30	2.40	2.55	2.70
5 Year Swap	2.70	2.80	2.95	3.10	3.20	3.30
10 Year Bond	3.00	3.10	3.30	3.40	3.45	3.50
NZD/USD	0.70	0.69	0.67	0.65	0.64	0.64
NZD/AUD	0.91	0.91	0.91	0.90	0.90	0.91
NZD/JPY	76.3	75.9	74.4	72.8	71.0	70.4
NZD/EUR	0.57	0.57	0.55	0.55	0.53	0.52
NZD/GBP	0.54	0.54	0.55	0.55	0.53	0.53
TWI	72.6	72.2	70.8	69.4	68.6	68.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 19 March 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.81%	1.78%	1.80%
60 Days	1.87%	1.84%	1.86%
90 Days	1.93%	1.90%	1.91%
2 Year Swap	2.27%	2.21%	2.17%
5 Year Swap	2.73%	2.71%	2.73%

NZ foreign currency mid-rates as at 19 March 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7222	0.7244	0.7385
NZD/EUR	0.5879	0.5865	0.5951
NZD/GBP	0.5178	0.5246	0.5269
NZD/JPY	76.53	76.39	78.57
NZD/AUD	0.9362	0.9322	0.9329
TWI	74.58	74.63	75.78

# International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
<b>Australia</b>						
Real GDP % yr	2.6	2.5	2.6	2.3	2.7	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	2.1	1.9
Unemployment %	6.2	5.8	5.7	5.5	5.4	5.5
Current Account % GDP	-3.0	-4.7	-3.1	-2.3	-2.2	-3.4
<b>United States</b>						
Real GDP %yr	2.6	2.9	1.5	2.3	3.0	2.5
Consumer Prices %yr	1.6	0.1	1.3	2.1	2.3	2.1
Unemployment Rate %	6.2	5.3	4.9	4.4	4.0	3.7
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	0.3	1.1	1.0	1.5	1.3	1.0
<b>Euroland</b>						
Real GDP %yr	1.3	2.0	1.8	2.4	2.1	1.6
<b>United Kingdom</b>						
Real GDP %yr	3.1	2.2	1.8	1.7	1.6	1.6
<b>China</b>						
Real GDP %yr	7.3	6.9	6.7	6.9	6.3	6.1
<b>East Asia ex China</b>						
Real GDP %yr	4.2	3.8	3.9	4.5	4.3	4.3
<b>World</b>						
Real GDP %yr	3.6	3.4	3.2	3.8	3.9	3.7

Forecasts finalised 14 March 2018

Interest Rate Forecasts	Latest	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.94	1.84	1.83	1.82	1.81	1.80	1.78	1.78
10 Year Bond	2.70	2.80	2.95	3.15	3.20	3.10	3.20	3.15
<b>International</b>								
Fed Funds	1.375	1.875	2.125	2.125	2.375	2.625	2.625	2.625
US 10 Year Bond	2.83	2.90	3.10	3.35	3.50	3.40	3.40	3.30
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.20	0.00	0.00	0.00

Exchange Rate Forecasts	Latest	Jun-18	Sep-18	Dec-18	Mar-18	Jun-19	Sep-19	Dec-19
AUD/USD	0.7800	0.77	0.76	0.74	0.72	0.71	0.70	0.70
USD/JPY	106.30	109	110	111	112	111	110	110
EUR/USD	1.2306	1.23	1.22	1.21	1.19	1.21	1.23	1.26
AUD/NZD	1.0715	1.10	1.10	1.10	1.11	1.11	1.09	1.08

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