

Weekly Commentary

25 June 2018



Taking stock

Last week's GDP figures provided more evidence that the New Zealand economy has lost some momentum. We have long been expecting a period of subdued growth, reflecting businesses' uncertainty about the new Government and a cooling in the housing market. Increased government spending will provide a boost to activity in coming years, but the pace of economic growth appears to be well past its peak.

GDP rose by 0.5% in the March quarter, following gains of 0.6% in each of the previous two quarters. Some minor revisions to history saw the annual growth rate nudge down to 2.7%, a little below market expectations.

There was little in the way of special factors that might have held down the quarterly result – growth was widespread across industries, but was unremarkable in most cases. Household spending was flat as consumers turned more cautious, and construction activity slowed in the face of capacity and finance constraints. Dairy production picked up a little after a poor start to the season.

Of course, GDP is a somewhat dated measure of how the economy is tracking; it's almost three months since the end of the March quarter. This week, we review the most recent data to assess how the economy has performed since then. There is not a lot of support for the idea that growth will re-accelerate strongly in the June quarter – our current forecast of a 0.7% rise in GDP may be on the high side.

Housing: House price inflation has slowed again in the last few months, with Auckland prices falling slightly. The new Government's array of policies aimed at dampening housing speculation appear to be having some bite. The 'bright-line' test for capital gains on investment properties has been extended from two to five years, restrictions on foreign buyers will soon come into force, and negative gearing will start to be phased out next year.

We are forecasting house prices to be essentially flat over the next few years. However, the extent of the housing slowdown will depend on how some of these policies are specified, which is still unresolved to some degree.

We note that the bill for restricting foreign buyers has been softened from the initial proposal. Under certain conditions, foreign buyers will no longer be forced to on-sell completed apartments that they had purchased off the plan. The property transfer statistics suggest that foreign buyers were already concentrated in the apartment space (they account for a higher share of sales in central Auckland and Queenstown). So this could make the policy significantly less binding than we had assumed.

Consumer: Property prices have a major influence on household's willingness to spend, and retail spending growth cooled in the March quarter as the housing market has slowed. The latest electronic card spending figures indicate that consumers remain cautious: card spending fell sharply in April, and picked up only modestly in May.

On the positive side, vehicle sales are shaping up better for the latest quarter. Sales were hampered in the March quarter, as some import shipments were delayed due to the discovery of marmorated stink bugs. The car registration figures up to May suggest that this backlog is now being cleared. That said, registrations are still down from last year's peak.

Taking stock ... continued

Construction: capacity constraints and access to finance continue to present a challenge for the building industry. However, building consents have remained high in recent months, and have been particularly strong for multiples (apartments and townhouses) in Auckland, which is precisely where the growth is most needed. We expect a lift in building activity over the rest of this year, but at a gradual pace.

Domestic activity: the monthly Business NZ surveys have shown mixed results. The manufacturing PMI has been on the soft side in recent months, apart from a brief spike in April. However, the services PSI activity has improved in the last few months, having slowed down in late 2017 and early 2018.

Labour: high-frequency information on the labour market is hard to come by, but we note that up to May the growth in job advertisements has continued to slow. While the labour market has tightened, it is not obvious that a shortage of skilled workers would deter employers from looking; the slowdown in ads is more suggestive of a softening in demand.

Trade: export volumes fell sharply in the March quarter, which we put down to a combination of weak milk production in the first part of the season and the timing of

export shipments. Both of these factors point to healthier export volumes in the June quarter. Export commodity prices have improved in the last few months, both in world price terms and after accounting for the lower New Zealand dollar. Tourist numbers are still trending higher, but the pace of growth has slowed.

Overall, the June quarter is shaping up to be another period of modest growth at best. That stands in contrast to the view of the Reserve Bank, which has long held bullish expectations for growth in 2018. The soft March quarter result (the sixth consecutive quarter in which GDP growth has fallen short of the RBNZ's forecast), along with the subdued growth signals for the June quarter, will provide food for thought at this Thursday's OCR review.

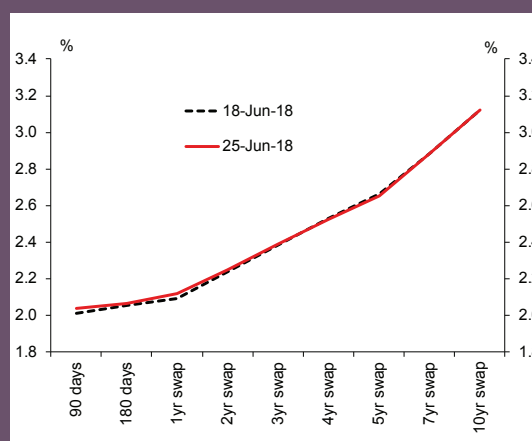
That said, there have also been some inflation-positive developments since the last OCR decision in May. The 2018 Budget was stimulatory, with Government spending likely to have an even larger impact on aggregate demand in the early-2020s than the RBNZ previously allowed for. And a sharp rise in fuel prices means that inflation is likely to rise back to 2% much sooner than the RBNZ expected (though this rise may not be sustained). While the balance of risks to inflation has probably tilted higher, we expect the RBNZ to maintain its basic message that the OCR will be on hold for an extended period.

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



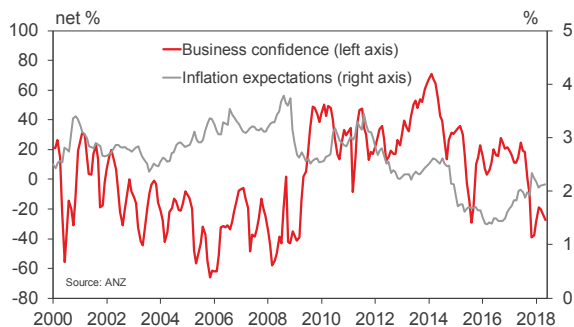
The week ahead

NZ June ANZ business confidence

Jun 27, Last: -27.2

- Business confidence has fallen over the last couple of months. The fall in confidence has been fairly wide spread with the construction sector particularly pessimistic in recent months.
- It will be interesting to see how confidence in the agricultural sector has responded to the Government's decision to attempt to eradicate Mycoplasma bovis.
- We expect soft confidence to translate to a lull in business investment this year.
- Inflation expectations have been relatively stable in recent months. They may edge higher over the second half of the year on the back of rising petrol prices and rising headline CPI inflation.

NZ business confidence and inflation expectations

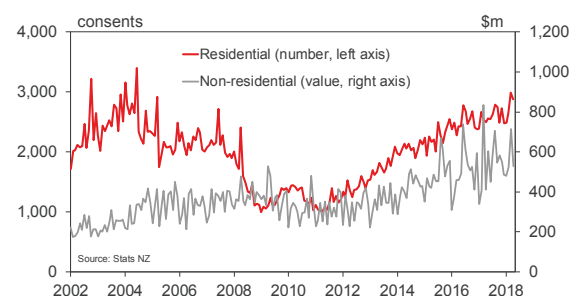


NZ May building consents

Jun 29, Last -3.7%, Westpac f/c: -8%

- Residential building consents fell only slightly in April. Consents for multiples (apartments, etc) were particularly strong in March, and we had expected a reversal in April. However, they actually remained at relatively firm levels. The multiple consents category, which now accounts for half of all consents in Auckland, can be lumpy on a month-to-month basis. With a large number of these consents in the past two months, we expect to see some normalisation in May. That would still leave consent issuance in Auckland at high levels. At the same time, we expect to see a continued gradual moderation in Canterbury and steady levels in other regions. This combination would leave overall consent issuance down by around 8% in May. Difficulties accessing finance and shortages of skilled labour continue to provide a brake on building activity.

NZ building consents

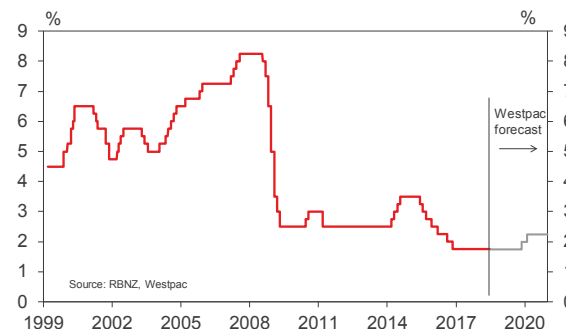


RBNZ OCR Review

Jun 28, Last 1.75%, Westpac 1.75%, Market 1.75%

- We expect the RBNZ to repeat its main message that the OCR is likely to remain on hold for a long while, but that the timing and direction of the next move will depend on how the economy evolves.
- Focus on whether the RBNZ repeats the words "up or down" in its policy guidance is a red herring. The RBNZ is keen to avoid formulaic communications. They may well choose different words but this would not necessarily constitute a signal that the OCR outlook has changed.
- Beneath the policy guidance paragraph, the details of the press release might be slightly more hawkish than the May statement.

RBNZ Official Cash Rate



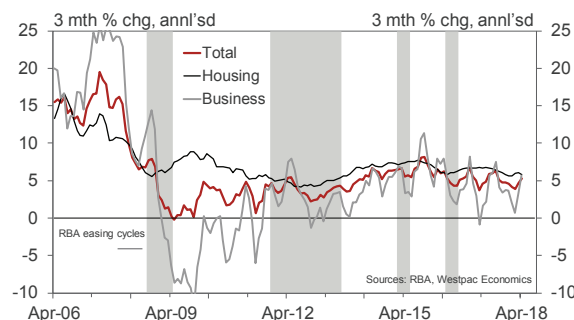
Aus May private credit

Jun 29, Last: 0.4%, WBC f/c: 0.3%

Mkt f/c: 0.4%, Range: 0.3% to 0.6%

- Private sector credit is expanding at a modest pace as the housing sector cools. In 2017, credit grew by 4.8%, slowing from 5.6% for 2016. For the month of May, we expect a subdued rise of 0.3%, one notch down from the recent average of 0.4%. Housing credit, at this late stage of the cycle, is slowing as tighter lending conditions see new lending decline. In April, housing credit grew by 0.43% mth, 6.0%yr, with the 3 month annualised pace at 5.8%, down from 6.8% a year earlier. Business credit, 4.3% above the level of a year ago, is volatile around a modest uptrend as businesses increase investment in the real economy. The past two months were above par results (0.7% and 0.5%) as the segment emerged from a soft spot at the turn of the year. The risk is a more modest gain is recorded in May.

Credit: housing slows



The week ahead

US May personal income and spending

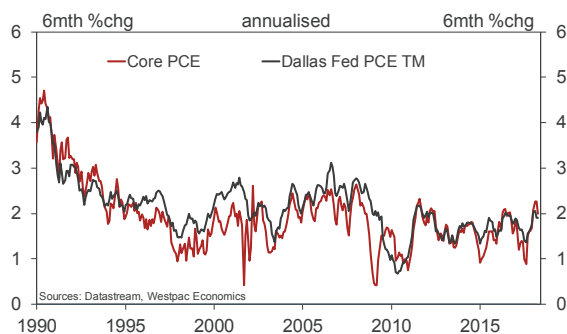
Jun 29, personal income, last 0.3%, WBC 0.4%

Jun 29, personal spending, last 0.4%, WBC 0.5%

Jun 29, PCE deflator, last 0.2%, WBC 0.2%

- Disposable personal income received a boost in Apr, rising 0.4% following respective gains of 0.3% and 0.2% in February and March. However, inflation offset half that gain, restricting real income growth to 0.2% – as in Mar. Slowly but surely nominal wage incomes should lift; growth in investment income should also hold up, relieving pressure on the savings rate, which has trended down to low levels in recent years. In light of consumers' improving financial position, in May we look for a 0.5% gain for spending after a positive lead from retail sales and given services should also support. Regarding inflation, on both a headline and core basis, PCE inflation looks set to settle near 2.0%yr.

Core inflation near target; to remain there



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 25					
UK	Jun Nationwide house prices	-0.2%	0.2%	-	Due this week. Weakness in London, other areas firmer.
US	May Chicago Fed activity index	0.34	-	-	Pointing to above-trend growth.
	May new home sales	665k	662k	-	Continue to trend higher.
	Jun Dallas Fed index	26.8	24.0	-	Very positive.
Tue 26					
US	Apr S&P/CS home price index	0.53%	0.40%	-	Price growth remains robust.
	Jun Richmond Fed index	16	15	-	Very positive.
	Jun consumer confidence index	128.0	127.5	-	Labour market key to household sentiment.
	Fedspeak	-	-	-	Bostic speaking in Alabama.
	Fedspeak	-	-	-	Kaplan, Greater Houston Partnership State of Talent event.
Wed 27					
NZ	May trade balance, \$m	263	-	100	Exports on the rebound, oil imports to pull back.
	Jun ANZ business confidence	-27.2	-	-	Has weakened again in recent months.
Chn	May industrial profits %yr	21.9	-	-	Commodity prices a lasting support.
Eur	May M3 money supply %yr	3.9%	-	-	Credit data also due.
UK	BOE Governor Carney	-	-	-	Speaking about the BOE's Financial Stability Report.
US	May wholesale inventories	0.1%	-	-	Set to support growth in Q2.
	May durable goods orders	-1.6%	-1.0%	-	To what extent will trade issues offset stimulus boost.
	May pending home sales	-1.3%	1.0%	-	Existing home sales held back by supply.
	Fedspeak	-	-	-	Rosengren on ethics and economics in Washington.
Thu 28					
NZ	RBNZ Official Cash Rate review	1.75%	1.75%	1.75%	OCR on hold for an extended period.
Eur	Jun economic confidence	112.5	112.1	-	There is good reason...
	Jun business climate indicator	1.45	-	-	... for confidence across sectors...
	Jun consumer confidence	-0.5	-	-	... to remain intact.
	EU Summit	-	-	-	In Brussels, 28-29.
US	Q1 GDP 3rd estimate %annualised	2.2%	2.2%	2.2%	Third estimate; no revision expected.
	Initial jobless claims	218k	-	-	Very low.
	Jun Kansas City Fed index	29	-	-	Very positive.
	Fedspeak	-	-	-	Bullard on the economy and monetary policy in St Louis.
	Fedspeak	-	-	-	Bostic on affordable housing and jobs.
Fri 29					
NZ	Q2 Westpac-MM employment confidence	115.9	-	-	Perceptions of jobs market improved over the last year.
	May building consents	-3.7%	-	-8.0%	Earlier gains in multiples to ease off, level still elevated.
	Jun ANZ consumer confidence	121.0	-	-	Household sector conditions have been softening.
Aus	May private sector credit	0.4%	0.4%	0.3%	Housing slowing; business volatile modest uptrend.
Eur	Jun Core CPI %yr (flash)	1.1%	1.0%	-	Core measure remains stuck around 1.0%/yr.
UK	Jun GfK consumer confidence	-7	-7	-	Brexit and economic uncertainty weighing on sentiment.
	Q1 GDP (final)	0.1%	0.1%	-	Poor wealth a drag, softness esp. in household sector.
US	May personal income	0.3%	0.4%	0.4%	Income growth robust but not strong.
	May personal spending	0.6%	0.4%	0.5%	Sentiment should aid spending.
	May PCE deflator	0.2%	0.2%	0.2%	Inflation settling near 2.0%/yr.
	Jun Chicago PMI	62.7	60.5	-	Very positive.
	Jun Uni. of Michigan sentiment	99.3	99.2	-	Labour market key to household sentiment.
Sat 30					
Chn	Jun non-manufacturing PMI	54.9	-	-	Activity has shown strength of late...
	Jun manufacturing PMI	51.9	51.8	-	... though employment continues to lag.

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	0.2	0.3	0.3	5.8	3.7	1.4	1.4
Unemployment Rate % s.a.	4.4	4.4	4.5	4.6	5.3	4.5	4.6	4.6
CPI	0.5	0.6	0.7	0.3	1.3	1.6	2.1	1.4
Current Account Balance % of GDP	-2.8	-3.1	-3.5	-3.6	-2.2	-2.7	-3.6	-3.7

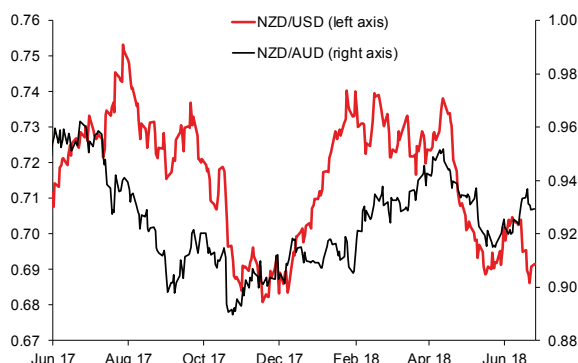
¹ Annual average % change

Financial Forecasts	Sep-18	Dec-18	Mar-18	Jun-18	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	2.75	2.90	3.05	3.15	3.25	3.30
10 Year Bond	3.00	3.20	3.30	3.35	3.40	3.45
NZD/USD	0.68	0.67	0.65	0.65	0.64	0.65
NZD/AUD	0.91	0.91	0.90	0.90	0.91	0.93
NZD/JPY	75.5	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	72.0	71.6	70.2	70.0	69.1	70.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 25 June 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.90%	1.90%	1.89%
60 Days	1.96%	1.95%	1.93%
90 Days	2.04%	2.02%	2.00%
2 Year Swap	2.25%	2.23%	2.20%
5 Year Swap	2.66%	2.71%	2.66%

NZ foreign currency mid-rates as at 25 June 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6915	0.7028	0.6920
NZD/EUR	0.5929	0.5967	0.5922
NZD/GBP	0.5217	0.5239	0.5196
NZD/JPY	75.97	76.77	75.89
NZD/AUD	0.9294	0.9259	0.9156
TWI	73.60	73.88	72.87

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	2.2	1.9
Unemployment %	6.2	5.8	5.7	5.4	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.5	-3.0	-4.2
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	1.3	1.0
Euroland						
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 14 Jun 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	2.10	1.98	1.94	1.90	1.88	1.86	1.85	1.83
10 Year Bond	2.64	2.90	3.05	3.20	3.10	3.10	3.00	3.00
International								
Fed Funds	1.875	2.125	2.125	2.375	2.625	2.625	2.625	2.625
US 10 Year Bond	2.90	3.10	3.35	3.50	3.50	3.40	3.20	3.10
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-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	0.7396	0.75	0.74	0.72	0.72	0.70	0.70	0.72
USD/JPY	109.98	111	112	114	113	112	110	109
EUR/USD	1.1614	1.17	1.16	1.15	1.16	1.18	1.20	1.21
AUD/NZD	1.0718	1.10	1.10	1.11	1.11	1.09	1.08	1.09

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