Weekly Commentary

29 October 2018

Glow Worm (Arachnocampa Luminosa)

Different strokes for different folks

Rapid population growth fuelled by record net migration provided a powerful boost to domestic demand in recent years. But while migration remains strong, it is now past its peak and we expect that it will fall further over the coming years, dampening GDP growth in the process. Underlying the cooling in overall population growth, we are seeing some notable regional differences which are being reflected in varied economic conditions across the country.

High rates of net migration were an important driver of the strong economy New Zealand experienced from 2014 to 2016. But the latest monthly data registered another decline, confirming that net migration is now trending downward. For the year to September, net migration was 62,700, down from the peak of 72,400 reached during 2017. The big factor weighing on net migration has been departures of non-New Zealand citizens. Three to four years ago, a large number of foreign citizens entered New Zealand on temporary work and student visas. Increasingly, those people are now heading home. But movements of New Zealanders are also evolving. We are now seeing fewer New Zealanders returning from abroad, and recently the number leaving for Australia has ticked up. The New Zealand economy is no longer outperforming Australia's, so it is not surprising to see people voting with their feet in this way.

We expect these trends to continue, and to be joined by a reduction in the number of foreign citizens entering New Zealand. This will add up to a continued decline in net migration, down to 53,000 by this time next year.

Businesses will feel the pinch from falling net migration in a few ways. Migration has been an easy source of growth for some businesses, simply by putting more feet in shop aisles. That source of growth is now waning. Some businesses might find that labour is harder to come by when net migration slows. And finally, strong population growth has been a major spur to construction activity – when population growth slows, there will be less need for new construction activity.

For households, the economic impact of the drop in net migration will be mixed. As businesses suffer from waning demand, there may be a negative impact on job availability. But there will also be less competition in the labour market.

For the Reserve Bank, falling net migration will reduce aggregate demand in the economy (tending to reduce inflation), but at the same time it will reduce aggregate supply in the labour market (tending to increase inflation). The Reserve Bank considers the aggregate demand effects to be slightly larger than the aggregate supply effects – in other words, falling net migration is considered to be a small negative for the inflation outlook, and is a (minor) argument in favour of reducing the OCR. That is very different to the perception in other countries such as Germany, where migrants are thought to add more to the supply side of the economy than to demand.

The reduction in net migration over the past year has been felt right across New Zealand. Almost every region experienced a small decline in the rate of population growth between the June 2017 and June 2018 years according to Statistics New Zealand's latest regional population estimates, released last week (the exceptions are Taranaki, West Coast and Southland).

Different strokes for different folks

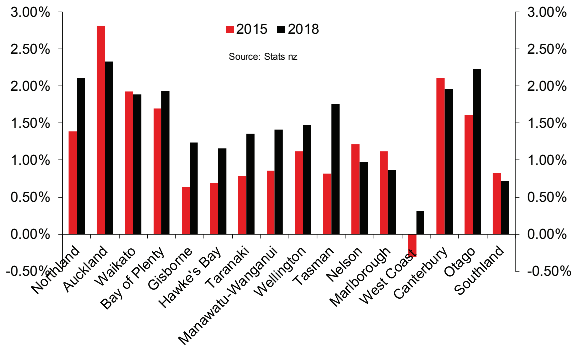
However, today's regional pattern of population growth is very different to what it was in 2015. While Auckland is still the fastest growing region, its rate of population growth has fallen sharply. Canterbury's population growth rate has also fallen. Meanwhile, population growth rates have stepped up sharply across the central and lower North Island, including Wellington, and in Otago.

There is a popular notion that these population trends are about Aucklanders leaving the big smoke for greener pastures in smaller towns, and that is no doubt part of the story. But changing patterns of overseas migration are probably playing a bigger role. Many of the overseas citizens now leaving New Zealand were based in Auckland, which partly explains Auckland's reduction in population growth. Meanwhile, the number of New Zealanders leaving the country for Australia is lower today than it was in the mid-2010s. This is part of the reason that population growth rates have increased in the central and lower North Island and southern South Island.

The regional pattern of population growth rates neatly matches the regional patterns we are seeing in housing markets and in economic performance. In Auckland and Canterbury, rent inflation has cooled, house prices are flat or falling, measures of regional economic activity are weaker than elsewhere, and in Auckland, regional economic confidence is very low. These are the regions where New Zealand's economic slowdown has really been felt to date.

Meanwhile, in some other parts of New Zealand it feels as though there has not been an economic slowdown at all. They are still experiencing rapidly accelerating rents, rising house prices, strong economic activity and high confidence. These conditions may last for a while yet. But for businesses in these regions it is very important to understand that today's economic exuberance is has partly been driven by a burst of population growth that will not persist forever. In many of these regions rates of construction activity are currently elevated, but will eventually drop away when population growth rates cool. That will mean fewer construction jobs locally. Similarly, consumer spending in many regions is still being propelled by an unsustainable rate of house price increase. When housing markets inevitably cool in these regions, so consumer spending will also take a breather.

Regional population growth 2015 and 2018



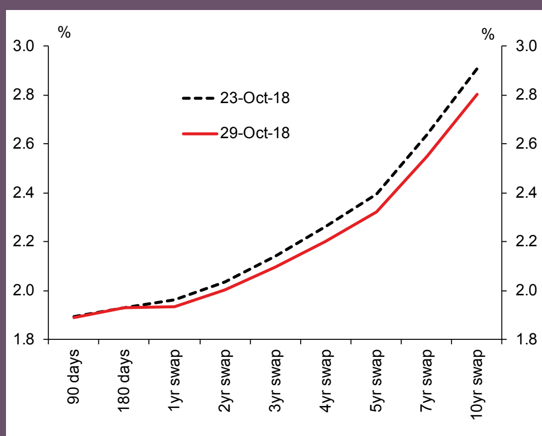
Fixed vs Floating for mortgages

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 Sep residential building consents

Oct 31, Last: +7.8%, WBC f/c: -10%

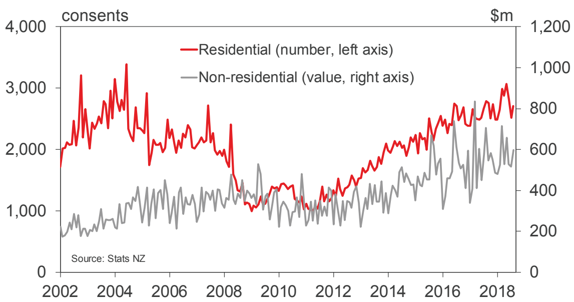
- Residential dwelling consent issuance rose by 7.8% in August. That strong increase was in part due to a large number of apartment consents in Auckland. As consents for apartments tend to be issued in lumps, we expect this will be followed by a pullback in September. We're forecasting a 10% drop over the month, which would still leave the annual figure at high levels.
- Looking through the month-to-month volatility associated with apartment consents, the real focus is on the longer-term trend for Auckland. There, population pressures and regulatory changes have prompted a strong lift in consent numbers for standalone and medium-density houses. We expect that annual consent numbers in Auckland will remain strong at around 13,000.

NZ Oct ANZ business confidence

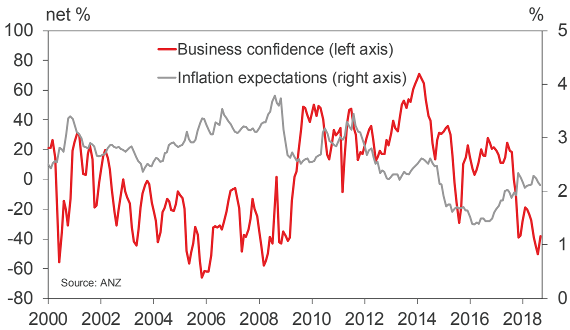
Oct 31, Last: -38.3

- Business confidence improved a little in September, but remained at very low levels. There were also small improvements in other components of the survey, including the outlook for firms' own activity. However, investment intentions deteriorated further.
- The level of business confidence continues to suggest downside risk to the growth outlook. However, other more direct indicators of economic activity suggest growth has maintained reasonable momentum heading into the second half of the year.
- Confidence surveys have shown a pickup in inflation pressure over the last year. In September pricing intentions rose further. We saw further rises in petrol prices over the early part of the month and this could put further upward pressure on inflation gauges in the October survey.

NZ building consents



NZ business confidence and inflation expectations



Aus Sep dwelling approvals

Oct 30, Last: –9.4%, WBC f/c: –2.0%
Mkt f/c: 3.8%, Range: -3.0% to 10.7%

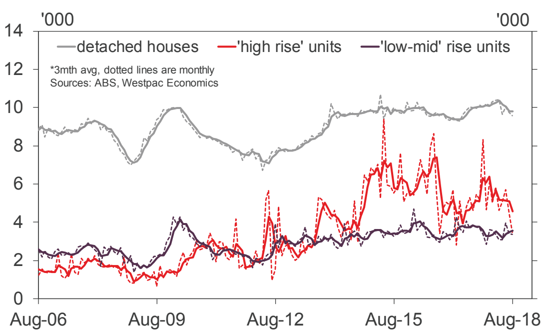
- Dwelling approvals fell sharply in Aug with a 9.4% decline led by a 17.2% drop in units (to the lowest level since Oct 2016) but with detached house approvals also moving 1.9% lower. The result provides the strongest confirmation yet of Westpac's view that activity is heading into a second leg lower.
- More declines are likely near term. Housing markets weakened significantly through the third quarter as lending conditions tightened. Investor activity and the previously strong Sydney and Melbourne markets continue to lead the declines.

Aus Q3 CPI

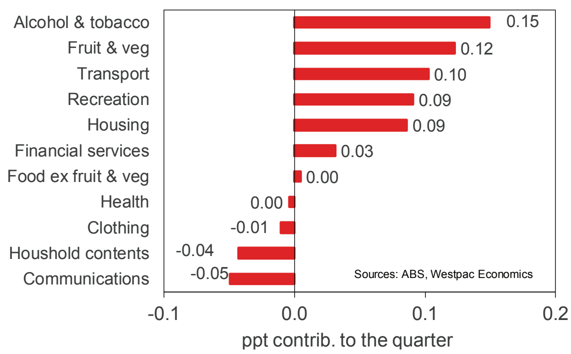
Oct 31, Last: 0.4%, WBC f/c: 0.5%
Mkt f/c: 0.5%, Range: 0.3% to 0.7%

- Westpac's forecast for the September quarter headline CPI is 0.5%qtr which will see the annual pace ease to 2.0%yr from 2.1%yr. Westpac's forecast leaves the two quarter annualised pace at 1.6%yr.
- Core inflation is forecast to print 0.3%qtr (0.31% at two decimal places) seeing the annual pace ease to 1.8%yr from 1.9%yr. The trimmed mean and weighted median are both forecast to rise 0.31%. The two quarter annualised pace of core inflation eases back to 1.5%yr from 2.0%yr putting inflation momentum below the RBA's target band.

Aus dwelling approvals: houses, low-mid & high rise



Contributions 2018 Q3 Aus CPI forecast



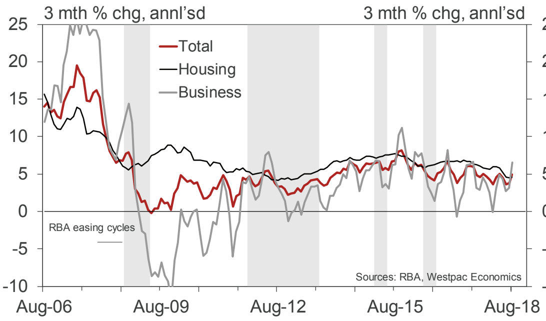
The week ahead

Aus Aug private credit

Oct 31, Last: 0.5%, WBC f/c: 0.3%
Mkt f/c: 0.4%, Range: 0.3% to 0.5%

- Private sector credit growth is modest, with a slowing trend as housing cools. Annual growth is 4.5% currently, having moderated from 5.4% a year ago. For September, we expect a rise of 0.3%, in line with the average for the June quarter.
- Housing credit, at this late stage of the cycle, is slowing as tighter lending conditions see new lending decline, particularly for investors. In August, housing credit grew by 0.4%, 5.4%yr (including investors, at 0.1%mth, 1.5%yr).
- Business credit, 3.8% above the level of a year ago, is volatile around a modest uptrend as businesses increase investment in the real economy. After two strong results (0.5% and 0.8%) a more modest gain is likely in August.

Aus credit growth

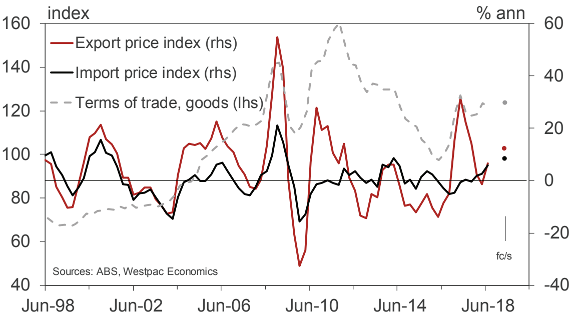


Aus Q3 import price index

Nov 1, Last: 3.2%, WBC f/c: 0.9%
Mkt f/c: 1.0%, Range: 0.5% to 2.2%

- Prices for imported goods increased by 3.2% in the June quarter to be 6.0% above the level a year earlier. The lift in prices is centred on rising global energy prices and, more recently, the impact of a lower Australian dollar.
- For the September quarter, we expect import prices to rise by a further 0.9% to be 8.7% higher than a year ago.
- The currency was mixed in the quarter, moving lower against the US dollar, down 3.4%, but little changed on a TWI basis, following falls over the previous three quarters.
- Oil prices moved higher once again, increasing the cost of imported fuels.

Aus import & export goods prices

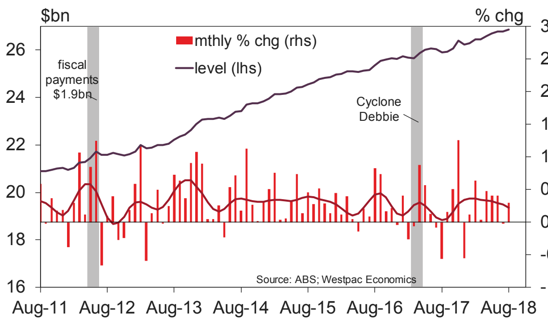


Aus Sep retail trade

Nov 2, Last: 0.3%, WBC f/c: 0.2%
Mkt f/c: 0.3%, Range: 0.1% to 0.6%

- Retail sales increased 0.3% in August, holding annual growth at 3.8%yr but tracking a slower 3.2% annual pace over the last six months.
- Indicators have been mixed in September. Consumer sentiment continued to unwind the mild positive boost from May's tax cut announcement, the change of PM, mortgage rate increases, and house price declines also impacting. Private business surveys showed soft readings amongst retail responses to the NAB survey but a lift in the AiG PSI. Aside from positives around population growth and job gains, July's extension of the GST to low value imported goods may be giving some support. On balance, we expect September to show a 0.2% gain. However, we are wary of downside risks.

Aus monthly retail sales

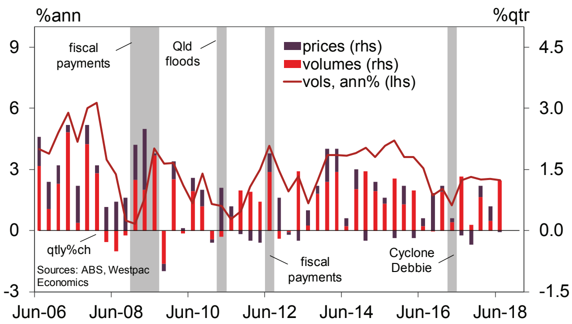


Aus Q3 real retail sales

Nov 2, Last: 1.2%, WBC f/c: 0.4%
Mkt f/c: 0.4%, Range: 0.2% to 0.8%

- The Q2 retail report was a rare win for the sector with sales volumes posting a robust 1.2% gain that followed a choppy run of gains around a lacklustre trend over the previous three quarters (0.2%, 0.8%, 0.2%). Despite the improved result, annual growth remained subdued at 2.5%yr.
- The Q3 update is likely to show a moderation. Nominal sales tracking towards a 0.6% gain for the quarter (vs 1.1% in Q2). On prices, the Q3 CPI detail is not yet available but our estimates point to a firmer retail deflator with drought-influenced food price increases contributing to an overall gain closer to 0.2%qtr than the –0.1%qtr dip in Q2. While the absence of price data makes the picture more uncertain than usual, the mix suggests retail volumes are likely to have posted a more subdued 0.4% gain in Q3.

Aus quarterly retail volumes and prices



The week ahead

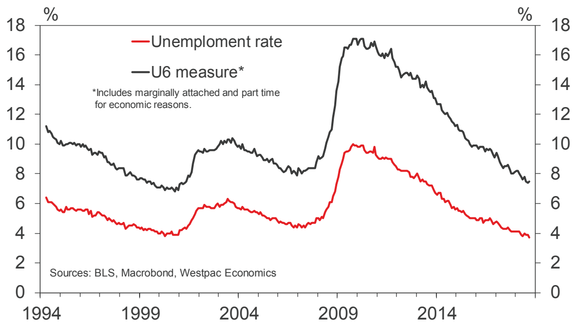
US Oct employment report

Nov 2, nonfarm payrolls, last 134k, WBC 190k

Nov 2, unemployment rate 3.7%, WBC 3.7%

- The September employment report again highlighted the susceptibility of nonfarm payrolls to poor weather, the 134k gain for the month well below the 3, 6 and 12-month averages. However, upward revisions to prior months made up for any disappointment. Coming out of hurricane season, the US economy is likely to again print a strong gain for jobs in November, likely in the region of 190k. Risks around revisions are skewed to the upside.
- For the unemployment rate, recent strength in employment growth points to a holding of the 3.7% level. However, such a result is conditional on unchanged participation.
- Hourly earnings growth will also remain a focus, with only a modest uptrend in place. To our mind, only when prime-aged participation heals will the wage growth trend accelerate.

US underemployment continues to decline

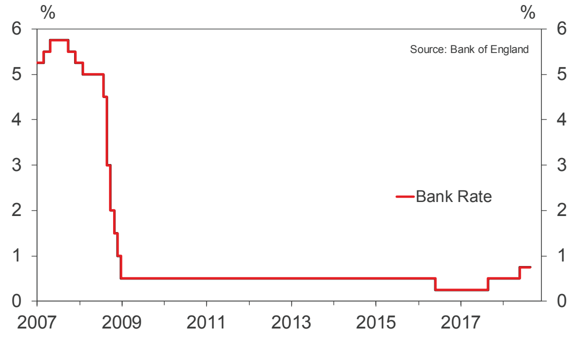


UK Bank of England Bank Rate

Nov 1, Last: 0.75%, WBC f/c: 0.75%, Mkt f/c: 0.75%

- The Bank of England left the Bank rate at 0.75% at its September policy meeting. The BOE also maintained its very modest tightening bias, reiterating that future increases are likely to be “at a gradual pace and to a limited extent”.
- Since the September policy decision, there have been mixed developments. Economic activity is continuing to expand at a moderate pace and unemployment remains low. However, inflation has eased back more than expected, and the slow pace of Brexit negotiations continues to cloud the outlook. Against this backdrop, we expect the BOE to remain on hold in November. The accompanying statement is likely to retain a very gradual tightening bias from September, but more weight may be given to uncertainties around the economic outlook.

Bank of England Bank Rate



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
UK	Oct Nationwide house prices	0.3%	0.2%	–	Due this week. Price growth remains muted.
	Sep net credit secured on dwellings	2.9	2.9	–	Slow housing market and interest rate increase.
US	Sep personal income	0.3%	0.4%	–	Wages growth slowly strengthening…
	Sep personal spending	0.3%	0.4%	–	… creating robust base for spending.
	Sep PCE deflator	0.1%	0.1%	–	Based on CPI, Sep a soft month.
	Oct Dallas Fed index	28.1	29.0	–	Showing strong momentum.
	Fedspeak	–	–	–	Evans at conference on regional competitiveness.
Tue 30					
Aus	Sep dwelling approvals	–9.4%	3.8%	–2.0%	Long anticipated 'second leg' lower finally coming through.
	RBA Asst. Gov. Bullock speaks	–	–	–	At CBA Global Markets Conference, Sydney 1:10 pm.
Eur	Q3 GDP 1st estimate	0.4%	0.4%	–	Growth normalising to just above trend.
	Oct consumer confidence final	–2.7	–2.7	–	Sentiment measures have fallen back from 2017 levels…
	Oct economic confidence	110.9	110.1	–	… but remain positive…
	Oct business climate indicator	1.21	1.18	–	… will recent momentum continue lower?
US	Aug S&P/CS home price index %yr	5.9%	–	–	Price growth aided by limited supply.
	Oct consumer confidence index	138.4	135.9	–	Well above average.
Wed 31					
NZ	Sep building consents	7.8%	–	–10%	Reversal of last month's apartment-related increase.
	Oct business confidence	–38.3	–	–	Remains at low levels despite some improvement last month.
Aus	Q3 CPI	0.4%	0.5%	0.5%	Petrol, drought & tobacco excise offset by falling childcare.
	Sep private sector credit	0.5%	0.4%	0.3%	Strong gains for business unlikely to be sustained.
Chn	Oct non-manufacturing PMI	54.9	–	–	External demand has softened…
	Oct manufacturing PMI	50.8	50.9	–	… but domestic economy offers promise.
Eur	Sep unemployment rate	8.1%	8.1%	–	Gradually trending down.
	Oct core CPI %yr	0.9%	1.0%	–	Core sticky around 1%. Headline higher on energy.
	ECB's Visco and Italy's Tria speak	–	–	–	World saving day. Speech from Italy Finance Minister Tria.
UK	Oct GfK consumer confidence	–9	–10	–	Brexit uncertainty to dampen households' spirits.
US	Oct ADP employment change	230k	190k	–	Another strong month expected.
	Q3 employment cost index	0.6%	0.7%	–	Wages growth building strength slowly.
Thu 01					
Aus	Oct AiG PMI	59.0	–	–	Manufacturing expansion, boost from construction & lower AUD.
	Oct CoreLogic home value index	–0.6%	–	–0.5%	Another soft month plus revisions to take annual to –4.5%.
	Sep trade balance, $bn	1.6	1.7	1.7	Disappointing coal & LNG exports limits surplus expansion.
	Q3 import price index	3.2%	1.0%	0.9%	Cost of imports up on rising energy prices & lower AUD
	Q3 export price index	1.9%	2.2%	2.2%	Export prices up on higher commodity prices & lower AUD.
Chn	Oct Caixin China PMI	50.0	50.2	–	For smaller firms, times are tougher.
UK	Oct Markit PMI manufacturing	53.8	53.0	–	Continues to point to moderate output growth.
	Bank of England bank rate	0.75%	0.75%	0.75%	Core inflation contained, activity/Brexit concerns persistent.
US	Q3 productivity	2.9%	1.8%	–	Still weak.
	Initial jobless claims	215k	–	–	Very low.
	Oct Markit manufacturing PMI final	55.9	–	–	Activity and sentiment still robust.
	Sep construction spending	0.1%	0.1%	–	Mixed by sector.
	Oct ISM manufacturing	59.8	59.5	–	Very strong.
Fri 02					
NZ	Oct ANZ consumer confidence	117.6	–	–	Petrol prices and economic concerns dampening sentiment.
Aus	Q3 PPI	0.3%	–	–	Background information rather than market moving.
	Sep retail sales	0.3%	0.3%	0.2%	Monthly indicators mostly softer. Slightly firmer prices point …
	Q3 real retail sales	1.2%	0.4%	0.4%	… to a weak wash-up for Q3 vols. Main risks to down side.
Eur	Oct Markit manufacturing PMI final	52.1	–	–	Flash dipped lower…
US	Sep trade balance US$bn	–53.2	–52.5	–	Deficit has deteriorated of late.
	Oct non-farm payrolls	134k	189k	190k	To bounce back after weather.
	Oct unemployment rate	3.7%	3.7%	3.7%	Participation a risk to forecast.
	Sep factory orders	2.3%	0.2%	–	Core durable orders disappointing.

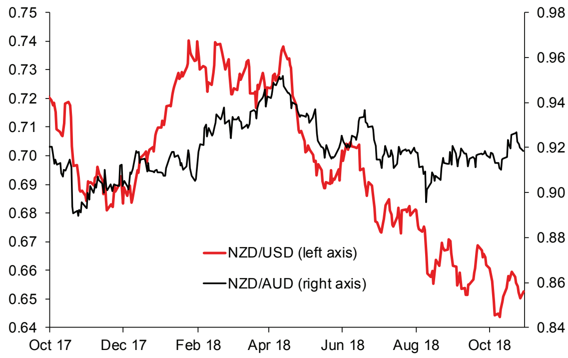
New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2018			2019	2019			
% change	Jun (a)	Sep	Dec	Mar	2017	2018f	2019f	2020f
GDP (Production)	1.0	0.7	0.7	0.7	2.8	2.8	3.1	2.9
Employment	0.5	0.4	0.3	0.3	3.7	1.8	1.4	1.7
Unemployment Rate % s.a.	4.5	4.5	4.6	4.7	4.5	4.6	4.6	4.4
CPI	0.4	0.7	0.5	0.4	1.6	2.1	1.4	1.8
Current Account Balance % of GDP	-3.3	-3.5	-3.5	-3.2	-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	0.65	0.65
NZD/AUD	0.92	0.92	0.91	0.91	0.90	0.90
NZD/JPY	75.2	74.1	72.3	71.7	72.8	72.2
NZD/EUR	0.57	0.57	0.57	0.56	0.56	0.55
NZD/GBP	0.52	0.53	0.52	0.52	0.53	0.53
TWI	72.4	71.6	70.6	70.4	70.8	70.8

2 Year Swap and 90 Day Bank Bills

NZD/USD and NZD/AUD



NZ interest rates as at market open on 29 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	1.86%	1.86%	1.87%
90 Days	1.89%	1.89%	1.92%
2 Year Swap	2.01%	2.04%	2.04%
5 Year Swap	2.32%	2.41%	2.39%

NZ foreign currency mid-rates as at 29 October 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6525	0.6507	0.6624
NZD/EUR	0.5723	0.5630	0.5702
NZD/GBP	0.5093	0.4946	0.5079
NZD/JPY	72.92	72.98	75.29
NZD/AUD	0.9184	0.9149	0.9166
TWI	71.83	71.36	72.21

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	5.5	5.3	5.5	5.5
Current Account % GDP	-4.7	-3.1	-2.6	-2.5	-2.9	-3.8
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 5 October 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	1.98	1.93	1.91	1.90	1.90	1.85	1.83
10 Year Bond	2.60	2.80	3.00	3.00	2.90	2.80	2.60	2.60
International								
Fed Funds	2.125	2.375	2.625	2.875	2.875	2.875	2.875	2.875
US 10 Year Bond	3.10	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	0.7033	0.72	0.71	0.70	0.70	0.72	0.74	0.75
USD/JPY	112.18	114	114	113	112	110	109	106
EUR/USD	1.1365	1.15	1.14	1.13	1.15	1.18	1.22	1.28
AUD/NZD	1.0862	1.09	1.09	1.09	1.09	1.11	1.12	1.10

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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